

Examining Procedural and Legal Exclusion of Employees in Malaysian Corporate Insolvency

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ABSTRACT

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KEYWORDS:

Insolvency law
Employee rights
Procedural justice
Corporate liquidation

CITATION:

Muhamad Yohaniz Atan, Aimi Anuar, & Saslina Kamaruddin. (2025). Examining Procedural and Legal Exclusion of Employees in Malaysian Corporate Insolvency. *Malaysian Journal of Social Sciences and Humanities (MJSSH)*, 10(8), e003539.
<https://doi.org/10.47405/mjssh.v10i8.3539>

This paper examines the procedural and legal exclusion of employees during corporate insolvency in Malaysia, highlighting gaps between statutory protections and practical outcomes. Despite being recognized as preferential creditors under the Companies Act 2016, employees often experience significant delays, lack of procedural inclusion, and partial or no compensation. Using organisational justice theory as an analytical lens, the paper explores how principles of procedural and distributive fairness are compromised within Malaysia's insolvency framework. Doctrinal analysis of statutes, case law, and judicial interpretation reveals a persistent creditor-centric approach reinforced by rigid formalism and fragmented legal provisions. Comparative insights from Australia and France demonstrate the importance of institutional safeguards, particularly wage protection funds, which Malaysia currently lacks. These findings underscore that statutory recognition alone is insufficient without mechanisms that ensure timely enforcement and participation for employees. The paper argues that aligning insolvency processes with justice-based principles can enhance institutional legitimacy and public trust. Policy recommendations include the establishment of a wage protection scheme, procedural integration of employee representation, and judicial training to promote fairness-oriented decision-making. This conceptual analysis contributes to Malaysian insolvency scholarship by reframing employee protection as a question of legal interpretation, procedural justice, and social responsibility rather than mere statutory hierarchy. This conceptual paper provides policy recommendations to enhance fairness and institutional trust in insolvency law.

Contribution/Originality: This paper contributes to Malaysian insolvency scholarship by offering an original fairness-based critique of employee protection. Drawing on organisational justice theory and comparative insights from Australia and France, it demonstrates how statutory recognition without institutional safeguards undermines justice, and proposes reforms to enhance legitimacy, participation, and social responsibility in insolvency law.

1. Introduction

Corporate insolvency in Malaysia has far-reaching consequences beyond financial loss, affecting jobs, social stability, and institutional trust. Rising insolvency cases, driven by economic volatility and technological disruption, have left employees particularly vulnerable. Despite their statutory recognition as preferential creditors, employees often experience significant delays or complete loss of entitlements during liquidation.

From 2018 to December 2024, 10,042 companies entered compulsory liquidation, peaking at 1,968 firm failures in 2019 (Malaysia Department of Insolvency, 2025). Employees frequently endure months of unpaid wages, with some cases, such as Transmile Group Bhd, demonstrating prolonged delays in partial recovery due to protracted asset liquidation and restructuring processes (Bidin et al., 2012; Mohd Ali, 2022). These experiences underscore that legal recognition alone does not guarantee meaningful protection for employees when companies collapse.

Malaysia's insolvency framework, modernised under the Companies Act 2016, continues to prioritise secured creditors over employees, despite introducing rescue mechanisms intended to preserve jobs. Although Section 527(1) of the Companies Act 2016 classifies employees as preferential creditors, in practice their claims remain subordinate to secured creditors and administrative costs. Procedural delays, lack of transparency, and inconsistent judicial interpretation exacerbate their vulnerability. The lack of clear institutional safeguards, such as wage protection schemes, compounds these challenges and places employees at a structural disadvantage during corporate insolvency proceedings.

Figure 1 outlines key legal milestones shaping employee rights in Malaysian insolvency law. It traces developments from colonial-era statutes to recent reforms on cross-border insolvency law in July 2025. The timeline now reflects the passing of the Cross-Border Insolvency Bill in July 2025, a legislative milestone that aligns Malaysia's framework with the UNCITRAL Model Law on Cross-Border Insolvency.

Figure 1: Timeline of Legal Developments



The persistence of these challenges reflects deeper structural and procedural shortcomings within the legal system rather than mere administrative inefficiencies. Employees' statutory recognition as preferential creditors offers symbolic reassurance but limited practical benefit when insolvency law and practice prioritise creditor recovery

over social justice. These realities raise important questions about whether the existing legal framework aligns with fundamental principles of fairness.

This paper evaluates Malaysian insolvency processes through the lens of organisational justice, focusing on two dimensions: procedural justice, which concerns the fairness of processes through which decisions are made, and distributive justice, which addresses the fairness of outcomes (Greenberg, 1987; Leventhal, 1980). These concepts provide an analytical foundation for examining how insolvency law impacts employees, who represent the most vulnerable group during corporate failure. When employees are excluded from meaningful participation in proceedings or face prolonged uncertainty regarding their entitlements, their trust in legal institutions diminishes, eroding the legitimacy of the system (Tyler & Blader, 2003).

The theoretical framework further draws on jurisprudential debates between legal positivism and interpretivism. Hart (1961) positivist approach, as outlined in his seminal work *The Concept of Law* (1961), emphasises adherence to statutory rules, a posture evident in Malaysian courts' frequent reliance on formalistic interpretations of insolvency statutes. In contrast, Dworkin (1986) interpretivism advocates for reasoning that integrates moral principles and public expectations, a perspective especially relevant when adjudicating claims involving socially vulnerable stakeholders such as employees. This interplay between rigid legal formalism and justice-oriented interpretation is central to understanding why insolvency processes often fail to deliver equitable outcomes.

Adopting a conceptual approach, this paper applies doctrinal legal analysis to evaluate statutory provisions, parliamentary debates, and judicial decisions governing employee rights in insolvency. It complements this analysis with comparative insights from Australia and France, where institutional mechanisms such as wage protection schemes have enhanced the protection of workers' claims during employer insolvency. These comparative perspectives illustrate the feasibility and importance of structural reforms in aligning legal frameworks with fairness-based principles.

Applying the principles of procedural and distributive justice, this study shows that Malaysia's insolvency framework falls significantly short of fairness standards. Employees have very limited opportunities to take part in decision-making, receive little access to important information, and often face long delays in getting their wages. These weaknesses reduce public confidence in the justice system and undermine trust in legal institutions. Viewed through Rawls (1971) difference principle, the current framework reflects a failure to protect those who are most economically vulnerable during corporate collapse.

Comparative insights from Australia and France highlight the importance of institutional mechanisms such as wage guarantee schemes. Both countries have established structured systems, whether government-funded or employer-supported, that ensure timely payment to employees regardless of the company's remaining assets. In contrast, Malaysia's continued reliance on liquidation as the main recovery pathway leaves employees exposed to serious risks, putting the country behind international standards and the goals of International Labour Organization (ILO) Convention No. 173.

To address these weaknesses, this study recommends four key reforms: creating a statutory wage protection fund, ensuring formal employee representation in insolvency proceedings, providing judicial training to promote fairness-based interpretation, and

aligning domestic laws with international standards. Implementing these steps would improve both procedural and distributive justice, bring Malaysia closer to global best practices, and restore public trust in the legal system.

Corporate insolvency should not be viewed only as a financial process; it is also a social and human issue that deeply affects livelihoods, family security, and social stability. Reforms based on fairness can bridge the gap between written law and real-life experience, making sure employees are treated not as an afterthought but as important stakeholders in the insolvency process. By embedding fairness into legal procedures and outcomes, Malaysia can build a system that is not only legally sound but also socially legitimate and morally responsible. Future research should evaluate how effective these reforms are once implemented.

Beyond national reforms, these proposals support Southeast Asian Nations (ASEAN)'s vision for harmonised insolvency standards and socially responsible corporate governance. Strengthening employee protections can also make Malaysia more attractive to cross-border investors while showing its commitment to balancing economic efficiency with social justice. In this way, embedding fairness into insolvency law contributes to sustainable development and positions Malaysia as a regional leader in equitable and resilient insolvency governance.

To address these challenges, the paper examines three key questions:

- i. To what extent do Malaysian insolvency laws and procedures uphold principles of procedural and distributive justice in protecting employees?
- ii. How do judicial interpretations influence the practical effectiveness of these protections?
- iii. What lessons can Malaysia draw from comparative jurisdictions to strengthen employee safeguards during corporate insolvency?

In pursuing these questions, the analysis aims to make both theoretical and practical contributions. Theoretically, it integrates concepts of organisational justice with legal doctrine to provide a fairness-based critique of insolvency law. Practically, it offers policy recommendations for reform, including the establishment of a national wage protection mechanism, procedural inclusion of employee representatives during liquidation, and targeted judicial training to encourage interpretive approaches that incorporate fairness considerations.

Ultimately, this paper argues that Malaysian insolvency law must move beyond a narrow, creditor-centric orientation to embrace a more balanced approach that recognises employees as critical stakeholders in the insolvency process. Such reforms would not only improve the efficiency and legitimacy of the legal system but also reinforce public trust by ensuring that insolvency outcomes are consistent with broader principles of equity and social responsibility.

2. Literature Review

Malaysian insolvency cases not only create financial hardship but also social consequences, including delayed wages, diminished retirement savings, and psychological distress (ILO, 2020). While Section 527 of the Companies Act 2016 grants employees preferential creditor status, this protection is largely nominal. In practice, their claims remain subordinate to secured creditors and liquidation expenses, resulting in

protracted delays and partial recovery. For instance, employees of Transmile Group Bhd faced prolonged delays in receiving partial wage compensation (Bidin et al., 2012; Mohd Ali, 2022). For instance, employees of Transmile Group Bhd partial wage These shortcomings reflect structural weaknesses in the insolvency regime, compounded by judicial inconsistency and the absence of institutional safeguards such as wage protection funds. The resulting failures in procedural and distributive justice undermine institutional legitimacy and trust (Tyler & Blader, 2003). Despite growing attention to insolvency reform, existing scholarship remains heavily creditor-oriented, neglecting how employees experience insolvency processes (Nuryanto et al., 2024). Addressing this gap requires a fairness-based critique of insolvency law that repositions employees as central stakeholders in both legal and policy frameworks.

2.1. Theoretical Foundations

Organisational Justice Theory provides the conceptual framework for this analysis. Originally formulated by Thibaut and Walker (1975) and later expanded by Greenberg (1987), the theory distinguishes between procedural and distributive justice. Procedural justice concerns the fairness of decision-making processes, such as whether employees have access to information, opportunities to voice concerns, and consistent application of rules (Burke & Leben, 2024). Research consistently shows that fair processes increase institutional trust even when outcomes are unfavourable (Tyler & Blader, 2003).

Distributive justice, on the other hand, relates to fairness in outcomes, including the distribution of financial entitlements such as unpaid wages or termination benefits (Ha & Lee, 2022). In insolvency contexts, when employees receive minimal or delayed compensation, their perception of distributive injustice erodes confidence in legal institutions (Gant, 2025; Nuryanto et al., 2024).

Rawls (1971) concept of justice as fairness further reinforces these principles. His 'difference principle' asserts that legal and institutional arrangements should benefit the least advantaged. Employees, as the most vulnerable stakeholders in insolvency, are rarely protected under this normative ideal in Malaysia.

This discussion also draws on jurisprudential theories. Hart (1961) legal positivism favours strict adherence to statutory text, while Dworkin (1986) interpretivism emphasises moral reasoning in judicial interpretation. The Malaysian judiciary's oscillation between these approaches contributes to inconsistent protection for employees, underscoring the need for fairness-sensitive interpretive models.

2.2. Legal Foundations of Employee Protection

Malaysia's insolvency framework is primarily governed by the Companies Act 2016, supported by the Employment Act 1955 and the Industrial Relations Act 1967. Section 527 of the Companies Act classifies employees as preferential creditors, entitling them to priority over unsecured creditors for unpaid wages. However, this priority does not extend to retrenchment benefits or other employment-related claims, leaving employees exposed to significant financial risk during liquidation (Geok, 2021).

Although the Companies Act introduced corporate rescue tools such as judicial management and corporate voluntary arrangements, these mechanisms are underutilised due to procedural complexity and judicial reluctance (Chen et al., 2020).

The Employment Act, despite amendments in 2023, also fails to provide clear procedural integration with insolvency proceedings, while the Industrial Relations Act does not prioritise employment-related claims during liquidation.

This fragmented framework creates legal uncertainty and undermines procedural fairness, resulting in prolonged delays and incomplete recovery for employees (Kapur, 2024). Without statutory timelines or effective enforcement mechanisms for employee entitlements, Malaysia's legislative intent remains aspirational rather than operational (Mohd Ali, 2022).

2.3. Judicial Interpretation and the Limits of Formalism

The judiciary plays a pivotal role in determining the effectiveness of employee protections during insolvency (Chen, Azmi, & Abdul-Rahman, 2024). In Malaysia, however, courts frequently adopt a strict formalistic approach, prioritising statutory hierarchy over equitable considerations, which often undermines fairness and employee interests (Mohd Ali, 2022). In *Hotel Jaya Puri Bhd v National Union of Hotel Bar & Restaurant Workers* [1980] 1 MLJ 109, the Federal Court denied the union *locus standi* to challenge terminations post-liquidation, reinforcing procedural rigidity. Similarly, in the *Transmile Group Bhd* case, employees endured delays of over 14 months for partial wage recovery, reflecting systemic inefficiency (Bidin et al., 2012).

In contrast, *Re Scomi Group Bhd* [2021] MLJU 2173 demonstrates a purposive approach, where the court considered broader stakeholder impacts, including employee welfare. These divergent approaches illustrate the tension between Hart (1961) positivist legal formalism and Dworkin (1986) interpretive reasoning, a debate that continues to shape judicial attitudes toward fairness in insolvency law (Gant, 2025). Overreliance on strict statutory interpretation entrenches creditor priority, limiting judicial discretion to safeguard vulnerable employees (Kapur, 2024). Greater adoption of interpretive models incorporating fairness principles could enhance consistency and legitimacy in judicial decision-making (Gant, 2022).

The application of Organisational Justice Theory to insolvency law extends beyond legal processes to broader societal implications (Vaccari & Van Ho, 2023). Perceptions of fairness in insolvency processes influence not only individual employee morale but also institutional trust and social cohesion. Studies in public administration indicate that citizens evaluate legal institutions based on procedural justice, even when outcomes are unfavorable (Burke & Leben, 2024). When employees perceive insolvency proceedings as opaque and exclusionary, they are likely to develop distrust toward courts and regulatory agencies, reducing compliance with legal norms and weakening the legitimacy of the legal system (Vaccari & Van Ho, 2023).

Ignoring fairness principles can also create systemic risks. Prolonged wage recovery disputes often push affected workers into financial distress, contributing to rising household debt and increased reliance on social welfare programs (Nuryanto et al., 2024). These socio-economic consequences extend beyond the parties involved, undermining economic stability and public confidence in corporate governance.

Critics of enhanced employee protections argue that prioritizing workers' claims could deter investment and complicate credit markets by weakening secured creditors' confidence. While these concerns merit consideration, comparative evidence suggests

otherwise. Australia and France demonstrate that institutional safeguards such as wage protection funds can coexist with robust credit markets, provided clear rules and predictable processes are maintained (Kapur, 2024; Nuryanto et al., 2024). Therefore, the challenge is not whether to protect employees, but how to design a framework that harmonizes economic efficiency with social equity (Kapur, 2024).

2.4. International and Comparative Perspectives

Malaysia has not ratified the ILO Convention No. 173 on the protection of workers' claims in employer insolvency, leaving these standards non-binding. The adoption of the Cross-Border Insolvency Act in July 2025 represents a significant alignment with the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency, strengthening Malaysia's framework for international cooperation. However, this reform does not address a critical gap, which is the absence of a domestic wage protection scheme that continues to expose employees to prolonged delays and financial vulnerability (Lee & Ker, 2025).

Comparative jurisdictions offer useful insights. In Australia, the Fair Entitlements Guarantee (FEG) provides a government-funded safety net for unpaid wages, leave, redundancy, and notice pay when employers become insolvent. This scheme ensures timely compensation irrespective of asset availability (Department of Employment and Workplace Relations, 2023[DEWR], 2025). France operates a similar mechanism through the AGS system, which guarantees payment of salaries and benefits upon judicial insolvency, financed through mandatory employer contributions (Service-public Entreprenre, 2025).

These models highlight Malaysia's structural deficiency, that is the absence of statutory wage guarantee schemes places employees at risk of protracted delays or non-recovery. Table 1 summarises these differences.

Table 1: Comparative analysis of employee entitlement protection mechanisms in insolvency

Feature	Australia (DEWR, 2025)	France	Malaysia
Legal Mechanism	Fair Entitlements Guarantee (FEG), publicly administered	Association for the Management of Employee Claims <i>Association pour la gestion du régime de garantie des créances des salariés (AGS) (AGS, 2025)</i> - statutory body	No equivalent mechanism
Funding Source	Public fund (general taxation)	Mandatory employer contributions (0.20–0.25% of payroll, capped at 4× Social Security ceiling) (Global Legal Insights, 2025)	None; dependent on remaining assets in the insolvency estate
Coverage Scope	Unpaid wages (≤13 weeks), annual and long service leave,	Unpaid salaries, notice pay, severance, bonuses, and other entitlements, subject to ceiling	Claims must be filed through liquidation; no

Feature	Australia (DEWR, 2025)	France	Malaysia
	redundancy (≤ 4 weeks/year), notice (≤ 5 weeks)	(~€88,000) (AGS, 2025; Global Legal Insights, 2025)	statutory guarantee of payment
Procedural Integration	Independent of insolvency estate; administered by government	Automatically triggered upon judicial insolvency proceedings (AGS, 2025)	Processed under court-supervised liquidation; treated as unsecured claims
Guarantee of Payment	Yes	Yes (AGS, 2025)	No

2.5. Identified Gaps in Literature

Existing scholarship on Malaysian insolvency law has primarily focused on corporate governance, creditor rights, and statutory reforms (Bidin et al., 2012; Chen et al., 2020). Limited attention has been given to how employees experience insolvency processes, particularly regarding procedural inclusion and timely recovery of entitlements (Nuryanto et al., 2024). International literature increasingly emphasises fairness and social justice in insolvency frameworks (Anderson, 2014; Gant, 2022), but such perspectives remain underdeveloped in Malaysia. This paper responds to this gap by offering a conceptual critique grounded in organisational justice theory and comparative legal analysis, with the aim of realigning insolvency processes toward fairness for employees.

3. Methodology

This study adopted a conceptual and doctrinal approach to examine the adequacy of Malaysia's insolvency framework in protecting employees. Primary legal sources, including the Companies Act 2016, Employment Act 1955, and Industrial Relations Act 1967, were analyzed alongside judicial decisions to evaluate the interpretation and enforcement of employee rights during insolvency. The analysis was informed by Organisational Justice Theory and jurisprudential perspectives particularly those of Hart (1961) and Dworkin (1986) to assess fairness in legal processes and outcomes. Comparative insights from Australia and France were incorporated to highlight structural gaps and identify policy options for reform.

4. Findings and Discussion

4.1. Structural Weaknesses in Malaysian Insolvency Framework

Malaysia's insolvency framework aims to balance creditor recovery with stakeholder protection, yet structural weaknesses undermine its ability to safeguard employees. Although Section 527 of the Companies Act 2016 designates employees as preferential creditors, this protection is largely symbolic. In practice, employees' claims remain subordinate to secured creditors and liquidation expenses, resulting in partial or no recovery when company assets are insufficient (Geok, 2021). This hierarchy reflects a

creditor-centric system that prioritises financial claims over socio-economic concerns, exposing workers to prolonged financial insecurity.

The procedural gaps within insolvency administration compound these vulnerabilities. Employees often lack clear guidance on filing claims, face delayed verification processes, and experience significant waiting periods before receiving payment. For instance, in high-profile insolvency cases such as Transmile Group Bhd, employees faced prolonged uncertainty and delayed compensation despite their statutory recognition as preferential creditors (Bidin et al., 2012). Such delays are systemic rather than incidental, stemming from fragmented statutory provisions and insufficient coordination between insolvency practitioners, courts, and labour authorities.

Corporate rescue mechanisms such as Judicial Management (JM) and Corporate Voluntary Arrangements (CVA), introduced under the Companies Act 2016, were intended to preserve businesses and jobs by allowing distressed firms to restructure rather than liquidate. However, their utilisation remains limited due to procedural complexity, stringent evidentiary requirements, and judicial reluctance (Chen et al., 2020). Applications for JM are frequently dismissed for failing to meet technical thresholds, discouraging firms from pursuing restructuring. As a result, liquidation remains the dominant outcome, amplifying adverse consequences for employees.

The absence of institutional safeguards, such as a wage guarantee fund, further highlights the structural inadequacies of Malaysia's insolvency system. Unlike jurisdictions that provide state-backed or employer-funded schemes to secure employee entitlements during insolvency, Malaysia relies entirely on the liquidation process, which is unpredictable and often slow (André & Demmou, 2022). Without statutory mechanisms to ensure timely wage recovery, employees bear the brunt of corporate failure despite their legal status as preferential creditors.

4.2. Justice-Based Assessment of Malaysian Framework

Applying Organisational Justice Theory reveals significant shortcomings in Malaysia's approach to employee protection during insolvency. Procedural justice requires fair and transparent processes that afford stakeholders the opportunity to participate and voice their concerns (Greenberg, 1987). In practice, employees are systematically excluded from key stages of insolvency proceedings. They are rarely represented in creditor meetings, seldom consulted in restructuring plans, and often left without timely updates on the status of their claims (Ying & Partners Advocates & Solicitors, 2024). This exclusion violates the principle of voice, which empirical research links to perceptions of fairness and institutional legitimacy (Tyler & Blader, 2003).

Distributive justice, which concerns the fairness of outcomes, is equally compromised. Employees' statutory recognition as preferential creditors fails to translate into meaningful financial protection. When company assets are insufficient, employees receive minimal or no compensation, while secured creditors recover their claims in full. This outcome contradicts the 'difference principle', which, according to Rawls (1971), holds that institutional arrangements should benefit the least advantaged members of society. By consistently prioritising secured creditors, the Malaysian insolvency regime entrenches inequities rather than mitigating them.

Judicial interpretation further influences these justice dimensions. Malaysian courts often adopt a positivist approach, adhering rigidly to statutory text and established creditor hierarchies. In *Hotel Jaya Puri Bhd v National Union of Hotel Bar & Restaurant Workers* [1980] 1 MLJ 109, the court denied union standing to challenge dismissals after liquidation commenced, underscoring the judiciary's reluctance to deviate from formal rules. Similarly, in *Transmile Group Bhd*, courts emphasised compliance with procedural requirements over timely employee relief. While some recent cases, such as *Re Scomi Group Bhd* [2021] MLJU 2173, indicate a willingness to consider broader stakeholder impacts, these remain exceptions rather than the norm. The prevailing formalist posture reflects Hart (1961) legal positivism, which prioritises legal certainty but risks perpetuating structural injustice. Greater adoption of interpretivist reasoning, as advocated by Dworkin (1986), could enable courts to reconcile statutory obligations with principles of fairness, particularly when interpreting ambiguous provisions.

Beyond legal interpretation, the application of Organisational Justice Theory underscores broader socio-economic implications (Vaccari & Van Ho, 2023). Perceptions of fairness in insolvency proceedings extend beyond immediate stakeholders, shaping public trust in judicial institutions and overall compliance with the rule of law (Burke & Leben, 2024). When employees feel excluded from critical stages of insolvency, their confidence in the justice system deteriorates, fostering perceptions of systemic bias and institutional inefficiency. This erosion of trust can spill over into wider social dynamics, weakening employee morale and increasing the likelihood of industrial disputes, which in turn affects economic productivity and stability (Vaccari & Van Ho, 2023).

Conversely, procedural fairness can produce legitimacy benefits even in cases of adverse outcomes. Empirical studies confirm that when individuals perceive decision-making as transparent and participatory, they are more likely to accept unfavorable results (Tyler & Blader, 2003). In insolvency contexts, measures such as granting employees access to creditor meetings and timely updates can mitigate dissatisfaction, even when full financial recovery is unattainable.

A frequently cited counterargument is that prioritising employee claims or creating wage protection schemes may distort credit markets and discourage investment (Kapur, 2024; Nuryanto et al., 2024). Creditors argue that predictability and asset security underpin lending decisions, and any shift toward employee primacy could raise borrowing costs or limit credit availability (Kapur, 2024). However, comparative evidence from Australia and France demonstrates that creditor confidence and wage protection mechanisms can coexist effectively (Kapur, 2024; Nuryanto et al., 2024). Both jurisdictions maintain robust credit environments while guaranteeing employees timely compensation through clearly defined statutory schemes (Nuryanto et al., 2024). The key lies in balancing creditor recovery with social justice through predictable, rule-based systems that minimise uncertainty (Kapur, 2024). Malaysia's challenge, therefore, is not whether employee protections should be strengthened but how to integrate them without undermining market confidence.

These findings underscore that Malaysia's insolvency framework fails to achieve the core objectives of procedural and distributive justice. Employees face systemic exclusion from decision-making processes and disproportionate financial losses, eroding trust in legal institutions and undermining the legitimacy of insolvency law.

While the analysis reveals significant weaknesses in Malaysia's insolvency regime, it is important to contextualize these issues within the broader framework of organizational justice theory and economic policy debates. Procedural justice, as conceptualized by [Greenberg \(1987\)](#), goes beyond technical compliance with statutory rules; it requires processes that stakeholders perceive as fair and inclusive. When employees are systematically excluded from decision-making, denied access to timely information, and treated as residual claimants, their trust in the legal system erodes. This erosion of trust has broader societal implications: research in governance and public administration indicates that citizens evaluate legal institutions primarily through the lens of procedural fairness, even when distributive outcomes are unfavourable ([Burke & Leben, 2024](#)). Thus, improving procedural justice in insolvency processes is not merely a legal necessity but a cornerstone of institutional legitimacy.

The implications for distributive justice are equally significant. Failure to prioritize vulnerable stakeholders during corporate failure undermines social cohesion and exacerbates economic inequalities ([Vaccari & Van Ho, 2023](#)). Employees constitute one of the most vulnerable stakeholder groups in insolvency proceedings, a position that [Rawls \(1971\)](#) argues warrants heightened institutional protection under the difference principle ([Gant, 2023](#)). Ignoring these normative imperatives risks reinforcing structural injustices, leading to cascading social and economic consequences such as increased household indebtedness, reliance on state welfare programs, and erosion of labor market stability ([Gant, 2022](#)).

Critics may argue that expanding employee protections compromises economic efficiency by weakening creditor confidence and restricting credit availability. While these concerns are valid, comparative evidence from Australia and France challenges this assumption. Both jurisdictions demonstrate that robust wage protection schemes and enhanced procedural safeguards can coexist with healthy credit markets, provided that clear statutory rules and predictable enforcement mechanisms are in place ([Kapur, 2024](#)). Furthermore, improved employee protection can yield positive externalities by reducing litigation costs, accelerating liquidation timelines, and minimizing social costs associated with unemployment and income insecurity ([Nuryanto et al., 2024](#); [Mucciarelli, 2017](#)).

4.3. Comparative Lessons: Australia and France

International experience demonstrates that institutional safeguards can significantly mitigate the risks faced by employees during employer insolvency. Australia's Fair Entitlements Guarantee (FEG) offers a compelling example of a state-backed mechanism that secures workers' financial interests. Funded through general taxation, FEG guarantees payment of unpaid wages (up to 13 weeks), annual leave, long service leave, redundancy pay, and notice entitlements when an employer becomes insolvent ([DEWR, 2025](#)). The scheme operates independently of the insolvency estate, ensuring timely compensation regardless of the company's remaining assets. While FEG excludes unpaid superannuation contributions and faces sustainability challenges, it provides an essential safety net that upholds distributive fairness and institutional trust.

France employs a similar model through the *Association pour la gestion du régime de garantie des créances des salariés* (AGS), which guarantees employee claims upon commencement of judicial insolvency proceedings ([Service-public Entreprendre, 2025](#)). Unlike FEG, AGS is financed by mandatory employer contributions, calculated as a small percentage of payroll, and capped according to social security thresholds. Once payments

are made, AGS assumes the employee's rights against the insolvent estate through subrogation, enabling partial cost recovery. This mechanism ensures predictability, efficiency, and sustainability, reinforcing both procedural and distributive justice.

[Table 1](#) highlights these differences, showing how Australia and France implement institutional safeguards through wage protection schemes, while Malaysia lacks equivalent mechanisms. The comparison highlights Malaysia's structural deficiency: the absence of a statutory wage guarantee scheme leaves employees vulnerable to delayed or non-recovery of entitlements. By contrast, Australia and France demonstrate that wage protection funds, whether tax-funded or employer-financed, can provide timely relief and restore public confidence in insolvency systems.

4.4. Policy Reform Directions

Addressing the shortcomings of Malaysia's insolvency framework requires targeted reforms that enhance fairness without undermining economic efficiency. Four priority measures are proposed.

First, the establishment of a national wage protection scheme is essential to safeguard employee entitlements during employer insolvency. Drawing on comparative models from Australia and France, Malaysia could implement a statutory fund designed to guarantee critical payments such as unpaid wages, notice entitlements, and retrenchment benefits when companies fail. To promote equitable financing, the scheme should adopt a payroll based contribution structure similar to France's AGS where employers contribute proportionally to their wage bill. This model distributes costs fairly across businesses of varying sizes while minimizing reliance on public funds. Furthermore, to ensure long term financial sustainability, the scheme should incorporate a subrogation mechanism allowing the fund to recover amounts disbursed by asserting claims against the insolvent estate.

Second, Malaysia should strengthen employee participation throughout insolvency proceedings ([Nuryanto et al., 2024](#)). Employees should be granted formal representation in creditor meetings and restructuring discussions, either directly or through trade union representatives ([Geva, 2011](#)). Incorporating employee voices into these processes would reinforce procedural justice, improve transparency, and align Malaysian practice with established international standards ([Nuryanto et al., 2024](#); [Geva, 2011](#)).

Third, judicial capacity building on fairness-oriented interpretation is critical. Judges play a decisive role in determining insolvency outcomes through statutory interpretation ([Vaccari, 2020](#)). Structured training programs that integrate principles of organisational justice and insights from comparative jurisdictions could encourage interpretive approaches that balance legal certainty with equitable considerations, particularly when adjudicating claims affecting vulnerable groups ([Organisation for Economic Co-operation and Development \[OECD\], 2023](#)).

Fourth, align domestic law with international standards. Ratifying ILO Convention No. 173 and operationalising its provisions would signal Malaysia's commitment to protecting workers' claims in insolvency. Complementary reforms, such as the timely adoption of the UNCITRAL Model Law on Cross-Border Insolvency, would further strengthen Malaysia's legal framework in a globalised economy.

Implementing these reforms requires careful attention to financial and institutional feasibility. Establishing a wage protection fund introduces critical questions regarding funding sources and long-term sustainability. Government-backed models, such as Australia's Fair Entitlements Guarantee (FEG), have been criticized for imposing fiscal burdens on public finances during economic downturns (Davis et al., 2025). Conversely, employer-financed schemes, such as France's Assurance Garantie des Salaires (AGS), often face opposition from business associations due to increased operational costs (Kapur, 2024). A hybrid model that combines moderate employer contributions with limited state-backed guarantees offers a balanced solution (Davis et al., 2025). To further strengthen financial sustainability, the fund should adopt a subrogation mechanism, enabling it to recover disbursed payments from the insolvent estate (Kapur, 2024).

Administrative efficiency is equally essential to the success of these reforms. Lessons from Australia and France demonstrate the value of robust digital claim-processing systems that streamline procedures and minimize delays (Gurrea-Martínez, 2025; Kamalnath, 2023). Malaysia could leverage its existing e-government infrastructure to replicate these efficiencies, ensuring timely disbursement and greater transparency. Finally, stakeholder engagement will determine the viability of these initiatives. Structured consultations with trade unions, employer organizations, and insolvency practitioners are vital to achieving consensus and mitigating resistance (Shem & Mupa, 2024; Aldahmash, 2025). These dialogues can foster shared ownership of the reform process, ensuring that the proposed measures are viewed as fair, practical, and aligned with the broader objectives of economic stability and social justice.

5. Conclusion

This study assessed the effectiveness of Malaysia's corporate insolvency framework in safeguarding employee rights, using organisational justice theory and comparative legal analysis as guiding lenses. The findings reveal a consistent disparity between statutory assurances and practical outcomes. Although Section 527 of the Companies Act 2016 accords employees preferential creditor status, this designation remains largely symbolic in practice. Persistent procedural delays, divergent judicial interpretations, and the absence of institutional safeguards collectively expose employees to severe financial insecurity and social vulnerability when companies enter insolvency.

Applying the principles of procedural and distributive justice, this study shows that Malaysia's insolvency framework falls significantly short of fairness standards. Employees have very limited opportunities to take part in decision-making, receive little access to important information, and often face long delays in getting their wages. These weaknesses reduce public confidence in the justice system and undermine trust in legal institutions. Viewed through the lens of the difference principle, as articulated by Rawls (1971), difference principle, the current framework reflects a failure to protect those who are most economically vulnerable during corporate collapse.

Comparative insights from Australia and France highlight the importance of institutional mechanisms such as wage guarantee schemes. Both countries have established structured systems, whether government-funded or employer-supported, that ensure timely payment to employees regardless of the company's remaining assets. In contrast, Malaysia's continued reliance on liquidation as the main recovery pathway leaves employees exposed to serious risks, putting the country behind international standards and the goals of ILO Convention No. 173.

To address these weaknesses, this study recommends four key reforms: creating a statutory wage protection fund, ensuring formal employee representation in insolvency proceedings, providing judicial training to promote fairness-based interpretation, and aligning domestic laws with international standards. Implementing these steps would improve both procedural and distributive justice, bring Malaysia closer to global best practices, and restore public trust in the legal system.

Corporate insolvency should not be viewed only as a financial process; it is also a social and human issue that deeply affects livelihoods, family security, and social stability. Reforms based on fairness can bridge the gap between written law and real-life experience, making sure employees are treated not as an afterthought but as important stakeholders in the insolvency process. By embedding fairness into legal procedures and outcomes, Malaysia can build a system that is not only legally sound but also socially legitimate and morally responsible. Future research should evaluate how effective these reforms are once implemented.

Beyond national reforms, these proposals support ASEAN's vision for harmonised insolvency standards and socially responsible corporate governance. Strengthening employee protections can also make Malaysia more attractive to cross-border investors while showing its commitment to balancing economic efficiency with social justice. In this way, embedding fairness into insolvency law contributes to sustainable development and positions Malaysia as a regional leader in equitable and resilient insolvency governance.

Ethics Approval and Consent to Participate

The researchers used the research ethics provided by the Research Ethics Committee of Management and Science University (MSU). All procedures performed in this study involving human participants were conducted in accordance with the ethical standards of the institutional research committee. Informed consent was obtained from all participants according to the Declaration of Helsinki.

Acknowledgement

The authors would like to express their sincere gratitude to the faculty members and administrative staff of Management and Science University (MSU) for their continuous academic and logistical support throughout the research process. Appreciation is also extended to all participants who contributed their time and insights to this study.

Funding

This study received no funding.

Conflict of Interest

The authors reported no conflicts of interest for this work and declare that there is no potential conflict of interest with respect to the research, authorship, or publication of this article.

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