

## HONG KONG COURT AFFIRMS EMPLOYERS' WIDE DISCRETION IN RELATION TO BONUS DECISIONS AND CONTRACTUAL RIGHT TO TERMINATE WITHOUT CAUSE

The Court of First Instance (CFI) in Hong Kong has recently handed down a decision concerning a financial institution employer's decisions to issue a written warning for an employee's conduct, award zero bonus subsequent to such warning, and terminate his employment for redundancy. The Plaintiff employee's claims against the Defendant employer were dismissed. The decision confirms an employer's wide discretion in relation to bonus decisions, and also affirms the long-established principle that where a contract of employment provides for the parties' right to terminate without cause, such right can be exercised "for no, good or bad reason". Clifford Chance acted for the successful Defendant in this case.

### INTRODUCTION AND KEY TAKEAWAYS

On 27 August 2024, the CFI handed down judgment in the case of *Yang Zhizhong v Nomura International (Hong Kong) Limited* [2024] HKCFI 2192. In the case, the Plaintiff employee challenged the Defendant financial institution's decisions to issue him a written warning, award zero bonus, and subsequently terminate him for redundancy. The Plaintiff's case was that the three decisions were in breach of nine implied terms in his employment contract. The Plaintiff argued that the terms should be implied as a matter of legal incidence of the employment relationship, and/or implied by obvious inference or business efficacy.

The Plaintiff's claims were dismissed, and most of the pleaded implied terms rejected by the Court. The case is significant in the following respects:

- it demonstrates the court's cautious approach in recognising claimed implied terms in an employment contract. Notably, without settled authority endorsing the implication of terms, the court would not lightly accept the implication, in particular where such terms contradict an employer's express right to terminate without cause. An express right to terminate without cause is not subject to established implied obligations of mutual trust and confidence between employer and employee;

#### Key issues

- There exists an implied obligation of mutual trust and confidence between employer and employee. The Court held that this obligation does not apply to an employer's express right to terminate an employee's employment without cause, as the implication of such term would water down that express right to terminate.
- Where a contract of employment provides for the right to terminate without cause and a party exercises such right, the termination would not be wrongful even if done for unreasonable or arbitrary reasons. Further, even if the provided reason for termination turns out to be untrue, this would not give rise to liability on the part of the terminating party.
- Where the employment contract confers a discretion on the employer, the court would not substitute its own view on how the discretion should reasonably be exercised. In particular, where the decision involves a qualitative judgment (such as assessment of bonuses), there is little scope for intensive scrutiny by the court of the employer's decision-making process.

- it highlights the court's restrained approach in examining an employer's decision made pursuant to a contractual discretion expressly granted to the employer. In this case, a zero bonus was awarded to the Plaintiff. Even though such decision is highly unusual, particularly in the investment banking and finance industry and given the seniority of the employee involved, the Court held that it would not substitute its own view of what is reasonable for that of the decision maker. Where the employer's decision is whether an employee should be awarded a discretionary bonus, there is little room for intensive scrutiny by the court of the employer's decision-making process; and
- it affirms a long line of authorities that where an employment contract provides for the right to terminate without cause, such right can be exercised "for no good or bad reason". In other words, termination need not be justified and will not be wrongful even if done for unreasonable or capricious reasons. This is subject only to the caveat that the employer cannot exercise the power to terminate in order to avoid the employee being eligible for or receiving a bonus. Termination would also not be wrongful even if the reason provided for termination turns out to be untrue. Hong Kong is unique in this sense as compared to other common law jurisdictions. England and Singapore have a statutory unfair dismissal regime whereby dismissal can be challenged as unfair or wrongful and compensation sought even if the contract provides for termination with notice or payment in lieu and requisite notice or payment has been given.

## **BACKGROUND AND KEY FACTS**

The Plaintiff was a senior employee in the Defendant with the corporate title of Senior Managing Director. The Plaintiff held dual roles as Head of China and Chairman of the Investment Banking Division, Asia Ex-Japan. He was registered as the Defendant's Responsible Officer and a licensed person with the Securities and Futures Commission ("**SFC**").

In May 2016, the SFC conducted an on-site inspection and discovered an incident where the Plaintiff, without prior knowledge or approval by the Defendant's Compliance Department, arranged a three-way meeting between himself, one of the Defendant's research analysts, and a potential IPO candidate. Shortly afterwards, the IPO candidate appointed the Defendant as bookrunner in its IPO. Since research analysts are expected to maintain independence when issuing equity research reports to the investing public, this situation created potential conflicts of interest. There was at least a perception that the research function might be preparing favourable reviews of the IPO candidate to assist the Investment Banking Division in securing IPO business. The SFC expressed strong disapproval of this three-way meeting.

In a subsequent internal investigation by the Defendant, it uncovered that the Plaintiff had arranged and attended two other similar three-way meetings, and had also on three occasions emailed research analysts about listed companies without name masking, thereby creating the risk of leakage of inside information concerning those listed companies.

It was the Defendant's view that the Plaintiff's conduct and judgment fell below the standards of a person of his tenure and seniority and accordingly, the Plaintiff was issued with a written warning, and was removed from his role as Head of China (the "**Warning Letter Decision**").

Subsequently, the Plaintiff was considered for a discretionary bonus in financial year 2016/2017, but primarily in light of the concerns with his conduct and judgment, the Defendant reached the decision to award the Plaintiff with a zero discretionary bonus (the "**Bonus Decision**").

The Plaintiff was ultimately made redundant (the "**Redundancy Decision**"). The Redundancy Decision was made after the Defendant reviewed its business needs and determined that there was no need to backfill the Plaintiff's remaining position of Chairman of the Investment Banking Division, Asia Ex-Japan. It was determined that it was not necessary for the Defendant to retain someone at the Plaintiff's level of seniority and experience to carry on the same level of business. (In the remainder of the briefing, the Warning Letter Decision, Bonus Decision and Redundancy Decision will together be referred to as the "**Decisions**"). As the Plaintiff refused to sign a general waiver and release when requested during the termination process, his unvested bonus awards were forfeited in accordance with the terms of the award scheme documents.

## PLAINTIFF'S CLAIMS AND ESTABLISHED COMMON LAW DUTIES

The Plaintiff alleged that the Defendant breached his employment contract in relation to each of the Decisions made by the Defendant. Importantly, the Plaintiff's claims were entirely based on implied terms with a total of nine implied terms being pleaded<sup>1</sup>.

The implied terms invoked by the Plaintiff were largely novel. Nonetheless, existing case law establishes the following duties:

- an implied duty of mutual trust and confidence between employer and employee, under which the employer would not, without reasonable and proper cause, conduct itself in a manner destroying or seriously damaging the relationship of trust and confidence between them (the "**Duty of Trust and Confidence**");
- where the contract gives one party the power to exercise a discretion, there is an implied requirement that it can only be exercised in good faith, rationally and for a proper purpose, and not arbitrarily or capriciously or in a manner which is not bona fide. This entails assessing (a) whether the decision maker has taken into account all relevant considerations and excluded irrelevant considerations, and (b) whether the decision is so outrageous that no reasonable decision-maker could have reached it (the "**Braganza Duty**")<sup>2</sup>; and

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<sup>1</sup> The pleaded implied terms were that the Defendant would not:

- (i) without reasonable and proper cause, conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence between employer and employee;
- (ii) censure/sanction the Plaintiff in an irrational, perverse or arbitrary manner or in a manner not bona fide or otherwise not in good faith;
- (iii) censure/sanction the Plaintiff unconscionably, without reasonable cause and/or contrary to the Plaintiff's legitimate expectations;
- (iv) administer the bonus schemes in an irrational, perverse or arbitrary manner or in a manner not bona fide or otherwise not in good faith;
- (v) exercise the right to terminate by giving three months' notice other than fairly and in good faith;
- (vi) exercise the power to terminate other than in good faith and not for arbitrary, capricious, perverse or irrational reasons;
- (vii) exercise the power to dismiss unconscionably, without reasonable cause and/or contrary to the Plaintiff's legitimate expectations;
- (viii) exercise the right to terminate in order to avoid the Plaintiff being eligible for or receiving a bonus award; and
- (ix) exercise the power to censure/sanction and/or dismiss the Plaintiff to deprive the Plaintiff of his bonus awards or which would result in the unreasonable deprivation of his bonus awards.

<sup>2</sup> *Braganza v BP Shipping Ltd and another* [2015] 1 WLR 1661.

- an implied duty that the employer cannot exercise the power to terminate in order to avoid the employee being eligible for a bonus (the "**Tadjudin Duty**")<sup>3</sup>.

The Court considered the extent implied terms should be recognised in respect of each of the three Decisions. The Court found the Duty of Trust and Confidence to apply to the Warning Letter Decision and the Bonus Decision; the Braganza Duty to the Bonus Decision and the Tadjudin Duty to the Redundancy Decision. The Court then evaluated, based on the facts, whether the applicable duties in relation to each of the Decisions had been breached.

## **COURT'S DETERMINATION**

### **Warning Letter Decision**

The Court held that the Duty of Trust and Confidence was the only duty that applied to the Warning Letter Decision, and rejected the other implied terms pleaded by the Plaintiff in relation to this decision. The Court also clarified that under the Duty of Trust and Confidence, the test is not whether the employer conducted itself in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence with the employee, but whether the employer acted in a manner calculated and likely to destroy or seriously damage the relationship of trust and confidence.

The Court found on the facts that the Defendant did not breach the Duty of Trust and Confidence by issuing the warning letter. The Court accepted the Defendant's evidence that the written warning was issued due to the Plaintiff's inability to recognise and manage the perception of a conflict of interest between the Investment Banking Division and research functions of the firm, and his failure to protect the Defendant from the risks arising from his actions. Given there was a proper basis for issuing the warning, and the fact that it was issued as a private and confidential document, the Court concluded that the written warning was not calculated and likely to destroy or seriously damage the relationship of trust and confidence with the Plaintiff.

### **Bonus Decision**

Regarding the Bonus Decision, the Court held that the Duty of Trust and Confidence and the Braganza Duty applied, and rejected the other implied terms pleaded by the Plaintiff in relation to this decision. Despite the rarity of awarding a zero bonus in the investment banking sector, especially given the Plaintiff's senior position as a Senior Managing Director, the Court rejected the Plaintiff's claims and concluded that the Defendant had not breached any of the applicable duties.

In relation to the Braganza Duty, the Court dismissed the Plaintiff's argument that the Defendant failed to take into account the crucial factor of the Plaintiff's contribution to the Defendant's business. The Court accepted the Defendant's evidence that the warning letter was the primary factor which the Defendant considered in reaching the Bonus Decision, and that whilst the Plaintiff made positive contributions to the Defendant's business, they were not sufficient to outweigh the negative factors. The Court also rejected the Plaintiff's case that the Bonus Decision was so outrageous that no reasonable employer could have reached it. The Court held that the weight placed on the various factors properly taken into account by the Defendant is a matter for the Defendant's judgment rather than the court's. The Court further held that whether another

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<sup>3</sup> *Tadjudin Sunny v Bank of America, National Association*, unreported (CACV 12/2015, 20th May 2016).

employer may have weighed the factors differently and awarded a bonus is not the test. The court only intervenes if the decision-making process is irrational, which the Plaintiff failed to demonstrate.

As for the Duty of Trust and Confidence, the Court found no breach on the basis that there was a legitimate basis for the Bonus Decision.

## Redundancy Decision

In relation to the Redundancy Decision, the Court upheld a well-established line of authorities confirming that under Hong Kong law, where a contract of employment provides for the parties to terminate the employment without cause, an employer (or employee) can terminate the employment "for no, good or bad reason"<sup>4</sup>. Even if the employer provides a reason for the termination which turns out to be untrue, this would not cause the termination to be wrongful<sup>5</sup>. This position is only qualified by the Tadjudin Duty, which stipulates that an employer cannot exercise his right to terminate in order to avoid the employee either becoming eligible for consideration for (as was the case in *Tadjudin*) or receiving (as the Court held in this case interpreting *Tadjudin*) a bonus award.

The Court held that apart from the duty not to terminate to prevent the employee from becoming eligible for or receiving a bonus, no other implied duties applied in relation to the Redundancy Decision. This is because the alleged implied duties contradict the Defendant's express contractual right to terminate the Plaintiff's employment without cause. Crucially, the Court also held that the Duty of Trust and Confidence does not apply to the Defendant's decision to terminate the Plaintiff as that duty relates to the maintenance of the ongoing employment relationship, and is therefore inappropriate to be applied to the termination of the relationship.

The Plaintiff claimed that even though he was made redundant, the true reason for his termination was to prevent him from being eligible for or receiving bonus awards. While the Court agreed that the Plaintiff's termination was not a genuine case of redundancy, it held that the redundancy decision was made to save the Plaintiff's face. The alternative would have been to terminate the Plaintiff for his conduct, which would have been more severe. On this basis, the Court determined that there was no breach of the Tadjudin Duty.

## CONCLUSION

Having determined that the Defendant did not violate the duties applicable to any of the three Decisions, the Court concluded that the Defendant did not breach the Plaintiff's contract of employment and accordingly dismissed the Plaintiff's claims in their entirety.

As discussed above, this decision clarifies key principles relating to an employer's duty of trust and confidence, exercise of discretion granted to the employer under an employment contract, and termination of employment without cause.

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<sup>4</sup> *Cheung Li On v Sun Life Hong Kong Limited* [2021] HKCFI 3784 at 115. This is distinct from the position under English law, which provides for the concept of unfair dismissal, under which a dismissed employee may have the right to claim compensation for unfair dismissal even if the employee has received notice or payment in lieu and has no contractual claim. The employer must show a fair reason for dismissal falling within the categories of misconduct, capability, illegality, redundancy or some other substantial reason as well as a fair procedure. In Singapore, if a reason for termination is provided, it must be based on substantiable grounds; it will be wrongful (and compensation may be sought) if it is discriminatory, for the purpose of depriving employee of his or her benefits or entitlements, or punishment for exercising employment rights.

<sup>5</sup> *Lam Siu Wai v Equal Opportunities Commission* [2021] 5 HKLRD 30 at 20, 39 and 42.

One practical takeaway from the case is that employers should maintain comprehensive and contemporaneous records of all decision-making processes if they anticipate that the employment relationship might become contentious. This would assist the employer in demonstrating its true intention in making particular decisions should they be challenged in any tribunal or court in the future (for example, to counter accusations that a decision was made to deprive an employee of bonuses or undermine the relationship of trust and confidence). Such records could include investigation findings, minutes of meetings in which disciplinary sanctions were imposed, records of discussions among management regarding disciplinary, remuneration or termination decisions, and talking points or records of any discussions with an employee explaining the rationale behind any contentious decision.

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