

## RIGHT TO TERMINATE WITHOUT CAUSE PREVAILS OVER THE IMPLIED DUTY OF MUTUAL TRUST AND CONFIDENCE BETWEEN EMPLOYER AND EMPLOYEE

LAM SIU WAI V EQUAL OPPORTUNITIES COMMISSION [2021] 5 HKLRD 30

### Background

In *Lam Siu Wai v Equal Opportunities Commission*<sup>1</sup>, the Court of First Instance (CFI) affirmed that the common law implied duty of mutual trust and confidence (**Duty**) was concerned with the preservation of the continued relationship between employer and employee, and could not be used to water down an employer's contractual or statutory right to terminate employment without cause by notice or payment in lieu of notice.

In this briefing, we will discuss the scope and applicability of the Duty.

### Facts

The Equal Opportunities Commission (the **EOC**) terminated the Claimant's employment after 22 years of her service, by paying her three months' salary in lieu of notice as well as all the accrued entitlements pursuant to the employment contract. The letter of termination referred to the Claimant's "recent attitude and behaviour" not closely matching with the requirements of the senior position she was employed for at the time.

The Claimant lodged a claim at the Labour Tribunal against the EOC for damages, on the ground that the EOC wrongfully terminated her employment in breach of the Duty. More specifically, referring to the reason for her dismissal stated in the letter of termination (the **Dismissal Reason**), the Claimant alleged that her termination was in bad faith, and not for a valid reason under section 32K of the Employment Ordinance (Cap 57) (the **Ordinance**) and that the wrongful termination in bad faith amounted to serious breaches of the EOC's implied duty of mutual trust and confidence contained under her employment terms. She claimed loss and damages, including loss of her income, loss of the employer's MPF contributions and loss of gratuity for the remaining period of the fixed term employment contract.

The EOC's case, however, was based primarily on its contractual or statutory right to terminate the

employment contract by payment in lieu. In particular, the EOC sought to rely on section 7 of the Ordinance which provides that either party to an employment contract may at any time terminate the contract without notice by making payment in lieu. There was indeed no obligation to provide any valid reason (indeed, any reason) for the termination without cause.

The Labour Tribunal decided in favour of the Claimant and held that the EOC had breached the Duty:

- (1) Section 7 of the Ordinance only establishes a mode of termination without cause (i.e. termination by payment in lieu of notice). In exercising the statutory right under section 7, the employer should make sure that there is no breach of any express or implied terms of the employment contract.
- (2) The most critical issue was whether there was a good and valid reason to terminate the employment. If the employer had a good and valid reason for the termination, there would not be any breach of the Duty in the employment terms.
- (3) The burden was on the employer to prove that the reason for dismissing the Claimant was good and valid.
- (4) Having considered the evidence given, the Labour Tribunal concluded that the EOC failed to prove that the Dismissal Reason was a "true and valid" reason for dismissing the Claimant. Indeed, the possible reason for termination was that the Claimant had lodged a complaint or grievance about a senior management personnel who then retaliated by creating a pretext for dismissing the Claimant.

### Decision of the CFI

The EOC appealed against the Labour Tribunal's decision. The relevant grounds of appeal were that the Presiding Officer erred in holding that the critical issue in determining the Claimant's claim was whether there was

<sup>1</sup> [2021] HKCFI 3092.

a good and valid reason for the termination of the employment contract when the EOC terminated the Claimant's employment without cause upon exercise of its contractual right in accordance with the terms of the employment contract and/or its statutory rights under the Ordinance. The Presiding Officer also erred in holding that the EOC acted in breach of the Duty when the Duty did not and could not override the EOC's right to terminate an employment by payment in lieu (whether contractual or statutory).

Referring to the English case of *Malik v BCCI*<sup>2</sup>, the CFI confirmed the existence of the Duty, namely that in respect of an employer, it shall not "without reasonable and proper cause, conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of confidence and trust between employer and employee". The Duty is apt to cover a great diversity of situations in which a balance has to be struck between an employer's interest in managing his business as he sees fit and the employee's interest in not being unfairly and improperly exploited.

*Malik* concerned two former employees of BCCI, a bank which went into liquidation in the summer of 1991. Shortly before the applicants were dismissed on the grounds of redundancy, it became widely known that the bank might have been carrying on its business fraudulently. The former employees claimed that stigma was attached to them and they were unable to find new employment in the financial services industry, notwithstanding that they were not implicated in the bank's misconduct. Their claims for damages were rejected in the first instance and by the English Court of Appeal.

The House of Lords, however, allowed the former employees' further appeal. It was decided that the bank as an employer was under a general implied obligation not to engage in conduct likely to undermine the trust and confidence between employer and employee, and this general obligation included an implied obligation not to conduct a corrupt and dishonest business. The former employees were awarded damages including loss of earnings owing to the failure to obtain new employment as a result of the stigma.

### Application of the Duty

As regards the application of the Duty, the CFI referred to the Hong Kong Court of Appeal's (CA) decision in *Tadjudin Sunny v Bank of America, National Association*<sup>3</sup>.

The CA in *Tadjudin Sunny* in turn referred to the House of Lords' decision in *Johnson v Unisys Ltd*<sup>4</sup>, in which the majority held that the Duty cannot be utilised as a foundation for an employee to recover damages for loss arising from the manner of his dismissal. This was because the Duty was concerned with preserving the continuing relationship which should subsist between employer and employee and therefore it was not appropriate for use in connection with the way that the relationship is terminated. The CFI confirmed that this represents where Hong Kong law stands and the Duty cannot be applied to water down an employer's right to terminate the employment of its employee without cause by invoking the notice provisions.

In *Johnson*, the plaintiff employee was dismissed for some alleged irregularity. To terminate the employment, the defendant employer paid the plaintiff employee four weeks' salary in lieu of notice pursuant to the employment contract which allowed the employer to terminate the employment for cause (based on gross misconduct on the part of the employee) or without cause (by notice or payment in lieu of notice). The plaintiff employee claimed damages at common law, alleging that his dismissal was in breach of various implied terms of his employment contract, one of which was that the employer would not without reasonable cause conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of trust and confidence between itself and its employees. The allegation lay in the fact that he was dismissed without a fair hearing and in breach of the employer's disciplinary procedure. Due to the manner in which he was dismissed, he suffered mental breakdown and was unable to work. His claim was rejected in the first instance and his subsequent appeals to the English Court of Appeal and the House of Lords failed.

Lord Hoffmann in the House of Lords, in particular, found it difficult to adapt the implied term of mutual trust and confidence to the dismissal in the face of the express provisions that the defendant employer was entitled to terminate the plaintiff's employment on four weeks' notice without any reason, given the principle that any terms which the courts imply into a contract must be consistent with the express terms.

*Johnson* should be distinguished from *Tadjudin Sunny*. Whilst the employer in the case of *Tadjudin Sunny* sought to terminate the employment contract by giving one month's salary in lieu of notice pursuant to the

<sup>2</sup> [1998] AC 20.

<sup>3</sup> [2016] HKEC 1128.

<sup>4</sup> [2003] 1 AC 518.

employment terms, the CA decided that the employer was in breach of an implied term.

The plaintiff there was employed by the defendant as an analyst. The employment contract expressly provided that the plaintiff's eligibility for any bonus under the defendant's performance incentive program was conditional upon her remaining in the defendant's employment at the time of payment of the bonus. Following a series of performance issues, the defendant placed the plaintiff on a performance improvement plan and ultimately terminated her employment. As the termination took place prior to the bonus payment date, the plaintiff did not receive any performance bonus prior to her departure.

The CA held that it was intended and understood by both parties that the performance bonus constituted an important benefit for the plaintiff and an integral part of her remuneration package. On this basis, the appellate court found it necessary to imply into the employment contract a term that the defendant could not exercise its contractual right to terminate the plaintiff's employment by notice or payment in lieu to deprive the plaintiff of her performance bonus. Without such an implied term, the plaintiff's contractual right to be eligible for consideration under the performance incentive program could be easily taken away by the defendant exercising its contractual right of termination by notice or payment in lieu.

The CA was satisfied that based on the evidence provided, the lower court was correct in finding that the defendant acted maliciously in invoking and conducting the performance improvement plan with the view to terminating the plaintiff's employment and avoiding payment of her bonus, and therefore was in breach of the implied term.

In *Lam*, the CFI made it clear that *Tadjudin Sunny* was not an authority for the general proposition that the right to terminate without cause was qualified by an implied duty to exercise such right in good faith. Indeed, the CA in *Tadjudin Sunny* acknowledged that the issue before it was "narrow and specific", based on the particular facts and circumstances of the case.

The CFI also stressed that consistent with the analysis on the Duty (i.e. the right to terminate without cause is not subject to the Duty), the contractual right to terminate an employment (on the part of either employer or employee) can be exercised unreasonably or capriciously so long as such right is exercised in accordance with the relevant employment contract, and the court is not

concerned with the rightness or wrongness of the dismissal. The case of *Cheung Chi Keung v Hospital Authority*<sup>5</sup> was referred to. Therefore, the CFI failed to see how or why the Dismissal Reason had any bearing on the termination of the Claimant's employment.

In *Cheung Chi Keung*, the defendant employer commenced disciplinary proceedings against the plaintiff employee due to the latter's unsatisfactory work performance pursuant to the human resources policies which were incorporated into the employment contract. The defendant subsequently terminated the employment contract by giving the plaintiff two months' salary in lieu of notice before the disciplinary proceedings were concluded. In the plaintiff's claim for wrongful dismissal, the CFI held that on a proper construction of the relevant employment contract, the defendant had a separate and distinct right to terminate the plaintiff's employment without cause by notice or payment in lieu. Such right was not subject to the disciplinary proceedings and could be exercised unreasonably or capriciously.

As an obiter, the Honourable Mr Justice Anthony Chan expressed that to imply a duty of good faith in the termination of employment without cause would lead to far-reaching effects on employment law. Reasons for termination may well have to be given for the exercise of such right, which may be subject to scrutiny by the Labour Tribunal. Litigation complexity and costs may increase significantly, and delay may be caused. It would be more appropriate for such significant changes to the law to be dealt with by the legislature.

### Takeaways

The CFI's decision in *Lam* reminds us that there is an implied duty of mutual trust and confidence between employer and employee under common law. However, in general, it has no application in the exercise of the contractual or statutory right to terminate an employment without cause.

Nevertheless, if an employer exercises the right to terminate an employment with the intent to deprive the employee's entitlement under the relevant employment contract, the Hong Kong courts may be ready to imply a term in the contract that the employer's right be exercised in good faith.

It is also important for employers to bear in mind that if the intention is to exercise the right to terminate without cause, the less they say about the reasons for the termination the better. As demonstrated in *Lam*, whilst the employer meant to terminate the employment

<sup>5</sup> [2006] 2 HKLRD 46.

contract by making a payment in lieu pursuant to the employment terms, the statement about the employee's

performance in the letter of termination unfortunately gave rise to the subsequent dispute.

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