

Insights**HK COURT UPHOLDS ENTITLEMENT TO GUARANTEED BONUS AND DISALLOWS EMPLOYER SET OFF**

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In the case of *Xu Yi Jun v GF Capital (Hong Kong) Limited* (CACV 502 & 577 / 2019) (Date of Judgment: 6 August 2020), the Hong Kong Court of Appeal (the “**Court**”) considered (i) the employee’s entitlement to a guaranteed bonus (“**Bonus**”), and (ii) the employer’s argument that it was entitled to set off its unliquidated claim for damages for breach of contract and implied duties, against the Bonus.

Background of the case

The defendant was a company which conducted regulated activities including advising on corporate finance. The plaintiff was employed to work as the managing director of the Structured Finance Department of the defendant.

The employment contract between the plaintiff and the defendant contained this provision on the Bonus:

“6. Guaranteed Bonus

In addition to the annual bonus and sign-on bonus referred to in clauses 4 and 5 above, we will grant you a guaranteed bonus of HK\$7,800,000 (“2016 Guaranteed Bonus”) for the calendar year ending 31 December 2016. The 2016 Guaranteed Bonus is payable to you irrespective of your performance or the performance of the Group during the calendar year. Any annual bonus in excess of the 2016 Guaranteed Bonus shall be calculated and payable to you in accordance with clause 4 above. The 2016 Guaranteed Bonus will be vested in the following calendar year and payable in full on the payment date of your monthly basic salary in March 2017 (the “Due Date”). If your employment with the Company is terminated voluntarily by you without cause or you have been found guilty of any gross misconduct, in either case before the Due Date, any outstanding payments of the 2016 Guaranteed Bonus will be forfeited.” (emphasis added)

On the basis of the plaintiff’s recommendation, the Structured Finance Committee of the defendant made a loan to a borrower to fund its investment in a target company. Thereafter, the Securities and Futures Commission ordered the target company to cease trading, and it became apparent to the defendant that the borrower would default on the loan. As a result, the defendant commenced an

investigation into the plaintiff's conduct as to whether the defendant properly had discharged her duties in recommending that the defendant make that loan.

The Due Date for payment of the Bonus to the plaintiff fell on 31 March 2017. However, no payment was made on 31 March 2017 because the defendant decided to delay payment of the Bonus pending the completion of its investigation into the conduct of the plaintiff. There was no dispute that prior to the Due Date, the plaintiff had not been found guilty of any gross misconduct. On 10 May 2017, the defendant completed its investigation and identified certain failings of the plaintiff, details of which were provided to the plaintiff on 12 May 2017. The plaintiff did not respond to the assertions, and resigned on 14 June 2017.

The plaintiff later brought proceedings to claim payment of the Bonus with interest.

The proper construction of the Bonus provision

In construing clause 6 of the employment contract, the Court agreed with the plaintiff's contention and held that the natural and ordinary meaning of the relevant part is clear. In order to fall within the sentence highlighted above so as to be able to forfeit for gross misconduct, it is necessary for there to be a finding of gross misconduct before the Due Date.

The defendant argued that it is not necessary for there to be a finding of gross misconduct before the Due Date, so long as the gross misconduct had occurred before the Due Date. The defendant contended that if the plaintiff already had engaged in gross misconduct before the Due Date but was able to pocket the Bonus simply because no finding was made by the Due Date, it would make no business common sense.

In rejecting the defendant's contention, the Court opined that on the defendant's construction of clause 6, the defendant simply could declare there were allegations of gross misconduct and withhold payment for an indefinite period while investigating the gross misconduct alleged to have happened prior to the Due Date. This lack of certainty as to when a finding of gross misconduct could and should be made does not make business sense, in the Court's view.

Setting off the Bonus against a counterclaim

In its counterclaim, the defendant argued that the plaintiff was in breach of express contractual duties, implied common law duties of fidelity to act faithfully and in the best interest of the defendant and to exercise reasonable care and skill in the performance of the plaintiff's duties, and the duty of care as an employee to exercise reasonable skill and care in her employment in relation to matters in respect of the loan. As a result of these breaches, the defendant argued that it had suffered loss and damage substantially exceeding the amount of the plaintiff's Bonus claim.

The plaintiff relied on section 32(1) of the Employment Ordinance (Cap 57) ("EO") which provides that:

“No deductions shall be made by an employer from the wages of his employee or from any other sum due to the employee otherwise than in accordance with this Ordinance.”

The Court held that the wording of “*or from any other sum due to the employee*” in section 32(1) is sufficiently wide to cover the Bonus, and therefore deduction by way of set off is statutorily prohibited.

The defendant sought to make a distinction between (a) an equitable set-off in the context of legal proceedings, and (b) an equitable set-off deployed by the employer outside legal proceedings. The defendant accepted a deduction made by the employer not in the context of an action may be prohibited under section 32(1). However, the defendant submitted that an equitable set-off in the context of proceedings is permissible and is not precluded by section 32(1).

The Court rejected the defendant’s contention, saying that it would not have been the legislative intent of section 32(1) to remove the protection against set-off and permit the employer to deprive the employee temporarily of the right to payment of a sum until the final resolution of the employer’s claim for unliquidated damages against the employee for bad or negligent work.

Major takeaway points

- Employers should review carefully the terms of the employment contracts to check when the employee’s entitlement to bonuses arise.
- Employers should be careful before making deductions from employees’ wages or other sums due to the employee (e.g. a bonus). There only are very limited grounds under which employers lawfully may deduct wages – see section 32(2) of the EO. However, given that definition of “wages” under section 2 of the EO expressly excludes “any end of year payment” (under which the Bonus falls, in the opinion of the Court) and “any annual bonus”, it is not permissible for employers’ to deduct bonuses, being not “wages”.
- Building on the point above, employers should ensure that they comply strictly with the terms of the contract. In this case, what the defendant should have done was to pay the plaintiff the Bonus (to which the plaintiff was contractually entitled), and then sue the plaintiff separately to recover its loss and damage.

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