

Update

High Court ruling on departing senior employees in Hong Kong

“All for one, one for all?”

We previously alerted readers to the case of *Cantor Fitzgerald Europe & Anor v Boyer & Ors*, [2012] HKEC 301, in which the High Court in Hong Kong delivered an interesting judgment on (among other things) the fiduciary duties owed (and not owed) by senior management staff and on the enforceability of restrictive covenants in their employment contracts. That judgment has become well publicised in Hong Kong. The circumstances of the defendants’ resignations from Cantor Fitzgerald should be of interest to employers and senior employees alike. In this article we take a more detailed look at the background to the case and at certain key points to note going forward.

Key points

- To be enforceable in Hong Kong, restrictive covenants in an employee’s employment contract must be reasonable and proportionate for the protection of an employer’s legitimate business interests.
- What is reasonable and proportionate will depend on the circumstances of a case but includes local market conditions in Hong Kong, which traditionally has had laissez-faire traditions and fluid employment practices.
- If an employer overreaches and seeks protection in a restrictive covenant that is found by a court to be unreasonable and disproportionate, the court will not re-write it into a more acceptable form. In this case, restrictive covenants not to solicit (“poach”) fellow employees and not to compete with the employer’s business were found to be unenforceable.
- Some employers not familiar with local conditions in Hong Kong may be taken aback a bit by the relative ease with which some employees change jobs without too much concern for the restrictive covenants

in their employment contracts; witness disputes in Hong Kong from (for example) hair stylists to property agents to senior employees of financial institutions.

- In addition to restrictive covenants, a senior management employee or director owes a fiduciary duty to his or her employer not to act contrary to the employer's interests. It is not a breach of fiduciary duty to look for another job, but it is if the employer can prove that an employee has recruited other employees while still an employee. However, proving this can be difficult.
- Even if an employer can prove breach of a fiduciary duty or of enforceable restrictive covenants, in order to recover any damages the employer will have to prove a loss. This may be difficult to do and employers should expect a court to analyse critically evidence put forward as to alleged loss. Evidence of such loss is usually more persuasive if it is presented by an independent expert witness.
- Even if an employer obtains temporary injunctive relief as regards a departing employee this does not mean that, if the court proceedings proceed to trial, success will follow. While interlocutory injunctions have their place, in the main they do no more than preserve a status quo pending satisfactory resolution or trial.
- The courts in Hong Kong are more likely to consider it unreasonable or disproportionate to restrict junior employees after their employment terminates.
- The courts in Hong Kong will adopt a more serious approach where the conduct complained of amounts to a planned attempt by employees subject to fiduciary duties to destabilise an employer's business, while also setting-up in competition with that employer. This is something to watch; particularly, in those business sectors or industries where capital is being attracted to new "start-ups" (backed by wealthy investors) who, in turn, are attracted by lateral hires, rather than organic growth.
- Employers should review the restrictive covenants in their employees' employment contracts (particularly those of their senior staff and management) and take good legal advice if they are not sure whether those covenants are reasonable. Amendments to the restrictive covenants in an employee's employment contract are a matter for individual negotiation.
- In Hong Kong section 7 of the Employment Ordinance (Cap. 57) entitles either party to an employment contract to terminate it without giving notice by agreeing to pay the other a sum of money calculated by reference to the notice period. It is doubtful whether this provision can be overridden by a term in an employment contract that applies the law of another jurisdiction. This is particularly worth noting in the context of employees seconded to work in Hong Kong from overseas.

Background

The Cantor Fitzgerald group is a well-known capital markets investment bank that does business in various major financial centres. In Europe and Hong Kong, Cantor Fitzgerald operates as Cantor Fitzgerald Europe (CFE) and Cantor Fitzgerald Hong Kong (CFHK), respectively.

The first defendant (D1) had been seconded from CFE to CFHK. D1's contract of employment was with CFE and was subject to English law, save that on his secondment his contract was varied by agreement to be subject to "any mandatory employment laws of Hong Kong". D1 had been the managing director of CFHK and responsible for its equities business; as such, he owed fiduciary duties to CFHK. D1 owed contractual duties, including a duty of good faith, to CFE (but not CFHK). D1's contract provided that he had to give four months notice, although he purported to terminate his contract immediately by, in effect, buying out his notice period.

Two of the other defendants (D2 and D3) were employed by CFHK as successful equities traders. The fourth defendant (D4) was also employed by CFHK as its chief economist for Asia.

The four defendants (the defendants) all separately resigned on 30 May 2011 to join a new brokerage company in Hong Kong, Reorient Financial Markets Ltd (Reorient). Reorient was part of a group led by investors with whom Cantor Fitzgerald had previously considered an alliance that did not come to fruition.

Prior to their resignations, the defendants were apparently each interviewed by the same firm of "head hunters" and each knew that the other was intending to join Reorient. The defendants eventually each used the same firm of solicitors for advice on their draft employment contracts.

CFE and CFHK sued the defendants in Hong Kong with respect to alleged breaches of duties of fidelity and in the case of D1 alleged breach of fiduciary duty owed to CFHK. Prior to trial, CFE and CFHK had obtained court orders (injunctions) against the defendants based on the restrictive covenants in their respective employment contracts.

Those covenants in effect purported (among other things) to prevent the defendants individually or collectively from enticing away certain classes of Cantor Fitzgerald employees or clients and placed restrictions on their working in a "competing" business. The court orders had been discharged by the time the trial started. At trial CFE and CFHK claimed damages against the defendants.

Principal issues

Various issues arose. The principal ones were as follows:

- had any of the defendants breached their duty of good faith or fiduciary duty by acting in a way that was contrary to the interests of CFE or CFHK? In particular, had they procured each other to resign to join Reorient or acted in concert to join a “competitor”?
- had the defendants failed to disclose their intention or that of each other to join a “competitor” or failed to disclose approaches made to them or any of them?
- was D1 required to serve out his four months notice period (notice having been given on 30 May 2011) or was he entitled to, in effect, buy out his notice period and leave immediately?
- were the restrictive covenants in D1, D2 and D3’s employment contracts, purporting (among other things) to prevent them from enticing other Cantor Fitzgerald staff for a period of twelve months after resignation or working for a business in “competition” after resignation (for twelve months in D1’s case and six months in D2 and D3’s case) or enticing certain Cantor Fitzgerald clients after resignation (for twenty weeks in D1’s case and twelve months in D2 and D3’s case), reasonable?
- in the event that the defendants were in breach of any duties or restrictive covenants, were CFE and CFHK entitled to damages assessed by what they claimed was a loss of revenue following the defendants’ resignations?

Decision

With respect to these issues, the court found as follows.

Duty of good faith or fiduciary duty

Each defendant owed a duty of good faith to his employer; CFE in the case of D1 and CFHK in the case of the other three defendants. However, the court found that only D1 owed a fiduciary duty as only he was properly to be regarded as a director (in this case he was also the managing director of CFHK). Although D2 and D3 had the title of managing director that was with respect to CFHK’s equities desk and was not equivalent to being directors of CFHK.

Interestingly, the judge was content to adopt a rather robust view of the distinction between an employee’s duty of good faith and a fiduciary duty, noting that:

“I shall simply proceed on the basis that, where a person owes either duty, that person must not act in a way which is contrary to the interests of an employer or company.”

The particular breach of good faith or fiduciary duty alleged related to the defendants all resigning together to join Reorient and the inferences that CFE and CFHK sought to draw from that. However, the court was unable

to find on the evidence that the defendants acted in concert or procured each other to leave their employer and join Reorient. On the evidence, the court considered that the defendants had not left their employers and joined Reorient as a “package deal”; rather, it was “each for himself”.

“Competitor”

CFE and CFHK argued that the defendants had breached an express provision in their contract of employment requiring them to notify their employer of an intention to join a competitor or an approach by a competitor. However, the court found that the word “competitor” (or “competition”) was ambiguous and that ambiguity counted against the employer.

The court also considered that it was difficult to see how Reorient (and more particularly, its legacy company) could be regarded as a competitor when it was, in effect, a start-up operation compared to “a leading and long-established global enterprise such as the Cantor Fitzgerald group”. The court noted that:

“It would be wrong to read the expression ‘competitor’ in the relevant clauses as encompassing a business which was little more than a start-up.”

D1’s notice period

The court found that D1 was entitled to tender a payment in lieu of his four months notice period as a matter of Hong Kong law, pursuant to section 7 of the Employment Ordinance (Cap. 57). This was a mandatory provision of Hong Kong employment law that took precedence over the governing English law clause in D1’s employment contract (which, in any event, was varied on his secondment so as to be subject to any “mandatory employment laws of Hong Kong”). The court ruled that (subject to certain express exceptions) section 7 applied to all employment in Hong Kong, including that governed by the law of another country.

Restrictive covenants

The court found that the various restrictive covenants were either unreasonable or that there was no evidence they had been breached. In particular, the twelve months period in D1’s contract of employment (not to entice other staff or work for a competitor) was found to be unreasonable because, on the evidence, it went further than was necessary to protect CFE’s legitimate business interests.

The same was true with respect to the twelve months restrictive covenants in D2 and D3’s employment contracts not to entice away fellow employees or solicit Cantor Fitzgerald clients. The six months non-compete covenants in D2 and D3’s employment contracts had expired by the time of the trial and were, therefore, academic, although

the court questioned whether six months was a reasonable period of restraint given the width of the clause (in particular, the meaning of “competition”).

Damages

The judge stated:

“I am therefore unable to conclude that the Plaintiffs suffered anywhere near the alleged 29% loss of revenue due to the Defendants’ departures. Had I found that the Defendants were in breach of any obligation to Cantor Fitzgerald, I would have been hard-pressed to quantify damages at other than a nominal figure.”

Comment

Aspects of the judgment will make uneasy reading for certain employers.

Duty of good faith or fiduciary duty

In light of a Hong Kong resident’s and employee’s freedom of movement¹, the judgment calls into question the effectiveness of imposing a duty on an employee to inform an employer of an approach by a competitor or that an employee is thinking of leaving. Certainly, breach of such a provision sounding in damages would be difficult to establish. However, given that such terms were expressly provided for in D1, D2 and D3’s employment contracts, and had been acknowledged by them, one might have expected more reasoning in the judgment on this point. In our view, not too much, perhaps, should be read into the court’s comments in this regard.

Employers who do seek to enforce similar duties against groups of departing employees will want to review the nature of the evidence that is collated. In this case, the court was not willing to draw too many inferences, even though:

- the defendants all met associates of their future employer at a lunch in January 2011 where they discussed the possibility of leaving to join Reorient;
- the defendants all took advice on their new employment contracts from the same firm of lawyers;
- the defendants resigned on the same day, by means of similar letters of resignation.

This should cause employers to consider what other “paper trails” may exist.

Clearly, in this case, whatever one thinks of each of the defendants’ own *modus operandi*, it was not (on the evidence) a case of “all for one, one for all” (“*tous pour un,*

un pour tous”)². In any event, given the judge’s finding as regards an absence of loss, the point is academic.

“Competitor”

The restrictive definition of “competitor” or “competition” adopted by the court will cause some employers concern; particularly, in the banking and financial services sector where such a provision is common. As capital markets and economies in the Far East continue to grow there will be start-up rivals that, while start-ups, do provide genuine competition to more established businesses. Reorient evolved out of a restructured brokerage business in Hong Kong and is reputed to have access to wealthy sources of funds.

Employers will need to give more guidance to their lawyers on the specific kinds of competition, and degree of competition, which warrant reasonable and proportionate protection from unfair practices.

D1’s notice period

In our view, the court’s reasoning in this regard is right. In Hong Kong an employee is usually entitled to “buy out” their notice period. That this overrides an alternative choice of law clause in an employment contract is not entirely free from doubt, but is unlikely (of itself) to justify an appeal.

Restrictive covenants

To be enforceable, restrictive covenants must be reasonable and proportionate (judged on a range of factors, including local market conditions) to protect an employer’s legitimate business interests. The judgment should remind employers that if this mark is overstepped then the whole covenant is ineffective; the court will not re-write it into a more acceptable form.

Interestingly, the court noted that D4 had similar restrictive covenants in his employment contract to that of D2 and D3 but limited to a three months period. The court considered that with respect to D4 this period was still too long in the absence of evidence of how this was necessary for CFHK’s legitimate protection (D4 having been more “back office” and CFHK’s chief economist for Asia).

Of course, a court’s approach to restrictive covenants and, more generally, to an employee’s duty of good faith is often influenced by its view of the departing employee’s overall conduct. In this case, that conduct does not appear to have pricked the court’s conscience. In a recent English case, a group of departing employees leaving an established insurance company for a start-up insurance business fared rather differently to the defendants³.

¹ Article 31, Basic Law of the HKSAR

² cf. “The Three Musketeers” (“Les Trois Mousquetaires”) by Alexandre Dumas, c.1844

³ *QBE Management Services (UK) Ltd v Dymoke & Ors* [2012] EWHC 80 (QB), 27 January 2012

Damages

Alleged damages in these sorts of cases are often difficult to prove, let alone quantify. CFE and CFHK led with evidence prepared by the latter's CFO, purporting to show a 29% loss of monthly average revenue in the five months following the defendants' resignations compared to the preceding five months. Of course, a drop in revenue in the summer of 2011 was not an unknown phenomenon for many businesses. The court's approach to the alleged loss demonstrates an element of scepticism; more reason to consider engaging an independent forensic accounting expert. Attempting to prove damages "on the cheap" by using in-house staff can be a false economy.

Further information

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Postscript

The parties have until 28th March 2012 to appeal the judgment without requiring permission of the court. Given that the defendants effectively won and, as a result, CFE and CFHK were ordered to pay the majority of the defendants' costs, one would not expect an appeal by them.

Whatever misgivings CFE and CFHK may have about the judgment, in light of the court's ruling on damages, a successful appeal by them will be difficult. In the event CFE and CFHK do appeal, they will be hard pressed to persuade an appeal court to accept new evidence of alleged losses. However, given the high profile of the case to date and the sometimes hard-nosed nature of the business in which the parties operate, an appeal would not be a surprise. We receive many instructions regarding the enforceability of restrictive covenants in Hong Kong and know from the attention these proceedings have already attracted that any appeal ought to be of considerable interest to employers and senior employees alike in Hong Kong.

55 COMBINED
YEARS IN ASIA