

Hong Kong: What Happens To Employees On The Transfer Of A Business? (21 Jun 2006)

Summary

A recent Court of Appeal decision has restored a sense of order into the world of employment law. Two recent Court of First Instance cases had come to the astonishing conclusion that a transfer of employment on a change of ownership of a business did not necessitate the termination and re-employment of the relevant employees. The first of these cases has now been overturned on appeal.

Full Update

(a) The Correct Legal Impact Of The Change In Ownership Of A Business

The basics

On a transfer of business from A to B any employee of A working in such business will cease to have a job (as the work will have transferred with the business to B). As such the relevant employees will be redundant and their contracts of employment will need to be terminated by A in accordance with the terms of such contracts. Normally this would necessitate A giving notice of termination or payment in lieu of notice.

If B wishes to keep the employees to work in the business (which is a common situation) then B will need to re-employ the employees. Such re-employment must be done expressly by means of B entering into new contracts with the employees.

So, there is a termination of employment by A and a re-employment by B. Simple.

Rights of employees on termination

On any termination of employment employees become conditionally entitled to certain statutory rights and protection. These include rights to severance or long service pay, accrued and untaken statutory or annual leave, prorated end of year payments as well as potential claims for unreasonable dismissal.

The employees may also be entitled to contractual benefits on termination of employment (e.g. retirement scheme benefits, gratuities, share option grants).

Conditions under which statutory benefits are payable

Entitlement to the statutory rights and benefits is, in certain cases, subject to the relevant employee not just ceasing employment, but also satisfying certain additional conditions. A common condition for statutory benefits is the requirement that the relevant employee must have been employed under "continuous employment" for a specified minimum period.

The First Schedule to the Employment Ordinance sets out the method for ascertaining when an employment contract is a contract providing "continuous employment". Section 5 of this Schedule expressly provides that where *"a trade, business or undertaking is transferred from one person to another, the period of employment of an employee in the trade, business or undertaking at the time of the transfer shall count as a period of employment with the transferee, and the transfer shall not break the continuity of the period employment"*.

In essence what this means is that in determining whether an employee has satisfied a "continuous employment" condition, the periods of employment pre transfer and post transfer (i.e. with A and with B in the above example) are added together.

In addition an employee's rights to certain statutory rights and entitlements are expressly limited where there is a transfer of employment as part of a change in ownership of a business. So:

- protection for unreasonable dismissal (section 32D)
- entitlement to severance pay (section 31J)
- entitlement to long service pay (section 31Z)

are not automatically available on a termination of employment which occurs as part of a change in ownership of a business. This is quite separate from the "continuous employment" provision in section 5 of the First Schedule.

Therefore:

- (i) a minimum period of "continuous employment" is a common precondition to entitlement to certain statutory payments (e.g. 2 years continuous employment for severance pay),
- (ii) certain statutory benefits are expressly held back where there is a termination due to a transfer of business, and
- (iii) employees can quite separately be entitled to contractual benefits on termination of employment

(b) What Did The Court Of First Instance Decide On Transfer Of A Business?

The Court of First Instance in the cases of *Law Shu Fat v Ng Kwong Yiu* (Yam J presiding) and *Leung Kin Chi v Chan Pui Man* (Poon J presiding) considered the impact of a transfer of business on employees employed in such business. Both learned judges in these cases focused upon the question of "continuous employment". More specifically they determined that section 5 of the First Schedule should be interpreted as having the effect that there is no termination of employment (for either statutory or contractual purposes) on a transfer of employment which occurs due to a transfer of a "trade, business or undertaking"!

If this were correct then:

- there would be no need for the "transferring" employer to give notice of termination (or payment in lieu),
- there would be no need to provide the employee with details of his or her "new" employer,
- the employee would not become entitled to any of his or her contractual entitlements under the "old contract" (notwithstanding the fact that the new employer is unlikely to be able to continue the "old" retirement scheme or share option plan),
- there would be no question of any employee becoming entitled to any statutory benefit or entitlement upon the "transfer" of employment.

These decisions are both incorrect.

(c) The Court Of Appeal Decision - The Return Of Reason

Yuen JA gave the leading judgment in the Court of Appeal and it is a breath of fresh air. The learned judge correctly identified the legal position as being that set out in (a) above. Her judgment is clear, well reasoned and thorough. It corrects the defective judgments of the lower courts.

(d) Conclusion

Employers (and their lawyers) have always been concerned about the possible lack of reasoned judgments in the Labour Tribunal. However, there would appear now to be a trend for judges in

the Court of First Instance to give judgments in employment cases which fail to reflect the statutory provisions. The judgments of Yam J and Poon J in the cases referred to above are, to be polite, ill considered.

It is important that the standard of reasoning (in employment cases in particular) in the lower courts is improved if employers and employees are to have faith in the judicial system. Nobody (other than lawyers) benefits from a poor judgment in the Court of First Instance.

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