

## What Do Employers Need to Know about the Hong Kong Contracts (Rights of Third Parties) Bill?

The Contracts (Rights of Third Parties) Bill (the “Bill”) has been introduced to the Legislative Council. If passed, Hong Kong will join a number of common law jurisdictions in reforming the age-old common law doctrine of “privity of contract”.

Is this good news or bad news for employers? In our view, it is a mixed bag. There are some aspects of the Bill that employers can certainly take advantage of, but there are also pitfalls to look out for.

In this legal update, we consider the key changes and the risks from an employment perspective under the proposed new law anticipated by the Bill. To manage the risks, it is possible for the contracting parties to opt out of the application of the new law. We will set out how to do this in a later update.

The Legislative Council is debating the Bill and we do not expect much movement until after October 2014.

### What Is the Current Position?

Under the current law, only the parties to a contract have the right to enforce the contract terms. This means the contract cannot be enforced either by or against a third party (i.e., a party who did enter into the contract), even if it intends to confer certain rights or benefits on the third party.

For example:

- If an employee signs a settlement agreement with his employer to waive all his claims against his co-workers and against associated companies of his employer, his co-worker and the associated companies would have no right to enforce the settlement agreement if the employee breaches the settlement terms and brings legal proceedings against them.
- A business transfer agreement signed between two companies may sometimes confer benefits

on the employees. Under the current law, an employee would have no right to enforce these terms against the companies if they fail to confer the benefits on him.

The current law has been criticised as artificial. In some situations, it can cause commercial hindrance.

### What Are the Key Changes ?

The Bill will impact upon current employment practices, benefits and incentive schemes.

Perhaps the first point to note is that the Bill will **not** give a third party the right to enforce a term of an employment contract *against an employee*.

For example:

- If an employee is required by his employment contract to courier parcels for the Company’s customers, a customer cannot rely on the proposed new law and sue the employee for failing to deliver a parcel.
- If an employee is required by his employment contract to serve not only the employer, but also the holding company of his employer, the holding company cannot rely on the proposed new law and sue the employee for refusing to provide the services. The employment contract can only be enforced by his employer, being the party to the employment contract.

However, the Bill will give a third party the right to enforce (a) a term of the contract of employment against *an employer* and (b) a term of an employment-related contract (which we explain below) against a party to that contract.

In order to confer this right on a third party, (a) the contract must expressly provide for the right, or (b) the contract term must seek to confer a benefit on the third party.

This means in some cases, the third party will have the right to enforce an employment-related contract by bringing legal proceedings against the *employer* and the *employee*.

For the third party to have the right to sue, the contract must expressly identify the third party by name, as a member of a class, or as answering a particular description. So long as the description of the third party in the contract is sufficiently specific, the new law will apply to a third party, even if the third party is not in existence when the contract is entered into.

In terms of remedy, the third party will be entitled to any remedy (e.g., money, benefits or both) that would have been available to him if he had been a party to the contract. Once the right of the third party has been crystallised, the contracting parties may not change or cancel the contract to extinguish or alter the third party's entitlement under that right without the third party's consent.

### What Are the Opportunities and Risks?

As discussed above, the proposed legislation will not confer any right on a third party to enforce a term of an employment contract against an employee.

However, if the Bill is passed, it will facilitate a third party to enforce a wide range of employment-related contracts, such as:

- Compromise/settlement agreement

- Standalone confidentiality agreement
- Standalone restrictive covenant
- Secondment agreement
- Share option/incentive agreement
- Collective agreement
- Retirement scheme
- Insurance cover
- Schemes conferring benefits on spouse and family members, such as medical & dental benefits, travel benefits, education, club membership and housing etc.
- Business transfer agreements

Where there is a contract between a customer and a company which anticipates the company engaging an independent contractor to perform work for the customer, the Bill will also facilitate the independent contractor (being the third party) to bring legal proceedings against the customer.

Under the Bill, it is possible to “contract out” of the new law. This means the parties to the contract can expressly agree that the new law is not applicable to that contract, with the result that a third party cannot rely on the new law and enforce the terms.

#### (1) THE GOOD NEWS FOR EMPLOYERS

The good news for employers is that the Bill will facilitate enforcement of some types of contracts. For example:

EMPLOYMENT-RELATED CONTRACTS	THIRD PARTIES WHO MAY ENFORCE THE TERMS
<ul style="list-style-type: none"> <li>• Settlement agreement with a waiver of claims against co-workers and companies associated with the employer</li> </ul>	<ul style="list-style-type: none"> <li>• Co-workers and companies associated with the employer</li> </ul>
<ul style="list-style-type: none"> <li>• Standalone confidentiality agreement with undertaking to keep confidential the trade secrets of associated companies</li> </ul>	<ul style="list-style-type: none"> <li>• Associated companies</li> </ul>
<ul style="list-style-type: none"> <li>• Standalone post termination restrictive covenants for employee serving multiple companies</li> </ul>	<ul style="list-style-type: none"> <li>• Associated companies</li> </ul>
<ul style="list-style-type: none"> <li>• Share incentive plan, if shares are issued to the employee by a company related to the employer</li> </ul>	<ul style="list-style-type: none"> <li>• Employer</li> </ul>

However, to take advantage of the new law, the contract must be separate from the employment contract. In other words, the contract must be a standalone contract independent of the employment contract.

The parties to the contract **must** also expressly identify the third parties who are intended to benefit from the agreed terms. A third party who is not expressly identified in a contract will not enjoy any implied right of enforcement. The courts will not interpret the contract in a way that would imply any right for a third party to enforce the contract.

## (II) THE BAD NEWS FOR EMPLOYERS

The bad news for employers is that the Bill will facilitate a third party in enforcing the following types of contracts and schemes against the employer. For example:

CONTRACTS	THIRD PARTIES WHO MAY ENFORCE THE TERMS
<ul style="list-style-type: none"> <li>Collective agreement made between the employer and trade unions, if the agreed terms are not incorporated into the employees' contract of employment<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>Employee</li> </ul> <p>The Bill, if passed, could be used as introducing collective bargaining through the backdoor.</p>
<ul style="list-style-type: none"> <li>Schemes conferring benefits on spouse and family members, such as medical &amp; dental benefits, travel benefits, education, club membership and housing</li> </ul>	<ul style="list-style-type: none"> <li>Employee's dependants</li> </ul>
<ul style="list-style-type: none"> <li>Share option/incentive agreement</li> </ul>	<ul style="list-style-type: none"> <li>Employee's dependants</li> </ul>
<ul style="list-style-type: none"> <li>Retirement scheme</li> </ul>	<ul style="list-style-type: none"> <li>Employee's dependants</li> </ul>

The following types of contract will also be affected by the new law:

CONTRACTS	THIRD PARTIES WHO MAY ENFORCE THE TERMS
<ul style="list-style-type: none"> <li>Insurance cover</li> </ul>	<ul style="list-style-type: none"> <li>Spouse and family members of the employee (against the insurer)</li> </ul>
<ul style="list-style-type: none"> <li>Secondment agreement made between the host company and the employer</li> <li>Secondment agreement made between the employer and the employee</li> </ul>	<ul style="list-style-type: none"> <li>Employee (against the host company)</li> <li>Host company (against the employee)</li> </ul>
<ul style="list-style-type: none"> <li>Contract made between a company and its customer, and the contract is performed by the company's independent contractor</li> <li>Contract made between a company and its independent contractor to serve a customer</li> </ul>	<ul style="list-style-type: none"> <li>Independent contractor (against the customer)</li> <li>Customer (against the independent contract)</li> </ul>
<ul style="list-style-type: none"> <li>Business transfer agreement made between the employer and the purchaser, which confers certain benefits on employees (e.g., maintenance of existing terms)</li> </ul>	<ul style="list-style-type: none"> <li>Employee (against the purchaser)</li> </ul>

If you do not wish to have these unintended effects on the new contracts, you should start reviewing the Company's standard contracts, staff handbook, schemes and policies and opt out of the application of the new law.

<sup>1</sup> In Hong Kong, there is no collective bargaining legislation, i.e., a legislation that regulates the negotiation between an employer with a trade union or staff association in relation to employment issues.

### (III) CONTRACTS NOT AFFECTED BY THE BILL

Some contracts will not be affected by the Bill:

- The Bill will not affect contracts made before the legislation comes into effect.
- A third party cannot enforce any term in an employment contract against the employee. This means a confidentiality undertaking, a restrictive covenant or an intellectual property clause in an employment contract, worded to benefit a third party (say, a holding company of the employer), would remain enforceable only by the employer and not by the third party.

### Take-away Points

Employers should keep an eye on the passage of the Bill and we will keep you updated.

If the Bill looks like coming into effect as law, then an employer should consider reviewing the range of employment and employment-related contracts and structuring them to maximise enforceability by third parties where this is desired and expressly excluding the law where it is not.

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