Bonus Season: Key considerations to minimise disputes

It is bonus season and inevitably each year there are employees who are disappointed that either they have not received a bonus at all or have not been awarded the amount of bonus they were expecting. Disputes relating to bonuses in the financial sector are coming into even sharper focus in light of the announcement that the cap on bankers' bonuses will be abolished. The PRA and FCA's consultation on the proposal closes on 31 March 2023 and it is possible the cap will be lifted towards the end of this year, with the result that bonuses for the 2024/25 performance year could be uncapped.

In this article we consider the main arguments that arise in bonus disputes.

Is there a contractual entitlement to a bonus?

The first bone of contention is often whether or not an employee is contractually entitled to a bonus.

If a contract of employment provides for a guaranteed bonus, or that a bonus will be paid upon certain performance criteria being met, this is likely to amount to a contractual entitlement to the bonus. A failure to pay the bonus, or the correct level of bonus, would give rise to a claim for breach of contract or unlawful deduction from wages.

However, it is important to be aware that bonus entitlements, including the level of bonus that could be awarded, may be expressed differently in offer letters and contracts of employment. Often this is missed – until a dispute arises in respect of a bonus.

Generally, offer letters set out broad expectations of the amount of bonus that could be awarded, and are used as a means of enticing employees to accept a role. However, if the right to the bonus and/or the level of bonus are not replicated in the contract of employment, it is unlikely to have contractual status. This is because, in the majority of cases (not all), the contract of employment will supersede the offer letter and/or any other pre-employment discussions or agreements between the parties, including those regarding bonuses.

More often than not, contracts of employment do not provide for a contractual bonus entitlement. Instead, they tend to provide that an employee is "eligible to be considered"' for a bonus and that the entitlement to a bonus, as well as the amount of any bonus award, is at the sole discretion of the employer.

Yet, even where bonuses are expressed to be discretionary in the contract of employment, there might be an argument that a term has been implied into the contract of employment such that the employee is, in fact, contractually entitled to a bonus. The Courts will look beyond the express terms of the contract and consider how it operates in practice. For example, if an employee receives a bonus at the same time each year and/or receives a certain amount of bonus each year, it could be argued that in reality the employee's eligibility is not discretionary – rather a contractual entitlement to a bonus has arisen over time as a result of custom and practice.

What constraints apply to discretionary bonuses?

Even if a bonus is truly discretionary, there are limits on how an employer may exercise such discretion. The Courts recognise that employers should not be able to treat bonus schemes as a sort of mirage, intended to encourage an employee on to better performance, only to find it later snatched away.

Employers are subject to the following duties which, if breached, may mean that the subsequent bonus award is unlawful:

- a duty not to breach the implied term of trust and confidence;
- a duty to exercise their discretion honestly and in good faith; and
- a duty not to exercise discretion in an arbitrary, capricious or irrational way.

In all contracts of employment, a term is implied such that an employer must not, without reasonable and proper cause, conduct itself in a manner calculated and likely to destroy or seriously damage the relationship of trust and confidence that exists between employer and employee. Should an employer single out an employee on capricious grounds and refuse to offer them the same terms as offered to similar employees, the employer may be in breach of contract.

This term of mutual trust and confidence obliges employers to treat employees even-handedly. It does not necessarily mean treating all employees identically, but there must be non-capricious, cogent reasons for doing so. Applying this principle here, should an employer fail to pay a bonus to an employee in circumstances where comparable colleagues have received a bonus, the employer could be in breach of contract (and depending on the reason for the treatment it may also have breached discrimination legislation). This is a high hurdle to cross, but one worth considering pursuing for potentially valuable bonuses.

Employees may also be able to challenge a bonus decision on the basis of a lack of good faith or irrationality on part of the employer. The duty to act rationally is not the same as a general duty to act reasonably. A test of rationality is subjective but applies a minimum standard to the employer's mental processes and the factors it takes into account when determining bonuses. It introduces a requirement that there should be some logical connection between the evidence and the apparent reasons for the decision. The absence of any evidence or logical or cogent reason for the decision might result in claims for breach of contract.

Merely because a bonus decision appears to be unreasonable does not necessarily mean it is unlawful. The Courts will only step in to remedy discretionary bonus decisions or processes which are not logical, contrary to accepted standards or practice, or as a result of sudden and unaccountable changes of mood or behaviour.

Recommendations for employees

When entering into a new employer contract it is important to ensure that your bonus expectations are expressly and accurately reflected in the contract of employment. If possible, it is also advisable to have the level of bonus that could be awarded, as well as the factors that will be taken into account in assessing the level of bonus, included in the contract as well, albeit this may not always be possible as performance factors are likely to change or evolve over time.

In any event, it is vital to ensure that discussions regarding bonuses, performance criteria, assessment of performance, etc are agreed in writing or, at the very least, recorded in writing contemporaneously by the employee. This may help in the event of a future dispute.

Where a guaranteed bonus has been offered the language of discretion is not appropriate and clear conditions for payment should be set out.

Employees should also be mindful that regardless of whether bonuses are expressed as contractual or discretionary, there is often a clause in contracts of employment stipulating that employees must remain in employment, and not be under suspension or under notice of termination (whether given by them or received from the employer) on a specified date or the bonus payment date in order to receive the bonus. If there is such a clause, care should be taken when considering resigning from employment. If it is not possible to wait until bonuses are paid before leaving employment, employees may wish to consider negotiating a guaranteed payment upon commencing new employment to compensate for the amounts that may be lost.

BDBF is a leading law firm based at Bank in the City of London

specialising in employment law. If you would like to discuss any issues relating to the content of this article, please contact Samantha Prosser (SamanthaProsser@bdbf.co.uk) or your usual BDBF contact.