The bonus is dead, long live the bonus!

The bonus culture in the financial services sector has been under scrutiny for some time. Across the world governments have looked to limit the bonuses paid out in the financial services sector. Two key concepts have been stressed by a number of regulators and politicians: bonuses should be deferred over a period of time and some or all elements of the bonuses should be able to be clawed back, to reflect longer term performance. These external pressures, together with the financial downturn, have led employers to review and often seek to amend their bonus policies. Employers have also looked to use their discretion to reduce bonus pay outs. Neither option is risk-free. Here we report on two recent cases which highlight some of the difficulties involved.

In *Khatri v Cooperatieve Centrale Raiffeisen-Boerenleenbank BA*, the Court of Appeal upheld a trader's application for summary judgment in respect of an entitlement to a performance related bonus. The trader had signed a contract in March 2008 providing for a guaranteed bonus and a performance related bonus according to a formula. The contract stated that the formula was applicable to his 2008 bonus. The Bank maintained it had the right to review or remove the formula linked bonus arrangements at any time. The Court of Appeal found that the wording of the contract entitled the employee to the bonus for 2008 while providing that variation was possible in subsequent years. The drafting did not allow the Bank to exercise any discretion in relation to the 2008 bonus.

Another interesting element of the case related to the Bank's previous attempt to vary the bonus provision using a side letter. It had sent a letter to the trader stating that he would continue to be eligible for a discretionary bonus but the formula-driven performance-related bonus was to cease with immediate effect. The letter asked for a signature to indicate acceptance. The trader did not sign the letter and was not pressed to do so. He continued to work for the Bank. While he had not explicitly rejected the variation, the Court found that nothing in the trader's conduct implied his acceptance of the change. The Court of Appeal therefore ruled that the trader was entitled to the formula-related bonus as his entitlement had not been varied.

Impact

This case is a warning to all employers that care must be taken to ensure clear drafting is used that demonstrates the discretionary nature of a bonus. This case also highlights the need to consider how best to implement variations to employment terms. Often for certainty it is recommended that a variation of terms should be implemented with a variation letter. Employers should decide if they wish to ask employees to agree to the variation by signing and returning the letter. If employees do sign it, this is clear evidence of an agreement. However, the difficulty is what to do if employees refuse to sign. Such a refusal will be taken as evidence of there being no acceptance to the variation. From this case it is clear that if employees are asked to sign variation letters it is important to chase for signature. Failure to sign the variation letter can easily be seen as evidence that the employee has rejected the variation. The employee's continued attendance at work will not automatically imply acceptance of the variation, particularly where the variation does not have an immediate impact on the employee's day-to-day role. In some cases, employers may consider stating in the letter that the variation will be deemed to be accepted unless the employee tells the employer otherwise. While this option is not ideal, it could be of some help in situations where employees are not expressly refusing to sign the variation letter.

Facts of second case

In *Anar & Ors v Dresdner Kleinwort Limited and Commerzbank AG*, the High Court also considered an application for summary judgment. Again the question

was whether employees had any contractual entitlements to certain bonuses. The employees pointed to two incidents which they suggested gave rise to an entitlement. Firstly, they had been informed at a town hall meeting that a guaranteed minimum bonus pool of €400 million had been allotted for them. The announcement was made in London, broadcast to staff in Frankfurt, Moscow and New York and placed on the Intranet. Secondly, a few months later, they had been sent letters advising them of their individual bonus awards. These letters stated that the awards were provisional, would be subject to review and would be reduced if "*additional material deviations*" in actual revenue and earnings, as against the forecasts for the months November and December were identified. Two months later employees were advised that their provisional bonuses had been reduced by 90%. The employees commenced proceedings for breach of contract. The Bank applied for the claims to be struck out on the basis that the employees clearly had no contractual entitlement to the bonuses. The High Court refused the application and held that:

- It was not clear cut whether the conditions that were attached to the award of provisional bonuses in the individual letters had been properly applied in the circumstances and required further investigation into the facts. This issue should therefore proceed to trial.
- The cause of action based solely on an announcement of a guaranteed minimum bonus pool of €400 million at a town hall meeting had no realistic chance of success at trial since it was insufficiently clear and precise to be contractually binding.

Impact

We will have to wait and see what happens when the case goes to full hearing. It is reassuring, although not surprising, that the High Court made clear that informal announcements at a town hall meeting about potential bonus pools would not result in a contractual obligation. Less positive for employers is the acceptance by the Court that the letters referring to "provisional" bonuses which were subject to review were potentially capable of giving rise to enforceable promises.

Outcome

Both cases emphasise the need for accurate drafting. In the leading judgment in *Khatri*, Jacob LJ noted that if employers "*decide to reward their employees by means of a purely discretionary bonus then they should say so openly and not seek to dress up such a bonus with the language of entitlement qualified by a slight phrase which does not make it absolutely clear that there is in fact no entitlement at all*". This applies both in the drafting of bonus clauses and also in any subsequent variation to bonus entitlements.

In the *Commerzbank AG* case it appears the drafting of the bonus letters may have limited the discretionary nature of the awards. Since the *Commerzbank AG* case is only at preliminary hearing stage, we are likely to get further clarification on discretionary bonus drafting as the case progresses.

The balance between using bonuses effectively to attract top talent and reining in bonuses in line with regulators recommendations and public opinion is not an easy one for employers. The key element for many employers is to ensure that bonuses do remain discretionary. Certainly, these recent cases suggest that employees will not give up their bonuses without a fight. Bonuses may be on the decline, but bonus claims are alive and well.

If you would like further advice in relation to any issues concerning bonuses and their variation, please contact Nicholas Robertson, Chris Fisher or Bernadette Daley in the London Employment Group.

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