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A recent High Court decision may limit the discretion of employers to curb payouts

Challenging the bonus award

It's bonus time in the securities industry, and traders and investment bankers are hoping for bumper payouts in respect of this year's bonus awards. Whether these expectations are met remains to be seen.

Since the mid-1990s, there has been a distinct move away from the formulaic bonus in favour of discretionary bonus schemes. New issue activity and the M&A business have been slowing, and in recent years employees have had to rely increasingly on the judgment of their bosses.

Surprisingly, considering the very large sums of money at stake and the fact that the bonus element usually constitutes the lion's share of many employees' overall remuneration package, bonus clauses in many instances now do not exceed two or three sentences in a contract of employment.

The rationale behind this development is not difficult to understand. Discretionary bonus clauses gave investment banks a relatively free hand to determine how much bonus, if any, to award. This flexibility makes it easier to manage overall remuneration levels. It also enables banks to reward staff they value and to send a signal to those they may want to get rid of.

However, banks are now finding they have less discretion than they might have thought. The law in this area has developed rapidly in recent years. It is now clear that an employer in exercising discretion has to do so in "good faith" and not act capriciously. In other words, the exercise of discretion does, in many instances, come with strings attached.

This point was graphically illustrated by the recent High Court decision in September, ordering Nomura International to pay damages to Steve Clark of £1.35m (€2.2m) for non-payment of a bonus after his employment was terminated without justification for summary dismissal.

In the Nomura case, the contract of employment provided for a "discretionary



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Guest column

bonus scheme, which is not guaranteed in any way and is dependent upon individual performance". The drafting of this clause is typical of many bonus clauses in the City of London.

Nomura's decision to award Steve Clark a nil bonus after he had earned profits for the company of over £6m in nine months was viewed by the High Court as being irrational and perverse. The High Court concluded that "no reasonable employer could have come to such a conclusion".

The robust judgment of the High Court in the Nomura case will have gladdened the hearts of many traders and investment bankers. On a practical level, the case should act as a warning of the folly in awarding a nil bonus when a trader has earned substantial profits for his or her employer. Had Nomura agreed to pay a modest bonus rather than nothing at all, the courts would very likely have taken a different view.

Beyond that, the Nomura case does have important implications. In the short term, it will psychologically strengthen the hand of a trader wishing to quiz an employer over the size of a discretionary bonus award. More importantly, the decision will lead to

the modification of many discretionary bonus clauses to reflect the fact that they are forward looking.

In other words, investment banks will want to state clearly that the objective is to "attract, motivate and retain employees", rather than reward them for past performance. In this way, an employer would be far better placed to downgrade a bonus award to an employee who it knew was leaving.

An issue that remains unresolved is the extent to which an employer may modify the implied duty to exercise discretion in "good faith", so that it can withhold paying out a bonus if an employee resigns.

Many contracts include what is known in the business as a "killer clause", which states: "No bonus will be paid to you if, on the date of payment of the bonus, you are not employed by the bank or if you are under notice to leave the bank's employment, whether such notice was given or received by you."

One line of attack for an employee faced with this situation would be to argue that the term is void under the Unfair Contract Terms Act 1977. An earlier decision this year opened the door for such a challenge by confirming that contracts of employment were within the scope of the act.

Most traders already understand and accept that if they leave or give notice prior to the end of the bonus year or bonus payment date, then they will lose their bonus. But what if a trader is dismissed, without just cause, by his employer, which then seeks to avoid paying him a bonus, discretionary or otherwise, relying on the protection afforded by a killer clause? Would the employer get away with it?

I suspect that this question will be resolved by the courts before too long, and I expect that the answer will be "No".

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