

Brachers Bitesize

Employee retention and incentivisation

Bonuses and Share Schemes

A whistle stop tour and top tips

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Welcome

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Today's Session

Debunking Terminology

Polls

Bonuses – Employment Key Issues and Top Tips

An Introduction to Share Schemes and Share Option Schemes.



Debunking Terminology

Today's Session

“STI” – “Short Term Incentive” - commonly an annual bonus scheme

“Annual Bonus” – commonly an annual bonus scheme!

“Variable Remuneration” – commonly bonus schemes

“Commission” – bonus schemes

Today's Session

“PRP” – “Performance Related Pay” - commonly a bonus scheme

“Profit Share” – often a bonus scheme/sometimes a share scheme

“LTIP” or “LTI” – Long Term Incentive [Plan] – often a longer term bonus plan (sometimes called Performance Share Plans)

“Commission” – bonus schemes

Today's Session

“SOP” – “Share Option Plan” - commonly a share option scheme

“Share Scheme” – a scheme under which the employee is given shares in the Employer or another group company.

“Unapproved” Share/Share options scheme - normally refers to a scheme that does not benefit from any specific tax advantages under UK tax law sometimes as the shares are in an overseas entity.

“CSOP”, “SAYE”, “EBT”, “EMI” – types of approved share option/share schemes in the UK

Today's Session

“CSOP” – “Company Share Option Plan” – a tax advantaged share option scheme.

“SAYE” – “Save as you earn” – all employee tax advantaged share option scheme

“EMI” – Enterprise Management Incentives – a tax advantaged share option scheme.

“SIP” – “Share Incentive Plans” – all employee tax advantaged share plans.

Today's Session

“Phantom” “Shadow” Plans – commonly bonuses linked to the value of a company's shares – normally for listed companies.

“EBT” – “Employee Benefit Trust” – used for various reasons including share plans for employees (sometime paired with a JSOP “Joint Share Ownership Plan”).

“EMI” – Enterprise Management Incentives – a tax advantaged share option scheme.

“SIP” – “Share Incentive Plans” – all employee tax advantaged share plans.



Poll 1

Do you currently operate any of the following?



Poll 2

Are you considering implementing/introducing any of the following?



Bonuses – Key Employment Law Issues

Bonuses – Employment Key Issues

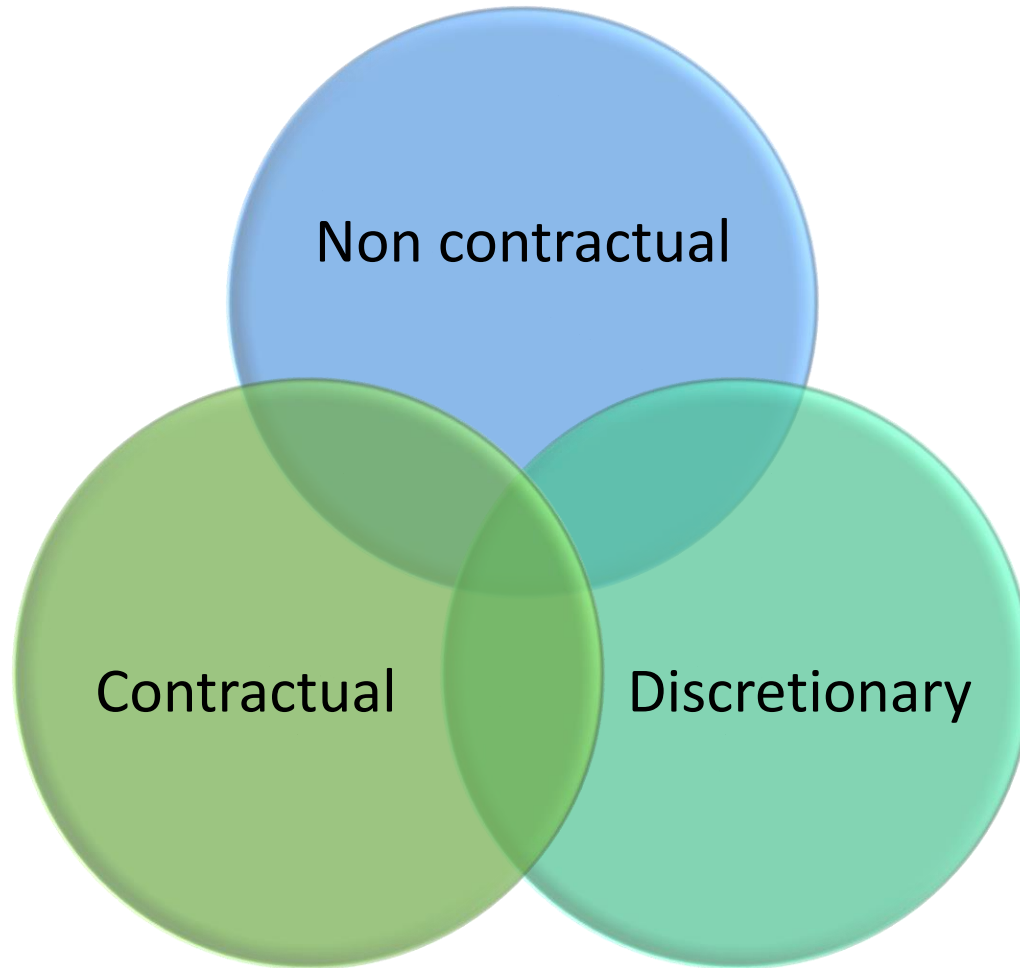
Legal Status of the Bonus

Drafting Issues – Contractual Bonuses

Discretionary Bonuses

Top Tips

Status of Bonuses



Contractual Bonuses - Interpretation

- **The key issue is quality drafting because interpretation law is a bit vague!**
- Investors Compensation Scheme v West Bromwich Building Society 1998.
- Words in a contract should be given their ordinary meaning:
 - "Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract."*
- Literal interpretation rules.

Contractual Bonuses - Interpretation

- The term "background knowledge" should be construed widely, to include

"absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man",

- Unless the material is not relevant.
- Absalom v TCRU Ltd (formerly Monument Insurance Brokers Ltd) 2005.

Contractual Bonuses - Interpretation

- However, it does not include previous negotiations between the parties unless there is an action for rectification
- Rectification is where it is argued that the written words did not reflect the true agreement reached but this is not always easy to show if you have a badly written bonus scheme.
- Contractual interpretation involves broad principles, rather than strict rules, for ascertaining the parties' intention.

Discretion

- Very common to see bonus provisions subject to the “absolute discretion” or “discretion” or “in the reasonable opinion of the Company”.
- Commonly two main types of discretion:
 - Bonus schemes where the employer has absolute discretion as to :
 - whether to consider an employee for a bonus; and
 - as to the amount of any bonus awarded.
 - Bonus schemes where the employer has partial discretion as regards the amount of any bonus awarded.

Discretions – Summary

- **Absolute discretions are never absolute.**
- **Contractual discretions are not all they may seem!**
- Case law has placed important limitations on the exercise of the employer's discretion within an employment relationship. This includes bonuses and share schemes.
- The duties overlap and can be summarised as:
 - The duty to exercise discretion honestly and in good faith.
 - The duty not to exercise discretion in an arbitrary, capricious or irrational way.
 - The duty not to breach the implied term of trust and confidence.

Discretions – Summary

- The general approach to the exercise of discretion in contracts is that a power conferred on one party to make decisions that affect both parties
 - **must be exercised honestly and in good faith,**
 - **for the purposes for which it was conferred, and**
 - **must not be exercised arbitrarily, capriciously or unreasonably (irrationally)**

Abu Dhabi National Tanker Co v Product Star Shipping (The Product Star) (No 2) 1993.

Discretions – Summary

- "unreasonably" in this context has been interpreted to mean something analogous to the public law concept of reasonableness (that is, Wednesbury reasonableness).
- Under which a discretion must be exercised in a manner which is not arbitrary, capricious, or irrational.
- The test is similar to the "range of reasonable responses" test in unfair dismissal cases, where the employment tribunal must not "substitute its view" for that of the employer.
- In the context of bonus litigation, this means that courts will only step in to remedy discretionary bonus decisions which are perverse or irrational.

Discretions – Key Cases

Clark v Nomura International plc 2000.

- Mr Clark was a senior equities trader.
- His contract provided for a "discretionary" bonus, dependent on his individual performance.
- In the nine months before his dismissal he had earned profits for Nomura in excess of £6 million, and had been responsible for a deal that would bring a further £16 million in the near future.
- **All other traders (including one who had made a loss) had received substantial bonuses for the period in question.**

Discretions – Summary

- The test was "one of irrationality or perversity ... i.e. that no reasonable employer would have exercised his discretion in this way."
- Nomura's decision not to award any bonus was "plainly perverse" and "irrational".
- Nomura could not take into account its reasons for dismissing Mr Clark when assessing his bonus entitlement (absent an express clause).
- Nor was it relevant that, as he had no future with Nomura, there was no need to incentivise him (absent an express clause).
- The employer will be in breach of contract if it exercises a discretion in a way that no reasonable employer would have done.

Discretions – Summary

- Despite finding in Mr Clark's favour, the court was keen to emphasise that, in order to establish perversity, an employee had to show more than that they were treated differently to other employees:

"Merely to treat different employees in different ways may (depending on the facts) lead to a charge of inconsistency, but by itself cannot in our view be capricious."

- It turned to the (shorter) Oxford English Dictionary definition of caprice, namely

"an unaccountable change of mind or conduct; a whim, a freakish fancy".

Discretions – Key Cases

Commerzbank AG v Keen 2006

- Mr Keen was employed to manage a proprietary trading desk. He was made redundant.
- He was contractually entitled to participate in a discretionary bonus scheme.
- The form, timing and amount of any awards were at the discretion of the bank.
- There was a non-exhaustive list of factors that the bank could take into account in exercising its discretion.
- The contract provided that no bonus would be paid if Mr Keen was not in employment at the bonus payment date or was under notice of termination.

Discretions – Summary

- The Court of Appeal awarded summary judgment to Commerzbank, finding that the claims had no reasonable prospect of success.
- Pointing to the very wide contractual discretion which the bank had reserved to itself, it could not be said that the bank's decisions on bonuses for 2003 and 2004 were irrational.
- The court held that:

"It would require an overwhelming case to persuade the court to find that the level of a discretionary bonus payment was irrational or perverse in an area where so much must depend on the discretionary judgment of the Bank in fluctuating market and labour conditions."

Discretions – Summary

- It was not for the court to interfere with the decision that had been taken to set aside a bonus pool of around 10% of profit for each of the years 2003 and 2004.
- The only function of the court was to determine the legal limits to the bank's discretion and whether the bank had acted within those limits.
- It is not enough for an employee to make the allegation that an award was irrationally or perversely low.
- Employees must establish a prima facie case either that the award is irrational or perverse on its face or that there is cogent evidence of irrationality, for example, by reference to what other employers in the same sector are doing in similar circumstances, or to inconsistent treatment elsewhere in the same organisation.

Discretions – Summary

- Keen also confirmed that the implied duty of trust and confidence will generally require an employer to give reasons for the exercise of discretion to pay or withhold a bonus.
- The Court of Appeal commented that this included identifying the decision-maker, unless there is a good reason not to do so.

Discretions – Share Options Example

- Mallone v BPB Industries plc 2002
- Mr Mallone was a member of a share option scheme.
- His employer had "absolute discretion" to decide what proportion of his options he could exercise after termination.
- After Mr Mallone was dismissed for poor performance, the directors decided that the appropriate proportion in his case was zero, and cancelled all his options.

Discretions – Share Options Example

- The Court of Appeal ruled that the decision was irrational.
- It commented that there was no justification for the employer to treat the scheme as "some sort of mirage", intended to encourage the employee on to better performance, only to find it later snatched away.
- Given that the options were granted to reward past performance and in anticipation of future loyalty, the decision to cancel all the claimant's vested options was an irrational exercise of their discretion.
- The correct test was whether the directors' decision was one "*which no reasonable employer could have reached*".

Top Tips

1. Think very carefully about how you write as a bonus commitment.
2. Ensure that you cover the core issues:
 - Amount/Basis for calculation of the value of the bonus
 - Disqualifying events i.e. under notice or been terminated, other good or bad leaver circumstances
 - Timing of payment/Timing of assessment of eligibility
 - Limitations (unjust enrichment provisions/caps etc.)
 - Clawbacks (net or gross) – circumstances etc.

Top Tips

3. Discretions – over what elements? All or part? If specific factors are to be relevant consider setting them out (but reserve the right to change them!)
4. Scenario Modelling
5. Examples in Contract/Bonus Rules to show the intention in common scenarios?
6. Reserve the right to vary/amend and withdraw (but again subject to mutual trust and confidence etc. as it is form of discretion).

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7 9072.84	AUD	F	+1437.42	+0
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			+8595.32	
			+9547.20	
		F	+7210.6	

Share Schemes and Share Options – An Introduction

Share Options and Share Schemes

- Share option schemes as a method of incentivisation and retention.
- Various tax advantaged and non-tax advantaged share option schemes with a focus on EMI options.

Enterprise Management Incentive Schemes

- EMI (enterprise management incentive) options introduction.
- EMI option statutory requirements.
- Qualifying shares.
- Qualifying employees.
- Qualifying options.

Enterprise Management Incentive Schemes

- Setting the exercise price and valuing shares.
- Limits on EMI options.
- Notification and annual reporting.

Enterprise Management Incentive Schemes

- When can an EMI option be exercised:
 - Exit
 - Time / vesting
 - Performance
 - A mixture of the above
- When can an option lapse:
 - Employee leaves

Enterprise Management Incentive Schemes

- EMI tax treatment for the company.
- EMI tax treatment for the employee.
 - On grant.
 - On exercise.
 - On disposal.

Other types of share schemes

- CSOP - Company share options plan.
- EBTs - Employee benefit trust.
- SAYE - Save as you earn.
- SIP - Share incentive plan.

Other types of share related schemes

- Unapproved Share Option Schemes (often in shares in non-UK companies)
- Bonuses linked to share price performance or growth (not share schemes or share option schemes)



Questions