



Bonuses



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Bonuses can be used as an effective incentive-based remuneration. However, unclear drafting, off-the-record conversations and uncertainty on the law can all lead to legal issues which could be prevented. This fact sheet looks at questions employers should consider before putting in place a bonus scheme.

Why make a bonus payment?

1. Bonuses can work as an incentive for employees to perform to a high standard.
2. They can make employees feel that they are being rewarded for their efforts, noticed for their good work and improve motivation.
3. They can help to attract and retain good employees.

It is important that businesses are clear at the outset what they are trying to achieve through having a bonus scheme as this is likely to affect the conditions which will trigger the bonus being payable.

Is the scheme going to be contractual?

If as a business you decide that a bonus scheme would be beneficial, you will need to decide whether or not you wish the scheme to be contractual.

A contractual bonus may give an employee the right to participate in a bonus scheme and/or receive a certain amount of bonus, subject usually to certain conditions. These conditions may relate to personal performance targets or profits of the business to name a couple.

The careful drafting of a contractual bonus scheme is key in avoiding uncertainties and misunderstandings. Essential points to include in such a scheme are details of what triggers bonus payments (if anything), how the bonus is to be determined (is there a cap?), what happens in regards to a bonus if an employee resigns, is dismissed or is suspended, what happens if an employee joins part way through a year.

With any contractual bonus scheme you will need to consider whether you want a power to vary the scheme or terminate it entirely. However, if you do have this power to vary the scheme, remember oral promises can also amount to a contractual right to a bonus. Consider whether appropriate training should therefore be given to managers on their discussions with employees on this subject.

Is the scheme going to be non-contractual?

A non-contractual bonus scheme where the employer has absolute discretion would usually say that the employee has no right to a bonus but that payment may be made entirely at the discretion of the employer. This type of scheme does allow an employer more freedom in granting a bonus but does not look as attractive to employees.

However, it is more common for the employee to have an express right to participate in the scheme but the employer has discretion as to the amount of the bonus to be paid.

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In this latter situation, if an employer has discretion as to the amount of the bonus this does not mean the employer can make any decision they like. Case law has held that such discretion must be exercised honestly and in good faith, it must not be arbitrary, capricious or irrational and must not breach the implied term of mutual trust and confidence.

There is no objective standard of reasonableness but instead an employer's discretion will not be able to be relied on if considered irrational or perverse.

Has a custom and practice been created?

A scheme may say that that it is 'discretionary' but there may be an argument that a contractual right has been created by the regular payment of bonuses. This is something which businesses should consider monitoring.

Note that the case of *Small and others v Boots Company PLC* and another UKEAT/0248/08 found that using the word 'discretionary' is not determinative.

Should the bonus be repayable?

You may wish to make the bonus repayable, for example, when you offer an employee a sign on bonus and you state that it must be repaid if they leave within a certain time or breach their contract. The drafting of such clauses must be done carefully as these clauses can be considered to be unlawful as a penalty clause.

Brachers regularly assist with the drafting of contracts and bonus schemes. If you require assistance please contact a member of the Employment team.

The information contained in this document provides background information only. The document may be misleading if relied upon as an exhaustive list of the legal issues involved. If any matter referred to in this document is sought to be relied upon, further information should be sought.