

BONUSES AND VARIABLE PAYMENTS ACROSS EUROPE

Bryan Cave European Labor and Employment Team

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Speakers



Gary Freer is head of the UK employment team at Bryan Cave. He advises and represents clients in all aspects of employment law, including in particular Executive Severance, team moves (including drafting and enforcement of garden leave clauses and restrictive covenants), unfair and wrongful dismissal, discrimination and all kinds of Tribunal claims. He also advises on transfer of undertakings (TUPE) and on global mobility issues.

He is recognized as a key individual by Chambers UK 2015 – "Gary Freer of Bryan Cave LLP advises on all aspects of employment law for his predominately respondent client base." One source notes his strength on tricky issues and calls him "a consummate employment lawyer." Also, The Legal 500 UK 2013 notes that clients regard Gary for his "expertise in all areas."

Gary is Chairman of the Employment Committee of the City of London Law Society. He is a regular speaker and writer on employment law issues.

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Speakers



François Alambret is based in Paris, France and dedicates his practice to labor and employment law. He has extensive experience in advisory work, as well as in handling litigation before the labor courts on both an individual and collective basis.

Mr. Alambret's practice includes all aspects of day-to-day HR matters (including drafting employment contracts or working time agreements, professional elections, disciplinary procedures). His employment litigation experience includes advising on sensitive cases (such as union-led disputes, sexual or racial discrimination, workplace bullying, illegal strikes or employee fraud).

He has also developed a recognized practice in dealing with the employment aspects of companies' reorganizations (for example, closure of industrial plants, redundancy schemes, negotiation with unions and works councils, bankruptcy and collective dismissal).

As a lawyer in private practice since 2000, Mr. Alambret has acquired in-depth knowledge of automotive, retail and luxury sectors.

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Speakers



Martin Lüderitz focuses his practice on Labor and Employment Law in Germany.

He advises companies as well as national and international businesses on all aspects of individual and collective labor law, including in the critical and complex area of German works councils consisting of reconciliation of interests and social plans, and tariff agreements.

His main practice comprises advising employers in the drafting of employment contracts, including post contractual non-competition clauses, restructurings, transfer of undertakings and mass redundancies; in matters of enforced redundancy and dismissals due to operational reasons, conduct or illness; and in the context of pre and post transactional labor and employment issues arising out of mergers and acquisitions (M&A) and restructurings. He is also experienced in advising on pension schemes, incentive plans and Employee Stock Options (ESO).

Mr. Lüderitz is a specialized attorney for Labor Law and represents employers before labor courts as well as board members and managers before civil courts.

He represents clients in various industries such as the hospital and health care sectors.

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Speakers



Federica Dendena began her legal apprenticeship in Milan and was seconded to the local Legal Department of Sony Europe Limited (2012) before joining SILS, the Italian law firm affiliated with Bryan Cave's international network, in 2013.

Her current practice focuses on civil, corporate and commercial law and litigation.

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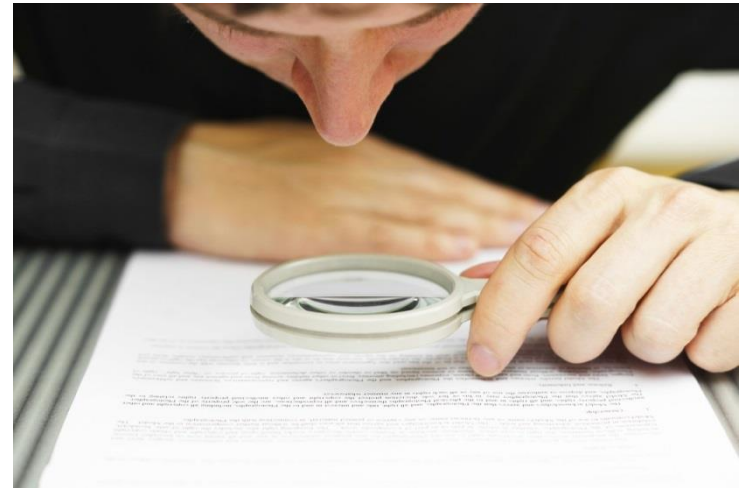
Agenda

1. Case study
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Case study

- You are appointed as the new sales manager of a business that develops software products.
- Most employees in the sales team have for each of the last four years received an annual bonus of between 35 and 40 percent of basic salary.
- Their contracts say only that they "may receive a discretionary annual bonus based on individual/company performance."
- This year, you are told by senior management that costs must be reduced.
- You inform the employees that any bonus for this year is unlikely to be more than 10 percent of basic salary.
- Some of the employees threaten to file legal proceedings.



Insight from Germany

Legal framework – bonuses and variable payments

- No obligation to pay bonuses or variable payments by statutory German law
- Primary source of entitlement for bonuses and variable payments:
 - individual employment agreement or
 - for non-executive employees, collective bargaining agreements with unions or works agreements (“*Betriebsvereinbarung*”) with works council
- If a works council is established: co-determination, sec. 87 para 1 No. 10 of the Works Constitution Act (“*Betriebsverfassungsgesetz*”)



Insight from Germany

Legal framework – bonuses and variable payments



- Bonus and variable payment clauses are subject to judicial control of general terms and conditions (Sec. 307 et seqq. of the German Civil Code (“*Bürgerliches Gesetzbuch*”) and thus
 - have to be transparent
 - must not provide an unreasonable disadvantage for the employee
 - need to be valid: pro rata portion of the bonus and variable payments for the entry/termination year



Insight from Germany

Legal framework – bonuses and variable payments

- Certain specific rules apply to executives in the banking and insurance industries
- Generally, bonus entitlements remain unaffected by garden leave
- ⇒ Take-over of foreign benefit plans without check of compliance with German law generally not recommended



Insight from Germany

Case study: “Discretionary” bonus and variable payment

- Provision in employment contact

“employee may receive a discretionary annual bonus based on individual/company performance”

highly likely to be invalid, because discretion for payment conflicting with bonus depending on individual and company performance

⇒ company cannot rely on reducing the bonus at its sole discretion

⇒ employee may correct discretionary decision by judicial review

⇒ If employee reaches his or her individual targets and company performance objectives are accomplished, high risk that 35% to 40% of base salary must be paid as bonus



Insight from Germany

Feasible Solutions?

- General revocation proviso
 - Idea: making the bonus/variable payment revocable at any time
 - But: such proviso is invalid if it does not explicitly specify the reasons and circumstances under which a payment can be revoked. Additionally, such proviso can only be implemented for an amount of up to 25% of employees total remuneration



Insight from Germany

Feasible Solutions?

- Revocation of (part of) bonus for “material reasons”?
 - Idea: sudden turnaround of company performance as a “material reason”
 - But: such revocation clause must comply with jurisdiction on control of general terms and conditions; it is highly likely that such clause be ruled as non-transparent and unreasonably disadvantageous for employee
- Making bonus/variable payment “voluntary”?
 - Payment does not constitute claim for the future even if paid in recent years
 - But: generally not valid if bonus/variable payment is paid in return for individual and/or company performance
 - If payment is made only for different reasons than performance, such provision may be legally valid



Insight from Germany

Feasible Solutions?

- Just paying bonuses/variable payments without any agreement?
 - Risk of “standard business practice” (*betriebliche Übung*). If granted three or more times in a row such behavior would be deemed as an offer of company, implicitly accepted by employee
 - According to recent jurisdiction of Federal Labor Court even if amount varied from year to year
 - ⇒ Employee has a contractual entitlement to such payment
- Risk of infringement of the equal treatment principal
 - If such payment is awarded only to some members of a group of employees (e.g., software developers), other comparable employees may file claims for being excluded from such payments
 - Company to have an objective reason for such differentiation
 - ⇒ As no agreement on individual objectives has been made, high risk that company fails to provide evidence about such reason



Insight from Germany

Feasible Solutions?

- For each bonus year: agreeing on (new) individual and company targets or unilateral determination of targets by company
 - Even if bonus is not discretionary, company can reduce bonus if forecast for the next year is rather poor
 - However, if the required goals are obtained, employee is eligible for bonus payment



Insight from Germany

Feasible Solutions?

- But, objectives need to be reasonable and assessment by company hard to challenge by employee
- Using soft targets rather than hard target may broaden the margin of evaluation by company
- Note: employer may be held liable for compensation if target agreement/determination has not been made or has been made, with some delay.



Insight from Germany

Solutions for Case Study

- Mutual agreement on lower bonus amount: consent of employee necessary
- Take the risk of legal proceedings: employee entitled to correct discretionary decision that will be subject to judicial review
 - A valid “exclusion clause” in employment contract may require employee to claim for his entitlement within 3 months after due date and after rejection by company to take legal action within another 3 months
 - Outcome hard to predict, courts tend to be employee friendly
- Thoroughly drafted provisions in employment contract are crucial to avoid such risks



Insight from Germany

What if the employee leaves during a bonus year?

- If bonus / variable payment inter alia granted based on employee's individual performance or his or her contribution to company performance, provisions stating
 - that employee must still be employed and not under notice on a specific date during the bonus year or
 - that employee must still be employed (even if under notice) on a date during the bonus yearare invalid
- Above all, such provision is invalid if payment depends on employee to still be employed on a date after the end of the bonus year
- General rule: pro rata temporis bonus entitlement
- Generally, good leaver / bad leaver clauses at risk to be invalid if bonus paid for individual or company performance



Insight from Germany

Solution for bonus and variable payment (generally)

- Keep track on agreeing/setting individual and company targets
- Check compliance of bonus and variable payment rules with German legislation (changing from time to time)
- Evaluate how to ensure flexibility if business becomes less productive, e.g., by
 - half-year reviews
 - quarterly targets
- Minimize risks by using provisions in employment contracts avoiding “standard business practice” and introducing valid exclusion clauses
- Problem of existing company practices and unfavorable clauses can be overcome by entering new employment contracts, e.g., in the course of general housekeeping or time of promotion



Insight from France

- As mentioned, the clause in the case study is not a written agreement: the employee “may receive”; no document was signed by the parties to set the conditions and the amount of the annual bonus.
- The process is quite flexible. Management is not bound by a signed agreement and prior written approval of the employee is not required.



Insight from France

- From a French perspective, the legal regime will differ depending on whether or not the manager has given specific targets to each employee.
- On one hand, if the manager gives specific targets to the employee, the payment will be triggered by the attainment of annual objectives.



Insight from France

- On the other hand, if the manager does not give specific targets for each employee each year, the annual review will be a key point for the employee.
- The manager will assess the performance of the employee and determine whether he should be paid or not.



Insight from France

- In the case study (with no written agreement and no specific targets), the employees have received a fixed percentage (35 % or 40 %) of their basic salary for four years.
- Could they claim that such payment is usual and demand its payment as a regular practice (un « *usage* ») ?



Insight from France

- From a French legal perspective, the risk should not be underestimated.
- As a matter of fact, the French labor courts could consider the payment of a similar bonus for four years as a clear repetitive action. Therefore, the employee would be entitled to such a payment as a company practice (« *usage* »).



Insight from France

Useful strategies

- (i) If the company does not want to establish and implement a structured bonus plan with individual targets (lightweight option)
 - In that instance, which is similar to the case study, the « minimum safety precaution » would be to vary the amount of the bonuses each year (it's not necessary to justify this annual choice)
 - Another tip would be to adapt the amount of the annual bonus to each employee's performance
 - Warning: the company should also carefully take into account the situation of each employee (potential period of sick leave, maternity leave, employee representative status to avoid any discriminatory actions)



Insight from France

Useful strategies

- (ii) If the company opts for a more structured process (including annual and individual targets for each employee, written annual review)



Insight from France

Useful strategies

- In a more structured process, the employer would need to carefully establish the individual target of each employee by taking into account :
 - The company's performance
 - The employee's performance : his seniority, his previous performance, his period of activity or inactivity (maternity leave, sick leave, employee representative mandate)



Insight from France

- In a nutshell, the individual target would need to be « reasonable » (taking into account the activity of the company and the employee's ability) and the employer should watch out for any criteria which could be deemed as discriminatory.



Insight from France

- What if the employee leaves during a bonus year?
- French judges would examine the good leaver/ bad leaver provisions.
- French judges would consider that an employee is entitled to his annual bonus on a pro-rata basis (even if he left the company before the official payment date)



Insight from Italy

- Italian System: (1) Productivity Bonus, (2) Fringe Benefits.



- General protection afforded to individuals by: (1) Collective Bargaining Agreements (National or Local); (2) Individual Employment Agreement and (3) Italian Civil Code and Workers' Statute.
- Fiscal and social security contribution laws: favorable treatment for both employers and employees.



Insight from Italy

- Mandatory Productivity Bonus → National and Local Collective Bargaining Agreements establish legal rights for the employees to obtain this payment.
- Problem: Productivity Bonus becomes a fixed part of the wage → employer may not freely reduce/cancel the productivity bonus.
- Dead-line for payments (quarterly; annually) → in case of dismissal or resignation of an employee – unless the Collective Bargaining Agreement establishes different statements - the productivity bonus is due proportionally on the basis of the results obtained by the Company at the moment of the dismissal/resignation.



Insight from Italy

Best Practices

- Negotiation and approval of Local Trade Unions on the reduction/cancellation of the productivity bonus
→ to avoid any order to pay by Italian labor courts.



Insight from the UK

- Complicated, mainly set out in decided cases,
- Drafting of contractual documents is very important.



Insight from the UK

Discretion

- The clause in the case study appears to give the employer a discretion both as to:
- Whether to pay a bonus; and
- How much it will be.
- It mentions a benchmark based on performance of company and employee.



Insight from the UK

What if there had been no clause in the contract ?

- Employees might argue that by virtue of custom and practice, they had a legal right to receive a bonus in line with previous years, but
- In this case, that argument would probably not succeed. Past payments were not consistent, and past practice is usually not decisive in itself. Difficult to establish.



Insight from the UK

Limits on employer's discretion

- There are limits which the UK Courts will impose: but employers are allowed wide discretion and the Courts will only interfere if the decision is not rational – a much tougher test than if it is reasonable.
- “It would require an overwhelming case to provide a Court to find that the level of a discretionary bonus payment was irrational or perverse.”

In this case...

- Given the evidence of difficult trading conditions, you are unlikely to be challenged successfully.
- But treat all employees in a broadly comparable way. Take individual performance into account.



Insight from the UK

- What if the employees leave part way through a bonus year?
- No implied right to receive a bonus : Depends on wording of contract.
- Most bonus schemes will clearly state that the employee must still be employed and not under notice on critical date (often the payment date).
- Many will include good leaver/bad leaver provisions.



Insight from the UK

Practical steps

- Improve wording of contract: should be made much clearer.
- Communicate and manage expectations.



Thank you for your attention

Any questions ?

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