

ARTICLE: Bonus restrictions cannot subsequently be implied

April 2010

Introduction

The issue of bonuses can be a thorny one when an individual's employment is terminated. Whether the employee is entitled to a bonus can be a sticking point, as it was in a recent case which came before the High Court (since the value of the claim was over £25,000 and so beyond the jurisdiction of an employment tribunal). The employee was held to be entitled to the bonus and, since the employer had not exercised its discretion, the judge did so on the employer's behalf. It was shown that there is very little leeway for an employer to imply a term restricting bonus entitlement into an employee's contract.

The facts

Mr Rutherford had worked for Seymour Pierce Limited (SPL) for four and a half years, his employment terminating in November 2007. In 2005 he got a total bonus of £80,000 and in 2006 this rose to £82,500. In May 2007 he had been promoted to Head of Institutional Sales. He was the highest earning member of the Sales Team and it was accepted that he was told in a meeting prior to taking the post that he could expect a larger bonus than previously, although no firm figures were agreed.

In October 2007 SPL's vice chairman Mr Ratner had a serious heart attack and died. This caused a major impact on SPL's business. On 11 October there was a strategy meeting where options following Mr Ratner's death were discussed. Following that meeting, Mr Rutherford carried out additional tasks which SPL alleged before the court (although not during Mr Rutherford's employment) he had failed to deal with properly, including handling Mr Ratner's client list. Before the court, Mr Feigen on behalf of SPL testified that he had had concerns about Mr Rutherford's performance by the time of this meeting, if not before.

Mr Rutherford was summarily dismissed by SPL on 28 November 2007. At the hearing, the judge noted that at his dismissal meeting, "other than a general assertion of poor performance, no details of what precisely it was said Mr Rutherford had failed to do or done wrong were provided to him". The focus of the hearing was whether Mr Rutherford was entitled to be paid a bonus.

The court's decision

The judge approached this matter by considering first the relevant law, then the facts and finally analysing whether Mr Rutherford was entitled to the payment of a bonus.

The bonus clause in Mr Rutherford's contract read simply: "On satisfactory completion of your probationary period you will be eligible to participate in the Company's discretionary bonus scheme. Any bonus payments or amendments made to the scheme are at the discretion of the Company". Evidence was given as to the workings of the scheme: 40% of commission earned by the employees and directors was set aside to form a bonus pool. Half of that pool was distributed at the end of the first three quarters (Q1, Q2 and Q3) while the remainder was distributed at the end of the financial year (Q4). SPL wanted to imply the following words into the term: "in order to be entitled to be considered for an award under the bonus scheme, an eligible participant has to be employed by and/or not under notice of

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termination of their employment (howsoever given) as at the date of payment of any award". It relied on the argument that there was widespread use and acceptance of such a term in similar City institutions.

When examining this assertion, the judge considered the principles applicable. A term may be implied where it is "necessary to give business efficacy to the contract" and where it "represents the obvious but otherwise unexpressed intentions of the parties". In effect, a term that "went without saying". The judge went on to elaborate that where a party wishes to show custom and practice for implication, the usage of the term must be "invariable, certain and general" or "notorious, certain and reasonable" and must be more than mere trading practice.

The judge did not think that SPL's term should be implied. The contract could function sensibly and fairly without it so there was no business efficacy case. SPL could not provide any written or expert evidence to suggest that the term was indeed widely accepted in the City. On the evidence before him, the judge felt that – at best – it could be considered a mere trade custom. SPL could not argue that the term went without saying since later contracts had in fact expressly included the term they now sought to imply. The fact that previous employees who had left had not received a bonus was of no relevance, the judge said, since an implied term should be considered on a case-by-case basis.

Furthermore, the judge felt it was "manifestly unreasonable" to imply such a term since it gave employers the ability to dismiss an employee the day before a bonus is distributed solely to avoid paying that bonus.

Having decided that the suggested term could not be implied, the judge went on to consider whether Mr Rutherford was entitled to be considered for a bonus. He held without hesitation that the answer to this was "yes". He came to this answer based on six reasons:

1. At the very least, Mr Rutherford was entitled to his remaining share of the bonus for Q1-Q3. Mr Feigen had given evidence that a director who performed well in Q1-Q3 would not receive nothing in Q4.
2. Mr Rutherford had earned total commission of £60,660.22 during three months in his role
3. No criticisms were made of Mr Rutherford's performance during that time
4. His three principle clients had paid SPL about £431,000 for the 2006-7 financial year, which dwarfed the figures for the other members of his team
5. Every director of SPL got a Q4 bonus in 2007

The judge then went on to ask if Mr Rutherford was in fact considered for a bonus. He concluded not, since Mr Feigen had made it plain that he (mistakenly) did not regard Mr Rutherford as eligible because he was no longer an employee. Mr Feigen had simply not exercised any sort of judgement in this matter at all which, the judge commented, explained why Mr Feigen was unable to assist the court with testimony of Mr Rutherford's poor performance. However, the judge add that a further consequence was that since there had been no decision made at all, "the court has to put itself in the position of SPL and consider the possible entitlement".

In order to carry out this role, the judge went on to consider the various allegations of poor performance against Mr Rutherford and whether this would affect his entitlement. His consideration took up 50 paragraphs and in each case, he decided the allegation must fail. The matters were all case-specific but one allegation is worth repeating to give a flavour of all the others.

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In relation to the allegation about his poor conduct of appraisals, the judge commented that this “gave rise to something of a farce”. Mr Rutherford claimed that at the time he carried out the appraisals of his staff, it was not suggested to him that they were inadequate. When cross-examined, he completely refuted the argument that he had not carried out any appraisals at all. Mr Rutherford had made an application for specific disclosure for the appraisal records before another judge, but SPL had successfully argued that disclosure was not required as the documents were irrelevant. However, the judge hearing the case had indicated that the appraisal forms should be disclosed, which had occurred at the start of the second day. These forms demonstrated that Mr Rutherford’s account was correct and that the appraisals had been fully and carefully performed.

When Mr Feigen and his colleague, Miss Rutherford (no relation), came to give evidence, they referred to the appraisal records to prove their argument that the appraisals had not been properly carried out. The judge commented with wry disapproval that “in order to keep this allegation going, SPL were forced to rely on the contents of documents which only last week they said were irrelevant”. On further cross-examination of Miss Rutherford, she claimed that Mr Doyle had been required to carry out additional appraisals after Mr Rutherford left. However, when asked where the records were of these further appraisals, Miss Rutherford admitted that she had searched the system but had been unable to find them. Needless to say, this did not carry much weight with the judge. This was just one of the several occasions when the judge criticised SPL for creating a new case in front of the court and making allegations that had not been put to Mr Rutherford in cross-examination. With some exasperation, he finally concluded that “this allegation was bogus and ... it was doomed to fail”.

After this detailed consideration and his rejection of the allegations, the judge concluded that “in a reasonable exercise of SPL’s discretion, Mr Rutherford was plainly entitled to be paid a bonus”. In addition, the judge felt that avoiding payment of the bonus was “at least a factor” in the decision to dismiss Mr Rutherford.

Quantum

The judge moved on to consider the issue of quantum. Given that in both 2005 and 2006, the Q4 element of Mr Rutherford’s bonus had been £50,000, the judge held that this was the lower limit of damages. In a conversation about bonus which Mr Rutherford had previously had with Mr Doyle of SPL, 50% of the pot (which was subsequently estimated to be £165,000) going to Mr Rutherford was suggested. Given these factors, the judge held that the right figure was £70,000. However, he added at the end of his assessment the following disparaging comment: “Because Mr Palmer [Counsel for SPL] had not dealt with quantum at all in his final submissions, I asked him what figure he contended for, and Mr Palmer took specific instructions from SPL. His instructions were that, by reference to the records pertaining to an unknown employee (not a director) who, unlike Mr Rutherford, had not received a Q2 bonus either, the right figure was nil. No explanation for the reasonableness of this comparison was offered. No other figure was put forward. I regret that SPL’s response, even on quantum, was so unreasonable and so uncompromising. But it was at least in keeping with their attitude to this claim as a whole.”

If SPL thought that their conduct of the case would have no bearing on the outcome, they were sorely misguided. On 20 August 2009, Mr Rutherford had offered to accept £50,000 in settlement but this was rejected by SPL who put forward no offers at all. Since he then proceeded to secure higher damages at court, the judge held that Mr Rutherford was entitled to 4% interest on the full £70,000 damages.

Mr Rutherford was entitled to all his costs after that offer in addition to damages, but furthermore, he was awarded all costs incurred prior to that offer as well. The judge held that this was fair due to SPL's "lamentable" conduct and treatment of him. The judge commented: "SPL have continued to act in a disreputable fashion, in order to try and keep their leaky defence to this modest claim afloat". Again, Mr Rutherford was awarded 4% interest on costs.

Conclusion

Although the issue of whether a bonus is due on termination will always be case-specific, this case provides a warning that contract clauses on bonus schemes must be clearly and consistently worded. This is to be borne in mind when drafting contracts for new employees. However, employers may struggle to negotiate a new restriction on bonuses for existing employees. Indeed, this case shows that there is a risk that including express terms in later contracts will go against an argument for implying the same term in earlier contracts. Furthermore, whether bonuses have been paid to departing employees before is considered of little relevance.

The need for written records is also of paramount importance, especially where disciplinary and performance matters are concerned. The judge described the lack of the relevant forms and records as evincing "a cavalier attitude" on the part of SPL which undermined the credibility of its witnesses.

This case also serves to highlight the litigation risk that all parties face attending court. It was noted by the judge that SPL had made no offer at all to settle to Mr Rutherford, presumably confident of their case or of Mr Rutherford's inability to see it through to the conclusion. However, when it came to the hearing before the court, SPL floundered spectacularly. The judge commented that he found Mr Rutherford "a patently honest witness". He did not take the same view of SPL's witnesses although he admitted this was partly due to circumstances beyond their control. SPL's failure to prepare its case properly, its inadequate disclosure of contemporaneous documents and its witnesses who knew little about the facts of the case and contradicted their own witness statements all contributed to the finding against SPL.

If you would like further information on this case or on the obligations of an employer or employee on termination, please contact David Hill at dhill@davidsonlarge.com or Lucy Bond at lbond@davidsonlarge.com.