Is A Bonus Really “Discretionary?” Employers Should Be Careful

Spring is bonus time in many workplaces. And many employers prefer to use “discretionary” bonuses rather than establishing formal bonus plans.

But employers shouldn’t be lulled into a false sense of security merely because a bonus is “discretionary” and is not established through a written employment contract and/or plan document. The common law presumption is that terminated employees are entitled to pay in lieu of reasonable notice based on their total compensation. If a bonus is found to be integral to an employee’s compensation, then he or she will have a claim for it as part of a wrongful dismissal action.

Employers who use discretionary bonuses need to be aware of the main factors courts consider in determining whether a discretionary bonus is an integral part of an employee’s compensation:

1. *Regularity*: bonuses that are paid consistently over time, perhaps at regular intervals, are more likely to be viewed by courts as integral to compensation. Courts reason that employees come to expect bonuses they consistently receive, and past practice may have “changed a discretionary benefit into an integral part of the wage structure”. As few as two or three years’ history can suffice in some cases.
2. *Value as a share of compensation*: the bigger the bonus is as a percentage of total compensation, the more likely a court is to see it as a contractual right. The logic is that employers and employees make trade-offs between fixed and variable compensation, and where the variable compensation component is large, a court will more readily assume it was meant to compensate for lower fixed compensation and is therefore claimable.
3. *Industry standards*: where bonuses are an industry standard and are necessary to attract and retain talent – such as in financial services or similar industries – courts are more likely to view the bonuses as a contractual entitlement.

Courts will also impose a duty on employers to act fairly when the amount of a bonus is discretionary. An employer cannot give an arbitrarily low bonus amount where a bonus is considered integral to compensation. Doing so may amount to constructive dismissal, and a court will give damages for what it assesses an employee was actually entitled to.

Once a judge has determined that a bonus is an integral part of an employee’s

compensation, he or she will be loathe not to include the bonus in damages for wrongful dismissal. Very clear – if not harsh – language will be needed in order to rebut the common law presumption of total compensation.

Using language in the employment contract and/or bonus plan that says an employee "must be employed" at the time the bonus is paid may not suffice. At common law, employees continue to be employed until the end of the reasonable notice period, and are entitled to be paid on the basis of their total compensation. The fact that an employee has been terminated without reasonable notice and, hence, a chance to earn the bonus, should not be the basis upon which they are denied the bonus. Judges would perceive this as allowing employers to profit from a breach of contract.

With this in mind, employers should clearly address an employee's bonus entitlement in the event of resignation, retirement, termination with cause, and termination without cause. If an employer does not intend to pay bonuses to employees during the reasonable notice period, this needs to be addressed directly in the employment contract and in any bonus plan. Be wary that any ambiguity will be resolved against the employer.

It is one thing to pay a small, one-off bonus as an act of goodwill. But if an employer intends to establish regular and significant bonus payments, treating those bonuses as "discretionary" does not insulate an employer from claims by terminated employees.

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