

The Context

Bonuses are a very common way of incentivising employee performance. However, they bring their own complexity and challenge.

One complexity is the issue of target re-setting or adjusting each year.

A recent German case illustrates the problem.

The Case

A director level employee's employment contract stated that he would be entitled to a performance related variable bonus. It further stated that the bonus targets were to be agreed each year between the employer and the director but failing agreement the employer had the right to set targets unilaterally.

For the year in question, the employee requested the employer start negotiations on the target but the parties were unable to reach an agreement. The employer then unilaterally notified the employee of the targets set.

Following the later termination of the director's employment the question, brought to the Court, was whether the employer had been entitled to rely of the right to set the bonus unilaterally, in the absence of mutual agreement.

The Court found:

- The term in the contract allowing unilateral target setting was invalid as it unfairly disadvantaged the employee and allowed the employer to undermine the order of priority agreed in the contract for target setting – e.g. by putting inappropriate pressure on the employee to agree the target.
- Once a contract provides for setting a target by mutual agreement, the employer can only fulfil its obligation if it allows the employee to influence the setting of the target.

The Advice

The wording of these types of clauses is critical. They are not necessarily invalid but the Court will set a very high standard on the employer to fulfil its obligation to negotiate. Employers should take care to have the negotiations on time and document all discussions, taking care to demonstrate that it is taking into account the employee's views.

It is also generally allowed to state in the contract that targets are always set unilaterally by the employer, without discussion or agreement. However, a Court may still consider whether the employer's discretion has been used reasonably.

Finally, employers should also consider (and take advice on) whether it is possible to leave the bonus structure outside the employment contract altogether, and so keep more flexibility.

This is a high level general update only. Legal advice should be obtained on specific circumstances.