

Bounty Bonuses

Well, well, well, how did it all come to this? From Timothy Geithner failing to check out bonus “entitlements” for A.I.G. Executives to Alistair Dowling allowing Sir Fred to slip away with a King’s bounty of a pension, things will ne’er be the same again.

So how have the Courts dealt with these apparently discretionary entitlements? What is now beyond doubt is this: whatever the rules of the game up until now, the tide has turned for buccaneers sailing close to the wind for future bounty hunting.

Unchartered Waters

In a recent case which England’s Court of Appeal has dubbed a “hoot”, a French Exchange Trader working in London with a French Bank, Alexandre Mouradian, has sued his employers for short changing him on his bonus. Some bonus! In addition to his paltry basic salary of £300k per annum, Mr Mouradian claimed a bonus of £1.32 million for the period June to December 2006. The Bank, silly people, actually paid him most of the bonus but the bold Trader says he is short £92,000.

Did his granny never advise her embryo Trader not to look a gift horse in the mouth? Rather than paying up in docile fashion as in former years, the Bank got stuck in and enquired into the calculation of said bonus. Turns out that Mr Mouradian headed a desk of 7 (humble) employees and a consultant, trading futures and options on various Exchanges around the world. The desk was entitled to split a bonus pool equal to 60% of its net billed income, **twice yearly!** In other words, the Bank took less than half the desk's earnings and the Traders got the lion's share.

Or rather the Trader. Cos Mr Mouradian was entitled, said he, to determine who got what. And guess who got most? Yes, you guessed right, £60,000 here and £40,000 there but out of a total bonus pool of £1.43 million, divided nine ways, Mr Mouradian took a cool £1.32 million or 92%.

Well, you can't blame him – it was there for the taking and the Bank didn't really seem to care as long as it received its widow's mite. But the Bank, taking a note out of Bob Dylan strumming "*the times they are a changing*", changed its tune.

One of the peculiar effects of the collapse of Lehman Brothers and the subsequent credit crunch and rebuilding of International National

Financial Institutions, may be a resurgence of remuneration by bonus, though with less flamboyance than in the past. Recent litigation, resulting in a reinterpretation of standard bonus clauses trotted out by corporate legal advisers, has highlighted the commonsensical approach applied by judges to such clauses rather than the strict linguistic definition.

The purpose of a bonus clause is to motivate an employee to give his or her best performance. The performance is measured according to certain criteria and a consummate reward is accordingly earned. Careless drafting and a reliance on catch-all phrases such as *“the bonus shall be at the absolute discretion of the CEO”* or some like eminence, had resulted in an assumption that the decision maker could award high or low or nothing at all, without any recourse being available to a dissatisfied employee. Until Mr Clark took a pot shot at Japanese owned Bank, Nomura International and Mr Horkulak took a similar aim at Investment Bank, Cantor FitzGerald International, that is.

In Mr Clark’s case the difficulty was over the interpretation over the word *“performance”*. Nomura relied on its absolute discretion to interpret *“performance”* to cover all aspects of Mr Clark’s performance and not only his financial performance, when they dismissed him with 3 months notice, put him on garden leave and refused to award him any bonus

whatsoever. Mr Clark's financial performance had been stellar, earning £6.5 million for his division of the Bank that year and contributing to overall profits of £16 million. Most bonus schemes provide that the employee must still be in employment with the employer at bonus time and Mr Clark also satisfied this criteria since, being on garden leave, he remained an employee of the Bank at the relevant date.

No, it was his personal behaviour to which the Bank took exception and failed him under "*performance*". Mr Clark was perceived as a maverick, very unbankable for a banker. For one he wore his hair long and according to his letter of dismissal, had failed to support the Bank's "*strategy and culture...by inappropriate dress and appearance, erratic time keeping...and outright criticism of the management committee and their strategy in front of peers and sub-ordinates*". He was outspoken in the hallowed halls – did make them £6.5 million in profit though, over a third of the total for the year, but in reality management could not stand him being a maverick and, despite instructions to the contrary **HE PERSISTED IN WEARING RED SOCKS!**

The High Court found in Mr Clark's favour and ordered the payment of his bonus of £1.35 million on the basis that the exercise of discretion by the Bank to deny him the bonus was perverse and irrational. Nomura, said the Court, had fettered its discretion by insisting that the bonus was

dependent on performance and Mr Clark had performed well and earned profits for the Bank.

How many employers give a deep sigh over the annual performance review? - How trite and nonsensical are many paper based evaluations and how defensive! Is performance in an employee's personal life, rather than professional, measured in such a meaningless manner, as a parent, sportsperson, or community organiser? Whatever happened to common sense?

Common sense was injected by the English Court of Appeal into Cantor Fitzgerald over its decision to deny Mr Hokaluk his bonus when he resigned claiming constructive dismissal in 2004. Mr Hokaluk had been a senior Managing Director in the Bank and he claimed that the CEO had behaved in an insulting and humiliating manner towards him when he resigned. Not a good position to be in when pursuing a bonus claim. Mr Hokaluk succeeded in his case for wrongful dismissal and the Judge included as damages a sum of £630,000 in respect of loss of bonus which Mr Hokaluk would have earned had he remained in employment with the Bank. On Appeal from the High Court, the Court of Appeal said that an unlimited discretion clause in the contract is subject to an **implied term** that the discretion will be **exercised genuinely and rationally.**

Closer to home a case taken in the Irish High Court by a Mr Finnegan against Davy's Stockbroker was similarly successful. Mr Finnegan was a stockbroker employed by J & E Davy, a firm owned by the Bank of Ireland. Davy arranged with its parent that a portion of the company's profits could be set aside as a bonus pool for senior managers and various restrictions were applied. One of those restrictions was that if the bonus in any one-year exceeded 3 times the salary, then it had to be paid over a 3 year period i.e. it was to be deferred. A further condition was that should an employee leave Davy's and join a rival firm, a bonus earned but unpaid at the date of leaving would be forfeit. Amazingly these arrangements were not reduced to writing – it was an oral arrangement only, somewhat akin to the manner in which Yasser Arafat ran the Palestine Liberation Organisation, granting arbitrary bonuses to, as he saw it, deserving lieutenants. The rationale for deferring bonuses awarded with the threat of forfeiture was, in the words of the company's Managing Director: *"to incentivise people going forward, generate loyalty and to try to keep key employees"*.

Mr Finnegan left Davy's to join a rival, NCB in 2000, having been with Davy's for some 9 years. At the time of leaving he had accumulated deferred and unpaid bonuses of over €260,000. This Davy's declined to

pay, on the ground that Mr Finnegan had broken a key condition of the bonus by joining a rival firm.

Mr Finnegan sued and, not surprisingly, succeeded. The Judge found that the penal restriction whereby the bonus was forfeit in the event of an employee joining a rival firm, was in restraint of trade and void. The Court observed that the restriction and penalty was an old fashioned recipe from another age.

So what do these cases add up to for an employer?

Firstly, whatever your lawyer tells you, absolute discretion does not mean open season against an employee. Discretion must be exercised rationally, in good faith and never perversely. If criteria are to be applied to the discretion, they must be open and transparent. Financial targets must not be unreasonably increased, individual behaviour and even perceived eccentricities, even if you are in a conservative environment, should be tolerated and respected. Employers do need to recognise that people who do not toe the traditional corporate line are often talented and add considerable value to the organisation. Mr Clark, was after all, responsible for £6.5 million of Nomura's £16 million annual profit. Mr Hokaluk did not deserve to be humiliated by the CEO: he had not achieved senior managing director status with nothing to

bring to the table. The more likely explanation for the CEO's conduct in that case, was jealousy. There is a need to think laterally by senior managers, who are either of the baby boomers generation (born between 1946 and 1961), or generation X (born between 1924 – 1980), and who should be aware of the mind set and resources of generation Y (born between 1981 – 2001) who, in 10 years time, will make up to 50% of the Western economy workforce.

A bonus system may, in the future, be seen by employers as the best way to motivate and reward key staff to grow and develop the business. Devise it carefully, respect its terms, engage openly and honestly with the employee at the performance appraisal and do not allow a difference to motivate a prejudice. An employer is entitled to commitment and dedication from its employees and they, in turn, are entitled to fairness in the assessment of their performance.

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