

Discretionary and target-based bonuses and French employment law: pay attention to the drafting of your clauses !

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In France, two categories of variable compensation are generally provided for in employment contracts: the contract may provide for variable compensation set on the basis of predetermined criteria and independent of the employer's discretion, in terms of the conditions to be achieved (quantitative, qualitative or mixed). These are most often conditions based both on the individual performance of the employee and the results of the company, or the group to which it belongs. These are referred to as target-based bonuses.

Conversely, the contract may provide for the possibility of a discretionary bonus, with both the payment and the amount left to the unilateral decision of the company. French case law considers that this clause is valid but not without limit.

In the case of classical target-based bonus, if the conditions are achieved, the bonus is due and legally payable by the employer. Conversely of course, if the required results are not achieved, no bonus is due.

However, in practice, there are still clauses in employment contracts that erroneously mention that a target-based bonus, with the conditions specified in the clause, will be "*paid at the discretion of the employer*". The employer may then consider that he can freely decide not to provide the target-based bonus, when legally he cannot do this. In fact, the payment of the target-based bonus can never be discretionary and it does not matter in this regard that the bonus is not mentioned in the employment contract, but in a separate document, such as a simple side letter. It is still a unilateral commitment of the employer which must be respected as soon as the conditions for granting the target-based bonus are met.

What are the key points when drafting a target-based bonus?

It is first necessary to avoid clauses stipulating that the setting of conditions will be done by mutual agreement with the employee. Such wording, which forces the company to renegotiate with the employee, can lead to a deadlock in the event of disagreement. The unilateral setting of the conditions for payment by the company is to be preferred, in compliance with the following rules: the document setting the conditions for the period during which the conditions must be achieved must be written in French and sufficiently precise so that there is no ambiguity in the understanding by the employee of the criteria likely to vary the amount of the bonus.

The clause may for example provide that the bonus will be made up of a percentage of the company's results (e.g. profits), set progressively according to the level of results achieved. However, clauses should be avoided according to which the bonus will be set each year according to the commercial directions unilaterally determined by the company or even according to market developments without further details.

It is also necessary to identify what elements will be used to measure the achievement of the conditions, the possible weighting criteria as well as the accounting elements (which must be verifiable) on which the methods of calculating the bonus are based. The conditions must also be achievable and they must be brought to the attention of the employee at the very beginning of the reference period.

On this last point, in practice there are still too often situations in which the conditions are set late, for example in March when the reference period coincides with the current calendar year. In such a case, the company cannot in good faith prejudice the employee for failure to achieve the results. In the event of a dispute, the company risks having to pay the maximum amount of bonus provided for in case of 100% achievement of the conditions.

It is therefore necessary to be particularly vigilant on this point and not to forget to set the conditions at the beginning of the reference period. As for the failure to set conditions, this constitutes a breach by the employer that may justify the termination of the employment contract to his sole fault.

How can you ensure that a bonus is a discretionary bonus and not a target-based bonus?

The discretionary bonus is paid by unilateral decision of the employer without any criteria or conditions of attribution, or precision as to how and when it will be paid. It is therefore not linked to the achievement of predetermined conditions, but is left exclusively to the assessment of the employer both as to its payment and its amount. Unlike a target-based bonus, the discretionary bonus does not impose any obligation on the employer to communicate its terms and criteria to the employee. In other words, the employer does not have to justify on the allocation criteria and the method of calculating the bonus.

Are there any limits on the discretionary bonus?

Yes, there are at least two. The first limitation lies in respecting the principles of equal treatment and non-discrimination. The attribution of a discretionary bonus for the benefit of an employee does not allow the exclusion of other employees with whom a fair comparison can be made (e.g. employees having the same job, the same training or qualification or the same seniority within the company).

Discretionary therefore does not mean arbitrary. If the employer decides to grant such a bonus to one of its employees, it must be able to establish that its non-attribution to other employees, who perform the same work or work of equal value, is justified by relevant objective elements. Justification may be provided by a lower level of performance or quality of work, particularly when supported by the annual appraisal reports. In this regard, companies must put in place the evaluation systems that are essential in order to be able to justify differences in professional qualities between their employees.

Finally, it is necessary to pay attention to the granting of a bonus in violation of the principle of non-discrimination which is penalized as it is based on an unlawful reason (the employee's sex, his/her union membership, etc.).

The second limitation is that the bonus loses its discretionary nature if it is paid to all employees or to a category of them, its amount is fixed and the payment is made on a recurring basis.

The law does not define what constitutes "a recurring basis". The courts have, for example, considered that the payment of a bonus for two consecutive years was not sufficient to make it compulsory, unlike

a bonus paid regularly for five years. Regardless of whether it is provided for in the employment contract, if the payment of the bonus becomes compulsory the employer can only discontinue it in compliance with a specific procedure involving the prior written and individual information of employees and employee representatives (if they exist) as well as the provision of a reasonable notice period. The law does not define the duration of this period either. In fact, what is a reasonable period will depend on the frequency of payment of the bonus or the number of years the employee has previously enjoyed it.

How do you preserve the discretionary nature of the bonus?

To be qualified as discretionary, the bonus should ultimately not be mentioned in the employment contract or any other document, and not give rise to the payment of an identical or similar amount from one year to the other. On the contrary, it should be paid on different dates and vary from one year to another without this variation resulting from a rule or pre-established criteria.

In any case, a discretionary bonus should not be paid on a constant and regular basis, the risk being that it will become a compulsory payment as an element of salary. It is also necessary to vary the employees who benefit from the bonus and for the employer to avoid communicating or informing them concerning the methods of calculation or the foreseeable amount of the bonus.

Ultimately, the qualification of the bonus will depend not only on the drafting of the document which provides for it (e.g. employment contract, annexed document or simple side letter) to which the greatest care must therefore be taken, but also on its history of payment.

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