

In the recent case of *Horkulak v Cantor Fitzgerald* [2003] IRLR 756, a senior managing director who had been wrongfully dismissed was awarded damages of £912,000. Of that sum, £630,000 was awarded in respect of discretionary bonus payments, which the judge found Mr Horkulak would have received during the remainder of his fixed-term contract had he not been dismissed.

Cantor Fitzgerald has been granted leave to appeal the award of damages. This will be the first occasion that the Court of Appeal has considered the extent to which the court can control or limit an employer's freedom under a discretionary bonus scheme.

Clark v BET

In *Clark v BET Plc* [1997] IRLR 348, the claimant was employed by the defendants as a senior proprietary trader in equities. His service agreement provided for a considerable basic salary which it stated "shall be reviewed annually and be increased by such amount if any as the board in its absolute discretion decide". The agreement also provided that the claimant would "participate in a bonus arrangement providing a maximum of 60 per cent basic salary in any year". The claimant was dismissed and claimed that he was entitled to compensation in respect of the salary increases and bonus payments he said he would have earned during his three-year notice period.

Timothy Walker J held that there was a contractual obligation on the employer to provide, and a contractual right for the claimant to receive, an annual upward adjustment in salary. It was only the amount (if any) that was in the absolute discretion of the board. If the board had exercised its discretion capriciously or in bad faith, so as to determine the increase at nil and therefore to pay the claimant no increase at all, that would have been a breach of contract. Similarly, he held that the agreement conferred a right on the claimant to participate in a bonus scheme, and there was a corresponding obligation on the employer to provide such a bonus scheme. In determining the claimant's loss, the court had to assess the position the claimant would have been in had the employer performed its obligations.

In assessing the claimant's loss, Walker J said the court should not assume that any discretion would have been exercised so as to give the least possible benefit to the employee, if such an assumption would, on the facts, be unrealistic. The employer argued that it was

Discretionary bonus payments

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- when an employer acts capriciously, irrationally or in bad faith
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entitled to perform the contract in the manner most favourable to them, and that the claimant would have received no bonus at all.

Walker J held that a realistic assumption had to be made of the position the employee would have been in if the employer had performed its obligation. He went on to look at the claimant's previous salary increases and bonus payments, and the payments received by comparable employees. He concluded that the claimant would have continued to receive an annual salary increase of 10 per cent and assessed the level of bonus payments at 50 per cent of his salary for the three-year notice period.

Clark v Nomura

In *Clark v Nomura International Plc* [2000] IRLR 766, a different Mr Clark, a senior equities trader, worked under a contract that provided for a remuneration package consisting of a basic annual salary supplemented by a bonus awarded under a discretionary scheme which was stated to be "not guaranteed in any way". He was dismissed and paid his basic salary in respect of his three-month notice period. However, although he was still in employment at the date for payment of the annual bonus and had earned substantial profits for the company during the relevant period, he received no bonus at all. Mr Clark made a claim for damages, alleging that the employer's failure to pay him any bonus amounted to a breach of his employment contract.

Burton J, considering the employer's discretion under the scheme, stated that the phrase "not guaranteed in any way" simply means there is no guaranteed bonus, ie no guaranteed minimum payment. Thus, a lawful exercise of discretion could lead to a nil bonus award. However, he held that an employer can breach the contract of employment if it exercises its discretion—which, on the face of the contract, is unfettered or abso-

lute—in a way that no reasonable employer would have exercised its discretion.

In adopting a perversity approach, Burton J said that "capriciousness" was too vague, while the concept of "without reasonable or sufficient grounds" provided too low a test. He noted that the court, in concluding that an employer has exercised its discretion irrationally, is not substituting its decision for that of the employer. However, if the court reaches the conclusion that the employer acted irrationally and therefore is in breach of contract, in assessing damages for the breach of contract the court must then determine, on the balance of probabilities, what would have occurred had the employer complied with its contractual obligations. That will involve the court assessing the employee's bonus, on the basis of the evidence before it, and thus putting itself in the position of the employer.

On the facts of the case, Burton J concluded that the employer's decision to award a nil bonus to an employee who had earned substantial profits for the company was irrational and did not comply with the terms of the employer's discretion. After considering the bonus payments made to Mr Clark in the years prior to his dismissal, and the payments made to his colleagues both before and after his dismissal, Burton J concluded that had his employer complied with its contractual obligations, it would have paid Mr Clark £1.35 million, rather than the nil bonus award.

Horkulak v Cantor Fitzgerald

In *Horkulak*, the claimant was employed by Cantor as a senior managing director under a contract of employment that provided that he was entitled to be paid a discretionary bonus, the amount of which was to be mutually agreed. The claimant resigned and claimed damages for constructive dismissal based on repudiatory breach of his contract by the chief executive officer, due to what he

claimed was the CEO's insulting and humiliating behaviour.

In finding that the claimant had been constructively dismissed, Newman J rejected as "fallacious" the proposition that where very substantial sums are paid by an employer, he acquires a right to treat employees according to a different standard of conduct from that which might otherwise be required.

Having found that the claimant had been constructively dismissed, Newman J stated that the claimant was entitled to no more than that to which Cantor would have been obliged to pay. However, following the approach in *Clark v BET* and *Clark v Nomura*, he said Cantor would have been obliged to exercise its discretion reasonably and in good faith.

In assessing damages, Newman J said he approached the figures by reference to the likely outcome from a fair and rational exercise of discretion, noting that having regard to the nature of the evidential exercise and element of uncertainty which is involved, it

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was necessary to exercise caution and moderation. Following the approach of the judges in the *Clark* cases, Newman J proceeded to apply the Cantor Fitzgerald discretionary bonus criteria. He concluded "it was highly likely" that over the course of the remaining two years of his contract Mr Horkulak would have received discretionary bonus payments totalling £630,000.

Court of Appeal

It will be interesting to see how the Court of Appeal in *Horkulak* deals with the issue of discretionary bonus payments. It has already applied the approach in *Clark v Nomura* in the context of employee share schemes in *Mallone v BPB Industries Plc* [2002] IRLR 452. In *Mallone*, Rix LJ—with whom the rest of the Court of Appeal agreed—stated that in order to establish that an employer had exercised its discretion irrationally, it was not necessary for the employee first to demonstrate dishonesty, improper motive, capriciousness or arbitrariness on the part of the employer. In particular, Rix LJ emphasised that an employer may act irrationally while being honest.

In any event, it seems that the construction of the discretionary bonus clauses in the *Clark* cases, as followed in *Horkulak*, is consistent with the employer's duty to not conduct themselves in a manner calculated or likely to destroy or seriously damage the relationship of trust and confidence between employer and employee, without reasonable and proper cause. In this regard, in *Mahmud & Malik v BCCI* [2000] AC 20 Lord Steyn said, "The major importance of the implied duty of trust and confidence lies in its impact on the obligations of the employer."

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