

# Bonuses

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December 2013 – January 2014

Employers often use bonus schemes as incentives to reward and retain valuable employees and this is usually the time of year when employers are reviewing performance and determining whether bonuses will be issued. The criteria on which performance is measured, and against which bonuses are ultimately quantified, vary across companies and market sectors and, although bonus schemes are common, there are no statutory restrictions or guidelines dealing with the payment of bonuses in the UAE.

## **Management of bonuses**

Employment relationships in the United Arab Emirates (“UAE”) are generally regulated by the UAE Federal Law No. 8 of 1980 (as amended) (the “Labour Law”) together with regulations promulgated under that law. The Labour Law applies to all employees working in the UAE, with a small number of exceptions. One of those exceptions relates to employees working in the Dubai International Financial Centre (“DIFC”) who are subject to the DIFC Employment Law No. 4 of 2005 (the “Employment Law”).

Neither the Labour Law nor the Employment Law contain provisions in respect of bonuses and it is therefore a discretionary matter for employers in the UAE and the DIFC as to whether employees receive bonus payments and, if so, how the underlying schemes are operated.

In some sectors or industries, it is commonplace for employees to receive bonuses as a result of custom or practice. Where this is the case, it is likely that the contract of employment will make some reference to the payment of a bonus. Contractual reference does not, contrary to popular belief, mean that a bonus is automatically guaranteed. Ultimately, entitlement to a bonus is a matter for whether the bonus is deemed to be discretionary or non-discretionary and this, in itself, can be a tricky matter.

## **Discretionary vs. non-discretionary**

Discretionary bonuses (whether contractual or not) are those which give the employer the ability to determine whether a bonus should be paid and, if so, in what amount. Frequently, where a discretionary bonus is operated, mention of such bonus will be omitted entirely from the contract of employment. Alternatively, the contract of employment may mention that a bonus scheme is from time to time operated but that payment of any bonus is entirely at the discretion of the employer’s management team and usually subject to certain performance criteria of the individual and the employer as well.

Non-discretionary bonuses are those which essentially guarantee payment of a bonus to the employee. Whilst such schemes may utilise eligibility criteria, for example, requisite length of service or performance targets, they nonetheless guarantee payment to the employee (subject to meeting the prescribed criteria) and remove discretion from the employer.

It is not unusual for employers to seek to retain an element of discretion whilst in reality implementing non-discretionary bonus schemes. This might arise where the employer implements a bonus scheme which refers to the company meeting certain levels of turnover or profit and subsequently the employee meeting targets but then goes on to state that the employer has overall

discretion as to payment of the bonus. In reality, such schemes are non-discretionary and can create difficulties where the employer believes that it has retained discretion when this is in actual fact not the case.

In order to avoid complaints, it is prudent for employers to proceed with some caution when exercising their discretion over the payment of bonuses. It is apparent that few employers consider exactly what is meant by the term “discretionary”, and to what exactly the discretion relates. A recent UK Employment Appeals Tribunal decision, which may be persuasive in cases in the UAE and particularly those before the DIFC Courts, indicated that “discretionary” in the context of bonus schemes may mean:

1. The provision of an overarching bonus scheme itself was discretionary;
2. A decision to operate the bonus scheme each year is discretionary;
3. The method of calculating the bonus is discretionary; or
4. The threshold or performance target which triggers a bonus payment is the subject of discretion.

The distinctions could potentially have a significant impact on the respective rights and entitlements of the employer and employee over the bonus scheme and therefore it is imperative, where the contract of employment or the bonus scheme documents refer to discretion, that there is little doubt as to what this discretion refers to. This case highlights the importance of setting out the terms of any bonus scheme very carefully, and at the very least making it clear where the employer can exercise its discretion – be that over the status of the scheme, the calculation of any bonus payment, and/or the terms of entitlement to any bonus payment. The fact that a bonus scheme has been referred to as “discretionary” may not in fact give the employer the unfettered right to withhold or refuse to make a bonus payment to employees.

### **End of service gratuity (“EoSG”)**

An employee is ordinarily entitled to an EoSG payment in the event of termination of employment, so long as he has the qualifying length of service (and is not being summarily dismissed). EoSG is calculated on the basis of 21 calendar days’ pay for each year of service for the first five years, and 30 calendar days’ pay for each year of service thereafter. Pay for the purposes of EoSG is generally accepted as being the employee’s “basic pay”, excluding allowances, provided that the contract of employment properly distinguishes between the basic pay and allowances.

A recent Court of Cassation judgment has added some confusion to this area. Essentially, the Court of Cassation has deemed that EoSG calculations should be based upon basic salary and, in addition, commissions or bonuses where such amounts are essentially fixed or guaranteed. Accordingly, there is now a risk for employers paying bonuses on a fixed or guaranteed basis that such bonuses may lead to a much larger obligation on termination than originally intended.

In order to seek to limit the potential liability for EoSG for employees who receive bonuses, it is advisable that performance indicators are utilised which, if not met, mean that the bonuses are not payable.

### **Managing expectations**

Despite efforts to manage employees’ expectations, the award of (or failure to award) bonuses can have both a detrimental effect on employee morale, and may lead to allegations of breach of contract and/or discrimination.

Where an employer is intending to introduce a bonus scheme, caution should be exercised to ensure that the rules of the scheme are sufficiently well drafted to cover most eventualities. When drafting discretionary bonus scheme rules, it is also important to consider in what circumstances payments may not be made to the employee. For example, it is useful practice to have a provision

in the employee's contract saying that any discretionary payment under the bonus scheme will only be made if the employee is in employment on the bonus payment date, and is not under notice (whether given or received). This is intended to enable an employer to exercise its discretion not to award an employee a discretionary bonus payment in circumstances where the employee has resigned to go to a competitor, or has been dismissed part way through the year.

To avoid any dispute as to this matter upon termination of employment, it is sensible to include wording in the contract of employment (where the bonus is contractual) which states that any bonus entitlement which has not been declared or paid out at the time of notice being given or received is forfeited.

It is also worth considering what specific factors will be taken into account in exercising discretion. Many employers prefer not to express this and to leave their discretion as wide as possible. However, it may be helpful sometimes to express that both employer and employee (and perhaps team) performance can be taken into account in assessing the discretionary payment which may be made to an employee. Moreover, mention of discretion without clarity as to the scope thereof, may lead to arguments as to what the discretion relates to (as discussed above).

### **Potential disputes**

The relevant case law also indicates that where an employer has an absolute discretion, it must not exercise, or fail to exercise, that discretion irrationally, and it must act in good faith particularly in the DIFC. Cases in other jurisdictions have suggested that the test may be even stricter than this, and that "it is presumed to be the reasonable expectation and therefore the common intention of the parties that there should be genuine and rational, as opposed to an empty or irrational, exercise of discretion".

If discretion is exercised perversely or irrationally, or in breach of any express conditions detailed in the employee's contract or bonus scheme rules, the employee could bring a claim for breach of contract. The damages sought would be the bonus monies the employee believes he should have been paid. In addition, as any breach would relate to the employee's remuneration (which is considered a fundamental term of a contract of employment), it would be open for the employee to resign and claim constructive arbitrary (or unfair) dismissal. The employee would seek his notice monies, and arbitrary dismissal compensation constituting a basic award of up to 3 months' remuneration (outside of the DIFC) and potentially damages (in the DIFC). Alternatively, the employee could remain in employment but protest at the level/lack of bonus and commence proceedings for an unlawful deduction from wages.

When paying out a contractual bonus, employers should be careful to ensure that they are making the award in accordance with the rules of the scheme, otherwise a claim for breach of contract is likely to ensue. Where this type of claim has come before the UAE Courts previously, a pro-rated payment of the potential bonus entitlement has been favoured.

Finally, the employee could claim that the discretion has been exercised in a discriminatory way. This is more likely to be a serious consideration for employers in the DIFC.

When determining bonuses, employers should therefore be cautious not to forget about those who remain employees but are not currently working in the office, such as those who are on long term sickness absence or maternity leave. Care should be taken to ensure that those employees are treated fairly and in accordance with the rules of the bonus scheme (which must not be discriminatory).

Given the complexities involved in drafting bonus schemes, it is often a good idea to seek advice at an early stage, before claims are brought as a result of employees not receiving what they had expected under the rules of the scheme.