

Bonuses 3/36/24

In many companies summer is the time when staff performance is being appraised, potentially leading to promotions and bonus payments. Yet the employer has discretion in paying bonuses – it's not an obligation but a choice. There are several preconditions to consider when it comes to setting up and running a bonus system. The case law¹ says a bonus shows appreciation for an employee's good work, so it's up to the employer to determine the amount of a bonus. However, this decision-making power should not be interpreted as the employer's unilateral opportunity to pay bonuses inconsistently and with no legal justification.

The legal framework dictates the scope for action

Section 62 of the Employment Act states that a company's pay structure includes a system of bonuses. The emphasis on putting a system in place is important to avoid major risks frequently identified by providers of legal assistance. In other words, the bonus system must be described in the employer's documentation.

It's advisable to include these conditions in the company's internal rules, or better still, in a separate bonus policy. The employer will find it difficult to amend any bonus rules that are inserted in the employment contract, as section 97 of the Employment Act states that an employment contract may only be amended by the parties entering into a written agreement.

While the law does not dictate how a bonus system should be documented, it's not advisable to pay bonuses in individual cases, e.g. by order of the employer addressed to a particular employee. The bonus system should essentially have a fixed procedure for paying bonuses with justification in accounting records and give employees equal opportunities to receive bonuses, as well as using transparent and objective payment criteria. The employer's failure to provide those increases the risk of unequal pay, which is prohibited by section 60(1) of the Employment Act.

From the general framework to the objective core

A precondition for objectivity is having an objective procedure for appraising employees. An employee's performance appraisal should be primarily based on quantitative data, such as sales volumes for sales staff. An appraisal based on qualitative data will be more subjective and involve broader legal risks, yet this one, too, can be built objectively, e.g. the number of well-served customers – data that can be confirmed by customer feedback, the employee's self-assessment, the manager's assessment, etc.

Detailed rules on exceptions also lend objectivity to the employer's bonus rules. Often these rules do not specify any exceptions where a bonus is not due, yet it's important to identify eligible employees. Employee groups can be divided in various ways – major divisions could be:

- a. According to the nature of work, e.g. only the manufacturing staff are eligible for bonuses while the administration staff are not.²
- b. According to employment status, e.g. an employee leaving the company before a particular date (e.g. the annual appraisal) is not eligible for a bonus.

The case law also deals with cases where an employee is not eligible for a bonus. A court has ruled that an individual facing a disciplinary penalty may lose their pay entitlement in the future.³ A bonus entitlement

can also depend on whether a female employee is at work or on maternity leave.⁴ It should also be assessed whether the employer has made a separate expression of his will (e.g. an emailed promise to pay a bonus to a particular employee regardless of appraisal), thereby circumventing the documented procedure by way of exception, which may pose additional risk.

Since these are only a few theoretical examples out of hundreds found in practice, exceptions should be explained as far as possible in the company's internal documentation, without always relying on the law or a lawyer's interpretation to justify non-payment of a bonus.

Negligence can be costly

Employees that are not covered by a clear payment procedure can have claims against the employer. Even if those claims are not justified, it still creates an extra administrative burden and consumption of resources, which could be prevented by adopting a clear bonus policy.

If bonuses are not fair, this will come to light sooner or later when the Equal Pay Directive 2023/970 takes effect, which imposes the obligation to evaluate payment systems, including the variable part of pay (bonuses and additional payments). An untidy bonus structure can lead to legal risks (administrative penalties and litigation) and financial risks (having to pay damages and dispute/litigation costs) so the bonus system's conditions should be detailed in the company's documentation.

In summary, we can treat the bonus system as successfully implemented and the legal risks as substantially limited if the employer is able to give the following affirmative answers about the bonus system:

- a. It's documented in the company's policy.
- b. It covers all employees (or comparable employee groups).
- c. It's supported by objective and transparent employee appraisal procedures.
- d. It includes detailed conditions for exceptional cases where a bonus is not due.

¹ The Supreme Court's Civil Division Ruling SKC-91 of 7 April 2010

² While such division could be prescribed, the employer should assess whether bonuses are payable to all employee categories even if that would mean an extra administrative burden and a different appraisal procedure for each category.

³ The Supreme Court's Civil Division Ruling SKC-281/2011 of 9 March 2011

⁴ CJEU Ruling C-333/97, Susanne Lewen v Lothar Denda, paragraph 26, European Court Reports, 1999, page I-07243, see also 'CJEU Case Law on Employment', 2011. Author: Dr. iur. Kristine Dupate. Latvian Confederation of Free Trade Unions, page 42