

Your Company's Bonuses Are Discretionary, You Say?

Labor & Employment Law Update

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When it comes to employee bonuses, employers often prefer “discretionary” bonus policies—as opposed to more rigid and definite policies and procedures that answer the questions of “who” is eligible to receive bonuses, “when” bonuses will be paid, and “how much” the bonuses will be.

A problem can arise, however, when the underlying method the employer uses to award bonuses remains consistent from year to year. Under Illinois law, for example, past practice—even in a non-union setting—can give rise to a legally-enforceable expectation that a given employee is entitled to a bonus under the same method that has been used, uninterrupted, in prior years.

So what is an employer to do to protect itself?

The actual facts behind the company's method for awarding bonuses will dictate whether a bonus is truly discretionary or not. But the bottom line is that if your company intends to make changes to a long-used and fairly clearly-defined method of calculating bonuses, such changes should be made and announced to affected employees prior to the start of the bonus year. Employers should also bear in mind that changes to a bonus procedure made in bad faith (for instance, where it appears clear that bonus procedures were changed specifically to deny a particular employee a bonus) may not withstand a court's scrutiny.

For companies that truly do use a discretionary bonus system, include language in employee handbooks and other policy documents clearly stating (1) that bonuses are a discretionary, voluntary contribution by the company, based on company profitability and employee performance; (2) that bonuses are not earned until they are actually awarded and, as such, may be withheld, increased, decreased, or discontinued, at any time up to the bonus award date; and (3) that management reserves the unilateral right to change bonus policies at any time and for any reason. Whether the company's bonus procedure is truly discretionary or not, factors that disqualify employees from bonus eligibility should also be clearly stated in all relevant handbooks and policies documents.

If you have concerns that your company's discretionary bonus policies may not stand up to court scrutiny, we recommend contacting experienced employment counsel for a comprehensive bonus policy review. In doing so, employers should bear in mind that state law often controls the question of whether a bonus is

discretionary or not, and the law may differ significantly from state to state, so employers must be sure they seek legal advice covering all states in which the employer operates.

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