

Legal News

September 2018

Legal certainty with bonus models

Marc Philipp Gugger, Attorney-at-Law, Senior Manager, Legal Services, marc.gugger@ch.ey.com

1. Introduction

Bonus payments, variable salary components, gratuities and employee share schemes. Regardless of their specific designation, payments like these, which are often agreed in regulations or employee share schemes in addition to the fixed contractual salary, have one thing in common. They are all intended, amongst other things, to enhance the attractiveness for new talent and to motivate and bind existing employees over as long a term as possible. This human resource policy interest of every employer often collides with the interest in comprehensive legal certainty. Especially in cases in which companies must let go their "low performers" and "bad leavers", it is decisive from a legal perspective how these incentives are contractually structured at the beginning of the employment relationship and how they may have been adjusted in the meantime. Because of this conflict of interest, the rules in practice are frequently not crystal clear, which is also apparent not least in the many court decisions in this regard. Today the majority of employment law decisions by cantonal courts concern salary disputes, which are often litigated up to the Federal Supreme Court. The most recent jurisprudence of the highest court now at least has started to shed some light on the so far often inconsistent judicial practice, specifically also in relation to (top) management.

2. Delineation criteria

The parameters that must be considered when making the specific legal assessment as to whether a bonus is to be classified as a

(variable) salary component pursuant to Article 322 CO or as a voluntary gratification (special remuneration) pursuant to Article 322d CO have in principle remained unchanged. It is still the case that the specific discretion exercised by the employer regarding the bonus payment (see 2.1 below) is assessed and an examination is made as to whether or not it in fact corresponded to the actual circumstances (2.2). However, the most recent jurisprudence significantly diluted the so-called principle of "accessoriness" originally developed by the Federal Supreme Court (2.3).

2.1 Reservation of discretion

The final decision over whether actually to grant a bonus is often contractually agreed as being at the discretion of the board of directors or the executive management. In addition, a certain practice of referring repeatedly, every time a bonus is paid out, to the fact that it constitutes a voluntary discretionary payment has - justifiably - developed. This is one of the many options available for stipulating the desired discretion in writing. However, the key aspect for assessing such discretion, alongside the actual wording, is whether the payment can be determined or calculated according to objective criteria (in particular numerical figures) or whether it is actually governed by subjective criteria (in particular individual characteristics or performance of the employee dependant upon the personal assessment of the supervisor). Objectively determinable elements indicate more of a salary payment, whereas subjective elements indicate more of a gratification.

In practice both criteria are sometimes combined, which often leads to difficulty although not always undesired delimitation issues.

2.2 Regularity

Not just the wording is decisive, but also the actual implementation in practice. For example, a retrospective assessment is made to what extent a poor financial year or the failure to meet individual targets actually resulted in a reduction or elimination of a contractually agreed bonus, often with reference to comparable cases. According to the Federal Supreme Court, the uninterrupted and unreserved payment over a number of years, without the exercise of discretion, may establish a legal entitlement in individual cases, even if accompanied by a respective disclaimer.

2.3 Accessoriness

It is in some cases possible to construe a gratification as a salary component based solely on the ratio of salary to bonus, regardless of the clear intention of the parties and even if payment has not been regular. This may occur in particular if the bonus makes up a considerable or even the overwhelming portion of the total remuneration, on the grounds that, based on experience, the employee bases his/her standard of living on this total remuneration and should be protected against excessively large fluctuations. This principle of accessoriness must continue to be taken into account for lower incomes, but only to a limited extent for middle to high incomes, and not at all for very high incomes.

According to the Federal Supreme Court, an income is a low income if the amount is equal to or lower than the simple median salary for the private sector. Medium to higher incomes are considered to be amounts that are higher than the simple median salary, but less than five times the median salary for the private sector. Very high incomes are greater than five times the median salary, which given a current median salary of around CHF 6,500 per month corresponds to an annual salary of around CHF 390,000.

Thus, there is generally clarity with regard to very high incomes, as in this case construing a bonus as salary contrary to

the (clear) intention of the parties is no longer considered.

The current jurisprudence further suggests that in future, for medium to high incomes as well, the principle of accessoriness will only apply in cases where the bonus consistently exceeds the fixed salary. For lower incomes, e contrario, this means that a reclassification can also occur if the bonus is lower than the fixed salary. Based on the current development of the jurisprudence, it may however be presumed that the principle of accessoriness will be applied less often in these situations as well and that, in order for it to apply, the bonus would need to amount to between at least one third and to one half of the fixed salary. However, to this day the Federal Supreme Court has not held in general terms that there must be a specific ratio between fixed salary and bonus or a maximum permitted range.

3. Conclusion

The decisive issue for bonuses is thus wording that is as clear as possible and its consistent implementation in the company's internal practice. Ideally, in accordance with the organisational structure, different incentive models are introduced and operated for each function and salary category. In addition, it is often advisable to work in parallel with multiple bonus systems and various performance indicators within the models in order to, on the one hand, establish sufficient legal certainty at least in certain sub-areas, and on the other hand, to continue to guarantee the desired attractiveness on the employment market. However, the specific structure of the particular bonus models remains a challenge and must always be tailored to individual requirements.

At least the Federal Supreme Court is now making a significant contribution to legal certainty regarding the principle of accessoriness, which was previously difficult to pin down, and which today, in practice, is being afforded considerably less significance. For instance, according to experience, bonuses of more than 100% of the fixed salary are quite rare, even in middle and senior management. Similarly, employees with low incomes only rarely, if at all, receive regular bonuses of considerably more than CHF 20,000.

About the global EY organization

The global EY organization is a leader in assurance, tax, transaction and advisory services. We leverage our experience, knowledge and services to help build trust and confidence in the capital markets and in economies all over the world. We are ideally equipped for this task - with well trained employees, strong teams, excellent services and outstanding client relations. Our global purpose is to drive progress and make a difference by building a better working world - for our people, for our clients and for our communities.

The global EY organization refers to all member firms of Ernst & Young Global Limited (EYG). Each EYG member firm is a separate legal entity and has no liability for another such entity's acts or omissions. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information, please visit www.ey.com.

EY's organization is represented in Switzerland by Ernst & Young Ltd, Basel, with 10 offices across Switzerland, and in Liechtenstein by Ernst & Young AG, Vaduz. In this publication, "EY" and "we" refer to Ernst & Young Ltd, Basel, a member firm of Ernst & Young Global Limited.

Legal News: Publication in German, French and English

Registration/address changes
www.ey.com/ch/newsletter

www.ey.com/ch/legal

© 2018
Ernst & Young Ltd
All Rights Reserved.
ED None

This publication contains information in summary form and is therefore intended for general guidance only. Although prepared with utmost care this publication is not intended to be a substitute for detailed research or professional advice. Therefore, by reading this publication, you agree that no liability for correctness, completeness and/or currentness will be assumed. It is solely the responsibility of the readers to decide whether and in what form the information made available is relevant for their purposes. Neither Ernst & Young Ltd nor any other member of the global EY organization accepts any responsibility. On any specific matter, reference should be made to the appropriate advisor.

www.ey.com/ch

Contacts Legal

Basel: Maja Krapf
maja.krapf@ch.ey.com

Bern: Jürg Strebelt
juerg.strebelt@ch.ey.com

Geneva: Aurélien Muller
aurelien.muller@ch.ey.com

Zurich: Oliver Blum
Oliver.Blum@ch.ey.com