

Member's Quarterly

Summer 2023 Edition

Feature

Discretionary Bonuses

Employers must always exercise fair and reasonable discretion

Introduction

In late 2022, the Ontario Court of Appeal reminded employers that the terms and conditions in an employment contract must be carried out in a fair and reasonable manner, even when the employer is explicitly granted discretionary powers. In *Bowen v JC Clark Ltd*, 2022 ONSC 614, the Court found that discretionary bonuses must be granted fairly and reasonably, despite the wording in the employment agreement.

Background

In *Bowen*, two hedge fund portfolio managers were terminated on a without-cause basis. At termination, the employer provided two weeks' salary in lieu of notice, in addition to a \$577 "2-week pro rata bonus." The portfolio managers sued the employer for \$1.3 million, claiming: (1) they were implicitly entitled to performance fees under their employment contract; and (2) they were entitled to a significant bonus for the portion of the 2014 year in which they were employed.

The discretionary bonus provision provided the following:

At the total discretion of the Company, you may be eligible for a bonus at the end of each fiscal year depending on factors that include your personal performance and the profitability of the Company.

At the trial level, the Ontario Superior Court of Justice declined to consider the discretionary bonus issue, finding that the claim was insufficiently pleaded. In addition, the trial judge found that they were not entitled to performance fees.

The Decision

On appeal, the Ontario Court of Appeal agreed that the employees were not entitled to performance fees. However, the Court overturned the trial judge's finding that the bonus issue was incorrectly pleaded, and fully considered the issue itself.

In the context of a discretionary bonus clause, the Court held that there is an implicit contractual term to exercise that discretion in a fair and reasonable manner. Despite the wording of the contract, the employer is not "entirely unconstrained."

The employer testified that the bonuses were always awarded entirely subjectively. The employer considers many factors, including corporate performance, individual performance, attitude, teamwork, fund performance, asset-raising and marketing. While the Court acknowledged this subjectivity, it held that any evidence demonstrating "unconstrained discretion" was inconsistent with the employer's duty to grant the bonuses fairly.

The Court looked to similarly situated employees in order to determine whether the bonus was fair. It looked at similar employees whose funds did not perform as well as those managed by the terminated



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employees. The employer gave these similarly-situated employees about \$200,000 in discretionary bonuses in 2014. Given these numbers, the Court found that there was a "significant bonus pool" in 2014.

The employer stated that there were significant concerns about the terminated employees' attitude and teamwork, and it believed that the employees were planning on leaving the company to start a competing business. However, the Court rejected this justification, pointing out that the employees were terminated on a without-cause basis. Rather than focusing on subjective criteria, the Court emphasized that the return on the funds was one of the best pieces of objective evidence regarding what constitutes a fair and reasonable bonus.

The Outcome

In the end, the Ontario Court of Appeal found that the \$577 "2-week pro-rata bonus" was not a fair exercise of the employer's discretion. The employees were entitled to a bonus in the amount of \$115,000 each, which reflected the bonus received by similarly situated employees in 2014, pro-rated until the date of termination.

Takeaways for Employers

The decision in *Bowen* is consistent with recent Supreme Court of Canada jurisprudence recognizing the duty of good faith as a fundamental principle of contractual interpretation (see e.g., *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7). While the duty of good faith does not remove discretion entirely, it places limits on *how* a party can exercise that discretion. For example, it cannot exercise discretion in a way that is ulterior or extraneous to the purpose for which it was given. In *Bowen*, while the Court never explicitly referred to the duty of good faith, the result was the same. Employers should exercise discretion carefully in all cases, not just discretionary bonuses.

Employers should also take note of the distinction the Court made between subjective and objective justifications for a bonus. It may be common practice for employers to consider subjective factors such as teamwork and attitude when awarding a bonus, especially in the case of a tension-fraught termination. However, the Court will not necessarily accept these factors when an employee is dismissed without cause, and employers must act fairly at all times.

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