What does “in the employer’s discretion” really mean?

This in depth article contrasts two recent cases which, at first sight, appear to take dramatically different positions on the extent to which the courts will review an employer’s exercise of its contractual discretion. The Supreme Court have recently made it easier for judges to second guess employers but it remains to be seen how willing judges will be to use this power. This is important in a wide range of situations including setting discretionary bonuses and exercising “good leaver” provisions.

All kinds of discretion

Employment documentation often gives an employer a discretion to make certain decisions. The classic example is the employer’s right to determine the size of an employee’s bonus. But contracts also give employers a discretion in a broad range of other situations. Depending on the terms of the contract examples might include the right to:

- determine that an employee is a “good leaver” under share plan;
- claw back or reduce a bonus;
- determine if an employee is unfit for work;
- exercise a mobility clause; or
- relax a contractual restriction (such as a restriction on outside interests).

When drafting these provisions and exercising a contractual discretion that they give the key question for an employer is the extent to which the courts will police the exercise of that discretion.

This question has received significant judicial attention over the years. But since the decision of Keen v Commerzbank AG [2007] (in which GQ’s Paul Quain and Jon Gilligan acted) the position has been clear. Traditionally, the courts will only intervene if the employer’s discretion was not exercised in good faith or was arbitrary, capricious or irrational. As the court said, “it would require an overwhelming case to persuade the court to find that the level of a discretionary bonus payment was irrational or perverse in an area where so much must depend on the discretionary judgment of the Bank in fluctuating market and labour conditions”.

The decision in Keen and the economic conditions prevailing in 2007/8 effectively put an end to most City bonus litigation.
It’s all about process

As reported by us last year, in Braganza v BP Shipping Limited [2015], the Supreme Court have extended the orthodox position represented by cases like Keen.

Now it appears that when exercising discretion:

(1) not only must the substantive decision be rational (i.e. made in good faith and not arbitrary, capricious or irrational as per Keen); but

(2) the decision making process must be rational (i.e. in the sense that the decision maker must only take relevant considerations into account and must disregard irrelevant considerations).

This is significant because is allows the court greater flexibility to unpick the employer’s decision.

Whilst Braganza is decision of the Supreme Court the facts are very unusual. It concerned an employment contract that provided for the payment of death benefits subject to an exclusion if “in the opinion of the employer or its insurers” the employee committed suicide. The employee concerned was an officer aboard an oil tanker who was tragically lost overboard in unexplained circumstances. The employer concluded that suicide was the most likely explanation and the employee’s widow challenged that decision.

Lady Hale, giving the leading judgment, held that whilst the substantive decision could not be said to be irrational (applying Keen) the decision making process was not rational because the employer had failed to take relevant considerations into account. In this case, she held that the decision maker failed to take into account the inherent improbably of suicide, had failed to have regard to evidence that pointed against suicide and had failed to properly apply his mind to the question.

These are principles familiar to those challenging Government in judicial review proceedings but until now are alien to employment lawyers.

What about bonuses?

The first case to seek to extend Braganza was Patural v DB Services (UK) Ltd [2015] which we reported late last year before the full judgment had been issued.

Mr. Patural was a banker, whose contract contained a typical discretionary bonus clause and which allowed the bank to determine the amount of his bonus at its discretion. When he joined the bank he was told that he might expect to receive a bonus equivalent to 10% of his trading profits in good years and a 5% of his trading profits in bad years. He received a bonus equivalent to 1% of trading profits. This was substantially lower than two colleagues whose contracts contained contractual/formula based bonuses and who received 8% and 11% of their trading profits respectively.

The judgment has now been issued giving the judge’s decision.

Mr. Patural argued that he had a reasonable expectation that his bonus would be at the level indicated, that the employer had breached a duty to treat him consistently with other employees and was irrational. The High Court dismissed his claim at summary judgment stage on all counts.

The High Court applied the decision of the Supreme Court in Braganza - accepting that it had the power to intervene had the bank taken irrelevant considerations into account. However the judge held that the decision of the bank to pay guaranteed bonuses to other employees on a formula basis and distinguishing their cases from that of Mr. Patural was “obviously” a rational one. In other words - the existence of the contractual guarantees was a relevant consideration when the employer decided the amount of Mr. Patural’s bonus.

The High Court also expressed caution about the importation of public law concepts into employment law. In that respect, it would appear to set it against the Supreme Court.

Bankers vs widows

As Patural demonstrates - the power to decide whether factors are relevant (or not) gives the court another basis on which to
intervene (or not) - depending on its views of the merits. A more interventionist judge might, in another bonus case, decide that an employer had failed to take into account considerations that that judge considers to be relevant.

This direction of travel makes it far more difficult to “second guess” how a case might be considered by a judge on the day. It remains to be seen how willing the judiciary will be to intervene – in the case of Mr. Justice Singh (who heard Patual) the answer is clearly a resounding “not at all”.

It has to be remembered facts of these cases could not be more different. Mr. Patural was seeking to challenge a discretionary bonus and one can understand the reluctance of judges to review those commercial decisions. Mrs Braganza on the other hand was challenging the operation of an exclusion clause in a traumatic situation which disentitled her to a valuable benefit.

Judges are human as well – shock horror! It is too easy for lawyers to forget the importance of having a compelling case. On one hand we had a $100 billion company (or more likely its insurer) trying to avoid paying death benefits to sailor’s widow. On the other we had a banker complaining about a €1.2million bonus. GQ’s Natasha Adom talks more about the importance in litigation of “likeability” in her recent article in Personnel Today.

We understand that Mr. Patural is to appeal against the decision and whatever the outcome of his case the decision of the Supreme Court in Braganza is likely to spawn significant litigation in this area in coming years.

These decisions also cause us to wonder the extent to which other principles of public law – such as the right to fair hearing, the doctrine of legitimate expectations and the duty to give reasons – will creep into the world of employment.

**What this means for employers**

The public sector are used to making decisions in a way that reduces the risk of judicial challenge and ministers are trained to ensure that their decisions are “judicial review proof”.

When exercising contractual discretions, particularly where they disentitle employees to valuable benefits, employers should ensure that they adopt an appropriately robust process. We have some practical tips available (without charge) upon request.