Follow 'Falkowski' and 'Lucian' to Control Annual-Bonus Programs

By Antonio R. Sarabia II

The navigation of employee bonus waters is difficult. Often, employers announce a program but do not want or intend to pay bonuses to employees who leave or who are terminated for cause. While bonuses are awarded for a wide array of achievements and over different periods, most common is the annual bonus.

The annual bonus may be tied to the performance of the employee, the performance of the employer or both. Because California is an at-will employment state, employers may believe that their right to terminate an employee means that they do not have to pay the terminated employee his or her bonus. But this is not necessarily so.

Employers with oral bonus plans have the least ability to control whether employees who resign or are terminated are entitled to their bonuses. But even the employers with a written bonus plan find it difficult to restrict payment to employees who resign or are terminated. Part of the problem is cases and statutes that are difficult to reconcile.

Lucian v. All States Trucking Company, 116 Cal.App.3d 972 (1981), upheld the right of a company to deny an incentive bonus after the resignation of employees. The written bonus plans provided that, if an employee resigned, he or she was not entitled to a bonus. The bonus was to be calculated at the end of the year. The employees' suits for payment of bonuses after they resigned were rejected on motions for summary judgment, which were affirmed. The important facts were that the plan was written, it provided that the bonus was calculated at the end of the year, became payable at a certain date and that an employee who resigned before that date was not eligible.

In another resignation case, the opposite result was reached. In *Sabatini v. Hensley*, 161 Cal.App.2d 172 (1958), an employee who resigned a little over a year after being promised a yearly bonus sued for the bonus. The court held that the purpose of the bonus was to encourage the employee to remain and that, since he did remain for another year, he was entitled to the bonus for that year. The *Sabatini* court found consideration was given by the employee for the bonus. Since the employee was an at-will employee and elected to stay, that was the consideration: "Continuing an employment to which one is not bound by contract is as clearly consideration as is entering the employment in the first place."

Sabatini is not an isolated case. See, *Newberger v. Rifkind*, 28 Cal.App.3d 1070 (1972), (continuing in employment was consideration for stock options).

Also consistent with *Sabatini* is *Division of Labor Law Enforcement v. Transpacific Transportation Co.*, 88 Cal.App.3d 823 (1979), which held that employees terminated just before the end of the fiscal year were entitled to their annual bonuses. An important factor was that the employees were not fired for cause. The court stated, "[T]he law does not support a forfeiture in these circumstances where the employees were terminated through no fault of their own after having substantially performed the services entitling them to a bonus." Like *Sabatini*, this court determined that the bonus was already earned and must be paid.

Coats v. General Motors Corp., 11 Cal.2d 601 (1938), was another termination-without-cause bonus case. The California Supreme Court upheld an award of a stock bonus to a terminated employee.

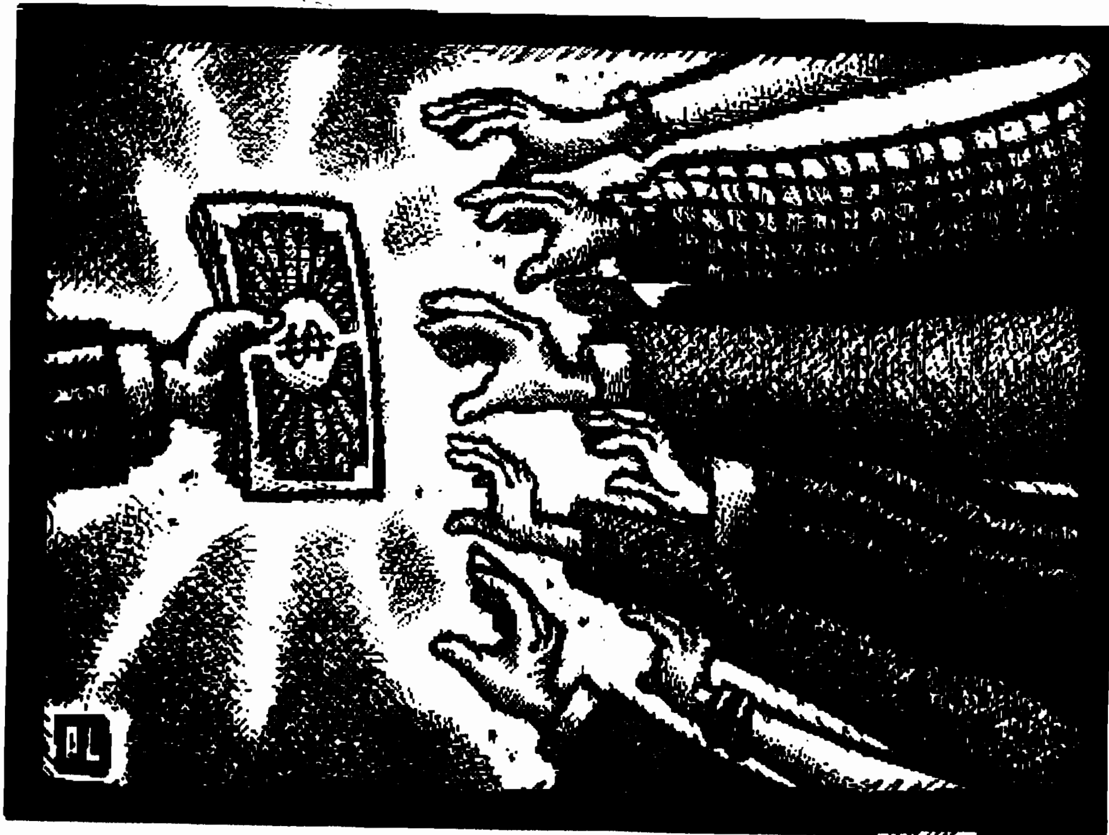
The difficulty is in reconciling *Lucian* with *Sabatini* and similar cases. *Lucian* said that *Sabatini* did not apply because the bonus in *Sabatini* was an inducement for initial or continuing employment. But *Lucian* does not address the issue of whether the employees in *Lucian* were induced to stay longer than they would have by the bonuses. It just says that they left voluntarily and violated the terms of the plan. The distinction *Lucian* made from *Sabatini* is a distinction without a difference.

The only time a bonus is clearly not an inducement to take a job or stay at one is when there is a fixed employment contract which already has been signed independently of the bonus — a rarity.

Labor Code Section 200 is consistent with the *Sabatini* line of cases. Under Section 200, a bonus is wages. Wages are earned by the services performed. Therefore, since a bonus is earned when the services are performed, it is difficult to argue that, if an employee is terminated, he or she does not have a right to that part of his or her wages which are the "bonus."

Also supporting the *Sabatini* analysis is another line of cases that holds that pensions and other benefits vest immediately. For example, *Suastez v. Plastic Dress-Up Co.* (1982), 31 Cal.3d. 774 (although it also involved a specific statute, the cases it cites for the same principle do not). This line of cases provides strong ammunition for the argument that rights to a bonus accrue.

The counterpoint is that a bonus plan is a contract with enforceable terms. The Department of Labor Services recognizes that bonus agreements are contracts and that it does not have authority to set standards for bonus agreements. D.L.S.E. Opinion Letter (Jan. 9, 1993). *Falkowski v. Imation Corp.*, 132 Cal.App.4th 499 (2005), applied a contract-construction approach in a dispute over stock options. The employees in *Falkowski* were employed by a subsidiary and were granted stock options in the parent company's stock. When the parent company sold the employer/subisidiary, the unvested options were cancelled. The employees were allowed to exercise those options that had vested. The employees sued, arguing that they continued to be employed by the same subsidiary, even though ownership of the subsidiary was transferred. Since their employment was continuous, the employees contended they should not have lost the benefit of their unvested stock options. However, the stock



option plan specifically provided that, if the employees were no longer employed by a subsidiary of the parent company, the employees would lose their rights to unvested options. Based on this provision, summary judgment was granted for the former parent company.

Employers seeking the most control over their bonus programs should heed the lessons of *Falkowski* and *Lucian* by taking specific steps. The first step is to have a written bonus plan. Second, the plan should avoid language that suggests the bonus is an incentive to stay. For example, do not call the bonus plan an "employee incentive plan." Instead, a recital should be added that the parties agree that the right to a bonus does not vest until completion of the year's service on which the bonus is based. This provision uses Evidence Code Section 622 (that recitals are conclusively presumed to be true) to buttress the employer's position. Third, state that the bonus is earned only on a specific date and only payable on a specific date. Fourth, specify that employees who resign or are terminated with cause before either the end of the applicable year of calculation or the time of payment are not eligible for a bonus.

To further protect the plan, it should provide that, if an employee is terminated without cause, the employee will receive a pro rata bonus (or some specified fraction of the bonus). Considering *Sabatini*, it is not reasonable to try to avoid paying a bonus entirely for termination without cause. But because the bonus plan is a contract, a reasonable adjustment to the bonus for less then a full year's work should be enforceable. This type of provision should allow an employer to avoid being liable for an entire year's bonus.

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