

Target-based variable remuneration: a reversal of case law favorable to companies

Because of the evolving case law regarding remuneration of employees, and more precisely the possibility to change employees' remuneration, companies have been facing difficulties and/or legal uncertainty.

In a decision dated March 2, 2011 (Cass.soc., n° 08-44.977), the *Cour de Cassation* (French Supreme Court) reconsidered its position and clarified the rules for amending targets used to determine the level of variable remuneration to be paid to employees.

Reminder of the rules governing amendments to the remuneration of employees:

The **amount** and **structure** of the remuneration paid to an employee may not be amended without the relevant employee's express consent (Cass.soc., April 18, 2000, n° 97-43.706).

As such, it is impossible to change a commission rate, to reduce a fixed salary while increasing the variable remuneration component or to include a bonus in the base salary without the relevant employee's consent, even if any such change would result in a higher total remuneration for the employee.

The employee's absence of reaction to a change in his/her remuneration must not be considered as a tacit consent: the *Cour de Cassation* held that the fact that an employee remained silent for 16 years following a modification of his remuneration was not to be considered as an acceptance of such change! (Cass.soc., July 2, 2008, n° 07-40.702).

This principle also applies in case of an "indirect modification", such as a change of workplace – since such change may have an impact on the sales figure and, therefore, on commissions – or the withdrawal of certain products from a salesman's product portfolio (Cass.soc., July 2, 2008, n° 07-40.702).

If the remuneration change is due to economic reasons, the specific procedure set forth in Article L.1222-6 of the French Labor Code must be applied: the employer must make a detailed amendment proposal by registered letter, return receipt requested, and the employee has one month to refuse such proposal, it being

specified that in this case the employee's absence of response will be considered as a consent to the proposal.

This tacit consent is only valid for remuneration changes due to economic reasons.

Lastly, concerning contractual clauses providing for a variable remuneration, the *Cour de Cassation* specified in October 2007 that any such clause must exclusively be based on objective elements beyond the employer's control (Cass.soc., October 17, 2007, n° 05-44.621).

Due to the legal uncertainty generated by this line of decisions, an increasing number of employees benefiting from a variable remuneration have refused to sign annual amendments setting updated performance targets, thereby reserving the possibility to subsequently claim enforcement of the last agreement actually signed by the parties in relation to targets.

The evolution of case law in respect of target setting:

In a decision dated July 12, 2000, the *Cour de Cassation* laid down the principle according to which "*targets must be determined by common agreement between the parties*" (Cass.soc, n° 98-43.604).

Even though the *Cour de Cassation* specified as early as in 2001 that "*targets may be set unilaterally by the employer in the exercise of his management powers*" (Cass.soc. May 22, 2001, n° 99-41.838 and 99-41.970), the circumstances of this case concerned a dismissal for poor performance, not a dispute over the payment of a target-based remuneration.

Consequently, companies soon recovered the possibility to unilaterally set targets pursuant to a qualitative and/or quantitative approach to the functions exercised by the relevant employees but there were no reasons to claim that the unilateral setting of targets used to determine a variable remuneration did not constitute an "indirect modification" of the employment contract requiring the relevant employee's express consent, as explained above.

The decision of March 2, 2011:

The decision of March 2, 2011 provides a clear answer for both companies and employees.

- If the employment contract stipulates that targets are set by common agreement, the old principle will continue to apply and such targets may only be amended with the employee's express consent;
- If the employment contract stipulates that targets are unilaterally fixed by the employer, the latter will be able to do so quite legitimately insofar as the targets are reasonable and communicated to the relevant employee at the start of the relevant reference period.

Practical consequences:

For existing contracts: this case law evolution requires companies to check the specific terms of the employment contracts, addenda and variable remuneration schemes to make sure the drafting is in line with the above mentions.

In some cases, it will be necessary to propose to the concerned employees to sign an addendum in order to include in the employment contract a clause stipulating that targets shall be unilaterally set by the employer.

For new employees: companies must amend the terms of their standard employment contracts and remuneration addenda accordingly.

Companies must however carefully comply with the requirements laid down by the *Cour de Cassation*. The expression “*at the start of the reference period*” is quite vague and will no doubt be a source of disputes. Companies must, therefore, take the measures necessary to make sure that the variable remuneration targets will be made available to the relevant employees as early as possible after the start of the relevant reference period.

Lastly, it should be recalled that since 2008 the *Cour de Cassation* requires companies to be fully transparent in respect of variable remuneration and, for this purpose, imposed that employees must be able to check that they have been duly paid all sums owed to them in this respect.

Companies must therefore make available to each employee all bases of calculation used for determining his/her level of variable remuneration. If this obligation is not fulfilled, the employee will be entitled to notify the company that he/she has no other choice but to acknowledge the termination of his/her employment contract due to a contractual breach of the company (failing to provide such bases of calculation being indeed deemed as a breach of contract). In such case, the company would suffer the financial consequences associated with a dismissal without real and serious cause.

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