Redundancy under German Labour Law

An Overview

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Contents

Introduction

This memorandum provides a general overview of the overall labour law situation and potential pitfalls with respect to a substantial redundancy of personnel. It is no substitution for a thorough legal evaluation of an intended restructuring in the particular case. Special requirements which may result from applicable collective bargaining agreements or existing works council agreements cannot be considered.

Regarding the preconditions and legal consequences relating to the employer's decision to downsize personnel, one needs to distinguish between collective employment law (relationship employer-works council – cf. no 1) and individual employment law (relationship employer-employee – cf. no 2).

1. Collective Labour Law

1.1 Co-determination of the works council

In companies with more than 20 employees, certain reorganizations (operational changes - *Betriebsänderungen*) require the notification of the works council, an amicable reconciliation of interests (*Interessenausgleich*) and an agreement on a social plan (*Sozialplan*).

Notification of the works council has to be effected in advance of any substantial operational changes which may negatively affect the entire staff or substantial parts thereof, sec. 111 Works Constitution Act (*Betriebsverfassungsgesetz – BetrVG*). Such events notably include the cut-back or closure of an operation or a significant part thereof, for instance the closure of a department within the operation. Furthermore, the mere retrenchment of personnel (by either dismissal or amicable termination) may constitute an operational change if a significant part of the entire workforce is affected. Both the closure of a part of an operation and the mere retrenchment of personnel, are, however, only deemed as an operational change if a significant number of employees is affected by the relevant measure. In order to determine whether or not a significant number of employees is affected, the following thresholds apply. Accordingly, an operational change within the meaning of sec. 111 *BetrVG* is present if

- in an operation with generally at least 20 but fewer than 60 employees, more than five employees regularly employed in the operation are affected,
- in an operation with generally at least 60 but fewer than 500 employees, either 10% of the employees regularly employed in the operation or more than 25 employees are affected,
- in an operation with generally at least 500 employees, 30 employees regularly employed in the operation are affected.

Employees who are prompted by the employer either to resign or to leave by way of a cancellation agreement are counted for these purposes, too.

The following remarks are based on the assumption (i) that the planned downsizing of personnel has to be qualified as a substantial change of operation in the meaning of sec. 111 BetrVG and (ii) that a works council has been established in the operation concerned.

1.2. Reconciliation of interests

(a) Content and steps in the negotiation

The competent works council has to be informed comprehensively about the envisaged measures. Employer and works council have to consult with each other in order to try and find amicable solutions to the social and personal matters related to the downsizing. In this negotiation, **issues like timing, extent and alternatives** to all or parts of the planned reorganization have to be discussed. As a reconciliation of interests may have a considerable impact on the reorganization itself and as it remains (at the end of the day) the exclusive decision of the employer how to run the business and which reorganization to carry out, a reconciliation of interests cannot be enforced by the works council. Rather, the works council can only demand to be properly informed and consulted with.

However, as a consequence of this co-determination right, the works council has considerable means to delay the negotiations, e.g. by means of information requests or involving external experts. The effort for the employer in connection with such information requests etc. can be enormous.

The employer **must not start any actions** which must be considered the implementation

of the planned changes (e.g. termination of employment contracts), unless either a reconciliation of interests with the works council has been concluded or instead at least all statutorily required negotiation steps with the works council have been carried out in order to reach such a reconciliation of interests.

These steps of negotiation are the following:

To begin with

- works council and management must seriously discuss timing, extent and alternatives to all or to parts of the planned operational change.

If no agreement can be reached

- works council or management can ask the president of the Federal Labour Office (*Bundesagentur für Arbeit*) to act as a mediator in the discussion (this step is optional and will usually not be taken).

If no agreement can be reached

- works council or management can request that a conciliation board (*Einigungsstelle*) be established.

If no agreement on the line-up and the chairman of the conciliation board can be reached

- each party can file an application to the labour court requesting the appointment of a chairman and the determination of the size of the conciliation board by the labour court.

The conciliation board consists of an equal number of members nominated by the employer and the works council, respectively, and an external chairman who is usually a labour court judge. After appointing the chairman and establishing the conciliation board, this board will have one (or most likely several) meetings in which the parties must argue their standpoint before the board.

The negotiations before the board have only failed as soon as the chairman of the conciliation board confirms the final failure of negotiations. This confirmation is recognized as the completion of the mandatory negotiation steps.

As a consequence and due to the fact that there is n**o statutory maximum period** of such negotiations, this process may take **several months** (maybe up to six months or - in extreme cases - even more), of course only if no agreement with the works council can be reached. Where there is a good relationship with the works council or where the employer is willing to provide for a generous social plan (see 1.3 below), this can be a **much quicker** process though.

(b) Consequences of a breach of the negotiation obligation

If the employer considers implementing the intended reduction in force without reaching agreement on the reconciliation of interests (and social plan), the employer has to bear in mind the potential legal consequences regarding a "premature" implementation of the downsizing. There are three consequences to be considered:

- **Preliminary injunction**

  It is disputed in German judicature whether or not a works council is entitled to stop the redundancy process when a reconciliation of interests has not been negotiated yet. Some German labour courts grant preliminary injunctions to works councils; some dismiss such applications for preliminary injunctions. It therefore depends very much on the respective labour court competent to deal with the injunction whether or not the application of the works council will be allowed. This must be verified in each particular case. If the labour court grants the preliminary injunction, the employer will be hindered from implementing the reduction in force for a considerable period of time. This period might take

one to three months if the injunction contains a "blocking period". In order to proceed with the implementation process, the confirmation of the chairman of the conciliation board about the failure of the negotiations has to be obtained (see 1.2 (a) above).

- **Compensation for suffered hardship**

  In case of a premature implementation of the downsizing plans, every affected employee is entitled to a compensation of hardship suffered due to the implementation, i.e. his or her dismissal (*Nachteilsausgleich*). The amount of the individual entitlement is limited by law. Each employee may claim for a maximum of 12 monthly gross salaries. Older employees with long years of service may claim up to 18 monthly gross salaries.

  Nonetheless, should a social plan regarding the downsizing be concluded at the same time (or later), the severance payments deriving from the social plan will usually be set off against the compensation for suffered hardship.

- **Regulatory offence**

  The infringement of the works council's co-determination rights may constitute a regulatory offence for which a fine of up to EUR 10,000.00 may be imposed on the employer.

1.3 Social plan

In addition to the reconciliation of interests, the employer and the works council have to negotiate a social plan. Practically the social plan is linked to the reconciliation of interests very closely. The purpose of the social plan is to ease the hardship that the employees concerned suffer due to the employer's redundancy plans by providing for financial compensation. Although the employer and the works council are generally free to agree the specifics of such a social plan, it will certainly provide for severances for the employees to be dismissed.

(a) Enforceability

In contrast to the balance of interests, the parties are not only obliged to negotiate but **must agree on both the overall budget of the social plan and on the criteria for distributing this budget** among the dismissed employees.

In case the operational change only consists of a mere retrenchment of personnel which is not related to other measures such as the closure of a department, a social plan is only enforceable if a certain number of employees will be retrenched. The relevant thresholds are met if

- in an operation with generally fewer than 60 employees, 20% of the employees regularly employed in the operation but at least six employees are dismissed for operational requirements,
- in an operation with generally at least 60 but fewer than 250 employees, either 20% of the employees regularly employed in the operation or at least 37 employees are dismissed for operational requirements,
- in an operation with generally at least 250 employees, but fewer than 500 employees, either 15% of the employees regularly employed in the operation or at least 60 employees are dismissed for operational requirements,
- in an operation with generally at least 500 employees 10 % of the employees regularly employed in the operation but at least 60 employees are dismissed for operational requirements.

(b) Formulas and criteria for severance payments developed in practice

Statutory law does not provide for a formula on how to calculate the overall budget or for

criteria as to how to distribute the budget among the affected employees. However, practice has developed two standard formulas.

A usual formula taking into consideration age, seniority and monthly salary of the affected employees is as follows:

Age x years of service x monthly gross salary

[divisor]

The divisor usually ranges between 25 and 90, depending on the financial background of the employer, the severance payment level in former social plans (if any), the negotiating power of the parties, the employer's ambition with regard to timing etc.

Alternatively, many social plans provide for a basic severance payment in accordance with the following formula:

Length of service x gross monthly salary x [factor]

Depending on the industry sector, the region, the economic situation of the employer and the negotiating power of the parties, the factor may vary between 0.3 and 2.5.

Furthermore, it is common that additional premiums are paid for disabled employees and for employees with alimony obligations. Therefore, the exact costs of a social plan cannot be predicted beforehand.

(c) Decision by the conciliation board

If the works council and the employer cannot agree on a social plan, the **conciliation**

board will determine both the budget and the criteria for the distribution. If the board cannot reach a majority vote, the chairman will have a casting vote. Besides the customary calculation methods mentioned above (see above 1.3 b), statutory law sets certain guidelines for the conciliation board as to how the overall funding shall be determined. *Inter alia*, the conciliation board must consider the following aspects:

- It must balance the social needs of employees facing dismissal on the one hand and the economic justifiability for the company as a whole on the other hand.
- It shall consider the prospects on the labour market of employees facing dismissal and shall exclude employees from compensation payments who are offered continued employment under acceptable and reasonable conditions in another operation of the company or another company of the group and who reject such offer.
- When determining the overall funding, the conciliation board must not endanger the remaining jobs, e.g. by deciding on a social plan which puts the company at a realistic risk to go bankrupt.

(d) Transfer Company

It has recently become quite common to agree outplacement measures when a major retrenchment is intended. German social law allows for the implementation of business reorganizations by transferring the affected employees to a so-called "transfer company" (*Transfergesellschaft*). Either such transfer company can be established by the employer or, more commonly, the employer can make use of an existing transfer company.

The purposes of such a transfer company are the following:

- The transfer of the affected employees to a transfer company brings along financial and administrative advantages for the employer by avoiding lawsuits. This is due to the fact that employees wishing to

transfer to a transfer company have to conclude tripartite (voluntary) agreements, thereby accepting the termination of their employment with their former employer. As a consequence, the employees cannot challenge their dismissal in the labour court. Furthermore, the employer can usually transfer the employees to the transfer company without having to observe the employees' notice periods which leads to a quicker reduction of the headcount.

- During the term of the employment with the transfer company, the affected employees will be trained with regard to potential future jobs and will benefit from outplacement support.
- The affected employees will receive a monthly salary during the term of their employment relationship with the transfer company. In order to cover these costs (in particular the employees' salaries) the transfer company will be funded partially by the Labour Office (*Agentur für Arbeit*) and partially by the former employer. The Labour Office will pay an amount of between 60% and 67% of the last regular net monthly salary (up to a certain limit). Usually the employer pays an additional amount (e.g. the gap between the state benefits and 80% of the employee's last monthly salary). The state benefits granted by the Labour Office are limited to a maximum period of one year.

(e) Risk of Strikes

In Germany, a strike is only legally permissible if the subject matter can be part of a collective bargaining agreement (*Tarifvertrag*), i.e. an agreement between an employer/ employers' association and a trade union. **Works councils cannot call for a strike.**

Until recently, it was unanimously agreed that the restructuring of a company could not be regulated by a collective bargaining agreement as such restructuring merely falls within the competence of the works council(s) and not of the unions.

However, the unions have developed a strategy in recent years to react to such redundancy programs with strikes. In recent decisions of the Federal Labour Court this strategy was accepted as legally permissible. The competent union may therefore organize a strike in order to force the employer to conclude a collective bargaining agreement which contains provisions comparable to a social plan (*Tarifsozialplan*). Usually, such collective bargaining agreements lead to higher redundancy payments for the affected employees.

2. Individual Labour Law

It is important to keep in mind that the employee's individual rights are not necessarily affected by the negotiations with the works council. In other words, every dismissed employee may individually sue the employer and challenge the validity of the dismissal by filing a claim for unfair dismissal in the competent labour court. When filling a claim for unfair dismissal, the employee may, in particular, address the following legal issues:

2.1 Notification of the Labour Office

The employer is obliged to notify the Labour Office of an intended mass dismissal (*Massenentlassungsanzeige)*, if certain statutory thresholds are met. These thresholds are the same as set out in 1.1 above.

A failure to comply with the statutory notification obligations will lead to the invalidity of the dismissals in question.

(a) Information of the works council

Before the employer can notify the Labour Office it has to inform the works council in writing, in particular regarding:

- the reasons for the planned dismissals,
- the number and the occupational groups of the employees to be dismissed,
- the number and the occupational groups of the employees regularly employed,
- the period of time over which these dismissals are to take place,
- the intended criteria for the selection of the employees to be dismissed, and
- the criteria for calculating of any severance payments.

A copy of this written information has to be sent to the Labour Office. The employer and the works council shall discuss ways of how dismissals could be prevented or limited and their consequences could be mitigated. This can also be done when negotiating the reconciliation of interests and the social plan.

(b) Notification to the Labour Office

The notification to the Labour Office has to be in writing and must contain the information required by law such as, for instance, the reasons for the planned dismissals, the number of affected employees and the occupational group of the employees to be dismissed.

It is advisable to **use the forms provided by the Labour Office**. Furthermore, the notification must include the comments of the works council regarding the dismissals. If the works council does not make any comments, the employer must be able to prove that the works council was informed properly at least two weeks prior to the filing of the notification. Moreover, information about the status of the discussions with the works council has to be given.

2.2 General protection against dismissal

Generally speaking, any employee who is employed for more than six months in an operation with more than 10 regularly employed employees enjoys protection against dismissal under the Dismissal Protection Act (*Kündigungsschutzgesetz - KSchG*). According to this Act, an ordinary termination must be "socially justified" to be valid. Such social justifications are:

- personal grounds
- mal-performance or mal-conduct
- business reasons.

Downsizing an operation can justify a **termination for business reasons**. However, such a termination is valid only if the employer can demonstrate and prove that either outside circumstances (such as reduction of turn-over or profit, lack of incoming orders) or an internal decision of the management to

reorganize the company structure results in the deletion of positions in the operation. The business decision itself, e.g. the employer's decision to downsize the operation, is generally not reviewed by labour courts.

Moreover, there must be **no other vacancies** for the employees within the entire company. Otherwise, such positions would have to be offered to the employees facing dismissal. A failure to offer such a vacant position renders the termination invalid. Principally, vacant positions in other companies of the (wider) group do not have to be considered. This means that employees can be asked to apply for such positions but there is no obligation on the part of the employer to offer these positions prior to giving notice.

However, even if the employer can prove the deletion of certain positions, he cannot automatically dismiss the persons working in these positions. The validity of a notice of termination due to business reasons requires a so-called **"social factor test"** (*Sozialauswahl*). This means that social criteria, i.e. age, years of service, disability and alimony obligations, have to be taken into account in order to select which employees within a group of comparable employees will have to be dismissed. Comparable employees in this sense are those employees who can be instructed by the employer to replace another employee without altering his or her employment conditions. Moreover, only those employees are comparable who have the occupational competence to work on the remaining position after a short job-training (max. three to four months).

Furthermore, the employer and the works council can, along with the negotiation of a reconciliation of interests, agree upon a **list of names** of those employees to be dismissed. In this case the *KSchG* presumes that the dismissal of the listed employees is justified by operational reasons. Moreover, the correctness of the social factor test carried out by the employer and the works council is then subject to a judicial review of a very limited extent only. However most works councils are reluctant to agree such a list of names for these very reasons or will demand a significant increase of the social plan budget in return for their consent to such a list.

2.3 Special protection against dismissal

Some groups of employees enjoy special protection against dismissal. Notice of termination is invalid if given to **women during pregnancy** and for four months after giving birth or to employees on **parental leave** during such leave, or to **disabled employees** with a degree of disability of at least 50 (30 in some cases), unless **prior government approval** has been obtained. Such procedure will take one to three months depending on the individual case and the area in which the application for consent is filed. Therefore, the delay in giving notice to these employees will be considerable.

Members of the works council also enjoy special protection against dismissal. They can only be dismissed by extraordinary notice for cause and only after the works council or the labour court has consented to the dismissal. An exemption to this rule exists if the operation in which the works council member is currently working will be shut down completely. In case of a shutdown of an entire department, a works council member can be dismissed if the works council member cannot be transferred to another department for business reasons.

2.4 Notice periods

The applicable notice period is based on the individual employment contracts. Most employment contracts refer to the statutory notice periods as set forth in sec. 622 German Civil Code (*Bürgerliches Gesetzbuch – BGB*). The statutory minimum notice period is four weeks effective the 15th or the end of a calendar

month. This means that a time period of at least four weeks must separate the effective date of termination (always the 15th or the last day of a calendar month) from the date of the notice of termination is served on the employee. After a specific record of service with the same employer, the basic statutory notice period is extended as follows:

- one month's notice must be given after two years of employment,
- two months' notice must be given after five years of employment,
- three months' notice must be given after eight years of employment,
- four months' notice must be given after ten years of employment,
- five months' notice must be given after twelve years of employment,
- six months' notice must be given after fifteen years of employment and
- seven months' notice must be given after twenty years of employment.

In any of these cases, the notice will always be effective as of the end of a calendar month.

Individual employment contracts or applicable collective bargaining agreements may provide for **longer** notice periods.

2.5 Hearing of the works council

Besides the negotiations with the works council concerning the reconciliation of interests and the social plan and the information of the works council in the course of the mass dismissal proceeding, the works council also has to be heard with regard to each individual notice of termination.

This means that the works council must be **informed comprehensively** about the factual situation leading to the planned **dismissal of the individual employee**. In order to be able to prove that the works council was properly heard, it is advisable to effect the hearing (at least partially) in writing.

After being informed about the planned notice of termination, the works council has the opportunity to comment on the reasons for the termination presented to the employer within one week.

If the works council does not react in due time, its consent to the notice of termination is deemed to be given. If the works council expresses doubts or objects to the notice of termination, the notice of termination can still be given. However, the arguments in the works council's objection will be taken into consideration by the labour court if the employee challenges the termination in court. Moreover, a failure to inform the works council properly (e.g. by withholding relevant information) will result in the invalidity of the termination.

2.6 Court review

In practice, a high number of dismissed employees will file legal actions and **contest the validity of the termination** with the aim to obtain a (higher) severance payment or the continuation of their employment with the employer. The dismissed employee must file such a claim for unfair dismissal within three weeks after the receipt of the termination letter. Otherwise he or she will lose the statutory protection under the *KSchG*.

Unless the employer can establish and prove a more or less airtight case (which is difficult in practice), he will usually not risk to go through court litigation which may take between two and three years at a maximum. The financial risk on the part of the employer is high as in case of loss he would have to re-instate the employee and pay the outstanding salaries. Therefore, in order to avoid this risk, **employers rather tend to settle cases against (higher) severance payments**.

Such settlements can be reached out of court through cancellation agreements (*Aufhebungsvertrag*) or in court (*gerichtlicher Vergleich*). Any settlement requires the consent of both parties; only in very exceptional cases can the court force a binding decision on a severance payment onto the parties.

The agreement on a reconciliation of interests or on a social plan does not affect the right of each employee to contest the notice given to him or her. However, under certain legal requirements it is possible to conclude an agreement with the works council containing special financial benefits to those employees who renounce their right to file an action against their employer because of the dismissal.

2.7 Cancellation agreements

The parties to an employment contract may, at any time, cancel the employment relationship by mutual agreement. Within the framework of a settlement, the employee is, as a rule, paid reasonable compensation for the loss of his or her job. Again, the amounts may differ according to the reasons leading to the cancellation and the parties' potential prospects of success in a subsequent dismissal lawsuit.

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