Jens Kirchner · Pascal R. Kremp
Michael Magotsch *Editors*

Key Aspects of German Employment and Labour Law

Second Edition

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Abbreviations

AG	Aktiengesellschaft (Stock Corporation)
AGB	Allgemeine Geschäftsbedingungen (General Terms and Conditions)
AGG	Allgemeines Gleichbehandlungsgesetz (General Equal Treatment Act)
AktG	Aktiengesetz (Stock Corporation Act)
AltTzG	Altersteilzeitgesetz (Partial Retirement Act)
ArbG	Arbeitsgericht (Labour Court)
ArbGG	Arbeitsgerichtsgesetz (Labour Court Act)
AÜG	Arbeitnehmerüberlassungsgesetz (Act Regulating Commercial Agency Work)
AVmG	Altersvermögensgesetz (General Act on Retirement Provisions)
BA	Bundesagentur für Arbeit (Federal Employment Agency)
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
BAG	Bundesarbeitsgericht (Federal Labour Court)
BCR	Binding Corporate Rules
BBiG	Berufsbildungsgesetz (Apprenticeship Act)
BDSG	Bundesdatenschutzgesetz (Federal Data Protection Act)
BDSG-neu	Neues Bundesdatenschutzgesetz (New Federal Data Protection Act)
BEEG	Bundeselterngeld- und Elternzeitgesetz (Federal Parental Allowance and Parental Leave Act)
BetrAVG	Gesetz zur Verbesserung der betrieblichen Altersversorgung, also: Betriebsrentengesetz (Company/Occupational Pension Act)
BetrVG	Betriebsverfassungsgesetz (Works Constitution Act)
BGB	Bürgerliches Gesetzbuch (Civil Code)
BGH	Bundesgerichtshof (Federal Court of Justice)

BMAS	Bundesministerium für Arbeit und Soziales (Federal Ministry of Labour and Social Affairs)
BSG	Bundessozialgericht (Federal Social Court)
BUrlG	Bundesurlaubsgesetz (Federal Holiday Act)
D&O Insurance	Directors and Officers Insurance
DBA	Doppelbesteuerungsabkommen (Double Taxation Treaty)
DGB	Deutscher Gewerkschaftsbund (German Association for Trade Unions)
DrittelbG	Drittelbeteiligungsgesetz (One-Third Participation Act)
EBRG	Gesetz über Europäische Betriebsräte (European Works Councils Act)
ECJ	European Court of Justice
EEA	European Economic Area
EFZG	Entgeltfortzahlungsgesetz (Continuation of Remuneration Act)
eG	Genossenschaft (Cooperative)
EStG	Einkommensteuergesetz (Income Tax Act)
EU	Europäische Union/European Union
EuGH	Europäischer Gerichtshof (European Court of Justice)
e.V.	Eingetragener Verein (Registered Association)
EWR	Europäischer Wirtschaftsraum (European Economic Area)
FPfZG	Familienpflegezeitgesetz (Family Nursing Care Act)
GAAP	Generally Accepted Accounting Principles
GbR	Gesellschaft bürgerlichen Rechts (Civil Law Partnership)
GewO	Gewerbeordnung (Trade Regulation Act)
GDPR	General Data Protection Regulation
GG	Grundgesetz (German Constitution)
GmbH	Gesellschaft mit beschränkter Haftung (Limited Liability Company)
GmbH & Co. KG	Gesellschaft mit beschränkter Haftung & Co. Kommanditgesellschaft (Partnership Company with a *GmbH* as Unlimited Liability Partner)
GmbHG	Gesetz betreffend die Gesellschaft mit beschränkter Haftung (Limited Liability Company Act)
HGB	Handelsgesetzbuch (Commercial Code)
ILO	International Labour Organization (Internationale Arbeitsorganisation)
KG	Kommanditgesellschaft (Limited Partnership)
KGaA	Kommanditgesellschaft auf Aktien (Partnership Limited by Shares)
KonTraG	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (Act on Control and Transparency within Companies)
KSchG	Kündigungsschutzgesetz (Dismissal Protection Act)

LAG	Landesarbeitsgericht (Labour Court of Appeal)
M&A	Mergers and Acquisitions
MarktmissbrV	Marktmissbrauchsverordnung (Market Abuse Regulation)
MgVG	Gesetz über die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Verschmelzungen (Act on the Co-Determination of the Employees in Cross-Border Mergers)
MiLoG	Gesetz zur Regelung eines allgemeinen Mindestlohns (Act for the Regulation of a General Minimum Wage)
MitbestG	Mitbestimmungsgesetz (Co-Determination Act)
Montan-MitbestG	Montan-Mitbestimmungsgesetz (Co-Determination Act for the Coal and Steel Industry)
MuSchG	Mutterschutzgesetz (Maternity Protection Act)
OECD	Organisation for Economic Co-Operation and Development
OHG	Offene Handelsgesellschaft (Partnership)
PflegeZG	Pflegezeitgesetz (Nursing Care Leave Act)
PSVaG	Pensionssicherungsverein a.G. (Insolvency Protection Fund)
RIF	Reduction in Force
RRG	Rentenreformgesetz 1999 (Pension Reform Act 1999)
RVG	Rechtsanwaltsvergütungsgesetz (Attorneys' Fees Act)
SCC	Standard Contractual Clauses
SE	Societas Europaea (European Company)
SGB	Sozialgesetzbuch (Social Security Code)
SprAuG	Sprecherausschussgesetz (Spokespersons Committee Act)
StGB	Strafgesetzbuch (Criminal Code)
StPO	Strafprozessordnung (Criminal Procedure Act)
TKG	Telekommunikationsgesetz (Telecommunications Act)
TVG	Tarifvertragsgesetz (Collective Bargaining Agreement Act)
TzBfG	Teilzeit- und Befristungsgesetz (Part-Time and Fixed-Term Employment Act)
UmwG	Umwandlungsgesetz (Company Transformation Act)
VIS	Visa Information System
VVaG	Versicherungsverein auf Gegenseitigkeit (Mutual Insurance Company)
ZPO	Zivilprozessordnung (Civil Procedure Act)

Chapter 1
Executive Summary: German Employment and Labour Law

Jens Kirchner and Sascha Morgenroth

A. Background

Germany is a civil law country. Therefore, the legal system is mainly based on written law, i.e. a constitution, codes and statutes. Besides the federal constitution and federal statutes, there are state laws and every state has its own constitution. However, the main areas of law, such as criminal law, civil law and commercial law, are regulated by uniform federal codes, such as the Criminal Code (*Strafgesetzbuch, StGB*), the Civil Code (*Bürgerliches Gesetzbuch, BGB*), and the Commercial Code (*Handelsgesetzbuch, HGB*). German employment and labour law is also largely governed by federal statutes. However, historically there has been no unified employment and labour law code. The relevant law is fragmented in several statutes and statutory gaps are filled by jurisprudence, which is therefore particularly important in this field of law. In practice, this all makes the understanding and application of German labour and employment law rather difficult for both employers and employees.

German employment and labour law is to a large extent influenced by European Union (EU) law, as the German legislature and jurisdiction have to comply with the regulations and directives of the EU and their interpretation by the European Court of Justice (*Europäischer Gerichtshof, EuGH*). For example, the EU Employment Equality Directive 2000/78/EC prohibits discrimination against employees because of their religion, disability, age, or sexual orientation. Germany has implemented this EU Directive in 2006 by the German General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*).

In Germany, there are strict federal procedural rules for the different jurisdictions, such as the Labour Court Act (*Arbeitsgerichtsgesetz, ArbGG*), the Criminal

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Procedure Act (*Strafprozessordnung, StPO*), and the Civil Procedure Act (*Zivilprozessordnung, ZPO*). These procedural rules apply to all courts at all levels of the respective subject matter jurisdiction. The courts must apply this statutory law. Although there is no doctrine of precedent, the lower courts tend to follow the higher courts' rulings. The highest courts have the constitutional right and duty to apply the law equally. In labour and employment law, case law has greater importance than in other areas, as the German labour courts often have to fill statutory gaps.

Employment law covers the relationship between employers and individual employees,[1] whereas labour law concerns the relationship between the collective parties, namely the employer, employers' organisations, works councils, and trade unions. Labour court proceedings are regulated in the Labour Court Act (*ArbGG*), which in many regards refers to the provisions of the Civil Procedure Act (*ZPO*).

In comparison to the United States, for example, there is no state agency like the National Labour Relations Board (NLRB) which deals with labour law claims. In Germany, there is also no binding arbitration in labour or employment cases, except in disputes between the employer and a works council before a conciliation committee (*Einigungsstelle*) regarding significant operational changes of businesses. Labour and employment law disputes rather go directly to court, namely the special jurisdiction for labour and employment law. However, in employment law court proceedings there is a mandatory conciliation hearing (*Güteverhandlung*) in order to attempt to reach a settlement of the case prior to the presiding judge considering the case on its merits. Further, the court may, and in most cases will, also set a conciliation hearing in collective labour law proceedings in order to assess if the parties are willing to settle the case without a verdict. However, conciliation hearings are not obligatory in labour law matters.

B. Company Perspective

I. Legal Entities

Generally, the laws affecting companies are federal laws, which are commonly applied in all parts of Germany. Most companies are treated as so-called "incorporated companies", which means that they can be parties to a lawsuit. This is the case for German as well as for foreign companies. Moreover, there are differences between the several forms of legal entities. The most common forms of legal entities are limited liability companies (*Gesellschaft mit beschränkter Haftung, GmbH*), stock corporations (*Aktiengesellschaft, AG*), civil law partnerships (*BGB-Gesellschaft, GbR*), and limited partnerships (*Kommanditgesellschaft, KG*).

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

II. Co-Determination

Employers of business operations with an established works council need to observe the significant co-determination rights of the works council.

Companies with usually more than 500 employees must establish a supervisory board (*Aufsichtsrat*), one-third of which must consist of representatives directly elected by the employees pursuant to the One-Third Participation Act (*Drittelbeteiligungsgesetz*, *DrittelbG*). However, limited liability corporations, stock corporations, and partnerships limited by shares with usually more than 2000 employees must even install a supervisory board consisting of an equal number of employees and shareholders according to the Co-Determination Act (*Mitbestimmungsgesetz, MitbestG*).

III. Managing Director and Management Board Member

Limited liability companies have one or more managing directors (*Geschäftsführer*) who manage the company and represent it in its dealings with third parties. The managing directors are appointed and can be removed by simple majority of the shareholders' meeting pursuant to the Limited Liability Company Act (*Gesetz betreffend die Gesellschaft mit beschränkter Haftung, GmbHG*). However, the legal acts of appointment of managing directors to, or removal from, their offices by shareholders' resolutions must be distinguished and treated separately from the company's employment contract relationship to the managing director. Managing directors are bound by instructions of the shareholders' meeting. They may be liable for damages because of violations of duties towards the company.

According to the Stock Corporation Act (*Aktiengesetz, AktG*), stock corporations are represented by managing board members (*Vorstandsmitglieder*) who are appointed by the supervisory board. Management board members can only be removed from their office for specific reasons (e.g. gross breach of duty or inability to manage the company properly). Similar to managing directors, the legal acts of appointment to and the removal from office of a management board member must be distinguished and treated separately from the contractual employment relationship and its termination. The management board (*Vorstand*) is not bound by directives issued by the supervisory board. However, the supervisory board approves the annual financial statement of the management board. The management board is liable for damages due to violations of its office duties (sec. 93 *AktG*).

Statutory managing directors and management board members are usually not considered "employees". As a consequence, they may not claim rights in labour courts but only in regular civil courts. In contrast, executive employees (*leitende Angestellte*) are usually considered employees; however, there are also certain exemptions for them concerning the general rules of labour and employment law. Particularly, they are less protected by the Dismissal Protection Act

(*Kündigungsschutzgesetz, KSchG*) and not covered by the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*). However, executive employees may elect a representative according to the Spokespersons Committee Act (*Sprecherausschussgesetz, SprAuG*) if the business operation has at least ten executive employees.

IV. Small Business Operations

A criterion which leads to different treatment, especially in the field of labour and employment law, is the size of the operation. Employees of smaller operations are less protected. Since a statutory reform in 2004, the Dismissal Protection Act (*KSchG*) is only applicable to business operations with usually more than ten employees (sec. 23 para. 1 *KSchG*). The previously applicable threshold was more than five employees. This has been changed in order to protect smaller business operations and providing them with opportunities of more flexible reactions to economic changes. Moreover, the right to elect a works council according to the Works Constitution Act (*BetrVG*) only arises in business operations with usually at least five permanent employees entitled to vote. Three of these five permanent employees must be eligible to be elected (sec. 1 para. 1 *BetrVG*).

V. Companies Abroad

These rules are basically also applicable to foreign companies. However, the provisions of the Dismissal Protection Act and the Works Constitution Act usually will not reach companies abroad if there is no operational organisation in Germany, and if all the employer functions are completely exercised abroad.

C. Employment Law

The most common issues in employment law are cases of wrongful termination and issues related to fixed-term contracts. Further, data protection in the workplace is increasingly important.

I. Employment Contract

Employment contracts drafted entirely by the employer are subject to the provisions of the Civil Code on General Contractual Terms and Conditions (*Allgemeine*

Geschäftsbedingungen). Therefore, such contracts must be sufficiently transparent and must not contain any substantial disadvantage to the employee.

II. Dismissal Protection

The German law does not recognise the concept of employment "at will". In principle, employment can only be terminated for cause.

There are in principle two types of employment termination:

- extraordinary termination for good cause (sec. 626 BGB), and
- ordinary termination observing statutory/contractual notice periods. In business operations with > ten employees if the employee is employed >6 months in the same business operation or company; additionally only for person-related, conduct-related or urgent operational reasons (sec. 1 *KSchG*).

The employer must inform and hear the works council—if one exists at the business operation—prior to any termination (sec. 102 *BetrVG*), otherwise it is invalid.

If the employee succeeds in dismissal protection proceedings before the labour court, the employee can claim to be reinstated under the same working conditions. Moreover, the employer must pay the employee for the period between the end of the notice period and the legally binding verdict.

To avoid any such cases, the employer must observe the statutory regulations, hear the works council, and carefully determine the employees to be terminated. If the layoff is caused by operational changes, e.g. rationalisation, the employer must give reasons for the underlying entrepreneurial decision. Moreover, in business operations with more than 20 employees, employers are obliged to negotiate a balance of interests (*Interessenausgleich*) and social plan (*Sozialplan*) with the works council. The balance of interests is intended to determine the particular measures of the operational change of business. The social plan attempts to compensate or mitigate the economic disadvantages for the employees due to the operational change. In any event, the employer and employee can end their employment relationship by concluding a mutual termination agreement. However, the employer is not allowed to force the employee to sign such a termination agreement.

1. Extraordinary Termination

Extraordinary terminations usually end the employment relationship immediately without observing notice periods. The employer must show good cause, i.e. an important reason (e.g. significant breach of contract, constant inability to work, severe defamation of the employer), which is hard to prove in court. There is a mandatory 2-week deadline that the employer must observe after receiving knowledge of the facts underlying the alleged good cause to terminate the employment relationship.

Termination for good cause must meet a two-prong test:

- there must be good cause for termination;
- notice must be given within 2 weeks of knowledge of the good cause.

2. Ordinary Termination and Wrongful Dismissal Protection

a) Ordinary Termination

In the case of ordinary terminations the employer generally has to continue the employment relationship until the end of the statutory notice period, pursuant to sec. 622 *BGB*, or the contractually agreed notice period. There is no principle of pay 'in lieu of notice'. The regular statutory minimum notice period is 4 weeks to the 15th or the end of the calendar month. The statutory minimum notice periods applicable to terminations by the employer gradually increase according to the employee's seniority (sec. 622 para. 2 *BGB*).

The statutory minimum notice periods for terminations by the employer increase according to the employee's seniority in the following steps:

- after 2 years of service, 1 month to the end of the calendar month,
- after 5 years of service, 2 months to the end of the calendar month,
- after 8 years of service, 3 months to the end of the calendar month,
- after 10 years of service, 4 months to the end of the calendar month,
- after 12 years of service, 5 months to the end of the calendar month,
- after 15 years of service, 6 months to the end of the calendar month,
- after 20 years of service, 7 months to the end of the calendar month.

However, due to the so-called principle of favourability (*Günstigkeitsprinzip*), if the contractual notice period is more beneficial for the employee, i.e. longer than the mandatory statutory minimum notice period, the contractual notice period will

always apply to the termination by the employer. It should be noted that the parties may initially agree on a probationary period of up to 6 months during which the employment relationship may be terminated with a 2 week notice period without cause (sec. 622 para. 2 *BGB*).

It is noteworthy that sec. 622 para. 1 sent. 1 *BGB*, which states that periods of service performed before the age of 25 are not to be taken into account is no longer applicable, since the European Court of Justice held that this regulation contains age-discrimination and therefore violates EU law.

b) Wrongful Dismissal Protection

Dismissals require social justification according to the Dismissal Protection Act (*KSchG*) if the employees to be dismissed have been employed in the same business operation or company for more than 6 months and if the respective business operation usually employs more than ten employees.

The Dismissal Protection Act (*KSchG*) applies to:

- every business operation with usually > ten employees
- if the respective employees to be dismissed have been employed in the same business operation or company for >6 months.

c) Statutory Grounds for Termination

In the event the Dismissal Protection Act (*KSchG*) applies, only three statutory grounds may socially justify the termination:

- conduct-related reasons,
- person-related reasons,
- urgent operational reasons.

- *Conduct-Related Reasons*
  Prior to conduct-related terminations, often the employer must have issued to the employee a warning letter (*Abmahnung*) for a similar misconduct before it can validly terminate the employment contract due to new misconduct for similar reasons.
- *Person-Related Reasons*
  Typical person-related termination issues involve long-term or frequent short-term illness. In order to be socially justified, such terminations require a

negative prognosis of the employee's health condition and that a weighing of the employer's and employee's interests show that the employee's expected health related absences lead to unreasonable detriment to the employer's business interests.

- *Operational Reasons*

  If an employment is terminated for operational reasons, such reasons must be proven by the employer, and a so-called social selection (*Sozialauswahl*) among comparable employees needs to be performed. The employer must compare the social data of comparable employees before choosing the employees to be terminated.

The crucial social selection criteria are:

- age,
- seniority,
- obligations to pay family support, and
- disability.

The employer must observe carefully whether there are comparable employees working in the business operation whose work could also be performed by an employee threatened with termination. In this case, the employer has to examine who of the comparable employees merits greater social protection. The social selection basically extends to all similar employees in an entire business operation. However, the social selection will not extend to other business operations of the company or the group. Further, the employer is free in its basic entrepreneurial decision to reduce the workforce in reaction to certain macroeconomic or internal situations. Finally, the employer may exclude employees from the social selection whose retention is in the legitimate interest of the business. In practice, this exception is not often applied due to the fact that such legitimate interest is difficult for the employer to prove.

In summary, the social selection process must be carried out in the following three steps:

- First, the employer must determine the categories of comparable employees within the business operation.
- Secondly, the employer then has the opportunity to exempt from the social selection process certain employees whose retention is in the legitimate interest of the business. However, the employer carries the burden of proof for such legitimate interest, and therefore, in practice, this exemption is not often applied.

(continued)

- Finally, the employer must, after having complied with the first two steps, perform a social selection with respect to the remaining employees in accordance with the above mentioned criteria of seniority, age, obligations to financial support and severe disability.

Moreover, in order to prove the social justification of the dismissal, the employer must show that there is no possibility of continued employment, even in another job position or part of the company.

d) Mass Dismissals

In case dismissals and other terminations of employment induced by the employer reach certain thresholds within a period of 30 calendar days, so-called mass dismissals, the employer must notify the Federal Employment Agency (*Bundesagentur für Arbeit, BA*) prior to the service of the dismissals (sec. 17 *KSchG*).

The relevant dismissal/termination thresholds for notification of the Federal Employment Agency (*Bundesagentur für Arbeit, BA*) of so-called mass dismissals are within 30 calendar days:	
• in business operations with usually >20 and <60 employees	> five employees
• in business operations with usually ≥60 and <500 employees	10% of the employees regularly employed in the business operation or > 25 employees
• in business operations with usually ≥500 employees	≥30 employees

According to the European Court of Justice, the competent state authorities must be notified prior to the service of the termination notice, not only prior to the employee's actual termination date.

e) Modification Dismissals

If the employer's goal is merely to change working conditions, it might choose a modification dismissal (*Änderungskündigung*), i.e. a termination by the employer connected with an offer to continue the employment relationship under changed conditions. However, the employee can file a complaint with the labour court against the dismissal according to the Dismissal Protection Act *(KSchG)*. Moreover, modification dismissals are only advisable in individual cases. They are not usually recommended to change working conditions in cases of mass dismissals.

3. Special Dismissal Protection

Moreover, special protection against dismissals applies to certain groups of employees.

Special Dismissal Protection applies to certain groups of employees, including:

- women during pregnancy and 4 months after childbirth pursuant to sec. 9 of the Maternity Protection Act (*Mutterschutzgesetz, MuSchG*),
- employees on parental leave (*Elternzeit*) and 8 respectively 14 weeks prior to parental leave pursuant to sec. 18 of the Federal Parental Allowance and Parental Leave Act (*Bundeselterngeld- und Elternzeitgesetz, BEEG*),
- severely disabled persons pursuant to sec. 85 et seqq. of the Social Security Code IX (*Sozialgesetzbuch IX, SBG IX*),
- members of the works council pursuant to sec. 15 of the Dismissal Protection Act (*KSchG*),
- data protection officers according to sec. 4f of the Federal Data Protection Act (*BDSG*).

The special termination protection particularly requires employers to obtain the consent of the competent administrative agencies or works council prior to the dismissal of specially protected employees.

III. Minimum Wage

A general, nationwide statutory minimum wage was introduced in Germany in August 2014. It is applicable to all kinds of employment relationships and throughout all professional sectors.

The Act for the Regulation of a General Minimum Wage (*Gesetz zur Regelung eines allgemeinen Mindestlohns, MiLoG*) stipulates that there is a general minimum wage in Germany; from 1 January 2017 on it is at 8.84€ gross per working hour.

The *MiLoG* binds all employers seated in Germany and/or abroad if they have employees working in Germany (cf. Chap. 8 for further details).

IV. Anti-Discrimination

1. Discrimination Criteria

The General Equal Treatment Act (*AGG*), which mainly implements the EU Employment Equality Directive 2000/78/EC into German law, prohibits discrimination based on race or ethnic origin, religion or belief, sex, disability, age or sexual identity (sec. 1 *AGG*).

The General Equal Treatment Act (*AGG*) prohibits discrimination based on:

- race or ethnic origin,
- religion or belief,
- sex,
- disability,
- age,
- or sexual identity.

Discrimination on the basis of these criteria is particularly prohibited regarding selection procedures, recruitment and employment conditions, conducting employment relationships and with respect to promotions (sec. 2 *AGG*).

The *AGG* protects all employed persons. This includes employees, apprentices, temporary employees, freelancers, persons similar to employees (*arbeitnehmerähnliche Personen*), home workers (sec. 6 *AGG*) and in relation to engagement or promotion matters also members of executive bodies (such as statutory managing directors and members of the executive board).

2. Discriminatory Behaviour and Justified Discrimination

According to the *AGG*, discrimination is unjustified unequal treatment due to one of the discrimination criteria as set out therein (sec. 1 *AGG*).

The General Equal Treatment Act (*AGG*) prohibits as discriminatory behaviour:

- direct discrimination,
- indirect discrimination,
- harassment (this includes "bullying"),
- sexual harassment, and
- employer instructions to discriminate.

Instructions to discriminate based on one of the discrimination criteria also constitute prohibited discrimination (e.g. instruction to the HR-Department not to hire any disabled persons). In exceptional cases, unequal treatment may be justified depending on the discrimination criteria, particularly if a substantial mandatory work-related requirement can be demonstrated.

3. Legal Consequences

The employees can file complaints to the company's competent complaints department if they feel discriminated against by the employer, management, other employees or third parties in relation to their employment relationship. The employer is liable for material damages based on its own fault (intent and negligence), its legal representatives' and its vicarious agents' fault (i.e. its management employees in relation to the general workforce). Fault is assumed, i.e. the employer has to prove that no fault is involved. The employee needs only to prove mere indications giving rise to the presumption of discrimination. The burden is on the employer to prove that no discrimination occurred and that the specific treatment is in fact justifiable. Liability for immaterial damages is limited to appropriate amounts. In the context of hiring of employees any compensation is generally limited to a maximum of 3 monthly salaries. Only for the best-qualified applicant not hired due to discrimination, the amount of compensation is not limited.

It should be noted that the person discriminated against does not have a claim for employment or promotion against the employer (sec. 15 *AGG*).

V. Employee Data Protection

1. Overview

Personal employee data is strictly protected. The Federal Data Protection Act (*BDSG*) permits employers to use personal employee data if necessary for the establishment of an employment relationship or, after its establishment, for its performance or termination (sec. 32 *BDSG*/sec. 26 of the new *BDSG* entering into force in May 2018). The usage of personal employee data might also be allowed based on a works agreement with a works council or, in principle, the employee's voluntary informed consent.

The employee's privacy is protected as a fundamental personal right (*allgemeines Persönlichkeitsrecht*) by the German Constitution. Therefore, monitoring of employees at the workplace is only lawful under very limited circumstances. For example, if the employer permits private use of company email and Internet, he is hardly allowed to access the content of such emails or continuously monitor private emails and Internet use unless private use has been made conditional on consent to monitoring/filtering activities. Exceptions may apply in case of

actual evidence causing the suspicion that the employee committed a criminal offence in the context of the employment relationship.

The works council must be properly involved regarding automated processing of personal data. Further, the employer shall appoint a data protection officer if more than nine persons are involved with automated processing of personal data in the company.

Outsourcing of employee data processing operations to third parties (including company group entities) demand appropriate outsourcing agreements meeting the legal requirements. Transfers of personal employee data outside the European Economic Area (EEA) additionally require safeguarding adequate levels of data protection by the data recipient.

2. The EU-U.S. Privacy Shield

In the past, U.S. companies that agreed to be bound by the "Safe-Harbour-Principles" of the EU Commission and the U.S. Department of Commerce had been acknowledged as providing an adequate level of data protection. The European Court of Justice's *Maximilian Schrems* decision of 6 October 2015, however, declared the "Safe-Harbour-Agreement" invalid. As a consequence, personal data can no longer be transferred to the USA based on this agreement. Following this decision the European Commission negotiated a new agreement with the U.S. authorities (especially the Department of Commerce), the EU-U.S. Privacy Shield (Privacy Shield).

The Privacy Shield is a system of self-certification by which U.S. organisations commit to a set of Privacy Principles. In July 2016 the European Commission declared that the U.S. ensures an adequate level of protection for personal data that is transferred from the EU to organisations in the U.S. that have signed up to the Privacy Shield. Since 1 August 2016 U.S. organisations are able to sign up to the Privacy Shield. As a consequence, a data controller within the EU should be able to transfer personal data, such as employees' personal data, to an U.S. organisation that has signed up to the Privacy Shield (as long as the general requirements for the transfer are met, e.g. because the U.S. organisation acts as a mere data processor and has signed a data processing agreement which meets the applicable *BDSG* requirements).

The Privacy Shield's validity remains subject to substantial uncertainty, inter alia because both the European as well as the German data protection authorities have strongly criticised the framework and it is not unlikely that it will be subject to review by the European Court of Justice in the near future. Furthermore, the Privacy Shield may need to be materially revised prior to implementation of the General Data Protection Regulation (*GDPR*) in 2018. Finally, certifying to the Privacy Shield may materially increase enforcement risks for U.S. headquartered multinationals.

Against this backdrop, companies are advised to also consider other measures that enable transfers of personal data to the U.S. and in fact all third countries that do not provide an adequate level of data protection.

Alternative measures for data transfers to third countries or U.S. organisations:

- Binding Corporate Rules (BCR);
- EU standard contractual clauses (SCC);
- consent of the data subject (but only to a very limited extent in the employment context).

For intra-group transfers, Binding Corporate Rules (BCR) provide a good basis for data transfers and also help demonstrate broader compliance with the upcoming *GDPR*, helping to comply with the new principle of accountability.

3. The European General Data Protection Regulation

The European data protection law is currently undergoing significant changes and therefore is of high importance to all employers situated within or working within the EU. The European Data Protection Directive 95/46/EC (*DPD*) which has been in force since 1995 will be repealed by the European General Data Protection Regulation (*GDPR*) on 25 May 2018. The *GDPR* will then be directly binding without further need of implementing legislation. Until that date the Member States and companies have the pressing obligation to adopt the new rules of the *GDPR* and adjust to them.

As a consequence of the harmonisation intended by the *GDPR* the Federal Data Protection Act (*BDSG*) which implemented the *DPD* into German law will not be applicable anymore. However, there are more than 30 areas covered by the *GDPR* where Member States are permitted to legislate differently in their own domestic data protection laws; one of these is the processing of employment data, art. 88 *GDPR*. The German legislator adopted a new Federal Data Protection Act which contains respective statutory provisions and enters into force in May 2018. Employers must therefore be aware of the specific regulations of the new BDSG.

The *GDPR* brings about multiple changes. For one, the *GDPR* introduces much higher penalties for basically any breaches of its provisions. These penalties can be up to 4% of the annual global turnover of the company and individuals can be found liable for breaches and be penalised with up to 20,000,000€, art. 83 *GDPR*. The *GDPR* intends to have a strong deterrent effect with these penalties and it is therefore urgently recommended to fully and correctly implement the changes and measurements the *GDPR* calls for. Further, under the *GDPR* not only data subjects who have suffered a material loss but also just an immaterial loss due to non-compliance with the regulations can now receive remedies. These high

financial risks for non-compliance make a full documentation of the compliance with all regulations of the *GDPR* and the future *ABDSG* absolutely necessary, see art. 5 para. 2 *GDPR*.

Another aspect in which the *GDPR* is stricter is in respect of the amount of data that may be collected and processed: from the outset, privacy by design and privacy by default IT-systems need to be in place (art. 25 *GDPR*), data protection risk assessments need to be carried out for certain types of processing (art. 35 *GDPR*) and there is a "right to be forgotten" (art. 17 *GDPR*), which is also of relevance for both employment candidates' as well as employees' data.

Generally, data collection is lawful if it is necessary to carry out a contract or other legal responsibilities (e.g. for insurance or tax reasons) or to secure legal interests (e.g. keeping applicants' data for evidentiary purposes in anti-discrimination cases); further, the data subject's consent and works agreements (*Betriebsvereinbarungen*) can make data collecting lawful, art. 6 *GDPR*.

Employers have a duty to instruct the (prospective) employee, beginning with the application process. The employer must inform the candidate or employee about the terminology, the collecting and processing of data, the persons responsible, and his rights in easy, unambiguous language, art. 12–14 *GDPR*.

Art. 22 *GDPR* contains another regulation that may be of interest for recruitment processes: it grants applicants the right not be subject to a decision based solely on automated processing, including profiling.

The *GDPR* brings about an increased scope of applicability of the European data protection laws. By introducing a market place principle the *GDPR* extends its scope to companies that are not placed within the EU but address the European single market and EU citizens. The processing of employee data from the EU by global corporations that monitor centrally outside of the EU will be covered by this regulation. This can be of particular importance with regard to the UK leaving the EU.

A legitimate interest to transfer e.g. employee data, as required by art. 6 para. 1 lit. f *GDPR*, can exist between undertakings of the same company group as recital 48 *GDPR* points out. This might potentially simplify data exchanges within company groups.

Through a "one-stop-shop" solution (introduced by recital 36 *GDPR*) the national data protection authority of the Member State in which the company group has its "main establishment" is responsible for the entire data protection supervision of the company group within the EU. An exception to this rule applies where a data processing is exclusively local, e.g. where an operation is monitored via CCTV. In such a case the local authority is responsible for the respective data processing.

Regarding the data subject's consent as a means to make the collecting and processing of data lawful, the *GDPR* introduces an important change. The consent given has to be genuinely voluntarily; the data subject must therefore not be required to give his consent in cases where the data processing is not required for carrying out the contract, art. 7 para. 4 *GDPR*. This is in line with the current legal

situation in Germany where an employer is not able to combine the request for consent to data processing with the signing of the employment contract.

VI. Part-Time and Fixed-Term Employment

1. Part-Time Employment

The Part-Time and Fixed-Term Employment Act (*Teilzeit- und Befristungsgesetz, TzBfG*) is intended to facilitate the establishment of part-time employment relationships. Employers are obliged to give their employees an opportunity to work part-time under certain preconditions.

Employers are obliged to give their employees the opportunity to work part-time if:

- the employee is employed >6 months,
- the employer has >15 employees, and
- there are no operational reasons opposing the reduction of the employee's working hours.

The employee must inform the employer at least 3 months prior to the intended start date of the reduction of his working hours. However, delayed information only results in a later beginning of the part-time work.

The employer must inform the employee in writing about its decision on the employee's request for part-time work at the latest 1 month prior to the intended beginning of the part-time work. Otherwise, the *TzBfG* assumes that part-time work has been granted by the employer.

In principle, part-time employees may not be treated worse than comparable full-time employees due to their part-time employment, unless objective reasons require a different treatment (principle of proportional treatment).

2. Fixed-Term Employment

Pursuant to sec. 14 of the Part-Time and Fixed-Term Employment Act (*TzBfG*) the establishment of fixed-term employment contracts is lawful:

- for cause (e.g. temporary need for employees, substitute employment);

(continued)

- without cause but limited to a total time period of up to 2 years. Employment contracts limited to a shorter time period can be prolonged by agreement up to three times for a total time period of 2 years. Violations of these limitations result in employment contracts for an unlimited time period. Thus, it is generally possible to test new employees for a period of 2 years.

VII. Employee Leave Entitlements

According to the Federal Holiday Act (*Bundesurlaubsgesetz, BUrlG*) every employee is entitled to 20 days of paid holiday, based on a five-day working week. Holiday that has not been taken during a calendar year usually remains valid for 3 months in the following year. The Continuation of Remuneration Act (*Entgeltfortzahlungsgesetz, EFZG*) grants employees up to 6 weeks paid time-off in case of illness. Further, a new 6-week-period commences if the employee gets sick again due to the same underlying illness and if 6 months have passed since the end of the last sick leave or if one year has passed since the beginning of the first sick leave. If the reason for the sickness is a new one, the 6-week period commences anew automatically.

VIII. Employee Liability

Employee liability for damages to the employer in the course of their work or activities caused by their work is limited according to principles established by the jurisdiction of the Federal Labour Court (*BAG*). According to these principles, in cases of minor negligence, liability is excluded. In contrast, employees who are grossly negligent are obliged to compensate the employer for the complete damage. However, except for particularly severe gross negligence, labour courts may decide differently if there is a disproportion between the employee's salary and the risk of damages. If the employee caused damage with average negligence, labour courts divide the damages between employer and employee according to equity and circumstances of the individual case.

The liability limitations, in principle, do not apply to damage caused to third parties. However, the employee has a right to demand from the employer to be indemnified from liability if he would not or would only to a limited extent be liable according to the principles explained above. If the employee injures a colleague, liability is excluded (sec. 105 para. 1 Social Security Code (*SGB*) VII), and the injured colleague may only claim under the statutory accident insurance

(*Unfallversicherung*). However, if the employee causes damages to a colleague's property, the employee is liable, but may also demand from the employer to be indemnified according to the liability principles applicable in the employment relationship.

D. Labour Law

The most common issues arising in the area of Labour Law in Germany regard works council co-determination rights and transfers of business operations (asset deals).

I. Works Council

The Works Constitution Act (*BetrVG*) provides for participation and co-determination rights of the works council (*Betriebsrat*) concerning managerial decisions in personnel, social, and operational matters. However, the Act is only applicable if a works council in fact exists in the business operation.

Works councils can be elected in business operations:

- with > five permanent employees who are eligible to vote,
- three of which must be eligible to be elected.

The employer may not prevent the election of a works council. The size of the works council depends on the size of the operation. Large operations have binding quotas for works council members who are released from their regular work but still paid by the employer.

The Works Constitution Act (*BetrVG*) distinguishes between the business operation (*Betrieb*), a part of the business operation (*Betriebsteil*), and the company (*Unternehmen*). The business operation is a unit of material and personnel under common management. Parts of such business operation have their own operational leadership with directive authority, but, however, are mostly regarded as belonging to the business operation they are a part of. The company forms the legal entity to which the business operation belongs. On the level of individual business operations, employee co-determination is exercised by works councils and on the company level by supervisory boards (*Aufsichtsräte*).

Employees may also establish a central works council (*Gesamtbetriebsrat*) for an entire company, a group works council (*Konzernbetriebsrat*) for a group, and a European works council (*Europäischer Betriebsrat*) for companies with at least two operations located in different European Member States.

In business operations with more than 100 permanent employees, there shall be elected a so-called economic committee (*Wirtschaftsausschuss*) to discuss economic issues with the employer. Even though the economic committee has no co-determination rights, the employer shall consult it.

II. Co-Determination Rights

1. General Principles

The works council has a general right of information (*allgemeiner Unterrichtungsanspruch*) and co-determination rights (*Mitbestimmungsrechte*) concerning social, personnel, and economic matters. The employer and works council can conclude works agreements about working conditions that are binding for the employer and all employees in the business operation. A violation of the works council's rights of participation and information may lead to losing a trial.

2. Operational Changes

The Works Constitution Act (*BetrVG*) stipulates that in companies with usually more than 20 employees the employer must inform the works council in a timely and comprehensive manner about significant planned operational changes, and discuss such changes with the works council (sec. 111 *BetrVG*).

Operational changes include:

- reduction and closure of the entire business operation or of significant parts;
- relocation of the entire operation or significant parts;
- mergers with another business operation or the spin-off of the business operation;
- fundamental changes to the operation's organisation, to the subject of the business operation, or to its facilities; and
- introduction of fundamentally new working methods and manufacturing processes.

The most common and important case is the reduction or closure of a significant part of the business operation. The labour courts interpret the mere reduction of staff as reduction of significant parts of the business operation if at least 5% of the workforce is affected by redundancies.

In cases of operational changes, the employer must inform the works council and consult its members. The employer is further obliged to conclude a social plan with

the works council, and usually also negotiates a balance of interests. A balance of interests covers the measures of operational changes and the details of their organisational execution. If the parties cannot reach an agreement on a balance of interests, both the works council and the employer may call on a conciliation committee to decide on a balance of interests. The works council cannot force the employer to negotiate a balance of interests. However, the employer should try to reach an agreement on a balance of interests in order to prevent possible claims of employees to compensation of disadvantages (*Nachteilsausgleich*). In contrast, it is mandatory for the employer to conclude a social plan in cases of operational changes. The social plan is intended to reduce the economic disadvantages employees face due to the employer's measures. They therefore usually include compensation payments. If the parties cannot agree upon its contents, a conciliation committee will decide on the details of the social plan. In this case, it is for the labour court to determine the chairman and the size of the conciliation committee if the parties do not reach an agreement in this regard.

In principle, it is crucial that employer and works council reach an agreement on the implementation of operational changes. If no agreement can be reached, it is usually for the conciliation committee to render a decision on the contents of the balance of interests and the social plan. As a general rule, employers and works councils should try to avoid conciliation committee proceedings, because they may be disadvantageous for either party. Moreover, there is only limited possibility to appeal the conciliation committee's decision.

Until an agreement has been reached, the employer usually cannot implement the intended measures and must continue the business operation unchanged. Some district labour courts (e.g. in the states of Hesse, North-Rhine Westphalia, and Berlin) granted the works council even a right to preliminary injunctions preventing employees from being dismissed unless the parties found a balance of interest or the employer initiates and finishes a conciliation committee proceeding.

As a result, it is recommendable for employers and works councils to be well prepared in all phases of planning and negotiating operational changes. Convincing arguments and a detailed plan are the keys to success.

III. Transfer of Business

The central regulation concerning employee rights in case of a transfer of business/undertaking (asset deal) under German law is sec. 613a *BGB,* which was particularly implemented into German Law due to European Union Directives regarding the transfer of business, e.g. the Transfer of Undertakings Directive 2001/23/EC which repealed the Acquired Rights Directive 77/187/EC.

1. Transfer of Employment Relationships

In the case of a transfer of a business, the purchaser of a business "steps into the shoes" of its predecessor and assumes all of its duties concerning the existing employment contracts. Thus, the parties of a transfer of business have to be aware that, according to sec. 613a para. 1 *BGB,* rights and duties that were regulated in a collective bargaining agreement or works agreement usually become part of the individual employment contracts between the employees and the purchaser.

2. Employees' Right to Information

Either the present employer or the purchaser shall, in the case of a transfer of business, inform the affected employees prior to the transfer comprehensively about certain aspects of the transfer by written text, e.g. paper document, email, fax (sec. 613a para. 5 *BGB*).

The employees' right to comprehensive information by written text includes:

- the date or planned date of the transfer,
- the reason for the transfer,
- the legal, economic and social consequences of the transfer for the employees, and
- the contemplated measures with respect to the employees.

3. Employees' Right to Object

Employees can object to the transfer of their employment relationship in writing within 1 month after receipt of the information about the transfer (sec. 613a para. 6 *BGB*). The 1-month period does not begin to run if the information provided was faulty. Therefore, the information text for the employees requires careful drafting. If an employee objects to the transfer of his employment, there is a chance to terminate the employment for operational grounds if there is no possibility of employment with the old employer. However, if the employee does not object to the transfer, all rights and duties of the employment relationship are assumed by the new employer.

4. Special Termination Protection

Employees who are part of the transferred business operation cannot be terminated as a result of the transfer (sec. 613a para. 4 *BGB*). They can be dismissed, however, on other grounds.

5. Liability

The purchaser is liable for all obligations arising from the transferred employment relationships. The seller is liable for obligations arising from employment relationships that ended before the date of the transfer of business. Furthermore, regarding employment relationships that have been transferred to the purchaser, the seller is jointly and severally liable only for obligations which arose before the transfer of business and become due within 1 year after this date (sec. 613a para. 2 *BGB*). Employees who suffer economic losses because of a failure or delay of information according to sec. 613a *BGB* might have a claim for damages.

6. Transfer of Business and Operational Changes of Business

A transfer of business may be connected with operational changes to the business. Often restructuring plans result in the relocation of a part of the unit, fundamental changes in the organisation of this unit, or the restriction and/or closing down of the entire business operation or major parts thereof. This leads to mandatory information and consultation rights of the works council pursuant to sec. 111 of the Works Constitution Act (*BetrVG*).

There are two issues that arise according to sec. 613a *BGB* and sec. 111 *BetrVG* in cases in which a transfer of business includes operational changes:

- information of and negotiations with the works council, and
- protection of and the obligations towards the employees whose employment relationships are transferred to the purchaser.

Thus, it is crucial to be prepared thoroughly in order to have a detailed action plan, time plan, and backup plan with respect to the alternative individual measures to be taken.

IV. Collective Bargaining Agreements

Employees may be bound by collective bargaining agreements because of their membership in the concluding trade union. An employer may be bound by a collective bargaining agreement in two ways: either if the employer concludes a collective company agreement (*Firmen-/Haustarifvertrag*) directly with the trade union, or if the employer is a member of an employers' organisation which concludes a collective association agreement (*Verbandstarifvertrag*) with the trade union. In principle, only the parties (or members of the contracting parties) are bound by the agreement. Employment contracts of non-union member employees may also contain express reference clauses to the provisions of collective bargaining agreements which then become part of the individual employment contracts. Typical contents of collective bargaining agreements are working conditions, particularly remuneration and working hours, overtime, bonuses, holidays, and notice periods.

V. The Principle of Tariff Unity

In July 2015, the Federal Act on Tariff Unity (*Tarifeinheitsgesetz*) which amended sec. 4a Collective Bargaining Agreement Act (*Tarifvertragsgesetz, TVG*) came into force. It stipulates that in a case where colliding collective bargaining agreements (i.e. collective bargaining agreements with different contents and from different unions) would be applicable in one operation, only the collective bargaining agreement of the union which represents most employees of the operation will be applicable.

The constitutionality of the Federal Act on Tariff Unity was reviewed by the Federal Constitutional Court (*Bundesverfassungsgericht, BVerfG*) in early 2017. In its judgement the court found that the Federal Act on Tariff Unity is "mostly constitutional" and demanded some changes to be undertaken by the legislator until December 2018 in order to ensure full constitutionality.

Until such changes are undertaken by the legislator, employment courts will have to decide whether the prevailing collective bargaining agreement of the majority actually represents the losing minority in an appropriate way. Furthermore, the court ascertained that the Federal Act on Tariff Unity does not affect the right to strike (cf. Chap. 19 for further details).

Part I
Employment Law

Chapter 2
Recruitment

Sascha Morgenroth

A. Introduction

Although the recruitment process precedes the formation of an actual employment relationship, certain duties and rights nonetheless apply to the prospective employer and candidate during this process.

B. Recruitment Practice

I. Diversity Issues

Prospective employees[1] are protected from discrimination during the recruitment process in much the same way as actual employees are during their employment. Under the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*), which came into force on 18 August 2006 (see Chap. 11 for further details), a person must not be directly or indirectly discriminated against on grounds of race or ethnic origin, gender, religion or belief, disability, age or sexual orientation. Employers cannot be forced to hire certain candidates, but discrimination during the course of the recruitment process or during employment may lead to claims against employers for damages or compensation. Claims for pecuniary losses could include wages that a candidate could have earned (until the first potential termination date) had he not been discriminated against and had been employed. In some cases,

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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candidates would not have been employed anyway (e.g. because another candidate was better qualified), and so compensation for non-pecuniary losses is limited to 3 months' salary. If a candidate wants to bring a discrimination claim, he must do so within 2 months of receiving a rejection letter from the employer.

II. Pre-Contractual Duties

Certain pre-contractual duties apply during the recruitment process under the Civil Code (*Bürgerliches Gesetzbuch, BGB*). Where an employer misleads an employee into believing that he will be given employment, and the employee leaves his current job in reliance upon this, an employer may be liable for damages. Further, an employer may also be liable if it fails to keep proper application documentation or if it fails to inform applicants that an advertised vacancy is no longer available. Where a candidate decides that he does not want to accept a position, in order to avoid liability he must inform the employer in good time. Neither an employee nor employer will be liable where contract negotiations are abandoned.

C. Recruitment Process

I. Job Advertisements

In Germany, the recruitment process usually begins with employers advertising vacancies in newspapers or on the internet. Employers also recruit through the Federal Employment Agency (*Bundesagentur für Arbeit, BA*) or through professional recruitment agencies.

Job advertisements must not be directly or indirectly discriminatory. Particularly, job advertisements must be drafted as gender and age neutral. As a basic rule, employers are not allowed to ask candidates for their age or date of birth, marital status or photographs. Even though asking for a photograph of a candidate could give rise to a claim for indirect discrimination, it is still common practice for candidates to send a photograph with their application.

II. Application Documents and Applicant Data

1. Application Documents

Job applications in Germany usually consist of a covering letter, CV, copies of reference letters from former employers, and certificates from schools, apprenticeships and universities. The candidate pays for the usual application documents and

the shipping costs. However, it has become increasingly common to hand in applications electronically. The potential employer is not obliged to respond to unsolicited applications or to return them. Any application documents that are sent to an employer in response to an advertisement must be kept. If the candidate is later employed, the application documents form part of his personnel file (*Personalakte*). Where a candidate is unsuccessful in his application, all of the application documents must be returned to the candidate in good condition. The employer will be liable for any loss of or damage to the application documents.

2. Applicant Data

In Germany, there is no obligation on employers to retain data relating to job candidates. However, companies should keep relevant applicant data until the period during which that applicant could bring a discrimination claim has passed. Under German anti-discrimination law, candidates must bring a claim within 2 months of the receipt of a rejection letter and have an additional 3 months to bring the claim to court. Relevant data on an unsuccessful candidate should therefore be retained for at least 5 months from the date of service of the rejection letter.

a) Obligation to Delete Data

Under German data protection law, employers can only keep personal data while it is required for justified interests (which includes for legal protection against discrimination claims). Once the retention of this data can no longer be justified, it must be deleted (cf. Chap. 12 for further details).

b) Aspects of Cross-Border Transfers of Applicant Data

Usually applicant data for positions in Germany remain in Germany. However, foreign multinational companies with an international matrix structure may have reasons to process and store employee and job candidate data centrally in foreign headquarters. The cross-border transfer of candidate data will not be permitted if the candidate concerned can show a legitimate interest that prevents his data from being transferred. Such candidate interest is assumed where the data recipient cannot guarantee an "adequate level of data protection" (*angemessenes Datenschutzniveau*). An adequate level of data protection is only deemed to exist within the European Union (EU) and in countries the EU Commission has declared as providing an adequate level of data protection, such as Switzerland, New Zealand, etc. The U.S., generally, are not considered to provide an adequate level of data protection. Nevertheless, until the *Schrems* Decision of the ECJ of 6 October 2015, U.S. companies that signed up to the "Safe-Harbour-Principles" of

the EU Commission and the U.S. Department of Commerce had been acknowledged as providing an adequate level of data protection. The *Schrems* Decision, however, declared the "Safe-Harbour-Agreement" invalid and as a consequence person related data can no longer be transferred to the U.S. based on this agreement. The EU Commission and the U.S. Department of Commerce drafted a new agreement, the "EU-U.S. Privacy Shield" as a basis for data transfers to the U.S. The EU Commission adopted the Privacy Shield on 12 July 2016 and thereby declared that the U.S. ensures an adequate level of protection for personal data that is transferred from the EU to organisations in the U.S. that are self-certified under the Privacy Shield (cf. Chap. 12).

Alternatively, an adequate level of data protection can also be achieved by using Standard Contractual Clauses (SCC) approved by the EU Commission. The use of Binding Corporate Rules (BCR) can provide an adequate level of data protection in case of data transfers between members of a company group (for both SCC and BCR cf. Chap. 12). Employers can further use encryption methods and other IT-based security mechanisms that ensure data security.

III. The Selection Process: Vetting and Screening

When a job candidate is invited to an interview, employers usually ask questions in order to obtain further information.

1. Procuring Information from Applicants/Job Interviews

a) Asking Questions

An employer can only ask the candidate questions that are reasonable, legitimate, and do not amount to a disproportionate invasion of the candidate's privacy. It is reasonable for an employer to ask questions relating to the vacancy.

It would be unreasonable and unlawful for an employer to question a candidate on the following issues:

- planned or current pregnancy
- illness (however, questions may be permissible if the illness is particularly severe or infectious and may affect the candidate's ability to carry out the position for which he is applying)
- criminal convictions (provided they are not formally recorded on a candidate's criminal record, or are not relevant to the position for which the candidate is applying; however, for example, a current criminal record of embezzlement by a cashier would be relevant)
- union membership
- religion

- membership of a political party
- personal circumstances (e.g. marriage, partnership, sexual orientation).

If an employer asks a candidate a question relating to the above issues during the recruitment process, the candidate is entitled to lie (*Recht zur Lüge*) to the employer. If the candidate is subsequently employed and it is revealed that he lied in response to a question on the above issues, the employer cannot bring any claim against the employee. On the other hand, if the candidate gives a false answer to a permitted question, the employer may challenge the validity of the employment contract for fraudulent misrepresentation.

b) Employee Questionnaires

Employee questionnaires must not ask questions relating to any of the above issues. They may only be used to enquire about those issues that an employer has a reasonable and legitimate interest in and are related to the position in question. Furthermore, where a works council is in place, employee questionnaires must be approved by the works council pursuant to the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*).

c) Assessment Tests, Medical Examinations and Screenings

An employer can require a candidate to undergo a medical examination (*Einstellungsuntersuchung*) and drug screening, provided a candidate has given valid prior consent and the examination relates only to the candidate's suitability for the position and does not violate his personal rights.

Other tests, such as assessment centres, psychological tests or financial background screenings will only be lawful if a candidate has given his prior informed consent and they are conducted by qualified institutions/personnel. The employer must have a reasonable and legitimate interest for obtaining this information. The test/screenings must be sufficiently related to the requirements of the position, must not violate the candidate's personal rights, and the information must not be acquired by other means. Financial background screenings usually require that the position for which a candidate is applying is an executive position or a position of trust.

d) Compensation of Travel Expenses

Candidates that have been expressly invited to an interview with an employer can claim their reasonable travel expenses. This is not the case, however, if the employer stated beforehand that it will not cover travel expenses.

2. Procuring Information from Third Parties

Usually, an employer can only obtain information about a candidate by approaching that candidate. However, third parties can be contacted where the potential employer can show that it has a reasonable and legitimate interest in particular information that cannot be obtained from the candidate. For example, a previous employer could be contacted where further information is required in relation to previous professional activities, or where an employer has evidence suggesting that a candidate has provided false information. Global companies increasingly make use of professional agencies to undertake a full assessment of at least the candidates that have been short-listed. For example, German subsidiaries of major U.S. companies tend to use professional interviewers or request references to get a clearer picture of the candidate. A candidate is entitled to be notified in detail where information relating to him is being gathered.

3. Procuring Information from the Internet

It has become increasingly common for employers to search for information about applicants on the Internet. Whether the gathering of applicant data on the Internet is permissible or not depends on the sources consulted. Generally, employers can make use of any freely accessible online source, i.e. online sources for which a registration is not required. Information that can be found through search engines can therefore generally be consulted by the employer.

The situation is slightly different with regard to social networks. These usually require a registration with the network in order to access it and are therefore not freely accessible. Generally, it is understood that employers can make use of information found on professional social networks the applicant is registered with, e.g. LinkedIn or Xing. It is generally considered that the applicant uses these networks for the purposes of his working life and career and therefore consented to employers using the data from this network. Private social networks such as Facebook or Instagram on the other hand are usually only intended for the private use of the users. It is therefore in principle not permitted for the employer to gather and use information from such private social networks.

IV. Concluding Employment Contracts

Once an employer has decided which candidate to employ, it will make an offer of employment by way of a signed employment contract. The accompanying covering letter should specify the deadline by which the candidate has to accept the employment agreement. The candidate can then decide to accept or reject the offer before

this deadline. Standard offer letters are not common in Germany and should not be used.

For an employment contract to be concluded, there needs to be agreement between the parties as to the work the employee is to carry out and the remuneration to be paid by the employer. Employment contracts can be oral as well as in writing, although it is advisable to have a written contract within which the terms of employment are clearly set out. Under the Part-Time and Fixed-Term Employment Act (*Teilzeit- und Befristungsgesetz, TzBfG*), the agreement on the fixed-term must be in writing; if it is not, the employment is assumed to be for an indefinite period. The employer must confirm the main employment terms to the employee in writing within 1 month of the start of employment as set out in the Documentation Act (*Nachweisgesetz*).

V. Unsuccessful Job Applications

Employers must not make a decision to reject an applicant directly or indirectly based on race or ethnic origin, sex, religion or belief, disability, age or sexual identity. A decision to reject an applicant must be based solely on his suitability for the role. As a general rule, a short, clear covering letter should be sent to the applicant when returning the application documents in order to avoid a claim of discrimination.

VI. Works Council Co-Determination Issues

Where requested by a works council, an employer must first advertise any vacancies within the business. In case a business has more than 20 employees eligible to vote for the works council, an employer must provide the works council with the proposed application documentation and obtain its approval prior to starting the recruitment process. A failure to obtain this approval could result in any subsequent employment contract being invalid, for example, in the situation where the employer has not advertised the vacancy internally. If the works council does not give its approval of the process, it must inform the employer within 1 week of their consultation. If it does not inform the employer of its decision, it is assumed that the process has been approved. Where the works council informs an employer that it has not approved the process, the employer can apply to the labour court for its approval, substituting the works council's consent. The employer does not need the works council's approval before entering into an employment contract with a new employee.

Where an employer uses applicant questionnaires and general abstract selection policies (*Auswahlrichtlinien*) during its recruitment process, these must be

approved by its works council. Where there are more than 500 employees, the works council can request the use of certain selection policies.

D. Reference Letters

Reference letters from former employers form an important part of the recruitment process in Germany. These are important for employers and employees, as they provide useful information relating to previous employment, such as dates and duration of employment.

In Germany, all full time and part time employees have the right to receive a qualified reference letter (*qualifiziertes Zeugnis*) when they leave employment. Employees can request an interim reference letter (*Zwischenzeugnis*) in certain circumstances, e.g. where an employer has announced that it plans to dismiss certain employees at a future date, where a change in job position, area of work or supervisor has been suggested, or where a transfer of business is proposed.

Qualified reference letters must be issued on paper bearing the employer's letterhead and must be titled "*Zeugnis*" (Reference). The reference letter must be in the proper form, i.e. typed, dated and signed by the employer. There must not be any defects, for example stains, crossing-out, corrections, accentuations or underlining. The letter must set out the employee's details, the duration of the employment (including start and end dates), the employee's position and a description of the employee's role, covering the tasks the employee performed. The letter must also address the performance of the employee, as well as his behaviour. This is different from the basic reference letter (*einfaches Zeugnis*), which does not require an assessment of the employee's performance. The labour courts have held that reference letters must be benevolent (*wohlwollend*) but also truthful. An employer does not have to specifically grade each aspect of the employee's employment in a reference letter but it must not hinder an employee's future employment prospects without cause.

When giving details of employee performance, it is common practice for employers to use the following grading system:

Performance evaluation overall grade	*Die übertragenen Aufgaben wurden . . . erledigt.*
Very good (*sehr gut*)	*stets zu unserer vollsten Zufriedenheit*
Good (*gut*)	*stets zu unserer vollen Zufriedenheit*
Satisfactory (*befriedigend*)	*stets zu unserer Zufriedenheit*
Non-satisfactory (*ausreichend*)	*zu unserer Zufriedenheit*
Poor (*mangelhaft*)	*im Allgemeinen zufriedenstellend*

There is also a similar grading system relating to an employee's behaviour:

Behaviour evaluation grade	*Das Verhalten gegenüber Vorgesetzten und Mitarbeitern/ Kunden . . ..*
Very good (*sehr gut*)	*war stets hervorragend*
Good (*gut*)	*war stets gut*
Satisfactory (*befriedigend*)	*war einwandfrei*
Non-satisfactory (*ausreichend*)	*gab keinen Anlass zu Beanstandungen*
Poor (*mangelhaft*)	*war im Allgemeinen einwandfrei*

Sometimes an employee will ask for the reasons for his departure to be included in the reference letter. Some employers include closing words, thanking the employee for his contribution and wishing him well for the future. However, employees cannot force the employer to include such closing words.

Employees may have claims for correction and/or damages where an employer has provided an incorrect, incomplete or delayed reference letter, or where it has refused to provide one. A current employer could bring a claim against a former employer for issuing a false reference letter, but these cases are very hard to prove and do not occur often in practice.

E. Key Aspects

- An employer will be liable where, during the recruitment process (covering advertising, selection process, rejection of applications and conclusion of employment contracts), it discriminates, directly or indirectly, against a candidate on grounds of race or ethnic origin, gender, religion or belief, disability, age or sexual orientation.
- Where there is a works council in place, there may be co-determination rights which need to be observed in relation to the recruitment process.
- Application documents must be securely kept and candidate data must be stored and dealt with in accordance with statutory data protection law requirements. Limitations on the cross-border transfer of candidate data must be observed.
- Employment contracts must contain the main details of employment and should be in writing.
- Employees have a right to receive a benevolent and truthful qualified reference letter (evaluating their overall performance and behaviour) when leaving employment.

Chapter 3
Employment Contracts and Further Legal Sources

Sascha Morgenroth

A. Introduction

Employment contracts can generally be freely agreed among employer and employee.[1] However, the agreed contract terms must comply with the applicable employee protection rules. These are largely influenced by European Union (EU) law and labour court jurisprudence.

Employment relationships and labour relations in Germany are governed by a complex system of different legal sources. Relevant regulations are provided by: EU law; the German Constitution (*Grundgesetz, GG*) and statutory law; collective bargaining agreements (*Tarifverträge*); works agreements (*Betriebsvereinbarungen*); individual employment contracts; general terms and conditions of employment; employers' collective grants and employers' directives; operational practices; the equal treatment principle; and, to a large extent, by labour court decisions.

Conflicts among the legal sources of German employment and labour law are resolved by certain legal principles, which determine the hierarchy and relationship between the different sources. According to the general superiority principle (*Rangprinzip*), higher ranked norms generally override lower ranked norms. For example, constitutional law has priority over statutory law whereas statutory law overrides unwritten legal principles. The pyramid below illustrates a simplified version of the hierarchy of legal norms.

The superiority principle is overruled by the principle of favourability (*Günstigkeitsprinzip*), which provides that lower ranked norms will still apply if

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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they are more favourable for the employee. However, the principle does not apply if another legal source states otherwise, such as collective bargaining agreements which basically block the provisions of works agreements. Where norms are of the same rank, the more specific norm will override the more general norm (*Spezialitätsprinzip*) and the more recent norms will replace the older norms (*Ablösungsprinzip*).

B. Employment Contracts

I. Content

Employers and employees are generally free to agree on the content of individual employment contracts. However, the agreed terms and conditions will only be valid if they comply with the extensive system of employee protection rules which are

superior to employment contracts, in particular mandatory statutory law, collective bargaining agreements and works agreements. Contract provisions which conflict with superior law are generally null and void. Moreover, employment contract provisions drafted entirely by the employer (e.g. where the employer uses a standard contract document intended to be used for at least three employees) are subject to the protection provisions of the Civil Code (*Bürgerliches Gesetzbuch, BGB*) on general contractual terms and conditions (*Allgemeine Geschäftsbedingungen, AGB*). Basically, if such contract clauses differ from these provisions and are to the detriment of the employee, e.g. contain unreasonable disadvantages for the employee or surprising or unclear regulations, they may also be null and void.

The main duties arising from employment contracts are the duty of the employer to pay the employee's salary and the duty of the employee to personally perform his work. There are further implied duties, like the employer's obligation to protect the life, health and safety of its employees, or the employee's duties to observe the employer's instructions, to keep business secrets confidential, to protect the employer's property and not to compete with the employer during the course of the employment relationship.

II. Form

Generally, employment contracts do not need to be in a special form and therefore may also be concluded orally. However, it is advisable to have a written contract clearly setting out the terms and conditions of employment. In practice, most employment contracts (approximately 90%) are concluded in writing. However, the employer must, in any case, confirm the main employment terms to the employee in writing within 1 month of the start of the employment according to the Documentation Act (*Nachweisgesetz*). Under the Part-Time and Fixed-Term Employment Act (*Teilzeit- und Befristungsgesetz, TzBfG*), the fixed-term must be agreed in writing; otherwise the employment is assumed to be for an indefinite period.

C. Further Legal Sources

I. European Union Law and International Law

1. European Union Law

German labour and employment law is largely influenced by EU law. EU law distinguishes between primary and secondary legal sources. The primary law consists of the European Union treaties which provide for some basic employee

rights such as the equality of remuneration of women and men and the freedom of movement of employees within the EU. The secondary law consists of regulations (*Verordnungen*) and directives (*Richtlinien*). Regulations contain directly applicable law. There are, for example, directly binding EU regulations in the area of workplace health and safety. Of particular importance will be the General Data Protection Regulation (GDPR; *Europäische Datenschutz-Grundverordnung*) which enters into force with direct effect for the EU member states on 25 May 2018. Directives on the other hand are the main tool of the EU to harmonise the national laws of the member states. EU directives oblige the member states to implement their binding rules into national law (e.g. the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*) implemented the EU anti-discrimination directives). Directives' rules will only apply directly to employment relationships after implementation into the national law. The European Court of Justice (ECJ; *Europäischer Gerichtshof, EuGH*) in Luxembourg is responsible for the interpretation of EU directives upon submission by the national labour courts. It has jurisdiction to decide whether or not the national laws implementing the directives are in accordance with EU law. Decisions of the European Court of Justice on the interpretation of EU law create precedents. Therefore they are binding upon the national court making the submission as well as other courts dealing with the same matter.

2. International Law

Germany ratified most of the important international charters and conventions of the international organisations it is a member of, particularly those of the Council of Europe, United Nations and International Labour Organization (ILO). Therefore, the most significant principles of international employment and labour law, such as those of the European Social Charter and the European Convention for the Protection of Human Rights and Fundamental Freedoms, are binding on employment relationships in Germany.

II. Constitution and Statutory Law

The German Constitution and the statutory law contain regulations on employment and labour law. The statutory law must be in accordance with the constitution in order to be valid.

1. Constitutional Law

The German Constitution guarantees basic rights (*Grundrechte*) to individuals, particularly human dignity and personal freedom, freedom to choose a profession

and workplace, equality and equal treatment, freedom of speech, freedom of religion, and protection of marriage and family. The freedom of coalition guarantees employees and employers the right to freely decide to join or not to join associations and the right to raise labour disputes, and for labour unions (*Gewerkschaften*) in particular, the right to call strikes. The constitution grants these rights (except the freedom of coalition) against the state but not directly against individuals due to the principle of freedom of contract. However, the basic rights of the constitution have an indirect effect on private law relations, like employment relationships, through the interpretation of employment law statutes. Furthermore, the basic rights constitute an objective system of social values that applies to all employment relationships.

2. Statutory Law

In Germany, there is extensive labour and employment law legislation which provides employees with a comparatively high level of protection. There is no comprehensive unified code on employment and labour law; rather, the regulations are historically contained in the Civil Code, Commercial Code (*Handelsgesetzbuch, HGB*) and numerous specific acts, like the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*), Maternity Protection Act (*Mutterschutzgesetz, MuSchG*), Part-Time and Fixed-Term Employment Act and the General Equal Treatment Act.

In principle, lower ranked regulations, e.g. employment contracts, can provide employees with higher levels of protection (principle of favourability). They must not, however, deviate from the mandatory provisions of statutory law (e.g. minimum annual holiday entitlements according to the Federal Holiday Act (*Bundesurlaubsgesetz, BurlG*)) to the employee's disadvantage.

III. Labour Court Jurisprudence

Although many fields of employment and labour law are codified in specific acts there are large areas of labour and employment law which are not codified (e.g. the law of labour conflicts). In addition, there are regulatory gaps in the statutory law, and statutory language which needs to be interpreted. Therefore, the jurisprudence of the German labour courts, particularly of the Federal Labour Court (*Bundesarbeitsgericht, BAG*), has an enormous influence on the establishment and development of German labour law by filling these gaps. Labour courts render decisions on specific matters but have the effect of legal precedence.

IV. Collective Bargaining Agreements

Collective bargaining agreements can be concluded between a labour union and a single employer or an employers' association (*Arbeitgeberverband*). Pursuant to the Collective Bargaining Agreement Act (*Tarifvertragsgesetz, TVG*), the regulations of such agreements are mandatory and immediately binding on the members of the contracting parties. Therefore, in principle, an employee is only subject to a collective bargaining agreement if he is a member of the respective union. It should be noted, however, that in specific industrial sectors collective bargaining agreements are declared generally binding (*allgemeinverbindlich*) and mandatory for all employees and employers in the sector, irrespective of union membership or membership of the employers' association. The parties to an employment contract can only deviate from the terms of a collective bargaining agreement to the advantage of the employee (principle of favourability). Collective bargaining agreements can regulate anything that might possibly be covered in an employment contract, e.g. remuneration, working time, holiday entitlements or termination notice periods. In these areas collective bargaining agreements basically block regulations by works agreements. If the employment contracts of non-union member employees make express reference to the provisions of collective bargaining agreements, the respective collective bargaining agreements referred to become part of the individual employment contracts.

In July 2015 the Federal Act on Tariff Unity (*Tarifeinheitsgesetz*) came into force. It provides that if there are colliding tariff agreements in one company, only the legal norms of the tariff agreement of the union which had the most members at the time when the latest colliding tariff agreements were concluded shall apply. The Federal Constitutional Court (*Bundesverfassungsgericht, BVerfG*) found on 11 July 2017 that this regulation is "mostly constitutional" and demanded some changes to be undertaken by the legislator until December 2018 in order to ensure full constitutionality. Until such changes are undertaken by the legislator, employment courts will have to decide whether the prevailing collective bargaining agreement of the majority actually represents the losing minority in an appropriate way.

V. Works Agreements

The conditions of employment relationships can also be regulated by a works agreement concluded between an employer and a works council. In contrast to collective bargaining agreements, works agreements apply to all employees of the business operation whether they are union members or not. However, certain conditions (e.g. wages and working hours) can only be regulated if this is explicitly allowed by an applicable collective bargaining agreement.

VI. Employer Directives and Operational Practice

1. Employer Directives

The employer may generally determine the time and place of the employee's work, provided it exercises its discretion reasonably. However, the employer's powers to issue directives are relatively weak since they are subject to strict limitations imposed by superior legal sources such as the express restrictions in employment contracts, collective bargaining agreements, works agreements and constitutional and statutory law.

2. Operational Practice

Employee rights to certain conditions of employment may arise from so-called operational practice (*betriebliche Übung*), i.e. the unconditional, regularly repeated grant of benefits from which the employees may conclude that the benefits will also be granted permanently in the future. This may, for instance, be the case if an employer granted unconditional benefits, like a Christmas bonus or reimbursement of transportation costs, at least three consecutive times. According to a decision of the Federal Labour Court, this shall also apply when unconditional benefits vary in their amount of the payment. As a consequence, employers should grant any benefits with the express reservation that they are voluntary without creating any future rights to the benefit. According to a decision of the Federal Labour Court, existing business practices may not simply be replaced by the fact that employees repeatedly not objected to changes to the benefit criteria (so-called negative operational practice), but only with employees' consent or by respective modification dismissal (*Änderungskündigung*).

VII. Equal Treatment Principle

Employees may base claims to certain employment conditions (e.g. remuneration) on the so-called equal treatment principle (*Gleichbehandlungsgrundsatz*), which is one of the basic legal principles of German labour law. The principle has also been codified in some specific labour law acts, such as the Works Constitution Act (*Betriebsverfassungsgesetz*) and the Part-Time and Fixed-Term Employment Act which provides that part-time and fixed-term employees may not be placed at a disadvantage when compared to full-time and permanent employees. A recent codification on equal treatment is the General Equal Treatment Act, providing protection rights for employees in cases of discrimination based on race, ethnic origin, gender, religion or belief, disability, age, or sexual identity.

According to the equal treatment principle, employers granting certain voluntary employment conditions (particularly remuneration) to the entire workforce of their business, or to employees of individual business parts or to employee groups, instead of agreeing them with the individual employees, are bound by these common employment regulations. Therewith, respective employers are generally prevented from arbitrarily deviating from such common regulations to the detriment of individual employees or employee groups. However, different treatment may be objectively justified, e.g. due to internal employee hierarchy levels.

The Remuneration Transparency Act (*Entgelttransparenzgesetz*), which entered into force in July 2017, aims at enhancing equal payment between male and female employees. The Act provides that in companies with more than 200 employees every employee shall have an individual right to information on the criteria of his/her remuneration and the remuneration paid for comparable work by an employee of the other gender. Employers who employ more than 500 employees have to implement specific review procedures to ensure they have equal remuneration schemes in place for both genders. Employers with more than 500 employees are obligated to issue an annual business report also covering the measures taken to ensure equal pay for both genders.

D. Key Aspects

- German employment and labour law is based on a broad system of different legal sources. Higher ranked norms have priority over lower ranked norms, e.g. constitutional law over statutory law. Lower ranked regulations which are more favourable for the employee may still apply. Among norms of the same rank the more specific or more recent norms have priority.
- Precedents of German labour courts are of particular importance for the establishment and development of German employment and labour law.
- EU Law has an ever increasing influence on German employment and labour law. Many German statutes on labour and employment law implement EU directives.

Chapter 4
Employee or Freelance Worker

Jens Kirchner and Karen Wilhelm

A. Introduction

Under German law the distinction between employees[1] and freelance workers is of particular importance in determining the applicability of employment and labour laws, as well as the payment of social security contributions and the obligation upon the employer to deduct income tax. In practice, the courts have interpreted the meaning of "employee" widely, often finding that relationships which were intended to be construed as freelance were in fact relationships of employer and employee. Consequently, such relationships fall within the scope of German employment law. Employment law offers greater protection to an individual who is an employee in comparison with a freelance worker. As an illustration, the termination of an employment relationship must be in compliance with restrictive employment law provisions which would not apply to a freelance relationship. Furthermore, employers are responsible for the payment of social security contributions and the deduction of income tax from an employee's salary. In order to avoid any doubt as to the status of a relationship, all parties are well advised to carefully analyse whether their relationship truly qualifies as freelance.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Definition Employee and Freelance Worker

A freelance worker (*Freier Mitarbeiter*) is someone who performs services on an independent basis and assumes the sole risk for his business. The "services" of a freelance worker may cover a project to be completed under a so-called *Werkvertrag*, which could be a specific works contract, or work performed within the scope of a so-called *Dienstvertrag*, i.e. a service contract.

The term employee (*Arbeitnehmer*) describes someone who performs services under an employment contract (*Arbeitsvertrag*). An employee will be required to perform services under the direct instructions and supervision of his employer whereas a freelance worker will usually be under no such obligation or duty.

C. Distinction Employees and Freelance Workers

Decisions of the Federal Labour Court (*Bundesarbeitsgericht, BAG*) have helped in understanding how the employment status of an individual will be assessed. For example, one of the major differences between an employee and a freelance worker concerns the degree of independence an individual has within the scope of his contract, as far as his duty to perform services is concerned.

An individual's independence is determined by the extent to which he has to comply with instructions, and stipulations relating to hours of work, the place of work and the nature and extent of the services provided for in the employment agreement.

Additionally, an individual's integration into a business is a further relevant consideration. The degree of integration within a business will be a particularly important consideration when the duty to comply with instructions is limited. It may be, for example, that an individual apparently working for a business independently and on his own initiative will still be sufficiently integrated within the business to be classified as an employee.

D. Evaluation of Employment Status

In order to identify if an individual is an employee or a freelance worker, an evaluation of the relevant criteria developed from decisions of the *BAG* is essential.

I. Duty to Comply with Instructions

According to the case law of the *BAG* it is unclear under which conditions an individual is bound by instructions from a business' managing director. Even in cases in which an individual has unlimited freedom to make decisions in his own professional field (for example, a head surgeon of a university hospital), the *BAG* has confirmed the existence of an employment relationship, deciding that an individual's freedom to make decisions within his professional capacity should not automatically preclude an employment relationship. However, it is important to note in this case that the head surgeon was bound by instructions from hospital management regarding organisational, disciplinary and commercial decisions, which resulted in a classification as an employee. Consequently, situations can also be envisaged in which the existence of an unlimited freedom to make decisions in an individual's professional capacity would not automatically preclude the existence of a freelance relationship.

An individual's freedom to independently decide what tasks to undertake within the range and scope of his ability/expertise will not be sufficient to reject the existence of a duty to follow instructions.

II. Observance of Fixed Working Hours/Working Schedules

An essential factor to consider is whether the individual is under an obligation to attend work on a regular basis and is bound by fixed working hours and working schedules. Should this be the case, it is likely that the services to be performed by an individual are services which qualify as employment services under an employment contract. This is primarily because the individual is under an obligation to follow the specific instructions of his superiors.

III. Place of Work

A further question is whether an individual is required to perform services at a location specified by the employer. Any further integrating measures, whether operational, organisational or otherwise will also be relevant, as they will point towards an employment relationship.

IV. Permission to Work for Others

It is also important to consider if the individual is exclusively working for the business or alternatively is free to carry out professional activities for other businesses without prior approval. If the latter is true, this could assist in demonstrating a freelance contractual relationship.

V. Term of Employment

A key issue is whether an individual has worked for the business over an extensive period of time, as this would potentially indicate an employment relationship. However, there may be exceptional cases in which freelance services have been provided to the same business over a significant period of time.

VI. Tax and Social Insurance Contributions

Another crucial issue is whether an individual invoices the business for his services and adds VAT to the figure. If so, this will assist in asserting that a freelance relationship exists. Any payment of salary during sickness or disability related absence will be relevant as evidence of an employment relationship. If tax and social insurance contributions are deducted from an individual's monthly salary or other payments, this will clearly prove the existence of an employment relationship.

VII. Entrepreneurial Activity

Any entrepreneurial activity on the part of the individual is a typical sign of a freelance relationship. In particular, if an individual hires and employs his own personnel, uses his own financial capital for his activity, uses his own equipment for his work, decides on the extent and timing of any such activity and advertises his activity, this will be evidence indicating entrepreneurial activity, which would potentially classify him as a freelance worker. Where there is no evidence of entrepreneurial activity, this will be a persuasive factor in deciding that an individual is an employee.

VIII. Integration/Hierarchy

This consideration concerns who the individual must report to and whose instructions he must follow. In the event that a managing director is not the only superior who gives an individual instruction and less senior employees also have such authority, then this subrogation would lead to the presumption that an employment relationship exists.

IX. Form of Payment and Holiday

On the one hand an employment relationship is likely to exist if a salary is paid to an individual on a monthly basis. On the other hand, the fact that an individual submits invoices based on fees will not alone be sufficient to argue that a freelance relationship exists. Where, however, an individual consultant submits an invoice for a specific project after its completion, this might point towards a genuine freelance arrangement.

Granting holiday is also an indication of an employment relationship, as is a requirement that any holiday must first be approved by the business. Furthermore, if an individual is paid during holiday this also leads to the presumption that an employment rather than a freelance relationship exists.

X. Intentions of the Parties

The parties' intentions are basically secondary. In order to evaluate whether a freelance or an employment relationship exists, it is of crucial importance to evaluate how the relationship works in practice.

Only when there are very few or no indications that an employment relationship exists, the intentions of the parties and any written terms of agreement will be of importance as a final indicator. Parties should always expressly draft an agreement as freelance if it is intended that an individual shall not be an employee.

If a business is in doubt as to whether an individual performing services for it will be considered as an employee or a freelance worker by the local authorities, it can request a status clearance (*Anfrageverfahren*) in advance to obtain an answer (see below).

E. Typical Factors Indicating Employment Status

The following factors are typically incorporated within contracts of employment and will therefore lead to the presumption that no freelance contract exists:

- Integration within an existing hierarchy;
- Duty to report to employees in addition to the managing director;
- Observation of fixed working hours and schedules;
- Observation of regular attendance at work;
- Prohibition on working for other businesses;
- Provision of services at the business' premises or a specific location;
- Payment of salary via payroll;
- Entitlement to vacation;
- Provision of working equipment and facilities by the employer;
- Keeping personnel records;
- Prohibition on any entrepreneurial activity.

However, the determination whether an individual is an employee or freelance worker has to be based on an overall assessment of all criteria and on a case-by-case basis.

F. Codification into the Civil Code

With effect of 1 April 2017 the German legislator introduced sec. 611a Civil Code (*Bürgerliches Gesetzbuch, BGB*) on the employment contract (*Arbeitsvertrag*) which has the following content:

> Para. 1: Through the employment contract the employee is obliged to carry out work directed by and bound by the instructions of another in personal dependency. The other's right of instruction can relate to the content, mode of carrying out, time, and place of the work. One is bound by instructions if he is not essentially free to organise his work and working time. The degree of personal dependence is also depending on the peculiarities of the respective work. In order to determine whether an employment contract exists an overall assessment of all criteria has to be made. In case the actual way in which the contractual relationship is carried out shows that an employment relationship is carried out, the title of the contract is irrelevant.
>
> Para. 2: The employer is obliged to pay the agreed remuneration.

This new provision is in essence merely a codification of the general rules the labour courts have set up for the interpretation of a contractual relationship as being employment. At the time of writing, the practical consequences of the new sec. 611a *BGB* remain unclear. It seems very likely, however, that case law will still play a decisive role in the determination of employment relationships since the codification uses many phrases that require legal interpretation (e.g. the understanding of being 'essentially free').

G. Legal Consequences

In the event that a relationship intended to be freelance is classified as an employment relationship, there are important implications for a business under German employment and labour, social security and tax laws.

I. Employment and Labour Law

In the event that a labour court finds that a relationship was declared as freelance simply to circumvent social security or other laws, an employment contract will be presumed. Consequently, the freelance worker will—from the point of view of the labour court—be considered an employee from the beginning of his contract. In this situation the individual presumed to be an employee would fall under the protection offered by the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*). An employee can only be dismissed under the Act for business- or person-related reasons or for his misconduct.

II. Social Security Law

It is important to note that local social security authorities are entitled to conduct audits of businesses, which will include an assessment as to the employment status of any individuals engaged by a business. If any relationship treated as freelance by a business is considered as an employment relationship by a local social security authority, the business will be liable to contribute both the employer and employee social security contributions for the last 4 years. More seriously, in the event that social security contributions were not paid and the business knew (intentional conduct) that it was an employment- rather than a freelance relationship, the business is liable for up to 30 years of unpaid social security contributions. It is worth noting that a business can only claim an employee's outstanding social security contributions from the employee for a period of 3 months, by deducting the respective amount from the employee's salary. Any outstanding liability for social security contributions must be paid in entirety by the employer and may not be requested from the employee.

III. Tax Law

Under German law the employer is under an obligation to deduct tax from its employees' salaries. If the employer fails to fulfil this obligation, either by failing to

deduct tax or by not deducting the correct amount, it is liable to pay 4 years of its employees' tax. A business is not responsible for the payment of any tax relating to any freelance workers it engages, as they are responsible for the payment of their own taxes. If the local tax authority considers that a freelance worker should be classified as an employee, the business is liable for any tax which the individual has failed to pay or has paid incorrectly.

In principle, the employee is the taxpayer which means that any money the employer pays to fulfil tax obligations on its employees' behalf can be reclaimed from each employee. This does not apply, however, to cases in which a circumvention of the obligation to pay social security contributions was intended by an employer. As such, if a local tax authority subsequently considers that a relationship intended to be freelance is instead an obvious employment relationship, it is usually very difficult to claim money back from an employee.

H. Status Clearance

In cases where there is uncertainty as to whether the relationship will be classified as an employment or a freelance relationship, businesses have the possibility of requesting an opinion, by filing a request for status clearance to the Federal Pension Insurance Department (*Deutsche Rentenversicherung Bund*). The parties involved will get an opportunity to comment on any proposed decision of the Federal Pension Insurance Department. The parties may also appeal any decision before a court. A status clearance request is therefore highly advisable in cases where the true nature of the contractual relationship is questionable. In practice, businesses are well advised to file such a request at the outset of a relationship, rather than years later, in order to avoid any unwanted consequences, whether financial or otherwise.

I. Key Aspects

- Whether an employment or a freelance relationship exists has to be determined on a case-by-case basis.
- Any circumstances which contradict the relationship intended by the parties should be changed as soon as possible to ensure that no court or authority can be in doubt as to the status of the relationship.
- Any ambiguity will most likely lead to a finding that an employment relationship exists, which could involve very unpleasant surprises for both the individual and the business (e.g. liability for social security contributions and income taxes).
- Attention should be paid to whether the terms of the freelance contract differ from its performance in reality. Even the best freelance contract cannot prevent a labour court or local authority from presuming that an employment contract exists if this conclusion reflects the actual practice between the parties.

Chapter 5
Agency Workers

Pascal R. Kremp and Till Basfeld

A. Introduction

Agency work (also called "leasing of employees[1]") is quite common in Germany and allows the client to be more flexible with its head count, e.g. during peaks in production. Agency workers are often provided by professional agency businesses, but may also be provided by employers (e.g. within a corporate group or joint venture from one group company or joint venture partner to another).

Agency work was legalised in Germany in 1972 by the Act Regulating Commercial Agency Work (*Arbeitnehmerüberlassungsgesetz, AÜG*). This Act allowed commercial agency work to be carried out for a period not exceeding 24 months. In 2003 the law changed and allowed agency work to continue for an indefinite period, meaning the agency (*Verleiher*) had the right to contract out an employee for an indefinite period of time, whereas the client (*Entleiher*) could engage an agency worker like an employee of its own without becoming his actual employer.

The result was that some employers dismissed employees and shortly thereafter hired the same persons as agency workers under reduced employment terms and conditions. This development alerted the legislator. The legislative reform in 2011 provided that temporary workers must not be leased out permanently, but only on a temporary basis. However, the difference between permanent and temporary agency work was not specified, neither were the sanctions for violating the prohibition to lease out employees permanently. This left considerable uncertainty for all parties involved.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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On 1 April 2017, the next legislative reform came into force. Most importantly, a statutory maximum lease period of 18 consecutive months was adopted. If this period is exceeded for an agency worker at a single client, an employment relationship between the client and the agency worker is established unless the agency worker objects because he wants to remain employed by the agency.

The law on agency work is based on the principles of "Equal Pay" and "Equal Treatment". According to these principles agency workers are entitled to the same remuneration and benefits as comparable permanent employees of the client. Lower remuneration of agency workers is only permissible on a collective wage scale basis. All agency businesses have signed up to relatively cheap collective wage agreements (*Tarifverträge*). With only a few exceptions, these collective bargaining agreements offer a comparably low level of remuneration for agency workers carrying out unskilled work. However, the legislative reforms of 2011 and 2017 limited the possibilities to deviate from the principle of "Equal Pay" by collective wage agreement: deviation is now prohibited when the agency worker was employed at the client within the past 6 months. Moreover, the general rule is that even in case a collective wage agreement exists, a deviation from the principle of "Equal Pay" is only permitted for the first 9 months of agency work.

As of April 2017, the client is prohibited from compensating work loss arising from employees who are on a strike with agency workers.

"Subleasing" of agency workers is prohibited too. The agency must conclude an employment contract with the agency worker, it may not contract out agency workers employed by other companies.

B. The Law on Agency Work

I. Permission to Contract Employees to Other Companies

Agency work is permitted in all sectors except the main construction trade.

1. Issue and Withdrawal of the Permit

Agencies must request an agency work permit from the state authorities before an employee can be contracted out when the agency work is conducted "in the course of the agency's economic activities". The term includes all activities where the agency work is offered as a service on a given market. This means that unlike earlier versions of the statute, the work does not need to aim to achieve economic benefits, so non-profit companies and agency work which occurs only as a side effect of a business require a permit, too.

The permit is relatively easy to obtain. It is issued by the Regional Office of the Federal Employment Agency (*Regionaldirektion der Bundesagentur für Arbeit*) for

a limited period of time. However, after 3 years the permit can be granted for an unlimited period of time. Every business which, due to its organisational structure, is able to manage the agency process can apply and obtain a permit in exchange for a fee (currently 1000€ for a temporary limited permit and 2500€ for an unlimited permit). Foreign agencies who contract employees in Germany may also be subject to the restrictions of the Posted Workers Act (*Arbeitnehmer-Entsendegesetz*).

The Regional Office of the Federal Employment Agency may also check the employer's adherence to legal regulations after the permit has been issued, e.g. by requesting relevant information and asking for access to business files (especially personnel files). In cases where legal regulations or valid collective agreements have been breached the Regional Office of the Federal Employment Agency has the right to withdraw the agency permit.

2. Agency Work Without Permit

The operation of agency work without a permit has considerable legal consequences. The *AÜG* states that in the absence of a permit the service contract between the agency and the client as well as the employment contract between the agency and the agency worker are not legally binding. Instead, an employment relationship between the client and the agency worker is established. However, the agency worker has the right to submit a declaration to remain with the agency. The deadline for doing so starts at the beginning of the agency work in cases without permit or at the moment of withdrawal of the permit and expires after 1 month. Submission prior to the start of this deadline is not permissible. The employee has to personally submit the declaration to the Federal Employment Agency, the latter has to verify the employee's identity and the client (*Entleiher*) or agency (*Verleiher*) must receive the declaration within 3 days after submission to the Federal Employment Agency. If the agency work continues even after such declaration without a permit, the service contract between agency and client as well as the employment contract between agency worker and agency will be void again; an employment relationship between client and agency worker is established and these consequences cannot be healed with another declaration of the agency worker.

As a consequence, in cases where illegal agency work occurs, the client as the "new employer" also becomes fully liable for submitting the employee's social security contributions (including the employee's part of the contributions) as well as his income tax.

Moreover, both the illegally operating agency and the client will have to pay a fine of up to 30,000€ for every individual case of illegal agency work.

In order to avoid these considerable legal risks of illegal agency work the client should ask the agency for a copy of the valid permit for agency work before taking on an agency worker.

II. Structure of the Contractual Relations

Agency work is carried out within a triangle of contractual relationships involving the agency (employer), agency worker and client. Thus, there are two contracts which need to be entered into:

- A service contract (so-called temporary hire contract) between the agency and the client and
- An employment contract, which regulates the employment relationship between the agency worker and the agency.

1. Contractual Relations Between Employer and Client

The contracting out of the employee is regulated by the temporary hire contract which is entered into by the agency and the client. This contract needs to be in writing, expressly declared as "agency work" ("*Arbeitnehmerüberlassung*") and state, for example, the number and qualifications of the agency workers provided by the agency, the period of time of the temporary hire and the remuneration which the agency receives for the contracting out of its employees. Furthermore, this temporary hire contract often covers issues concerning liability and warranty between the agency and the client as well as the legal consequences in cases where the employer does not hold a valid permit for agency work. Before the agency work starts, employer and client must determine by name the exact person(s) who will be leased out referring to the contract.

If the names of the agency workers are not determined in advance or the contract does not expressly mention "agency work", an employment relationship between the agency worker and the client is established (unless the agency worker objects within 1 month) and both parties can be sanctioned by fines of up to 30,000€.

2. Contractual Relationship Between Employer and Agency Workers

The employment relationship between the agency and the agency worker forms the legal basis for the employee's obligation to provide his services. The obligation to provide services involves carrying out work for the respective client according to their instructions. The agency has to inform the agency worker prior to each deployment that he will be deployed as agency worker. Otherwise, a fine of up to 1000€ will be imposed upon the agency.

III. Statutory Maximum Lease Period of 18 Months

The key element of the reform of the Regulating Commercial Agency Work Act in 2017 was the adoption of a statutory maximum lease period of 18 months. Agency

workers must not be contracted out to the same client for a longer consecutive period. If the engagement at the client is interrupted for 3 months or less, the periods must be added up. If, however, the interruption is longer than 3 months, the 18-month-period begins to run anew. The application of this maximum lease period started on 1 April 2017; possible previous engagement periods are not included. This makes the end of 30 September 2018 the first date where the maximum lease period can be exceeded. Longer maximum lease periods can be agreed upon in collective wage agreements of the client.

Compliance with the statutory maximum lease period must be carefully observed. In the event of an exceedance the employment contract between the agency and the agency worker is invalid and an employment relationship between the client and the agency worker is established. The only exception is that the agency worker objects within 1 month after the excess because he wants to remain employed by the agency. Again, illegal agency work can also be sanctioned by a fine for the agency of up to 30,000€ for every individual case.

IV. Labour Protection of Agency Workers

German labour law protects agency workers to a similar extent as other employees. They are protected against dismissal in accordance with the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*).

During the period of agency work, the employment relationship with the agency continues. Consequently, the agency remains the agency worker's employer. Nevertheless, the client exercises the rights of an employer during the period of agency work. In line with the right to give instructions, the client determines the tasks/work the agency worker has to carry out during that period.

The agency worker is paid by the agency, even during the period of agency work. It is also the agency who is obliged to pay the employee's social security contributions and income tax. Nevertheless, the client is liable for any unpaid social security contributions.

The agency is responsible for terminating the employment relationship. If there is an intention to dismiss the employee, the legal requirements have to be fulfilled. A dismissal is only possible if the agency is no longer able to employ the agency worker due to operational reasons, i.e. being unable to contract out the employee. The termination of a contract with a client is not always a reason for dismissal. Other reasons for dismissal, such as a violation of the employee's contractual duties or permanent incapacity to work, also enable the agency to dismiss the employee.

The client has no right to dismiss the agency worker. However, the client does have the right to force the agency to take back an unsuitable worker and, if necessary, provide a suitable worker. The client can enforce this right if the agency worker is unable to perform the agreed work or does not carry out the work as efficiently as agreed.

A limitation of the employment relationship between the agency and the agency worker is only permitted within the general limits. The general rules of the Part-Time and Fixed-Term Employment Act apply. Thus, a temporary employment relationship can be limited to a maximum of 2 years when the employment relationship is established for the first time, but it is possible to extend the employment relationship three times within this period. Some collective wage agreements, however, stipulate that the limitation period may be extended to a maximum of 3 years and that four extensions are possible within this period.

V. Health and Safety Regulations

Due to the division of the functions of the employer between the agency and the client which is characteristic for the situation of an agency worker, both the agency and the client are responsible for the agency worker's health and safety in the working environment.

1. Responsibility of the Client

The actual provision of occupational safety can, of course, only be effected by the client. Therefore, it bears the so-called "local responsibility" (*Vor-Ort-Verantwortung*), i.e. it must make sure that occupational safety regulations are adhered to during the period of agency work. In particular, the client must train the agency worker accordingly before work commences and, in the event of changes in his working environment, make him aware of the health and safety dangers to which he may be exposed in the course of the work, as well as measures and facilities for averting such dangers.

2. Responsibility of the Contractual Employer/Agency

On the other hand, the agency as the contractual employer bears the so-called "final responsibility" (*Letztverantwortung*); it must monitor the client's adherence to occupational safety regulations and ensure they are complied with.

VI. Collective Employee Representation

A distinction must be made between the works constitution, the representation of interests and the co-determination of labour.

In the agency's company, agency workers have the same right as other employees to take part in electing a works council responsible for the representation of their

interests in accordance with the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*). Since a majority of agency workers are employed in unskilled work and have periods of unemployment they have a limited choice of who can represent their interests. Collective representation is rarely used where employment is temporary and few agencies have a works council. Along with this, only very few agency workers are members of trade unions.

However, since the agency workers provide services in the client's company it is the obligation of the works council in that company to represent their interests there, as far as they concern work and performance. Moreover, the agency workers are allowed to make use of the works council's consultation hours, attend staff meetings and exercise individual grievance rights at the client company.

If the agency worker's term of assignment lasts for more than 3 months, he is entitled to vote in elections for the client's works council. Agency workers do not have the right to stand for election into the client's works council.

It should be noted that the works council of the client must be consulted before an agency worker is taken on. In particular, the works council of the client must be provided with the contracts between agency and client. The client's works council need not be consulted when the agency worker stops working for the client.

Another important consequence of employing agency workers is the fact that agency workers must be taken into account by the client when calculating whether the number of employees exceed certain thresholds. For thresholds relating to works council rights, at least agency workers with a term of assignment of more than 3 months must be taken into consideration. For thresholds relevant for employee co-determination at company level, agency workers with a term of assignment of more than 6 months must be taken into consideration.

C. Key Aspects

- Agency work is a way of allowing a company to be more flexible with its head count. In Germany, a permit is required for agency work.
- Companies should carefully review agencies; in particular they should ask the agency for a copy of the valid permit for agency work before taking on an agency worker. Furthermore, the client should ask the agency to provide evidence that the agency worker is an employee of that agency and not of another company.
- The relationship between the agency and the client is based on a temporary hire contract which has to be expressly constituted as an "agency work contract" and has to identify the individual agency workers. This is distinguished from the employment relationship which exists between the employee and the agency.
- The statutory maximum lease period with the same client is 18 months. If this period is exceeded, an employment relationship between the client and the agency worker is established unless the agency worker objects because he wants to remain employed by the agency.

- Agency workers are legally entitled to the same employment conditions as comparable permanent employees in the client's business (equal pay and equal treatment). Agencies used to operate on the basis of various area and company wage tariffs, which are tailored specially towards the agency business and which usually provide for comparatively low wages. As of April 2017, this workaround to avoid the equal pay principle is heavily restricted.
- The agency remains the agency worker's contractual employer throughout the term of the contract with the client. The agency therefore bears the risk of employment and must continue to pay the agreed remuneration even when the employee is not contracted out.
- Aspects of occupational health and safety must be observed by both the agency and the client.
- During the agency worker's assignment with the client, the client's works council (if there is one) is responsible for representing the agency worker's interests. If the agency worker's term of assignment lasts for more than 3 months, he is entitled to vote in elections for the client's works council. He is, however, not eligible to stand for election.
- Agency workers may be relevant for thresholds determining works council rights and co-determination on company level.

Chapter 6
Immigration

Sascha Morgenroth and Kathrin Schlote

A. Introduction

Foreigners intending to take up employment in Germany usually require a residence permit (*Aufenthaltstitel*) permitting the employment. Nationals of European Union (EU) member states as well as nationals of the other countries of the European Economic Area (EEA), i.e. Iceland, Liechtenstein and Norway, and also Swiss nationals, are usually entitled to take up employment in Germany without any residence and/or work permit.

B. Residence and Employment

I. EU Nationals and Equally Treated Nationals

1. Residence

Nationals of EU member states are generally treated equally to Germans. Due to the EU law principle of freedom of movement within the EU, nationals of EU member states are entitled to enter Germany with a valid identity card (*Personalausweis,* or similar) and to take residence without any residence permit. However, in order to reside in Germany for longer than 3 months, they must register with the German Registration Offices (*Einwohnermeldeamt*) in the same way as German residents.

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2. Employment

Nationals of the 28 EU member states (i.e. besides Germany: Austria, Belgium, Denmark, Finland, France, Great Britain (at least until the so-called "Brexit", i.e. the withdrawal of the United Kingdom (UK) from the EU according to art. 50 TEU, is completed), Greece, Ireland, Italy, Luxemburg, Netherlands, Portugal, Spain, Sweden, Estonia, Latvia, Lithuania, Poland, Slovakia, Slovenia, Czech Republic, Hungary, Cyprus, Malta, Bulgaria, Romania and Croatia) generally enjoy unrestricted freedom of movement within the EU, which includes the freedom of employment. They are therefore able to take up self-employment or dependent employment without obtaining a work permit.

II. Non-EU Nationals

1. Residence

Non-EU nationals (except, of course, nationals of Iceland, Liechtenstein, Norway and Switzerland) usually require a valid residence permit *prior* to entering Germany.

2. Employment

Work permits are usually granted together with and as part of the residence permit. Non-EU nationals intending to take up employment in Germany must indicate this when applying for the residence permit with the competent authorities (i.e. German embassies, consulates abroad or the aliens offices (*Ausländerbehörde*) in Germany). The German authorities forward the application to the competent local aliens office at the intended place of residence in Germany for approval (so-called "one-stop-government").

3. Types of Residence Permits

a) Visa

aa) Competent Authorities

Visas are issued by the German embassies or consulates abroad. Prior to issuing visas for stays longer than 3 months, for employment in Germany or for nationals of certain countries (e.g. Turkey), the embassies and consulates consult the local aliens office at the place of intended residence in Germany.

bb) Visa Waivers

Nationals of certain countries, however, do not require a visa prior to entering Germany for tourist visits of up to 3 months. This currently applies to nationals of Albania, Andorra, Antigua and Barbuda, Argentina, Australia, the Bahamas, Barbados, Bosnia-Herzegovina, Brazil, Brunei, Canada, Chile, Columbia, Costa Rica, Dominica, East Timor, El Salvador, Georgia, Grenada, Guatemala, Honduras, Israel, Japan, Kiribati, Macau, Malaysia, Marshall Islands, Mauritius, Macedonia, Mexico, Micronesia, Moldavia, Montenegro, New Zealand, Nicaragua, Palau, Panama, Paraguay, Peru, Samoa, San Marino, Serbia, Seychelles, Singapore, Solomon Islands, South Korea, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Taiwan, Tonga, Trinidad and Tobago, Tuvalu, Uruguay, Vanuatu, Venezuela, United Arab Emirates, and the U.S.

If nationals of these countries intend to take up employment in Germany or wish to stay for a longer time period in Germany, they may apply for the required residence permit with the competent aliens office in Germany. However, they must not start to work until they have obtained the required residence permit. Certain activities such as consultations and negotiations during business travel limited in time or attending trade fairs are usually not regarded as taking up work in Germany.

Special rules also apply to Turkey. Due to the agreement dated 12 September 1963 on the foundation of an association between the European Economic Community and Turkey, Turkish nationals may have a right to reside in a country of the European Economic Community. Nevertheless, Turkish nationals may be required to prove their right to reside in Germany by a residence or settlement permit.

cc) Schengen-Visa

Tourist visas and visas for business travel are usually issued as so-called "Schengen-Visas" valid for up to 90 days per 180 day-period and for all 26 member states of the Schengen Treaty. Schengen-Visas particularly require proof that the non-EU national has sufficient funds to last throughout the stay in Germany (e.g. a current bank statement of the foreigner or confirmation of a host in Germany), of sufficient travel health insurance (with an insured sum of at least 30,000.00€), a passport which is valid for at least 6 months from the date of application for a Schengen-Visa, and payment of a fee (in 2017, 60€). The non-EU national must not be a danger to public order, inner security, public health or international relations to another member state.

dd) Visa Information System (VIS)

Since October 2011, the member states of the Schengen area work with the Visa Information System (VIS). The VIS is a system that enables data exchange for short-stay visas between the Schengen member states. The main aims are the facilitation of the application procedure and the border controls to increase security.

The VIS is progressively implemented in different regions of the world by the Schengen consulates and all Schengen-Visa application offices are connected to the VIS since November 2015.

The VIS contains biographic and biometric data of third-country nationals who apply for a Schengen-Visa. From now on the personal appearance to a consulate or an authorised visa centre upon the first application is required in order to receive a short-stay Schengen-Visa. For the follow-up application within 5 years the biometric data can be copied from earlier applications.

ee) National Visa

Visas for longer time periods than 3 months or for employment in Germany may only be issued as national visas.

Upon submission of all required documents (additional documents will normally be needed beyond the Schengen-Visa requirements, e.g. a signed employment contract) and payment of the fee (in 2017 60€), the application will be forwarded for approval to the competent local aliens office at the intended place of residence in Germany. The aliens office will, in most cases, consult with the local employment agency (*Bundesagentur für Arbeit, BA)* for its consent. In particular, the local employment agency reviews whether German or EU citizens are available to fill the position (so-called "priority review", *Vorrangprüfung*), and ensures that the foreign employee[1] will not be employed under less favourable conditions than comparable domestic employees. The entire application process usually takes a few months.

b) Restricted Residence Permit

Non-EU citizens that entered Germany with a valid visa (depending on their nationality, intended purpose and duration of their stay) must apply for a residence permit with the aliens office if they decide to extend their stay or to work while in Germany. Non-EU nationals who have entered Germany without the necessary visa are generally expulsed and may only obtain a restricted residence permit once they have left the country and reentered under fulfilment of the necessary visa requirements.

Residence permits are only granted for specific purposes (e.g. university studies, self-employed work or dependent employment, or for spouses and children of foreign residents) and for a limited time period depending on the purpose of stay. Residence permits may involve further restrictions and conditions (e.g. geographical restraints, time limitations, restrictions to a specific job position).

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

The aliens office reviews whether the general legal prerequisites for a residence permit are fulfilled (e.g. valid passport, sufficient means to live, no reasons for expulsion, German interests not jeopardised). Furthermore, the requirements for obtaining a residence permit vary according to whether the non-EU national intends to study at the university, take up self-employment or dependent employment.

aa) University Studies

Non-EU nationals may be granted a residence permit in order to study at a national or nationally recognised university or similar institution if they have already been accepted by the university. They may also be granted a residence permit for language classes or the attendance of a studying college (so-called preparatory measures). Non-EU nationals cannot obtain a residence permit for any other purpose while they are in possession of a residence permit for university studies. Since August 2012, non-EU nationals who study at a German university are allowed to work 120 full or 240 half days per year. A work permit from the Employment Agency is not necessary. Jobs as an academic or a student assistant can be carried out without such limitation, the aliens office must, however, be informed about the exercised occupation as an academic or a student assistant. Students in language classes or studying colleges (*Studienkolleg*) still need a work permit from the aliens office and employment agency which allows them to work only during lecture-free time.

Upon completion of their university degree, non-EU nationals may obtain a residence permit for other purposes if they fulfil the necessary requirements. This enables them to take up a job immediately after completing their studies. The exerted job must not necessarily be appropriate to the obtained qualification. However, if it is, the residence permit does not require the consent of the employment agency. Accordingly, a priority review does not take place.

Given that the job search can take a considerable amount of time, non-EU nationals may be granted a residence permit for the duration of up to 18 months upon completion of their university degree in order to search for an appropriate position. However, granting of such a residence permit lies in the discretion of the aliens office. During the time non-EU nationals are in possession of such a residence permit, they may work without the consent of the employment agency.

bb) Self-Employment

Residence permits for self-employed work may be granted if all of the following prerequisites are met:

- An economical interest or special regional need,
- A positive effect on the German economy can be expected,
- Secure funding through own capital or a loan commitment.

The prerequisites are examined in terms of the viability of the business idea, the business experience of the non-EU national, the amount of invested capital, and the

effects on employment and training as well as the contribution to innovation and research. Non-EU nationals who are older than 45 years will only receive a residence permit for self-employed work if they have an adequate old age pension.

After 3 years, the non-EU national might be granted an unrestricted settlement permit if the planned business was successfully implemented and if his and his family's livelihood is secured by sufficient income.

A non-EU national may also obtain a residence permit for self-employed work if he has completed his studies at a German university or a comparable institution or disposes of a residence permit for purposes of employment or research. There must be a connection between the self-employed work and the knowledge gained during the university studies or the activity as a researcher.

cc) Dependent Employment

A residence permit may be granted to a non-EU national for the purpose of dependent employment if he has a concrete job offer. The aliens office must request approval from the employment agency in most cases of dependent employment. Certain employment activities, however, do not require the consent of the employment agency (e.g. executive employees with proxy or general power of attorney; executive employees on management board level of companies with businesses located abroad; shareholders; university internships; scientific staff at universities or institutions of research and development).

In principle, approval by the employment agency may only be granted if all of the following requirements are fulfilled:

- No detrimental effects on the German job market and
- The job position cannot be filled by a German or EU citizen (so-called "priority review").

  Note that the employment agency can exempt some areas of employment or economic sectors from the two requirements above.

  or
- The employment agency has decided for certain groups of employment or economic sectors that the employment of foreign workers is reasonable from an economic and political point of view.

In any case, consent can only be given if the non-EU national will not be employed under less favourable conditions than comparable German employees.

The law distinguishes between qualified and non-qualified employment:

Qualified Employment

Consent for employment in job positions requiring at least 2 years professional training may only be granted without priority review to certain groups of qualified non-EU nationals (e.g. those who have obtained their qualification in Germany; caregivers and nurses, provided that their home country's labour administration has concluded an according agreement with the German Federal Employment Agency;

as well as all other qualified individuals if this is necessary to meet the demand for qualified workers on the German employment market). A residence permit may also be granted in individual cases if there is a specific public, especially regional, economic or political interest in the employment of the non-EU national.

Blue Card

In 2012, the blue card has been introduced as a further residence permit based on European Directive 2009/50/EG of 25 May 2009. The blue card is limited in time (up to 4 years) and issued to non-EU nationals with an academic or a comparable qualification and a defined minimal income. The necessary qualification may be replaced by a pertinent job experience of at least 5 years. The minimal income is determined by the Federal Ministry of Labour and Social Affairs (*Bundesministerium für Arbeit und Soziales, BMAS*). In 2017, it was set at 50,800€ gross for ordinary professions and 39,624€ gross for understaffed professions. Compared with other European countries, this minimal income is rather low. In general, Germany has been rather liberal with the transposal of the directive in order to further open up its market to employment immigrants.

Within the first three quarters of 2016, Germany had already given out about 13,166 blue cards.

The employment agency must consent to the granting of a blue card. However, the consent of the employment agency is not necessary if the non-EU national has an income that amounts to at least two thirds of the annual social security contribution ceiling (*Beitragsbemessungsgrenze*) in the statutory pension insurance. A consent of the employment agency is also not necessary if the non-EU national has completed a German university degree, exerts a job that belongs to the job category listed in the recommendation of the European Commission of 29 October 2009 and has a minimal income. Those in possession of a blue card can obtain an unrestricted settlement permit after 3 years. Provided that they are still in employment and prove sufficient knowledge of the German language (Level B1), the unrestricted settlement permit can already be granted after 2 years.

Qualified non-EU nationals can obtain a residence permit for the duration of up to 6 months in order to search for a job that is appropriate to their qualification. The non-EU national must have sufficient means for the whole duration of the stay. Such residence permit cannot be extended. It must be noted that this permit only allows for conducting a job search, but not for actual work.

Intra Corporate Transfer

The EU Directive 2014/66/EU on the conditions of entry and residence of third-country nationals in the framework of an intra-corporate transfer regulates that in case of a transfer of qualified employees within an international group of companies or within operations of one legal entity an intra-corporate transferee permit can be obtained for up to 3 years for managers and specialists and up to 1 year for trainee

employees. The Directive is implemented into German law trough changes in the Residence Act (*Aufenthaltsgesetz*) with effect of 1 August 2017.

According to the Directive, this applies only to non-EU nationals who reside outside the territory of the member state of the time of application and apply to be admitted or who have been admitted to the territory of a member state under the terms of the Directive, in the framework of an intra-corporate transfer as managers, specialists or trainee employees.

Therefore, the foreign employees must hold an employment with the respective foreign group entity or must be employed in a foreign operation of the legal German entity (preceding the date of the intra-corporate transfer for at least 3 and up to 12 uninterrupted months for managers and specialists, and for at least 3 and up to 6 uninterrupted months in the case of trainee employees). It is either necessary that employees are exchanged between a foreign country and Germany (*Personaltausch*) or in connection with foreign projects (*Auslandsprojekten*). Furthermore, it is up to the member states whether they require a period of up to 6 months to elapse between the end of the maximum duration of an "intra corporate transfer" and another application concerning the same non-EU national in the same member state. The German Residence Act requires such "cooling off" period.

The Directive also specifies that non-EU nationals who hold a valid intra-corporate transferee permit issued by the first member state shall be entitled to stay in any second member state and work in any other entity, established in the latter and belonging to the same undertaking or group of undertakings, for a period of up to 90 days in any 180-day period per member state subject to the conditions laid down in art. 21, 22 and 23 of the Directive (so-called short-term mobility). In such a case the Directive provides for an information procedure through which the national authorities of the second member state can ask the entity in the first member state to inform the authorities of both member states concerned of the change of the member state. Contrary to the Directive, the German Residence Act does not allow for a waiver of the information procedure regarding the short-term mobility.

Non-Qualified Employment

Residence permits for the purpose of taking up employment which does not require at least 2 years of professional training are only granted if the agreement to a residence permit has been allowed by regulation for this particular profession or if this is provided for in a bilateral agreement. The professions for which the relevant regulation has allowed the granting of a residence permit include seasonal workers, showmen, au-pairs and domestic helps. Bilateral agreements have been concluded with Turkey, Serbia, Bosnia Herzegovina and Macedonia on residence permits for employees working on the realisation of contracts for work and services (*Werkvertragsarbeitnehmer*).

c) Unrestricted Settlement Permit

Settlement permits grant permanent and unrestricted residence in Germany and generally entitle the non-EU national to take up any self-employment or dependent employment without approval by the employment agency. They are granted if all of the following prerequisites are met:

- Possession of a restricted residence permit for 5 years,
- Sufficient means to live,
- Social security insurance contributions paid for at least 60 months,
- No threat to public order or security,
- The non-EU national is permitted to work in Germany,
- The non-EU national disposes of all the other necessary permits to exert a permanent employment,
- Sufficient knowledge of German language and basic knowledge of the German legal and social system (e.g. successful attendance of an integration course), and
- Sufficient accommodation for the applicant and his family members.

For non-EU nationals who have completed their studies at a German university or comparable institution, the hurdles for obtaining an unrestricted settlement permit are significantly lower. Those non-EU nationals are granted an unrestricted settlement permit if they have exerted an employment that is appropriate to their qualification for at least 2 years and paid into the statutory retirement insurance during those 2 years.

Highly qualified non-EU nationals may, in special cases, immediately be granted a settlement permit if there is a special need for highly-qualified professionals. A concrete job offer must have been made and there must be sufficient evidence that the non-EU national is sufficiently integrated into German culture and that he can provide for his own living without any help from the state. The granting of the permanent settlement permit lies in the discretion of the aliens office.

d) EU Long-Term Residence Permit

Non-EU member state nationals that possess a long-term residence permit in another EU member state can obtain an EU long-term residence permit in Germany. The EU long-term residence permit provides basically the same rights as the national unrestricted settlement permit and has the same prerequisites, except that the non-EU national need not have paid social security insurance contributions for 60 months. Once the EU long-term residence permit is obtained in Germany, the long-term residence permit of the other EU member state ceases to exist.

4. Visa Regulation for Russian Citizens

Russian citizens still need a Schengen-Visa for a short-term stay of up to 90 days per 180 day-period; for longer time periods than 90 days or for taking up employment in Germany national visas are required. However, the entry requirements between the EU and Russia were eased in 2007 with the visa facilitation agreement. This agreement lowered the cost of a visa (35€), allowed for a wider distribution of multiple-entry visas, simplified supporting documents, and waived visas for diplomats.

Furthermore, on 14 September 2015 the Visa Information System (VIS) was introduced to Russian citizens and now applies to the Russian Federation. The EU and the Russian Federation were discussing future visa regimes in order to make travelling between the EU and Russia easier, including the possibility of a visa free regime. Hence, in December 2011 the "common steps towards visa free short-term travel for Russian and EU citizens" were agreed. However, the EU suspended the negotiations in March 2014.

5. Integration Act

In 2016, a new Integration Act regarding a better integration of refugees in the job market and in the society was enacted. Pursuant to the Integration Act, the local employment agency can suspend the priority review whether German or EU citizens are available to fill a job position for a period of 3 years. Thereby, also temporary work is permitted. However, in order to avoid possible negative consequences in regions with tight labour markets, it is up to the German Federal States to decide which employment agencies' districts should implement this amendment.

Refugees may also receive an unrestricted settlement permit after 3 years if their German language skills reach level C1, or after 5 years if their German language skills reach only the lower level A2 of the Common European Framework of Reference for Language, and they are able to mainly secure their living themselves.

III. Administrative Offences

Employing non-EU nationals who do not have the required residence or work permit is an administrative offence. Fines of up to 500,000€ may be imposed on employers who commit this offence. It is also an administrative offence for non-EU nationals to work in self-employment without the required residence permit. Doing so can result in fines of up to 5000€.

C. Employment Relationships with Foreign Employees

I. Principles of Conflict of Laws

Employers and employees may, in principle, freely agree on the law applicable to their employment relationship. Foreign law may generally be agreed to govern employment relationships in Germany but only if this does not result in any unreasonable changes. Particularly if the employment has only links to one country, e.g. only Germany, the choice of law must not exclude mandatory provisions under German law. In order to prevent circumvention of mandatory employee protection laws, the rules of the country where the employee usually performs his work (or if the employee performs his work in several countries without focus on a specific country, the mandatory law of the domicile of the company branch office) cannot be waived effectively (e.g. national employee protection laws on dismissal protection, working-time, holidays, transfer of undertakings). Further, internationally mandatory principles (e.g. the law applicable to mass dismissals) must not be excluded.

If there is no agreement on the applicable law, the applicable law is of the country in which the employee usually performs his work (or if the employee performs his work in several countries without focus on a specific country, the law of the domicile of the branch office). However, a closer link to a different country may be indicated by the circumstances of the employment (e.g. the parties' nationalities or domiciles; contract language; currency of remuneration; place of conclusion of the contract). If this is the case, the law of that country would apply.

German collective labour law, social security and tax law, in principle, apply to employees working in businesses in Germany and residing in Germany (so-called "territoriality principle").

II. Social Security Insurance

1. General Principles

Employees permanently working in Germany are generally subject to German social security insurance contributions. Consequently, employer and employee have to pay about half of the mandatory social security insurance contributions respectively. Those amount to approximately 40% (i.e. employer and employee each pay about 20%) of the employee's gross salary up to the applicable social security contribution ceiling effective from time to time. The employee's share is deducted from his gross salary and the employer pays its share on top. The employer is generally also responsible for the payment to the respective social security insurance authorities.

2. Citizens of the European Economic Area and Switzerland

With respect to EU citizens and citizens of the other countries of the European Economic Area (i.e. Iceland, Liechtenstein, Norway) and Switzerland, EU law provides regulations coordinating the various national social security schemes of the member states in order to avoid that employees have to pay national insurance in more than one member state. These regulations are directly applicable and, in principle, have priority over German law. The main object of the regulations is to regulate the applicable national social security scheme. Generally, the law of the place of employment applies. In case of secondments from abroad of up to 24 months, employees may remain subject to the social security law of their home member state. The competent home state social security administration issues a secondment certificate (form A-1) which is binding upon all other member states. It may be extended for further 24 months upon application if the required extension was not foreseeable. The competent authorities of the member states (which in Germany is the *Deutsche Verbindungsstelle Krankenversicherung Ausland, DVKA*) may agree on further exceptions.

3. Citizens of Other Countries

Germany has concluded bilateral social security treaties (*Sozialversicherungsabkommen*) with several countries on the applicable national social security law to prevent double insurance.

According to the social security treaties, the employee may remain subject to foreign social security laws. This may be the case if the employee is only seconded for a limited term (e.g., in case of secondments from the U.S. to Germany: fixed-time periods of up to 60 calendar months, i.e. 5 years) by his foreign employer from his home country to Germany in order to perform work for the foreign employer and to the latter's costs. The secondment agreement must clearly stipulate that the employee returns to his employer in his home country after the expiry of the fixed-term. The competent home country social security administration issues a respective secondment certificate on the applicability of the social security scheme abroad.

The social security treaties may apply to all or only certain branches of the national social security schemes (e.g., the treaty between Germany and the U.S. applies only to statutory old-age pension insurance, but not to health insurance, nursing insurance, unemployment and accident insurance). If certain social security branches are not covered by such treaty, or if no bilateral treaty exists at all (e.g. with Indonesia, or South Africa), in principle, the employee might be subject to social insurance abroad and in Germany, i.e. double insurance is generally not excluded.

III. Tax

1. General Principles

Taxation of the employee's income depends on his domicile or usual residence, irrespective of his nationality. In principle, if the employee is domiciled or has his usual residence in Germany, his income for his activities physically performed in Germany is subject to taxation in Germany.

2. Double Taxation Treaties

Germany has concluded bilateral so-called "double taxation treaties" (*Doppelbesteuerungsabkommen, DBA*) with several (EU- and non-EU-) countries, in order to avoid the same income being taxed in both countries. Most of the treaties are based on the OECD model treaty.

For example, according to the double taxation agreement between the U.S. and Germany, in principle, if the employee is a resident in the U.S. or Germany and working in Germany, he has to pay income taxes in Germany. However, if the employee is a U.S. resident he may be exempt from income taxes in Germany if all of the following three requirements are fulfilled:

- He is present in Germany for one or more time periods not exceeding in sum 183 days in the respective calendar year,
- The remuneration is paid by, or on behalf of, the employer who is not a resident in Germany, and
- The remuneration is not borne by a permanent establishment or a fixed base of the employer in Germany.

The last two requirements may be fulfilled if the remuneration will be paid by (or on behalf of) the company residing in the U.S. and will be borne by that company. As a result, only if the employee is a U.S. resident and present in Germany for a time period not longer than 183 days per calendar year, he is generally free from income tax obligations in Germany; however, if the employee stays more than 183 days per year in Germany, he is generally subject to German tax law. Of course, if the employee is a German resident, he is subject to German tax law and the exception explained above does not apply.

D. Potential Impact of the Brexit

The eventual implications of the UK's withdrawal from the EU, the so-called "Brexit", on employment law and immigration law will largely depend on the negotiation process with the EU. Independently of the negotiation process,

EU law would stop applying to the UK 2 years after the announcement of the withdrawal intention which occurred on 29 March 2017, as regulated by the Treaty on the European Union.

Following the withdrawal from the EU, UK citizens in the European Union could, in the worst case, lose their status as citizens of the EU which could consequently lead to a suspension of free movement in the EU for them. They might then no longer fall under the scope of the German Freedom of Movement Act (*Freizügigkeitsgesetz/EU*) which implements Directive 2004/38/EG. This could also apply vice versa to EU citizens who live and work in the UK.

However, there is a considerable uncertainty as the impacts of the withdrawal process of the UK on employment law and immigration law—and in fact any area of the law—will depend on negotiations with the European Union and each member state. At the time of writing three options seem possible: first, the UK remaining in the European Economic Area with the consequence that both parties still operate in accordance with the four freedoms (goods, capital, services and workers), secondly the UK joining the European Free Trade Area (EFTA) under a separate legal structure after withdrawing from the EU, and thirdly arrangements with single member states regarding immigration matters.

The current developments of the negotiation process between the EU and the UK should be closely monitored by employers in order to be able to adjust in time to any potential changes.

E. Key Aspects

- Foreigners intending to work in Germany usually require a residence permit containing a work permit prior to entering Germany. This generally does not apply to EU citizens and nationals of other countries in the European Economic Area,i.e. Iceland, Liechtenstein and Norway, or Swiss nationals.
- Employing an employee without the necessary residence or work permit is an administrative offence and may result in fines of up to 500,000€ for employers for each case. It is also an administrative offence for non-EU nationals to work in self-employed work without the required residence permit—fines of up to 5000€ may be imposed.
- Foreign employees working in Germany are usually subject to German social security and income taxes. However, exceptions may apply, particularly where bilateral treaties have been concluded.

Residence permits are issued as
Visa (*Visum*)
Restricted residence permit (*Aufenthaltserlaubnis*)
Unrestricted settlement permit (*Niederlassungserlaubnis*)
EU long-term residence permit (*Erlaubnis zum Daueraufenthalt EU*)
Practical advice
If in doubt as to whether the intended activity requires a permit, it is advisable to consult the German authorities in advance. Required residence permits should be obtained prior to entering Germany.
Member states of the Schengen Treaty
Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxemburg, Malta, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, and Switzerland.
Practical advice
In order to avoid liabilities, employers should only allow nationals of non-EU and the more recent EU member states to work for them upon proof of a valid residence permit and/or a sufficient work permit valid for the term of employment.
Bilateral social security treaties exist between Germany and
Australia, Bosnia-Herzegovina, Brazil, Canada and Quebec, Chile, China, India, Israel, Japan, Kosovo, Macedonia, Montenegro, Morocco, Philippines, Serbia, South Korea, Tunisia, Turkey, Uruguay, and the USA.
Practical advice
In each case the competent social security administration (of the foreign employee's home country or in Germany) should be consulted well in advance in order to obtain reliable information on the national social security scheme applicable to the employee.

Chapter 7
Employee Secondments

Jens Kirchner and Pascal R. Kremp

A. Introduction

It has become common for employees[1] to be seconded to foreign countries. Germany, as an export nation, has traditionally had close links to foreign markets, and foreign companies often second their employees to Germany. There are many different reasons for such secondments, for example, where the company has entered into a new market and the employee is tasked with setting up a local branch office or entering into a joint venture to establish a presence in the new market. Sometimes an employee is seconded to a foreign office to coordinate development and expansion, or to bring specific expertise into the new market. In all cases, however, both employer and employee face many issues that should be addressed in advance of the secondment. Consequently, the terms and conditions of the secondment contract should be carefully drafted, for example in order to avoid disappointment or dispute among the parties in the event of termination of the secondment as well as in cases where the employment itself terminates.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Cultural Awareness and the Appropriate Secondee

To ensure that the secondment will be successful, both for the company and the employee, it is often crucial to provide a cultural awareness training before its commencement.

In many cases secondments fail because of the significant cultural differences; a cultural awareness training ensures that the transition from the domestic culture to the foreign culture goes smoothly.

Surprisingly, companies often fail to place sufficient focus on the language skills of secondees. If the purpose of the secondment is merely to broaden the employee's experience it might be acceptable for a company that a secondee is not fluent in the local language. If, however, the company aims to achieve more than broadening the employee's experience, particularly if the purpose of the secondment is to expand the business to the foreign market, it is extremely helpful if the secondee is familiar with the local language and market. The individual will not only need certain language skills but also a very good understanding of local culture, customs, and business practice.

Because of these difficulties in establishing a domestic employee abroad, it may be advantageous, in some regards, to hire a local person who is acquainted with the foreign market. At the same time it must be considered that the local person has not yet developed close ties to the company.

C. Employment Law Issues

I. Contractual Structure

The contractual structure of the secondment depends very much on the purpose of the secondment. On one hand, if the employee is only posted for a short time (e.g. only a few weeks for a short term project), this will not usually result in any relevant amendments to the existing contract of employment. On the other hand, if the employee is posted for an indefinite period of time, it is strongly recommended that an agreement is entered into with the local subsidiary, while the contract with the original company is terminated.

Most secondments fall into one of these two basic categories. Usually the employee will be seconded to the foreign country for several months or years, but it is planned that he will return to the original employer at some point. In this situation, the parties may agree on a supplemental agreement to the initial employment agreement in order to cover the temporary employment abroad.

Alternatively, the employee may enter into a new employment contract with the foreign entity, suspending the operation of the contract with the original employer for the duration of the secondment. In this case, the original contract would revive upon the employee's return.

Furthermore, and particularly in the case of longer term secondments (e.g. upwards of 3 years), it is often advisable to enter into a separate secondment agreement that replaces the original contract of employment. Moreover, often the employer will be uncertain whether the same or a similar job position will be available upon the employee's return. Therefore, it is usually advisable to end the original employment rather than suspending it for the duration of the secondment. The parties should take the length of the employee's absence and the potential for his replacement into account when drafting the basic terms of return from secondment.

Typical contract models of secondments

1. Employee receives a supplemental agreement with original employer
2. Local employment agreement with foreign entity, suspending the operation of the original contract of employment for the duration of the secondment
3. Local employment agreement with foreign entity while a separate secondment agreement replaces the contract with the original employer

In evaluating the best structure for the secondment agreement, consideration should be given to the documentation required to obtain a work permit for the employee. In some countries it will be necessary for an employee on secondment to possess a local contract of employment.

Moreover, it should be noted that, in all cases, harmonisation of the essential terms of employment of the original and new contracts must be ensured. In particular, this applies to notice periods, terms of post-contractual non-competition clauses, non-solicitation clauses and so-called "garden leave" provisions. Secondment terms that deviate from the terms of an additional agreement with the foreign entity often result in major disputes between the parties. For example, a secondee might wish to end the secondment prematurely in order to join a competitor abroad, whilst the original employer wants to hold him to his non-compete obligations for as long as possible. If the secondee then remains abroad, as in most cases, it will be difficult for the original employer to enforce a preliminary injunction against him.

II. Content of the Secondment Agreement

In all cases, several areas should be addressed in the contract in order to ensure a sound legal basis for the secondment and to avoid disappointment on the employer's and the employee's side. Typically, the areas covered in this type of agreement are:

1. Job Description/Reporting Structure

The job description, purpose of the secondment, and the reporting structure of the secondee should be covered in the secondment agreement.

The secondment agreement should include a brief outline of the job the employee will be required to do while abroad. Furthermore, it should include the purpose of the secondment (e.g. setting up a production site abroad) to ensure that there is no misunderstanding about this. Moreover it is important to lay down the reporting structure (e.g. to someone locally or to his company of origin) before the secondment commences to ensure that there are no misunderstandings as to who has the authority to issue instructions to the secondee.

2. Duration of the Secondment

The duration of the secondment should be clearly specified in the agreement. In practice, however, many agreements omit to stipulate the duration of the secondment, creating the potential for legal disputes between the parties. Additionally, the parties may stipulate whether the secondment may be extended mutually or unilaterally and set the length of such an extension in the contract.

Furthermore, the agreement should regulate whether either party may terminate the secondment prematurely and, if so, whether this will result in the termination of the general employment relationship with the original employing entity. In this context, in particular resignations from management positions which the secondee may hold within the company or any associated company should also be addressed.

3. Expenses for Preparatory Training

Preparatory courses (e.g. cultural awareness, language skills) can turn out to be expensive, and this expense is usually borne by the company. The company should ensure that the employee is obliged to reimburse the company for these expenses if he does not begin the secondment or terminates the secondment prematurely.

4. Remuneration

In general, the employee will draw a higher remuneration during the term of the secondment. Whilst the base salary and bonus payments may change, the company usually provides an allowance to cover a higher cost of living. Depending on the position the employee holds within the company the employer may provide for tuition, childcare or similar benefits.

Further, the parties should agree on the currency in which the remuneration will be paid (and therefore who will bear the risk of fluctuating exchange rates) and the

bank account into which it will be paid (i.e. either to the employee's bank account in his country of origin or to his account in the foreign country).

The costs of the employee's relocation to the foreign country and of his return to his home country are usually borne by the employer. However, in circumstances where the employee terminates the employment during the secondment, the contract may stipulate that the employer will not be responsible for the costs of his return to his home country.

If the employment agreement with the original employer is dormant during the secondment, the employee's salary following his return should be agreed upon in advance. Typically, parties agree that the employee will be entitled to the same increase in salary as comparable employees received during the term of his secondment.

5. Annual Leave and Public Holidays

Under German law an employee is entitled to a minimum of 20 working days annual leave, based on a 5 day working week. Depending on the individual circumstances, this rule may also apply to inbound secondments to Germany or may not apply to outbound secondments. It should be clarified at the outset whether the employee will be subject to the same terms as local employees or employees in his country of origin. With regard to public and bank holidays it will be necessary to clarify whether the employee will observe local public holidays or the public holidays applicable in the country of origin.

6. Travel Expenses

While business travel expenses are usually regulated by the company's travel policy, the company might also provide for reimbursement of private expenses for non-business related flights home. If the employee is entitled to reimbursement for private travel, the conditions of such trips (e.g. their frequency, whether they will be by economy or business class) should be agreed upon. A decision should also be reached as to whether travel costs for family members (e.g. spouse, partner, marital/non-marital children) shall be covered by the company.

7. Emergencies

It is quite common to provide flights home in case of an emergency within the employee's immediate family. The agreement should specify who falls within the scope of the immediate family and what constitutes an emergency. In addition, it should be stipulated that the employee is obliged to consult with the employer regarding travel expenses before commencing the journey.

In cases of political unrest (e.g. riots), natural disasters (e.g. earthquakes), health hazards (e.g. epidemic dangers), or risk of detention, the employee should be contractually obliged to leave the country of his secondment.

8. Return of the Employee

Many companies and employees do not give sufficient consideration to the return of the employee after termination of the secondment. In practice, the terms and conditions of return are often of crucial importance, both for employee and employer. The employee will usually seek maximum job security upon return from secondment or a generous severance package in case no suitable alternative position can be offered. The employer will often require a long-term commitment by the employee which offers the company sufficient flexibility to withstand shifts in the economic landscape. Post-contractual non-compete clauses can provide a certain level of security for the company and allow it to protect its interests. At the same time, however, the cost of compensation for non-compete clauses needs to be taken into consideration. Another problem faced by many companies is a failure to reintegrate former secondees, resulting in them leaving their jobs shortly after their return. The reasons for this vary but may include changes to the management and business environment during the period of secondment or the fact that the employee has been demoted following his secondment. The fact that many employees are promoted for the duration of their secondment often adds to the feeling of having been downgraded upon return. Crucially, this failure to reintegrate will see the company losing out on a return on their investment in the employee's know-how and experience during the secondment.

In order to ensure the employee's successful reintegration the parties should discuss the issue honestly and well in advance of his return. It may be stipulated in the relevant agreement that the employee will be offered the same level of job that he had prior to the secondment. Due to the often lengthy duration of secondments, however, it will usually be difficult for the employer to guarantee a specific position for the employee upon his return.

9. Other Issues

In addition to the above, the following issues are often relevant and should be considered in the drafting of the secondment agreement:

- Confidentiality
- Intellectual property
- Non-competition
- Employee's share options

The requirement of respective clauses usually depends on the business environment of the employer and the specific job position of the employee.

10. Governing Laws

Whether the individual employment relationship is governed by German law or the law of the foreign country shall be determined on a case-by-case basis. A review of the international conflict of laws rules of the respective country is sometimes necessary. It is strongly recommended that the governing law is identified in the secondment agreement. If the contract with the original employer has been suspended for the duration of the secondment, the original contract usually continues to be governed by the laws of the country of origin and the secondment contract by local laws.

D. Social Security

As a general rule, every country has the power to regulate its social security system and its participants. Therefore, under German law and in accordance with the territoriality principle (*Territorialitätsprinzip*), both German nationals and non-nationals, working on a permanent basis in Germany, will be subject to Germany's mandatory social security system, i.e. state pension insurance, health insurance, unemployment insurance, and nursing insurance. However, there are exceptions to the territoriality principle by supranational laws; these are, basically, European Union (EU) law (I.), and bilateral social security treaties (II.). With regard to secondments to/from countries outside the EU or the European Economic Area (*Europäischer Wirtschaftsraum, EWR*) exceptions to the territoriality principle may also arise due to the principles of "inward/outward radiation" (*Einstrahlung/Ausstrahlung*) (III.).

I. European Union Laws

Provided that the anticipated duration of their work does not exceed 24 months, European Union (EU) citizens or foreign citizens with legal residence within the EU who are seconded to countries in the EU or the European Economic Area (EEA) fall exclusively under the social security system of their country of origin. In this case, the employee should apply to his insurance provider to issue him with a secondment certificate (form A-1; for Switzerland form E-101) (*Entsendebescheinigung*) regarding the social insurance coverage of the employee.

II. Bilateral Social Security Treaties

In order to avoid duplicating the employee's insurance from his country of origin where he meets the requirements for local social security as well, Germany has entered into bilateral social security treaties with the following countries outside of the EU and EEA:

Country	Area (of social security) comprised	Status
Albania	Pension insurance	Agreed in September 2015, not yet in force at time of writing
Australia	Pension insurance	In force
Bosnia-Herzegovina	Pension, accident, unemployment and health insurance; child allowance	In force
Brazil	Pension and accident insurance	In force
Canada	Pension insurance	In force
Prov. Quebec	Pension insurance; agreement on provision of benefits in kind in the accident insurance	In force
Chile	Pension insurance	In force
China	General posting of workers agreement	In force
India	General posting of workers agreement; Pension insurance agreement	Pension insurance agreement that integrates the general agreement made in October 2011, not yet in force at time of writing
Israel	Pension and accident insurance; agreement on maternity aid in the health insurance	In force
Japan	Pension insurance	In force
Kosovo	Pension, accident, unemployment and health insurance; child allowance	In force (although with difficulties in practice due to limited administration in Kosovo)
Moldova	Pension and accident insurance	Signed 12 January 2017, not yet adopted by parliaments at time of writing
Morocco	Pension, accident and health insurance; child allowance	In force with the exception of agreement on benefits in kind in the health insurance
Macedonia	Pension, accident, unemployment and health insurance	In force
Montenegro	Pension, accident, unemployment and health insurance; child allowance	In force
Philippines	Pension insurance	Agreed in September 2014, not yet in force at time of writing
Republic of Korea	Pension insurance	In force

(continued)

Country	Area (of social security) comprised	Status
Serbia	Pension, accident, unemployment and health insurance; child allowance	In force
Turkey	Pension, accident and health insurance; child allowance	In force
Tunisia	Pension, accident and health insurance; child allowance	In force
Uruguay	Pension insurance	In force
USA	Pension insurance	In force

As can be seen in the table above, not all of these treaties cover all social security subjects. Thus, if no treaty exists at all or if the treaty does not cover all forms of insurance, the risk of duplicating insurance still exists. In such cases, it is important to review at an early stage whether the employee will be subject to both countries' security systems. Often, there is a possibility for an exemption by the public authorities if the secondment is for a fixed-term, e.g. the United States will allow exemptions for secondments of up to 5 years. This also applies to inbound secondments to Germany.

III. Principles of "Inward/Outward Radiation"

In relation to secondments to/from non-EU countries with which no bilateral treaties have been concluded, an exception to the territoriality principle applies if, in the course of a continuing employment relationship with a foreign employer, employees are temporarily seconded to Germany. The employee must

1. Be seconded for a fixed-term only,
2. Have entered Germany in the course of his secondment alone, and
3. Continue to receive instructions from his employer abroad.

In these cases the employees are subject only to the foreign social security system, due to the principle of inward radiation (*Einstrahlung*). In contrast, employees seconded from Germany to a foreign country basically remain subject to the German social security system, according to the so-called principle of outward radiation (*Ausstrahlung*). If the employee is seconded to the foreign country

1. Only for a fixed-term,
2. Continues to receive instructions from the German employer, and
3. It is intended that he will return to the original employer upon termination of the secondment

the prerequisites of outward radiation are met.

E. Tax Laws

Generally, the employee is subject to the tax laws of his country of residence. In case of a secondment there is a risk that the employee will be deemed to be resident in both countries, i.e. the country of origin and the foreign country. In order to avoid double taxation, Germany has entered into double taxation treaties (*Doppelbesteuerungsabkommen, DBA*) according to the OECD Model Convention With Respect To Taxes On Income And On Capital (OECD Model Tax Convention) with more than 90 countries:

Albania	Ireland	Philippines
Algeria	Island	Poland
Argentina	Israel	Portugal
Armenia	Italy	Serbia
Australia	Jamaica	Singapore
Austria	Japan	Slovakia
Azerbaijan	Jersey	Slovenia
Bangladesh	Kazakhstan	South Africa
Belarus (White Russia)	Kenya	Spain
Belgium	Kyrgyzstan	Sri Lanka
Bolivia	Korea, Republic	Switzerland
Bosnia-Herzegovina	Kuwait	Sweden
Bulgaria	Latvia	Syria
Canada	Liberia	Tadzhikistan
China (without Hong Kong and Macau)	Lithuania	Thailand
Costa Rica	Liechtenstein	Trinidad and Tobago
Côte d'Ivoire	Luxembourg	Tunisia
Croatia	Macedonia	Turkey
Cyprus	Malaysia	Turkmenistan
Czech Republic	Malta	Ukraine
Denmark	Mauritius	United Arab Emirates
Ecuador	Mexico	United Kingdom
Egypt	Moldova	United States of America
Estonia	Mongolia	Uruguay
Finland	Montenegro	Uzbekistan
France	Morocco	Venezuela
Georgia	Namibia	Vietnam
Ghana	Netherlands	Zambia
Greece	New Zealand	Zimbabwe
Hungary	Norway	
India	Pakistan	
Indonesia	Romania	
Iran, Islamic Republic	Russia	

In principle, where a double taxation treaty applies, the employee will be taxed in the country where he actually works, if he

1. Works there for more than 183 days in the calendar year, and
2. Is paid by the local employer in whose business he works.

Otherwise, the employee is only taxed in the country of his origin.

Usually, the company provides for a tax advisor who will assist the employee for at least the first year of the secondment. However, it should be stipulated in the secondment agreement that income tax payments are the responsibility of the employee alone. In countries where fiscal administration authorities are not organised very efficiently or where cases of tax fraud are frequent, it is often advisable to appoint a tax advisor for the income tax of the employee for the duration of the secondment. This will allow the employee to retain control over the proper taxation of his income and to provide the fiscal authorities with evidence of that taxation where necessary.

F. Key Aspects

- In order to guarantee a successful secondment a thorough preparation is essential.
- The secondment agreement must be carefully drafted to reflect the laws of the country of origin as well as those of the country of secondment.
- Reference must be made in advance of the secondment to relevant social security and tax laws.
- The terms of the original contract and the secondment contract must be harmonised in order to prevent subsequent legal disputes.
- It is recommended to consider well under what conditions the employee shall return to his country of origin.

Chapter 8
Pay and Benefits

Jens Kirchner and Sascha Morgenroth

A. Remuneration

I. Agreements

Remuneration of employees[1] can be regulated by individual contract of employment as well as by collective bargaining agreement. Salary can be negotiated between employer and employee. However, an agreement on salary may be deemed to be null and void if the work performed and the salary agreed are grossly disproportionate (i.e. salary extortion) (*Lohnwucher*). A salary will be found to be grossly disproportionate if the employee is paid less than two thirds of the amount agreed by way of collective bargaining or of the comparable customary remuneration. In cases of salary extortion the employee has a right to receive the customary remuneration.

It should be noted that remuneration can be grossly disproportionate even when it is at the level of the statutory minimum wage (*Mindestlohn*). This may be the case where the indications of gross disproportion between the work performed and the salary paid, as stated above, are given.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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II. Remuneration for Overtime Work

There is no statutory obligation for employers to pay employees for overtime worked. Many collective bargaining agreements, however, contain comprehensive rules in relation to overtime, and according to respective case law, employers have to pay employees for overtime worked if they work in excess of their contractually agreed working hours and in the specific case it cannot be expected of them to do so without remuneration. In practice, employers are sometimes unaware of overtime worked. To avoid disputes about such overtime it is advisable to implement comprehensive overtime regulations. The employer could, for example, provide payment for overtime only in circumstances where the work had been previously approved by it.

A clause in the employment contract which generally states that all overtime work is already included in the remuneration or that the employee has to work overtime "according to the business' needs" is deemed not to be transparent because the employee cannot estimate how much work he will have to provide for the remuneration.

With regard to the Act for the Regulation of a General Minimum Wage (*Gesetz zur Regelung eines allgemeinen Mindestlohns, MiLoG*) employers need to observe the following two special situations:

First, the monthly remuneration has to meet the statutory minimum wage even in cases where a lump-sum payment for overtime work is made, i.e. the employee must receive the statutory minimum wage on an average for all hours actually worked.

Secondly, it is questionable whether overtime pay and/or supplemental pay can be included in the calculation to meet minimum pay requirements.

III. Minimum Wage

The German legislator has passed the Act for the Regulation of a General Minimum Wage (*MiLoG*) on 11 August 2014. This Act introduces a general, nationwide statutory minimum wage throughout all professional sectors.

The *MiLoG* stipulated that from 1 January 2015 on the general minimum wage in Germany is 8.50€ gross per working hour. The amount of the statutory minimum wage can be subject to change every 2 years, commencing 1 January 2017. A special "minimum wage commission" (*Mindestlohnkommission*) was installed which consults on the necessity to change the amount of the minimum wage; however, the commission's suggestion would first need to be implemented through a statutory ordinance if the government wants to amend the statutory minimum wage. In accordance with this process the minimum wage was raised since its introduction to 8.84€ from 1 January 2017 onwards.

All employees working in Germany are entitled to this minimum wage (sec. 22 para. 1 sent. 1 *MiLoG*), whether they work part- or fulltime, with fixed-term contracts or in a marginal employment with a monthly income of up to 450€. There are few exceptions for certain kinds of internships, long-term unemployed persons, adolescents under the age of 18, and volunteers. An important exception also applies to apprentices: they are not entitled to minimum wage during their apprenticeship.

The *MiLoG* binds all employers in Germany and/or abroad if they have employees working in Germany. It remains unclear if this might even include cases in which foreign employees work just temporarily in Germany, e.g. truck drivers in transit.

The statutory minimum wage is indispensable and employees cannot waive their claim to it. Employers are liable for the difference between the actually paid wages and the statutory minimum wage as well as additional claims of the social security insurance (*Sozialversicherung*). Furthermore, sec. 17 *MiLoG* stipulates specific documentation obligations to ensure compliance with the Act in certain branches.

The regulations of the Posted Workers Act (*Arbeitnehmerentsendegesetz*), the Act Regulating Commercial Agency Work (*Arbeitnehmerüberlassungsgesetz, AÜG*) and the statutory ordinances issued thereunder precede the Act for the Regulation of a General Minimum Wage insofar as the respective branch's minimum wage does not fall short of the statutory minimum wage under the *MiLoG* (sec. 1 para. 3 *MiLoG*).

IV. Remuneration Transparency

In summer 2017 the German legislator introduced the Remuneration Transparency Act (*Entgelttransparenzgesetz*) which provides employees in companies with more than 200 employees with an individual right to information on the criteria for their remuneration and the average remuneration paid for employees of the opposite gender who carry out comparable work. In companies with more than 500 employees specific reviewing procedures have to be implemented by the employer in order to ensure that equal remuneration schemes for both genders are in place. It remains to be seen which impact this Act will have in practice and what case law might develop around it.

V. Operational Practice

Rights of employees to certain payments may arise from so-called operational practice (*betriebliche Übung*). An operational practice may develop if the employer has granted similar benefits repeatedly (usually three times) to the employees. It is the prevailing opinion of German labour courts that the employer impliedly offers

to change the employment contract so that the employees get a claim to the benefits and the employees impliedly accept this offer. Thus, an entitlement to the specific payment for the employees may arise, even though the employer did not intend this. As an example, the payment of a Christmas bonus for 3 consecutive years to all or certain groups of the employees could lead to an operational practice.

There are possibilities for the employer to avoid the development of an operational practice. However, due to constantly changing case law in this respect highest diligence and caution need to be paid.

1. Reservation of Voluntariness

Generally speaking, a reservation of voluntariness (*Freiwilligkeitsvorbehalt*) is a clause in which the employer states that a payment is voluntary and does not establish a claim to this payment in the future.

The Federal Labour Court (*BAG)* is of the opinion that a reservation of voluntariness can prevent operational practice, as long as it does not (also) cover regular pay and meets the following strict criteria.

Most importantly, it needs to be worded clear and understandable. This means that the reservation of voluntariness must state precisely for which kind of payment it shall prevent the arising of an operational practice. It is important that it states that it shall only hinder the arising of operational practice, since it must not refer to future claims individually agreed between the employer and the employee. Furthermore, it must not stand in contradiction to other parts of the employment contract. According to case law this would be the case where a reservation of voluntariness would be connected with a reservation of revocation (*Widerrufsvorbehalt*). Therefore both clauses must not be combined.

Such reservation of voluntariness may be stated in the employment contract. However, it must be declared, for purposes of proof in writing, with each and every single payment made and from the first payment on.

2. Requirement of Double Written Form

A clause containing a requirement of double written form (*doppelte Schriftformklausel*) states that changes to the employment contract need to be in writing and that the change of the clause itself needs to be in writing, too.

Such clause may prevent the arising of operational practice as long as it meets certain requirements. It is important that the requirement of double written form does not cover whatever possible changes to the contract but states that it shall only hinder the arising of an operational practice.

Both the reservation of voluntariness and the requirement of double written form can be used jointly to hinder the arising of an operational practice.

3. No Possibility for Contrary Operational Practice

According to earlier case law an existing operational practice could be changed to the employees' detriment by establishing a new operational practice through three consecutive changed benefits payments without objection by the employees.

This case law is abandoned. Therefore a once existing operational practice cannot be revoked unilaterally by the employer but only through termination with change of terms of employment (*Änderungskündigung*) or a bilaterally agreed change of contract. Since these instruments entail their own requirements and problems it is highly recommended to make every effort to prevent an operational practice from arising in the first place.

VI. Bonus Payments

Employers may grant their employees bonus payments in addition to their fixed basic remuneration (1). They may, however, consider awarding bonus payments on a voluntary basis alone or subject to the condition that the right to revoke the benefit is reserved (2).

1. Types of Bonus Payments

There are numerous different kinds of bonus payments, for example, commission (*Provision*), gratuity (*Gratifikation*), profit sharing (*Tantieme*), and supplemental pay (*Zuschlag*/*Zulage*).

a) Commission

Commission is a payment based on the employee's performance and is commonly applied to sales staff. According to the statutory regulation model of the German Commercial Code (*HGB*), commission is generally paid upon the conclusion or the procurement of a contract. The employer has to ensure that the total pay including commission is not lower than the statutory minimum wage. However, commission is only considered for this purpose if it is paid out irrevocably with the monthly remuneration.

b) Gratuity

Gratuities are one-off payments granted by the employer for specific reasons in addition to the employee's basic remuneration. Common examples are Christmas

gratuities or anniversary bonuses. Gratuities can have the purpose of awarding the employee for his length of service/loyalty to the business (*Betriebstreue*) and/or to supplement the employee's remuneration on the basis of his performance. Whether gratuities can be taken into account for the statutory minimum wage depends on the way and conditions under which they are paid. A one-off payment in 1 month (e.g. December) would not have the potential to balance out wages in other months that did not meet the statutory minimum wage. Where a gratuity is spread over several months, however, it can be taken into account for the statutory minimum wage for those months.

c) Profit Sharing

Profit sharing bonuses allow the employees to benefit from the company's results. They are usually granted to executive employees (*leitende Angestellte*). In practice, profit sharing bonuses are often implemented in cooperation with and with the consent of the company's shareholders.

d) Supplemental Pay

Supplemental pay to the basic remuneration may be granted by the employer for specific reasons, e.g. to compensate the employee for taking on a particular burden at work (e.g. Sunday work or night shifts), or, more generally, in order to increase the employee's income to meet the terms of a relevant collective bargaining agreement. Supplemental pay may be taken into account in order to reach the statutory minimum wage. However, this is only possible where the supplemental pay is granted as a reward for the normal work performance. In cases where the supplemental pay is supposed to compensate for negative working conditions, e.g. working night shifts or in dirty environment, it can probably not be taken into account for reaching the statutory minimum wage.

2. Reserving Voluntariness, Revocation Rights and Reasonable Discretion

In order to avoid establishing a right to remuneration, the employer may consider declaring certain payments voluntary (a), reserving a right to revoke them (b), or putting the amount of the payment to its reasonable discretion (c).

a) Reservation of Voluntariness

By declaring certain payments voluntary the employer seeks to prevent the employee from establishing a legal right to future monetary claims.

The jurisprudence of the Federal Labour Court concerning reservations of voluntariness has become increasingly stricter. Due to the changed case law, commissions, profit sharing, and supplemental payments can generally not be declared voluntary, since they are performance-related. However, since 'true' gratuities (e.g. for Christmas, holidays or anniversaries) are not paid for the employee's work performance, they can in principle still be subject to a reservation of voluntariness, as long as it fulfils the strict requirements set out by the Federal Labour Court:

In order to be valid and effective the clause must be transparent. Therefore, clear and unambiguous wording is required (*Transparenzgebot*). Merely declaring a payment to be voluntary is insufficient as this does not clearly stipulate if the initial payment alone or also subsequent payments are intended to be voluntary. Additionally, it is not transparent to declare a payment as voluntary if the employer explicitly grants a gratuity in the contract of employment, whilst at the same time declaring that no right to the gratuity shall arise. This strict jurisprudence of the Federal Labour Court makes it almost impossible to formulate a legally effective reservation of voluntariness. The Federal Labour Court further decided that a clause seeking to make a payment discretionary which is held to be void may not generally be interpreted as, for example, a revocation right.

The employer should therefore consider not to promise a bonus payment at all but rather just pay it out if it wants to and declare the reservation of voluntariness in connection with each and every single payment.

b) Revocation Rights

In contrast to seeking to make a payment voluntary in nature, revocation rights provide the employer with the possibility of ending further payment of sums which have become routine in the respective employment relationship. According to the Federal Labour Court the revocable part of the remuneration, i.e. the relevant bonus payment, may only amount to a maximum of 25% of the employee's total remuneration. Thus, bonus payments constituting more than 25% of the employee's total remuneration are, despite express stipulation in the contract of employment, not freely revocable. Moreover, the Federal Labour Court has ruled that revocation clauses must specify objective grounds for revocation, for example, employee performance, conduct related or economic reasons. Also, the extent to which a payment may be revoked must be as clear as possible to ensure that the clause meets the requirements of being sufficiently transparent and valid. Hence, contract clauses on revocation rights should be drafted in clear language with simple parameters, for example, economic reasons referring to revenue/losses of a certain percentage.

According to the Federal Employment Court it is not transparent and therefore impermissible to combine a contract clause making a payment discretionary with a revocation right, since the employee may not be able to foresee which of these regulations is applicable in the circumstances.

c) Reasonable Discretion

As an alternative, the employer could grant an entitlement under the condition of reasonable discretion (*billiges Ermessen*). In this possibility the employee has a contractual claim to a certain bonus payment but the amount of this is not specified. The employer has the discretionary power to specify the amount each year anew. However, the reasonability of the discretionary decision can be reviewed by court.

VII. Sick Pay

The Continuation of Remuneration Act (*Entgeltfortzahlungsgesetz, EFZG*) grants employees 6 weeks of mandatory paid time off in the event of sickness, unless the employee has gross negligently caused his own sickness. Where an employee subsequently falls ill due to the same underlying illness, the 6-week period will recommence if 6 months have elapsed since the end of the last sick leave, or if 1 year has elapsed since the beginning of the first sick leave. If the underlying cause of illness is a new one, the 6-week period automatically commences anew.

B. Benefits

I. Social Security Insurance Scheme

1. Overview

In Germany, most employees are subject to the mandatory statutory social security insurance scheme.

Freelance workers are, generally, not subject to the mandatory statutory social insurance scheme. Persons contracted as freelancers but who are in fact working under the same or similar circumstances as employees may, however, be subject to the mandatory statutory social security insurance scheme (see Chap. 4).

2. Social Security Insurance Branches

The mandatory social security insurance consists of the state pension insurance (*Rentenversicherung*), unemployment insurance (*Arbeitslosenversicherung*), health insurance (*Krankenversicherung*), nursing insurance (*Pflegeversicherung*), and accident insurance (*Unfallversicherung*).

a) Pension Insurance

The state pension insurance, regulated in book VI of the Social Security Code (*SGB VI*), is compulsory for all employees, apprentices, persons in civil or military service, etc. The responsible body for the state pension is the Federal Pension Insurance Department (*Deutsche Rentenversicherung Bund*), which consists of federal and regional divisions and divisions for certain industries. It is financed according to the "generation contract" concept, meaning that the actual state pensions of the generation of retirees are mainly paid by the contributions of the current generation of employees, with the exception of an additional sustainability surplus fund (*Nachhaltigkeitsrücklage*). Hence, due to disadvantageous demographic developments, particularly with regard to the imbalance between the growing numbers of retirees entitled to pension payments and the decreasing numbers of employees contributing to the pensions fund, the whole system has been placed under increasing strain. It has recently been the subject of several reforms; however, further reforms are necessary in order to adapt the state pension scheme to the realities of the last decades' demographic developments. As a consequence of the strain on state pension insurance, the importance of company pension schemes has increased significantly in the last years.

In 2014, the German legislator has implemented a full pension entitlement for 63 year old employees who have worked and contributed to the pension insurance scheme for 45 years; the general retirement age, however, remains at 67.

b) Unemployment Insurance

The statutory unemployment insurance is codified in books II and III of the Social Security Code (*SGB II* and *III*). The Federal Employment Agency (*Bundesagentur für Arbeit, BA*) is the responsible body for unemployment insurance. In principle, the insurance requires the cooperation of the unemployed person with the employment agency. The insurance is mandatory for employees, apprentices, and others who are committed to work. Freelancers, generally, do not have to sign up for unemployment insurance; nevertheless they may insure themselves voluntarily.

The unemployment insurance offers a wide range of benefits. Amongst others, employees fulfilling the respective statutory requirements can receive unemployment payments, short-term working benefits, payments in case of insolvency and payments for vocational training. Unemployment benefits are limited in time and may be suspended if, for example, the employee does not properly cooperate with the employment agency or declines offers of employment. When the unemployment benefit period expires, the unemployed person is entitled to basic social insurance benefits.

Under certain conditions, employers can apply for benefits for employing new workers, benefits for employees who are, for example, disabled or untrained and benefits due under the Partial Retirement Act (*Altersteilzeitgesetz, AltTzG*).

c) Health Insurance

About 90% of the German population have statutory health insurance, regulated in book V of the Social Security Code (*SGB V*). Statutory health insurance is organised by health insurance companies (e.g. *Allgemeine Ortskrankenkassen*, *Betriebs- und Innungskrankenkassen*, *Ersatzkassen)*. Membership is generally compulsory for employees, students and apprentices. However, employees whose regular annual salary has exceeded a certain limit (in 2017: 57,600.00€) for 1 year are free to choose private health insurance or to stay with the statutory health insurance.

Health insurance is intended to cover medical services necessary for rehabilitation following illness, as well as services for the prevention of illness. In the case of the latter, individual insurance companies slightly differ in their coverage. Furthermore, insurance companies provide sick pay (*Krankengeld*) if the employee has been sick for more than 6 weeks, since usually the employer will then suspend payments if not otherwise agreed in the contract of employment or any relevant collective bargaining agreement. Sick pay usually amounts to approximately 70% of the employee's previous basic salary.

d) Nursing Insurance

Nursing insurance, governed by book XI of the Social Security Code (*SGB XI*) covers nursing benefits. Nursing insurance funds are supporting organisations which are attached to each statutory health insurance company. Consequently, those who are mandatory members of the statutory health insurance are, in general, also subject to compulsory nursing insurance. Those who are voluntarily insured under a statutory health insurance scheme may be exempted from nursing insurance under certain circumstances. Members of private health insurance schemes must join private nursing insurance schemes.

The benefits are scaled in relation to the different levels of care (*Pflegestufen*) required. Benefits of the nursing care insurance may include, for instance, home care, cash benefits and benefits for the education and social protection of the carer (e.g. adult child of the ill person).

e) Accident Insurance

Statutory accident insurance, regulated in book VII of the Social Security Code (*SGB VII)*, covers benefits in case of accidents involving employees in the workplace, occupational diseases, and accidents on the way to or from work. The responsible bodies are professional associations (*Berufsgenossenschaften*). Benefits may involve, for example, treatment of the illness or injury, rehabilitation and payment of compensation and pensions.

Contributions to statutory accident insurance are made exclusively by the employer. The calculation of the amount of contribution (*Umlageverfahren*)

depends on several criteria, particularly previous expenses for damages in the past year, the level of risk of the company's working environment and the total remuneration paid by the company in the relevant time period.

Within statutory accident insurance employers are highly privileged, as they can only be held liable by employees for insured personal injuries caused by intentional acts. Employers are, however, liable to social security insurance funds for expenses arising from insured injuries caused by gross negligence and intentional conduct, up to the amount of a possible claim for damages.

II. Social Security Insurance Contributions

1. Obligations of the Employer

According to the general provisions applicable to all social security insurances, stipulated in book IV of the Social Security Code (*SGB IV)*, the employer is obliged to register employees in a social security insurance scheme with a competent institution of statutory health insurance. It must report the beginning and end of employment and must give annual status reports.

2. Obligations of the Employee

The employee has to provide the employer with the information necessary to report to the health insurance scheme. In particular, at the beginning of the employment, the employee must present the employer with his social security insurance identity card (*Sozialversicherungsausweis*), issued by a competent state pension insurance institution.

3. Composition and Calculation of Contribution Payments

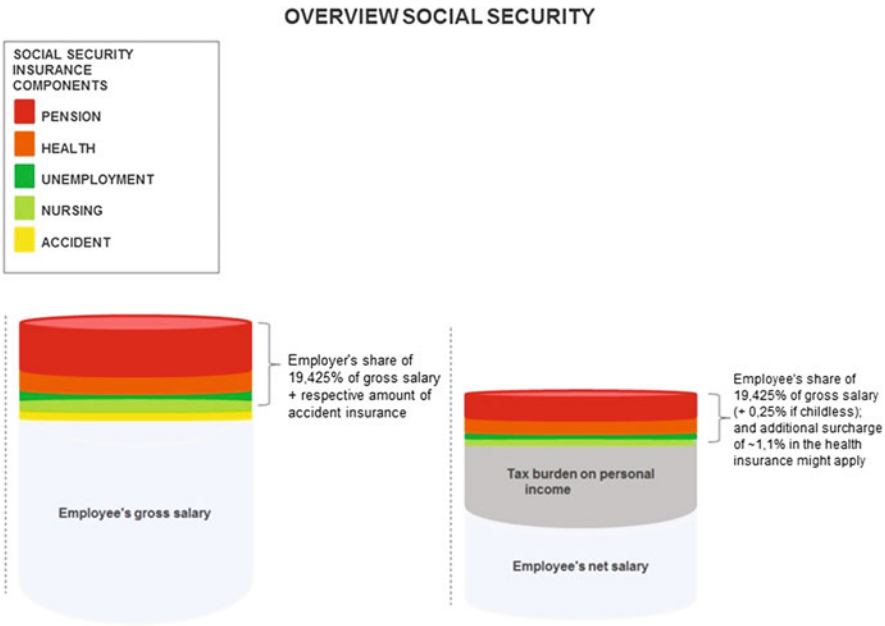
Contributions to social security insurance schemes, with the exception of accident insurance, are made by the employer and the employee in equal (50%) shares.

The total (employer and employee) social security insurance contributions are determined on the basis of the gross amount of the employee's monthly salary and are currently approximately 40% of the employee's gross salary.

Contributions to the various branches of social security insurance constitute the following percentages of the employee's gross salary: state pensions insurance (18.70%), health insurance (14.60%), unemployment insurance (3.00%), and nursing insurance (2.55% plus 0.25% paid by a childless employee).

However, the level of contribution is limited by the employee's monthly gross salary (*Beitragsbemessungsgrenzen*). The maximum monthly salary considered for calculating the contribution for the state pension and unemployment insurance

schemes in 2017 amounts to 6350.00€ gross in the Western German states and 5700.00€ gross in the Eastern German states. The maximum monthly salary considered for calculating the contribution for health and nursing care insurance schemes is uniformly 4350.00€ gross.



4. Employer's Civil and Criminal Liability

The employer is responsible for making all of the contributions to the employee's health insurance scheme through the so-called "collecting centre" (*Einzugsstelle*). The employer is liable to pay all the contributions for 4 years if it fails to pay them accurately and in case of intentionally withheld contributions it will be liable for 30 years, from the end of the calendar year in which the social insurance contributions fell due. The employer must determine whether the employment is subject to the statutory social insurance scheme and calculate the contributions (e.g. with help of a pay-roll provider). In case of doubt whether the employee is subject to the statutory social security insurance scheme, the employer can request a binding decision by the collecting centre. In case of incorporated companies, the companies as the employers, and their governing bodies, for example, managing directors of a limited liability company (*Gesellschaft mit beschränkter Haftung, GmbH*), may be held liable. In practice, employers often forget that the intentional withholding of social insurance contributions is a criminal offence according to the Criminal Code

(*Strafgesetzbuch, StGB*) for which the governing bodies may hold the employer responsible. Therefore, in all cases of doubt if an individual person is self-employed or an employee of the company, it is advisable to seek a decision by the collecting centre.

5. Employer's Claims Against Employees

In principle, the employer has a claim against the employee for the employee's social security insurance contributions. However, the employer may only enforce its claim by way of deductions from the employee's salary, usually in the same month as the employee's salary payment. If the employer omits to deduct the employee's social insurance contributions from the employee's salary for the respective month, it may only compensate for this omission with the next three monthly salary payments. The employer may only exceed this period if it did not contribute to the failure to deduct the correct amount. This limitation does not apply if the employee breached his obligation to provide the employer with the necessary information for the health insurance scheme and intentionally or negligently failed to pay the social security insurance contributions.

C. Example Calculation for Social Security Insurance Contributions

The following is an example for the calculation of social security insurance contributions and income tax for an unmarried person in the year 2017 with a fictitious gross salary of 3000€:

Social Security Insurance Component	Percentage of Gross Salary	Assessment Ceiling (€ gross/month)		Share of Employer|Employee	
		West	*East*		
Pension	18.70%	6350.00	5700.00	9.35%	9.35%
Health	14.60% (+ possible additional surcharge of ~ 1.1%)	4350.00	4350.00	7.30%	7.30% (+ possible additional surcharge of ~ 1.1%)
Unemployment	3.00%	6350.00	5700.00	1.50%	1.50%
Nursing	2.55% (+ 0.25% for childless employee)	4350.00	4350.00	1.275%	1.275% (+ 0.25% if childless)
Accident	1.31%[a]			1.31%[a]	0%

[a]Average figures

D. General Tax Law Aspects

Germany imposes wage tax (*Lohnsteuer*) on salaries, wages, and other remuneration of dependent employment under the Income Tax Act (*Einkommensteuergesetz, EStG*). The employer is obliged to subtract the income tax from the employee's gross salary after deduction of social security insurance contributions and to pay it to the tax authorities on behalf of the employee. Nevertheless, the employee himself is the legal debtor of the tax. Income tax currently ranges from 14 to 45% of the employee's gross income.

The payment of a car allowance by the employer is taxable employee income. Tax savings may be achieved by providing a company car to the employee that the employee may be permitted to use also for private purposes. The private use of a company car constitutes a benefit with monetary value which the employee must declare as income. The taxable monthly benefit resulting from permitted private use of a company car may, however, be calculated as a flat-rate percentage of around 1% of the manufacturer's listed gross purchase price. This flat-rate amount is usually considerably lower than the actual cost of the car.

Employees working and living in different jurisdictions are generally protected from being taxed twice by Double Taxation Treaties between Germany and other countries. The majority of these treaties are based on the OECD Model Tax Convention (see Chaps. 6 and 7 for further details). According to these treaties, salaries, wages, and other remuneration earned from dependent employment by a resident of a contracting country are usually taxable in the country of residence. However, if the employment is carried out in the other contracting country, the income is taxable in that country if the employee has spent more than 183 days during a 12 month period in that country, or if the salary has been paid by or on behalf of an employer domiciled in that state. Thus, under the Double Taxation Treaties, in order to be subject to German income tax, a non-resident employee actually has to work for more than 183 days in Germany, or his income tax contributions have to be borne by the employer's permanent establishment in Germany, or an employer who is resident in Germany. Where there is lower income tax in the employee's country of residence, the employee would usually seek to avoid exceeding the 183-day period; the employee's income would usually then only be taxable in his country of residence.

E. Key Aspects

- Employee salaries can be based on individual employment contracts between employer and employee or on collective bargaining agreements.
- Germany has introduced a general statutory minimum wage of at the moment 8.84€ gross per working hour (from January 2017).

- Employers are not generally obliged to pay employees for overtime worked, unless this is provided for in a collective bargaining agreement or individual employment contract. However, in certain circumstances, employees may have a payment claim for overtime work.
- Employers may grant bonus payments, such as a gratuity, supplementary pay, profit sharing and commission. In order to avoid future claims and/or an operational practice it has to be evaluated on a case-by-case basis whether a reservation of voluntariness, revocation right or reasonable discretion can be declared.
- In Germany there is a mandatory statutory social security insurance scheme, covering pension, unemployment, health, nursing, and accident insurance, which applies to most employees and apprentices. With the exception of accident insurance, which employers alone pay, the contributions are equally shared between employer and employee.
- If the employer does not pay or pays incorrectly the social insurance contributions to the collecting centres, it is liable for the payment of the entire (employer and employee) contribution payments for 4 years. It may also be held criminally liable if it intentionally withholds social security insurance contributions.
- The employer must deduct wage tax from the employee's gross salary after the subtraction of the social security insurance contributions.

Chapter 9
Working Hours, Holidays and Health and Safety

Sascha Morgenroth and Nadine Hesser

A. Introduction

Under German law the employee's[1] working time is regulated by several legal sources such as the Working Hours Act (*Arbeitszeitgesetz*), collective bargaining agreements, works agreements, business practices, or individual employment contracts. The same applies to holidays. A minimum statutory standard with regard to holidays is regulated by the Federal Holiday Act (*Bundesurlaubsgesetz, BUrlG*) but collective bargaining agreements and individual employment contracts usually provide for regulations regarding holidays that go beyond the statutory minimum. In addition, there are several public holidays for all of Germany and extra Christian holidays in certain German states. With regard to health and safety a complex system of regulations provides for protection of employees at the workplace in Germany. It is complemented by measures and provisions of the mandatory public Accident Insurance (*Unfallversicherung*).

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Working Hours

I. Working Hours Act

1. Purpose and Applicability

The Working Hours Act is intended to protect the safety and health of employees regarding the organisation of their working time. It implements the EU Working Time Directive 2003/88/EC.

The Working Hours Act generally applies to all employees in Germany, except for executive employees (*leitende Angestellte*).

Any regulations violating the protective provisions of the Working Hours Act are null and void. Employers that have employees work in excess of the permissible working hours may be punished with fines in the amount of up to 15,000.00€.

2. Working Hours

According to the Working Hours Act, the employee's working time may generally not exceed 8 h per work day. Working time is the time from the beginning until the end of the work excluding rest breaks. Work days are the days from Monday until Saturday. As a consequence, employees may work 48 h on a 6 day work week. The working time may be extended to up to 10 h per work day if it does not exceed 8 h per work day on the average within 6 calendar months or within 24 weeks.

Work on Sundays and public holidays is generally prohibited. There is, however, an extensive statutory catalogue of exceptions. Nevertheless, employees must have at least 15 Sundays per year off work. Further, work on Sundays must be compensated by an alternative day off within a period of 2 weeks (within a period of 8 weeks in case of work on public holidays that fall on work days).

3. Rest Breaks

Employees must not work for more than 6 h without a rest break (*Ruhepause*). Thus, working time must be interrupted after more than 6 h of work by a previously determined break of at least 30 min., which may be split into two periods of 15 min. each. In case of working time of more than 9 h, the break must amount to at least 45 min.

4. Rest Period

At the end of the work day, the employee must have an uninterrupted rest period (*Ruhezeit*) of 11 h. During this period, the employee must not be subject to any obligations towards his employer preventing him from freely enjoying his time off.

5. Records

The Working Time Act obliges the employer to record employees' working time in excess of 8 daily working hours. These records have to be kept for at least 2 years. Violations of this recording duty may be punished with fines of up to 15,000.00€.

II. Collective Bargaining Agreements

Collective bargaining agreements may regulate the duration of working time. They may permit extending daily working time to more than 10 h without compensatory time off if the working time usually consists mainly of "readiness to work" (*Arbeitsbereitschaft*) or on-call service (*Bereitschaftsdienst*). The entire working time must, however, not exceed 48 h per week on average over 12 months. Furthermore, collective bargaining agreements may allow employers to reduce the rest period by up to 2 h if required by the kind of work and if the reduction will be compensated within a determined time period.

III. The Role of the Works Council

In the event that a works council exists in the business operation, the employer may not allocate the working time unilaterally. The works council has a mandatory co-determination right regarding the regulation of the beginning and the end of the daily working time with respect to the individual work days, including breaks and their allocation. The co-determination right also applies to a temporary reduction or extension of the customary working time of the business. However, the determination of the duration of the general working time of the business operation is not subject to the works council's co-determination, unless provided otherwise by collective bargaining agreement. Further, there is no works council co-determination concerning the duration of working time agreed with individual employees in their employment contracts.

C. Holidays

I. Applicability and Amount

According to the Federal Holiday Act (*Bundesurlaubsgesetz*), every employee is entitled to a minimum of 24 paid days of holiday based on a 6 day working week (Monday to Saturday). Most employees nowadays have 5 day working weeks (Monday to Friday), resulting in 20 days of paid holiday. Many collective bargaining agreements or individual employment contracts grant holiday entitlements between 24 and 30 days based on a 5 day working week.

Holidays
Entitled to holidays are:

- full-time employees
- part-time employees
- temporary employees
- persons similar to employees (i.e. who are economically dependent on the employer)
- marginally employed employees (i.e. who are working for up to 450 € a month)

Part-time employees must not be discriminated against due to their part-time employment. However, if part-time employees work fewer days per week than full-time employees, their holiday entitlements are pro-rated. In case of regular allocation of their working time, the annual holiday entitlement is determined by dividing the mandatory minimum of 24 annual holidays by a reference period of 6 working days per week and multiplied by the number of actual working days per week. For example: if a part-time employee works 3 days per week, his holiday entitlement is 12 holidays per calendar year ($24/6 = 4 \times 3 = 12$ days). Extended reference periods may be required if the working time is allocated irregularly.

Employees only qualify for full annual holiday if they completed a 6 months waiting period or leave the company in the second half of the calendar year (i.e. later than 30 June). Employees are not entitled to full annual holiday if they do not complete the waiting period, or leave the company in the first half of the calendar year (i.e. before 30 June). In these cases the entitlement is 1/12th of the annual holiday for each calendar month worked.

II. No Waivers

Employees must take their annual holiday during the calendar year and employers must generally grant employees their holiday. Employees cannot waive their statutory holiday entitlement. Collective bargaining agreements may also not contain holiday waivers. Further, any agreement providing the employer with the right to recall the employee from holidays under certain circumstances will be invalid.

The statutory annual holiday entitlement generally expires at the end of the respective calendar year. The holidays can only be carried forward to the end of the first quarter (31 March) of the following calendar year if the employee was not able to take the holidays for operational reasons (i.e. the employer did not grant the employee holiday he applied for, e.g. because of particularly labour intensive periods in certain industry sectors) or for personal reasons (e.g. incapacity for work due to sickness).

The European Court of Justice (*Europäischer Gerichtshof, EuGH*) has ruled that in cases of long-term sickness statutory holiday entitlements can be carried forward for up to 15 months if the employee was unable to take the holiday in the year it accrued and also not in the following year, due to ongoing sickness.

Statutory holiday an employee was unable to take during the calendar year or before the end of the transfer period due to sickness cannot be forfeited. Therefore, statutory minimum holidays must generally be paid out if the employee stays sick until the end of the employment relationship. This does, however, not apply to any holiday granted in addition to the statutory minimum holiday by individual employment contract or collective bargaining agreement. Also, the monetary claim to the payout of the holiday entitlement can fall under strict cut-off periods in collective bargaining agreements.

III. Obligations of the Employee

Employees are not permitted to take up paid work during their holidays. They may only perform permitted secondary employment as well as work on their own property. A violation of these rules by an employee may lead to disciplinary action up to dismissal if the respective prerequisites are fulfilled (see Chap. 15).

IV. Holidays in Case of Termination

Employers should explicitly specify when outstanding holiday is to be taken in a termination notice letter. If untaken holiday cannot be taken due to the end of the employment relationship, employers have to pay in lieu of the untaken holidays.

The compensation amount is calculated based on the employee's average income received during the 13 weeks prior to the end of the employment.

Employers should be aware that if employees are suspended prior to the termination date, holidays are not automatically set off against release periods. Further, holidays may only be set off against periods of irrevocable release. Therefore, employment contracts and/or separation agreements should explicitly state that holidays are set off against days of irrevocable release.

V. Public Holidays

There are nine public holidays in Germany (plus, as an exception the Reformation Day in 2017; the expected dates for 2017 until 2019 are listed below) and additional Christian holidays in certain German states. Public holidays as well as Sundays are generally mandatory free time. In some sectors employees may work Sundays and public holidays, but are entitled to corresponding time off on other days of the week.

Public holidays	2017	2018	2019
New Year's Day	1 January	1 January	1 January
Good Friday	14 April	30 March	19 April
Easter Monday	17 April	2 April	22 April
Labour Day	1 May	1 May	1 May
Ascension Day	25 May	10 May	30 May
Whit Monday	5 June	21 May	10 June
Reunification Day	3 October	3 October	3 October
Reformation Day	31 October	–	–
First Christmas Day	25 December	25 December	25 December
Second Christmas Day	26 December	26 December	26 December

D. Health and Safety

In Germany there exists a complex system of regulations protecting employees' health and safety at the workplace. It is complemented by measures and provisions of the mandatory public accident insurance (*Unfallversicherung*) (see Chap. 8).

I. Protection Regulations

The regulations on the protection of the employees' health and safety consist in particular of the general Workplace Protection Act (*Arbeitsschutzgesetz*) and further specialised acts (e.g. on work in front of monitor screens) and supplementing ordinances of particular practical importance. The Workplace Protection Act is based on EU directives and contains general rules and prohibitions. It applies to all private and public employees.

Pursuant to the health and safety protection regulations, the employer must ensure appropriate measures of workplace health and safety protection, must monitor respective measures and make required adjustments. The responsibilities of employers include for example:

- Ensuring appropriate business organisations and appropriate work equipment;
- Taking measures enabling supervisors and employees to comply with their duties of care (e.g. instructions);
- Avoiding hazards for employees by analysing potential hazard risks and appropriate protection measures (e.g. non-smoker protection) and remedies;
- Recording hazard analyses and safety measures;
- Bearing the burden of costs of required protection measures.

The trade supervisory department (*Gewerbeaufsicht*) is responsible for monitoring compliance with health and safety protection provisions. It may inspect businesses without prior notice, remedy violations and impose fines.

II. Health Examinations

Voluntary medical examinations may be required, e.g. if employees handle hazardous materials, perform heavy physical work, are exposed to heavy noise, or shift or night work. In certain areas of work that involve particular health risks, there are mandatory special medical examinations required by law (e.g. work with cancer-producing hazardous materials). If employees refuse such mandatory medical examinations, the employer will generally be prohibited from employing them on hazardous positions.

III. Employee Duties

Employees are obliged to comply with safety measures and regulations in the workplace. They are obliged to report to their employer if they discover significant immediate hazards or damages to the employer's safety systems.

IV. The Role of the Works Council

The employer is obliged to inform an existing works council about compliance with workplace protection measures in a comprehensive and timely manner. The works council has the right to co-determine health and safety protection measures to which the employer is obliged by law. Measures taken by the employer without proper consideration of the works council co-determination rights are void.

E. Key Aspects

- Working hours
  - Employees' working time must, in principle, not exceed 8 h per work day.
  - Working time may be extended to up to 10 h per work day if it does not exceed 8 h per work day on the average. Collective bargaining agreements may provide for further extensions under certain conditions.
  - The employer is obliged to record overtime hours.
  - Working time must be interrupted after more than 6 h by a previously determined rest break (of at least 30 min.; 45 min. in case of a 9 h work day).
  - At the end of the work day there must be an uninterrupted rest period of 11 h.
  - Work on Sundays and public holidays is generally prohibited. There are, however, extensive exceptions.
  - Works councils have co-determination rights regarding the regulation of the beginning and the end of the daily working time, including breaks and their allocation.
- Holidays
  - Every employee with a 5 day working week is entitled to a minimum of 20 paid holidays per calendar year.
  - Holiday entitlement is pro-rated for part-time employees working fewer days per week than full-time employees.
  - Employees only qualify for full annual holiday if they completed a 6 month waiting period or leave the company in the second half of the calendar year (i.e. later than 30 June). Otherwise, their entitlement is pro-rated.
  - Statutory annual holiday entitlement generally expires at the end of the respective calendar year. Holidays can usually only be carried forward to the end of the first quarter (31 March) of the following calendar year if the employee was not able to take the holidays for business or personal reasons.
  - There are at least 9 public holidays per calendar year. In certain German states there are additional Christian holidays.

- Health and safety
  - The employer is obliged to protect its employees against hazardous conditions at the workplace.
  - The trade supervisory department monitors compliance with health and safety protection provisions.
  - Works councils have information and co-determination rights regarding employers' health and safety protection measures.

Chapter 10
Partial Retirement

Eva Einfeldt and Jens Kirchner

A. Introduction

Partial Retirement (*Altersteilzeit*) aims to facilitate the smooth transition from working life into retirement of older employees[1] and is codified in the Partial Retirement Act (*Altersteilzeitgesetz, AltTzG*). However, in most significant economic sectors collective bargaining agreements have been concluded to regulate partial retirement.

Since the partial retirement also belongs to the system of long-term accounts (*Langzeitkonto*), it has become another model of early retirement next to long-term accounts, partial pensions, company pension schemes, and severance agreements.

B. Prerequisites of Partial Retirement

I. Qualifying Employees

To qualify for partial retirement, the employee must have reached the age of 55. Further, the employee must have been in an employment according to the Social Security Code, book III (*Sozialgesetzbuch, SGB III*) for at least 1080 calendar days

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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(3 years) during the previous 5 years, and must have paid social insurance contributions. This minimum period does not necessarily have to be completed with the same employer. During this time, a period of up to 1 month of unpaid leave does not prevent the continuity of employment. Periods of employment subject to social insurance contributions in other EU member states are credited as well as periods during which the individual is entitled to unemployment or sickness benefits.

II. Agreement on Partial Retirement

There is no statutory entitlement to partial retirement. Nevertheless, such a right may be codified in a collective bargaining agreement or in a works agreement. Employer and employee must both agree in writing to reduce the employee's working hours. This agreement must be signed prior to the commencement of the partial retirement, a retroactive effect is not allowed unless due to a court decision with which the employee successfully enforces his entitlement. The partial retirement must run until the employee reaches the statutory retirement age and is entitled to a state funded pension, subject to deductions if his pension is drawn early.

III. Reduction of Working Hours

The employee's previous weekly working hours must be reduced by exactly 50%. The previous weekly working hours are those which were agreed between the parties before partial retirement commences or, if the employee does not work regular hours, his average weekly working hours over the last 24 months. This average value also resembles the maximum of the working time that may be taken into consideration in order to prevent any potential abuse by partially raising the working time prior to the commencement of the partial retirement.

Partial retirement working hours shall remain subject to social insurance contributions. This means that the reduction in working time must not result in a reduced salary which falls short of the minimum income threshold for social insurance contribution purposes. As a result, only employees whose monthly salary is at least double the minimum threshold for social insurance contributions (currently 450.00€) may agree on partial retirement.

C. Models of Partial Retirement

The Partial Retirement Act provides for two different models of partial retirement: the so-called "continuity model" (*Kontinuitätsmodell*), provided for by law and the so-called "block model" (*Blockmodell*), which prevails in practice. Both models can be combined and alternate.

I. Continuity Model

The continuity model allows the employee to continuously work reduced working hours during the entire partial retirement period. This even reduction of working hours shall enable the employee to slide into the early retirement pension. However, working continuously may include, for example, working half-days, working two-day weeks, or alternating between full-time work and rest periods on a weekly or monthly basis.

II. Block Model

The block model is the most common in practice. It consists of two blocks of equal time periods: in the first block, the so-called "working period" (*Arbeitsphase*) the employee continues to work his usual hours, and in the second block, the so-called "release period" (*Freistellungsphase*), the employee is completely released from work. During the working period, 50% of the remuneration are booked to the employee's account (*Wertguthaben*), which is paid out during the release period.

D. Special Issues of the Block Model

I. Duration

Unless an applicable collective bargaining agreement provides otherwise, a partial retirement using the block model may generally not exceed the duration of 3 years, thus 1.5 years of working period and 1.5 years of release period. By combination of block model and continuity model, the partial retirement may be longer, e.g. 1.5 years working period, 3 years part-time work and 1.5 years release period.

If in the field of business no collective bargaining agreement concerning partial retirement has been concluded or is usually not concluded, a works agreement may allow for a longer duration of a partial retirement by block model. If, however, no

works council exists, the employer may simply agree with the employee on a longer duration. This applies especially for independent professions, such as lawyers, auditors or management consultants. Moreover, all non-tariff employees are covered by this regulation, since the working conditions are usually not covered by a collective agreement.

II. Remuneration

During the release period, the employee is paid out of his account where 50% of his remuneration earned during the working period are booked. As this remuneration is based on a work already performed, its amount reflects the employee's wage group during the working period. Any wage increase during the release period does not apply to the employee unless otherwise stipulated in the collective bargaining agreement or partial retirement agreement. Likewise, any wage cuts during the release period do not affect him anymore.

Any allowances paid for the actual work have to be paid out in total during the working period only. Whether other benefits, e.g. a company car, have to be paid during either the working or the release period, is subject to the collective agreement or partial retirement agreement.

III. Holiday

Usually, collective agreements stipulate that the employee may not accrue any holiday entitlements during the release period as he is not obliged to work any longer. Even without a collective agreement, it is generally accepted that no such entitlements accrue. Any remaining holiday entitlement from the working period may be paid out at the end of the release period if not lapsed by then.

IV. Sickness

Any sickness of the employee during the working period does not have any effect on the partial retirement, as long as the period of sickness is covered by the period of continued remuneration according to the Continuation of Remuneration Act (*Entgeltfortzahlungsgesetz, EFZG*). If he is sick for a longer period than he receives continued remuneration, he cannot earn any remuneration booked on his account and paid out during the release period. To compensate the missing amount, either the parties may agree on a prolongation of the working period (*Nacharbeit*), or the employer agrees to fill the employee's account with the missing amount.

In case the sickness is longer than the period of continued remuneration, the sick pay paid by the health insurance only refers to the part time salary without any increase amounts. The employer may agree to pay the increase amounts in the partial agreement contract to supplement the health benefits without having to pay any salary.

V. Termination

An employment relationship may only be terminated due to operational reasons if there is no possibility to further employ the employee. As the employee is not employed any longer during the release period, such termination for operational reasons is not possible any more after the end of the working period. Neither is it possible to terminate the partial retirement agreement during the release period due to sickness of the employee. A termination for misconduct during the release period may still be possible but requires a serious loss of trust.

VI. Malfunction

A malfunction (*Störfall*) means that the employment relationship on partial retirement is terminated prior to its expiry. In such a situation, the employer has the obligation to compensate all the work which was performed by the employee in advance during the working period. Therefore, he has to calculate the difference between the salary to be paid for working full-time and the actual part-time remuneration. Whether he may deduct the increase amounts is subject to mutual agreement.

VII. Insolvency Insurance

During the working period the employee works full-time but receives only part-time salary. 50% of his salary are booked to the employee's account. Since 2004, the Partial Retirement Act contains a mandatory obligation for the employer to insure this money on account against the possibility of insolvency of the company during the release period.

Any "work time bonus" accrued over more than 3 months also needs to be insured by the employer against the risk of its insolvency. The increase payments made by the employer cannot be offset against this. The employer's obligation to insure exists from the first month of the working period and it is required to confirm to the employee in writing that the insurance is in place on a regular basis every 6 months. In order to relieve the employer, the parties may agree on another, equivalent form of evidence. The insurance shall cover the remuneration including the social insurance contributions but without the increase amount.

The following schemes are **appropriate** insolvency insurance schemes:

- Bank guarantees;
- Insurance by way of collateral securities (e.g. pledge of securities, especially funds) in favour of the employee;
- Specialist insurance schemes of the insurance industry;
- The scheme of double side trust.

The following schemes are **inappropriate** for insolvency insurance:

- Financial accruals;
- Obligations to assume liability;
- Declarations within a group company, especially bonds, comfort letters and collateral promises.

If the employer fails to comply with the above mentioned obligations, the employee can claim the insurance at labour courts. A personal liability of the company's legal representatives may not apply.

E. Payment Obligations

I. Increase Amounts to the Salary

During partial retirement, the employer has to pay such employees an increase amount (*Aufstockungsbetrag*) which amounts to at least 20% of the standard salary (*Regelarbeitsentgelt*), in addition to the employee's income. Collective bargaining or works agreements may provide for a higher amount.

The standard salary is the monthly salary (reduced to reflect part-time hours during partial retirement) which is subject to social security contributions and which is paid by the employer on a regular basis.

The portions of the salary which are subject to social security contributions are:

- Bonuses and extra pay;
- Payments in kind and other benefits in money's worth;
- Capital forming payments.

Not subject to social security contributions are certain surcharges, e.g. for work on Sundays and public holidays.

The standard salary is only taken into consideration up to the social security contribution ceiling (*Beitragsbemessungsgrenze*), which in 2017 amounts for the

state pension insurance to 6350.00€ per month in the western German states and to 5700.00€ per month in the eastern German states.

Not part of the legal standard salary are one-off payments such as holiday or Christmas bonus as well as remuneration which is not paid on a regular basis or for the regular working time (e.g. overtime payments). It may be agreed that these payments are part of the standard salary and therefore subject to the increase amount.

II. Additional Contributions to the Statutory Pension Insurance

Furthermore, the employer has to make additional contributions to the statutory pension insurance. These additional contributions amount to the contributions for at least 80% of the standard salary with a restriction to 90% of the difference between standard salary and the social security contribution ceiling. As such, the assessment ceiling may not be exceeded. In opposition to the increase amount, one-off payments may not be taken into account for the calculation of the standard salary for these contributions.

Collective bargaining agreements, works agreements, and individual agreements will commonly include an obligation to contribute increase amounts.

In respect of contributions to statutory health insurance, nursing insurance and unemployment insurance, the employee's basic reduced salary during partial retirement is decisive and no increase amounts have to be paid by the employer in this regard.

III. Tax Privileges

If the personal prerequisites are met and the agreement between employer and employee is valid, the increase amount and the additional payment to the statutory pension insurance are tax-free and free of social security contributions. This tax privilege also applies if the increase amount and the additional payment are higher than the statutory minimum, but only until the net income during the partial retirement (net salary plus increase amount) does not exceed what the employee would have received as net income without partial retirement. However, these payments are relevant in relation to the taxable amount of the yearly income. For the determination of the rate of taxation within the progression, the tax-free increase amount is incorporated.

F. Key Aspects

- There is no statutory entitlement to partial retirement, but there can be entitlements under collective agreements, works or individual agreements.
- Partial retirement requires the fulfilment of prerequisites by the employee and a prior written agreement between the employee and the employer.
- The weekly working hours must be reduced by exactly 50%.
- There are two models of partial retirement, namely the block model and the continuity model. The continuity model allows to work reduced working hours throughout the entire partial retirement period. The block model consists of the "working period" and the "release period" and is the most common in practice.
- The employer is obliged to pay an increase amount to the standard salary as additional contributions to the state pension insurance.
- The increase amounts are exempted from taxation and social security contributions up to certain limits.
- If using the block model, employers are obliged to insure employees' money on account against insolvency.

Chapter 11
Diversity and Discrimination

Pascal R. Kremp and Sascha Morgenroth

A. Introduction

Diversity and discrimination is a relatively new development in German labour and employment law. While the general concept of equal treatment and a prohibition against gender discrimination have existed in German statutory law for a long time, most other discrimination laws were only introduced on 18 August 2006 in the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*) which implemented three European Union (EU) anti-discrimination Directives (2000/43/EC, 2000/78/EC and 2002/73/EC). Since then, there have been some discrimination cases making the headlines, but in general discrimination legislation does not play such a significant role in Germany as it does in the U.S. or in the UK. This might be partly due to the fact that German courts are traditionally very reluctant to grant substantial compensatory awards. By virtue of its wording, the *AGG* furthermore does not apply to company pension schemes and to dismissals. However, the Federal Labour Court ruled that the *AGG* must be interpreted in accordance with the EU anti-discrimination Directives which prohibit discrimination surrounding dismissals and pension schemes and thus, the *AGG* is applicable in spite of the wording.

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B. General Equal Treatment Act

Discrimination is predominantly governed by the General Equal Treatment Act (*AGG*).

Under the *AGG* illegal discrimination occurs if:

- the discrimination is based on one of the eight discriminatory grounds prohibited by the General Equal Treatment Act,
- the individual falls within the scope of the Act, and
- the discrimination is not justified.

I. Grounds of Discrimination

The *AGG* prohibits discrimination based on race or ethnic origin, religion or belief, gender, disability, age, or sexual identity.

The grounds of discrimination in the *AGG* and key issues which arise are considered below.

1. Race and Ethnic Origin

Although the *AGG* speaks of races it does not promote the idea of different races. It rather includes the term "race" merely for clarification and political reasons.

The definition of ethnic origin covers discrimination based on the origin of a person, not necessarily his nationality (for example, against Turkish people even though they have a German passport and history, etc.). A German labour court ruled that Eastern Germans (i.e. local German groups, similarly Bavarians) do not qualify as an identifiable ethnic origin under the *AGG*. However, the ECJ has not yet decided this question.

2. Religion or Belief

Obviously, religion includes e.g. Catholics, Protestants, Muslims, and Jews. German case law is ambiguous with regard to whether Scientology qualifies for protection under the *AGG*. This question will not be settled until a relevant case is brought to the ECJ. Membership of a political party or a union is not covered by the definition of belief, but general beliefs in political systems, such as communism do come within the ambit of the *AGG*. Union membership is, however, protected by the German Constitution.

3. Gender

Gender discrimination protects both men and women. Under German law, gender discrimination may also occur if a woman is treated less favourably than other women because she is pregnant or on maternity leave.

4. Disability

Until recently, German employers have usually only been concerned with severely disabled employees[1] (i.e. with a degree of disability of at least 50%). Discrimination law also protects employees with minor disabilities. Under German law, a condition qualifies as a disability if it affects an individual's mental or physical status for a period of more than 6 months. The question is whether employees on long-term sick leave are covered by the *AGG*. To date, employers can dismiss employees on long-term sick leave (usually more than 18 months) if it is unlikely that they will return to work. However, although it is likely that there will be some form of discrimination in most cases, it may generally be capable of justification on objective grounds.

5. Age

Under German law employers must not discriminate on the grounds of age. German law protects both "old" and "young" age. It is, for example, unlawful to refuse an employee close to retirement continued education because of his old age. Equally, it would be unlawful to refuse to consider an employee for promotion based on stereotypical assumptions about his perceived youth.

Age discrimination is likely to play a major role in future. Many pay and benefits schemes are based on age or years of service (involving indirect age discrimination). Therefore, employers should carefully consider whether granting certain benefits to employees on the basis of age or years of service is capable of being justified.

6. Sexual Identity

Unlike the EU anti-discrimination Directives, German law prohibits discrimination against sexual identity, not against sexual orientation. Germany's legislators intended to prohibit not only discrimination related to homosexuality, but also transsexual and intersexual discrimination.

[1]The term "employee(s)" or "person(s)" shall cover female and male persons, as far as not indicated differently.

In summary, the General Equal Treatment Act prohibits discrimination based on:
Race or ethnic origin
Religion or belief
Gender
Disability
Age
Sexual identity

II. Factual Scope of Application

Discrimination is specifically prohibited in relation to selection procedures, recruitment conditions, employment and working conditions, conducting the employment relationship and promotion.

By virtue of its wording, the *AGG* does not apply to company pension schemes, which are regulated by the Company Pension Act (*Betriebsrentengesetz, BetrAVG*), and to dismissals which remain subject to general and special employment protection laws, in particular the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*). However, the Federal Labour Court ruled that the *AGG* must be interpreted in accordance with the EU anti-discrimination Directives which prohibit discrimination surrounding dismissals and pension schemes. Thus, the prohibition of discrimination must be considered when assessing the social justification of the dismissal. Regarding pension schemes, the Federal Labour Court ruled that the General Equal Treatment Act shall be applicable if the Company Pension Act does not grant equivalent protection from discrimination.

III. Protected Individuals

German discrimination law protects all employees. In addition to employees (including executive employees (*leitende Angestellte*)), apprentices, contractors who are similar to employees (*arbeitnehmerähnliche Personen*) as well as home workers are protected. Likewise, job applicants and those who have had their contracts of employment terminated are protected. German discrimination law also extends the protection to freelance workers and members of executive bodies (such as statutory managing directors and management board members), but only where issues of engagement or promotion are concerned.

Protected individuals:
Employees
Apprentices
Executive employees
Contractors who are similar to employees
Home workers
Job applicants
Ex-employees
Limited protection
Freelancers
Members of executive bodies (managing directors, management board members)

Example: whilst it would be discriminatory to refuse promotion to a managing director because of old age, it is likely to be lawful to pay the younger managing director a lower salary than the older managing director because of his age.

IV. Discriminatory Behaviour

According to the *AGG*, discrimination is defined as unequal treatment on one or more of the grounds of discrimination in the *AGG*, which cannot be justified. The *AGG* explicitly prohibits direct and indirect discrimination, harassment (this may include "bullying"), sexual harassment, instructions to discriminate and retaliation.

The General Equal Treatment Act prohibits as discriminatory behaviour:
Direct discrimination
Indirect discrimination
Harassment (this may include "bullying")
Sexual harassment
Employer instructions to discriminate
Retaliation

1. Direct Discrimination

Direct discrimination occurs if a person experiences, experienced or would experience less favourable treatment than another (hypothetical) person in a comparable situation due to one of the protected grounds of discrimination. Here, an actual disadvantage is required (e.g. a woman is not employed purely because of her gender); the mere risk of a disadvantage is not sufficient.

2. Indirect Discrimination

Indirect discrimination occurs when a business imposes apparently neutral provisions, criteria or practices which particularly disadvantage a class of people qualifying under one of the protected grounds of discrimination under the *AGG* when compared to other persons. For example, if unlike full-time employees, part-time employees do not receive a Christmas bonus. As most part-time workers are female, indirect gender discrimination is an issue. No indirect discrimination occurs if the discriminatory treatment is objectively justified by a legitimate aim and the means of achieving this aim are appropriate and necessary.

3. Harassment

Harassment is discrimination within the meaning of the *AGG* if unwanted conduct relating to one of the protected discriminatory grounds occurs with the purpose of violating the dignity of a person and creating an intimidating, hostile, degrading, humiliating or offensive environment. Systematic "bullying" by colleagues, i.e. acts against another person with the purpose of mentally and/or even physically injuring him over a sustained period, also constitutes harassment if it relates to one of the protected grounds of discrimination.

4. Sexual Harassment

Sexual harassment is discrimination if an unwanted, sexually motivated act is committed which is intended to or results in the violation of a person's dignity, particularly where this creates an intimidating, hostile, degrading, humiliating or offensive environment. Sexually motivated conduct includes unwanted sexual practices and demands, sexually intended physical contact, remarks with sexual content as well as unwanted illustrations and displays of pornographic material. In comparison with the law of harassment, generally a single act may be sufficient to constitute sexual harassment (e.g. sending one "fun" e-mail with sexual content at work).

5. Instructions to Discriminate

The instruction to discriminate against a person on one of the grounds of discrimination is also prohibited and constitutes an act of discrimination. For example, a managing director's instruction to the HR-Department not to hire any disabled persons would constitute discrimination even if the HR-Department does not follow the instructions. This form of discrimination will also be shown if it is established that someone appointed a person to behave in a manner which is deemed to be

discriminatory or may be discriminatory towards an employee under the *AGG*. An actual act of discrimination is thus not required; rather a potential act of discrimination is sufficient.

V. Justified Discrimination

Not every instance of unequal treatment constitutes discrimination. The *AGG* tolerates unequal treatment under various conditions depending on the type of discrimination in issue:

Discriminatory treatment on the basis of race or ethnic origin, gender, religion or belief, disability, or sexual identity can only be justified if a substantial and vital work-related requirement can be demonstrated. Such discriminatory treatment must be mandatory for performing an activity, for example the exclusive employment of women as models for lingerie is admissible. It is, however, not admissible to exclusively hire female flight attendants as this job may equally be performed by men. Considerations of mere expediency or advantageousness are not sufficient.

Unequal treatment based on age is less difficult to justify. It is sufficient if the employer can demonstrate that the unequal treatment is impartial, appropriate and justified by a legitimate aim. The resources needed to achieve this objective have to be appropriate and necessary. The *AGG* contains a non-exhaustive list of examples of admissible unequal treatment on the grounds of age. The following examples are particularly worth noting:

- Special conditions for access to employment, terms and conditions of employment (remuneration, etc.) for an occupational integration of adolescents and older employees;
- Minimum requirements with respect to age, work experience, or seniority upon recruitment, or regarding certain benefits associated with an occupation;
- Age limits for recruitment on the basis of specific educational requirements or due to the necessity of an appropriate period of employment before retirement;
- An agreement providing for the termination of the employment relationship without dismissal at a time when the employed person may apply for a state pension because of his age.

VI. Rights of Persons Concerned

Discrimination law provides for the following remedies.

1. Voidness of Discriminatory Act

The discriminatory act or behaviour is null and void. Thus, no employee has to follow such behaviour (in particular discriminatory instructions by the employer).

2. Compensation for Damages

The employer may be liable for material damages for which it is deemed responsible. The employer is responsible for its own acts, whether caused intentionally or negligently. If works agreements and collective agreements are applicable, any liability is limited to intended acts and gross negligence. The employer is also liable for the acts of its legal representatives and of its vicarious agents (i.e. its executive employees in relation to the general workforce). Employer fault is assumed and the burden of proof is on the employer to show that it is not liable.

3. Compensation

Furthermore, there is potential liability for immaterial damage. Pursuant to the EU anti-discrimination Directives, this liability is presumably not dependant on any act of negligence, although this is not clearly expressed in the *AGG*. The amount of compensation for immaterial damage has to be appropriate. Again, the *AGG* does not provide guidance on what is considered as appropriate. The EU Directives, however, demand that the amount of the compensation should be effective, proportionate and sufficient to act as a deterrent. In this respect, it has to be assumed that labour courts will measure the amount of the compensation according to the economic status of the respective employer. In the context of recruitment, any compensation is limited to a maximum of 3 months' salary, except for the best-qualified applicant. In cases where the best qualified candidate has not been hired for reasons which are discriminatory under the *AGG*, the amount of compensation is unlimited.

4. Right to Complain

Employees have the right to complain to the company's complaints department (*Beschwerdestelle*) if they feel discriminated against by their employer, its management, other employees, or third parties in relation to their employment.

5. Right to Refuse Performance

If the employer does not take any action or takes obviously inappropriate measures in order to prevent harassment or sexual harassment, the person concerned is entitled to cease working whilst still receiving his wages, provided this is required for his protection.

6. No Claim to Employment or Promotion

An employer's breach of the *AGG* does not entitle an employee to claim for reinstatement/re-engagement or promotion.

7. Injunctive Relief

An employee discriminated against has the right to apply for injunctive relief. In cases of an employer's gross breach of the *AGG*, a works council or competent union are permitted to legally assert the rights mentioned herein (particularly a claim to injunctive relief). They are, however, not entitled to bring claims of discrimination on behalf of individuals.

VII. Burden of Proof

The burden of proof in any claim under the *AGG* is in favour of the employee who has allegedly been discriminated against. The claimant only has to make out facts sufficient to form a presumption that an act of discrimination occurred under the *AGG*, i.e. the employer then has to prove that no discrimination occurred and that the specific treatment is in fact justifiable. Thus, employers should ensure, before taking personnel measures, that no circumstances exist from which it could be presumed that a prohibited act of discrimination is involved. Documents released into the public domain, such as job advertisements, should be treated with caution and worded carefully in order to avoid any automatic presumption of discrimination sufficient to shift the burden of proof to the employer. As a basic starting position, job advertisements should always adopt gender-neutral wording. Minimum and maximum age limits should be avoided in such advertisements and no issues which could be associated with discrimination should be mentioned in interviews or assessment centres. Staff that is conducting job interviews should therefore be well trained.

VIII. Practical Consequences

As a result of the *AGG* employers should pay attention to the following.

1. Prevention

The employer has to take preventive measures to comply with its duty of protection and to organise the business in accordance with the laws. Employees, particularly senior employees, should receive equality and diversity training. Furthermore, a complaints department must exist for all employees. A full text version of the *AGG* as well as sec. 61b of the Labour Court Act (*Arbeitsgerichtsgesetz, ArbGG*), containing the relevant procedural regulations, particularly on the complaints procedure, should be communicated to the entire workforce and displayed in a suitable place, whether that be the company's intranet or a staff notice board.

It is advisable that companies provide codes of anti-discrimination and diversity to their employees. Such codes should effectively set out the company's complaints policy and procedure, with particular reference to complaints concerning discrimination. The company's complaints policy and procedure could be incorporated within a works council agreement, or alternatively in an employee manual. Furthermore, it is advisable to check for any potential pre-existing facts or circumstances which could amount to discrimination under the *AGG*. Particular attention should be paid to gender-neutral wording in employment contracts, works agreements and codes of conduct, etc. Further, the company's current salary scheme should be examined for discriminatory practices (e.g. on grounds of age).

2. Investigations

In response to a potentially discriminatory situation, it is advisable to accurately understand the circumstances by holding interviews with all persons involved (i.e. offender, victim, and witnesses). Any interviews should preferably be held with an employee representative present, and all evidence should be carefully recorded.

3. Sanction

Sanctions should not be imposed against an individual accused of discrimination under the *AGG* until the facts have been established and verified. Any sanction must be appropriate, necessary and reasonable. Under the *AGG*, potential sanctions could include a warning, relocation, or dismissal. Further feasible measures—if third parties are involved—are a ban on that third party entering the business premises. In theory, the employer might be obliged to terminate a contract e.g. with a supplier or a customer if they do not stop acting discriminatory against the employer's employees.

C. Key Aspects

- Discrimination and diversity are relevant in Germany, but it is not comparable to the importance in the U.S. or the UK.
- German discrimination laws protect against discrimination based on race and ethnic origin, religion or belief, gender, disability, age, and sexual identity.
- Discrimination law basically covers the entire employment relationship, from the initial job application, through to pay, benefits, and promotions.

Chapter 12
Data Protection and Monitoring

Verena Grentzenberg and Jens Kirchner

A. The Employee's Right to Privacy

In Germany, no specific "Employee Privacy Act" exists. Still, there are several sources of law in Germany which result in rather strict protection of personal employee data. First of all, the provisions of the Federal Data Protection Act (*Bundesdatenschutzgesetz, BDSG*) apply to the collection, processing and use of personal data of employees with sec. 32 *BDSG* explicitly governing the collection, processing and use of employee data. Secondly, specific data protection obligations might follow from applicable works agreements (*Betriebsvereinbarungen*). As of 25 May 2018, the General Data Protection Regulation (*GDPR*) will replace national data protection laws throughout the EU. However, art. 88 of the *GDPR* allows for national legislation for processing in the employment context which specifies the requirements of the *GDPR* and the German legislator has opted for keeping a slightly amended version of the current law under the *GDPR*.

Moreover, the employees'[1] privacy is protected by their respective personal right (*allgemeines Persönlichkeitsrecht*), which is enshrined as a fundamental right in the German Constitution. In particular, the fundamental right on informational self-determination and the fundamental right on confidentiality and integrity of IT systems are significant constitutional guarantees for employment relationships in Germany. The employer, like the works council, is obliged to safeguard and

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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promote the free development of the personality of the employees in the company, sec. 75 para. 2 Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*). Starting out from the aforementioned rights enshrined in the German Constitution, the extensive case law of the labour courts has developed principles for information—and data protection in the German labour law framework.

B. Lawfulness of Utilising Personal Data of Employees

According to the *BDSG*, the collection, processing and use of personal data shall be lawful only if a statutory provision permits or prescribes it or if the data subject has consented.

I. Statutory Provisions

The Federal Data Protection Act permits the employer to utilise personal data of employees if the usage of the respective data is necessary for the establishment of an employment relationship or, after its establishment, for its performance or termination (sec. 32 para. 1 s. 1 *BDSG*). Necessary "for the purpose of an employment relationship" is the collection and processing of any personal information which is relevant for the establishment, administration and termination of the employment relationship (e.g. name, address, bank details, sex, works council membership, emergency contact), for personnel planning (e.g. language skills, schooling, family status) and for job performance measurement (e.g. times absent, sickness).

II. Works Agreement

It is also generally held that a works agreement qualifies as a statutory provision in terms of the Federal Data Protection Act. Therefore, a works agreement might allow the utilisation of personal data of employees which is to the benefit of the employer. In practice such works agreements are often used as the legal basis for processing employee data.

It must be borne in mind that under current law the data protection safeguards of the works agreement can also differ from the statutory provisions but should not fall considerably below the statutory standard.

III. Consent of the Employee

Personal data in principle can also be legally utilised by obtaining the employee's consent to such use. Such consent shall only be effective if it is the data subject's free decision. Moreover, the data subject shall be informed of the purpose of the collection, processing or use of the data and in so far as the circumstances of the individual case require, or at his request, the data subject should be informed of the consequences of withholding consent (Informed Consent). Consent shall also be given in writing unless special circumstances allow for any other form of communication. If consent is given in writing simultaneously with agreement to other matters, the employee's attention must be drawn, in particular, to the declaration of consent. Finally, where special categories of personal data (i.e. data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, genetic data, biometric data for the purpose of uniquely identifying an employee, data concerning health or sex life respectively sexual orientation) are collected, processed or used, the consent shall explicitly include a reference to these types of data.

With respect to the consent given by employees (in particular as standard terms in the employment contract), the following points are relevant:

- Some commentators in legal literature and also the data privacy watchdogs in Germany generally doubt the voluntariness of data privacy consents in an employment contract due to the relationship of subordination between employer and employee. Therefore, a declaration of consent is recommended as a proper basis for the utilisation of personal data only in specific cases. The German data protection authorities for example acknowledge the validity of employee consent concerning certain monitoring and filtering activities of the employer if it is given in return for the possibility to use the employer's IT resources, namely email and Internet, for private purposes.
- If the data privacy consent is included in a larger document which also comprises other declarations (e.g. the employment contract), special prominence must be given to the consent (e.g. by typing the declaration of consent in bold and giving it a clear headline like "Consent to Data Processing").
- As to the language of the declaration of consent, no specific requirements are enshrined in German data protection laws. However, it is a mandatory requirement of an informed consent that the data subject is informed properly of the scope and purpose of the data processing steps he is being asked to consent to. Accordingly, the information, and also the declaration itself, shall be drafted in a language that the data subject is capable of reading and understanding. If the employer can prove that all German employees are capable of reading and understanding English, no German translation is necessary.
- If the employer intends to process special categories of data based on employee consent, the consent declaration must explicitly refer to such data.

C. Data Uses With Relevance for the Employment

I. Monitoring of Employees

Monitoring mechanisms in the workplace affect the privacy rights of employees. For a legal appraisal of surveillance in the workplace (in particular video surveillance), a distinction between the surveillance of premises that are open to the public and the surveillance of premises with restricted access has to be made.

1. Surveillance of Premises Open to the Public

Under the Federal Data Protection Act video surveillance of premises that are open to the public (which may include salesrooms and restaurants) is only allowed if (1) there is no indication of prevailing legitimate interests of those affected and if (2) it is necessary for the purpose of

- Enabling public agencies to fulfil their tasks
- Keeping out trespassers, or
- Achieving justified interests in certain defined situations (e.g. suspicion of crime).

If these prerequisites are met, it must be made clear in advance that surveillance is going to be conducted and who is going to be included. Clandestine surveillance is not permissible. The data must be deleted as soon as it is no longer needed for the defined purpose. Audio functions must be disabled. The German data protection authorities have issued guidance and a checklist for data controllers on the surveillance of premises open to the public in 2014.

According to the authorities, continuous surveillance of areas where people typically spend time communicating with each other (like in restaurants or cafes) is, in principle, inadmissible. The employer may, however, meet these concerns by limiting the pick-up area of the camera to spaces only entered by employees (e.g. employee side of a counter).

2. Surveillance of Premises with Restricted Access

More relevant in practice is the surveillance of premises with restricted access. According to case law of the Federal Labour Court (*Bundesarbeitsgericht, BAG*) the relevant provision of the Federal Data Protection Act does not apply to workplaces which, unlike salesrooms, are not open to the general public. In these cases, the admissibility of surveillance evidence by video cameras or other technical devices follows from the general provisions protecting the privacy of employees.

The personal rights guaranteed by the constitution include the right to one's own image. The right to self-determination implies that individuals can freely decide

whether they may be videotaped and whether the pictures can be used against them. Moreover, there is also protection for the spoken word, i.e. the right to determine oneself whether the spoken word is available to the partner of the conversation only or also made accessible to third parties or even the general public and whether it may be recorded by electronic or other means.

The assertion of the overriding legitimate interests of the employer may justify interference in the privacy rights of the employee. When there is a conflict between the general privacy rights of the employee and the employer's interests, the legally protected interests have to be weighed against the employer's interests on a case by case basis.

According to the Federal Labour Court clandestine surveillance by technical devices is only permitted if:

- A specific indication of a criminal offence or other serious misconduct at the expense of the employer exists;
- Less drastic means to clear up the suspicion have been exhausted;
- Covert surveillance is practically the only remaining means;
- The surveillance is proportionate, e.g. a cash deficit that cannot be cleared up in any other way.

Surveillance measures must not invade the employees' private sphere. Therefore, video surveillance is never permitted in rooms such as changing rooms and toilets. Even if the employees have been informed that a video camera or a similar technical device is to be installed at the workplace, this does not mean that surveillance is automatically admissible. Continuous surveillance will, in most cases, not be permissible because the pressure on employees caused by the feeling of being under constant observation could constitute a considerable infringement of their personal right. This applies particularly to situations where the employer has potential to use undetected surveillance. Again, in this case the interests of the employees have to be weighed against the legitimate interests of the employer.

The above-mentioned principles to safeguard the employees' privacy also apply to other surveillance measures by employers, e.g. eavesdropping on phone calls of employees at the workplace. If such calls are to be intercepted, employees must be notified in advance.

3. Data Processing Steps in Order to Reveal Criminal Conduct

With respect to monitoring measures which are intended to reveal criminal conduct by employees, it must further be noted that sec. 32 para. 1 s. 2 *BDSG* sets an explicit framework for such data processing. According to this provision, any kind of processing and use of employee data for purposes of unveiling criminal actions by employees is only lawful if:

- There is actual evidence which causes suspicion that the employee has committed a criminal offence in the framework of the employment relationship;

according to the Federal Labour Court, also "similar serious offences against the employer's assets" will justify investigations;
- The processing and use of the data is necessary for the prosecution of the crime; and
- There is no overriding legitimate interest of the employee in his data being excluded from such processing and use (in particular the data usage must not be excessive).

4. Involvement of the Works Council

Additionally, the monitoring of employees triggers a co-determination right for the works council (sec. 87 para. 1 no. 6 Works Constitution Act). The works council has a right of co-determination especially in the event of the introduction and application of technical systems which are suitable for monitoring the conduct or performance of the employees. According to the rulings of the Federal Administrative Court (*Bundesverwaltungsgericht, BVerwG*) automatic time recording systems or video surveillance are examples of technical monitoring systems within the meaning of the Works Constitution Act.

II. Internet/Email Use by Employees in Workplace

Employees' private Internet and email use in the workplace is a constant privacy issue. It is generally held that by allowing the private use of Internet and/or email in the workplace, the employer qualifies as a telecommunication service provider in terms of the Telecommunications Act (*Telekommunikationsgesetz, TKG*), so that it is principally bound to the telecommunication secrecy obligation enshrined in sec. 88 of this act. Violations of the telecommunication secrecy obligation constitute a criminal offence according to the Criminal Code (*Strafgesetzbuch, StGB*). Moreover, the data protection law provisions of the *TKG* apply with respect to permitted private email and Internet communication. As a matter of fact, these provisions hardly allow the employer to access the content of such emails or the continuous monitoring of private email and Internet use. Since it is not always possible to ascertain whether a certain email is of a private or business nature, conflicts with data protection laws are bound to occur. In order to avoid such conflicts it is recommended to either prohibit private email and Internet use or to put in place a clear policy which determines if and to what extent private communications may be subject to monitoring and may be forwarded to third parties (e.g. holiday replacements, successors). In addition, an informed consent of employees to all monitoring and filtering operations concerning the use of IT resources should be obtained. Employees which refuse to consent should be disallowed to use the employer's IT resources for private purposes.

III. Sharing Employee Information Within Groups of Companies

Many German companies have IT-based systems in place for administrating their employee relationships. Apart from the storage of employees' basic data (e.g. name, address) such databases often serve additional purposes, for example the recording of the times worked by employees, reviewing their performance, etc. In groups of companies, such databases often are centralised and access to the data is granted not only to the local HR department but also to individuals who are formally employed by sister or parent companies in order to make a centralised budget possible, as well as fee calculations or coordinated salary- and bonus assessments. Such practice might give rise to data protection concerns because as a general rule, groups of companies enjoy no privilege under German data protection law as regards intra-group transfers of personal data. Nevertheless, the German data protection authorities acknowledge that intra-group controller-to-controller transfers can be justified, e.g. if the individual employment relationship has a group context or if the employee is part of the management. For other employees the centralisation of HR functions can be permissible based on statutory provision or works agreement if certain safeguards are met; for example, German data protection authorities expect that the employer remains fully liable for all data subjects' rights (like access rights or right for damages).

IV. Outsourcing Employee Data Processing Operations

The outsourcing of data processing operations also has data protection law implications for employers. The Federal Data Protection Act provides for a so-called data processor privilege. According to this data processor privilege the communication of personal data to a data processor and the processing and use of this data by the processor do not require a specific legal basis. The data controller (i.e. the body which transfers the data to the processor) remains responsible for the data processor's compliance with the data protection rules. Yet, the establishment of a valid data processing agency (and accordingly the enjoyment of the privilege) requires certain arrangements:

- In particular, a written agreement establishing the data processing agency must be in place. Moreover, in this agreement, the technical and organisational measures to be taken by the data processor, the scope, purpose and type of data processing as well as other contractual terms such as inspection and control rights of the data controller etc. must be specified in detail (in accordance with the requirements laid down in sec. 11 para. 2 *BDSG*).
- Moreover, according to the German data protection authorities, the outsourcing of operations must be mainly restricted to commissioned data processing

operations and must not be tantamount to a transfer of functions (*Funktionsübertragung*). Where there is such a transfer of functions, the data processor privilege shall not apply, with the effect that the transfer of personal data to the recipient will require a separate legal basis. In practice, it is often very difficult to determine whether an outsourcing of certain services should be regarded as a mere data processing or rather a transfer of functions. While an outsourcing of IT services (e.g. hosting of systems, storing of data) and functions such as the operation of a call-centre can generally be structured as commissioned data processing, the complete outsourcing of key functions to another group company will most likely exceed the scope of such commissioned data processing and instead be regarded as a transfer of functions. Therefore, if for example the complete human resources (HR) functions and their respective employee data were to be outsourced it would most likely not benefit under the data processor privilege. In case of a transfer of functions it would be necessary to assess whether a valid legal basis for the data processing operations that are inherent to the transfer (e.g. sec. 28 para. 1 no. 2 *BDSG*) could be found and that the specific requirements of the German data protection authorities for such transfers are met (e.g. the employer must remain fully liable, cf. III above).

V. Transfer of Employee Data Outside the EU

1. General Requirements for the Transfer of Employee Data Outside the EU

For the assessment of the lawfulness of transferring employee data to third party recipients, the place of residence of the recipient is of particular relevance. In the event that the data are transferred within the European Economic Area (EEA) only, no particularities have to be observed. For legal purposes, the transfer of data within the EEA is treated in the same manner as a domestic transfer of data.

However, there is a difference if the data is transferred to a recipient in a jurisdiction outside the EEA (Third Country). Such data transfers are only permissible subject to the additional requirement that an adequate level of data protection is established by the body receiving the data (sec. 4b para. 2 s. 2 *BDSG*).

Thus far, the EU Commission has confirmed in a general manner the adequacy of the data protection levels in Andorra, Argentina, Canada (commercial organisations only), Faeroe Islands, Guernsey, Israel, the Isle of Man, Jersey, New Zealand, Switzerland and Uruguay.

If the data transfers are to be made to other Third Countries, the transfer of data can nevertheless be organised in a manner that is in accordance with the law. According to the relevant provision, personal data may be transferred even if an adequate level of data protection has not been generally established by the recipient of the data if the person concerned has consented or if the competent supervisory authority has permitted the data transfer because the recipient of the data furnishes

sufficient guarantees for the protection of the transferred data. In particular, such guarantees may result from contractual clauses or so-called Binding Corporate Rules (BCR).

The EC Commission has issued so-called Standard Contractual Clauses (SCC or Model Clauses) for the transfer of data to recipients in Third Countries. Different sets of SCC exist depending on whether the recipient acts as a commissioned data processor or as a data controller. In Germany, SCC do not require an authorisation by the authorities.

Binding Corporate Rules only apply to group companies. They provide a good basis for intra-group transfers and also help to demonstrate broader compliance with the upcoming General Data Protection Regulation, especially with regard to the new principle of accountability. Also a group of data processors may enter into Processor Binding Corporate Rules (PBCR), enabling them to prove to their customers that they have established an adequate level of data protection group wide. Both BCR and PBCR require an authorisation by the competent data protection authority.

2. Transfer of Employee Data to the USA

In the past, U.S. companies that agreed to be bound by the "Safe-Harbour-Principles" of the EU Commission and the U.S. Department of Commerce (Safe Harbour) had been acknowledged as providing an adequate level of data protection until the European Court of Justice invalidated Safe Harbour in its *Schrems* decision (6 October 2015—C-362/14). As a consequence, personal data can no longer be transferred to the USA based on Safe Harbour. Following this decision the European Commission negotiated a new agreement with the U.S. authorities (especially the Department of Commerce), the EU-U.S. Privacy Shield (Privacy Shield).

The Privacy Shield is a system of self-certification by which U.S. organisations commit to a set of privacy principles. With its implementing decision of 12 July 2016 the European Commission declared that the U.S. ensures an adequate level of protection for personal data that is transferred from the EU to organisations in the U.S. that are self-certified under the Privacy Shield (Commission Decision). Since 1 August 2016 U.S. organisations are able to sign up to the Privacy Shield. As a consequence, a data controller within the EU can transfer personal data lawfully collected within the EU, such as employees' personal data, to an U.S. organisation that has signed up to the Privacy Shield if the data transfer itself is lawful (because, for example, a statutory provision or a works agreement permits the specific transfer).

There are seven Privacy Principles the U.S. organisations must adhere to under the Privacy Shield:

- *Notice Principle*: Organisations have the duty to inform data subjects on several key elements relating to the processing of their personal data and have to make public their privacy policies.

- *Data Integrity and Purpose Limitation Principle*: Personal data needs to be limited to what is relevant for the processing, it has to be reliable for the intended use and accurate, complete and current. Personal data may only be processed in a way that is compatible with the originally envisaged purpose it was collected for. Further, personal information may only be retained in a form identifying an individual (or leaving it identifiable) as long as it serves the original purpose it was collected for or for which it was subsequently authorised.
- *Choice Principle*: The data subject has a right to opt out of the processing of data where there is a change in the purpose of the processing that is still compatible with the original purpose. For sensitive personal data a positive "opt in" is generally required.
- *Security Principle*: Organisations have to take "reasonable and appropriate" security measures, relative to the risks involved in the processing of the kind of data in question. Contracts for sub-processing have to guarantee the same level of protection as provided by the Principles.
- *Access Principle*: Data subjects must be able to gain information from the organisation on whether and which kind of personal data related to them is being processed. They have the right to amend, correct or delete the information if it is inaccurate or processed unlawfully.
- *Recourse, Enforcement and Liability Principle*: Organisations have to provide effective mechanisms to ensure compliance with the other Privacy Principles and recourse for EU data subjects whose personal data have been processed unlawfully, including effective remedies. It is compulsory for every organisation that signed up to the Privacy Shield to follow its Principles. Organisations have to re-certify their participation in the framework every year. Further, the organisations must ensure compliance with the Principles through effective measures within the organisation.
- *Accountability for Onward Transfer Principle*: The organisation can only transfer personal data onwards to controllers or processors (1) for limited and specified purposes, (2) based on a contract (or agreement in a company group), and (3) if that contract (agreement) provides the same level of protection as the Privacy Principles.

It should be noted that there are additional safeguards for human resources data processed in the employment context; these can be found in annex II sec. III.9 of the Commission Decision. For example, U.S. organisations processing human resources data in the context of the employment relationship under the Privacy Shield are obliged to cooperate and comply with the advice of the competent EU data protection authorities.

D. Appointment of a Data Protection Officer

If a certain number of people are concerned with personal data in the company, the employer shall appoint an internal Data Protection Officer. The officer is obliged to ensure that the company complies with the applicable data protection laws. In particular he shall monitor the proper use of data processing systems and take suitable steps to familiarise the employees with the applicable data protection rules. The threshold for the number of people concerned with the processing of personal data by automated means that triggers the obligation to appoint such an officer is 10 people (in the unlikely case of a manual processing of personal data, the threshold is 20 people under current law).

Even if the threshold is not reached, it can be advisable to appoint a Data Protection Officer on a voluntary basis because it might spare the company notification obligations (small companies are typically exempt from notification obligations in the employment context but the exemptions are narrower than those concerning the appointment of a Data Protection Officer). If a Data Protection Officer has been appointed, notification obligations only apply to companies which process personal data commercially (e.g. credit rating agencies).

Eligibility for the appointment as Data Protection Officer is restricted to those who possess the necessary expertise and reliability. Therefore, in practice the CIO and/or head of IT are usually not eligible for this post due to possible conflicts of interest. Employees appointed as Data Protection Officers enjoy special dismissal protection: Their employment relationship can only be terminated extraordinarily for good cause. The protection does not only apply during their term of appointment but also for 1 year after their dismissal. Against that background many employers appointed external Data Protection Officers (e.g. from third party service providers) in the last years.

E. The General Data Protection Regulation

I. Key Facts

The European data protection law is currently undergoing significant changes and therefore is of high importance to all employers situated within or working within the EU. The European Data Protection Directive 95/46/EC (*DPD*) which has been in force since 1995 will be repealed by the European General Data Protection Regulation (*GDPR*) on 25 May 2018. The *GDPR* will then be directly binding without further need of implementing legislation. Until that date the Member States and companies have the pressing obligation to adopt the new rules of the *GDPR* and adjust to them.

As a consequence of the harmonisation intended by the *GDPR* the *BDSG*, which implemented the *DPD* into German law, will not be applicable anymore. However,

there are more than 30 areas covered by the *GDPR* where Member States are permitted to legislate differently in their own domestic protection laws; one of these is the processing of data in the context of employment. The German legislator has issued a new *BDSG* (*Bundesdatenschutzgesetz, BDSG-neu*) in spring 2017 which contains respective statutory provisions. This *BDSG-neu* will come into force at the same time as the *GDPR*.

The *GDPR* brings about multiple changes. For one, the *GDPR* introduces much higher penalties for basically any breaches of its provisions. These penalties can be up to 4% of the annual global turnover of the company and individuals can be found liable for breaches and be penalised with up to 20,000,000€, art. 83 *GDPR*. The *GDPR* intends to have a strong deterrent effect with these penalties and it is therefore urgently recommended to fully and correctly implement the changes and measurements the *GDPR* calls for. Further, under the *GDPR* not only data subjects who have suffered a material loss but also just an immaterial loss due to non-compliance with the regulations can now receive remedies. These high financial risks for non-compliance make a full documentation of the compliance with all regulations of the *GDPR* and the *BDSG-neu* absolutely necessary, see art. 5 para. 2 *GDPR*.

Another aspect in which the *GDPR* is stricter is in respect of the amount of data that may be collected and processed: from the outset, privacy by design and privacy by default IT-systems need to be in place (art. 25 *GDPR*), data protection impact assessments need to be carried out for high risk processing including video surveillance (art. 35 *GDPR*) and there is a "right to be forgotten" (art. 17 *GDPR*), which is also of relevance for both employment candidates' as well as employees' data.

Through a "lead authority" solution (introduced by art. 56 *GDPR*) the national data protection authority of the Member State in which the company group has its "main establishment" is responsible for the entire data protection supervision of the company group within the EU. An exception to this rule applies where a data processing is exclusively local, e.g. video surveillance. In such a case the local supervisory authority is responsible for the respective data processing. Furthermore, data subjects may always raise complaints with their local authority.

II. Territorial Scope

The *GDPR* brings about an increased scope of applicability of the European data protection laws. By introducing a market place principle the *GDPR* extends its territorial scope to companies that are not placed within the EU but address the European single market and EU citizens. The processing of employee data from the EU by global corporations that monitor centrally outside of the EU will be covered by this regulation. This can be of particular importance with regard to the UK leaving the EU.

If the *GDPR* applies to a controller or processor not established in the EU, a representative in the EU must be designated who serves as a contact point for the local supervisory authorities, art. 27 *GDPR*.

III. Lawfulness of Utilising Personal Data of Employees Under the GDPR

Generally, data collection is lawful if it is necessary to carry out a contract or other legal responsibilities (e.g. for insurance or tax reasons) or to secure legal interests (e.g. keeping applicants' data for evidentiary purposes in anti-discrimination cases); further, the data subject's consent and works agreements can make data collecting lawful, art. 6 and 88 *GDPR*.

For the employment context, the *BDSG-neu* basically maintains the current sec. 32 *BDSG* (sec. 26 para. 1 *BDSG-neu*). In addition, works agreements are now expressly named as legal basis for processing of employee data (sec. 26 para. 4 s. 1 *BDSG-neu*). However, works agreements may—just like national legislation—only provide for specifications but may not fall below statutory standards provided by the *GDPR*. They shall include suitable and specific measures to safeguard the employees' rights, with particular regard to transparency, transfer of employee data within a group of companies and monitoring systems at the work place (art. 88 para. 2 *GDPR*).

In the explanatory memorandum of the *BDSG-neu* the German legislator elaborates that in order to determine whether the processing is necessary in the sense of sec. 26 para. 1 s. 1 *BDSG-neu*, a fair balance must be struck between the conflicting fundamental rights of the employer and the employee respectively the employer's interest in the processing and the employee's personality right. Typically, the employee's interests will override those of the employer if the employee does not reasonably expect processing of his data at the time and in the context of its collection (recital 47). In practice, the intended processing must comply with a proportionality test, which is in line with the case law of the Federal Labour Court.

As a consequence, we expect that German Labour Courts will continue to apply the principles for the processing of personal employee data established by the jurisdiction of the Federal Labour Court. Under the *BDSG-neu*, employers are also still required to carry out a strict proportionality test with regard to the processing of employee data for the detection of criminal offences (sec. 26 para. 1 s. 2 *BDSG-neu*). Just like the *BDSG*, the *BDSG-neu* expands the provisions to non-automated processing operations, e.g. handwritten notes taken by an HR manager. Under the *GDPR*, the same requirements apply to the processing of employee data by works councils or other representational institutions of employees.

Regarding the data subject's consent as a means to make the collecting and processing of data lawful, all of the current requirements for consent (see above B. III.) will continue to apply (sec. 26 para. 2 and 3 *BDSG-neu*). According to sec.

26 para. 2 *BDSG-neu* the subordinate position of the employee and the circumstances of the consent must be taken into account when determining if consent is voluntary. Consent will be granted voluntarily in particular if the processing leads to advantages for the employee (like in the example above when the consent is the precondition for private use of IT resources) or employer and employee have "similar interests".

In addition, under the *GDPR* valid consent requires that the data subject will be informed of its rights to withdraw consent for the future prior to giving consent in text form (art. 7 para. 3 *GDPR*, sec. 26 para. 2 s. 4 *BDSG-neu*).

The *GDPR* has codified the long-held interpretation that special categories of data which are subject to additional controls on processing (often referred to as sensitive personal data) includes genetic and biometric data. Hence, employers who currently rely on the grounds of legitimacy for using biometric data in the employment context (e.g. for purposes of controlling access and attendance of employees) might not be able to do so in the future. The *BDSG-neu* only states that sensitive personal data may be used for "carrying out the obligations and exercising specific rights (. . .) in the field of employment and social security and social protection law or a collective agreement" (sec. 26 para. 3 s. 1, para. 4 s. 1 *BDSG-neu*).

A legitimate interest to transfer for example employee data can exist between undertakings of the same company group for administrative purposes as recital 48 *GDPR* points out. This might potentially simplify data transfers within company groups based on art. 6 para. 1 lit. f *GDPR*.

The *GDPR* also takes into account that data processing might be carried out by joint controllers. In the employment context, several group companies might for example act as joint controllers when jointly processing employee data. In such cases responsibilities must be clearly allocated, for example for tasks like managing the rights of data subjects.

Under the *GDPR*, involving a data processor will require a data processing agreement which must contain even more details than agreements under current German law (cf. art. 28 *GDPR*). It is already being questioned whether the German peculiarity that a third party may not act as a data processor if a "transfer of functions" (*Funktionsübertragung*) takes place can be upheld under the *GDPR*. The new regulation does indeed not provide for such an exception: as long as the processing entity processes personal data only on documented instructions of the data controller, it should be considered a data processor.

As regards video surveillance of premises open to the public, the *BDSG-neu* basically intends to preserve the current law (sec. 4 *BDSG-neu*). For surveillance of premises with restricted access we expect that the Federal Labour Court will uphold its position on surveillance under the *GDPR*. However, employers should watch out for new developments in case law.

IV. Fair Processing and Individual Rights

Employers have a duty to instruct the (prospective) employee, beginning with the application process. The employer must inform the candidate or employee about the terminology, the collecting and processing of data, the persons responsible, and his rights in easy, unambiguous language, art. 12–14 *GDPR*.

Data subjects are entitled to receive the personal data they have provided to a data controller in a structured, commonly used and machine-readable format if, *inter alia*, the data processing is based on consent or on a contract and if it is carried out by automated means, art. 20 *GDPR*. According to this "data portability" right they may also request that their data will be transmitted directly to another controller. Candidates for a job position could, for example, request that they receive a copy of their online application or could even demand that it will be transmitted to another potential employer.

Art. 22 *GDPR* contains another regulation that may be of interest for recruitment processes: it grants applicants the right not to be subject to a decision based solely on automated processing, including profiling. Recital 71 explicitly names e-recruiting practices without any human intervention as example for a forbidden processing operation. Further areas where automated decision making may be in play in the employment context include: performance management, attendance bonuses, holiday or shift rostering, monitoring and profiling using the application of Big Data algorithms.

Under the *GDPR*, controllers and processors have joint obligations to implement appropriate technical and organisational measures to ensure a level of security appropriate to the risk. Appropriate measures can be, *inter alia*, pseudonymisation or encryption of personal data, art. 32 *GDPR*. The *GDPR* contains personal data breach notification obligations for controllers both towards the data protection authorities and the data subjects, art. 33 and 34 *GDPR*. Notifications to the authorities have to be made no later than 72 h upon becoming aware of the breach.

V. Principle of Accountability

The *GDPR* requires each data controller to demonstrate compliance with the data protection principles. This general principle of accountability manifests itself in specific enhanced governance obligations which include:

- Keeping a detailed record of processing operations (there is some relief granted to organisations employing fewer than 250 people but the exemption is very narrowly drafted).
- Performing data protection impact assessment for high risk processing.
- Implementing mechanisms and procedures for monitoring and verifying compliance.

- Introducing measures to enhance awareness of data protection issues within the organisation (e.g. training).
- Appointment of a Data Protection Officer, if required.
- Notifying and keeping a comprehensive record of data breaches.
- Adoption of the principles of data protection by design and by default.

Under the *GDPR* obtaining a privacy certification by an approved certification body or a competent supervisory authority allows an organisation to provide assurance that it is in effective compliance with the above.

VI. Appointment of a Data Protection Officer Under the GDPR

A peculiarity of the German data protection law is the quite extensive requirement for Data Protection Officers in companies. Even though the *GDPR* introduces a less extensive requirement for Data Protection Officers, it allows for stricter rules in Member States and the German legislator has opted to uphold the current provision that a Data Protection Officer must be appointed if 10 or more people process personal data by automated means (sec. 38 para. 1 *BDSG-new*). The contact details of the Data Protection Officer shall be published and notified to the competent authority. There are no further notification requirements.

VII. Transfer of Data to Third Countries Under the GDPR

The *GDPR* restates the principles in the *DPD* that transfers of data to countries outside the EEA are only permissible subject to the additional requirement that an adequate level of data protection has been established. The existing decisions of the EU Commission confirming an appropriate level of data protection in a Third Country and Standard Contractual Clauses (SCC) are supposed to remain in force. At the same time, the significance of Binding Corporate Rules (BCR) has grown. In addition to the existing instruments (SCC, BCR, PBCR), the *GDPR* contains other mechanisms to support lawful transfers, including codes of conduct approved by the competent supervisory authorities and the new certification mechanism. Data subjects (including employees) must be informed about the fact that the controller intends to transfer personal data to third countries, the existence or absence of an adequacy decision by the Commission respectively about the appropriate or suitable safeguards (SCC, BCR, PBCR or EU-U.S. Privacy Shield) and how they may obtain a copy of them (art. 13 para. 1 lit. f, 14 para. 1 lit. f *GDPR*).

F. Key Aspects

- Ensure sufficient documentation and internal control of collection and processing of employee data. Keep records of all processing activities.
- Appoint internal or external Data Protection Officer (if required).
- Ensure that each time the personal data of employees is collected and processed it is either permitted by law, a works agreement (*Betriebsvereinbarung*) or by a valid consent of the individual.
- If an employee does not voluntarily consent, a declaration of consent by the employee might not be a valid basis for the processing of personal data.
- The centralisation of personal data of employees will only be admissible under certain conditions and with specific safeguards in place.
- Appropriate outsourcing agreements that meet the legal requirements shall be in place when appointing data processors.
- Transfers of the personal data of employees outside the EEA will require the implementation of Standard Contractual Clauses (SCC) or other means to safeguard an adequate level of data protection by the recipient.
- Monitor developments regarding data transfers to the USA.
- Prepare in time for the requirements under the *GDPR*, in particular by
  - updating records of processing activities;
  - reviewing the legal basis for processing and establishing a new basis where necessary (e.g. if consent can no longer serve as legal basis);
  - observing the privacy by design and privacy by default principles;
  - carrying out privacy impact assessments, where required;
  - updating internal procedures to ensure that data subjects can readily exercise their (new) rights under the *GDPR* (for example regarding access, deletion of data or data portability);
  - reviewing and amending privacy policies and information clauses in order to meet the employees' and candidates' information rights;
  - implementation of organisational and technical measures to protect personal data, taking into consideration the level of risk, and including periodical monitoring of such measures;
  - reviewing the internal breach notification procedure, implementing an incident response plan and maintaining records of all incidents;
  - reviewing agreements with data processors in light of art. 28 *GDPR*.
- Comply with additional requirements for the processing of employee data under the *BDSG-neu*.
- Ensure the proper involvement of the works council with respect to the automated processing of personal data.

Chapter 13
Employee Inventions and Copyrights

Burkhard Führmeyer and Fabian Klein

A. Introduction

Other than in many jurisdictions, inventions and technical improvement proposals made by employees under German law belong to the employee. A "work made for hire" doctrine in principle does not apply. Yet, the employer may claim these rights, but must, however, grant the employee financial compensation. The rules and procedures for this are provided in the Act on Employee Inventions (*Arbeitnehmererfindungsgesetz*).

Employees'[1] works that are protected by copyrights or ancillary rights are governed by the Copyright Act (*Urheberrechtsgesetz*). Deviating from most other jurisdictions, copyrights or ancillary rights cannot be transferred, but remain with the natural person that is the author. Third parties, including employers, may, however, be granted usage and exploitation rights in a very wide scope. The Copyright Act foresees that an employee must even grant such rights to his employer without being entitled to an additional financial remuneration unless agreed differently between the parties. Yet, revocation rights remain with the employee, and also moral rights cannot be excluded in full.

For software, which is also protectable by copyrights, these general rules are modified and the employer is granted usage and exploitation rights to such software created during the employment automatically by virtue of law.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Employee Inventions and Technical Improvement Proposals

I. General

The rules and procedures for inventions and technical improvement proposals made by an employee are regulated by the Act on Employee Inventions. The Act on Employee Inventions primarily aims to ensure that employees are not exploited and that they are compensated adequately for inventions and technical improvement proposals made in connection with their employment. The provisions are mandatory. Before inventions or technical improvements are made the parties may not deviate from these provisions to the disadvantage of the employee. Only after the invention was made the parties may agree on different regulations. In any case, the obligation to provide the employee with an adequate additional compensation for his invention or technical improvement proposal cannot be excluded completely. In case of a dispute, the question of whether an agreed-upon remuneration is adequate is subject to review by a special arbitration panel located with the German Patent and Trademark Office, or the German civil courts.

II. Scope of Personal Applicability

The Act on Employee Inventions applies to employees only. It therefore does not apply to (1) managing directors or board members (these are part of the executive body of the company and not employees) or (2) to freelancers (these being persons who perform services on an independent basis and who bear the commercial risk of their business, cf. Chap. 4). Since these persons do not fall within the scope of the Act on Employee Inventions it is advisable to include comprehensive provisions in their work contracts, ensuring e.g. that they must inform the company about inventions or technical improvements and are obliged to transfer such rights to the company.

III. Employee Inventions, Free Inventions and Technical Improvement Proposals

The Act on Employee Invention differentiates between employee inventions on the one side and free inventions on the other side.

Employee inventions are inventions that an employee develops or conceives while fulfilling his obligations under the employment contract, or by using specific know-how of the company. All other inventions are free inventions.

Inventions are developments that are eligible for patent or utility model protection. In general, this requires a technical innovation that is new and contains an inventive step. Mere discoveries, scientific theories, mathematical methods, schemes, rules or methods for performing mental acts are not considered inventions. Three-dimensional structures of semiconductors (topographies), design rights or aesthetic creations and computer programmes as such are also no inventions but can be subject to protection by other IP rights. Especially computer programmes are usually covered by the Copyright Act (which is outlined below).

Technical improvement proposals are suggestions for technical improvements that do not qualify for patent or utility model protection and are thus no inventions, but nevertheless contain new creations and provide the employer with similar possibilities to exploit the technical improvement.

IV. Rights and Obligations of the Employer and the Employee

While the Act on Employee Inventions grants the employer a chance to secure employee inventions and technical improvement proposals—in exchange for an adequate compensation—it does not grant the employer access to free inventions. It further stipulates detailed requirements that both the employer and the employee must follow for an employee invention to be validly transferred from the employee to the employer; similar rules apply to technical invention proposals.

1. Notification

The employee must notify the employer about an invention in text form. This includes notification in writing, via email or via fax. The notification must be made without undue delay after the invention has been made. Several employees that jointly contributed to an invention can make a joint notification.

The purpose of the notification is to enable the employer to make a decision on whether it wants to claim the invention (thereby triggering compensation claims, cf. below) or not. For this, it must be put in a position to understand the nature of the invention and to assess the patentability of the invention. The notification must therefore contain at least the following information:

- Description of the technical task and the technical outcome the invention achieves.
- The technical solution of the invention. This also requires stating the technicalities needed for the technical task to be solved. A mere outline of the main idea of the invention is not sufficient. Further, it requires stating potential variations, particular embodiments and alternative solutions. This is of course limited to the employee's knowledge.

- Description of how the invention was developed or conceived, including what instructions or guidelines were given to the employee from the employer (if any). It also must state the experience the employee gained while working for the employer. It should further state which other employees (or additional persons) where involved and how they contributed.

The exact scope of the information that needs to be provided must be decided on a case-by-case basis; however, it is advisable for companies to prepare a standard form for the employee to fill out, requesting sufficient information.

2. Claiming of the Invention by the Employer

After receiving an adequate invention notification the employer must decide within a 4-month period on whether it wants to claim the invention or not. If the received notification does not provide sufficient information (or no notification is given at all), this period does not commence.

To calculate the exact time span the employer must confirm the date on which it received the invention notification. If the notification is not sufficient or unclear, the employer must request the missing details within 2 months after receiving the initial notification.

If the employer does not want to claim the invention, it must declare its waiver in writing towards the employee (within the 4-month period). If the employer does not declare such waiver of the invention within this 4-month period or does not make a declaration itself at all, the invention is deemed to be claimed, triggering the additional remuneration claim of the employee.

If the employer validly declines the invention, the rights remain with the employee who is then free to seek protection in his own name, dispose of the invention or otherwise proceed (e.g. not take any steps toward protection at all).

3. Consequences of the Employer Claiming the Invention

If the employer claims the invention (by actively claiming it or by not declining it within the 4-month period), it is obliged to apply for patent (or utility patent) protection in Germany. Where possible, the employer shall also secure a priority. In this regard, it may be possible for the employee to file for patent protection on behalf of the employer. In other countries the employer is not obliged to file for such protection but is free to do so. For those countries where the employer does not file for protection, it must release the invention to the employee. The employee then may claim protection in his own name.

In certain cases, the employer is not obliged to file for patent (or utility patent) protection. This may e.g. be the case where the employer can claim a legitimate interest such as to keep the invention confidential.

V. Remuneration

The main objective of the Act on Employee Inventions is to ensure a fair and adequate compensation of the employee for his inventions. The employer must therefore pay the employee such a compensation in addition to his salary in exchange for the transfer of the invention after it has been claimed.

1. Extent of the Obligation to Compensate the Employee

Generally, the employer is required to remunerate the employee until the expiration of the obtained patent or utility model. However, the obligation to pay remuneration does not require that the patent or utility model is registered. If the employer has used the invention before registration, it has to pay a preliminary compensation. Usually, the employee is entitled to a percentage of the overall compensation, depending on the likelihood that a registered patent or utility model can be obtained. Even if ultimately no patent or utility model is granted, the employee is entitled to keep the remuneration already obtained.

2. Calculation of the Remuneration

Employer and employee must agree on an adequate compensation. If they cannot reach an agreement, the employer must determine the amount of the adequate remuneration. Usually, this is calculated according to guidelines issued by the Federal Ministry of Labour and Social Affairs (*Bundesministerium für Arbeit und Soziales, BMAS*). In case the employee does not agree to the set amount, he may turn to the mediation panel at the German Patent and Trademark Office or, subsequently, to the general courts.

a) Procedure

The parties must reach an agreement on the adequate compensation within 3 months after a patent or utility model has been registered or after the underlying invention is put to use. If employer and employee cannot reach such an agreement, the adequate compensation is determined by the employer, who then informs the employee about it in text form. If the employee does not object to the amount determined by the employer within 2 months, the determined amount is deemed to be agreed upon and the employer is obliged to pay such amount.

b) Calculation Method

The Guidelines on the Compensation for Employee Inventions in the Private Sector (*Richtlinien für die Vergütung von Arbeitnehmererfindungen im privaten Dienst*) issued by the Federal Ministry of Labour and Social Affairs in many cases serve as basis for the calculation of an adequate compensation. These stipulate detailed provisions and calculation methods on how to determine which compensation is adequate. The main factors for the calculation are the contribution of the employee, the position of the employee within the company of the employer, and the value of the employee invention.

Even though these guidelines are not binding, the courts as well as the mediation panel usually refer to them when determining the adequate compensation.

c) Determining the Value of an Employee Invention

The value of the employee invention may be calculated based on one of the three following methods:

- License analogy: This is the most common calculation method and must be used if turnover is generated by the employer with the invention. The turnover generated with the sale of the products that make use of the invention serves as indicator of the market value of the invention.
- Internal Value: If the invention is only used within the company of the employer, the internal advantages and benefits of the application of the invention are the relevant factors upon which the value of the invention is determined.
- Estimate: If no other indicator exists, the value is estimated, taking into account the likely benefit of the invention.

d) Contribution of the Employee

According to the guidelines, the employer's contribution to the invention reduces the value of the invention. This is based on considerations that an employee inventor has to bear much lower risks compared to an independent inventor. Important factors therefore are (1) who was requesting the technical task, (2) the contribution of the employer to the solution and (3) the role and duties of the employee inventor within the company.

The guidelines provide additional information on how to determine the value of the employee's involvement. The smaller the employer's contribution in respect of the technical task and its solution is, and the lower the previous knowledge and the position of the employee is within the company, the higher is the compensation to which the employee inventor is entitled.

3. Litigation About the Compensation

In case of a dispute between the employer and the employee regarding the amount of an adequate compensation, both parties may submit the issue to the mediation panel (*Schiedsstelle*) at the German Patent and Trademark Office. A procedure before this body is free of charge and neither party can claim a reimbursement of its expenses.

Only after consulting the mediation panel is it possible for either party to file a lawsuit before the civil courts.

VI. Abandonment of the Rights

The employer is required to maintain patent or utility model protection at its own costs. It may only abandon any such granted right after the employee has been fully compensated, which is rarely the case before the termination of the maximum protection time.

The employer therefore usually must inform the employee of its intention to let such a right based on an employee invention lapse. Within 3 months after having been informed of such an intention the employee can request for the right to be transferred to him at his own costs. If the employee does not request such a transfer, the employer is free to abandon the granted right. A violation of this duty to inform the employee will result in the employer being liable for damages towards the employee.

C. Copyrights

For works created by the employee in the course of his employment which are protected by copyrights no legislative act comparable to the Act on Employee Inventions exists. These are rather subject to the general Copyright Act. Such works may include art works (including applied art, e.g. furniture), works of speech, text works (including e.g. handbooks), music works, photographs (including e.g. product pictures), or graphics (including e.g. layouts). It also applies to software and databases, albeit there are special regulations for these types of works.

The Copyright Act does not strictly follow the "work made for hire" principle. Yet, if the copyrightable work was created by an employee in fulfillment of his main obligations under the employment contract, German copyright law foresees that the employee is obliged to grant the employer the exclusive right to use and exploit this work. The copyright as such is not transferable at all, but remains with the author at all times. The employer can therefore only be granted a license.

For software, the law stipulates that the rights to use and exploit software works (where created in the fulfillment of the main duties under the employment contract) are automatically by virtue of law granted to the employer; thus, no additional granting of these rights is required.

For both copyright in general and software copyrights in particular, the parties may agree upon regulations regarding the allocation of usage rights that deviate from the regime stipulated by the Copyright Act. It is therefore advisable to include explicit and comprehensive regulations in the employment contract.

Whether an employee author is entitled to any additional compensation beyond his salary is not clearly regulated and still subject to controversy. This must therefore be assessed for each case individually, taking into account all circumstances, including the overall work description of the employee and the wording of the employment contract. A duty to pay an additional compensation is, however, more the exception than the rule.

Additional copyrightable works created by the employee, i.e. works that were created beyond or not in relation to his main obligations under the employment contract, remain with the employee and the employer has no right to be granted any usage and exploitation rights.

D. Key Aspects

- Employee inventions and technical improvement proposals belong to the employee. The employee must, however, notify the employer of these.
- The employer can claim such employee inventions and technical improvement proposals. If it does not decline these within 4 months after being notified, they are deemed to be claimed.
- If the employer claims such inventions and technical improvement proposals, it must pay an additional compensation to the employee.
- Copyrights (which include computer programmes) created in the performance of the employment are not transferred to the employer, but the employer is usually granted extensive usage and exploitation rights.

Chapter 14
Non-Competition Clauses

Michael Magotsch and Pascal R. Kremp

A. Introduction

In Germany, the law in relation to non-competition clauses is regulated by the Commercial Code (*Handelsgesetzbuch, HGB*) and applies both during the term of the employment relationship and after its termination (provided there is contractual post-employment non-competition provision). The relevant provisions of the Commercial Code are mandatory and must be observed.

The provisions contained in the Commercial Code are different from those found in most other countries, since they provide for a compensation payment (*Karenzentschädigung*) for the term of a post-contractual non-competition clause. Such clauses can consequently become a heavy financial burden for an employer, especially during periods of economic crisis when major downsizing is necessary. Therefore, it is advisable for the employer to carry out an audit of its contracts to establish whether the non-competition clauses are in fact necessary or whether a part of them can be waived. Usually, post-contractual non-competition clauses are advisable only for key employees[1] with knowledge of company's business secrets (e.g. R&D employees) or with very close client relationships (e.g. Head of Sales).

The regulations on post-contractual non-competes are mandatory. Therefore, where such clauses deviate from the provisions of the Civil Code to the disadvantage of the employee, they are likely to be invalid and not enforceable towards the

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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employee, or even void. As a basic principle, any ambiguities concerning contract clauses are solved to the advantage of the employee. Therefore, it is advisable for the employer to draft non-competition clauses very carefully and, generally, in German language.

It is the established legal practice of the Federal Court of Justice (*Bundesgerichtshof, BGH*) that the principles laid down in the Commercial Code do not apply directly to executives such as managing directors and board members. However, the court has ruled that post-contractual non-competition clauses for executives need to comply with the principles of public policy and should not unreasonably affect a person's freedom to choose and carry out their career, pursuant to art. 12 of the German Constitution (*Grundgesetz, GG*).

B. Post-Contractual Non-Competition Clauses

Post-contractual non-competition clauses for employees must comply with the provisions in the Commercial Code, whereas the strict regulations of the Code do not necessarily apply to executives/managing directors as officers of the company.

I. Employees

The Commercial Code sets out detailed requirements for the validity of post-contractual non-competition clauses for employees, as follows.

1. Form

Post-contractual non-competition clauses must be in writing and signed (wet ink!) by both parties, otherwise they are null and void. It is sufficient for such a clause to be regulated by the employment contract if the contract itself is in writing and signed by both parties. A signed version of the post-contractual non-compete clause must be handed over to the employee in order to be effective—the employer must be able to prove the handover in case of dispute.

2. Compensation Payment During Non-Competition Period

The clause must make provision for a compensation payment in relation to the whole length of a non-competition clause, regardless of the extent of its application to the branch or business of the employer. If the compensation payment as stipulated in the contract does not meet the minimum statutory requirements, the employee has a choice whether or not to comply with the non-competition clause.

When the employee chooses not to comply, the clause is not enforceable by the employer. In case the employee decides to comply, the employer must pay the compensation payment as stipulated. If the clause does not contain a provision for a compensation payment at all, such post-contractual non-compete has, so far, been considered as null and void by the Federal Labour Court. However, according to recent rulings of several regional labour courts, this could be different in the individual case if the employment contract provides for a severability clause. Employers should therefore audit their employment contracts in order to see if they run a risk in this regard and should monitor the development of the case law.

Case law has prohibited any attempts to bypass the requirement to make a compensation payment by drafting very extensive client protection clauses. The courts treat extensive customer protection clauses as non-competition clauses which should therefore provide for a compensation payment in order to be enforceable.

3. Calculation and Payment of the Compensation

The employee should receive a monthly payment of at least half of his former gross earnings. In detail, compensation payments are calculated as follows:

- The compensation payment is calculated by reference to the gross salary, including bonus, incentive payments, payments in kind and/or other elements of pay. Only the employer's contributions to social security schemes are excluded. Where the amount of bonus and incentive payments change over a year, the average of the last 3 years must be taken into account. The Federal Labour Court has not yet had to decide whether the calculation should be based on the last annual gross salary or on the gross salary earned in the last month of employment. The lower courts tend to refer to an annual period. However, the matter is subject to controversial discussions so careful attention should be paid to future court decisions.
- The employee will receive at least 50% of the total for the year.
- This amount is then divided by 12 so that the payment to the employee must be made monthly.
- It does not make any difference if parts of the employee's salary, e.g. bonuses or stock options, are paid by a third party as long as it is paid to compensate the employee for his performed services. This might be the case if the employee works for a company which is part of an international group.

Note that even if the employee is not in a position to compete, for example in the event of illness, or in case the employee is undertaking a further qualification course, the employer is still obliged to pay the compensation payment for the whole length of the non-competition clause.

4. Further Requirements: Legitimate Interest of Employer: Sector, Geographical Area and Duration

A non-competition clause can only have effect to protect the legitimate interests of the employer. The courts have developed the following criteria from this requirement:

- Sector and geographical area: Case law has shown that a non-competition clause that is extended beyond the sector of the employer is too broad, as is a worldwide clause. In such cases the courts will adjust the clause. The adjusted clause will still be enforceable and the employer will therefore still have to pay the compensation payment.
- Length of non-competition clause: Non-competition clauses can only be binding for a period of up to 2 years. If a longer period has been agreed between the parties, after 2 years the employee will have the choice of continuing to comply with the non-competition clause and receiving a compensation payment, or ceasing to comply and entering into competition.

5. Set-Off of Employee's Earnings Against Compensation Payment

If the employee works during the length of the non-competition clause, any earnings from his new job must be offset against the compensation payment if the compensation payment plus the earnings from the new job together exceed 110% of the salary used to calculate the compensation payment. If the new earnings and the compensation payment exceed 110% of the old annual salary, the compensation payment can be reduced by the amount exceeding the 110%-level.

Average of last 12 salaries	3000€
Compensation	1500€
New salary	2500€
110% of old salary	3300€
Amount to be deducted	700€ [(1500€ + 2500€) − 3300€]
Compensation payment can be reduced to	800€ (1500€ − 700€)

In such a situation, the employer has the right to ask for disclosure of the employee's new salary.

If the employer has agreed on a compensation payment which is higher than 50% of the average of the last 12 salaries, the 110% limit will not be increased to take account of this.

In the event that the employee is forced to move location in order to obtain new employment due to the post-contractual non-compete, the threshold that has to be exceeded by new earnings and compensation payment is increased to 125% of the old salary.

6. Rights of the Employer in the Event of Breach

If the employee breaches the non-competition clause, different options are available to the employer, as follows:

- Claim damages from the employee,
- Apply for an injunction to restrain the employee immediately from the competing activity (Cease and Desist Order), or
- Immediately stop paying the compensation payment and demand reimbursement of the compensation already paid during the period the employee has been competing.

Under German law it is almost impossible to prove that the employer has been damaged by the breach of a non-competition clause. It is therefore advisable to include in the employment contract a penalty clause applicable to breaches of the non-competition clause.

7. Choice of Employee

Even if the clause is valid under the statutory provisions of the Commercial Code, the clause may not be enforceable in all cases. The Code provides for the employee to have a choice of whether to comply with the clause or not in the following cases:

- In the event of dismissal due to business reasons.
- In the event of summary resignation of the employee following a breach of contract by the employer.

In such cases, the employee can either choose to comply with the non-competition clause and claim the compensation payment, or choose not to comply with the competition clause which will then become unenforceable. In the latter case the employee has to give written notice that he is not bound by the non-competition clause within 1 month of the date of dismissal.

8. Waiver by the Employer

Non-competition clauses can become a substantial financial burden so the employer will often want to waive the clause on the basis that any potentially competitive activity of the employee will be less harmful to the business than having to make the compensation payment.

Where the employer decides to waive the non-competition clause, the obligation to pay the compensation payment will continue for the period of 1 year following the waiver. It should be noted that such waiver is only possible during the term of the employment relationship, i.e. prior to the termination date (*Beendigungszeitpunkt*). As the compensation payment is only payable after the end of the employment

relationship, it is only worthwhile waiving the non-competition clause at a point in time considerably prior to the end of the employment relationship. Therefore, regular audits are recommended.

II. Legal Representatives

Legal representatives of the company, such as the managing director of a limited liability company (*GmbH-Geschäftsführer*) or a board member of stock corporations (*AG-Vorstand*), are generally not considered to be employees under German employment law. Thus, the rules set out above do not directly apply to them. Case law has developed rules based upon the Commercial Code and the reasoning that a non-competition clause is only justified if it protects a legitimate interest of the company, and that it should not hinder the legal representative unduly in his professional development, as follows:

1. Legitimate Interest of the Company

A non-competition clause must be intended to protect the confidential information and client connections of the business.

If a non-competition clause merely aims to prevent a competitor from employing a certain legal representative, it will not be valid since this is not recognised by case law as a legitimate interest of the company.

2. Geographical Scope of the Non-Competition Clause

In order for a non-competition clause to validly apply to a legal representative, such clause has to contain a geographical limitation. If the clause applies worldwide, or if a geographical limitation is omitted, the clause will be considered too broad and will be null and void and therefore unenforceable under German law.

3. Term of the Non-Competition Clause

Generally, clauses prohibiting a certain activity or activity in a certain geographical area or in a specific business sector can only be applicable for a period of up to 2 years. However, a shorter term may be required depending on the circumstances.

4. Compensation Payment

The rules laid down by the courts in relation to compensation payments in non-competition clauses for legal representatives are not as clear or precise as they are in respect of employees. Whether a compensation payment is required will depend upon the particular circumstances, i.e. the nature and sector of the business or the geographical scope. It is usually advisable to provide for a compensation payment to ensure the validity of the clause. However, it is not possible to give general guidance as to whether to include a compensation payment and for what amount, because the courts tend to evaluate each case according to its specific circumstances.

5. Set-Off of Earnings of the Legal Representative During the Period of the Non-Competition Clause Against Compensation Payment

In contrast to the provisions in the Commercial Code applicable to employees, there is no automatic set-off of a legal representative's earnings. A set-off provision must be included in the non-competition clause from the outset.

6. Waiver

If provided in the contract, the company may waive a non-competition clause before the end of the contract relationship, but it will then be bound by the obligation to pay the compensation payment for the period of 1 year from the date of the waiver.

In contracts with legal representatives it may generally be agreed that the non-competition clause can be waived subsequent to the end of contract and with a shorter remaining non-competition period (e.g. 6 months). However, the company will, in any case, have to respect the notice period for the termination of the service contract as well as for the waiver of the non-competition clause.

7. Legal Representative's Choice

If the executive resigns due to the employer's breach of contract, the legal representative has the choice of whether or not to comply with the non-competition clause.

8. Breach of Non-Competition Clause: Options of the Company

If the legal representative breaches a non-competition clause, the company has a number of options:

- Claim damages from the former legal representative;
- Seek an injunction requiring the executive to cease the competing activity immediately;
- Cease making compensation payments and demand reimbursement of the amount of compensation paid during the period the legal representative has been competing.

As previously mentioned, in respect of employees, in German law it is virtually impossible to prove that the company has suffered damage as a result of the breach of a non-competition clause. It is therefore advisable to include provision for a penalty payment in the event of breach of a non-competition clause.

C. Contractual Non-Competition Obligation During Employment

I. Employees

The Commercial Code imposes a legal obligation on employees to refrain from competing with their employer's business during the employment relationship.

1. Scope of Prohibition

The obligation not to compete prohibits the employees from setting up their own business, working as an employee or contractor for a competitor, and acting occasionally as a competitor within the field of the employer's business. This is not an exhaustive list but all activity which may be considered to be competition is prohibited.

2. Steps Available to the Employer in the Event of Breach

The employer may:

- Claim damages;
- Demand disclosure of the employee's profits made while competing;
- Demand that the employee hands over the profits made while competing;

- Demand the transfer of the rights and duties under ongoing contracts entered into by the employee and in this way take over the employee's ongoing competing business;
- In the case of a substantial breach, dismiss the employee without notice, on the grounds of misconduct.

II. Legal Representatives

Managing directors (*Geschäftsführer*) and board members of stock corporations (*AG-Vorstand*) have a legal obligation not to compete even in the absence of particular provisions in their contracts, as this is part of their fiduciary duty to the company.

1. Scope of Prohibition

Legal representatives must refrain from any action which could be seen as competitive, e.g. setting up their own businesses and becoming managing directors or major shareholders of the company's competitors. The reasoning behind this rule is that legal representatives should not benefit or profit personally from knowledge they have acquired as a result of their positions with their employing companies.

2. Steps Available to the Company in the Event of Breach by the Executive

The company may:

- Claim damages;
- Claim disclosure of information relating to sales and profits made while competing, and demand payment of profits made while competing;
- Apply for an injunction;
- Dismiss the legal representative without notice.

D. Key Aspects

The following lists the basic requirements for post-contractual non-competition clauses for employees and the options open to an employer in the event of breach.

Requirements for a non-competition clause:

- The non-competition provision must be in writing.

- It must provide for a compensation payment during the entire time period covered by the clause.
- The compensation must amount to at least 50% of the employee's total earnings in the last year, calculated according to the specific rules of the Commercial Code.
- The clause must be limited to a maximum of 2 years.
- The clause must be justified by the legitimate interests of the employer and cannot be extended beyond the employer's sector and geographical scope of business, thus, it can be extended worldwide only on very rare occasions.
- In the event of breach of contract by the employer, the employee can choose whether or not to comply with the clause. This applies also to a dismissal for business reasons.
- Options for an employer in case of a breach of contract by the employee:
  - Apply for a cease and desist order (injunction);
  - Claim damages;
  - Demand disclosure of profits made while competing;
  - Demand the employee hand over the profits made while competing;
  - Dismissal.
- Last but not least, any employer should carefully consider to conduct regular audits to verify whether unnecessary non-compete clauses should be waived and thereby cancelled.

Chapter 15
Termination of Employment

Michael Magotsch and Pascal R. Kremp

A. Introduction

At a first glance, terminating an employee's[1] contract of employment seems to be more complicated in Germany than in other jurisdictions. If someone is familiar with the practice, however, this is not necessarily the case. One main difference in comparison to most other jurisdictions is that employees are entitled to reinstatement if the dismissal is not supported by sufficient reasons. If this is the case, the employee is generally not entitled to any severance at all. Usually, courts cannot award a severance payment. Due to this situation—"all or nothing"—employer and employee mutually agree in more than 80% of all cases on a termination of the employment relationship in consideration of a severance payment. Negotiating the severance payment may be troublesome and time consuming, but will result in a fair severance payment in most situations.

German law does not recognise employment at will. In principle, employees can only be dismissed if the termination is supported by specific reasons and if the applicable notice period is observed. Only in rare circumstances, e.g. expense fraud or other gross misconduct, is the employer entitled to dismiss with immediate effect (so-called summary dismissal).

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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There are in principle two types of employment termination:

- Regular termination in observation of the applicable notice period
  Such termination has to be supported by sufficient person-related, conduct-related or operational reasons in operations with more than 10 employees
- Summary dismissal for cause with immediate effect

Prior to any dismissal, the employer has to inform and consult an existing works council. Otherwise, the dismissal is null and void.

B. Notice Period

The parties to an employment contract may agree on a specific notice period. The notice period for termination by the employee must not exceed the notice period for a termination by the employer. For key employees, the contract often provides for an extended notice period of 3–6 months, sometimes even longer.

Most employment agreements, however, provide for the statutory notice period. The Civil Code (*Bürgerliches Gesetzbuch, BGB*) provides for minimum notice periods for a dismissal by the employer. Only if the parties are subject to an applicable collective bargaining agreement, may the statutory notice period be reduced.

The statutory notice period depends on the duration in years of service.

The statutory minimum notice periods for terminations by the employer are (after 2 years of service always effective to the end of the calendar month):

During first 2 years of service, 4 weeks effective to the 15th or to the end of a calendar month
After 2 years of service, 1 month
After 5 years of service, 2 months
After 8 years of service, 3 months
After 10 years of service, 4 months
After 12 years of service, 5 months
After 15 years of service, 6 months
After 20 years of service, 7 months

The minimum notice period for a termination by the employee is 4 weeks effective to the 15th or to the end of a calendar month. Since many employers want to avoid that employees, in particular employees with important know-how, can resign with such short notice period, the employment agreement often provides for the same notice period that is applicable to a termination by the employer.

Most employment contracts provide for a probationary period which may not exceed 6 months. During the probationary period, both parties may terminate the employment relationship by giving 2 weeks' notice if the contract does not provide for an extended notice period.

C. Termination Notice

Any termination of an employment agreement—either a notice or a severance agreement—has to be in writing (wet ink). Otherwise, the termination is null and void and the employment relationship continues.

The termination notice has to be signed and must be served to the other party in original form with the original signature. Copies, faxes, emails, electronic signatures etc. do not meet the statutory requirements and render the termination null and void. Employers should assure that the dismissal is signed by an individual that is registered in the commercial register (e.g. managing director, proxy holder). Otherwise, the employee might be able to reject the dismissal letter without undue delay (usually 1–2 weeks) arguing he would not have knowledge if the person who signed the dismissal letter is duly authorised. In this case, the dismissal would again be null and void. The employer would have to repeat the dismissal, but the notice period would start anew.

Usually, the termination notice does not need to provide for the reasons for the termination. There are certain exceptions for termination of employees on maternity leave and for apprentices (*Auszubildende*).

D. Service of the Termination Notice

The notice becomes only effective upon service to the other party. Only then the notice period will be triggered.

The burden of proof that the notice has actually been served to the employee is on the employer. Therefore, the employee should be asked to confirm receipt of the notice (as original letter) on a copy of the original letter. If the employee refuses to confirm the receipt, the employer should call for another person who witnesses the service and confirms duly service on a copy of the original termination notice letter. However, it should be noted in this regard that managing directors or board members are not permissible witnesses since they are the legal representatives of the employer. If the termination notice letter cannot be served in person, but to the employee's home, the employer again needs to make sure he can prove the service and on what date (and time) the original letter was served. The best practice is to use a courier who again confirms on a copy that he dropped the original termination notice in the mailbox of the employee and the date and time of service. Normal post or registered mail is not recommended. In case of the latter, if the employee is not at home, the service would only occur once the employee picks up the letter at the post office (if at all). Only then the notice period would be triggered.

E. General Termination Protection by Social Justification

Under German Law, employees are protected against termination of their employment by the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*). According to the Act, the termination of the employment relationship with an employee will be legally effective only if "socially justified". Social justification means that there is one of three statutory grounds that support the dismissal, i.e. that there is either a conduct-related, person-related or operational reason for the termination.

I. Scope of Application

The Act is, however, only applicable to employees who have been employed for more than 6 months and if more than 10 employees are employed in the business operation (*Betrieb*).

The Dismissal Protection Act basically applies to:

Every business operation with usually $>$ 10 employees
If the respective employee to be dismissed has been employed in the same business operation or company for $>$ 6 months

1. Size of the Business: Small Business Exemption

The Dismissal Protection Act applies only to business operations with usually more than 10 employees in Germany.

Part-time employees count pro rata. Employees working not more than 30 h per week count 0.75, employees not working more than 20 h per week count 0.5.

Students or cleaning services may also be considered as employees depending on the circumstances.

Due to a subsequent amendment, the Dismissal Protection Act also applies to employees of a business, with not more than 10 employees, who were already employed on 31 December 2003, provided that there are more than five employees that have been employed since then.

For example: A company has eight employees, six of them have been employed at least since 2003. Those six would enjoy protection under the Act, the other two would not. If only five employees had been employed at least 2003, none of the eight would enjoy protection.

2. Term of Employment

The Dismissal Protection Act applies only to employees who have been employed for more than 6 months. This is even true if the employment agreement does not explicitly provide for a probationary period.

It is sufficient to serve the dismissal letter on the very last day of the 6 months period even though the notice period would expire only after 6 months of employment. E.g., if the employment relationship commences on 1 January, the termination notice letter must be served on 30 June at the very latest.

3. Reasons for Termination

If the Dismissal Protection Act does not apply, the employer does not need a specific reason to terminate an employment relationship. Thus, the risk that the employee will challenge the effectiveness of the termination in the courts resulting in a severance payment, which would be mutually agreed, is very low. The termination would, however, be deemed null and void if it is found in violation of public policy (e.g. in particular if it is based on discriminatory grounds, please see also Chap. 11).

Therefore, employers should carefully review newly hired employees during the first 6 months and take a decision during this time whether to continue the employment relationship or not. Once the employee has been employed for more than 6 months, a dismissal will become significantly more expensive.

Also, in small businesses employers should carefully consider whether to hire more than 10 employees. Passing this threshold of 10 employees will immediately provide all employees with protection under the Dismissal Protection Act.

II. Reasons for Termination

Social justification of a termination requires that the employee's termination is on grounds related to the employee's conduct, for person-related or for operational reasons.

The Dismissal Protection Act (*KSchG*) sets out three statutory reasons which may socially justify a termination:

Person-related reasons
Conduct-related reasons
Operational reasons

1. Person-Related Terminations

Generally speaking, a termination for person-related reasons will be considered socially justified if the employee has lost his ability to perform his contractual duties. Pursuant to case law, such a termination has to meet a three-tier test:

- First, at the time the termination is served, it can be presumed that the employee will not regain his ability to perform the working duties in the foreseeable future (negative prognosis).
- Second, due to the inability of the employee to work the employer has to suffer a serious detriment to its business interests. Such a detriment may be assumed, e.g. from a loss of production, machinery breakdowns, loss of customers, inability to find adequate substitute staff.
- Finally, the interests of the employer must outweigh the interests of the employee. The employer has to consider on behalf of the employee, e.g. his age, number of dependents, years of service. As the termination has to be ultima ratio, the employer is also required to consider relocating the employee to another vacant position within the same business or to take any other appropriate action to avoid the termination.

Since person-related reasons are not due to the employee's own fault and can therefore not be changed by him, no prior warning is required.

Typical person-related termination issues are illness and alcohol or drug addiction. Since it is up to the employer to prove before court that the employee is in fact incapable of working, it is nevertheless often advisable to issue a warning letter first to also meet the requirements for a conduct-related dismissal—in particular, where there is a potential addiction of the employee. Often, the employer may not be able to provide convincing evidence for the addiction of an employee.

a) Illness

Illness may be a sufficient reason for a person-related termination. The key issue is whether it can be expected that the employee will not come back to work for the foreseeable future. The reason for such a termination is not to punish the employee for past illness. Please note that depending on the individual circumstances the implementation of an occupational integration management (*Betriebliches Eingliederungsmanagement*) needs to be adhered to prior to giving notice.

aa) Long Term Illness

Long term absence from work may justify a termination for person-related reasons. There is no settled case law on the length of such illness before it can be assumed that the employee will not return for the foreseeable future and that this would result in a significant detriment to the business. This obviously depends on the individual

circumstances of the case at hand. Certainly, an absence of 6 weeks is not sufficient since this equals the period for statutory sick leave. Case law has ruled that in the event an employee has been off work for 18 months and his return is not foreseeable, a detrimental impact on the company's business might be assumed, thus, a dismissal could be justified.

bb) Frequent Short Term Absences

Frequent short-term absences may be sufficient reason for a termination if it is very likely that the employee will be absent due to illness in the future. According to case law only absences of about 15–25% in total within the last 3 years will be regarded as frequently. Absences of not more than 6 weeks per year (equals maximum sick pay leave) are unlikely to be sufficient for a termination.

b) Alcohol or Drug Addiction

A serious alcohol or drug addiction is an illness. Therefore, the employment can only be terminated on person-related grounds, similar to terminations for other illnesses. The employee cannot be terminated for misconduct occurring due to the addiction (e.g. unexcused absences). The addiction as such is not normally a reason for giving a person-related termination, as long as the interests of the employer are not impaired. A termination is therefore only valid if the employee is permanently unable to fulfil his contractual duties in an orderly way. German Labour Courts require a prognosis to be made at the time of serving the termination: if the employee is not willing to undertake a rehabilitation and/or therapy, the prognosis will be negative and the termination therefore generally possible.

c) Work Permit

Losing a work permit may justify a termination if it is not likely that the employee will be reissued a new work permit within due course.

2. Conduct-Related Termination

The employer may respond to a breach of the employee's contractual duties by termination on conduct-related grounds. The social justification of such a dismissal is to be determined by four criteria:

- First, there has to be an objective reason, meaning that the employee has significantly breached the contractual duties.
- Second, it must be likely that the employee will breach the working duties again in the future (negative prognosis). The aim of a conduct-related termination is

not to punish the employee for his past conduct, but to avoid future breaches of the contractual duties. Consequently—and unlike a termination based on person-related grounds—the employer is obliged to issue a warning to the employee prior to a dismissal. A dismissal without prior warning is void. A warning is, however, not required if it is evident that the employee does not behave in compliance with the contract of employment, in particular in cases of a severe breach of contractual duties or criminal offences.

- Third, the employer's interest to terminate the relationship outweighs the interest of the employee. The social data (e.g. age, number of dependents, seniority, duration of employment without any complaints) have to be considered on behalf of the employee.
- Finally, the termination must be *ultima ratio*. No less restrictive means may be available. Hence, the employer has to consider, e.g. to reallocate the employee to a different job position.

The burden of proof is on the employer with regard to the objective reason constituting a breach of contract. The employer has to introduce evidence that, e.g., the employee was absent from work and at what time. Thereafter, the burden of proof shifts to the employee. He must come up with evidence that he was absent for good reason, e.g. because he was sick.

a) Typical Issues of Misconduct

Typical issues arising out of conduct-related dismissals include:

aa) Alcohol or Drug Use (Not Addicted)

Usually, employees are not allowed to drink at the work place or to work under the influence of alcohol or drugs if there is the possibility of harming themselves (e.g. working at dangerous machines) or others (e.g. drivers). In such a case, it might not even be necessary to issue a warning letter prior to a dismissal. The employer may generally prohibit any alcohol or drug use with the consent of the works council. As a matter of fact, the employer has to provide evidence before court that the employee consumed alcohol or drugs. Since alcohol or drug tests are not permissible without the consent of the employee, this can be difficult. It can be useful to have witnesses reporting that the employee had alcohol on his breath.

bb) Unexcused Absence

Repeated unexcused absences constitute a breach of the employment contract. A typical situation includes one where the employee unilaterally "extends" vacations. In fact, in most cases employees provide a medical certificate which is quite easy to obtain in Germany. It is nearly impossible for the employer to show before court that the employee was in fact not sick.

cc) Misconduct Off-Work

Off-work misconduct may only justify a termination if the misconduct has an impact on the employment relationship. This may be the case, for example, if a truck driver loses his driving license because of a private drive under the influence of alcohol.

dd) Union Activities

Union activities are generally protected by the constitution and do not justify a termination.

ee) Poor Performance

Surprisingly, it is rather difficult to terminate an employee based on poor performance. The case law is very strict. The reason is that employees only have a duty to perform their job to the average kind and quality and based on their individual abilities. Otherwise, there will always be someone in the workforce who does not perform to the required standard. Thus, it may only be permissible to terminate a low performer if the work performance is significantly lower than comparable average employees—case law has often discussed a requirement of at least 30%. The key issue is to determine which employees are really comparable. For example, if sales employees are responsible for different territories, the employee might argue that it would be much more difficult to create new business in his particular territory since the region has a weak economy. Also, the employee could provide evidence that he is working to the best possible standard under the circumstances. In fact, employers are well advised to better manage low performers by giving clear working instructions, e.g. a specific number of calls or customer visits per week. Compliance with these instructions needs to be closely monitored. If the employee fails to follow such instructions, the employer may give a warning and then later terminate the employee's contract if there is a continuing failure to follow the instructions.

ff) Inappropriate Conduct Towards Employer or Co-Workers

Employees denunciating and treating co-workers inappropriately may be terminated for conduct-related reasons. However, in particular in cases of sexual harassment, the employer could face difficulties to prove the allegations.

b) Warning

Terminations based on conduct-related reasons usually require a prior warning to request the employee to stop his misconduct in the future. Without such a warning a conduct-related termination will usually be null and void.

A warning does not necessarily have to be in writing. However, in order to give evidence in a subsequent lawsuit for wrongful dismissal, it is advisable to state warnings in written form and to be able to prove service of the letter.

Also, warning letters have to include specific content to be effective. In particular, they have to describe the shortcomings of the employee and set out how the employee should have performed his job. Also, the warning letter has to emphasise that, should the employee repeat his misconduct, this may result in a dismissal.

3. Terminations for Operational Reasons

A dismissal for operational reasons has to meet a three-tier test:

- First, the dismissal must be based on compelling operational or business reasons. The employer has to show why a specific job position ceases to exist.
- Second, the employer has to carry out a so-called "social selection" between employees who are comparable to each other.
- Third, there should be no other available job position which could be offered to the employee in question.

a) Compelling Operational Reasons

The dismissal must be based on compelling operational or business reasons. The employer has to provide evidence for why a specific job position should cease to exist. Case law distinguishes between so-called internal and external business reasons. Usually, it is much easier to argue on the basis of internal reasons.

A termination for operational reasons may be on the basis of a commercial decision by the business—perhaps a decision by which the employer is trying to react to a certain economic, possibly industry wide situation. Thus, the demand for a product might drop, sales may fall, or profits shrink. The Federal Labour Court (*Bundesarbeitsgericht, BAG*) recognises such grounds as external business reasons.

Moreover, based on an analysis of the business' situation within the economy, the business may set goals and make plans which lead to particular commercial decisions. The Federal Labour Court recognises such commercial decisions as internal grounds for a termination for operational reasons. Examples of such commercial decisions include modifications of production methods or the introduction of new ones, changes within the organisation (such as the introduction of lean management or group labour), operational shutdowns, closure of a business unit or a department, or outsourcing of work to other companies.

The employer must prove and substantiate the internal or external reasons for the business decision which has led to the elimination of the employment position. Labour courts can review such commercial decisions only to the extent to which they may be considered totally arbitrary in nature.

The loss of the employee's position must be a consequence of the commercial decision. Therefore, it is often easier to argue that a dismissal was based on internal reasons. If, e.g., profits or sales decrease (i.e. an external reason), the employer would have to provide evidence why such decrease resulted in the elimination of a specific number of job positions. The employer would have to show why, for example, 200 employees were made redundant, and not only 180 or 50. Usually, the employer can provide such evidence only if he has analysed the working capacity in detail. However, if the employer makes a commercial decision to shut down an entire business unit (i.e. an internal reason), regardless of whether the business is making a profit, it is obvious that this decision results in all job positions in the particular unit to be made redundant. Having said this, it is also much easier to implement a vertical head count reduction (i.e. closing units or departments) instead of a horizontal reduction in force (e.g. 10% reduction in all departments).

Given the large number of possible situations, only a few typical examples of terminations for operational reasons shall be listed in the following.

aa) Operational Shutdowns (Fully or in Part)

If a business is shut down, this will, in general, justify a termination for operational reasons. The necessity of shutting down a business is a commercial decision which cannot be judicially reviewed in wrongful dismissal actions. In these situations, the employer does not have to wait until the business has actually been shut down before issuing termination notices. The dismissal can be served once such business decision to shut down has been taken. However, the individual termination dates to which the termination becomes effective must be in line with the point in time at which the work factually ceases to exist. If a works council is in place, the company might have to consult with the works council first, prior to terminating any employees (see Chap. 22).

bb) Downturn in Sales and Orders

Downturns in sales and orders may justify a termination for operational reasons if the volume of work is reduced to such a degree that there is no longer any need for the continued employment of one or more employees. The requirements set forth by case law in this respect must not, however, be underestimated. The employer will meet the labour courts' requirements only if, for example, he can prove that a lower total number of working hours to handle the remaining orders is necessary as a result of the downturn in sales.

In these cases, employers may have particular difficulties showing that the downturn in turnover and orders has led to a specifically reduced work volume in various departments. The Federal Labour Court requires that the decrease in work volume be expressed numerically. In addition, these numbers must be presented in such a way as to show that any remaining tasks can, in fact, be assumed by other employees without working overtime.

cc) Outsourcing

Many employers decide to outsource individual aspects of their business. Such a decision will be based on commercial reasons, which, in effect, cannot be reviewed by the labour courts. Outsourcing measures, however, may result in the transfer of parts of the business to a third party. The employment relationships of all employees dedicated to this part of business would be assumed by the third party in accordance with sec. 613a of the Civil Code (*BGB*).

b) The Social Selection Process

The social selection is one of the key issues in the area of terminations for operational reasons.

aa) Criteria for Social Selection

Before the employer issues a termination for operational reasons, it must examine whether there are comparable employees working in the business whose work could also be performed by the employee at risk. If this is the case, the employer must examine whether the employee at risk requires greater social protection than the other employees. Statutory law sets forth as social criteria the years of service with the company (seniority), age, family support obligations and severe disability. The employer must adequately account for these criteria in making his selections.

The crucial social selection criteria are:

Age
Seniority
Obligations to pay family support
Severe disability

None of the four criteria generally has priority over the others. The employer has a certain amount of leeway (which is in practice very limited) when taking the decision. It must, however, carefully weigh the social criteria.

It can be difficult to establish whether someone should enjoy more protection if he has 2 years more of service, but is 5 years younger than another colleague. Therefore, it might be helpful to get a better overview of the social selection by applying a point scheme by giving each of the above named criteria certain amount of points (e.g. seniority—two points per year of service, age—one point per year, married—five points, children—10 points per child, severely disabled—10 points). There are certain point schemes which have been approved by case law in the past. If a works council has been established, however, the employer would need the approval of the works council to implement such a point scheme.

bb) Employees to Be Included in the Social Selection

The extension of the social selection depends on the wording of the individual employment agreement. Only those job positions to which the employee at risk of termination could be relocated have to be included in the social selection. Most employment contracts provide that the employee is obliged to also accept other appropriate work he is qualified for. While this provision is advantageous for the employer during the employment relationship, it has a disadvantage in the event of social selection. Due to this provision the social selection would have to extend to all job positions the employee at risk could perform. However, only those job positions have to be reviewed which are on the same hierarchy level.

Even if the employment agreement provides for such a provision, the social selection has to include the entire operation and is not limited to the department or business unit only. The social selection would not, however, include comparable job positions in other operations of the same legal entity.

In practice, it is often difficult to thoroughly establish what job positions have to be included in the social selection. This is usually the key dispute when employees challenge the dismissal before court.

cc) Exemptions from the Social Selection

Employees who enjoy specific protection against dismissals are usually not included in the social selection. However, the employer could include severely disabled persons or an employee on maternity or parental leave; it would then need the approval of the competent authorities to terminate such employees.

Employees statutorily excluded from ordinary termination are not to be included in the social selection procedure. This applies in particular to:

Severely disabled persons
Pregnant employees and mothers after childbirth
Parents on parental leave
Works council members

Employees whose employment, according to a collective bargaining agreement, cannot be terminated are not to be included in the social selection.

The employer may also exempt certain employees whose retention in employment is in the legitimate interests of the business. This could, for example, be employees with very specific knowledge which is difficult to obtain, or with very close customer relationships. The threshold is, however, high. The employer carries the burden of proof for such legitimate interest. The exemption should therefore be applied only when necessary.

dd) Social Selection Step by Step

When conducting a social selection, the employer has to follow certain steps.

In summary, the social selection process must be carried out in the following four steps:

- Determine the categories of comparable employees within the business operation (check employment agreement, same hierarchy level only)
- Exempt employees with specific dismissal protection (maternity leave etc.)
- Exempt specific employees whose retention in employment is in the legitimate interests of the business
- Conduct social selection between the remaining employees

ee) List of Names in Restructuring Measures

Significant operational changes of a business (e.g. operational shutdowns, mass dismissals) have to be consulted with the works council. In this event, employer and works council may, in addition to the balance of interests (*Interessenausgleich*) (cf. Chap. 22), agree on a list of names of employees to be terminated. Such list has the effect that the labour court will review the social selection only for evident faults which have to be proved by the terminated employee.

This provision is a great improvement from the employer's point of view. However, works councils are usually reluctant to set up such list or may agree only in consideration of significantly increased severance payments to the employees who will be terminated.

c) No Open Job Positions

Before terminating an employment contract the employer has to review whether another job position is vacant within the company—i.e. in the legal entity—and if the employee to be terminated would be qualified for such position. If so, the employer would have to give notice but offer at the same time the opportunity for the employee to relocate to the different position. The employee can then decide within 3 weeks whether to accept such offer, to deny it, or to start working on the new job position but ask the competent labour court to review whether the termination of his current job position as well as the offer of the new position was justified.

The employer, however, is only obliged to offer job positions which are on the same or on a lower hierarchy level than the current job position of the employee. The employee has no right to promotion. The new position might result in a lower salary or even be at a different site of the same legal entity within Germany.

Usually, employers are not obliged to offer a vacant job position within another group company in Germany or a job position outside of Germany.

The new job position has to be reasonable. Labour courts construe "reasonable" very widely. Thus, employees might face the risk to accept a job position with significantly lower salaries or on a significantly lower level. Employers are usually well advised to always offer a lower vacant job position as long as it is not obvious that this position is not reasonable at all. Otherwise, if the employer failed to offer this job position (while terminating the employee at the same time) the dismissal might be null and void.

d) Mass Dismissal

In the event of mass dismissals the employer has to notify the Federal Employment Agency (*Bundesagentur für Arbeit, BA*) prior to giving notice to the individual employees. Otherwise, the dismissal would be null and void.

This rule applies if employer's terminations exceed a specific threshold (depending on the size of the business) within 30 days. Employer's notice or separation agreements initiated by the employer are considered as termination in this meaning.

The relevant dismissal/termination thresholds for notification of the Federal Employment Agency of mass dismissals within 30 calendar days are:	
Size of operation	Intended layoffs
21–59 employees	More than five employees
60–499 employees	More than 25 employees or 10%
500 or more employees	At least 30 employees; but at least 5% of the employees

For more details see Chap. 22.

F. Severance Payments

As a general rule, if the dismissal is supported by sufficient reasons (social justification), the employee is not entitled to any severance payment at all. Courts usually cannot rule on a severance payment. If the dismissal is not supported by sufficient reasons, the dismissal is null and void and the employee would have to be reinstated and is also entitled to back pay.

To avoid such "all or nothing" situations, employers and employees agree in most cases on a mutual termination in consideration of a severance payment. The severance payment has to be negotiated. As a general rule, employers should expect severance payments of at least 0.5 monthly salaries per year of service. But the amount might be significantly higher, e.g. 1.0 or even 2.0 or more monthly salaries if the legal position of the employer is rather weak.

In the event of a dismissal for business reasons, the employer may offer a severance payment of 0.5 monthly salaries per year of service up-front in the termination letter pursuant to sec. 1a of the Dismissal Protection Act. If the employee does not challenge the effectiveness of the dismissal before court within the statutory 3 weeks deadline, the dismissal would be effective and the employee would, at the same time, be entitled to this severance payment. If the employee goes to court, he loses this severance entitlement even if the court rules that the dismissal had been effective. This tool can therefore be considered by employers as this may result in less wrongful dismissal claims before court.

In case of a significant restructuring measure which is subject to consultation rights of the works council, the works council and the employer have to agree on a social plan to mitigate the detriments for the affected employees, inter alia, through severance payments to the employees (see Chap. 22). In such a case, employees are usually entitled to a severance payment according to the social plan without any further conditions. Employees might nevertheless review the effectiveness of the dismissal before court.

G. Termination with the Option of Altered Conditions of Employment/Modification Dismissal

If the employer's goal is to change certain working conditions, it might use a "modification dismissal" (*Änderungskündigung*), i.e. a termination together with an offer to continue the employment relationship under altered conditions. As aforementioned, the employee may accept such changes, deny them, or—what most employees do—accept the changes, but ask the court to review whether the changes are justified.

Such modification dismissals are only advisable for individual cases. They are usually not recommended in cases of mass dismissals for the purposes of changing working conditions.

If the purpose of such dismissal is only to reduce the salary of the employee or of all employees, case law is very strict. Usually, this is only permissible in circumstances where the company is trying to avoid insolvency. In fact, under German case law, it is easier to terminate employees than reduce their salary.

H. Special Termination Protection

In addition to the general termination protection, there are also special protection provisions against termination for certain groups of employees.

Special termination protection applies to certain groups of employees, including:

- Women during pregnancy and 4 months after childbirth
- Employees on parental leave (*Elternzeit*) and 8 weeks prior to parental leave
- Employees who take care of relatives
- Severely disabled persons and persons who enjoy an equal status (*gleichgestellte*)
- Members of the works council, candidates and members of the election board

I. Special Termination Protection for Pregnant Employees and Mothers After Childbirth

The dismissal of a woman during pregnancy and for up to 4 months following childbirth is not permitted. If the employer has not been aware of the pregnancy when giving notice, the woman has to notify the employer within 2 weeks of receiving notice. The dismissal would then be null and void.

In exceptional cases the competent state authority may permit termination for reasons which are not related to the woman's condition during pregnancy or her situation through the term of 4 months after childbirth. Typical examples are criminal acts of the employee or if the entire business is shut down. In the event of a partial closure of business, the employer must generally continue the pregnant employee's employment in another department. In any case, a termination notice issued without the relevant authority's prior consent is null and void.

II. Special Termination Protection for Employees on Parental Leave

The employer may not terminate the employment of an employee who has requested parental leave—however not more than 8 weeks prior to the commencement of the parental leave—or during the parental leave. In exceptional cases (e.g. shutdown of business) a termination may be permitted by the relevant state authority.

III. Special Termination Protection for Employees Who Take Care of Relatives

Employees who need to take care of relatives pursuant to the Nursing Care Leave Act (*Pflegezeitgesetz, PflegeZG*) are protected against termination as of the point in time when the employer is informed about the nursing care time, but at the most 12 weeks prior to the commencement of the nursing care time, and during the term of the nursing care time. The competent authority can, in exceptional cases, approve the termination.

IV. Special Termination Protection for Severely Disabled Persons

Disabled employees with a minimum grade of disability of 50 (i.e. severely disabled employees) may not be terminated without the prior consent of the competent authority. This also applies to employees with a grade of disability over 30 who have been officially recognised as "equal to severely disabled employees".

The authority has, in principle, complete discretion in deciding such cases. The discretion is, however, limited in cases of a shutdown of the operation or a significant reduction. Usually, the authorities consent if the dismissal is not related to the disability, e.g. terminations for business reasons or criminal acts.

Additionally, the employer has to duly inform the severely disabled persons representatives (*Schwerbehindertenvertretung*) of the termination and its reasons prior to applying for consent to the competent authority.

V. Special Termination Protection for Members of the Works Council

Members of the works council enjoy strong protection against dismissals and may generally be terminated only for cause. In addition, the works council has to give its prior consent to such dismissal. If it refuses to do so, the employer must initiate a proceeding with the labour court to replace such consent. Only once a court ruling has been obtained—which might easily take 2 years if someone appeals all instances—the member of the works council can finally be dismissed. During this period of time the works council member is entitled to full salary pay.

An ex-council member's employment within 1 year from the end of his term in office can also only be terminated for cause. However, the prior works council's approval is no longer required during this phase.

Substitute works council members will also enjoy this special 12 months protection every time they replaced a works council member, even if it is just in one works council meeting.

Members of the election committee for the works council from the time of their appointment until the results are published can also only be terminated for cause and again only with the consent of the works council. The termination will not be permissible within 6 months following publication of the results unless for good cause; the consent of the works council is no longer required. The same applies to candidates for the works council.

Employees requesting an election committee or employees running for election to a works council may be terminated only for good cause until the results of the elections have been published.

If the entire business is shut down, then also the aforementioned individuals may be terminated by ways of an ordinary termination, but only with effect to the time of the closure.

If only one department, for which the works council member is working, will be shut down, the employer has to offer the works council member a reasonable job position in another department. If no open job positions are available, the employer might even have to terminate another employee and move the works council member to this position. Only if the works council member is not qualified for another job position or the employee to be terminated enjoys significantly more protection than the works council member, the employer may terminate the employment of the works council member.

I. Works Council Consultation Prior to Termination

Prior to giving notice, the employer has to duly inform the works council of the termination and its reasons (if a works council exists). This also applies to terminations during any probationary period.

The information can be provided verbally. However, since the employer has to prove before court that it informed the works council sufficiently, written information is strongly recommended.

Employers should not underestimate the importance of giving such information. Often employees win a lawsuit challenging the effectiveness of the dismissal because the employer did not provide sufficient information to the works council. It is therefore worthwhile to prepare such information thoroughly. Reasons which have not been originally provided to the works council may not be relied on later as grounds for the termination during a labour court proceeding.

In addition to the employee's personal data and business details the grounds for termination must be provided. In the case of a termination for operational reasons this includes showing the commercial decision which has led to the elimination of the position. If a social selection procedure has been conducted, the works council must also be informed in detail about the group of comparable employees and

which criteria influenced the decision. Finally, the works council must be informed about the type of termination, namely regular termination or a summary dismissal, the notice period, and the termination date.

In the case of a regular termination, the works council has 1 week to process the termination of the employee's employment. In the case of a termination for good cause without notice, the works council will be granted a period of 3 days. The works council may consent to the termination, reserve its opinion, or object to the termination. Even if the works council objects, the employer nevertheless can give notice to the employee.

If the works council objects in a proper and timely manner to the dismissal and the employee files an action for unfair dismissal he has to be further employed, under the same conditions as before, until the final judgment is delivered.

J. Summary Dismissal

A summary dismissal (also called termination for good cause) ends the employment immediately and there is no notice period. The employer has to show a significant reason (e.g. significant breach of contract, severe defamation of the employer, criminal offences). Additionally, the employer has to give notice within 2 weeks upon gaining knowledge of the reasons justifying the summary dismissal.

A summary dismissal must meet a two-tier test:

There must be good cause for termination
Notice must be given within 2 weeks of knowledge of the good cause

I. Good Cause

Generally speaking, good cause exists if it would be unreasonable for the employer to employ the employee until the end of the notice period. The threshold for terminations for cause is very high. Examples of effective terminations for cause are:

- Any kind of theft of employer's property (whereas, according to recent case law, e.g. theft of minor goods may not be sufficient to justify a termination if the employment relationship had already existed for a long time without any prior complaints; however, case law is not consistent in this respect and depends on the specifics of each case)
- Expense fraud

- Severe defamation of the employer if this was not committed in a mere private conversation with a third party or a colleague
- Working for a competitor of the employer

II. Two Week Deadline

Notice must be given within 2 weeks of receiving knowledge of the facts qualifying for "cause". Otherwise, the notice for cause is void but may be construed as a regular termination without cause, terminating the employment at the end of the notice period.

Within this 2 week timeframe the employer must have provided the necessary information to the works council. Since the works council has 3 days to review its reply, the employer is well advised to speed up once it found a reason for a summary dismissal. The employer is, in particular, also obliged to conduct any necessary investigation without undue delay.

III. Suspicion of a Severe Breach of Contractual Duty or Criminal Offence

Often the employer is not able to prove that an employee actually committed a criminal offence or a severe breach of the contractual duties. If there is nevertheless a strong suspicion, this might justify a summary dismissal. In any event, the employer has to give the employee the opportunity to justify his actions. Theoretically, the 2 weeks deadline will only be triggered once the employer has thorough knowledge of the wrongdoing, thus, the deadline might only start once the employee has replied. However, to avoid any discussions before court as to whether the 2 weeks deadline has been met, employers should, if at all possible, try to conduct the hearing of the employee and the information of the works council within the first 2 weeks since the employer gained knowledge of the wrongdoing of the employee.

K. Wrongful Dismissal Claims

If individual employees want to challenge the effectiveness of a dismissal, they have to file a complaint before the labour court within 3 weeks upon service of the termination notice—not upon expiration of the notice period. Otherwise, the dismissal will be deemed effective.

If the dismissal requires the prior consent of the authorities (i.e. for employees on maternity leave, parental leave or disabled employees) the 3 week deadline will only be triggered after the authorities consented to the dismissal.

L. Termination Agreements

As an alternative to risky termination notices, entering into a termination agreement represents a quick and suitable means of ending an employment relationship. Termination agreements require neither a prior hearing by the works council nor the consent of a government authority. Termination agreements stipulate in particular the termination date, often provide for a severance payment and can contain a release of either party's claims. The employer will generally give the employee a written offer, which may be accepted by signing the termination agreement. However, the employer may not force the employee to sign such a termination agreement.

The main issue in connection with a termination agreement is that the employee is likely to suffer a so-called 12 weeks blocking period, i.e. the employee will not receive unemployment benefits (between 60 and 67% of the net salary) for this period of time. Thus, an employer should always inform an employee of such consequences prior to the conclusion of a termination agreement in order to exclude possible liability claims.

According to internal guidelines from the employment agency, such blocking period can be avoided if (1) the employer would otherwise have given notice for operational reasons, (2) the parties observe at least the applicable notice period (even if the employment may be extended), and (3) the employee receives a severance payment of 0.25 to 0.5 monthly salary per year of service.

A blocking period will generally also not be imposed if the employer had given notice, but the parties later on agree on a separation agreement or a settlement before court.

M. Key Aspects

- German law does not recognise employment at will.
- Generally, employment relationships may be terminated for person-related reasons, a reason related to conduct, or operational reasons by giving the applicable period of notice.
- If the employee is in severe breach of the employment agreement (e.g. expense fraud) the employer may terminate the employment relationship with immediate effect, provided the termination takes effect within 2 weeks of the employer gaining knowledge of the facts warranting summary dismissal.

- If the termination is not supported by sufficient reasons, the employee has to be reinstated and obtains back pay. If the dismissal is effective, the employment usually ends without any severance payment. In significant restructuring cases a social plan between employer and works council may provide for mandatory severance.
- No specific reason is required for termination of employees with not more than 6 months' service or in small business with usually not more than 10 employees.
- In fact, most dismissal protection claims are settled before court upon a severance payment.
- Prior to giving notice, the employer must inform and consult with an existing works council, otherwise the termination is null and void.
- The main issues which arise in cases of termination for operational reasons are demonstrating why a specific work place should cease to exist and conducting a social selection between comparable employees.
- Be aware of special termination protection for certain groups of employees such as severely disabled employees, pregnant employees, parents on parental leave and works council members.
- There exists no compulsory statutory severance claim under German employment law.
- Be aware of the relevant thresholds for notification of the employment agency for mass dismissals which will all take place within a 30 day time frame.

Chapter 16
Family Friendly Rights

Kai Bodenstedt and Sascha Morgenroth

A. Introduction

German constitutional law emphasises the duty of all public authorities to protect the family as an institution. German statutory employment law reflects this with two main aspects of family friendly rights: special protection against dismissals and leave entitlements. The German legislator has repeatedly confirmed that employees[1] in special family-related circumstances shall not have to bear existential worries while having to cope with the family-related situation.

The statutory family friendly rights involve provisions giving special protection against dismissals, regarding the termination of pregnant employees and employees on parental or nursing care leave. However, the protection of employees during these times is not limited to protection against dismissal. Furthermore, employees may be entitled to periods of leave. Since the notice periods for these leave entitlements are relatively short, employers may face situations in which they have to reorganise their staff on short notice. This requires employers to be flexible with respect to labour utilisation.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Statutory Family Friendly Rights

German statutory law provides special protection for employees during maternity, parental leave and nursing care.

I. Maternity Protection

During pregnancy and for a certain period after childbirth any termination of employment is principally considered invalid. Furthermore, the employer has to respect certain provisions of the Maternity Protection Act (*Mutterschutzgesetz*) which limit the types of employment available for pregnant employees during and after pregnancy.

1. Special Protection Against Dismissals

During pregnancy and until 4 months after childbirth any termination of employment is invalid unless the competent public authorities have granted their prior consent. However, in practice, the public authorities only grant such consent under exceptional circumstances.

a) Term of the Special Protection

The special protection against dismissal starts with the employee's pregnancy. If the exact date of the beginning of the pregnancy is in doubt, it is determined by deducting 280 days from the anticipated day of childbirth as calculated by a physician or a midwife. In cases of in vitro fertilisation the special protection against dismissal begins with the implementation of the fertilised ovum. The employer is entitled to ask for a certificate of pregnancy at its expense.

The special protection against dismissals ends 4 months after childbirth. For example, if childbirth takes place on 25 September, the respective employee falls under special protection against dismissal until the end of 25 January.

Childbirth is determined by labour courts considering the latest state of medical analysis. The Federal Labour Court (*BAG*) ruled that childbirth only occurred if the child developed a stadium in which it is in principle able to exist independently from the mother. This is generally the case if the child weighs at least 500 g at the time of childbirth. Otherwise, the special protection against dismissal ceases to exist.

From the legal point of view a stillbirth is considered to be a childbirth, whereas a miscarriage does not generally trigger the special protection. The 4-month period

of special protection against dismissal remains unaffected if during this term the child dies or is given away for adoption by the mother.

In cases of so-called uniform employment agreements—e.g. for a janitor and his wife—the special protection against dismissal applies to both employees.

b) Scope of Protection

Pregnant employees enjoy special protection against all kinds of dismissal—terminations with or without good cause, terminations for conduct, person-related or operational reasons.

Even if it is undisputed that the employee's conduct would justify a termination for cause without notice, the employment relationship may only be validly terminated with the prior consent of the competent public authority.

However, termination agreements may validly be agreed upon during the special dismissal protection period. In these cases the employment must end due to a mutual agreement between the employer and employee and not because of an employer's unilateral decision.

The special protection against dismissal applies during insolvency proceedings, strikes, and operational shutdowns of businesses.

In case a termination is held invalid by the labour courts, the employer will be obliged to continue to employ the employee after the intended termination date. Further, if the employee stopped working after the intended termination date, the employer will be obliged to reimburse the employee for the remuneration which would have been due between the termination date and the date of the court's decision.

c) Employer's Knowledge of Employee's Pregnancy

The termination of the employment of a pregnant employee is invalid if (1) the employer had positive knowledge of the employee's pregnancy at the time the termination notice was served or (2) the employer was informed about the pregnancy within 2 weeks after the service of the termination notice. The employee does not expressly need to claim special protection against dismissal due to her pregnancy. It is, however, necessary that she informs the employer that the pregnancy existed when the termination notice was served. The employee does not need to inform the employer in person about the pregnancy. It is sufficient if a co-worker regardless of his position informs the employer on the employee's behalf. Thereby, the requirements for such information are rather low. It is sufficient that the employee informed the other person casually.

If the employer is a legal entity (e.g. a corporation), the entity's legal representative needs to be informed about the pregnancy. If the employer consists of different people, knowledge of one of these people will be sufficient to trigger the special protection rights. However, knowledge of co-employees or even the

company physician will not trigger the employee's special protection unless they inform the employer accordingly.

In case of a transfer of business the transferee is the legal successor of the transferor. This means that it assumes all legal positions of the transferor in respect of existing employment relationships. Therefore, the transferor's knowledge of the pregnancy transfers to the transferee and, hence, the special dismissal protection applies to the pregnant employee.

The special protection laws apply if the employer has positive knowledge of the pregnancy. Gross negligent lack of knowledge is not sufficient; neither are mere suspicions of the employer or rumours at the employee's workplace.

If more than 2 weeks have passed since the service of the notice of termination, the employee may only benefit from special dismissal protection if she (1) proves that she missed the 2 week deadline without fault and (2) notifies the employer about the pregnancy immediately after the reason preventing her from informing the employer elapsed.

It will be unlikely for the employee to prove absence of fault if she has positive knowledge or gross negligent ignorance of her pregnancy. However, mere negligence does not trigger the 2-week period (e.g. in case of temporary absence of menorrhoea).

Failure to meet the 2-week deadline will not be a problem for the employee if she can prove that she mailed a notification letter within the deadline. Further, the employee is entitled to wait for a medical certificate of the pregnancy, issued by a physician, before she informs the employer.

The employee needs to inform the employer "immediately" after the obstacle which prevented her to meet the 2-week period has elapsed. There is no general rule as to the meaning of "immediately" in these circumstances. However, if for example the employee waits another 4 days she may have to explain the further delay.

d) Moral Damages

The Federal Labour Court recently decided that an employee may also have a claim for damages because of gender-based discrimination in case of a dismissal. That will only be the case, however, if the discriminating act is not limited to the dismissal as such but has a broader effect. In the relevant case the Federal Labour Court took the view that this is the case if the employer dismisses the employee on the day the employee had to undertake an abortion and it is indicated that in fact the pregnancy was a reason for the dismissal. In such a case the dismissal may be invalid and the employee may be entitled to moral damages.

2. Other Protection Rights of Pregnant Employees

Other protection rights of pregnant employees refer mainly to employment prohibitions (*Beschäftigungsverbote*) before and after childbirth. The employee may, however, be entitled to remuneration.

If employers intentionally violate employment prohibitions and order employees to work, they might be subject to criminal charges, which can result in fines or even prison sentences.

a) Prohibition from Work Prior to Childbirth

Employees are prohibited from working 6 weeks prior to childbirth, as calculated by a physician or a midwife, regardless of the nature of the work or any threat to life and health. However, the employee may waive this protection. Such waiver needs to relate expressly to the fact that the employee intends to continue working regardless of her entitlement to stay at home.

b) Prohibition from Work After Childbirth

Under German law, there is a prohibition from work until 8 weeks after childbirth. In cases of premature birth or twin or multiple childbirths the 8-week period is extended to 12 weeks. In case of premature birth, the period is further extended by the 6-week period before childbirth, which could not be taken advantage of due to the premature birth. Under German law, premature birth is considered as any birth which involves a child with a birth weight of less than 2500 g.

The prohibition from work after childbirth is mandatory and may not be waived by the employee. Violations might lead to the (criminal) consequences described above. However, if the child dies during or after childbirth, the employee may—upon her explicit request—start working before the 8/12-week period has elapsed. The purpose of this is to help the employee cope with the death of the child.

However, if the employee prefers to stay away from work until the end of the protection period, the employer has no legal means to force the employee to return to work.

Furthermore, it is important to note that the employee is entitled to nurse her child during the lactation period at least twice a day for half an hour each time. If the working time exceeds eight consecutive hours, the nursing time is statutorily extended to 45 min. each time. The employer is obliged to continue paying the employee's remuneration during nursing time.

c) Alternative Work or Temporary Release from Work

Further to the maternity protection periods explained above, when an employee is pregnant or breastfeeding, the employer must assess the particular risks which the employee faces in the workplace and take measures to avoid them. Moreover, the employment of pregnant employees may generally be prohibited by law, or if a

medical certificate states that the individual life or health of the mother or the unborn child would be endangered by the continuation of the particular occupation. In these cases the employer is obliged to offer suitable alternative work or to temporarily release the employee from her work with full pay.

The employer must temporarily release a pregnant employee on full pay if a medical certificate states that the life or health of the expectant mother or the unborn child would be endangered by continued employment. Such danger can arise from the nature of work or the woman's state of health. Even if this temporary release is related to health problems, it is not considered sick leave. Thus, the employee does not receive sick pay by the statutory health insurance; rather, the employer has to continue to pay the employee's remuneration.

Further, pregnant employees are prohibited by statute to work e.g. in the following cases:

- Work involving exposure to hazardous materials or radiation, dust, gases or vapours, heat, cold or moistness, vibrations or noise;
- Regular hand-operated handling of loads of more than 5 kg or occasionally loads of more than 10 kg without mechanical equipment or machine-operated handling of heavier loads;
- After the 5th month of pregnancy, work requiring the employee to stand continuously for more than 4 h per day;
- Work requiring the employee to frequently stretch or bend significantly or to permanently crouch or stay ducked;
- Jobs requiring the operation of equipment and machines of all kinds with high stress for the feet, particularly by feet-operated machines;
- Work by which the employee is particularly exposed to the risk of occupational diseases due to her pregnancy or by which the employee or the foetus are particularly endangered;
- Beginning from the end of the 3rd month, work on vehicles of any kind;
- Work in which the employee is exposed to a greater risk of accidents, in particular the danger of slipping and falling;
- The pregnant employee is not allowed to work more than 8.5 h per day or over 90 h during 2 weeks, and pregnant employees under the age of 18 are not allowed to work more than 8 h per day or 80 h per 2 weeks;
- Piecework or any other kind of work in which the employee can achieve higher earnings by working faster;
- Assembly line work.

If necessary, the employer may ask for the consent of the competent administration for an exception to the last two prohibitions if the kind of work and the work place do not indicate negative effects on the health of the expectant mother or the child.

d) Remuneration During Maternity Protection

aa) Remuneration During Suspension from Work

During suspension from work, as explained above, employees are entitled to full pay. The remuneration entitlement is calculated on the average remuneration of the last 13 weeks or of the last 3 months prior to the beginning of the month of pregnancy. The employer can essentially choose between these two methods of calculation.

In order to calculate the remuneration during suspension for maternity (*Mutterschutzlohn*) the employer has to take into account an evaluation of the average remuneration which consists of normal salary, commission, overtime pay, capital-forming payments (*vermögenswirksame Leistungen*), and extra pay. Temporary increases of the remuneration that become effective after 13 weeks or 3 months have to be included in the calculation. However, reductions of the earnings due to short-time work, shortage of work, or sick leave or reimbursement of expenses are not considered in the calculation. The employer may not take into account one-off payments as emoluments, bonuses or profit sharing because they are considered to be paid for the entire year and not only for time of suspension for maternity protection.

bb) Maternity Allowance During Protection Periods

During the protection periods before and after childbirth of usually 14 weeks in total (see above) the employee is entitled to receive maternity allowance (*Mutterschaftsgeld*) from the statutory health insurance scheme, provided that she has been a member of the statutory health insurance scheme between the 10th month and the 4th month before the childbirth for at least 12 weeks. The maternity allowance is paid by the health insurance scheme up to a maximum amount of 13.00€ per calendar day.

The employer has to pay the difference between the maternity allowance and the employee's net remuneration. The average daily pay has to be calculated as described above for the remuneration during the suspension for maternity protection. After the evaluation of the daily average pay the compulsory deductions and the 13.00€ have to be subtracted in order to calculate the supplementary maternity allowance that the employer has to pay.

If the employee is not entitled to a maternity allowance, either because she does not comply with the conditions or because she is not a member of the statutory health scheme, she is only entitled to a maternity allowance provided by the Federal State. This is limited to a maximum total amount of 210.00€ plus the difference between the maternity allowance and the average daily net salary for the entire period of maternity leave. The supplementary payment by the employer to the maternity allowance and the average daily net salary are calculated as if the employee received the maternity insurance allowance which amounts to 13.00€.

The Federal Constitutional Court (*Bundesverfassungsgericht, BVerfG*) held that the employer's duty to pay the difference between the maternity allowance and the net pay of the employee violates the employer's constitutional rights. Therefore, the German legislator passed a regulation under which, from 1 January 2006 on, the employer may make a claim for reimbursement from the employee's statutory health insurance scheme for the contribution which it had paid to the maternity allowance and for the remuneration paid during the period of protection.

II. Parental Leave

German statutory law on parental leave (*Elternzeit*) enables parents to spend time with their child within the first years after the child was born without having to carry existential risks. This is similar to statutory law on the protection of pregnant employees and in the view of the legislator this goal may only be achieved if the employee in question enjoys special protection against dismissal during parental leave. Hence, a dismissal will generally be considered invalid during parental leave. Only on rare occasions the competent public authority might grant its prior consent to a dismissal. In this context there has been a recent amendment to the statutory law, according to which employees might be eligible to parental benefits for the first 14 month after childbirth (or, in light of recent legislation, even longer).

1. How to Qualify for Parental Leave

a) Scope and Prerequisites

Pursuant to the Federal Parental Allowance and Parental Leave Act (*Bundeselterngeld- und Elternzeitgesetz, BEEG*) both female and male employees are entitled to take parental leave up to the third birthday of each child of the employee. The employee and employer may also agree to transfer up to 12 or 24 months if the child is born after 1 July 2015 of parental leave to a point in time before the child's eighth birthday. Under certain conditions, employees may also be entitled to parental leave in respect of children who are not their biological children. However, if an employee wants to take parental leave to take care of a child that is not in his legal custody, the employee needs to obtain the biological parent's consent to qualify for parental leave.

Parents may unilaterally decide how to split the 3 years of parental leave between them. Theoretically, it is possible that each parent can take 3 years leave. Additionally, parents whose child is born after 1 July 2015 can split the total amount of parental leave into three different periods. However, since the employer is not obliged to pay the employee's salary during parental leave this is a rather unlikely scenario because one parent will usually have to provide an income.

An employee intending to claim parental leave needs to inform the employer at least 7 weeks prior to the contemplated parental leave about the date and duration of the leave if the parental leave is taken before the child's third birthday. For parental leave between the third and the eighth birthday the employer needs to be informed at least 13 weeks prior to the date of the leave. A shorter notice period may only be acceptable under special circumstances, e.g. if the person usually taking care of the child has fallen ill. In general, the employer is not entitled to reject the employee's claim for parental leave. Therefore, e.g. even if the employee in question is not dispensable for a certain project, the employer does not have any (legal) means to deny the employee parental leave. However, the parental leave may be ended prematurely only with the employer's consent.

b) Maternity Protection and Parental Leave

In case of female employees who take parental leave directly after the protection period for pregnant employees, this period will be deducted from the term of the parental leave.

c) Part-Time Work During Parental Leave

It is not mandatory that the employee stays at home throughout the whole term of parental leave. In fact, the legislator allows employees to work up to 30 h per week during parental leave.

The employee is entitled to claim that his working time shall be reduced during parental leave. The employer may only deny such claim for urgent operational reasons. German case law has identified that costs connected with the training of a different employee on the position of the employee on parental leave is not sufficient to qualify as such an urgent operational reason. Similarly, the employer may not deny a reduction of the working time just because the operations in the business are affected by the reduction of the working time. However, if the employer can prove that in fact the purpose and nature of the business are threatened by the reduction of the working time or if there is a need to substantially change the working organisation, the employer might be entitled to deny the reduction of the working time.

The employee needs to claim the reduction of the working time at least 7 weeks (or 13 weeks if the working time reduction lies between the third and eighth birthday of the child) before the commencement of the reduced activity.

d) Several Children and Multiple Births

In case of multiple births or the birth of several children within a short period, the employee is entitled to take 3 years parental leave for each child. This means that it

is legally admissible to transfer 12 months of the parental leave for each child to a point in time before the eighth birthday of each child.

This allows the employee to take advantage of his entitlement to parental leave in a very flexible way. For example, if twins were born on 1 February 2008, the employee would be entitled to take 2 years of parental leave for child A until his second birthday and transfer the 3rd year of parental leave with the consent of the employer e.g. to 1 February 2011 until 31 January 2012. In respect of child B, the employee might transfer 12 months of the 3-year leave with the employer's consent e.g. to 1 February 2012 until 31 January 2013. In respect of child B's 3rd year the employee could claim parental leave e.g. for the period commencing after the 2-year leave period in respect of child A. This would have the consequence that the parental leave of the employee would last from 1 February 2008 until 31 January 2013 (5 years). During this time, the employee would fall under the special statutory dismissal protection.

The same applies in case the child is born after 1 July 2015. The only difference is that up to 24 months can be transferred between the time after the child's third birthday and before the eighth.

e) Parental Leave and Unused Holidays

During parental leave the employer can reduce the employee's claim for holidays by one twelfth for every month parental leaven taken. However, if the employer fails to reduce the employee's claim before the employment relationship ends, it is obliged to reimburse the employee for untaken holidays. That would include the accrued holidays which were not reduced during parental leave.

It is also important to note that the employee is entitled to claim unused holidays for the year the parental leave commenced in the year following the parental leave. The Federal Labour Court recently ruled that an employee who takes parental leave for two children consecutively is still entitled to unused holiday claims arising from a term before the first term of parental leave. It may still be claimed after the second term of parental leave has elapsed.

2. Special Dismissal Protection

The statutory special dismissal protection applies from the time the employee claims parental leave, but not earlier than 8 weeks prior to the commencement of the parental leave. The dismissal protection applies also to dismissals served during the parental leave.

According to German case law, a termination will even be invalid if it was served because the employee simply stopped coming to work after he claimed parental leave. However, this might be a case where the public authority should consider granting its consent to such a dismissal.

If the employee takes advantage of the option to split the parental leave into different periods, the law on special protection against dismissals will still take effect no earlier than 8 weeks before the commencement of the first period of parental leave. The special protection will not apply again 8 weeks prior to the second term of parental leave. Thus, in this case, a termination will be valid as a result of the special dismissal protection not applying before the beginning of the second term of parental leave.

The special protection against dismissal ends effective with the end of the (last term of) parental leave. However, it is important to note that German case law has proved to be rather generous in favour of the employee in the past. The Cologne labour court of appeal ruled that an employer who was aware of the date of birth of the employee's child implied his consent to a split term of parental leave just because the child was (at the time the employee claimed parental leave) 1.5 years old. This had the consequence that a termination that was served after the child's third birthday was held invalid by the court.

A termination which is served despite the special protection against dismissal is invalid. Pursuant to German law the notice of termination may not be interpreted as only taking effect after the special protection has ended. Similar to the legal situation in case of maternity protection, in rare cases a termination may be valid if the competent public authority has granted its prior consent.

3. Parental Benefits

a) Parental Allowance

Since 1 January 2007, employees who are parents of a newborn child may be entitled to a substantial public parental allowance (*Elterngeld*) of 67% of the last net income up to an amount of 1800.00€ per month for a term of 14 months. The biological parents of the child or other people who are statutorily defined are entitled to such benefits. However, if both parents decide to take advantage of these benefits, each parent will only be entitled to payment for a term of 7 months.

These benefits will be borne by the state alone. The employee remains eligible for the benefits even if he works part time and less than 30 h per week. In this case, he is entitled to a payment of 67% of the difference between a full salary and the part-time salary.

In case the child is born after 1 July 2015, more flexible rules apply. Parents, i.e. biological parents as well as other persons meeting certain criteria, can now choose between the basis parental benefit *(Basiselterngeld)* and the so-called additional parental benefit (*Elterngeld Plus*). The additional parental benefit allows parents to receive half the amount of money for a longer period of time. Thus, 1 month of the basis amount constitutes 2 months of the additional benefit. Furthermore, parents can choose freely between the different benefits and may gain additional benefits if both parents work between 25–30 h a week for 4 consecutive months (*Partnerschaftsbonus*).

b) Care Allowance

The Federal Parental Allowance and Parental Leave Act granted another governmental benefit. This care allowance (*Betreuungsgeld*) was granted for parents after the parental benefit expired if they took care of their children and stayed at home. However, the Federal Constitutional Court (*BVerfG*) rendered these provisions invalid as the federal legislator did not have the legislative power for this allowance.

III. Nursing Care

On 1 July 2008 the Nursing Care Leave Act (*Pflegezeitgesetz, PflegeZG*) came into force. The act was part of the legislator's initiative to emphasise the importance of domestic care. The new law entitles employees and persons similar to employees (*arbeitnehmerähnliche Personen*) to short-time release from work to care for close relatives in urgent need of care or to take nursing care leave, both on relatively short notice. In January 2012 a second act with regard to nursing care leave came into force. The Family Nursing Care Act (*Familienpflegezeitgesetz, FPfZG*) entitles employees and persons similar to employees to reduce their weekly working time for a maximum period of 24 months.

During nursing care, persons may only be dismissed if the competent authority has granted its prior consent. Both acts do not provide an obligation for the employer to pay the employee's (full) salary during the nursing care leave; however, such obligation may well arise from other provisions. Nevertheless, the employee may be entitled to a governmental loan for the time of nursing care leave or reduction of working hours.

1. Applicability

Both acts have a rather wide scope of applicability. For the first time in German legal history, persons who are only similar to employees enjoy the benefits of employee protection law. This is a clear contradiction to decades of jurisprudence and legislation.

Persons who are only similar to employees are not part of the business organisation of the employer and are—contrary to employees—largely free in dividing their working and spare time. However, these persons usually work only for one person; hence, there is an economic dependence which makes them comparable to employees. Persons similar to employees are usually people working from a home office or, like distribution agents, traveling for most of their working time.

2. Special Dismissal Protection

Employees and persons similar to employees enjoy special protection against dismissals from the moment they claimed short-term release from work or nursing care leave but the earliest 12 weeks before the beginning until the end of these periods.

a) Short-Term Release from Work

If there is an urgent need to care for a close relative, the employee or person similar to an employee may inform the employer that he intends to take up to 10 days off to organise care for the close relative. There is no period of notice in which the employee must inform the employer of the leave.

The term "close relative" is defined very broadly under the Nursing Care Leave Act and includes siblings, parents, grandparents, grandchildren, husband or wife, children, life partners and children of life partners.

Whether or not there is in fact urgent need for care will be determined in accordance with the statutory provision on the public nursing insurance (*Pflegeversicherung*). If its prerequisites are met, the employee or person similar to employees is entitled to stay at home for up to 10 days. During this time and starting from the announcement of the release from work, a termination of the contract will be invalid unless the competent authority has granted its consent.

b) Nursing Care Leave

Employees or persons similar to employees are entitled to nursing care leave of up to 6 months for each close relative in need of care. However, only employers who usually employ more than 15 employees and/or persons similar to employees are subject to nursing care leave entitlements. The number of employees and/or persons similar to employees will be determined upon calculating the average number of persons that are necessary to run the business.

The employee or person similar to an employee needs to inform the employer in writing that he intends to take nursing care leave at least 10 working days prior to the commencement of the nursing care leave. This information needs to specify the period of the contemplated nursing care leave, which may be up to 6 months for each close relative in need of care. Again, whether or not a close relative is in need of care will be determined along the lines set out by the statutory law on the public nursing insurance.

As previously discussed, the definition of a "close relative" is rather broad under the Nursing Care Leave Act. Since the entitlement to nursing care leave covers a period of up to 6 months for each close relative in need of care this might have the

consequence that an employee or person similar to an employee may not be terminated for a rather long period of time.

The special protection against dismissal is triggered at the point in time the employer receives the written notification of the nursing care leave and ends upon the end of the leave.

c) Family Nursing Care

The Family Nursing Care Act allows the employee to reduce the working hours to a minimum of 15 h a week for a maximum of 24 months. In case the employee also took nursing care leave, this time will be deducted from the total period of 24 months. This shows how the concepts of family nursing care and nursing care are interwoven.

As for nursing care the employee must give notice to the employer 8 weeks prior to the intended reduction of hours, specifying the period of time as well as the amount of the reduction. With regard to definitions and the special protection against dismissal the provisions of the Nursing Care Act are applicable.

However, in contrast to nursing care, the employee is only entitled to a reduction of working hours if the employer has at least 25 employees or persons similar to employees.

C. Key Aspects

- Maternity protection
  - Dismissal during pregnancy and until the end of 4 months after childbirth is only permissible for reasons not related to the pregnancy and only in exceptional cases with prior consent of the competent supervisory authority.
  - A discriminatory dismissal may lead to an employee's entitlement for moral damages.
  - Maternity leave starts 6 weeks prior to assumed childbirth and normally ends 8 weeks after childbirth, altogether 14 weeks.
  - During maternity leave the employer has to pay only a contribution to the maternity allowance usually paid by the employee's health insurance.
  - Beyond maternity leave, if life or health of mother or child is endangered, or in the event of certain kinds of work generally prohibited by the law, the employer has either to offer suitable alternative work or to suspend the employee from work.
  - If an expectant mother is suspended from work due to her pregnancy, she receives full pay. However, the employer has a claim for reimbursement against the statutory health insurance.

- Parental leave
  - Parental Leave may be taken for a time period of up to 3 years. The statutory framework differs with regard to the date the child is born:

    Before 1 July 2015:
    Two years have to be taken until the child's third birthday. The remaining year can, with the consent of the employer, be taken until the child's eighth birthday.
    After 1 July 2015:
    24 months of the parental leave can be taken after the third but before the eighth birthday of the child even without the employer's consent.
  - The employer does not have to pay remuneration during parental leave except one-off loyalty payments.
  - The employee must notify the employer in writing of the decision to take parental leave.
  - During parental leave the employer cannot dismiss the employee unless in exceptional circumstances with prior consent of the competent supervisory authority.
- Nursing care
  - Employees may request a short-term release from work for up to 10 days in order to organise or assure required nursing care for a close relative in an urgent situation of need of care.
  - If the employer usually employs more than 15 employees, employees are entitled to unpaid nursing care leave of up to 6 months to provide nursing care for close relatives. The request must be announced to the employer at least 10 working days prior to the beginning of the leave period.
- Family Nursing Care
  - If the employer usually employs more than 25 employees, the employee is entitled to a reduction of working hours to a minimum of 15 h per week over a maximum period of 24 months.
- During all four options special dismissal protection applies. A termination of employment during these periods requires prior approval of the competent supervisory authority.

Chapter 17
Managing Directors and Management Board Members

Michael Magotsch and Jens Kirchner

A. Introduction

Unlike in common law jurisdictions, managing directors (*Geschäftsführer*) of German Limited Liability Companies (*Gesellschaften mit beschränkter Haftung, GmbHs*) as well as Management Board Members (*Vorstände*) of German stock corporations (*Aktiengesellschaften, AGs*) are not considered as employees[1] under German employment law. On the contrary, they work under "service agreements" which in addition to their office and role as organ of the company stipulate the terms and conditions of their contractual relationship. This chapter deals with the specific role and office of these key managerial employees, their respective duties and obligations under German law as well as their liability. This includes cases of alleged mismanagement and the respective personal liability of managing directors or board members in Germany. In connection with the personal liability of managing directors we will also briefly cover the issue of Directors and Officers (D&O) insurance coverage for top management.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Managing Directors

I. Appointment

The shareholders of a *GmbH* have the power to appoint managing directors. Managing directors are appointed by shareholders' resolution, passed by a simple majority of the votes cast, unless the articles of association (the articles) of a company provide otherwise or the applicable co-determination regulation assigns the appointing authority to the supervisory board (*Aufsichtsrat*) of the company. According to the One-Third Participation Act (*Drittelbeteiligungsgesetz, DrittelbG*), *GmbHs* with more than 500 employees must establish a supervisory board consisting of 1/3 of employee representatives. Further, by virtue of the Co-Determination Act (*Mitbestimmungsgesetz, MitbestG*), *GmbHs* with more than 2000 employees must establish a supervisory board composed equally of employee and shareholder representatives (see Chap. 27).

1. Qualification for the Position as Managing Director

Both shareholders and non-shareholders may be appointed managing directors. Managing directors are therefore not required to hold shares in the *GmbH*. However, only individuals, not legal entities, are eligible for the position of managing director.

Corporate law does not require that any or all managing directors be German citizens or have their domicile or residence in Germany. They are also not legally required to perform their duties within Germany. If none of the managing directors permanently or temporarily stays in Germany, or at least is legally allowed to enter Germany to perform his duties, the courts may, however, hold that the company does not have its corporate offices in Germany, as required by law, and thus cannot be registered. Further, from a tax perspective, this may result in the place of effective management being abroad and therefore also the residence for tax purposes would be abroad unless at least the key management decisions are actually taken in Germany.

Corporate law imposes only two requirements regarding the personal reliability and professional qualification of managing directors. First, a person convicted of certain criminal offences in the course of insolvency is precluded from becoming a managing director for a period of 5 years from the date of his conviction. Second, a person prohibited by court judgment or administrative order to perform a specific profession or business cannot, while the judicial or administrative prohibition is in effect, become a managing director of a *GmbH* which is partially or totally involved in that profession or trade.

A managing director cannot at the same time be a member of the supervisory board if the company has such a board. The same is true for being an authorised signatory, i.e. a holder of a proxy (*Prokura*) on behalf of the company.

2. Service Agreement

Despite the fact that the typical managing director is not an employee by virtue of case law, a managing director may be considered to be comparable to an executive employee under particular circumstances. However, there are important labour law statutes that explicitly exclude managing directors from their scope (e.g. Dismissal Protection Act, Works Constitution Act, Labour Courts Act).

The service agreement of a managing director is an agreement with the company and not with the shareholders, unless the agreement provides otherwise. However, the service agreement is concluded and terminated on behalf of the company by the shareholders, unless a co-determination act requires otherwise.

II. Representation of the Company

1. The Managing Directors

The managing directors represent the company in and out of court. If several managing directors have been appointed, they represent the *GmbH* jointly.

The company's articles (*Satzung*) may require or permit the shareholders to pass separate shareholders' resolutions, in order to deviate from the statutory principle of joint representation. The power of representation of each managing director, or of one or several specific managing directors, may be extended so that they are empowered as follows:

- To represent the company acting singly;
- To represent the company acting jointly, with one or several other managing directors;
- To represent the company acting jointly with one or several managing directors or holders of a proxy.

2. Publication of Representation Rights

The right of representation of the managing directors, and any extension thereof, must be entered in the commercial register and must then be published in the appropriate publications. This act is not necessary in order for the appointment to become effective; however, in practice the entry into the commercial register serves as evidence for appointment as managing director.

3. Limitation of the Authority of Managing Directors

In contrast to an extension, a limitation of the statutory authority of the managing directors to represent the company will have no effect vis-à-vis third parties.

However, internally the articles or a shareholders' resolution may limit the authority of the managing directors to represent the *GmbH*. For instance, it might be resolved that the managing directors must not engage in activities not included in the purpose of the company or that all, or several, or one managing director shall require the consent of the shareholders to engage the *GmbH* in specific transactions.

Should such a limitation be violated, the *GmbH* cannot invoke it against third parties to defeat a commitment made to such a third party by managing directors. The *ultra vires* doctrine is unknown to German law. However, the violation of such a limitation constitutes a breach of the service agreement with the *GmbH*, which in turn gives rise to a claim by the company against the managing director for damages and may also justify a dismissal for cause.

III. Internal Management Structure

The affairs of a company are managed by its managing directors. The management responsibility of the managing directors relates only to matters within the field of activities defined as the purpose of the company in the articles. Even within this field, certain matters of major importance are reserved for decision by the shareholders. The shareholders may, either through the articles or by shareholders' resolution, extend or restrict the managing directors' scope of responsibility.

The statutory management concept is one of joint management of the company by all managing directors. Under this concept, management decisions require the consent of all managing directors. It is possible to deviate from the concept of joint management. The shareholders might assign specific fields of responsibility (e.g. accounting, finance, production, distribution) to one or more managing directors.

IV. Summary of Main Duties and Responsibilities

1. Diligent Management

In all matters concerning the company, the managing directors must employ the diligence of an orderly businessman. Each year the managing directors have to submit a list of shareholders to the commercial register. In the event that shares are assigned, the managing directors must notify the commercial register of the assignment.

This general obligation of diligent management is owed to the company and not to the shareholders, the creditors of the company or third parties. If a managing director negligently or intentionally violates his obligations, he is liable to the company for damages, jointly and severally with any other managing director who also violated his obligations in this way. However, no liability for damages

arises if the conduct of the managing director was approved by a shareholders' resolution, unless such shareholders' resolution was illegal.

Because of the particular emphasis of the Limited Liability Company Act (*Gesetz betreffend die Gesellschaft mit beschränkter Haftung, GmbHG*) upon ensuring the contribution and preservation of the share capital of the company, special obligations and liabilities are imposed upon managing directors with respect to these matters.

a) Liability for Incorrect Statements

If incorrect statements were made for the purpose of forming the company or increasing its share capital, managing directors who acted negligently or intentionally are jointly and severally liable to the company to contribute the missing sums, reimburse money to the company which should have been included in formation expenditures but were not, and to make good any other damage they have caused.

b) Liability to Shareholders

If an illegal disbursement of share capital contributions has occurred that cannot be recovered from the recipient, the other shareholders are proportionately liable for the refund owed to the company. Such a sum becomes due to the company from the shareholders if that sum is needed to satisfy creditors of the company. The managing directors who negligently or intentionally made the disbursement are jointly and severally liable to those shareholders who are required to refund the sum to the company.

c) Liability in Case of Liquidation of the Company

Finally, if the company is liquidated, managing directors who act as liquidators are jointly and severally liable to reimburse the company for amounts negligently or intentionally distributed to the shareholders before such a distribution should have been made. In these situations, the managing directors cannot defend themselves by asserting that they acted in accordance with a shareholders' resolution.

d) Duty to Inform Shareholders

If the annual or interim balance sheet of the company shows that half or more of its share capital has been lost, the managing directors must call a shareholders' meeting as soon as possible. Managing directors who negligently or intentionally fail to do so are jointly and severally liable for damages to the company and are also subject to criminal penalties.

e) Commencing Insolvency Proceedings

Insolvency proceedings are commenced against the assets of a company if it is either over-indebted or insolvent. The petition to commence insolvency proceedings can be filed by any creditor of the company or by any of its managing directors or liquidators.

In case of over-indebtedness or insolvency, each managing director, whether authorised to represent the company singly or jointly with others, is obligated to file a petition for the institution of composition proceedings (*Vergleichsverfahren*), or an insolvency petition (*Insolvenzantrag*) without undue delay but in no event later than 3 weeks from the date on which the over-indebtedness was asserted or the insolvency arose. Managing directors who negligently or intentionally fail to meet this obligation commit a criminal offence and are liable for damages in respect of both the company and its creditors.

2. Special Responsibilities Regarding the Preparation of Annual Accounts, the Payment of Taxes and Social Insurance Contributions

a) Annual Accounts

The managing directors have to prepare annual accounts that have to be submitted to the shareholders and the commercial register. The shareholders have to give formal approval to the actions of the managing directors and have to approve the profit distribution by resolution.

b) Compliance with Tax Laws

Pursuant to their general obligation to ensure that the company is in compliance with the law, the managing directors must ensure that the company is in compliance with tax law. They become liable towards the company for damages if they negligently or intentionally fail to ensure such compliance. The managing directors have to file monthly VAT returns, the corporate income tax return and the trade tax return, which must be filed by May of the following year. In addition to this obligation of the company, the tax laws impose on the managing directors a direct responsibility to the government to ensure the company's compliance with its obligations. Managing directors, who by intent or gross negligence fail to carry out such responsibility, are personally liable for payment of relevant taxes and subject to administrative sanctions and even to criminal penalties.

c) Payment of Social Insurance

Similar obligations and liabilities are imposed upon managing directors to ensure payment of the statutory social insurance contributions owed with respect to

remuneration paid to the company's employees. These contributions are owed in part by the company directly and in part by its employees. To the extent that contributions are owed to the company's employees, the company is obligated to withhold such contributions from the employee's compensation and pay it to the appropriate social insurance institutions.

d) Liability for Damages

The managing directors are obliged to ensure the company's compliance with the above obligations. If they fail to do so, they may become liable for damages to the company, subject to dismissal for cause, and exposed to administrative fines. Furthermore, they can become personally liable to the relevant insurance institutions for the payment of the part of the contributions owed by the company's employees, which should have been withheld and paid by the company.

e) Compliance with Instructions of Shareholders

In addition to complying with the articles and their service agreements with the company, the managing directors are obliged to comply with the instructions given to them by the shareholders, unless those instructions are illegal. Negligent or intentional violations of this obligation render the managing directors liable to the company for damages and may, in certain circumstances, justify their dismissal for cause.

V. Removal and Resignation

The removal and resignation of managing directors from their office are corporate acts governed by corporate law and must be distinguished from the termination of service agreements between the company and its managing directors.

1. Removal by the Shareholders

Managing directors are removed from office by shareholders' resolutions passed by a simple majority of the votes cast, unless the articles provide otherwise or a co-determination law assigns the authority to remove managing directors to the supervisory board.

Notwithstanding their claims for compensation under their service contracts, managing directors can be removed from office at any time with or without cause, unless the articles or the Co-Determination Act (*MitbestG*) provide otherwise. The

articles can restrict the right to remove managing directors without cause but cannot restrict the right to remove them for cause.

The removal of a managing director must be entered in the commercial register and the remaining managing directors must apply for registration of the removal. While the removal does not have to be registered to be effective, registration should not be delayed. This is because as long as someone is registered in the commercial register as managing director, the fact that that person is no longer a managing director is no defence against third parties who were not aware of the managing director being removed from his office. Therefore, the company will be bound by any act of a former managing director towards such third parties if his removal has not been registered and can only claim damages from the former managing director which may not be sufficient in some cases.

2. Resignation

Resignation, whether for cause or not, is a unilateral act which becomes effective when the resignation is declared, even if it is a violation by the resigning managing director of his contractual duties and therefore creates a claim by the company for damages. Resignations must be registered on the commercial register. Registrations should not be delayed unduly for the same reasons given above concerning registration of the removal of a managing director from office.

3. Service Agreement

Either the company or the managing director may give notice with respect to the service agreement. In this case, the notice period is to be determined according to the Civil Code (*BGB*).

However, in many cases a termination with notice (*ordentliche Kündigung*) will be excluded, at least for a certain period of time. In particular, if the service agreement is concluded for a fixed term and does not explicitly provide for a termination with notice, the service agreement may be terminated only for cause (*wichtiger Grund*). If the service agreement is not for a fixed term, such agreements will, in practice, often provide for long notice periods between 6 and 18 months or provide for minimum terms of the service relationship.

In general, the service agreement can be linked to the office as managing director. This can be achieved through a contract clause stipulating that the resignation or removal from the office as managing director shall constitute a cause for termination of the service agreement or shall respectively be considered as an ordinary termination upon observance of the applicable termination notice period to the next possible termination date.

VI. Personal Liability

It used to be an unwritten rule that in the event of alleged mismanagement, directors were simply removed from their offices without any further consequences. Nowadays, however, increasing internationalisation and globalisation, concepts of shareholder value and return on investment and the companys' increasing pressure to commence actions and claim damages against their former directors result in more German directors requiring D&O insurance coverage in their role.

Moreover, an increasing amount of laws to be complied with and respective central decisions of the Federal Civil Court (*BGH*) have resulted in increasing damages claims against directors by the supervisory bodies. While US style D&O insurance policies do not cover "internal claims," i.e. claims from the company against its own officers and directors, German insurance polices in general cover such claims (*Innenverhältnisdeckung*) provided there was no gross negligence or intent nor gross violation of contractual obligations (*Nichterfüllung vertraglicher Pflichten*). It is therefore advisable to obtain expert advice on this topic when concluding service agreements with directors.

VII. Application of Employment Laws

As previously mentioned, managing directors are generally considered not to be employees under German employment law. As a consequence, managing directors do not fall under the scope of the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*) and severance payments in case of a termination of a managing director are not common in Germany (with the exception of change of control clauses). At the same time, managing directors often benefit from longer contractual termination notice periods and/or individual company pension promises. However, due to case law, some labour laws may also apply to managing directors if the managing director is in need of protection like an executive employee (*leitender Angestellter*). This may be especially true for managing directors who are neither major nor minor shareholders of the company (so-called *Fremdgeschäftsführer*).

Whether a managing director is in need of protection is to be determined by the degree of his economic dependence of the company on a case-by-case basis. If a managing director is considered to be comparable to an executive employee, provisions regarding the statutory notice period or the right to reference letters may apply.

According to a decision of the Federal Labour Court (*BAG*), the service contract of a managing director is not transferred to the buyer in the course of a transfer of business, as would be the case with employment contracts. In case of a transformation of the company according to the Company Transformation Act (*Umwandlungsgesetz, UmwG*) the service contract of the managing director

remains valid. However, in most of the cases the office as managing director will end due to the transformation. The consequence would be that the company's duty to factually employ the managing director (not the obligation to pay him) will cease, and the managing director will have a reason to terminate the service agreement for cause.

C. Management Board Members

Most of the legal principles described above regarding managing directors of *GmbHs* apply also to management board members (*Vorstandsmitglieder*) of stock corporations (*Aktiengesellschaften, AGs*). However, certain particularities exist with regard to management board members. Therefore, the following shall be restricted to explain some basic legal principles and the main differences to managing directors of *GmbHs*.

The composition of the management board is regulated in the company's articles. The management board may consist of one or several members. If the company's basic capital (*Grundkapital*) amounts to more than 3 million Euro, the management board must consist of at least two members; however, the articles may provide that it consists of only one member. In companies with regularly more than 2000 employees, a labour director (*Arbeitsdirektor*), essentially responsible for personnel and social matters, must be appointed as equal member of the management board by the supervisory board. The German Corporate Governance Codex recommends management boards with several members.

I. Appointment

1. Supervisory Board Resolution

Appointing a member of the management board is a corporate act requiring a resolution of the supervisory board by a simple majority of the votes cast. This is mandatory and the supervisory board may not delegate its appointment authority to the supervisory board committee.

2. Term

The supervisory board may appoint management board members for a time period of up to 5 years. This time limitation is intended to avoid the company being bound by long-term appointment commitments. Management board members may however be reappointed for a further term or their term may be extended for a maximum of further 5 years. Only if the management board member has been appointed for a

term of less than 5 years may his term be extended to a total term of 5 years without new resolution.

3. Deputies

The supervisory board may appoint deputy management board members (*stellvertretende Vorstandsmitglieder*) besides the regular board members. In principle, these usually have the same rights and obligations as regular management board members.

4. Chairmen and Spokesmen

If the management board consists of more than one member, the supervisory board may appoint a chairman of the management board (*Vorstandsvorsitzender*) by a simple majority of the votes cast. In case the supervisory board has not appointed a chairman, the management board may appoint its own spokesman of the management board (*Vorstandssprecher*). The German Corporate Governance Codex, however, recommends the appointment of a chairman.

5. Service Agreement

As with managing directors of *GmbHs*, the corporate act of appointment must be distinguished from the service contract. In principle, both are legally independent from each other.

At the conclusion and the termination of the management board member's service contract, the stock corporation is represented by its supervisory board.

6. Qualification for the Position as Management Board Member

Only individuals, not legal entities, are eligible for the position as management board member. Members of the management board are not necessarily required to be German citizens, and therefore may be foreign nationals. Further, members of the management board do not have to be shareholders of the stock corporation; rather, they are appointed by corporate act and obliged by service agreement, even where they are, in fact, shareholders. The company's articles may provide for further qualifications (e.g. professional experience).

In principle, management board members may not simultaneously be members of the supervisory board, if one exists, which oversees the activities of the management board.

II. Representation of the Company

According to the Stock Corporation Act (*Aktiengesetz, AktG*), the stock corporation is legally represented by the management board both in and out of court. The members of the management board are usually only authorised to represent the company jointly. However, the articles of the corporation may provide otherwise.

III. Internal Management Structure

The management of the company is monitored by the supervisory board. Management tasks may not be assigned to the supervisory board. In principle, the management board is independent from the instructions of the supervisory board. The company's articles or the supervisory board must provide that certain kinds of business activities may only be conducted with the consent of the supervisory board. If the supervisory board denies its consent, the management board may instead request that the shareholders resolve to grant their consent by a majority of at least three-fourths of the votes cast.

IV. Duties and Responsibilities

1. Duties and Responsibilities of Management Board Members

The management board is responsible for the entire management of the stock corporation. If the management is subdivided among the management board members, the members still have a duty to exchange information and to intervene in the case of undesirable developments.

The management board prepares and executes shareholders' resolutions. It must inform the shareholders immediately where there is a loss of half of the basic capital and file for bankruptcy in case of insolvency or over-indebtedness. The annual statement of accounts (*Jahresabschluss*) and the status report (*Lagebericht*) are also established and presented by the management board.

2. Violation of Duties

The members of the management board must act in accordance with their duties, otherwise they may be held liable for damages. In comparison to managing directors of *GmbHs*, a rather strict liability scheme corresponds to the broad authorities of the management board. In particular, management board members

are held jointly liable for damages to the company due to violations of their duties if they cannot prove that they acted without fault (reversed burden of proof).

Management board members are not liable to the company if their actions are based on a lawful shareholders' resolution. Their liability is, however, not excluded by mere approvals of the supervisory board. Further, stock corporations may only waive claims for damages against management board members at least 3 years after accrual of such a claim. Such waivers require the consent of shareholders holding at least 90% of the basic share capital. Where the managing director is subject to bankruptcy proceedings, the time restriction for waivers of damage claims does not apply.

V. Removal and Resignation

1. Removal by Supervisory Board

Management board members of *AGs* can only be removed from office by the supervisory board for cause. This is different from managing directors of *GmbHs*, and is intended to increase the management board member's independence and motivation to carry out his duties in a responsible way. Removal for cause may particularly be considered in cases of gross negligence (*grobe Pflichtverletzung*), inability to manage in an orderly way (*Unfähigkeit zur ordnungsgemäßen Geschäftsführung*) or where there is a vote of no confidence (*Vertrauensentzug*) by the shareholders. Votes of no confidence will only constitute cause if the confidence was withdrawn on objective grounds. Such shareholders' resolutions do not oblige the supervisory board to remove the respective management board member, instead, the supervisory board decides this by a resolution in its own right.

Causes for removal are gross breaches of duty, lack of fitness for proper management, or withdrawal of confidence by a general meeting (*Hauptversammlung*) of the shareholders if the withdrawal is not based on obviously unreasonable grounds.

Where a management board member has been removed by a supervisory board resolution without cause, the management board member may file a claim for a determination of invalidity of the removal. The removal remains valid and effective until a final court decision renders it invalid.

2. Resignation

In principle, management board members may resign from their office. The legal requirements for their resignation are, however, not yet resolved. In particular, it is disputed whether a management board member needs cause to resign (e.g. in case of his denied discharge). Some assume that management board members may resign without cause, in a way similar to managing directors of *GmbHs*. Insofar, resignations are held to be void only under special circumstances constituting abuse

of rights (e.g. in a company crisis or in order to achieve a changed service agreement or an early reappointment).

3. Service Agreement

As with the managing director, the management board member's service contract is legally independent from the corporate acts of appointment and withdrawal (or resignation). Particularly, in case of resignation or withdrawal from the office, usually only the corporate position as management board member ends. The service agreement may persist, due to the fact that a cause for withdrawal does not necessarily form sufficient cause for the summary dismissal of the service agreement. The service agreement may provide differently although high thresholds regarding the required cause apply to terminations of service agreements before the end of their term.

VI. Application of Employment Law

Since the management board member is executing employer functions, his contractual relationship to the employing stock corporation is not strictly an employment relationship, but rather a service contract on business management functions. Therefore, statutory employee protection provisions of German employment law (e.g. the Dismissal Protection Act) do not apply to management board members. Service relationships of management board members may, however, show similarities with employment relationships, particularly to those of executive employees. As far as this is the case, certain labour law provisions may apply accordingly.

The ordinary civil courts and not the labour courts have jurisdiction in relation to disputes between management board members and the stock corporation.

D. Key Aspects

- Managing directors and management board members are not considered employees of the company.
- Service contracts of managing directors and management board members are generally legally independent from the corporate acts of their appointment and removal.
- Appointment and removal of managing directors require shareholders' resolutions by a simple majority of the votes cast.
- Management board members are appointed and removed by the supervisory board by a simple majority of the votes cast. Different from managing directors, they may only be removed for cause.

- Appointment and removal of managing directors and management board members must be registered with the commercial register, particularly in order to be legally effective towards third parties.
- Since managing directors and management board members execute employer functions for their companies, in principle, the statutory employee protection provisions of German employment law do not apply to them.
- Ordinary civil courts are competent for legal disputes regarding the service contract relationships of managing directors and management board members.

Chapter 18
Compliance Investigations

Pascal R. Kremp and Jens Kirchner

A. Introduction

Compliance is a "hot topic" in German labour and employment law. Press and media report on a regular basis about major compliance cases affecting various industries. Companies who are not compliant with mandatory law may face severe fines, criminal prosecution, exclusion from (public) tender proceedings, but also significant reputational issues. Such consequences can in worst case even destabilise the whole company.

More and more frequently, companies must handle situations where suspicious facts with regard to corruption, bribery, tax fraud, or violations of anti-trust and competition laws, arise suddenly and which force the company to quickly investigate this in order to avoid or reduce penalty payments that can reach into millions of Euros.

Investigations do not come with advance notice. Therefore, once a suspicion arises, it is crucial to have an efficient organisation in place, which enables the employer to investigate without undue delay.

At the beginning of such compliance investigations the main focus is often on how to reduce potential criminal sanctions including fines. Typically, only at a later stage the investigation focuses on possible consequences against individual

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employees.[1] It is not unusual that the employer may then be in a very weak position and must try to settle a termination case for high severance payments or face reinstatement, even in cases where employees may have committed criminal offences. Employers are therefore well advised to consider potential labour and employment law pitfalls already at the outset of the investigation.

B. Process of Investigation

The process of investigation is not determined by statute and therefore not uniform; however, due to case law, some guidelines can be established. Due to the lack of legal stipulations and the developments in the jurisdiction the process of internal investigations is subject to constant change. Therefore, the following can only give a high level overview about the steps to be taken and risks to be considered when it comes to compliance investigations.

I. Start of Investigation

Prior to any investigation the question arises whether the investigation, which will regularly be connected with (at least) significant costs, should be conducted at all and to what extent. Not only from a financial point of view compliance investigations can be onerous for a company. Especially the working atmosphere can worsen significantly during compliance investigations, depending on the number of employees affected. Whether or not a compliance investigation should be initiated must be decided on a case by case basis. Questions such as the following may help to decide whether the investigation process should be initiated:

- What is the subject of the allegations (e.g. severe criminal offences such as bribery, sexual harassment)?
- Which (reputational or financial) risks are threatening (e.g. fines, criminal prosecution, exclusion from specific markets, interest of publicity, reputation of company)?
- How many employees/departments are affected?
- Which effort is required to investigate the accusations?

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

II. Compliance Team

Once the decision is made to investigate, the question who should be part of the compliance team needs to be decided.

Larger companies usually have in-house compliance departments with well-experienced teams. If a separate compliance department does not exist, employers must evaluate carefully which employees can be involved without endangering the confidentiality of the investigation. In most cases it is advisable to use employees who work in a separate, non-affected department, business unit or even legal entity to ensure the neutrality of the team as far as possible.

Irrespective of the existence of an in-house compliance department it should be considered to involve third parties such as law firms, forensic consultants, or tax advisers. The advantage of this is that the investigation process appears more neutral and independent (also in the view of the public). Depending on the subject and status of the investigations, experts from different areas of laws such as employment law, data protection law, criminal law, anti-trust law, tax law, etc. may need to be involved by the internal or external leads within the compliance teams.

III. Gathering the Facts

The purpose of the investigation is usually to collect the facts after some initial information was provided through witnesses, third parties or a whistle-blower. Apart from interviews of individual employees a good source for information can be the screening of electronic data.

1. Collection and Screening of Data

The collection and the screening of data is one of the most important, but also time-consuming phases of the investigation process, since it is necessary in order to get a full picture of the misconduct on the one hand, and to provide a profound evidence base for all further steps on the other hand. Depending on the scope of the investigation the collection and screening of data may delay the investigation process itself or—depending on the findings—extend the scope of the investigation significantly.

a) Hold Notice

Prior to the collection and screening of data and in order to prevent a loss of data it should be considered to issue a legal hold notice to the employees, asking them not

to delete any relevant data connected to the subject of the investigation. Such notice may need to involve a warning that the deletion of data itself may be followed by disciplinary actions.

b) Data Protection Laws

Employees are obliged to hand over all official business documents that are in their possession. Besides hard copies of documents, one of the most promising sources of information during an investigation is an employee's email inbox. Many employers have, however, no clear rules whether the company email address may be used only for business purposes or also for private purposes. In particular, if private use is allowed or tolerated, some courts take the view that the employer must be considered as a telecommunication provider with the consequence that accessing the email account bears the risk of criminal sanctions against the employer. To avoid this employment law pitfall companies are therefore well advised to review the rules on access to emails well ahead of any compliance investigation. In that regard, generally each collection of data requires the execution of a weighing of interests between the interest of the respective employer to investigate and the protection of the employee's privacy rights prior to any review of data (cf. Chap. 12). The interest of the employer to investigate has to predominate, and the review of the respective data needs to be the least severe measure.

In the case that a potential criminal offence of the employee indicates the investigation, the employer is furthermore required to document the concrete circumstances which led to the respective suspicion.

It cannot be ruled out that the respective requirements might have to be adapted in particular due to probable future case law in regard of the General Data Protection Regulation (*GDPR*; *Europäische Datenschutz-Grundverordnung*) entering into force in May 2018 and national legal provisions related to it.

c) Documentation

In most cases a vast amount of data must be analysed. To limit the amount of data the search can be conducted by using a specific forensic search software.

From an employment law perspective it may be advisable to have a detailed documentation on the collection (e.g. laptops/smartphones collected) and screening of data (e.g. list of search terms, accounts/data screened) which enables the employer to determine at what time which finding was made. This may become crucial in case of a summary dismissal, i.e. a termination for good cause (*außerordentliche Kündigung*) where the employer must establish at what time it has gained knowledge of the facts qualifying for "cause".

d) Works Council Participation

Where a works council exists the review of email accounts may require the consent of the works council. It is not unusual that employers then face a situation where they have to make a decision between taking the risk of delaying the review or accepting a possible breach of works council rights, possibly with the consequence that evidence is not admissible in a lawsuit against an employee. Such pitfall can be avoided by agreeing with the works council on general rules about investigations far before any suspicion of an investigation.

2. Interview of Suspected Employees

a) Legal Outline

Based on the findings gathered from the data screening the next step (or a step before the email screening) is often to confront employees with the (possible) misconduct in a personal meeting. Whilst attending the interview and answering the questions of the employer is usually part of the employee's duties, it may be advisable not to put too much pressure on the employee. In complex cases it may also be necessary to allow the employee preparation time, which means that the employee must then be informed about the purpose of such meeting or be invited for a second meeting if the employee cannot immediately answer all questions.

There is no clear case law on whether an employee is entitled to consult a lawyer or a works council member during the interview. Since in many cases the employer consults lawyers during the interviews, employees should be allowed to consult a lawyer or a member of the works council in such situations, too.

b) Admissible Questions

Under German employment law there is no absolute obligation of the employee to provide information. Therefore, the employer is only allowed to ask questions which it has a legitimate interest in knowing the answer of. Otherwise the employee may have the right to refuse the answer or—in case the question proves to be a breach of the employee's personal rights—even lie without having to fear sanctions by the employer.

As a general rule, an employee is obliged by his contractual duty of loyalty to answer all questions that will prevent potential damages and risks to the employer. The extent of this obligation is governed by the hierarchical position of the employee. A senior manager's duty to answer may in general exceed the obligation of a common employee.

Furthermore, an obligation to answer exists in respect to questions related to the employee's work tasks as long as the employer has a legitimate interest in obtaining the respective information and disclosing the information does not pose an

excessive burden to the employee. Questions regarding subject matters outside of the scope of the employee's tasks are only admissible if the legitimate interest of the employer in obtaining a certain information outweighs the employee's interest in protecting his personal sphere, which has to be evaluated individually on a case-by-case basis.

Therefore, the employee is generally obliged to answer all questions in regard to his job tasks and relating to these tasks, while he is only obliged to answer questions regarding issues outside of the scope of his tasks if the employer's interests in obtaining an information is not overridden by an interest in the protection of the employee's personal sphere.

There is no clear case law on whether employees are obliged to answer questions if the answer would be self-incriminating. Whilst it is clear that employees (just as anybody accused) are privileged against self-incrimination towards the criminal investigation authorities, it is discussed to what extent such right might exist versus the employer. In light of this, an outweighing interest of the employee in protecting his personal sphere could be given if by answering a question related not only to his job tasks the employee would incriminate himself; he might therefore have a right to refuse an answer in such a situation.

c) Works Council Participation

If a works council exists, it has the right to information regarding all circumstances of which knowledge is expedient and necessary for the works council to fulfil its lawful duties. It therefore might request information every time consultation rights of the works council could be affected.

As a result, the works council generally has to be informed extensively and in due time about the fact that the employer is intending to conduct several interviews as well as the subject and the extent of the planned interviews, so that it can assess whether its co-determination rights are affected. The works councils co-determination rights that could be triggered by the interviewing process concern standardised sets of personnel question used by the employer regarding the personal situation, background, knowledge and skills of an employee, regardless of whether they are in writing or not. This may also include all questions concerning the order of the operation and the employees' behaviour within the operation.

In case co-determination rights are triggered, the employer must negotiate the intended measures with the works council first to find an agreement. With regard to standardised questionnaires the works council has to agree upon the language and content of such standardised questionnaires; however, it may not impede the fact that the employer is asking questions. In case no agreement on the implementation of the measures can be made, a conciliation committee has to be established which is likely to lead to a substantial delay of the implementation of the measures.

As timing is generally crucial for the success of the interview process, it might be advisable to carefully choose the phrasing of the questions in the interview process in order to prevent them from being subject to co-determination. This is the case,

for example, if the employer only asks questions regarding operational occurrences or the employee's work behaviour and not such concerning the employee's personal relationship to clients or competitors. Again, pitfalls occurring with regard to the interview can be avoided by thoroughly planning and thinking through the interviewing process and its details.

C. Disciplinary Consequences

Once a misconduct of an employee or at least a strong suspicion based on facts has been established, the employer must make a decision whether to take disciplinary actions or not.

I. Dismissal

The disciplinary consequence that is typically considered first is the issuing of a termination notice. This can either be an ordinary termination by observing the individually applicable notice period (*ordentliche/fristgemäße Kündigung*) or a summary dismissal, i.e. a termination for good cause with immediate effect.

1. Ordinary Dismissal

The termination can be based on a criminal act committed by the employee or the severe violation of his contractual duties, as well as, in the special case of a termination for suspicion (*Verdachtskündigung*), on the suspicion of such a criminal act or severe violation of contractual duties.

A criminal offence committed by the employee may only justify a termination if the criminal act was committed in the course of the employment relationship and/or to the employer's detriment. Therefore, offences committed in personal matters and which do not affect the employer generally do not have an impact on the employment relationship.

The severe breach of contractual duties can justify a termination regardless of whether the breach was committed intentionally or negligently. However, usually the employer must have issued at least one warning letter reprimanding the same or a similar kind of behaviour prior to issuing a termination, otherwise the termination is usually null and void. No warning letter may be required if the employee's behaviour is such a clear breach of his contractual duties that he cannot reasonably expect the employer to tolerate his behaviour. It is crucial to note that, in general, once the warning letter is issued the employee cannot be terminated for the same misconduct as set out in the warning letter.

The employer's interest in the termination must outweigh the employee's interest in the continuation of the employment relationship, otherwise the termination may not be valid.

When assessing the prospects of the success of a termination, employers should also consider that the court will take into account not only aspects of the misconduct itself, such as the severity and consequences of the violation, the extent of fault as well as the employee's individual contribution to the damages incurred. It will also take into account aspects such as the awareness or even involvement of supervisors and/or the management, failure of the employer to establish and implement clear compliance policies and trainings, and the employee's efforts to reduce damages and to cooperate with the employer. In case of compliance investigations it often occurs that not only single employees have committed criminal offences but also co-workers in the same department, supervisors and even the senior management are involved. If the supervisor or the management have tolerated the misconduct, the termination of the employee may be null and void since the employee may not have culpably violated his contractual duties.

The suspicion of a criminal act or a severe breach of contractual duties by the employee may justify a termination due to the reason that the employer's faith in the employee's loyalty might have been destroyed. However, prior to issuing the termination, the employer first has to take all measures necessary to investigate and clarify the circumstances of the suspicion, especially give the employee the opportunity to explain himself by confronting him with the allegations.

2. Dismissal with Immediate Effect

The sharpest sword is a termination for good cause without notice (*außerordentliche/fristlose Kündigung*). In this case, the employer has to demonstrate and prove a significant reason (e.g. fraud, theft, corruption) or, in the special case of a termination for suspicion, the suspicion of a significant reason which could not be dispelled. The significant reason or the suspicion thereof must lead to a situation where it cannot reasonably be expected of the employer to continue the employment relationship until the end of the ordinary notice period; the employer's interest in the immediate termination of the employment must therefore outweigh the employee's interests in the continuation of the employment.

If a termination for good cause is intended, a 2 week deadline must be observed. Notice must be given within 2 weeks of receiving knowledge of the facts qualifying for cause. The employer is allowed to investigate a misconduct and to collect evidence (e.g. affidavits) before the 2 weeks deadline is triggered if done without undue delay. Also, in case of a suspicion it is legally required to confront the employee with the allegations without undue delay (usually 1 week after the employer became aware of the suspicion). However, many employees try to challenge that the employer has observed the 2 weeks deadline, which indeed

may be difficult to prove before court in complex cases. Thus, as mentioned above, it is advisable to have a detailed documentation about the collection (e.g. laptops/smartphones collected) and the screening of data (e.g. list of search terms, accounts/data screened) when gathering and screening the facts. The 2 week deadline becomes particularly crucial if a regular termination with the applicable notice period is not permissible. For example, many collective bargaining agreements allow only a termination for good cause depending on years of service and age of the employee. If the 2 weeks deadline is missed, the employer may not be able to terminate the employment at all, even in severe cases. In case of criminal offences the employer may then have to wait for a prosecution by the criminal court against the employee, which will trigger the 2 weeks deadline anew. However, obtaining such court ruling can take years.

II. Formal Warning

As a less severe means compared to a termination, a warning letter can be considered. As mentioned earlier, it is important to note that in general once the warning letter is issued the employee cannot be terminated for the same misconduct as set out in the warning letter. In case of ongoing compliance investigations it may be advisable to explicitly mention in the warning that the employer reserves the right to take further measures if further facts occur in the context of the investigation.

The warning letter must clearly and precisely describe the unacceptable behaviour of the employee, outline that this behaviour is considered a misconduct or violation of contractual duties and is therefore not tolerable, and contain a threat of possible consequences in case of this behaviour being repeated or continued.

III. Assignment to Another Position

Another disciplinary measure to be considered is assigning the employee to another position. While employees can always be assigned to another position based on a mutual agreement, a unilateral assignment to another position is only possible if the employment contract allows for such an assignment and the employer's interest in transferring the employee outweighs the employee's interests in keeping his current position.

In case the employee does not consent and a unilateral assignment to another position is not provided for in the respective employment contract, a termination with change of terms of employment may be justified.

IV. Release From Work With Full Pay

Finally, the employer may consider a release from work with full pay. Like the assignment to another position, this measure is always possible with the employee's consent based on a mutual agreement. A release imposed by the employer is only possible if the employment contract of the respective employee was terminated and provides for a unilateral release, or the employer's interest in releasing the employee outweighs the employee's interest in being employed. This might be the case where the employer reasonably assumes that the employee has committed a criminal act or other severe breaches of his contractual duties.

Before releasing the respective employee from his duties, the employer should, however, first consider to what extent it is reliant on the cooperation of the employee to prevent further damages to its business.

D. Criminal and Other Consequences

In practice, compliance investigations often require a review and support of the case from a criminal law point of view and may even involve the company in investigations by the public prosecutor. As a consequence, experienced criminal lawyers are often crucial to limit the exposure of the company (e.g. company fines, media attention). Depending on the case it may also be required to take internal investigation measures, in particular with the support of regulatory, corporate or intellectual property lawyers, to understand the case sufficiently before reasonable consequences are taken to protect the interest of the company successfully.

E. Foreign Investigations

It is quite common that government authorities of a foreign jurisdiction may launch investigations concerning a German entity and its business activities if the company is doing business in this country and therefore is under the supervision of those authorities. However, the mere fact that such an investigation has been launched by foreign authorities and the ongoing of the investigation itself cannot justify any measures which might lead to a potential infringement of employees' personal rights or the failure to observe the rights of the works council. Employers have to make sure that those rights are adhered to even in such a case.

This also concerns cases in which the authorities have agreed with the company on the implementation of a compliance monitor as a condition of resolving regulatory proceedings after a guilty plea, settlement or other resolution of government enforcements.

F. Preventive Measures

Employers can take various measures in order to have an efficient organisation in place once a compliance case appears. Apart from a strong compliance team the following may be considered:

I. Code of Conduct: Tone of the Top

Many companies have implemented a code of conduct. However, it has often not been carefully reviewed to what extent it is binding to the individual employees. Depending on the content, a code of conduct may have to be agreed on with the works council. If the code of conduct does not require the consent of the employee, it should be even more ensured that the individual employees are aware of the code of conduct and that the employer has evidence for this. Also, companies are well advised to regularly train the individual employees on the code of conduct and about other relevant policies and guidelines.

Most important is, however, that also the (senior) management applies the code of conduct to its own acts and that it acts according to the code of conduct in daily business life. Otherwise, if the management is not following the code of conduct, it may become more difficult to take actions against individual employees.

II. Works Agreement About Compliance Investigations

As outlined earlier, compliance investigations often trigger various co-determination rights of the works council and if there are no clear rules in place about how to conduct investigations this can result in delays and/or frictions with the works council once an investigation is required. This can be avoided by entering into a works agreement with the works council well ahead of a specific compliance investigation. Moreover, this gets the works council on board of the cause and may result in a greater acceptance of compliance investigations by the works council and employees.

G. Corporate Whistleblowing Programmes

In order to be able to initiate investigations to detect compliance breaches, the suspicion of a wrongdoing has to be brought to the employer's attention first. Initial information regarding such suspicions may be provided by employees blowing the whistle. Even though there is no general legal obligation to implement a corporate

whistleblowing programme, employers are well advised to establish whistleblowing programmes, potentially including a whistleblowing hotline or an online portal to encourage employees (and third parties) in making a disclosure and to ensure that suspicions about possible wrongdoing can be addressed internally.

I. Legal Outline

Apart from a few regulations regarding civil servants and employees in the finance sector, Germany lacks specific legislation concerning whistleblowing, so there are no general laws encouraging employees to raise concerns about corporate wrongdoing. As a general rule internal rather than external reporting is encouraged. The employee in general has to report any concerns to the employer first before disclosing information externally. External whistleblowing is only permissible if internal reporting was unsuccessful or appears to be unreasonable. In some cases employees may be obliged to disclose wrongdoing to the employer due to holding a certain function, special agreements or the employee's general duty to loyalty as a secondary contractual obligation.

Whistleblowers are therefore only protected from termination or other detrimental actions of the employer by general laws, such as the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*), and employees might thus shy away from making disclosures as they fear negative consequences. Hence, employers are well advised to provide clear explanation about the procedure of how to make a disclosure.

II. Conditions of the Programme

Whistleblowing hotlines or online portals implemented by the employer are an option. However, these hotlines are sometimes still seen critically by works councils or employees, as the anonymity may encourage false and malicious reporting. In contrast, hotlines where users have to reveal their identity may discourage employees from using them due to the fear of consequences and therefore might not be as effective.

Employers offering whistleblowing hotlines often provide the possibility to report anonymously or alternatively by revealing the employee's identity, but making sure that, in the latter case, the data of the reporting employee will be handled confidentially.

III. Co-Determination and Data Protection

Establishing a whistleblowing programme usually triggers co-determination rights of the works council. Also, involving the works council will help to make such programme more widely accepted by the workforce.

Furthermore, using a whistleblowing hotline will typically raise data protection issues that must be considered.

H. Key Aspects

- There are no legal stipulations for the process of internal investigations. Thus, it is the company's obligation to determine a structure and to have the legal pitfalls in mind during each step.
- Internal investigations may trigger co-determination rights of the work council. This is especially the case with regard to the screening of email accounts and standardised interviews with employees. To avoid any conflicts in the case of an imminent or ongoing investigation the employer is well advised to set up together with the works council general rules about investigations well ahead before any investigation.
- During the investigations the employer should have a clear documentation which steps have been taken and what findings were made at what time.
- In case of a termination based on suspicions only it is required to interview the employee and confront him with the relevant facts first. Otherwise, the termination is null and void.
- In case of severe breaches like criminal offences the employee may be dismissed for good cause with immediate effect. However, such termination must be served within 2 weeks after the employer gained sufficient knowledge of the underlying facts. This can become difficult to meet in complex investigations.
- The employee's personal rights as well as the works council rights must also be respected in case an investigation against a company has been launched by foreign authorities. There mere fact of such an investigation and its ongoing cannot justify measures that might breach those rights.
- Due to the lack of specific legislation in Germany there are no general laws encouraging employees to raise concerns about corporate wrongdoing. Employers may introduce corporate whistleblowing programmes in order to detect infringements using whistleblowing hotlines or online portals.

Part II
Labour Law

Chapter 19
Unions and Collective Bargaining

Jens Kirchner and Pascal R. Kremp

A. Coalitions

I. Background

From the times of early capitalism, employees[1] in Germany started to form trade unions in order to improve their working conditions. Employers responded by creating employers' associations. These associations act as a counterbalance to the trade unions, forming a negotiating partner for conflicts with the unions. Both trade unions and employers' associations fall under the generic heading of "coalitions".

II. Definition of the Term "Coalition"

A coalition exists where the following conditions are met:

- It is a voluntary and private body of employees or employers, which has been established for a certain period of time, has a corporate organisation and is democratically administrated.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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- Independence (especially independence from employers and employers' associations, from the State, and from other social groups, such as political parties).
- The primary purpose is the protection and promotion of working and economic conditions.

In order to conclude collective bargaining agreements the coalition must be willing to be part of respective agreements, must accept the current law concerning labour conflict and arbitration, and must have so-called "social power", which means that it must be able to put pressure on the employer and the employers' association.

III. Freedom of Association

The basic right of the so-called "Freedom of Association" is codified in art. 9 sec. 3 of the German Constitution (*Grundgesetz, GG*). The purpose of the freedom of association is the protection and promotion of working and economic conditions. It is a basic right, encompassing rights for individuals as well as for coalitions themselves.

Freedom of association allows individuals to found coalitions and to participate in or refrain from them. This basic right is highly protected under German labour law. Thus, clauses in employment contracts preventing the freedom of association are void, as are dismissals based on an employee's participation in a coalition. Further, clauses in collective bargaining agreements which oblige the employer to employ members of a specific union are not valid.

Moreover, it is freedom of association which assures the existence and activity of the coalition itself, including the right to advertise for new members, the right to decide freely on its activities, the right to take part in labour conflicts and particularly the right to conclude collective bargaining agreements.

IV. Employers' Associations and Trade Unions

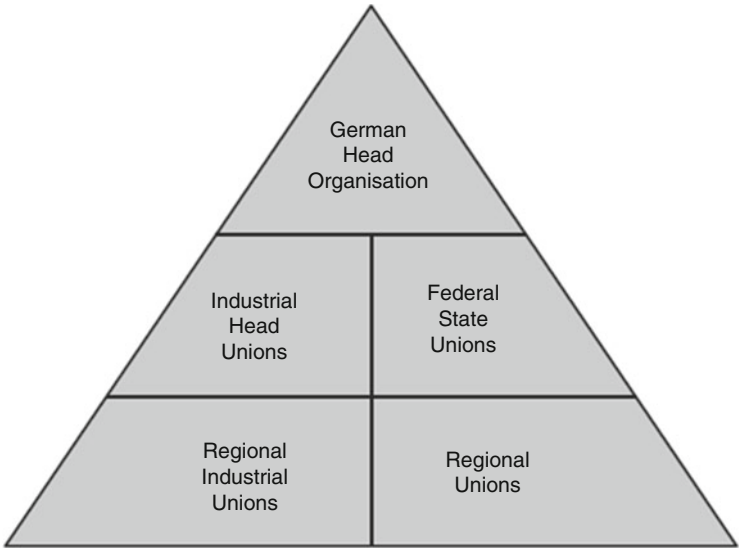
1. Employers' Associations

About 80% of employers in Germany are represented by employers' associations. The associations are organised either in the form of industrial unions or in the form of regional unions. Industrial unions encompass employers within the same industry, while regional unions encompass employers from the same region, regardless of which industrial sector they belong to.

Nevertheless, it is also possible for both types of unions to be combined into a regional industrial union (e.g. the union *Hessen Metall*, which is open to all employers of the metal industry in the region of Hesse). Regional industrial unions

regularly belong to industrial head unions (*Bundesfachverbände*) and regional unions to the respective federal state union (*Landesvereinigungen*), such as the *Vereinigung der hessischen Unternehmerverbände* (*V.h.U.*). For example, the aforementioned *Hessen Metall* is a member of the industrial head union *Gesamtmetall*.

Industrial head unions and federal state unions, on the other hand, usually belong to the Head of the German State Union (*Deutsche Arbeitgeberverbände e.V.* (*BDA*)) and/or to other head organisations such as the *Bundesverband der Deutschen Industrie e.V.* (*BDI*).



Example of the structure and relationship between employers' associations

2. Trade Unions

Trade unions are organised either as industrial or as professional organisations. Industrial organisations operate on similar principles to the employers' industrial unions: they are associations of employees working in the same industrial sector. The *IG Metall* union, for example, represents employees working in the metal, electronics, textiles and clothing, wood and synthetics sector, as well as employees in the information and communication technology sector.

Professional unions, on the other hand, are unions for members of the same profession, such as the *Marburger Bund*, the union for medical doctors.

At the head of the trade unions is the German Association for Trade Unions (*Deutscher Gewerkschaftsbund, DGB*), to which the majority of trade unions belong. In 2016, the *DGB* had 6,047,503 members from eight different Employees'

Associations. Usually trade unions are organised as associations without legal capacity.

Most of the professional unions, e.g. the *Marburger Bund, Vereinigung Cockpit e.V.* (*Cockpit*, a pilots' union), and the *Gewerkschaft Deutscher Lokomotivführer* (*GDL*, a train drivers' union), are not organised within the *DGB*.

V. Coalition Rights in Companies

Trade unions have numerous rights in companies in which they are represented. This is the case if at least one employee of the company, excluding the managing director, is a member of the trade union, and if the trade union is responsible for the company according to the terms of its own statute. Coalition rights in companies can be divided into three categories:

- The trade union has a controlling function in respect of the formation of works councils and compliance with the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*). The union has, for example, the right to appeal against the election of a works council because of its violations of law, or to file an application against the formation of a works agreement with the labour court.
- The trade union has a supporting function in relation to the activities of the works council. A representative of the trade union may participate in meetings of the works council as a consultant if 25% of the members of the works council make an application.
- The trade union acts as the counterpart to the employer. The union has the right to recruit new members within the company. For this purpose, the trade union is allowed to mobilise union members who are not employed by the company; these union members have the right to access the company.

B. Collective Bargaining

I. Background

The right to collective bargaining agreements overcomes the weaker position of the employee in relation to the employer, allowing for a balanced negotiation about working conditions. Thus, a collective bargaining agreement guarantees a minimum standard of working conditions, such as remuneration, working hours and holiday entitlement.

II. Forms of Collective Bargaining Agreements

A collective bargaining agreement is a contract between an employer or employers' association and a trade union. It can be concluded in different forms.

1. Collective Association Agreement

A collective association agreement (*Verbandstarifvertrag*) is a contract between two coalitions. On the one side, there is the trade union, representing the employee; on the other side there is the employers' association, representing the employer or numerous employers.

2. Collective Company Agreements

In collective company agreements (*Firmen-/Haustarifvertrag*), the trade union and the employer are directly involved. Instead of an employers' association, the employer itself is the contracting partner.

III. Preconditions for Collective Bargaining Agreements

There are certain preconditions, set out by the Collective Bargaining Agreement Act (*Tarifvertragsgesetz, TVG*), which have to be met in order to conclude a collective bargaining agreement.

1. Written Form

The agreement must be concluded in writing and must be signed by the contracting parties.

2. Capacity for Collective Bargaining

Only trade unions, their head unions, employers' associations and their head associations, and the individual employer itself have the capacity to be a party to the contract. Making collective bargaining agreements is part of the statutory duties and responsibilities of trade unions and employers' associations.

3. Competence for Collective Bargaining

Finally, the parties to the contract must have the competence to conclude collective bargaining agreements. The competence of trade unions and employers' associations is regulated by their own statute. The individual employer, however, is always competent for its own business.

IV. Scope of Application

The parties to the agreement must stay within their regional and factual competencies when setting the scope of the agreement. Thus, the parties can regulate whether the agreement will be applied regionally or nationwide and so on. The parties also define the companies to which the contract will apply. Often the agreement is narrowed to a specific sector (e.g. all businesses in the construction sector).

If both parties to the contract are organised according to the industrial association principle, the collective bargaining agreement is usually concluded for all businesses in the relevant industrial sector. Such a collective bargaining agreement is a contract applied to the whole industry (*Branchentarifvertrag*).

Furthermore, the parties have to decide upon the agreement's scope with regard to personnel. In this respect the agreement can be limited to certain positions, such as employees, apprentices and so on. Usually, collective bargaining agreements stipulate that key employees do not fall in the scope of agreement.

Finally, collective bargaining agreements often include regulations concerning the beginning or ending of the contract.

V. Effect of Collective Bargaining Agreements

Collective bargaining agreements combine two legal components which have different effects: on the one hand, they form legal obligations, giving rights and duties to the contracting partners ("contractual effect"). On the other hand, they have a normative component, meaning that they have an immediate and direct legal effect for employers and employees ("statutory effect").

1. Contractual Effect

Collective bargaining agreements place the contracting partners under legal obligations.

The following contractual duties always arise:

- During the term of the collective bargaining agreement the contracting parties may not call for labour disputes (e.g. strike).
- The obligation to ensure compliance with the provisions with statutory effect of the collective bargaining agreement. Note, however, that it is for the employers and employees to enforce the provisions with statutory effect.
- The obligations on employers' associations to ensure their members respect the provisions with statutory effect.

Another obligation which may arise is the duty to have arbitrational proceedings after the expiry of the contract.

2. Statutory Effect

The agreement has a statutory effect for individual employment contracts. It overrides the terms of the employment contract, even if the employer and employee did not have knowledge of the collective bargaining agreement.

The statutory effect of collective bargaining agreements has several practical consequences.

a) Priority Over Contractual Terms

The collective bargaining agreement overrides less advantageous terms of an individual employment contract. As the provisions of the collective bargaining agreement with statutory effect apply directly, the employment contract does not have to be amended for this to take effect. It is not even essential that the affected employer or employee is aware of the provisions contained in the collective bargaining agreement.

Due to the statutory effect of a collective bargaining agreement, a deviation from its terms is generally not allowed. However, there are two exceptions to this:

- More favourable terms

  Where a term in an employment contract differs from the collective bargaining agreement to the benefit of the employee, it will still be valid. The more beneficial rule will apply.

  The evaluation of whether a term in the employment contract is more favourable than a term in the collective agreement is made by an objective comparison of matters such as the number of holidays, remuneration during holiday, and the notice period.

  However, the evaluation cannot consider each contractual matter by itself but rather has to compare related subjects of the contract, e.g. all remuneration related clauses.
- Exemption clauses

  The collective bargaining agreement may provide for permissible exemptions by individual agreement or, which is common, by works agreement with the

works council. In such a situation, the individual agreement of the works agreement will overrule the collective bargaining agreement, even if it is to the detriment of the employee. Collective bargaining agreements often, for example, allow increasing the weekly working time for a limited number of employees by individual or works agreement.

b) Waiver, Cut-Off Periods

The waiver of collective rights is only permissible if the waiver is authorised by the parties to the collective bargaining agreement. However, many collective bargaining agreements provide for a specific deadline for the employee to bring forward his claim; otherwise the claim will forfeit.

VI. Binding Effect of Collective Bargaining Agreements

Collective bargaining agreements can generally apply to an employment relationship in the following situations:

- Immediate application since employer and employee are members of the respective association and union or the employer itself is a party of the collective bargaining agreement;
- Reference clause in the employment agreement;
- The collective bargaining agreement is generally binding (*allgemeinverbindlich*);
- Operational practice.

Collective bargaining agreements can be declared to be generally binding by the Federal Ministry of Labour and Social Affairs (*Bundesministerium für Arbeit und Soziales, BMAS*). In this case, employers and employees who were not previously bound by the agreement will then be covered by it.

1. Immediate Application

A collective bargaining agreement applies to an employment relationship on one side if the employer is either a member of the employers' association which has entered into a collective bargaining agreement, or if the employer itself is a party to the company agreement. On the other side, the employee has to be a member of the respective union which has entered into the collective bargaining agreement. Only if both sides, employer and employee, are bound by the bargaining agreement, the collective bargaining agreement applies to the employment relationship of the respective employees.

The provisions of the agreement are binding on the parties until it expires. It is important to note that termination of membership in the union or association will not end the responsibilities imposed by the agreement. The Federal Labour Court upholds this principle, considering it important to promote the stability of associations and to protect employees. The binding effect of the collective bargaining agreement shall not be evaded in cases where a party bound by it is dissatisfied with the regulations stipulated therein.

In this context, the consequences of a transfer of business (German implementation of the EU Transfer of Undertakings Directive) are of high practical importance. According to sec. 613 of the Civil Code (*Bürgerliches Gesetzbuch, BGB*), rights and obligations set out in a collective bargaining agreement will become part of the individual employment contract in the event of a transfer of business. This process is called transformation. No provisions set out in the agreement must be changed to the disadvantage of the employee until at least 1 year after the transfer of business. The 1 year period is irrelevant, however, if the agreement expires or if the acquirer's business falls under a different collective bargaining agreement. If the acquirer is part of another collective bargaining agreement which governs the same matter, those terms supersede the old contract and the old agreement is no longer binding.

2. Contractual Application

In order to ensure that the benefits of a collective bargaining agreement apply to employees who are not automatically bound by it ("outsiders"), individual working agreements often have reference clauses (*Bezugnahmeklausel*). Employers usually put such reference clause in all employment agreements in order to avoid administration of two different salary schemes and to avoid that all employees would immediately join the union to get the benefits of the collective bargaining agreement. Under a reference clause, the provisions of a collective bargaining agreement apply to those employees who are not members of a trade union. The question of which agreement will be applied depends on the wording of the reference clause.

The clause may refer to a specific version of a collective bargaining agreement. In this case, under a so-called static reference clause, only provisions of that specific collective bargaining agreement are binding. If the bargaining agreement is modified (e.g. salary increase), the "new" collective bargaining agreement is not covered by the reference clause.

The reference clause may make reference to the collective bargaining agreement for a specific region and industry effective from time to time (e.g. to the collective bargaining agreements of the metal industry in Bavaria). This is called a "small dynamic reference clause". If the employment agreement only refers to the collective bargaining agreements applicable to the business and effective from time to time, such clause is known as a "large dynamic reference clause". Therefore, through dynamic clauses, employees will participate in the modification of the collective bargaining agreement over time.

a) Jurisdiction of the Federal Labour Court

As dynamic reference clauses mainly have the purpose of treating all employees as if they were union members, the Federal Labour Court has interpreted dynamic reference clauses in the past as equal treatment clauses. As a result, if the employer's membership of the association ended, the reference clause lost its dynamic effect and only the current collective bargaining agreement was binding on the employees.

The Federal Labour Court has changed its position on this issue. Employment contracts signed after January 2002 are no longer interpreted as equal treatment clauses. Now it must be explicitly mentioned in the reference clause if it is to have the purpose of equal treatment. Otherwise, dynamic clauses are interpreted literally, in other words, as having dynamic effect. As a result, modifications of the contract, whether to the benefit or to the detriment of the employee, are binding.

b) Consequences of the Jurisdiction

The impact of legislation with regard to the transfer of businesses is interesting. In the event of a transfer of business, dynamic clauses guarantee that collective norms referred to in the individual employment contract will continue to apply.

Dynamic reference clauses entered into before 2002 are interpreted as equal treatment clauses. Therefore the specific collective bargaining agreement that was binding on the seller at the time of the transfer of business will apply. However, if a new collective bargaining agreement in the acquirer's business is binding on the employees who are union members, the same agreement will be binding on the "outsiders" due to the interpretation of the clause as an equal treatment clause. This holds true even if the new contract differs to the detriment of the employee.

Dynamic reference clauses in employment contracts signed after 1 January 2002 are not automatically interpreted as equal treatment clauses. The clauses are taken literally as dynamic clauses. Therefore, future modifications of the collective bargaining agreement will be binding on employees. As a result, different collective bargaining agreements may be applied in the same company depending on the date of the employment contract.

The question of the interpretation of dynamic reference clauses is also interesting where the employer resigns from the contracting association. The Federal Labour Court had to decide a case where an employment contract concluded in May 2002 included a dynamic reference clause. The employer resigned from the contracting employers' association and was not willing to continue to apply the collective bargaining agreement. The court ruled that the employer was obliged to apply the collective bargaining agreement referred to in the employment contract, even though it was no longer a member of the contracting employers' association. The reasoning of the court was that there was no evidence that the clause had the sole purpose of an equal treatment clause. Thus, resignation from the employers'

association does not result in the non-application of the relevant collective bargaining agreement.

3. General Binding Effect

Collective bargaining agreements can be declared to be generally binding. In this case, the agreement is directly and compulsorily binding on all employees. The Federal Ministry of Labour and Social Affairs may only declare the agreement to be generally binding if one party to the contract has applied for such a ruling, and if a commission of three members of each head association of employers and employees gives its consent to the declaration.

An exception exists for the construction and building cleaning industry, postal services, security services, laundry services, the coal mining industry, the waste industry, trade union institutions for further education, and butchery and meat processing services.

Under the Posted Workers Act (*Arbeitnehmerentsendegesetz*), all minimum employment conditions contained in collective bargaining agreements which have been declared to be generally binding are applied to employment relationships between employers which have their head office in one country and employees working for them in a different country. The collective bargaining agreement about a minimum wage for the electronics industry is one such agreement, whereby all employees of that sector are granted a specific minimum wage. These minimum wages agreed upon in collective bargaining agreements have to be distinguished from the statutory minimum wage according to the *MiLoG* (for further information see Chap. 8). The collective bargaining parties cannot agree upon a minimum wage that is lower than the statutory minimum wage and the statutory minimum wage cannot be subject to a cut-off period as is often agreed in collective bargaining agreements.

4. Operational Practice

A collective bargaining agreement may also be applicable to the employment relationships if the employer has actually applied such bargaining agreement over an extended period of time. However, future changes to the collective bargaining agreement will not apply based on this theory of operational practice (*betriebliche Übung*).

VII. Termination of Collective Bargaining Agreements

Collective bargaining agreements come into force either by signing the contract or within a specific date set out by the contracting parties. Retrospective

implementation is possible and quite common. The publication of the agreement is not a precondition for its effectiveness.

A collective bargaining agreement may end on an agreed expiry date, through the triggering of some condition in the agreement, regular termination, termination for good cause or by means of a cancellation agreement. The agreement also ends if one party to the contract (i.e. the employer or its association, or the trade union) resigns from its association. Normally, though, the agreement ends on its expiry date. In this case, however the agreement comes to an end, the post-termination effects must be considered.

VIII. Post-Termination Effects

As a period of time without the implementation of a collective bargaining agreement must be avoided, collective rules with statutory effect continue to exist, even if the agreement expires, until a new arrangement enters into force. As a result, the content of the negotiations which led to the original agreement will be protected.

Nevertheless, the Federal Labour Court has limited the post-termination effects to those employment relationships which were in force during the term of the collective bargaining agreement. Employment contracts which are concluded after the expiration of the collective bargaining agreement will not be covered by the post-termination effects.

As mentioned above, a new arrangement will override the effects of the previous agreement with post-termination effect even if it is to the detriment of the employee. A new arrangement may be in the form of a collective bargaining agreement, works agreement or individual agreement.

For example, an individual agreement granting 28 days of annual leave will override the provision of an expired collective bargaining agreement which granted 30 days of annual leave.

IX. Concurrency and the Principle of Tariff Unity

If an employment relationship is covered by multiple collective bargaining agreements, the agreements apply alongside each other, insofar as they differ in their content. If one matter is covered by more than one collective bargaining agreement, however, the concurrency of agreements, or the question of which agreement is to be applied, arises (*Tarifkonkurrenz*). As a result of overlapping agreements, the legal rules applying to an employment contract often conflict. According to the Principle of Uniformity, only one collective bargaining agreement, the one which is most specific, will be applied to the relevant employment contract. Whether one contract is more specific than another is decided by examining the geographical, factual and personal connection to the business. For example, a company agreement

will be more specific than an association agreement, a regional agreement will be more specific than a nationwide agreement, and so on.

Another situation where collective bargaining agreements conflict is the case of plurality of agreements (*Tarifpluralität*). This arises where numerous collective bargaining agreements would apply to employment relationships in the same business, i.e. one employer would have to deal with different unions.

For over 50 years, until 2010, the Federal Labour Court (*BAG*) was of the opinion that only the most specific agreement applies to the employment relationship, which is usually the collective bargaining agreement which would apply to most employees in the business (*Tarifeinheit*).

In 2010, the Federal Labour Court (*BAG*) changed this settled case law, arguing that there was no statutory basis for it. As a consequence, professional unions like the *GDL* (a train drivers' union) and *Cockpit* (a pilots' union) who do not represent the majority of the employees in their operations, made use of their right to strike and concluded collective bargaining agreements for their members. These collective bargaining agreements could stand beside other collective bargaining agreements in the same business because of the possibility of plurality of agreements.

On 10 July 2015, the Federal Act on Tariff Unity (*Tarifeinheitsgesetz*), which amended sec. 4a *TVG,* came into force. It stipulates that in a case where colliding collective bargaining agreements (i.e. collective bargaining agreements with different contents and from different unions) would be applicable in one operation, only the collective bargaining agreement of the union which represents most employees of the operation will be applicable. The union which represents less employees in the operation can, however, claim from the employer or the employer's association (as applicable) to sign a collective bargaining agreement just like the one of the union which represents most employees. Therefore all unionised employees would basically fall under the same collective bargaining agreements. Sec. 13 para. 3 *TVG* states that sec. 4a *TVG*, i.e. the principle of tariff unity, does not apply to collective bargaining agreements in force on 10 July 2015.

In early 2017 the Federal Constitutional Court (*Bundesverfassungsgericht, BVerfG*) reviewed the Federal Act on Tariff Unity and found that it was "mostly constitutional" (cf. Chap. 1). It explicitly stated that the Federal Act on Tariff Unity does not limit the right to strike. Even when it is clear from the outset that the Union leading the strike only represents the minority of employees in the operation and its collective bargaining agreement will therefore not prevail, the strike must not be considered unlawful or disproportionate solely for this reason.

C. Key Aspects

- Employers form employers' associations, whereas employees may represent themselves in trade unions. The generic term for both associations is "coalition".
- The right to join a coalition is guaranteed by the German Constitution. This so-called freedom of association also includes the right to refrain from joining a coalition.

- Employers' associations are based on industrial sectors and regional areas. Trade unions are categorised by industrial sectors and professions.
- Trade unions have special rights in businesses, such as being able to supervise the cooperation between a works council and the employer.
- Trade unions and employers' associations, or trade unions and employers, may regulate working conditions jointly through a collective bargaining agreement.
- Collective bargaining agreements form legal rules which apply directly and are binding to the individual employment relationships, just like ordinary statutory law.
- Collective legal rules are only binding upon members of the contracting unions and the contracting employer by making reference in the individual employment agreement or by a decision of the Federal Ministry of Labour and Social Affairs.
- The scope of application of the collective bargaining agreement is defined by the parties to the contract themselves.
- If a collective bargaining agreement expires, the collective provisions will stay in force until they are overridden by a new agreement (so-called post-termination effect).
- If two collective bargaining agreements apply to the same employment relationship, the more specific agreement will be applied.
- Where different collective bargaining agreements would be applicable for one operation, only the agreement of the union which represents more employees of the operation is applicable.

Chapter 20
Labour Conflicts

Jens Kirchner and Hanna Goedecke

A. Introduction

The German legal system does not explicitly regulate rights relating to labour conflicts. As a result, these rights are predominantly developed by jurisprudence and are mainly based on the guaranteed constitutional right of coalition. Labour conflicts are an admissible tool in negotiations concerning collective bargaining agreements, particularly in order to adjust the agreement to changed operational circumstances or the general business environment. Therefore, if negotiations fail, the parties may try to achieve the conclusion of a new collective bargaining agreement by putting pressure on the other party through labour conflict. Labour conflict means that usually the employees,[1] but sometimes also employers, are collectively and purposefully exerting pressure on the other party by disturbing the employment relationship. Most of the conflicts between employers and employees are related to salary issues or job retention. The most important instrument in a labour conflict is a strike, organised by a labour union.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Labour Conflict Practice

I. Principle of Parity

The aim of a labour conflict is to regulate employment issues in collective bargaining agreements. In order to achieve this, the principle of parity (*Prinzip der Kampfparität*) ensures the balance of powers between the parties. By virtue of this principle, labour conflicts are only admissible if they are appropriate and necessary to secure the balance of powers between employers and employees.

II. Employees' Instruments

1. Strike

The strike is the most effective and most important instrument for employees in labour conflicts. A strike is defined as the temporary and planned collective work stoppage of a larger number of employees in order to achieve a specific collective aim. The aim of a strike must be the achievement of a collective bargaining agreement, as the strike is an implementation of tariff autonomy. Therefore, the following requirements have to be fulfilled in order for the strike to be lawful.

a) Formal Requirements

A lawful strike has to be organised by a trade union and can only be carried out by, and against, parties who are able to be parties to the collective bargaining agreement. This is commonly the case where the employer is part of an employers' association and the employee is a member of a trade union. Nevertheless, employees who are not members of the trade union are entitled to participate in a strike.

So-called 'wildcat strikes' (i.e. strikes which are not organised by the trade union) are generally illegal.

The holding of a strike ballot (*Urabstimmung*), in which a certain majority of members of the trade union shall support the execution of the strike, is not considered a mandatory formal requirement.

However, a call for labour conflict (*Arbeitskampfaufruf*) has to be made known: the parties to the labour conflict need to be able to determine who made the call for labour conflict, which actions will be taken, and when the actions shall begin and end.

Generally, single employees are not allowed to strike by themselves. An exception to this principle can be made for an employee holding a key position. However, if the trade union makes use of the employee's extraordinary position (for example when he is the only crane operator) in order to put pressure on the other party this would have a disproportionate impact on the balance of powers. This would therefore lead to a violation of the principle of parity.

b) Purposeful Action

Another requirement for a lawful strike is that the strike must be aimed at a result that can be achieved by collective bargaining agreements.

Demonstration and protest strikes are unlawful if the purpose is to criticise or influence the employer, i.e. the aim is not to achieve a conclusion of a collective bargaining agreement.

Political strikes are illegal, as the aim is to gain concessions from public authorities and to put pressure on the parliamentary legislative procedure.

In 2007, the Federal Labour Court (*Bundesarbeitsgericht, BAG*) ruled that supporting strikes (*Unterstützungsstreik*) are considered legal. Strikes through which one trade union supports another in its labour conflict are lawful if a certain economic closeness exists between the businesses organised by the different trade unions. However, the supported strike itself needs to be lawful, since supporting an unlawful strike is unlawful, too.

Moreover, according to the Federal Labour Court, unions are entitled to strike for the conclusion of a so-called collective social plan (*Tarifsozialplan*) within the course of a change in operation. A collective social plan is quite similar to a social plan concluded with the works council, i.e. it shall compensate the economic disadvantages of the affected employees. However, since the union is party to the collective social plan, the regulations are usually significantly better for the affected employees than those regulated by a social plan with the works council on operational level.

c) Relative Peace Obligation

A so-called 'relative peace obligation' (*relative Friedenspflicht*) is immanent to every collective bargaining agreement, i.e. it does not have to be explicitly agreed upon. This means that no labour conflict concerning issues regulated by an applicable collective bargaining agreement may be held until the respective agreement terminates. The peace obligation is 'relative' since it only covers such issues regulated in the existing agreement. An 'absolute' peace obligation that prohibits labour conflicts for any issue would have to be expressly written down in the collective bargaining agreement in place between the parties.

d) Principle of Proportionality

The strike itself is governed by the principle of proportionality (*Verhältnismäßigkeitsgrundsatz*). This implies that the strike is only admissible after all other options for settling the issue have been exploited, which in turn means that all negotiations must have failed (the so-called 'ultima ratio' principle). The ultima ratio principle is of high importance in cases where employees refuse to work for a few hours during negotiations in order to put pressure on the employers. According to case law of the Federal Labour Court, such so-called warning strikes

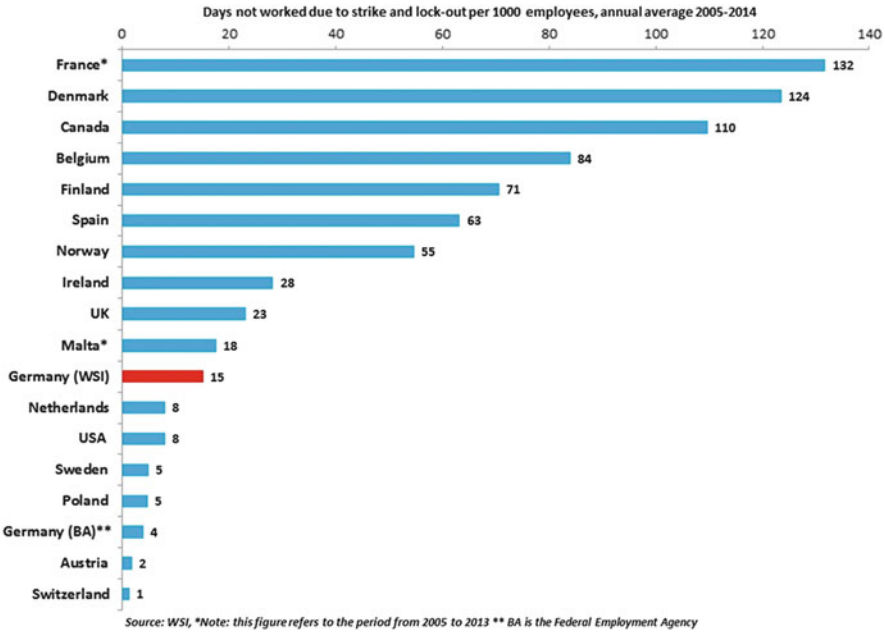
(*Warnstreiks*) are also restricted by the ultima ratio principle and are therefore unlawful if negotiations have not failed at the time of the warning strike. The warning strike itself implies that negotiations have failed and the failure does not have to be announced specifically to the employers.

Due to the principle of proportionality the trade union has to respect the principle of fair labour conflict measures. Therefore, certain actions may be considered unlawful and can lead to claims for compensation. As an example of this principle it is unlawful to prevent non-striking employees from getting to their workplace and fulfilling their duty to work.

It is also a violation of the principle of fair labour conflict measures if the trade union does not ensure a minimum of emergency and conservation measures. Emergency measures are measures necessary for ensuring the minimum supply of basic personal and public necessities. Conservation measures are essential measures which are necessary to ensure that at the end of the labour conflict the business is functional and that work can be immediately resumed.

e) Overview of Days Not Worked Due to Labour Conflicts Worldwide

According to union linked sources, the number of days not worked in Germany because of strikes is, in comparison to other countries, considerably moderate (*source: WSI, Hans-Böckler-Foundation*).



2. Further Instruments of Labour Conflict

The German Constitution (*Grundgesetz, GG*) does not limit the instruments of labour conflicts to certain types like strikes. Therefore, the labour unions may introduce new instruments of labour conflicts, as long as they are necessary and meet the requirements for lawful actions set out by the Federal Labour Court.

An action the employees might take is a boycott (*Boykott*). In a boycott a labour union appeals to employees who plan on continuing work in an operation where employees are on strike, and asks them to cease working in order to secure the success of the strike. If the only reason for the boycott is to ensure the effectiveness of a strike, without applying additional pressure on the employer, the boycott is considered legal.

So-called 'sit-ins' (*Betriebsbesetzung*), in which the employees on strike will not leave the operation, as well as business blockades (*Betriebsblockade*) are generally considered unlawful, since such measures violate the employer's rights regarding the business establishment, domiciliary right and the sole ownership of the production facilities.

Another instrument utilised by employees in labour conflicts is a slowdown strike ('*Bummelstreik*') or a restriction of work (*Teilsuspendierung*) respectively. With regard to these a distinction needs to be made: a clearly stated restriction of work, e.g. declaring that the employees will only work 50% until an agreement is reached, is comparable to a strike and therefore considered lawful as long as the general requirements for labour conflicts are observed. In a slowdown strike on the other hand the employees' poor performance is not carried out openly. The German Labour Courts consider this obscured 'strike' unlawful.

A recent instrument of labour conflict is the so-called flash mob (*Flashmob*). Such flash mobs mostly occur in the retail sector and are carried out to support a strike. For example, trade unions instruct their members to block retail stores by filling shopping carts with goods and then leave them standing in the aisles, or to buy one cheap item per person and thereby block the till. The Federal Labour Court (*BAG*) ruled in 2009 that flash mobs in support of a strike can be lawful labour conflict tools as long as the principle of proportionality is maintained: first, the employer must be able to recognise the flash mob as an action carried out and answered for by the labour union. Secondly, the labour union must be able to control the duration and extent of the flash mob. Lastly, the employer must have effective counter-measures, e.g. the possibility to exercise its domiciliary right.

A new possible instrument of labour conflicts that has not come to practical relevance yet is an interference with the internet or phone connection of an employer. In such actions, mass calls to the employer's hotlines or mass accesses to the employer's website might lead to a temporary breakdown of the IT and/or telephone system. These actions are being compared to flash mobs and are therefore considered lawful under the same conditions; however, there exist no court decisions on this matter yet.

III. Employers' Instruments

1. Lockout

The employer's most important instrument in labour conflicts is the lockout (*Aussperrung*). Even though the lockout is considered the most important employers' instrument in labour conflicts, it is only rarely used.

Through a lockout the employer rejects the offered work performance of the locked out employees and refuses to pay their remuneration. The lockout may only suspend the main obligations of the employment relationship, i.e. the obligation to work and the obligation to pay remuneration; it may not end the employment relationship.

Similar to the strike, a lockout is only admissible after the employer has made every effort in negotiations and must be approved by the employers' association, except in cases where a single employer is the party to the labour conflict. As a consequence, a 'wild' lockout is unlawful.

In practice, the lockout is always a 'defensive' lockout as a reaction to a lawful strike. A defensive lockout against an unlawful strike is considered unnecessary and therefore disproportionate, since there are legal means against unlawful strikes. Whether an 'offensive' lockout would be permissible is disputed and remains undecided, although a general inadmissibility seems unlikely.

The lockout has to maintain the principle of proportionality. In 1980, the Federal Labour Court (*BAG*) introduced a still applicable quota system regarding the quantity of employees affected in the course of lawful strikes:

- If less than 25% of the employees of the respective collective bargaining area are asked to participate in the strike, at the most 25% on top of these employees can be locked out.
- If 25% of the employees (or more) are asked to participate in the strike, the total sum of striking and locked out employees in the respective collective bargaining area may be 50%.
- If at least 50% of the employees are called to strike or are affected by the lockout, a further lockout is unlawful.

Nevertheless, the *BAG* tends to evaluate the proportionality of a lockout on a case-by-case basis. Therefore employers and employers' associations are well advised to not rely on the quota system for lockouts, but only consider it as a basis.

2. Further Instruments of Labour Conflict

Another possibility for the employer is to endure the strike with the help of the employees willing to work. As an incentive, a premium for employees who do not strike but rather carry out their work can be paid out. In order to be lawful, this strikebreaking premium (*Streikbruchprämie*) must be declared as such, be

proportional and offered during the labour conflict to all employees willing to work, regardless of whether they are union members or not.

Furthermore, the employer may temporarily shut down its undertaking where employees are on strike. As a consequence, the employees' obligation to work and the employer's obligation to pay remuneration are suspended. A temporary shutdown means that no work (except for emergency and conservation work) must be carried out, not even by the employer or third persons. The decision to temporarily shut down the undertaking has to be made known to all employees of the relevant undertaking in the usual manner. It has to be noted that the shutdown must remain within the scope of the labour conflict as set out by the call to the labour conflict (*Arbeitskampfaufruf*) of the labour union.

In case an employer is faced with a flash mob, it can either make use of its domiciliary right and expel the participants of the flash mob from the store, or shut down the store temporarily.

C. Legal Consequences

The end of a labour conflict will have different legal consequences for those who were involved and third parties who were not.

The legal consequences and especially the success of possible claims also depend on whether the actions taken by the parties to the labour conflict were lawful or not.

I. Consequences of an Unlawful Labour Conflict

In cases where the actions taken in a labour conflict do not meet the requirements set out by the Federal Labour Court (as explained above), the labour conflict is unlawful. This results in different consequences for the parties involved.

- Employer against labour union:
  - The employer can ask for an injunction against the striking union due to violations of its right to an established and operating business. A preventive claim for an injunction may exist in cases were the unlawful conduct is imminent. Furthermore, an injunction can be claimed on the basis of the peace obligation between the parties to the collective bargaining agreement since this also affords protection to the individual employer.
  - The employer may claim for compensation. However, this requires fault on the part of the union, i.e. the union must have known it was initiating an unlawful labour conflict. Given that the rules of labour conflicts are not regulated by law, the courts are very reserved in determining fault of the union.

  - The employer may even prevent a labour action from taking place through a preliminary injunction (*einstweilige Verfügung*) (see D. below).
- Employers' association against labour union:
  - The employers' association can also ask for an injunction. The legal basis for this claim is the obligation of peace agreed between the employers' association and the labour union which gets breached by an unlawful strike.
- Employer against employees:
  - Unlawful labour actions do not lead to a suspension of the main contractual obligations, i.e. for the employee the obligation to work or for the employer the obligation to pay remuneration. Therefore, employees who participate in unlawful labour actions violate their contractual obligations. The employer might have a claim for damages against the employee. However, a strike initiated by a labour union is generally presumed to be lawful and will only be considered unlawful if certain circumstances arise. The employee's participation in the strike is therefore generally considered lawful, too.
  - Another possibility would be that the employer terminates the employment contract of an employee who is participating in an unlawful strike; however, a prior warning (*Abmahnung*) is generally required. The decision about the employees to be dismissed has to be made on a factual basis, e.g. a leading position in the unlawful strike action.

II. Consequences of a Lawful Labour Conflict

1. Consequences for the Parties of the Labour Conflict

In the case of a lawful labour conflict, the labour union and employers' association are obliged by the principle of fair labour conflict measures to carry out organisational duties and to influence their members. For example, they have to make sure that emergency and conservation measures are carried out. The parties of the labour conflict also have the obligation to avoid labour actions which put a disproportionate burden on the other party. They therefore have to influence their members who do not respect these standards.

Another consequence of a lawful labour conflict is that the labour union and employers' association have to support their members, especially through so-called strike pay (*Streikgeld*) as set out in the articles of incorporation of labour unions.

2. Consequences for the Parties of the Employment Contract

The participation in a lawful strike leads to the suspension of the main obligations of the employment agreement, i.e. the employee's obligation to work and the

employer's obligation to pay remuneration. The striking employee is therefore not entitled to remuneration during the labour conflict. However, trade unions pay strike pay to their striking members for the duration of the strike.

The suspension of the main obligations begins with the employee's participation in the strike and ends with the offer to take up employment again.

Secondary obligations of the parties, for example the obligation of confidentiality or a non-competition agreement, remain unaffected during the labour conflict. Moreover, the employment relationship itself persists during a lawful strike. Therefore, the underlying main obligations will revive automatically as soon as the labour conflict ends. Explicit re-employment is not required.

III. Legal Consequences for Third Parties

Third parties not involved in the labour conflict can also be affected.

Where a company is directly affected by the conflict, e.g. where employees in key positions are on strike in an operation or where only some operations of a company are on strike, the rule of risk of labour conflict (*Arbeitskampfrisiko*) applies. According to this rule, the entitlement to remuneration of employees willing to work can be suspended if the employment is technically impossible or economically unreasonable for the employer because of the strike.

Even where a company is just indirectly affected, the employment of employees willing to work can be technically impossible or economically unreasonable for the employer. For example, a company can be indirectly affected if a labour conflict that occurs at a supplier company in collective bargaining area A affects the production of an employer in collective bargaining area B because of a lack of vendor parts.

Recently, the consequences for third parties affected by strikes in the travel sector have been subject to several court decisions. Strikes in the travel sector have increased in the past few years due to the upcoming of professional unions for so-called functional elites, e.g. the *Gewerkschaft Deutscher Lokomotivführer* (*GDL)*, a train drivers' union (see Chap. 19).

In its decision *Finnair* (4 October 2012—C-22/11) the ECJ stated that Council Regulation No. 261/2004 also awards claims to compensation and support to airline passengers when the operational reasons for flight delays or cancellations occurred due to a strike. In the underlying case the airline Finnair had to cancel flights because the airport staff in Barcelona was on strike.

The Federal Labour Court decided in 2015 (1 AZR 754/13) in favour of the unions that airlines that are not parties to the labour conflict themselves but who are affected by a strike of air traffic controllers do not have any damage claim against the labour union.

D. Preliminary Legal Protection and Conciliation

When a strike or other action of the labour union is unlawful, the labour court can prohibit it through a preliminary injunction (*einstweilige Verfügung*).

A preliminary injunction can be sought against a labour union by an employers' association or an employer threatened by a strike. Since a preliminary injunction has to be decided on in short time and affects the right of coalition activity, the court can only issue the injunction under the following strict requirements.

A preliminary injunction may only be issued where it is necessary to avert an essential disadvantage for the employer that a labour conflict would entail. Whether this would be the case has to be evaluated in an overall assessment and balancing of interests. However, the labour courts are quite strict and require the (envisaged) labour action to be clearly unlawful.

The preliminary injunction against actions of labour unions is of utmost practical relevance. In almost every huge labour conflict, employers try to prevent strikes from happening by calling to the courts for preliminary injunctions. Due to the fact that the (envisaged) labour action has to be obviously unlawful, the success rate of preliminary injunctions in practice is rather low.

A different way of settling labour conflicts is through a conciliation (*Schlichtung*). Through a conciliation a labour conflict can be prevented or brought to an end. Many collective bargaining agreements oblige the parties to the agreement to enter into a conciliation in case the negotiations for a collective bargaining agreement fail. The conciliation award (*Schlichterspruch*) is binding on the parties and has the same effect as a collective bargaining agreement. A conciliation by the state authority on the other hand is only possible on request of the parties.

E. Key Aspects

- Strikes as well as lock-outs are permissible labour conflict instruments for the enforcement of collective bargaining aims, as long as the legal prerequisites are fulfilled, especially the principles of parity and proportionality and compliance with the peace obligation and the principle of fair labour conflict measures are observed.
- Lawful labour conflicts result in the suspension of the main obligations of the employment relationship.
- Unlawful labour conflicts have no suspending effect, with the result that claims for damages against the employee may arise. Employment contracts may even be terminated.

- Labour conflicts shift increasingly from association level to individual employers. Even employers that are not members of employers' associations can be affected directly or indirectly by labour conflicts.
- A labour conflict can be averted by a preliminary injunction issued by a labour court when the envisaged labour conflict is obviously unlawful.

Chapter 21
Employee Representation

Pascal R. Kremp and Jens Kirchner

A. Introduction

German law provides for employee[1] representation at different levels. The most important employee representative body is the works council (*Betriebsrat*), a body elected by employees for a term of 4 years. The works council has to be consulted on a wide range of subject matters. However, the works council is usually not competent to negotiate salaries and other key terms of employment. This competence rests with the unions. The unions are usually nationwide organisations and do not only exist in a single company. Also, only unions have the competence to call for a strike. Key members of the works council, particularly in larger companies, are, however, often union members and have a say within the union. Employees are also represented in an "economic committee" (*Wirtschaftsausschuss*), a body of employee experts mainly appointed by the works council. The committee has a right to be informed of relevant economic circumstances of the employer. In large companies with significant operations within at least two member states of the European Union (EU) employees may set up a European Works Council, competent for matters affecting several countries.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Works Council

Employees in operations with at least five employees may elect a works council. The works council has to be informed and consulted in regard to certain matters; in some instances the employer might even need the consent of the works council, without which the employer would have to ask a conciliation committee (*Einigungsstelle*) to make the ultimate decision. Failure to involve the works council may mean that the employer cannot implement a measure, even though an employee might have agreed to it on individual level.

Whilst such participation rights of employee representatives might be unusual for foreign investors, the system has proven successful. The key to such success is to build up a trusting working relationship with the works council. This will undoubtedly take effort and patience at the beginning and will depend on the individual characters on both the employer's and the employees' side. In the long term it is better for the employer to be co-operative than to take a hostile approach. Employers are well advised to take an educated stance and treat the works council with respect. This does not mean that the works council should be permitted to be involved in areas where it does not have a say, but its statutory information and consultation rights (so-called co-determination rights (*Mitbestimmungsrechte*)) should be respected. Otherwise, if the relationship between employer and works council is frayed and full of distrust, this will be detrimental to both the employer and the employees.

The works council is the representative body of the employees. Key employees such as managing directors or board members are not represented by the works council and may not participate in the elections of the works council. The works council has no information and consultation rights with regard to these individuals.

Employers should also be aware that hindering the works council members in performing their office or trying to stop elections of a works council can constitute a criminal offence.

I. Elections

Employees in operations with at least five regularly employed employees, who are eligible to vote, may elect a works council. There is no legal obligation to elect a works council and the employer is not obliged to call for elections. In fact, in some industries such as IT, PR or marketing there may not be a works council in place, despite the fact that such operations have several hundred employees. For a long time a well-known German software company did not have a works council in an operation, despite employing several thousand employees.

The costs of the elections, including the time off of all employees to participate in the elections have to be borne by the employer.

1. Operation

A works council may be elected in every operation (*Betrieb*). An operation has to be distinguished from the legal entity (e.g. Limited Liability Company (*GmbH*)). A legal entity might have several operations.

Usually, every site with management responsible for taking all employee related decisions (e.g. hiring, dismissals) can be considered as an operation which is eligible for a works council.

Sometimes, two separate legal entities run a joint operation (*Gemeinschaftsbetrieb*) together. This is often the case with two companies who are part of the same group; these companies might take all employee related decisions together. In circumstances such as this, only one works council would have to be elected by the employees of both companies at this operation.

2. Eligible Employees

All employees over the age of 18 are eligible to vote, including agency workers who are to be employed for more than 3 months. This means, agency workers are allowed to vote twice, i.e. both in the lessor's operation and in the lessee's operation.

Generally speaking, all employees (not agency workers) over 18 who have been employed in the operation for at least 6 months are eligible to stand for election.

3. Election Process

The election procedure is governed in detail by law. A simplified two-step election process can be carried out in operations with 50 or less employees eligible to vote.

a) Regular Election Process

In operations with more than 50 employees eligible to vote a sophisticated election process has to be followed.

If no works council exists, three employees or a union represented within the operation may call for the election of a three member election committee in a staff meeting. If a works council exists, the works council has to appoint the election committee at least 10 weeks prior to the end of the term.

The election committee has to create a list of employees eligible to vote. Often, there will be discussions as to whether individual employees are key employees (and thus are unable to vote) or not. 6 weeks prior to the election date the election committee publishes an official announcement of the upcoming elections. Within 2 weeks of this announcement employees can be nominated as candidates. In order

to stand as a candidate, employees need a certain number of signatures of employees eligible to vote (depending on the size of the operation). Employees then vote on the list of candidates. The voting is done in secret. The election committee counts the votes and publishes the result of the election.

b) Simplified Election Process in Small Operations

In operations with 50 or less employees eligible to vote a simplified election process applies. The employees vote the election committee in a staff meeting. If a works council already exists, the election committee is appointed by the works council. During the staff meeting employees may hand in notification that they would like to stand as a candidate in the elections. The elections take place in a second staff meeting 1 week later. Again, the voting is done in secret.

4. The Timing of Works Council Elections and Term of Works Council Members

The works council is elected for a term of 4 years. Elections take place throughout Germany every 4 years from 1 March through to 31 May. The last elections took place in spring 2014, next elections will be in 2018, 2022, then 2026 and so on.

If elections take place during the 4 year period (e.g. because no works council has been in existence so far or the works council resigned) and only 1 year is left until the beginning of the next term, the elected works council will remain in office until the end of the next term.

Example: The works council is elected in summer 2019. This works council remains in office until spring 2022. If the works council is elected in 2021, it would then remain in office until spring 2026.

5. Size of the Works Council

The size of the works council depends on the number of employees regularly employed in the operation.

The size of the works council depends on the number of employees in the operation	
5–20 employees eligible to vote	1 member
21–50 employees eligible to vote	3 members
51–100 employees eligible to vote	5 members
101–200 employees[a]	7 members
201–400 employees	9 members
401–700 employees	11 members
701–1000 employees	13 members

(continued)

The size of the works council depends on the number of employees in the operation	
1001–1500 employees	15 members
1501–2000 employees	17 members
2001–2500 employees	19 members
2501–3000 employees	21 members
3001–3500 employees	23 members
3501–4000 employees	25 members
4001–4500 employees	27 members
4501–5000 employees	29 members
5001–6000 employees	31 members
6001–7000 employees	33 members
7001–9000 employees	35 members

In operations with more than 9000 employees the number of works council members increases by 2 for every further 3000 employees (e.g. in operations of 9001–12,000 employees there are 37 members and so on)

[a]From 101 employees onwards it is not decisive whether the employees are eligible to vote or not

6. Challenging Works Council Elections

If important rules of the election process have been breached, the elections can be challenged in court in the 2 weeks following the announcement of the results. The employer, three employees or a union having members in the operation can file such an application. If the court agrees that the process has been breached, the elections have to be repeated.

If the rules which have been breached are sufficiently important, so that someone might not call it a democratic election process, the elections are null and void. In this case, there is no time limit as to when the elections can be challenged and the 2 week deadline is not applicable.

7. Protection Against Dismissals

To ensure that the employer cannot hinder the election process, German law protects employees who are involved in the process against dismissal. Employees who call for elections, members of the election committee, and candidates for the works council are generally protected against dismissals until the end of the elections. They can only be given notice to terminate where there is significant cause (e.g. fraud) and if the works council or the labour court consents to the dismissal.

Members of the election committee and candidates may not be dismissed for a further period of 6 months following the official announcement of the results of the elections, except for significant cause. During this period the consent of the works council or the labour court is not required.

Since it takes very little effort to call for works council elections or to become a candidate—and given the protection against dismissal afforded to those involved—employers should carefully review any parallel restructuring measures. There have been cases where 80% of the entire workforce have suddenly signed up for candidacy, ostensibly for the protection from dismissal that they were then given. A court of appeal ruled that this would not have been an abuse of statutory rights.

II. Role of Members

Members of the works council enjoy wide protection in order to fulfil their office without interruption.

1. General

Members of the works council should not suffer any disadvantages, nor enjoy any additional benefits due to their office. The salary of members of the works council has to increase in accordance with the salary of comparable employees.

The works council usually holds regular meetings. In order to attend such meetings, and also for other works council related matters, the members have to be released from their duties on full pay. Indeed, in larger operations a specific minimum number of works council members have to be released from work on a permanent basis (see table below) in order to be able to carry out works council duties full-time. The number might be higher if necessary for the works council to perform its duties.

Number of members of the works council to be permanently released from work (depending on the size of operation)	
200–500 employees	1 member of the works council to be released
501–900 employees	2 members
901–1500 employees	3 members
1501–2000 employees	4 members
2001–3000 employees	5 members
3001–4000 employees	6 members
4001–5000 employees	7 members
5001–6000 employees	8 members
6001–7000 employees	9 members
7001–8000 employees	10 members
8001–9000 employee	11 members
9001–10,000 employees	12 members

In operations with more than 10,000 employees, one additional member has to be released per every additional 2000 employees (e.g. in operations with 10,001–12,000 employees—13 members, in operations with 12,001–14,000—14 members and so on)

Every works council member is also entitled to attend external training on how to perform his role as member of the works council. In general, members of the works council can claim at least 3 weeks' time off for training per 4 year term. Such training, like all other expenses, has to be financed by the employer.

To perform its duties, the works council may obtain professional advice (e.g. lawyers, consultants) if necessary. Again, such costs have to be borne by the employer.

2. Protection Against Dismissals

Members of the works council are protected against dismissal during the term of office and for 1 year after the end of term. During this period they may only be dismissed for good cause (e.g. fraud). During the 4 year term the works council has to consent to the dismissal of individual members. If the works council does not consent, the employer has to apply to the labour court for its consent.

Works council members can only be dismissed for significant reasons related to their employment relationship and not for reasons related to their office only (e.g. continual refusal to co-operate with the employer in relation to the works council). If a member of the works council is in gross breach of his duties as works council member, 25% of the employees in the operation, the employer or the union may apply to the labour court to withdraw the member from office. Such applications are usually filed in very rare circumstances only.

III. Information and Consultation Rights

The works council enjoys a wide range of information and consultation rights, in some cases even the right to veto decisions of the employer. The veto may only be overridden by a ruling of a mediation committee. Such rights are usually called "co-determination rights".

The works council has general information and consultation rights. The co-determination rights mainly concern three subject matters falling into the categories of personnel matters, so-called social matters, and economic matters.

1. Works Agreements

Where the works council has information and consultation rights, employer and works council may agree on a so-called "works agreement" (*Betriebsvereinbarung*). This is usually the case for social matters (see below). Such a works agreement is binding on all employees (except executive employees). If, however, the individual employment agreement, collective bargaining agreements or statute provides for terms which are more beneficial to employees, such

terms will override those in the works agreement. Employer and employee may not deviate from such works agreements to the detriment of the employee by individual agreement.

A works agreement may usually be terminated by giving 3 months' notice, unless otherwise stipulated in the agreement.

In areas where the employer needs the consent of the works council (in particular in social matters), the works agreement will remain in effect even after the expiration of the notice period (so-called "after effect" (*Nachwirkung*)). However, employer and employee may then deviate from the works agreement, even to the detriment of the employee, by individual agreement.

2. General Rights

The works council has general participation rights. The works council is, for example, obliged to ensure that all the laws, rules and health provisions are applied correctly and to the benefit of the employees. It should also prevent discrimination. In order to perform its job, the works council has to be informed by and provided with information from the employer.

3. Personnel Matters

The works council enjoys certain co-determination rights in relation to personnel matters. The co-determination rights concern three different areas: general personnel matters, continued professional education, and individual personnel matters.

a) General Personnel Matters

The employer has to inform the works council of staff planning, in particular on the current and future need for staff.

Upon request by the works council, an employer has to advertise job positions internally before looking externally.

Employee questionnaires (i.e. for job candidates or for current employees) and performance review schemes have to be agreed with the works council. If employer and works council cannot come to an agreement, the conciliation committee will find a ruling.

Employer and works council may also agree on binding "selection guidelines" particularly for hiring, transferring and dismissing employees. In the event of dismissals for business reasons such selection guidelines may, for example, provide for a specific number of points assigned to the employee for age, years of service, child and family support obligations, and disability. Such social selection may only be reviewed by a court for gross mistakes; the threshold for the court to establish gross mistakes is quite high in this respect.

b) Matters of Continued Professional Education

Upon request by the works council the employer and works council have to consult on continued professional education and development measures for employees. In particular, they have to consult on the need for such measures.

c) Individual Personnel Matters

This is, next to participation rights in social and in economic matters, one of the key areas in which the works council has a right to be involved.

aa) Hiring, Transfer and Regrouping of Employees

In operations with more than 20 employees the employer has to inform the works council prior to hiring an individual, prior to the transfer of an employee from one job position to another, and prior to an employee being moved from one pay grade to another. The works council has to be provided with all necessary documents, including the application form for the employee concerned, in order to make an educated decision.

The works council may only refuse its consent to such measures for specific reasons, e.g. if the measure would be in breach of the law, or if it is likely that other employees will suffer a detriment as a result. The works council has to notify the employer of its refusal in writing (including the reasons for the refusal) within 1 week since notification by the employer. If the refusal is too late or is in incorrect form, the works council's consent is assumed.

If the works council lawfully refuses its consent, the employer may ask the labour court to give consent in its place.

In urgent cases the employer might—despite the refusal of the works council—implement the measure anyway (e.g. hire an employee). However, the employer then has to ask the court for consent within 3 days.

bb) Dismissing Employees

Prior to giving notice to an employee the employer is obliged to inform the works council of the reasons for the dismissal. This can be done verbally. However, for reasons of proof it is recommended that this is done in writing.

The works council has 1 week to provide its comments on the proposed dismissal in writing. In the event of a dismissal for significant cause (e.g. fraud) the works council has only 3 days.

Even if the works council objects to the dismissal, the employer can still serve the dismissal letter to the employee. It is however imperative to await the 1 week or 3 days period prior to giving notice. Otherwise, the dismissal will be null and void.

The dismissal will also be null and void if the works council has not been duly and sufficiently informed on the reasons for the dismissal. In fact, many wrongful

dismissal claims succeed because the employer has failed to thoroughly inform the works council about the reasons for dismissal.

4. Social Matters

a) Catalogue of Co-Determination Rights

Pursuant to sec. 87 of the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*) the works council has powerful co-determination rights, particularly in relation to the following.

aa) Policies Relating to the Order of the Operation and Conduct of Employees

Prior to implementing policies which govern the conduct of the employees the employer has to obtain the consent of the works council. Typical examples of such policies are dress codes, access to premises, and prohibition of alcohol or drug use on the company's premises.

Also, certain provisions of a code of conduct/code of ethics are subject to the co-determination rights of a works council. US companies are unable to implement some types of code of conduct without the consent of the works council, even though they might be able to do so under US law, in particular under the Sarbanes Oxley Act.

Employers should take care when implementing whistle-blowing hotlines. Due to the past history of Germany, employees tend to be very sensitive to such hotlines, particularly if they allow anonymous reports. Such hotlines may be considered a tool of denunciation. However, due to a number of publicly well-known compliance cases in the last several years the public perception of such hotlines has improved. Nevertheless, the implementation of whistle-blowing hotlines is not only subject to the consent of the works council, but also to strict data privacy laws, i.e. multinational companies in Germany must observe the stringent provisions of the Federal Data Protection Act (*Bundesdatenschutzgesetz, BDSG*) and, from 25 May 2018 on, additionally the European Data Protection Regulation.

Depending on the content, employee handbooks might also be subject to co-determination rights.

bb) The Start and End of the Working Day and Allocation of Hours on Weekdays

It is up to the individual employment agreement and to collective bargaining agreements to determine how many hours per week employees have to work (e.g. 40 h per week). However, the employer has to agree with the works council on a general scheme regarding the allocation of hours on weekdays as well as the start and end time for every day. Such schemes include rules on flexible working times, schemes on shift work, and duty rosters.

cc) Temporary Increase or Decrease of Operational Working Time

The employer also needs the consent of the works council to temporarily increase or decrease the working hours for the entire operation or a group of employees. Usually, consent is only required if the employer is asking several employees (e.g. a department or a business unit) to work overtime or work on a weekend, not if it is only individual employees who are being asked to work overtime.

Also, the employer and works council have to agree on "short-time work" (*Kurzarbeit*), i.e. a general reduction of working time with equivalent reduction of salary for a group of employees. Such "short-time work" is supported by the Federal Employment Agency as an appropriate means to overcome a temporary period with a reduced work load due to economic reasons (e.g. loss of customers).

dd) Introducing and Using of Technology to Control the Conduct or the Performance of Employees

The implementation of any technology which may potentially be used to monitor performance or conduct of employees has to be agreed on with the works council. Such systems include video surveillance and the recording of personal internet or email use. Also, computer software used to evaluate performance has to be agreed on with the works council. Depending on the circumstances, video or computer evidence which has been obtained without the consent of the works council may not be used against the individual employee.

ee) Implementation of "Social Institutions"

Employer and works council have to consult and agree on any kind of "social institutions", i.e. institutions which are to the benefit of employees, like a cafe or on-site childcare facilities. Such "social institutions" also include the implementation of a company pension scheme.

ff) Operational Pay Scheme

The implementation of any remuneration scheme has to be consulted on with the works council. If the pay scheme is already governed by collective bargaining agreement—which is often the case—only a remuneration scheme which supplements the collective scheme has to be agreed on with the works council.

Typical issues to be consulted on are the implementation of bonus schemes, stock options or other long-term incentive schemes. The works council does not have the ability to determine whether the scheme is introduced nor can it decide the level of remuneration. These decisions remain solely with the employer. However, once the employer has decided to introduce a scheme, the structure of the scheme has to be agreed on with the works council.

In multinational companies there is usually no leeway to change the terms of a stock option or long-term incentive scheme since such schemes are implemented on

a global basis. When this is the case, it is usually advisable for the employer to make it a "take it as it is or leave it" decision for the works council since the scheme is usually only an additional benefit for the employees and not part of their contractual entitlement.

b) Conciliation Committee

If employer and works council cannot come to an agreement on the aforementioned social matters, either party may call for a conciliation committee (*Einigungsstelle*). This is an internal committee which may either be established permanently or from time to time as and when necessary. The conciliation committee consists of an equal number of representatives from the employer and the works council. Both parties have to agree on a chairman, who is usually a judge. The appointment of the chairman itself might take weeks or months if one party is uninterested in reaching a quick resolution. The committee will then come to a final ruling which is binding for both parties and may be reviewed before a court only in very limited circumstances. If the chairman is not able to mediate an agreement between employer and works council, he or she has to take a final decision on the matter at hand.

The costs of the committee are, as all works council related costs, to be borne by the employer.

c) Remedies for Breach of Co-Determination Rights

Where the works council has co-determination rights it may stop the employer from implementing such matters without the agreement of the works council or the mediation committee by injunction. In urgent cases, the works council may even make an application for a preliminary injunction. Also, if the employer is in breach of mandatory co-determination rights of the works council, measures taken with regard to individual employees are null and void. Individual employees would not have to follow such measures or instructions of the employer.

5. Economic Matters

In the event of a significant restructuring—so-called changes of operation (*Betriebsänderung*)—the employer is obliged to inform the works council in good time and to consult with the works council on such measures before their implementation.

Changes of operations which are subject to the information and consultation rights of the works council are:

- Reduction or closure of operations or significant parts of it
- Relocation of the entire operation or significant parts of it

- Merger or split of operations
- Major changes to the organisation or the purpose of the operation
- Introduction of new working methods

Generally speaking, the employer is only obliged to inform and consult with the works council if a significant number of employees is affected, i.e. dismissed. Case law uses the thresholds for mass redundancies as a rough guide as to when the obligation to inform and consult arises. There is no obligation to consult with the works council in operations of 20 or less employees.

Employers are obliged to inform and consult with the works council if a specific number of employees are affected depending on the size of operation:
21–59 employees: more than 5 employees
60–499 employees: more than 25 employees or 10%
500 or more employees: at least 30 employees and exceeding 5% of all employees

If the threshold is met, the employer and works council have to negotiate a so-called balance of interests and a social plan. The balance of interests describes the restructuring measure (e.g. relocation to a different city, dismissal of 300 employees). The social plan sets out the compensation for the employees affected (typically severance payments, but may also include other benefits such as commuting allowance, moving expenses).

The works council has a statutory right to be informed at an early stage, so that it has the opportunity to influence the business decision of the employer. Ultimately, however, the works council cannot prevent the implementation of the restructuring measures as planned by the employer. If the employer is unwilling to reconsider its measures, the works council has the ability to heavily delay the implementation. Employers are well advised to thoroughly prepare any restructuring measures before approaching the works council to avoid lengthy negotiations.

Depending on the competent court, employers might be able to implement the restructuring measures without informing and consulting with the works council or without completing such negotiations. This would, however, be regarded as a highly aggressive approach which might have a negative impact on the reputation of the employer. Individual employees may also be able to claim compensation from court for their economic detriment. In other jurisdictions, courts might issue a preliminary injunction upon request of the works council. Such injunction is very troublesome for employers and immediately stops the implementation of any restructuring measures; otherwise the employer faces administrative fines of up to 250,000€ or 6 months imprisonment.

For further detail on restructuring measures see Chap. 22.

C. Central and Group Works Council

I. Central Works Council

As set out above, a company, i.e. a legal entity, might well have several operations. If at least two works councils have been created, a so-called central works council (*Gesamtbetriebsrat*) has to be appointed.

The local works council is only competent for matters at the local level. The central works council is competent for matters affecting at least two operations of the same company. For example, if the employer decides to shut down only one site, only the local works council is competent to negotiate a balance of interests and a social plan. If the restructuring measures, however, affect several sites, the central works council is likely to be competent.

The central works council, however, is not competent for local matters in operations where no works council exists at all. Thus, if the employer decides to shut down one site where no works council has been set up, it is not obliged to inform and consult with the central works council.

In practice, it is not always easy to establish whether it is the local works council or the central works council who has the competence. It might even be that the two works councils argue about their position. In cases such as this employers are well advised to ask the local works council to give the central works council the authority to negotiate on behalf of the local works council.

II. Group Works Council

Similar to the central works council at company level, the central or local works council may also set up a group works council (*Konzernbetriebsrat*) at group level. The group works council is competent for all matters affecting at least two operations of two different companies (e.g. group-wide restructuring measures).

D. Economic Committee

In companies with more than 100 employees the works council has to set up an economic committee (*Wirtschaftsausschuss*) consisting of three to seven members. The members of the works council have to be employees of the company; this may also include key employees. At least one member has to be a works council member. The purpose of the economic committee is to be informed by and consult with the employer on economic matters, in particular:

- The financial situation of the company
- Production and investing programmes
- Reduction, closure or relocation of sites
- Changes of production methods
- Planned takeovers or changes of control of the company

In smaller companies, where no economic committee exists, the works council has to be informed on planned takeovers and changes of control.

The economic committee usually holds meetings on a monthly basis. If the economic committee believes that it has not been informed sufficiently or within due time, it may call the conciliation committee who will then determine the issue. However, the economic committee does not have real power to enforce its rights.

E. European Works Council

Employees in companies or groups with at least 1000 employees within the European Union and at least 150 employees in each of two member states may set up a European Works Council. The European Works Council is governed by a EU Directive (Council Directive 94/45/EC) which has been implemented by a national act in each member state. The Directive has been reviewed in 2009 which led to minor changes in the national act implemented in Germany in 2011. The main purpose of the Directive is to prevent national information and consultation rights from being circumvented solely because the ultimate business decision is made by the management in another member state.

The main concept behind the Directive is for the company or group and employee representatives to agree on the structure of the European Works Council and its information and consultation rights. If no agreement can be achieved, the European Works Council can be set up based on statute.

Whilst the European Works Council itself does not have a particularly powerful position, employers are nevertheless well advised to respect the information and consultation rights of an existing European Works Council since its members are usually also employee representatives at national level where they might have much stronger participation rights.

I. European Works Council Based on Agreement

At least 100 employees or the employee representatives in at least two member states or the employer itself may call for the formation of a special negotiation committee. Such a committee consists of employee representatives from each state.

The purpose of the committee is to negotiate an agreement on cross-border information and consultation of employees with the employer. The agreement on

the employee representation is at the full discretion of the employer and the negotiation committee. If employer and negotiation committee come to an agreement, the agreement should be made in written form and include:

- The names of all companies and operations covered
- The composition of the European Works Council
- The competence of the European Works Council and procedure of information and consultation
- The location and periods of meetings of the European Works Council

II. European Works Council Based on Statutory Laws

If the company refuses to negotiate on the European Works Council, the employee representation bodies (which may vary from country to country) appoint the European Works Council.

The European Works Council generally consists of one member from each EU member state where the company has operations. Depending on the size of business in a member state the number of representatives may increase. Members are appointed for a 4 year term.

The European Works Council is competent for matters which affect at least two operations or companies in at least two different member states, in particular:

- Information on the development of the business and the perspective of the company (including financial situation, planned reorganisations, mass redundancies) on an annual basis, including providing relevant documents upfront
- Information and, upon request, consultation on unexpected circumstances which may have a significant impact on the interests of the employees, in particular the relocation or closure of companies or operations, and mass redundancies

Failure to inform or consult with the European Works Council may result in administrative fines of 15,000€.

F. Agency Workers and Thresholds

For employers which employ agency workers leased from other companies in their German operations, it is of critical importance to assess in each case where one of the above thresholds becomes relevant, whether the agency workers must be taken into consideration when calculating the number of employees. In general, agency workers count too if they are to be employed for more than 3 months. Only few exceptions apply.

G. Key Aspects

- Employee representation takes place at different levels: on the business level by the works council, in economic matters by the economic committee, and on European level by the European Works Council.
- Employees in operations with at least five employees may elect a works council—although there is no legal obligation to do so. Employers are well advised to build a trusting relationship with an existing works council, recognising its rights, but not over-participating with it.
- The works council is fully financed by the employer.
- Members of the works council, the election committee and candidates for the works council enjoy significant protection against dismissal.
- The works council has considerable information and consultation rights, in some instances even the right to veto, which may be overruled by a mediation panel.

Chapter 22
Restructuring

Michael Magotsch and Jens Kirchner

A. Introduction

This chapter shall address the means of restructuring operations in Germany from a labour and employment point of view. It will focus on (1) short-time working; (2) reduction in force (RIF) programmes including changes of operations in the meaning of sec. 111 of the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*) and issues relating to the transfer of undertakings and three examples of common restructuring scenarios.

B. Short-Time Working

In Germany, short-time working (*Kurzarbeit*) may be an attractive temporary measure for cost reduction in order to avoid lay-offs. As the employees'[1] working hours are reduced, they are only remunerated for the reduced hours of work by the employer.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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I. Preconditions

German law requires a legal justification for the establishment of short-time work. In respect of the change of working hours, German law usually provides that such measures require an individual agreement with each employee or modification dismissals (*Änderungskündigungen*) of the individual employment contracts. Businesses with a works council can implement an agreement with their employee representative body in order to establish short-time work for the employees. Collective bargaining agreements setting out preconditions for short-time work (e.g. notice periods for the introduction of short-time work) may also be in place, and if so, these will bind the company.

In order for employees on short-time work to be entitled to a short-time allowance (*Kurzarbeitergeld*) by the employment agency the employer must file an application with the competent employment agency. The employer has to demonstrate an unavoidable temporary and significant loss of work (resulting in at least 10% gross salary reduction) and must show that the statutory requirements for the receipt of short-time allowance are satisfied.

There is a 3 month exclusionary period for the application of short-time work benefits following the last month of short-time work. Forms for the indication of short-time work and application for short-time allowance will be provided by the employment agency and need to be followed closely.

II. Content of Short-Time Allowance

The maximum period for the grant of short-time allowance is generally 6 months; for employees whose entitlement to short-time allowance arose on or before 31 December 2015 this period can be extended to 12 months.

The short-time allowance amounts to 60% (67% in case of existence of dependent children) of the net salary difference resulting from the reduced working hours during the period of eligibility. It is free of income tax for the employee (the employment agency pays the short-time work benefit to the employer who forwards it to the employees).

C. Reduction in Force Programmes

RIF programmes in Germany are often complex and demand careful advance planning. This is particularly true for companies having a works council and in cases where the number of affected employees exceeds the collective dismissal filing requirement (see Sect. III).

I. Action Plan and Timelines

The time frame and in particular the duration of the information and consultation process with the works council is very difficult to predict. Thorough preparation is the key driver for an efficient consultation process. Also, the motivation or frustration of the work force confronted with potential RIF programmes heavily depends on the age and job role profiles of the employees—in general, employees are less resistant to RIF programmes the younger and less senior they are.

The length of negotiations with the works council over agreements to balance the interests of the parties and the social plan (*Sozialplan*) heavily depend on the support of local German management and staff support from human resources in providing the preparatory work (e.g. drafting of a "story book" for works council information and consultation, notification of works council on each individual dismissal; preparation of mass dismissal filings etc.). The negotiations usually last from a few months up to 9 months. In this estimated timescale, mediation and consequential wrongful dismissal cases before German labour courts are not included.

The implementation of RIF programmes may for example be divided into three phases.

1. Preparation (Phase 1)

1.1 Internal preparation

- Planning of the restructuring measures
- KEY: Drafting of a "story book" for works council information and consultation
  - Reasons for restructuring measures
  - Units/employees affected
  - Timing for implementation of restructuring
- Rehearsal of works council presentation with local management
- Drafting of Q&As (from employer's and works council's perspective)

1.2 Written resolution to "plan" restructuring measures

- Resolution by the board/local management to plan restructuring measures; rough description of such planned measures

2. Information and Consultation with the Works Council (Phase 2)

2.1 Information of works council in Germany on restructuring measure

- Presentation of "story book" by management
- Usually preparation of responses to Q&A's by works council
- Agree on fixed meeting schedule

2.2 Works meeting with all employees to inform on planned restructuring measure
2.3 Consultation with works council on planned restructuring measure and on compensation of detriments suffered by employees

- Consultation usually results in two agreements with the works council: a so-called "balance of interests" (*Interessenausgleich*) describing the measure, and a social plan providing compensation to employees suffering detriment (e.g. severance payment)
- Time (information and consultation): subject to the individual case, the time frame may need to be adjusted as and when a more precise estimation for the timing is possible
- If the consultation on the restructuring measure fails: Mandatory conciliation committee proceeding (*Einigungsstelle*)
  - The conciliation committee will consist of representatives of employees and the employer, and both sides have to agree on a chairman (usually a labour judge). Obtaining agreement between the parties on the appointment of a chairman can take a considerable amount of time, often several weeks.
  - The chairman may rule on the social plan, but not on the balance of interests.
  - The entire conciliation committee proceeding can take a few weeks or several months.
  - Please note that some labour courts grant preliminary injunctions for the benefit of works councils if employers attempt to implement restructuring measures prior to finalising negotiations with the works council (e.g. preventing employers from serving dismissal notices prior to this, or transferring services or assets to other subsidiaries, operations or locations (please also refer to Sect. III para. 2 below).

2.4 Works meeting for all employees on outcome of consultations

3. Implementation (Phase 3)

3.1 Filing for collective redundancies with local labour agency

- Dismissal letters should only be served after written confirmation of filing of the complete documents

3.2 At the same time: Notification of works council on each individual termination
3.3 Potentially application to competent authorities to permit termination (e.g. in case of maternity or parental leave or in case of severely disabled employees)
3.4 Service of termination letter to each employee (usually no earlier than 1 week after notification to works council)
3.5 Expiration of individual notice period
3.6 Individual court proceedings with employees challenging the effectiveness of the termination

Generally about 10–30% of employees file a claim to the court; nevertheless, the number might be higher if employees feel that a reasonable severance has not been offered.

Court cases often end up with higher severance payments to be bargained.

The vast majority of cases get settled at first instance before court.

II. Geographical, Material and Personal Scope

The Works Constitution Act (*BetrVG*) applies to all businesses located within the Federal Republic of Germany (so-called principle of territoriality), irrespective of who the owner of the enterprise in question is. It does not apply to any businesses located abroad, even if they are owned by German enterprises. An exception can apply to German employees temporarily sent abroad who might still be subject to certain regulations of the Act (*Ausstrahlungswirkung*).

The Works Constitution Act covers any operations (*Betriebe*), as well as any ancillary plants and units (*Betriebsteile*; see sec. 4 of the Works Constitution Act).

It applies to all employees except for directors and so-called executive employees (*leitende Angestellte*) within the meaning of sec. 5 para. 3 of the Works Constitution Act. This distinction can create significant problems in individual cases. In practice, however, it can often be assumed that only the management level directly below the managing directors (*Geschäftsführer*) of a company may be regarded as executive employees. Moreover, in many cases proxy holders will be deemed executive employees.

In wrongful termination cases it is common for employees to claim that they are not executives. If the employee was considered as an executive in the last works council election, this may be indicative in determining whether an employee is an executive or not. When in doubt, the works council should be consulted as a precaution prior to any termination.

III. Works Council's Rights of Co-Determination

Co-Determination exists in personnel, social and economic matters. The following explanations concentrate on the latter in the context of restructuring measures.

1. Change of Operations

According to sec. 111 of the Works Constitution Act, the employer of enterprises which generally have more than 20 employees who are eligible to vote for the works council must inform the works council in a timely and comprehensive way

about any planned operational changes which may result in material detriments to the workforce or large sections thereof. Such operational changes include:

- Reduction and closure of the entire operation or of significant parts thereof
- Re-location of the entire operation or significant parts thereof
- Merger with other operations or the spin-off of operations
- Fundamental changes to the organisation of the operation, its purpose or its facilities
- Introduction of fundamentally new working methods or manufacturing processes

The most common case is the reduction or closure of a large section of the operation. Whether or not a "significant" part of the operation is affected is assessed based on its importance within the organisation of the operation as a whole. Under case law, a "significant" part of the operation is involved if, pursuant to the thresholds in sec. 17 of the Dismissal Protection Act, the following staff reduction occurs:

Threshold Consultation Requirement	
Size of operation	Intended layoffs
21–59 employees	More than five employees
60–499 employees	More than 25 employees or 10%
500 or more employees	At least 30 employees; but at least 5% of the employees

The decisive factor is the number of employees who will be affected, even if the layoffs will take place in several "waves." If there are periods of only a few weeks or months between the various "waves", there is a factual presumption that such measures stem from one overall business plan.

An operational reduction within the meaning of sec. 111 of the Works Constitution Act generally also requires that material operational resources are reduced. Settled case law holds, however, that a mere reduction in personnel while maintaining material operational resources also constitutes a reduction in operations. Case law, however, requires that in the case of major operations at least 5% of the employees are affected by the reduction.

Another question to consider is whether redundancies without alteration to material operational resources create an obligation to enter into an agreement for a social plan with the works council. Sec. 112a para. 1 of the Works Constitution Act provides for this case for additional thresholds of affected employees to be met.

2. Balance of Interests

If an operational change is planned, the works council must be timely and comprehensively informed. The works council has the right to negotiate the envisaged operational change as well as the intended timing for the execution hereof with the employer.

The works council may be able to obtain an interim injunction to assert these negotiation rights in several state labour courts. In such cases, the employer is prevented from dismissing employees or executing any other changes until the conclusion of the discussions concerning the balancing of interests. This type of case law exists, for example, in the states of Berlin, Brandenburg, Hesse, Bremen, Hamburg, and parts of North Rhine-Westphalia, Mecklenburg-Western Pomerania, Lower Saxony, Schleswig-Holstein and Bavaria.

Please note that—in the worst case scenario—even if the employer has given the works council comprehensive information, the procedure to balance interests does not automatically end at some fixed term period. It may therefore, in principle, be extended without any limitation. To conclude these negotiations, the employer needs to initiate a so-called conciliation committee proceeding (*Einigungsstellenverfahren*).

The negotiations with the works council may result in the conclusion of a so-called balance of interests (*Interessenausgleich*). The balance of interests is intended to determine the particular measures of the change in operations, the number and scope of affected employment relationships and the way in which the employment relationships are affected.

The preparation of such balance of interests negotiations need to start in due time prior to any meetings with the works council in order to have a detailed action plan as well as a back-up plan with respect to the alternative individual measures to be taken.

3. Social Plan

In the event of an operational change within the meaning of sec. 111 of the Works Constitution Act, the employer is obliged to conclude a social plan (*Sozialplan*).

The social plan mitigates the economical disadvantages the employees may suffer from the operational change. The means offered in a social plan depend on the concrete measures resulting in the operational change. A typical form of mitigation is, for example, severance payments in case of termination or the payment of moving costs in case of relocation. The contracting partners are, in general, free to decide upon the means that shall be granted to the employees.

The benefits under a social plan are only meant to mitigate the disadvantages suffered by the employees due to the operational change. Further, general principles of employment law need to be observed. As a consequence, the payment of severance payments may not be made subject to the condition that the employees do not file a wrongful dismissal claim. Further, e.g., the equal treatment principle and other regulations against discrimination have to be observed (see Chaps. 3 and 11) when setting up a social plan.

Should no agreement on a social plan be reached, a conciliation committee proceeding needs to be initiated. If the parties are unable to agree on the chairman of the conciliation committee and the number of representatives for each side, then,

upon application by the employer/works council, the competent labour court will decide on the above.

If no agreement on the content of the social plan can be reached by the parties during the conciliation proceeding either, the conciliation committee will decide on the social plan. This potential enforcement of the social plan by the conciliation committee is the decisive difference between the conclusion of a balance of interests and a social plan. Unlike the parties of the social plan, the conciliation committee is bound by certain guidelines stipulated in the Works Constitution Act when setting up the social plan. Thereafter, for instance, the social interests of the employees and the economical defensibleness of the decision for the company have to be respected.

The social plan may be rescinded in limited circumstances only (sec. 76 para. 5, s. 4 of the Works Constitution Act): within 2 weeks, the employer or works council can rescind the social plan, by claiming that the conciliation committee has exceeded its discretionary authority.

Also, mere redundancies may require the preparation of a social plan. However, this is only the case if the thresholds pursuant to sec. 112a of the Works Constitution are met. A social redundancy plan must be prepared, for example, if in an operation having at least 60 but less than 250 employees, 20% of the regularly employed workers or at least 37 employees are intended to be dismissed for operational reasons. "Dismissal" includes also the conclusion of an agreed termination under a settlement agreement triggered by the employer.

Labour unions are—according to case law—allowed to increase pressure on the employer to conclude collective social plans which satisfy the demands of the employees. In this respect the labour union may even call upon the employees to arrange a lawful strike. As a strike is regularly followed by enormous costs, employers can be forced to conclude social plans rapidly. Consequently, social plans may—under the pressure of the labour union—strongly benefit the employees.

Such strike is only lawful, though, if matters are concerned that are currently not collectively regulated. It has to be noted, though, that social plans are often not part of collective bargaining agreements. In order to avoid the impact of a strike, it is therefore often advisable to try to quickly conclude a satisfactory social plan with the works council before the labour union gets involved.

4. Transfer Company

Transfer companies (*Transfergesellschaften*) often play a major role in larger redundancies and restructurings that involve a large number of dismissals. In such complex scenarios, unions and works councils often insist on transfer company schemes being part of any social plan negotiations. The provision of transfer companies shall enable companies to reduce headcount in a "socially reasonable" manner and to allow employees to prepare for new employment challenges and opportunities out of a status of employment for up to 12 months. Further points of

interest for the employees to be made redundant are continued insurance in the statutory social security systems, in particular the statutory pension schemes, professional qualification, coaching and training as well as "risk free" trial employment with potential new employers. The costly introduction of transfer companies will ultimately delay the point of unemployment of the employees during the term of the transfer company. The companies may also benefit from transfer companies by improving their liquidity, transferring long notice period payroll payments into funding the transfer company and avoiding wrongful dismissal claims. Further, under certain circumstances, the employees in such a transfer company may also receive a special kind of short time allowance by the employment agency.

Please note that not each and every restructuring will justify the establishment of a transfer company. Strategic ideas in connection with the partial sale of assets or units may, however, be a reason for considering the tool of a transfer company in addition to or as replacement of a social plan. Often potential investors make any transfer depending on a large amount (if not all) of the employees being transferred to a transfer company prior to any transfer of business. The majority of transfer companies have a union background or are run by former union representatives or lawyers who are specialised in representing works councils and/or unions. Therefore, time is needed to carefully analyse the offered set-up of transfer companies, their quality as well as all involved costs and administrative responsibilities prior to agreeing to any transfer company.

5. Transfer of Undertaking Related Issues

While it is well established that the transfer of an undertaking (also known as transfer of business) by virtue of law pursuant to sec. 613a of the Civil Code (*BGB*) does not as such constitute a change in operations in general, in most of the typical asset deals, a partial transfer of business almost always leads to further measures that have to be considered as operational change.

This is particularly true when a restructuring plan results in the relocation of part of the unit, fundamental changes in the organisation of this unit, or the restriction and/or closing down of the entire business or major parts of it.

In the majority of cases it will be difficult to allocate the individual employees to the individual measures which are intended by the restructuring and transfer of the business parts into individual units.

Therefore, in such cases the works council will be in a position to easily construct a scenario that requires the commencement of negotiations for a social plan and a balance of interest under sec. 111 *et seq*. of the Works Constitution Act. In such situations it is essential to undertake the preparation well in advance (prior to any meetings with the works council) in order to have a detailed action plan, time plan, lay-off plan (if necessary) and back-up plan with respect to the alternative individual measures to be taken (see action plan and timeline above under I.).

D. Examples

I. Reduction of Central Functions

A typical scenario is the plan to reduce overhead services by way of centralising the overhead administrative functions to individual divisions.

Such a plan must be considered a change in the business within the meaning of sec. 111 of the Works Constitution Act. Here, the key issue will be to undertake a social selection (*Sozialauswahl*) among those currently employed as employees, as not all positions will become redundant. There will still be a need for some employees in each unit. The basic approach under German labour law is that any social selection must protect those employees who are more senior, are older, have more family support obligations and those employees who have a severe disability. Therefore, the best course of action will be to try to agree with the works council on a so-called appendix to the balance of interests (*Namensliste*), which is an agreed list of those employees that in the view of the management as well as in the view of the works council should be made redundant. A social plan must then be negotiated only for those employees. Such plans should also be thoroughly prepared internally before discussing the restructuring plans with the works council.

II. Outsourcing of a Group of Employees

The fundamental questions are first whether the group of employees who should be outsourced could be considered a stand-alone unit, and second whether all involved employees are to be clearly allocated to this unit only. In such a case the potential outsourcing of this group to a third party could be considered a transfer of a part of a business as outlined above. Therefore, in principle, such an outsourcing project would not automatically be a change in the business within the meaning of sec. 111 of the Works Constitution Act. However, in reality almost every outsourcing project results in a change of the business structure at the operational level at the same time; i.e. triggering the results of mandatory balance of interests and social plan negotiations with the works council as described above.

The plan must be closely analysed and it is strongly recommended that a due diligence exercise from an employment law perspective is undertaken with regard to the relevant employees prior to raising this issue with the works council.

III. Collective Dismissals

Collective dismissals are often part of restructuring measures. In the case of collective dismissals, special rules have to be observed according to sec. 17 of

the Dismissal Protection Act. This sets out, for example, that the employer is obliged to duly inform and to negotiate with the works council before the terminations. Additionally, the employer is obliged to inform the employment agency about the planned collective dismissals before issuing the termination notice letters to the employees.

A minimum period of 1 month has to elapse between providing the information to the agency and the actual end of the employment relationship, i.e. the termination date. During that so-called "stoppage period" (pursuant to sec. 18 Dismissal Protection Act), the employment agency will have the chance to look for solutions for any problems arising from of the collective dismissals. However, the termination notice letters may be served to the employees before the expiration of this stoppage period. Further, this period pursuant to sec. 18 Dismissal Protection Act does not necessarily have to be added to the individually applicable termination notice period. It will only become relevant in situations where the termination period is shorter than 1 month. It should be noted that in certain cases the competent employment agency may extend the above period to 2 months.

IV. Impact of Special Protection Against Dismissals

The special protection against dismissal, especially for works council members and candidates, may cause severe problems particularly if terminations for operational reasons are to be conducted or restructuring measures are planned. That is particularly true if a social plan and balance of interests must be negotiated with the works council or even with the labour union in the case of an operational change (*Betriebsänderung*). Therefore, from a strategic point of view, the point in time of the next works council elections should be considered when restructuring measures are planned. Numerous employees may apply for the works council just to obtain special protection against dismissals. There have been cases where up to 80% of the employees applied for the works council to get special protection against dismissals. Even though there are only few cases concerning this issue, some labour courts have held this collective effort lawful. Thus, all applicants have enjoyed special protection against dismissals.

This may jeopardise the restructuring measure. Therefore, employers should consider waiting to announce the restructuring measure until after the employees have handed in their election proposals in order to avoid applications solely to obtain special protection against dismissals. This might lengthen the process by a few months, with corresponding personnel costs; however, otherwise, the employer faces the risk that the restructuring measure might be delayed even more significantly because of a large group of employees enjoying the special protection against dismissals.

E. Key Aspects

- RIF programmes have to be prepared carefully and sufficiently ahead in time due to their complexity.
- The implementation of RIF programmes can be divided into three phases:
  - Preparation (1), information and consultation with the works council (2), and implementation (3).
- In the case of a change of operation, the works council must be informed and consulted with. The negotiations may lead to a balance of interests.
- In the event of a change of operation, the employer is obliged to conclude a social plan.
- Typical scenarios in respect of restructurings are (1) the reduction of central functions, (2) the outsourcing of a group of employees and (3) collective dismissals.
- In cases of collective dismissals within the meaning of the Works Constitution Act, the employment agency has to be informed about the planned collective dismissals before the declaration of the dismissals.

Chapter 23
Mergers and Acquisitions

Pascal R. Kremp and Jens Kirchner

A. Introduction

M&A transactions often involve many labour and employment issues which should be carefully considered at the very beginning of the transaction. In fact, a number of transactions fail to complete because of labour and employment issues, particularly in relation to the unforeseeable risk of pension liabilities of the target company. Therefore, a company interested in acquiring a business is well advised to conduct a thorough due diligence to obtain a full understanding of how to structure the transaction and how to integrate the acquired business into its own business (post-merger integration).

B. Overview of a Typical Transaction

Most transactions are structured in a similar way. Typically, at the beginning of the transaction the seller (also called transferor) and purchaser (also known as transferee) enter into confidentiality agreements that must be signed by executives and employees involved in the transaction. After some initial talks on the transaction the parties sign a letter of intent (also called a memorandum of understanding or term sheet). In the letter of intent the parties set out some of the main terms agreed in principle in respect of the transaction. Depending on the wording of the letter of

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intent and depending on the relevant laws, the letter of intent may sometimes be legally binding and at other times not. Then, the purchaser is allowed to conduct a due diligence exercise. This may include many different topics such as financial, tax, environmental and, of course, the legal due diligence. Once the purchaser has obtained a better understanding of the target, the parties will then negotiate and sign the purchase agreement. After signing, the parties usually have to fulfil certain closing conditions, often including anti-trust clearance procedures. Once all conditions have been fulfilled the closing takes place and the transaction becomes effective. Subsequent to the closing, the purchaser has to integrate the target into its own business. At every step, labour and employment law issues are involved. Typical issues are:

- Disclosure of specific information about the employees[1] of the target
- Structure of the transaction: can the purchaser pick and choose employees?
- Information and consultation rights of the employee representatives (e.g. works council)
- Stipulations and warranties in the purchase agreement
- Post-merger/transaction integration

C. Due Diligence

In most transactions, the purchaser conducts a due diligence exercise, i.e. reviews the business of the target. Usually, the seller compiles some information on the target and makes it available to the purchaser in a data room (physically or, more common today, in a virtual data room). The purchaser and its advisers review the data within a short time frame and produce a due diligence report which describes the business and highlights the risks involved. Depending on the purchaser's requirements the due diligence report might be very detailed and may show all contracts that the business has entered into. It may, however, provide only an executive summary or it may even focus only on major issues (red flag report).

Labour and employment rights play a significant role in Germany (and most of Europe) and it might be difficult to remedy any employment issues later in the transaction. The purchaser should therefore conduct a thorough due diligence of the labour and employment situation of the target company since staff costs may have a significant impact on the future profitability of the business.

The purchaser usually has a considerable interest in receiving as much information as possible on the business, including on all employees. In Germany (and in the European Union) employees enjoy personal data protection which conflicts with the interest of the purchaser. Therefore, the parties must also address such data protection issues during the course of the due diligence exercise (see below in II.)

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

I. Issues to Be Addressed in a Due Diligence

The purpose of the legal labour and employment due diligence is to get a full understanding of the terms of employment and often also of the feasibility and the costs of potential later restructuring measures.

The purchaser usually provides the seller with a questionnaire which covers many labour and employment topics. The seller should either answer those questions or compile the necessary information in a data room accordingly.

Typical questions and requests for information in respect of the acquisition of a German business are set out below. However, this is not a complete list and may have to be amended or expanded significantly depending on the target and the deal structure.

- Complete lists of all relevant managing directors and employees with the following details: name, employer, position, date of birth, years of service, remuneration, fringe benefits, notice period, fixed term, remaining holiday, special protection against dismissals depending on status of individual employees (member of works council, disabled, employee on maternity or parental leave, etc.) or based on individual or collective rules
- Employees in partial retirement (*Altersteilzeit*), terms of partial retirement
- Employees subject to post-contractual non-competition provisions
- Employees who have given notice or expressed intend to give notice
- Identification of key employees (e.g. with special know-how, customer relationships or special skills)
- Copies of employment agreements of managing directors and key employees
- Templates of standard employment agreements (e.g. for white and blue collar workers); information on employment agreements deviating from standard templates
- Identification of all employees exceeding a specific annual income or with extended notice periods
- List of employees with change of control provisions and other entitlements in case of a change of control
- Copies of consulting and freelancer agreements
- Copies of agreements with temporary employment agencies and list of agency workers; copies of official licenses of temporary employment agencies to contract employees to other companies
- Copies of benefits and other remuneration plans (e.g. stock option plans, bonus plans, sales compensation plans, life and accident insurance) and identification of employees with entitlements to such benefits and variable remuneration
- Salary increases in the preceding fiscal year and agreed future salary increases (either based on individual or collective agreements)
- Copies of all company pension plans (including widow or survivor pensions and pensions for invalidity) and all amendments, including pension plans that have been closed in the past and detailed information on the closure of such plans (e.g. agreements with works council, communication to employees)

- List identifying current and former employees (including pensioners) entitled to each plan and vested or non-vested accrued benefits
- Actuarial reports for the last 5 years
- Information on adjustments/increases to pensions in the past as required by statutory law pursuant to the Company or Occupational Pension Act (sec. 16 *Gesetz zur Verbesserung der betrieblichen Altersversorgung, BetrAVG*); if no full increases have occurred in the past, detailed information on reasons for omitting such increases
- Agreements relating to pensions that have been outsourced to a third party (e.g. articles of relief funds including information on whether the purchaser can remain a member of such funds post transaction)
- Employee agreements in respect of any insurance policy
- Schedule of costs of pension or retirement benefits (for example insurance premiums, payments to relief or pension funds, contributions to the Insolvency Protection Fund (*Pensions-Sicherungsverein a.G., PSVaG*)
- Copy of company policies (e.g. employee handbook, code of conduct, company car or travel guidelines)
- Information on past transfers of business (*Betriebsübergang*) pursuant to the EU Transfer of Undertakings Directive 2001/23/EC (implemented in sec. 613a Civil Code, *Bürgerliches Gesetzbuch, BGB*) affecting any employee within the scope of the transaction
- Information in respect of recent disposals of businesses according to sec. 613a Civil Code (regarding risk of employees objecting to the recent transfers and claiming employment with the target)
- List of employees with loan agreements
- Information regarding the existence of a works council, central works council and/or economic committee or other employee representatives together with a list of all members including substitute members
- Copies of all works agreements (*Betriebsvereinbarung*), even those expired if still taking effect (so-called after effect, *Nachwirkung*) and other agreements with the works council
- Lists of all operational practices (*betriebliche Übungen*) providing legal entitlements to the employees
- Lists of all unilateral collective promises (*Gesamtzusagen*)
- Copies of minutes of the meetings of the economic committee (*Wirtschaftsausschuss*) from the last 3 years
- Copies of all collective bargaining agreements which apply to any of the employees within the scope of the transaction (also if based on "after effect"); information on unions in each business operation; list of employees showing relevant collective bargaining agreements
- Estimated number of union members within the workforce
- Information on membership in employer's organisations or past memberships
- Description of all collective actions and labour disputes (*Arbeitskämpfe*) (e.g. strike) during the last 5 years

- Description of the status of current and/or upcoming negotiation of collective bargaining agreements
- Organisational charts providing an overview of the structure of the company's workforce and (in the event of an asset deal) the relevant unit
- Asset deal: description of the unit to be transferred and an explanation of why all employees within the scope of the transaction are part of the unit to be transferred and why the employees not within scope cannot claim that they should transfer to the purchaser based on sec. 613a Civil Code
- List of all agreements or commitments providing for severance payments
- Information on past restructuring measures including amount of severance payments paid, social plan and balance of interests (agreements with works council on such restructuring transactions), number of wrongful dismissal claims before court
- Information in respect of pending or upcoming negotiations with the works council in relation to restructuring measures affecting any relevant employee
- Overview of conciliation committee proceedings (*Einigungsstellenverfahren*) in the last 5 years, including the topic, name of the chairman, and outcome of the proceeding
- Overview of all audits by authorities (in particular regarding social security) during the last 5 years and copies of statements of the authorities
- List and brief summary of all recent (in the last 5 years) pending or threatened labour court proceedings
- Documentation of employee compliance and anti-discrimination training

II. Data Protection

As the aforementioned due diligence questionnaire shows, the purchaser wants to learn as much as possible about the business and its employees. While in larger businesses the purchaser might be happy with some general information on the employees, in the case of a smaller target the purchaser usually wants to have a full understanding of all employee data such as salary, fringe benefits, age, years of service, membership in the works council, employees on maternity or parental leave or disabled employees. In any event, the purchaser will want this information in respect of any key employees who have significant know-how or customer relationships and are important to the running of the business.

All this information is, however, protected under German data protection laws (which are based on European law). The seller is therefore not generally allowed to share this information with a third party without the consent of the individual employees or any other legal basis. In particular American and Asian companies struggle with these obstacles since the data protection level in the European Union is much stricter than in other countries. These issues may, however, be approached in different ways.

If the target is very small, it might be feasible to obtain the consent of all employees so that the business may disclose the personal data to the purchaser. This will usually only work in very small privately owned businesses where the employees are aware of the sales process.

Even in larger transactions it is quite common to obtain the consent from the top level management or selected key employees of the target since they are usually aware of the transaction and are key to running the business after completion.

Large companies with regular divestitures of their business may consider entering into a general works agreement with the works council in order to address the disclosure of personal employee data to potential purchasers. Such works agreement may also be a sufficient legal basis on which to disclose the information. Works agreements, however, usually stipulate that the works council must be immediately informed of any disclosure which might not always be practicable if the parties wish to keep the deal confidential for as long as possible.

German data protection law does not hinder the seller from providing anonymised lists containing certain limited employee data, as long as it is ensured that the data cannot be decrypted by the purchaser in a way that enables it to link the data to individual employees.

Especially at an earlier stage of the deal, the seller may consider providing the purchaser with only some general information on the employees, such as average salary, average years of service and age (or split by certain age groups) which does not allow the purchaser to identify individual employees.

In any event, the seller should enter into an agreement with the purchaser in order to ensure that the purchaser may only use the personal data for the purpose of the transaction and to ensure that the purchaser deletes all data if the transaction does not continue. Also, the seller should make sure that the purchaser undertakes to provide access to this data only to those of its employees and advisers who have signed up to a confidentiality agreement.

D. Structure of the Transaction

From a corporate point of view there are basically two different types of deal structures. Either the purchaser acquires all shares in the target company or the purchaser acquires all or some assets of the company. The Company Transformation Act (*Umwandlungsgesetz, UmwG*) provides for some additional structures such as merger, spin-off or split of the company.

I. Share Deal

In a share deal the purchaser acquires all the shares of the target company. Thus, the legal entity the employees are employed by, i.e. the employer, remains the same

after the transaction. All employees will continue to be employed by the same employer. Employees do not have the option to object to the transfer. The works council will continue to be in office and the collective bargaining agreements will usually continue to apply. Generally speaking the terms and conditions remain unchanged. The focus of the purchaser will therefore be on getting an understanding of the current terms and conditions.

If, however, some terms and conditions at the seller had been provided at group level, the purchaser needs to have a close look at the impact of the transaction on these terms and conditions. Typically, stock options (or other equity awards) are provided by the ultimate parent company and not the target company. The same might be true for sales compensation plans, bonus plans and sometimes pension schemes. If this is the case, the purchaser will usually have to provide equivalent benefits to the employees of the target company after the acquisition.

II. Asset Deal

In the event of an asset deal the purchaser does not acquire the shares of a company, but all or parts of the assets of the seller.

1. Transfer of Business

In many situations the employment relationships dedicated to the relevant business or business unit will be transferred to the purchasing entity by operation of law according to the EU Transfer of Undertakings Directive 2001/23/EC (implemented in Germany in sec. 613a Civil Code). This is the case if the relevant business (unit) can be considered to be an economic entity, i.e. an entity which retains its identity, meaning an organised grouping of resources which has the objective of pursuing an economic activity, whether or not that activity is central or ancillary. The European Court of Justice interprets the meaning of an economic entity quite broadly.

If all assets are acquired, this will usually trigger sec. 613a Civil Code. Furthermore, if a business unit (e.g. production) or a specific department (e.g. canteen of a department store) is acquired, this can be considered to be an economic unit and can therefore result in a transfer of business. The same is true for many outsourcing deals (e.g. outsourcing of an IT department).

2. Assumption of All Employment Relationships by Purchaser

As a consequence of the transfer of business the purchaser assumes all rights and liabilities of the employment relationships assigned to the business (unit). In Germany, this usually also includes all pension liabilities. The seller and purchaser

are generally not able to opt out of the employee consequences of a transfer of business.

If the purchaser does not have collective bargaining agreements or works agreements with the works council in place, the collective bargaining agreements and works agreements applicable at the seller will remain in effect for the transferred employees after the acquisition. They may be changed to the detriment of the employees only with the consent of the individual employees and only after the expiry of 1 year from the date the transfer became effective. The transferred employees will not, however, be affected by future amendments to the collective bargaining agreements or works agreements of the seller (e.g. future salary increases that have not yet been agreed on at the seller). They will only keep the status quo as of the day the transfer of business becomes effective.

If the purchaser has collective bargaining agreements or works agreements in place, they will replace the collective bargaining agreements and works agreements of the seller provided that these collective agreements govern the same topic. For example, the purchaser's works agreement on working time will replace any such works agreement of the seller, but not the seller's other works agreements dealing with different topics.

III. Transactions According to the Company Transformation Act

1. Corporate Structure

The Company Transformation Act provides for different structures of a transaction on a corporate level (besides the aforementioned share deal and asset deal):

- Merger, i.e. company A will be merged into company B and A ceases to exist
- Spin-off (*Abspaltung* or *Ausgliederung*): assets of A will be spun off and transferred into another legal entity
- Split: all assets of A will be split and transferred into at least two different legal entities

2. Labour and Employment Consequences

In the event of a merger all employment relationships of the seller company will be transferred to the purchaser company in accordance with sec. 613a Civil Code, i.e. the transfer of business rule. The purchaser company becomes the employer of the employees with the same terms and conditions. However, to the extent collective bargaining agreements and works agreements exist at the purchaser company, they will usually replace such agreements of the seller company.

Essentially, the same rules apply in the event of a spin-off or of a split of a company. In such a situation it might, however, sometimes be unclear which employees belong to the part that will form the spin-off and therefore be transferred to the other legal entity. Similarly, in the event of a split it might be unclear who will be transferred to the one entity and who will be transferred to the other entity. In such uncertain cases, the employer and works council may agree on a list of names of the employees that will be transferred. If an employee brings a claim, the labour court would only review this allocation by the employer and works council for significant mistakes.

IV. Pre-Transaction Considerations

In light of the number of different types of possible transactions, the parties should consider how best to structure the transaction in order to achieve the best outcome.

1. Carve Out

It might well be that a potential purchaser is only interested in specific assets and related staff (e.g. a specific product line) of the seller company, but not in the entire business. Also, the seller might only want to dispose of specific assets or a business unit which, from a mid- or long-term perspective, are no longer in the core business of the seller.

However, only those employees who are assigned to the relevant business unit on an organisational level will be transferred to the purchaser. Thus, employees in administrative functions, which are not part of a business unit, for example shared service centres, will usually not fall in the scope of the transaction. Even if, for example, an employee of the centralised shared service centre works exclusively for the relevant business unit, that employee would usually not be part of the transaction in case he is reporting to the head of the shared service functions only.

Therefore, to ensure that the relevant business unit is self-functioning, the seller might consider carving out the respective business unit prior to the transaction. It may also change the reporting lines of employees in centralised functions to ensure that they become part of the transaction.

The carve out will often trigger information and consultation rights of the seller's works council. Therefore, if the seller plans to dispose of a business unit on a mid- or long-term perspective, the seller might be well advised to carve out the business unit at an early stage so that it will be easier to handle the later sale of the unit.

In addition, the seller could transfer the carved out unit into a separate legal entity. This would allow the seller to sell only the shares in this new legal entity and thereby, in many cases, avoid consultation with the works council which may otherwise heavily delay or even jeopardise the transaction.

2. Reduction of Headcount Prior to Transaction

Dismissals of employees in operations with more than ten employees must be justified by specific reasons such as operational reasons. The employer may reduce the headcount even in the absence of an acquisition in order to make the target company "leaner" and thus more attractive to potential buyers. In order to do this the employer must have a specific strategy for the reduced headcount (for example, closing a department or business unit which is not a core business).

In the event of an asset deal, however, dismissals "because of" the transfer of business are not permissible. The reasoning behind the transfer of business rule is to ensure that the employment relationships will continue with the purchaser after the acquisition. A company is not able to terminate employment relationships by merely transferring the assets to a different legal entity. This means that the seller must either reduce the headcount in advance based on its own operational needs, or the purchaser will assume all employment relationships and may then reduce the headcount in a second step. Strategic investors often want to avoid the latter in order to keep the transferred employees motivated and not notify the employees of redundancies as a "welcome gift".

In insolvency situations, however, the seller does not intend to continue the business at all. Nevertheless, the Federal Labour Court (*Bundesarbeitsgericht, BAG*) has allowed dismissals by the seller in situations where an agreed plan is in place with a purchaser. This enables the parties in an insolvency situation to restructure the business even before the transaction takes place; the parties can therefore avoid employees remaining on the payroll for too long. This case law makes restructurings in insolvency situations much easier.

3. Separation Agreements in Insolvency Situations

As previously outlined above, a dismissal "because of" a transfer of business is null and void. Also, any attempts to circumvent this rule are not permissible. For example, it is not permissible to sign separation agreements with all employees and then offer them employment with the purchaser of the assets on lower salaries or other less favourable terms. Also, it is generally not permissible to sign separation agreements and then offer employment only to a selected number of employees. Any employees who were not selected would be able to claim employment with the purchaser of the assets since the separation agreement would be null and void.

The Federal Labour Court has, however, permitted a certain construction for specific situations, in particular for insolvency situations.

In the event of larger headcount reductions or an entire shutdown of a company, often the Federal Labour Court will allow employees to transfer to a separate legal entity, a so-called transfer agency. The employees will remain with the transfer agency usually for a period of 6–18 months. The purpose of the transfer agency is to

enable the employees to qualify for future job positions and provide outplacement services. The transfer agencies are usually run by third party service providers and are subsidised by the government.

In the event of an insolvency situation, the Federal Labour Court allows a selling employer to ask all its employees to sign a separation agreement and transfer them into the transfer agency, provided that there is not yet an agreement with the purchaser on the acquisition of the assets. In this situation, the employees do not know if the purchaser will finally acquire the assets or not. At this point the employees therefore have no guarantee that they will be re-hired by the purchaser. In this specific situation the purchaser may pick and choose employees from the transfer agency.

4. Collective Bargaining Agreements

The purchaser should look carefully at the application of collective bargaining agreements to the relevant employees and the consequences of the transaction. This is particularly true for asset deals (transfer of business according to sec. 613a Civil Code).

The application of a specific collective bargaining agreement usually depends *inter alia* on the kind of work the majority of the employees is performing. For example, if a company providing only canteen services acquires only the canteen staff of a large industrial metal company, then often the collective bargaining agreements for the canteen business will apply to the staff after the acquisition. These will usually provide for a lower salary than the collective bargaining agreements for the metal industry.

On the other hand, if the acquired employees exceed the number of staff of the acquiring business, then the entire business of the purchaser might become subject to a more expensive collective bargaining agreement.

E. Information and Consultation Rights of Employee Representatives

Employees are represented on different levels. In the event of a transaction, information and consultation rights might exist on all levels of employee representation. All levels must be considered at a very early stage of the transaction and ideally the parties should agree on a plan in respect of how and when to approach each employee representative body. If the transaction is multi-jurisdictional, the information and consultation rights of employee representatives must be considered not only on different levels, but also in different jurisdictions, making the transaction even more complex.

I. European Works Council

In large operations with more than 150 employees in at least two jurisdictions of the European Union, employees may set up a European works council. The rights of the European works council may be agreed on with the company, otherwise statutory laws will apply.

Generally speaking the seller has to inform and consult with the European works council on all measures that may have a significant impact on the workforce. In the case of either a share deal or an asset deal this mainly depends on the size of the business to be sold. If the transaction also involves the restructuring or relocation of operations or mass redundancies, the information and consultation rights of the European works council will be triggered. The information process must take place in good time prior to the measures.

In practice, many companies have been able to create a good working relationship with their European works council, resulting in a reasonable consultation process.

II. Works Council

The German works councils enjoy extended information and consultation rights in the event of restructuring measures such as mass redundancies, split transactions or relocation of operational sites. In many states in Germany the works council can stop the implementation of a restructuring measure by preliminary injunction.

However, the works council has no authority in respect of pure share deals. Also, if the seller disposes of its entire business by asset deal, the works council has no consultation rights on this entrepreneurial decision of disposal. In practice, however, the disposal of the business usually implies organisational changes which are subject to information and consultation rights.

If the seller splits the operation or sells only part of the business, the seller must fully inform and consult with the works council on the acquisition. The information and consultation theoretically should take place when the employer sets up a plan, and has not yet taken any final decision. The works council should be in a position to influence the plan of the company. The negotiations with the works council usually result in two agreements. The first is the so-called balance of interests (*Interessenausgleich*) which describes the measure, and the second is a social plan (*Sozialplan*) providing for compensation, in particular for those employees who might lose their job position or suffer any other detriments. Ultimately, however, the works council cannot legally stop the restructuring measure and the sale of the business. It can nevertheless heavily delay the sales process, with the result that the purchaser might walk away from the transaction.

The purchaser should be prepared that the works council of the seller might ask for certain commitments to the employees to be assumed by the purchaser. Often,

such requests include a guarantee that the purchaser will avoid dismissals for operational reasons for a specific period of time, location guarantees for a defined term, guaranteed severances in the event of restructuring measures, or guarantees of minimum remuneration or benefits.

In general, the seller and purchaser are well advised to have clear communication with the works council in order to build up a trusting relationship. Without the consent of the works council it will be very difficult to ensure that the transaction will be a success. Also, the works council can in fact often strongly support the transaction and convince employees of the advantages of the transaction.

III. Economic Committee

In operations with more than 100 employees, the works council may set up a so-called economic committee. The economic committee consists of representatives of the works council, employees and the employer. The economic committee must be informed on a regular basis of the financial and economic development of the company. This also includes information on planned disposals of the business or even the entire company. In the event of the latter, if no economic committee has been set up, the works council has to be informed of the possible sale of the entire company.

Ignoring the information rights of the economic committee may trigger some administrative fines. However, the economic committee cannot stop the transaction.

IV. Timing of Consultation with Employee Representatives and Ad Hoc Notifications to Stock Markets

On the one hand, the European works council, the economic committee, and, more importantly, the local works councils must be informed in good time prior to the transaction, so that the employee representatives can still take influence on the transaction or restructuring measures involved in the transaction.

On the other hand, the seller and purchaser might be listed on a stock exchange and may therefore be obliged to notify the stock market on the transaction.

Even though the employee representatives are usually subject to strict confidentiality obligations, companies sometimes prefer to notify the stock markets first in order to avoid severe sanctions. The employee representatives should then be informed directly afterwards. When informing the stock market, it should be pointed out that possible restructuring measures are at planning stage only, and are still subject to consultation with the competent employee representatives.

In any case, it is important to review the local laws very carefully and to set up a communication plan to ensure compliance with all applicable laws.

In multi-jurisdiction acquisitions it is even more important to set up a clear communication plan at a very early stage since in some jurisdictions the seller or purchaser might even be obliged to consult with the employee representatives on a share deal or sale of the entire business.

F. Purchase Agreement

Typically, the purchase agreement on the acquisition of the shares or assets of the target company is split into several sections. In the "main part" the parties stipulate in detail how to handle labour and employment issues. In a separate section or *addendum* the seller will give certain warranties, including warranties on labour and employment issues.

I. Employee Related Provisions

From a purchaser's point of view several employee related issues should be addressed in the purchase agreement. In particular in an asset deal the parties often address additional issues. The purchaser who usually assumes the employment relationships by operation of law according to sec. 613a Civil Code has a strong interest in having a clear understanding of the allocation of liabilities, since the purchaser will generally assume all liabilities. Matters that are typically addressed in the purchase agreement are:

- Provision on who will notify the employees of the impending transfer of business:

  The seller and purchaser are obliged to inform the employees about the impending transfer of business, the date of transfer as well as the legal, social and economic consequences for the employees. Following the provision of thorough and correct information, employees may object to the transfer within 1 month. In this case, these employees would remain with the seller. If the information provided to the employees is not thorough and correct, the 1 month deadline is not triggered. Employees may then object to the transfer several months or possibly even years after the transaction. The seller has a strong interest in avoiding employees returning after a long period of time. Therefore, it is in the seller's interests to shift the liability for insufficient information to the purchaser.
- Allocation of costs of employees who object to the transfer or claims of employees who will not transfer:

  The parties should also address the allocation of costs of relevant employees who should transfer to the purchaser, but object to the transfer and will therefore remain with the seller. The seller will usually terminate these employees

resulting in termination costs to be borne by the seller if not agreed otherwise. If the deal has not been properly prepared and communicated to the employees and employee representatives, a large number of employees might object to the transfer, which would be a significant risk for the seller but also for the purchaser since the deal may fail.

- Material adverse effect clause:

  Purchase agreements often include a material adverse effect clause (MAC clause) which covers unexpected events. With regard to labour and employment laws, the purchaser might not be prepared to close the deal or may wish to rescind the purchase agreement at a later date if specific key employees do not join or a certain number of employees (threshold) object to the transaction.
- Employee related accruals:

  Employers must make provisions in the balance sheet for certain employee entitlements such as pensions (depending on the pension scheme), annual leave and accruals for worked hours. In the event of an asset deal these provisions will obviously not be transferred to the purchaser, but the purchaser will be fully liable for any employee claims which arise. Therefore, the purchaser needs to ensure that a cash amount which corresponds to the amount of the provision will either be transferred to the purchaser, deducted from the purchase price, or somehow negotiated by the purchaser in determining the purchase price.
- Pensions:

  Pensions often have to be explicitly addressed, whether a share deal or an asset deal is at hand. Pension obligations can create a significant liability for the purchaser and should therefore be very carefully reviewed. A number of transactions fail to complete as potential purchasers step back from the transaction due to the size of the pension liabilities and the difficulty in estimating such liabilities.

  Depending on the pension scheme it should be specified that not only the pension liability, but also the corresponding pension assets (if any) will transfer to the purchaser. This may also apply to a share deal since the pension assets might have been outsourced and will not necessarily be transferred to the purchaser of the target company. In an asset deal close attention should be paid to pension provisions for two reasons. First of all, as set out before, the amount of the accruals will not be transferred to the purchaser if not explicitly stipulated otherwise in the purchase agreement. Secondly, if such provisions are made in line with German GAAP rules (according to the Commercial Code (*Handelsgesetzbuch, HGB*)) the provisions will not fully reflect the true pension liability since the discount rate is still too high compared to U.S. GAAP discount rules.

II. Warranties

In most transactions, the purchaser will ask the seller to provide certain warranties with regard to labour and employment laws. Usually, the seller is willing to give such guarantees to a certain extent. The seller may provide such warranties with some restrictions, in particular if it has only acquired the business quite recently itself. However, in some situations, in particular if the seller is the insolvency administrator, it will be difficult for the purchaser to obtain any warranties at all. Sometimes, the seller might limit the warranty to the knowledge of specific individuals. If the seller gives warranties, such warranties may include:

- Confirmation that all numbers of employees, salaries, years of service, age, fringe benefits, applicable collective bargaining agreements and works agreements are true and complete
- Confirmation that no employees (except as otherwise disclosed) are entitled to bonuses, severance payments or any other benefits in the event of a change of control
- Confirmation that all labour and employment related accruals are correct
- In an asset deal: confirmation that only the relevant employees can claim employment with the purchaser
- Confirmation that no pension liabilities exist beyond the liabilities set out in the actuarial reports; confirmation that pension liabilities are fully funded
- Confirmation that no freelancers or consultants could claim that they are employees
- Confirmation that all contributions for social security and all withheld taxes have been duly paid

G. Post-Merger Integration

Surprisingly, a number of companies still underestimate the importance of integration of the acquired business into their own business. It cannot be emphasised often enough: post-merger integration begins at the beginning of the entire transaction, in particular at the beginning of the due diligence exercise.

The main purpose of the labour and employment due diligence should not only be to get a thorough understanding of the current employment terms and conditions of the target company, but also to get a thorough understanding of how to integrate the business into the purchaser's own business. In many cases, the transaction may not pay off for the purchaser if the integration costs—and time of integration!—have not sufficiently been considered.

In fact, it is not unusual for a purchaser not to think too much about how to integrate the future business, in particular with regard to labour and employment laws. In many transactions the executives or other key employees are kept busy with the transaction itself and do not have time to think about the later integration.

Many companies simply do not have sufficient resources to review the integration in depth.

The post-merger integration often, however, involves highly complex issues, ranging from tax and corporate laws to labour and employment issues (not to mention the integration of different IT systems).

With regard to labour and employment, post-merger integration involves, for example, the merger of existing operations of both companies, the use of synergies, relocation of businesses, and adjustments to headcounts.

In particular in bigger transactions involving several jurisdictions it is of major importance to have a competent team in place that has significant experience in post-merger integration since usually works councils and other employee representatives in different jurisdictions must be consulted with in relation to such integration.

H. Key Aspects

- The consequences of labour and employment issues in respect of share deals, asset deals and mergers, spin-offs and splits of companies are very diverse and should be carefully reviewed at an early stage.
- The purchaser is well advised to conduct a thorough due diligence of labour and employment issues since staff costs may have a strong impact on the future profitability of the target. In particular pension liabilities can be significant.
- Employee representatives may have significant information and consultation rights with regard to transactions.
- The seller and purchaser should conduct clear and open communication with employee representatives in order to address concerns of the employees so as to make the transaction a success.
- The seller and purchaser should come to a clear understanding of all obligations in the purchase agreement.
- The purchaser should review post-merger or transaction integration issues at a very early stage.

Chapter 24
Business Transfers

Jens Kirchner and Michael Magotsch

A. Introduction

Section 613a of the Civil Code (*Bürgerliches Gesetzbuch, BGB*) governs employers' and employees'[1] rights and duties in the case of business transfers (*Betriebsübergang*). In practice, business transfers are also known as transfer of business or transfer of undertaking. Furthermore, outsourcing measures often qualify as business transfers. The spirit and purpose of sec. 613a—which mainly implements the EU Transfer of Undertakings Directive 2001/23/EC—is to maintain the employee's social status quo and to grant comprehensive employee protection. In particular, the employee must not suffer any disadvantage as a result of the business transfer. The function and continuity of business operations must be protected alongside the preservation of the employee's job position. Moreover, employees have a right to comprehensive information about the planned transfer of the business as well as a right to object to the transfer of their employment relationship. Thus, sec. 613a *BGB* is designed to achieve the following three key objectives:

- The business transfer should not affect the continued existence of the employment relationships of individual employees and therefore serves as an additional system of protection against wrongful dismissals;
- Ensuring the continued existence of the works council in the transferred business;

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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- The acquiring party (transferee) assumes all rights and duties of the seller (transferor) arising from the employment relationships existing at the time of the business transfer.

B. Scope of Application

Section 613a *BGB* is applicable to all employment relationships existing at the time of the business transfer. It applies equally to fixed-term employment relationships and to employment relationships terminated during the notice period. All employees, without distinction between normal workers and executive employees (*leitende Angestellte*), or between full-time and part-time employees, are included. However, the Federal Labour Court (*Bundesarbeitsgericht, BAG*) has determined that the relationship of managing directors (*Geschäftsführer*) does not fall within the scope of a business transfer, i.e. the managing director does not get transferred to the acquiring party. The same applies to freelance workers.

In the case of a transfer of part of a business, only those employment relationships which can be assigned to the transferred business part will pass on to the transferee. If a concrete assignment is not possible, the relevant employment relationship remains with the present employer. Administrative employees are often difficult to assign to the respective part of the business and as a consequence sometimes cannot be included in the business transfer.

C. Mandatory Rule

Due to its intended purpose, sec. 613a *BGB* is a mandatory rule. The parties cannot preclude the legal consequences of sec. 613a *BGB* prior to the transfer of business. Corresponding agreements are null and void as well as circumventions, for example, dismissals with the agreement of re-employment by the transferee on less favourable working conditions. However, agreements due to a planned transfer of business may be treated differently. They might relate to rescissions of the employment contract or to the amendment of contractual terms.

D. Business Transfer as a Precondition

I. Transfer of a Business or Part of a Business

1. Definition of the Jurisdiction

The definition of "business transfer" as it is used by the Federal Labour Court is owed to the European Court of Justice (ECJ), which defines it—consistently with

the Directive 2001/23/EC—as a change of ownership (employer) of an economic entity maintaining its identity after the transfer. In matters before the Federal Labour Court, the identity of the economic entity and, hence, the determination of a business transfer is based on an overall assessment of seven criteria established by the European Court of Justice (18 March 1986—C-24/85—*Spijkers ./. Benedik*, regarding art. 1 para. 1 of Directive 77/187).

The seven criteria of the European Court of Justice that determine the identity of the economic entity and, hence, a business transfer consist of an overall assessment of the following:

1. The type of business;
2. The transfer of tangible assets such as buildings and moveable property;
3. The value of intangible assets at the time of the transfer;
4. The takeover of the majority of the employees by new owner;
5. The transfer of customers;
6. The degree of similarity between the activities carried on before and after the transfer;
7. The period, if any, for which those activities were suspended.

The Federal Labour Court generally distinguished between businesses rich in tangible/intangible assets (*betriebsmittelreich*) and those with no or few tangible/intangible assets (*betriebsmittelarm*). In the first case, if such assets basically form the identity of the entity transferred and the transferee takes over and continues the main part of the assets, there will generally be a business transfer within the meaning of the definition. Thus, in the case of a production plant, as a typical business rich in tangible/intangible assets, the transfer of the fundamental utilities within the existing operational organisation is essential.

In businesses with no or only few tangible/intangible assets, i.e. people-intensive service sector businesses (call centres etc.), the workforce usually forms the main part of the entity. Hence, if the transferee does not take over a relevant part of the workforce, usually no business transfer occurs. For complex work tasks, the transfer of all key-employees, even if they form only a small part of the work force, may be a relevant business transfer.

In the past years the Federal Labour Court held that a transfer of an economic entity requires that the organisational structure that was in place at the transferor is transferred and carried on as such at the transferee. The ECJ held in *Klarenberg* (12 February 2009—C-466/07) that the determination of the identity of the economic entity would not require maintaining its organisation. Rather, a very broad and in practice difficult to apply "*retention of a functional link of interdependence, and complementarity, between various transferred elements of production*" would already be sufficient. The Federal Labour Court decided, with reference to the ECJ decision, that for the economic entity to retain its identity it is sufficient if its functional link (*funktionelle Verknüpfung*) is preserved within the transferee.

However, the Federal Labour Court still requires there to be a separable organisational unit at the transferor that can be transferred in the first place.

The question of whether a functional unit was transferred is to be distinguished from the question of functional succession (*Funktionsnachfolge*). The Federal Labour Court does not recognise a business transfer where there is simply a continuation of certain functions (a so-called functional succession, e.g. by an independent contractor).

2. Self-Functioning Unit

In the case of a change of the employer, the entire operations of a self-functioning unit (*Funktionseinheit*) or a part of the business must be transferred. Such a unit must operate in a way that enables an effective execution of composite tasks and the fulfilment of certain operational purposes. Therefore, if a third party intends to continue using the operational means for their former purpose, i.e. maintaining the same facilities and/or continuing to support the same customers, a transfer of part of a business according to sec. 613a *BGB* might take place.

3. Outsourcing

The applicable law is quite ambiguous with respect to the issue of whether outsourcing is a transfer of (part of) a business or not. The European Court of Justice states that a transfer of business may occur where not only a task but also a substantial part of the personnel is taken over. Thus, if a company sources out part of its business to another company (supplier), but the supplier employs a substantial part of the employees of the outsourcing company to perform the services, this might be considered a business transfer. The effect would be that the supplier assumes all employment relationships from the respective unit by virtue of law. However, the traditional case of outsourcing, namely the simple transfer of a task formerly done internally to an external supplier, will often not be deemed a transfer of business if the new supplier neither takes over personnel nor working equipment.

4. Change of Ownership

Another prerequisite for the application of sec. 613a *BGB* is a change in the ownership of the business. This requires that the person who assumes control of the business and its organisation must change (asset deal). This prerequisite is not fulfilled by a mere change of the legal form of the owner or by a change of shareholders (share deal). Rather, it is crucial that the transferee continues or

restarts the business. According to the Federal Labour Court, these principles also apply to a civil law partnership (*Gesellschaft Bürgerlichen Rechts, GbR*).

II. Leading Cases

Unfortunately, the European Court of Justice and the Federal Labour Court have taken deviating positions once in a while over the last years regarding the prerequisites of business transfer situations. As a consequence, no clear and transparent line of case law exists. The question whether a potential investor is faced with a business transfer scenario or not has become more and more difficult. The following important leading cases of the European Court of Justice and the Federal Labour Court provide a helpful view of situations that might be considered business transfers in practice:

1. Klarenberg

This case before the European Court of Justice (12 February 2009—C-466/07) concerns the interpretation of art. 1 sec. 1 lit. a and b of the Directive 2001/23/EC. The ECJ had to decide on an order of reference of the higher labour court in Düsseldorf, Germany.

The claimant (Mr Klarenberg) was employed as department manager by ET Electrotechnology GmbH (ET), which entered into an asset purchase agreement with the defendant (Ferrotron). Pursuant to that agreement, Ferrotron acquired the main tangible assets associated with this department and re-engaged a few of ET's employees. These former employees of ET were integrated into the structure established by the defendant.

The claimant wanted to be re-employed by the defendant under the same terms and conditions of the employment contract concluded with ET as his employment relationship had been transferred. The higher labour court found that the department formerly headed by Mr Klarenberg was a part of the business in the meaning of sec. 613a para. 1 *BGB* and was transferred to the defendant. The ECJ's ruling followed the higher regional court and stated that a transfer of business can take place even though the organisational autonomy of the business or part of the business might not be retained. According to the ECJ, art. 1 sec. 1 lit. a and b of the Directive must be interpreted so that the Directive may also apply in situations where the part of the undertaking or business transferred does not retain its organisational autonomy, provided that the functional link between the various elements of production transferred is preserved and that the link enables the transferee to use those elements to pursue an identical or analogous economic activity.

The Federal Labour Court, however, dismissed the case in 2011 taking the position that the department did not form a part of a business that could have transferred to Ferrotron in the first place.

2. Temco

In the case of *Temco* (24 January 2002—C-51/00), a business had assigned the cleaning of its premises to company A, which subcontracted the job. After terminating the contract with company A the business entered into a new cleaning contract with company B. Company B employed most of the subcontractor's employees. In this case the European Court of Justice considered the contract to be a business transfer, since company B took over a substantial part of the staff of the subcontractor, with emphasis being placed on the number of employees transferred and their expert knowledge.

3. Ayse Süzen ./. Zehnacker Gebäudereinigung Krankenhausservice

In the case of *Ayse Süzen ./. Zehnacker Gebäudereinigung Krankenhausservice* (11 March 1997—C-13/95), the European Court of Justice refused to find that a business transfer had occurred. The claimant was working for the cleaning company Zehnacker, which was contracted to clean a school. The school terminated the contract with the cleaning company. As a consequence, Zehnacker itself dismissed all employees who were working in the school, including the claimant. The school then contracted with another cleaning company to clean the school. The new company neither inherited any relevant material or immaterial operating facilities nor any substantial part of the staff from Zehnacker. The plaintiff filed the suit claiming that her employment relationship may not be terminated, as a business transfer has taken place. The Court ruled with regard to a business transfer that there is no need for a contractual relationship between the previous owner and the purchaser. However, the mere loss of a customer to a competing company does not constitute a business transfer. The transfer of an organisational entity, which exists on a continuing basis, is the determining factor. This requirement was not fulfilled in this case.

4. Carlito Abler and Others

A business transfer might occur even when none of the former employees are transferred if the supplier performs its services on the premises and in the same accommodation of the company the former supplier had used. In November 2003 the European Court of Justice heard the case of *Carlito Abler and Others* (20 November 2003—C-340/01), concerning the change of a hospital catering company. The operator of a canteen kitchen, Sanrest, which was contracted to

provide the entire catering facilities at a hospital, was replaced by another company, Sodexho. The hospital provided Sodexho with the complete production facilities Sanrest had previously used. The Court considered the change to be a business transfer even though Sodexho did not intend to employ any of Sanrest's employees. The Court held that the relevant entity preserves its identity if the business is continued or resumed and the subsequent operation operates on the same premises, using the same inventory and production facilities.

5. Güney-Görres and Demir

In the cases of *Güney-Görres and Demir* (15 December 2005—C-232/04 and 233/04) the European Court of Justice held that it is not decisive for the evaluation of a business transfer whether the transferee continues to use the work equipment for its own economic interest or not. In the second case the security service provider at the Düsseldorf airport changed from the employer Securicor to the company Kötter. Kötter continued to use the same equipment as Securicor, which was owned by the German State, and took over several employees. Two airport security staff members, whose employment contracts were terminated, claimed that a business transfer had taken place. For the evaluation of the transfer the question arose whether the business transfer was already excluded as Kötter had no economic interest in the equipment. The court ruled that a business transfer is not excluded by the fact that the new company does not have an economic interest concerning the operating equipment.

6. Federal Labour Court

The Federal Labour Court has applied the decision of the European Court of Justice in the cases of *Güney-Görres and Demir* (15 December 2005—C-232/04 and 233/04) abandoning some former prerequisite requirements. Thus, the court found a business transfer to have occurred between two printing service companies (6 April 2006—8 AZR 222/04), where the transferee continued to use the machines owned by the same client to perform the same services, even though the use of the equipment for its own economic interest had been excluded in the service contract. However, the Federal Labour Court held in a parallel decision of the same date that a business transfer is nevertheless negated if the transferee does not use the transferor's work organisation (the Federal Labour Court calls this "to lay down in a made bed"), but creates a new one or implements the former independent economic entity in its already existing organisation, thereby terminating the separate identity of the entity (6 April 2006—8 AZR 249/04).

The Federal Labour Court also refused to find a business transfer in the case of a womens' refuge, claiming that the transferor only concentrated on providing a shelter house for battered women. The transferee—in contrast—significantly changed the concept and the organisation of the business by providing a broader

concept of consultation. The womens' refuge played only a minor role in its concept, as the former independent business was integrated in a new structure of several consultation centres (4 May 2006—8 AZR 299/05).

In a more recent decision the Federal Labour Court also held that a transfer of business had not occurred (18 September 2014—8 AZR 733/13). In this case a petrol station with an attached shop was formerly leased from the oil company "T" by "A" but then "T" transformed it into a self-service petrol station. About 800 m from the old petrol station, "T" built a new petrol station and leased it to "B" who employed roughly 50% of the former employees of "A". The plaintiff, who had not been employed by "B", claimed that a transfer of business had taken place. The Federal Labour Court stated that an evaluation of all aspects to the case is necessary. It found that the economic entity of the old petrol station did not retain its identity since neither essential assets nor a significant amount of staff had been taken over.

Another decision of the Federal Labour Court dealt with the prerequisites for a transfer of business in the public service (22 May 2014—8 AZR 1069/12). A city had assigned its employment service to a municipal public agency called BFG. After the expiration of this fixed-term assignment the city took over the employment service itself. This resulted in a reduction of workplaces at BFG whilst the city employed most of the former employees of BFG who had worked in the employment service sector. The plaintiff's employment contract was terminated by the city. He argued that this was unlawful because a transfer of business had occurred. The Federal Labour Court held that sec. 613a *BGB* is applicable in the public service when economic activities are transferred. However, this is not the case when the activities are transferred through the exercising of public authority. According to the Federal Labour Court the employment service is an economic activity. Therefore the Federal Labour Court argued that since a high amount of (specialised) employees had been taken over, a transfer of business had occurred. The termination of the plaintiff's employment contract was declared unlawful.

E. Impact on Collective Agreements

The main impact of sec. 613a *BGB* is that the employment relationships existing at the time of the business transfer pass to the transferee and continue. Legal agreements between the parties concerning the transfer of employment relationships are unnecessary and agreements to the contrary are ineffective. At the time of the business transfer the transferee becomes the new employer substituting the transferor as the previous employer. It will be bound by all duties (for example back pay) and has the benefit of all rights based upon the employment relationship. The transferor is liable for all duties existing prior to the business transfer. Where applicable, this will be on a pro-rata basis.

In principle, the employment relationships and duties continue to exist with the transferee on the same terms. If the terms of employment for a transferring employee are to be qualified or changed, the employee must raise these claims promptly after knowledge of the business transfer with the new business owner. Otherwise, the employee is free to object to the transfer of the employment relationship. As a consequence, the employment relationship with the transferor continues (see below). The continuity of the works council may also be assumed if the business continues as a separate economic entity.

In practice, one of the most problematic areas of a business transfer is the impact of the transfer on collective bargaining agreements and works agreements. In principle, these collective agreements are either incorporated into each employment relationship (transformation), continue to be applicable unchanged on a collective level (continuation) or get replaced by already existing collective agreements at the purchaser of the business (replacement). It is to be noted that exceptions might apply for various reasons and the explanations below are simplified to make them more transparent.

I. Transformation

As a result of the business transfer (sec. 613a para. 1 sent. 2 *BGB*) the collective standards sometimes become part of the individual contracts by virtue of law. The employer cannot change these standards to the disadvantage of the employee within a period of 1 year. Thereafter, any modifications to the contents of a collective agreement that has been transformed into individual employment contracts will have to be agreed upon with every single employee. Thus, the transformation of collective bargaining agreements is usually to the disadvantage of the employer and to the benefit of the employee.

II. Continuation

In some cases, collective agreements such as collective bargaining agreements (*Tarifverträge*) or works agreements (*Betriebsvereinbarungen*) remain applicable and unchanged throughout the business transfer. That will particularly be the case if the transferee is a member of the employers' organisation that entered into the collective bargaining agreement or if a collective bargaining agreement has been generally binding for the respective industry sector. An existing works agreement might stay in effect as a whole if the identity of the transferred business is preserved. As a consequence, where a works agreement stays in effect, modifications can be made on a collective level, i.e. the transferee does not need to negotiate modifications with each individual employee, but rather with the works council.

III. Replacement

In other cases, the transferee is already bound by collective agreements on the same subject matter. In this event, so far as is applicable, the collective agreements will be replaced by the existing collective agreements applicable at the transferee. For example, the Federal Labour Court has ruled that if the transferee already has a company pension plan based on a works agreement, it replaces the works agreement of the transferor. However, the employees keep their pension entitlements from the old pension plan already earned till the day of the business transfer. Thereafter, the pension plan at the transferee applies even if the entitlements that can be acquired under the new pension plan are lower than under the previous plan.

F. Effective Date of Transfer

The decisive point in time for the triggering of the legal consequences of sec. 613a *BGB* is the date at which the change of ownership of the business occurs. A particular assignment of the management is not necessary according to German law. The transferor merely has to quit its commercial activity regarding the business to be transferred, and the transferee has to start continuing the business. In this respect it is not relevant if the sales agreement demands the complete payment of the purchase price for the ownership to change. If the transferee has taken over the business but the purchase price has not been paid, the business transfer will still have occurred according to the Federal Labour Court.

G. Liability

The transferee takes on the employment relationships on terms equal to those existing at the time of the business transfer, i.e. it is basically liable for existing debts of the transferor. However, according to the applicable statutory provisions (sec. 613a para. 2 *BGB*) the transferor is liable for any liabilities generated prior to the business transfer as well as for those which were generated prior to the transfer and become due up to 1 year after the transfer.

The transferor and the transferee are jointly and severally liable. In case of doubt both are liable in equal shares. The respective statutory provisions (sec. 613a para. 2 *BGB*) are mandatory in favour of the employees and cannot be subject to a contrary agreement between the transferor and transferee, nor can they be subject to the disposition of individual employees.

If a body corporate ceases to exist following the transfer, however, no joint and several liability occurs. With expiry of the body corporate the transferor ceases to exist and thus no source of liability can exist (e.g. company A merged with company B, company A ceases to exist). All assets are located with the transferee.

H. Dismissal Protection

I. Introduction

The most serious provision for the transferee is the prohibition against dismissal according to sec. 613a *BGB*. Under this provision the termination of an employment relationship either by the transferor or by the transferee on the grounds that a business transfer has taken place is ineffective.

II. Scope of Application

The prohibition against dismissal in business transfer cases applies to regular terminations (*ordentliche Kündigung*) as well as to terminations for good cause (*Kündigung aus wichtigem Grund*). The complaint against the dismissal has to be filed against the employer who gave notice. The business transfer must be the main reason and the ultimate cause of the dismissal. At the time of the dismissal the fact of the business transfer must have been known. The legal consequence is that such a dismissal will be deemed invalid.

The prohibition provision is not applicable to dismissals which are factually justifiable irrespective of the business transfer. Moreover, this provision for prohibition against dismissals stands independently of the general Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*). A notice which is given against the prohibition is deemed to be void.

III. Closing Down of the Business

A difficult case occurs if employees are dismissed due to the closing down of a business, but later the business is sold and continued. The Federal Labour Court deals with that difficulty by examining strictly if facts prove that it was intended to close down the business by the time notice of the dismissals was served. Pursuant to the *BAG* an intended closing down can be assumed if the operational circumstances and a reasonable business analysis justify the outlook that the business would be closed down and that the employees are thus dispensable. In these cases, dismissals

will be valid even if later a transfer of the business takes place. However, the dismissals will be invalid if by the time notice was served there was an equal likelihood of a business transfer or the closing down of the business.

IV. Claim to Reinstatement

If a business transfer takes place shortly after the termination, the terminated employee has a claim to be reinstated under his previous contractual conditions by the transferee. The *BAG* negates this claim for terminations caused by insolvency (28 October 2004—8 AZR 199/04), in particular if the business transfer occurs after the expiration of the individual notice period.

I. Information of the Employees

The provisions regarding business transfers set out the transferor's and transferee's obligation to inform the employees about the transfer of business and the employee's right of objection against the business transfer. Every employee who is employed with the transferor at the time of the business transfer and who will be affected by the business transfer has to be informed prior to the transfer.

The purpose of these provisions is to inform the employees about the prerequisites and consequences of the upcoming business transfer and thus enable them to take a decision whether they wish to object against the transfer of their employment relationship or not. The obligation to inform those employees affected by the transfer exists in all instances, no matter how large the business is. It is also irrelevant whether workers' representatives exist in the relevant business operation.

I. Employee Notification

Employees affected by the business transfer must be notified in writing by the transferor or the transferee of the time of and reason for the transfer, as well as the legal, economic and social consequences and the contemplated measures to be taken with respect to employees.

II. Issues Concerning the Information in the Notification

The notification, the contents of which are prescribed, has to be issued prior to the business transfer. Attention should be paid to the accuracy of the information given.

The information does not need to be drafted on behalf of the individual employee; however, it must be precise and without legal errors.

1. Time of the Transfer

The proper date of the transfer is not the date of the legal transaction (for example the asset purchase contract), but the commencement of the new ownership of the business. In cases of corporate restructuring, it is sufficient to set a prospective deadline for the registration of the corporate restructuring, which usually takes between 4 and 8 weeks following the filing of the registration. In case the business transfer is delayed or postponed, it is advisable to provide an adjusted version of the notification for all employees.

2. Grounds for the Transfer

The correct notification will include information about the legal grounds for the business transfer, such as an acquisition, lease or change of corporation form. It is definitely not intended, though, to disclose confidential business information by way of detailed justifications, supported by commercial operating figures. Thus, the economic forces and entrepreneurial motivation leading to the business transfer generally do not have to be explained. In cases where the economic reasons will affect the employees' employment, e.g. where the transferor will close down the business and therefore terminate the employment due to operational reasons, this background has to be part of the information. In this regard it is sufficient to roughly reconstruct the economic reasons that might affect the employment.

3. Legal, Economic and Social Consequences of the Transfer for the Employees

The direct legal, economic and social consequences of the business transfer have to be disclosed in sufficient detail to the affected employees. A blanket reference to the listed regulations will not be sufficient to satisfy the obligation of providing correct information, but individual and impartial legally binding advice to the employees goes further than is necessary. In all events, the notification should contain an explanation of the main legal consequences of the transfer of the existing employment contracts to the transferee, the continuity or the transformation of effective provisions of collective agreements, the provisions regarding liability and the prohibition of dismissals. Furthermore, in this context the information about the right to object and potential legal consequences of the exercise of that right are essential in order to notify correctly. The indirect consequences have to be made specific and be easily recognised by the employee. They should have a connection to the employment relationship and, in addition, be associated with the business

transfer through a factual and temporal context. This limitation applies especially with respect to the social consequences.

It is also necessary to inform about the identity, form of organisation and head office of the transferee. In this respect the *BAG* held that it is not sufficient to refer to the transferee as the "new" company. The German labour courts have made various decisions in recent years about whether the information about the solvency of the transferee is necessary or not. The Federal Labour Court ruled that employees have to be informed if a considerable reduction of company assets will take place. Considering that some consequences of the transfer depend on the plans of the transferee, and these plans might not be known to the transferor, the obligation to inform about legal, economic and social consequences should not expand beyond the direct legal consequences provided in the statutory provisions for business transfers.

4. Contemplated Measures

According to the explanatory memorandum of the legislator, the measures that need to be contemplated by the employer in respect of the employees include further training concerning the planned reorganisation of production, or restructuring and other measures that concern employees' professional development. In the event the business transfer involves a change in operations, an indication as to the conclusion of agreements between the employer and its works council on a so-called balance of interests (*Interessenausgleich*) and a social plan (*Sozialplan*) or as to any corresponding negotiations will be necessary.

5. Content of the Notification

The obligation of notification about the transfer applies to both the transferor and the transferee. According to the explanatory memorandum of the legislator, both of them have to reach an agreement as to the manner in which they want to fulfil their obligations to give notification. In view of liability issues in respect of the concerned businesses, a concerted schedule of action becomes a necessity. A demarcation of respective liabilities in the event that inadequate notification is given should become a regular item in an asset purchase agreement.

6. Time of the Notification

The law does not contain any provision regarding the point in time for the notification. In practice the parties often wish to identify at the earliest opportunity those employees that do not wish to transfer to the transferee. A notification of the transfer at an early stage forces the employees to decide in advance of the transfer about the exercise of their right to object. Since the employees are

entitled to object to their transfer within 1 month of the notification, employers are usually well advised to issue the notification at least 1 month prior to the upcoming business transfer so that they are able to identify the number of employees who plan to exercise their right to object prior to the transfer. This provides for greater certainty when planning the sale, but also increases the risk that any essential changes to the terms of the sale make the notification incorrect. In each individual case the employer should consider the right time for the notification of the employees.

7. Form of the Notification

The notification has to be given in text format, as provided by the Civil Code. The statement must therefore be in writing, state the identity of the issuing person and must be capable of being recognised as made by that person (e.g. by being evidenced by their signature or in another acceptable form). It is therefore permissible to give the notification via email or on a notice board. However, in view of the fact that once the notification has been given, the 1 month objection period is triggered, the employer might have to provide sufficient proof that the notification has been received. Therefore, it is advisable that the employee signs an acknowledgement of receipt.

8. Legal Consequences of an Omitted Notification

The legal consequences arising from an omitted or deficient notification are not fully governed by the law. The respective provision merely stipulates that the objection period of 1 month for the relevant employees does not commence prior to the receipt of the notification. In addition to that, deficiencies regarding the notification may cause claims for damages against both the transferor and the transferee.

The Federal Labour Court had to decide on a wrongful termination case involving an employee who was insufficiently informed about an upcoming business transfer, objected, and was then terminated by his old employer, the transferor. The court held that an insufficient notification results in the consequence that the 1 month period to object (see below) does not begin to run, but does not lead to the invalidity of a termination (24 May 2005—8 AZR 398/04). Even though that decision takes some pressure from transferors and diminishes the danger of omitted or insufficient notification significantly, employers should continue to comprehensively inform their employees, as that will increase the chance to reach a mutual solution in the course of the transfer.

J. Right of Objection

I. Prerequisites

The employee has the right to object to the transfer of his employment relationship from the transferor to the transferee within 1 month of receiving a complete notification. The objection does not require a statement of reasons. The objection statement has to be in writing and the intention of the employee to object has to be sufficiently apparent. The period of 1 month cannot be shortened unilaterally; it can be extended, though, by a tripartite contract as the extension is to the benefit of the employee.

The party to which the objection has been given should inform the other party. It is quite apparent that the parties involved in the transfer will have to cooperate and reciprocally inform each other about the receipt of any objection. Even when one of the parties fails to inform the other about having received an objection, the other party will be prevented from contesting the omission. In the event that a deficient or inadequate notification has been supplied, the time limit for the objection will not be triggered. However, it can be presumed that the employee forfeits his right for objection after a certain time period upon the transfer.

II. Consequences of Objection

An effective objection prevents the employment relationship from being transferred, so that the employment relationship continues with the transferor on the same terms as before. In practice, however, the transferor often terminates the employment for other reasons than the business transfer, in particular for operational reasons, since the relevant business was transferred to the transferee.

In principle, the effective exercise of the right to object cannot be revoked by the mere commencement of work with the transferee. Since the right to object is a constitutive right, it cannot be explicitly or implicitly revoked. Admittedly, there are cases of abuse of rights and of forfeiture in which the employee's right to object lapses and becomes irrelevant. In this regard the concept of forfeiture gains importance. A German labour court has adjudicated that an employee is not entitled to return to his former employer if he has joined the transferee in the meantime, even though he has objected to the transfer of the business. In that particular case, the employee had worked 3 months for the transferee after his objection without any protest and had drawn his salary from the transferee. Therefore, the court excluded the employee's right to object.

Employees may object collectively to a business transfer as long as they only exercise their contractual rights and the right to keep their employer. However, if the employees intend to obstruct a business transfer as such and harm the employer, the collective objection might be an abuse of rights.

K. Cross-Border Transactions

Cross-border M&A transactions, i.e. transactions involving businesses in different countries, raise a number of questions regarding the applicable labour and employment law.

I. National Transfers

In principle, mergers, spin-offs and transfers of assets as a whole or in part—except mere share deals—may form a transfer of business in the meaning of sec. 613a *BGB* if there is a change of ownership and if the identity of the economic entity remains the same after the transfer. The new ownership may be obtained by a foreign owner although its "nationality" is irrelevant. The German statutory provisions apply if the transferred business is still located in Germany, i.e. not relocated abroad, and if the employment contracts are governed by German law. However, outsourcing of work tasks to a contractor abroad is not a relevant business transfer if the transferee does not take over a considerable part of the personnel or tangible/intangible assets of the transferor. Thus, the transfer of business provision does not apply in cross-border and off-shore outsourcing if a mere functional succession (*Funktionsnachfolge*) takes place.

II. International Relocations

The international relocation of a business may also generally involve a business transfer. However, this may only be the case if, preceding or following the relocation, a change of ownership takes place and if the identity of the economic entity remains intact. However, if the business is relocated from Germany to a site abroad, the relocation preceding or following the change of ownership results in a closure of the business in Germany. Further, the termination protection of the employees pursuant to the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*) and also the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*) are limited to businesses located on German territory. Thus, the employees lose their termination protection pursuant to the Dismissal Protection Act regarding a termination of their employment for operational reasons due to the loss of their work place at the closed business in Germany, and they do not have to be offered vacant positions in the relocated business abroad. Moreover, the employees may also experience a considerable modification of their right to establish and keep a works council.

The same will apply to the employees who did not object to the transfer of their employment if the transferee takes over only parts of a business, e.g. its single branches, but not its local head office in Germany. According to the Federal Labour

Court, a business operation located on German territory requires that the employees are integrated into an operational organisation at least partly managed from Germany. It is insufficient, for example, if independent field employees are managed by a distribution organisation located abroad. However, if a business is relocated abroad from Germany, the employees are not obliged to continue their employment at the relocated site abroad; rather, the employees may object to the continuation of their employment.

According to the Federal Labour Court, although disputed by the Higher Regional Labour Courts, a relevant business transfer may arise in cross-border relocations with simultaneous change of ownership and the continuation of the work abroad, like in businesses with no or only few tangible/intangible assets. However, in such businesses in which the workforce constitutes the identity of the economic entity, the transferee may avoid a business transfer by employing a new workforce at the relocation site abroad.

L. Stock Option Plans

The legal consequences for employee rights arising from stock option plans are disputed and remain ambiguous.

The Federal Labour Court has decided that if a stock option right is granted by an affiliated or parent company and not by the employer, that right is not part of the employment contract but arises from a separate contract. Therefore the stock option right is not transferred in case of a transfer of business.

In case the stock option right is granted by the employer, i.e. the transferor, a distinction between such stock options that are due at the time of the transfer and such that are not yet due has to be made.

Stock options that are due can be exercised by the employee; therefore no transferable claim exists but rather the employee can claim his existing stock option right against the transferor.

On the other hand, stock option rights that are not yet due are transferable. However, since the transferee is generally legally unable to fulfil the claim when it becomes due, the employee is entitled to compensation payments. This is why many stock option plans contain forfeiture clauses (*Verfallsklauseln*) which state that undue stock option rights shall forfeit when the employee leaves the company and will therefore not transfer.

M. Key Aspects

- The preconditions of a business transfer are dominated by decisions of the European Court of Justice but also by the Federal Labour Court.

- Statutory managing directors do not fall into the scope of the transfer of business provisions.
- In case of a business transfer it is of high importance that the employees receive the correct information.
- The transferor and the transferee are in principle bound by joint liability towards the employees transferred.
- A dismissal due to the business transfer is invalid.
- Employees who want to object to the business transfer should be made aware of all consequences, especially of the possibility that the transferor will have to terminate the employment relationship due to operational reasons.
- Collective agreements in principle either (1) become transformed into the individual employment contract, (2) continue to be applicable unchanged or (3) get replaced by existing collective agreements at the transferee.
- Cross-border transfers might result in the German protective regulations no longer being applicable.
- Outsourcing, insourcing or change of contractorship (*Auftragsneuvergabe*) bear the risk of direct application of transfer of business rules.

Chapter 25
Stock Options

Martin Heinsius and Pascal R. Kremp

A. Introduction

The participation of employees[1] in the company's economic success serves to bring the interests of the employees in line with the interests of the shareholders in increasing the profit of the company. Stock options and other equity awards may help to create an entrepreneurial spirit within the company's workforce increasing the motivation and loyalty of the staff. Since stock options usually cannot be exercised for several years after they have been granted and become void if an employee leaves the company, the options tie employees to their employer. In addition, they enable firms to pay competitive wages without a drain on liquid funds. The stock corporation (*Aktiengesellschaft, AG*) is the most suitable corporate form under German law for participation of the employees in such a scheme as the shares are most interchangeable and marketable. Due to the financial and economic crisis, stock options and other equity incentive awards came under stringent review. It can be expected that in the future stock options will only be permissible if the focus is on long-term incentives. The grant of stock options and other equity awards affects various areas of law, including corporate, labour and employment, insider trading, securities and tax law.

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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B. Corporate Law

I. Real Equity Capital Instruments

If the company chooses a model where the employee is granted the right to actually acquire shares, the company has the duty to transfer the shares at the time the employee exercises his option. However, at the time of offering employees the opportunity to participate in the programme, the company is obliged to acquire or create sufficient shares to be in a position to fulfil the employees' claims once they exercise their options. Under German statutory law there are different ways for a company to acquire or create those shares. These include:

1. Cost-Free Allocation of Shares from Existing Shareholders

The easiest and cheapest way for the company to acquire or create shares is for the existing shareholders to agree to make their shares available. However, this form is rare in practice and is chosen by companies with only very few major shareholders which are about to go public.

2. Contingent Capital Increase

The most common practice is the creation of shares by contingent capital increase (*bedingtes Kapital*). Here, the stated share capital increases only at the time the employees exercise their options and acquire shares from the company. The contingent capital increase requires a shareholders' resolution in a general meeting by a majority of 75% of the capital represented.

The employees' option right to acquire shares from the company usually has one of the two following forms in the case of a contingent capital increase.

a) Simple Preemptive Rights

To facilitate the employees' participation in the company, the legislator created the possibility to grant so-called "simple preemptive rights" ("naked warrants"). Only the so-called strike price has to be paid upon the exercise of the option.

The details and the exercise of the simple preemptive rights are subject to general provisions. A shareholders' resolution adopted at a general meeting with a majority of 75% of the capital represented is required. The resolution must determine the allocation of the preemptive rights to senior executives and employees, i.e. to the management board (*Vorstand*) of the company and senior executives of the subsidiaries, as well as the employees. A double allocation to board members who are also executives of subsidiaries should be avoided.

The acquisition period for the preemptive rights must also be determined. The initial exercise period, i.e. the waiting period between the grant of the preemptive right and the first opportunity to exercise the right for each tranche is also significant. A waiting period of 5 years is the norm; a shorter period would appear to be appropriate only in special cases, for example, for very innovative companies with very short product cycles. According to statutory regulations, under no circumstances may the period be shorter than 4 years.

The resolution must define the requirements of the acquisition. That is, restrictions for the exercise of the preemptive right, usually determined by a certain future price level for the shares of the company (strict performance). An additional tie to a share index is also permissible (relative performance) as well as other economic performance criteria.

The nominal value of the shares related to the "naked warrants" may not exceed 10% of the registered capital at the time of the shareholders' resolution on the contingent capital increase.

b) Convertible Bonds/Warrant Bonds and Option Bonds

In case of convertible and warrant bonds (*Wandelschuldverschreibungen*), the employee grants the company an interest-bearing loan. A convertible bond entitles the employee to request the transfer of a fixed number of shares instead of repayment of the loan. In case of an option bond (*Optionsanleihe*), the employee may acquire a certain number of shares for a fixed price in addition to the repayment of the loan. In view of the right to acquire shares for a fixed price, the interest rate for the loan is below the market rate for both the convertible bond and the option bond.

The issuance of convertible bonds requires a shareholders' resolution by a majority of 75% of the capital represented. This resolution may authorise the board for a period of no more than 5 years to issue the bonds. The shareholders of the company have a preemptive right relating to the convertible and option bonds. Therefore, an exclusion of the preemptive right by shareholders' resolution is necessary as well as a report by the board justifying this exclusion of the preemptive rights.

3. Purchase of Own Shares

The company may also acquire its own shares on the market to pass them on to the employees exercising their options. However, this procedure reduces the liquidity of the company. If the strike price is lower than the purchase price, the company will suffer a loss. The acquisition of a company's own shares is subject to strict conditions: the total number of own shares held must not exceed 10% of the stated share capital of the company. The acquisition cost must be covered by the annual

profit or the revenue reserve, and the cash contribution on the shares (nominal value plus any agio to be paid) must be fully paid up.

The employees' option right can differ as follows.

a) Employee Stocks

The law provides for the issuance of so-called employee stocks (*Belegschaftsaktien*). Only employees of the company or of affiliated companies within the meaning of German labour law can be beneficiaries, i.e. no members of the management board or of the supervisory board of a stock corporation. The shares admissibly acquired for this purpose must be fully issued to the employees within 1 year. A shareholders' resolution is not required.

b) Stock Options on the Basis of General Authority to Acquire Own Shares

Generally, companies are allowed to acquire their own shares for any purpose except for the trade of their own shares. Unlike employee stocks, those shares may also be issued to members of the management board of the company and affiliated companies. However, this would be under the condition that the board is authorised by a shareholders' resolution adopted by simple majority to acquire the shares for a maximum period of 5 years. There is no obligation to sell them after the end of a particular time period.

The resolution granting such authority should also specify both the lowest and the highest amount for which the shares may be purchased, the addressees of the stock options, the performance targets, the acquisition and exercise periods, and the waiting period for the first exercise of the right. The law requires a minimum waiting period of 4 years. It should be made clear that there may be a gap between the end of the authorisation period for the acquisition of a company's own shares and the time at which the option is first exercised.

Issuing a company's own shares to its employees requires an exclusion of shareholders' preemptive rights as they would otherwise be entitled to own the shares as if they were created in a capital increase. Therefore the shareholders must agree at a general meeting to exclude the preemptive right, and the board must justify this exclusion of the preemptive rights in a report. This resolution requires a 75% majority of the votes present at the meeting.

4. Authorised Capital

Although the Stock Corporation Act (*Aktiengesetz, AktG*) recognises the possibility of granting stock options by "naked warrants" through a contingent capital increase, it should, nevertheless, be possible to allocate shares to the members of the board, to employees of the company and also to the executives and employees of affiliated

companies on the basis of authorised capital. This requires a shareholders' resolution with a majority of 75% of the represented capital. The resolution may authorise the board to increase the capital for a maximum period of 5 years upon registration of the resolution. The amount of the authorised capital must not exceed one-half of the share capital existing at the time of authorisation; in the case of a simultaneous regular increase of capital, the higher share capital is relevant. The shareholders have a preemptive right relating to the authorised capital and this must be excluded when authorised capital is created for the stock options of board members and employees. The board must give reasons for this exclusion of the preemptive right to the general meeting in a written report.

II. Virtual Equity Capital Instruments (Synthetic Options, Phantom Stocks, Stock Appreciation Rights)

Synthetic Options are characterised by option holders never becoming actual shareholders. The company, acting as the seller, offers its employees "custom made" options with the company's own shares or the listed shares of the group parent company as underlying security. In the terms and conditions for the option the performance of the option transaction by means of delivery of shares is excluded, and instead the option holder receives a cash payment from the company, in principle compensating the difference between the strike price and the stock exchange price on the exercise date.

Phantom stocks differ from stock appreciation rights in that they are subject not only to positive, but also negative developments in share price. They also provide for the payment of dividends.

Usually, the option terms and conditions will determine whether it can only be exercised within certain time periods during the term of the option if certain price targets are met with regard to the underlying security.

III. General Restrictions Concerning Stock Option Plans for Board Members

German law provides for significant restrictions for stock options for board members. The aggregate remuneration of a board member, namely the fixed salary, the reimbursement of expenses, insurance premiums and other fringe benefits, as well as any variable remuneration elements, must be in direct relation to the duties of the board member and to the financial situation of the company.

There are a wide range of variations of stock option plans available, a description of all of which is not possible here. Accordingly, an individual evaluation is necessary for each individual stock option plan to determine which is most suitable.

C. Contractual and Labour and Employment Law Issues of Granting Stock Options

In addition to the question of how to acquire stocks under a stock option plan, another issue which requires consideration is the contractual relationship between the company and the employee regarding the stock options.

I. Stock Corporation Law Aspects

According to the German Stock Corporation Act, any offer to subscribe to new shares may only be made subject to the preemptive rights of the current shareholders. Any contractual obligation made prior to a resolution on the capital increase is invalid in relation to the stock corporation. This applies to a regular capital increase in the same way as to a capital increase with authorised capital or contingent capital. The company should therefore avoid entering into a binding agreement with the employees prior to the shareholders' resolution, as the employees may recover damages from the company or even the board members if the general meeting does not approve the stock option plan.

II. Labour and Employment Law Aspects

The key concerns in respect of stock options from a labour and employment law perspective include the legal basis of the grant to the individual employees and information and consultation rights of the works council.

1. Legal Basis for Granting Stock Options

The grant of stock options to employees is typically based on one of the following legal bases:

- Individual agreement
- Works agreement with the works council (*Betriebsvereinbarung*)
- Operational practice

a) Individual Agreement

Stock options for managing directors and key employees are usually granted by individual agreement—i.e. by a provision in the employment contract, an

addendum or a side letter stating that the board may decide to grant a specific number of stock options to the individual employee.

b) Works Agreement

In companies with a works council, the employer has to inform and consult with the works council prior to implementing a stock option plan. This does not apply to stock option plans for individuals who are managing directors or key employees.

It is up to the employer to decide if a stock option plan is to be introduced at all as well as the extent of such a plan. The works council must be consulted and given details about the allocation of the options to individual employees.

In the case of local companies, the works council might have considerable influence on the stock option plan since the board which has to decide on the structure of the plan is located in Germany and the plan is subject to German law.

In foreign companies (i.e. if the parent company issuing the options is located abroad) however, the board usually decides on the introduction of a stock option plan on a global basis. In this case, a local works council will have minimal influence on the structure of the plan and eligible employees. Employers are advised to inform the works council that the implementation of the plan would be a "take it or leave it" decision. Since stock options are an add-on to the remuneration of the employees, the works council will usually sign off such plans.

If the employer ignores the consultation rights of the works council, the works council could theoretically stop the implementation of the plan by injunctive relief or preliminary injunction. In practice, however, this is very rare since stock options are an additional remuneration for employees which they otherwise would not receive.

If the employer has not consulted with the works council and proceeds to send grant letters to individual employees, the works council could force the employer to renegotiate the stock option plan. This could result in an amendment of eligible employees and then increase the total volume of the plan.

c) Operational Practice

Employers should be aware that employees might be entitled to stock options based on a theory of operational practice (*betriebliche Übung*).

If the employer has voluntarily granted a benefit three consecutive times without a reservation that such benefit is on a voluntary basis, employees may be entitled to receive such benefits in the future.

Employers should therefore always have thorough documentation that the stock option grant is only a one-off grant and shall not support any future claims (cf. Chap. 8).

2. Typical Employment Issues

a) Principle of Equal Treatment

When introducing a stock option plan, the employer must respect the principle of equal treatment. According to this principle, employees shall be treated equally unless there is an objective reason for a difference in treatment. Employers should give particular consideration to what groups of employees will be eligible for stock options and whether the distinction between them and other employee groups is justified.

Examples of permissible justifications would include granting stock options to key employees only or choosing to exempt fixed-term employees (since stock options are usually a long-term incentive).

b) Discrimination

Employers are not allowed to discriminate against employees based on race, ethnicity, religion, belief, gender, sexual orientation, disability or age unless the discriminatory behaviour is justified. Nor is such discriminatory behaviour permitted with regard to the introduction and grant of stock options.

In particular, it might be discriminatory not to grant stock options to part-time employees, since most part-time employees are female and this could therefore constitute indirect gender discrimination.

c) Forfeiture Provisions

Stock option plans typically stipulate that the options forfeit or have to be exercised within a specific period of time if the employment relationship is terminated.

According to a ruling of the Federal Labour Court, it is permissible that the options cease to exist at the end of employment.

D. Insider Trading

In Germany, insider trading is sanctioned by means of criminal punishment. In principle, the beneficiaries of a stock option plan are persons who, as members of the executive body of a company or because of their profession, activities or work, inevitably obtain insider knowledge. They are prohibited from using such knowledge for the purpose of trading securities. Insider trading issues involved in stock option plans are described in the following according to the time sequence of stock option plans.

I. Introduction of the Stock Option Plan

At the time of introducing a stock option plan there are usually no problems under the insider trading laws.

II. Allocation of the Stock Options

Problems may, however, arise in connection with the allocation of stock options if the beneficiary under a stock option plan is given the right to choose between fixed remuneration and receipt of option rights. Beneficiaries with insider knowledge who decide to receive the option rights may be criminally liable. Therefore, option rights should only be granted to employees automatically and without the beneficiary getting involved in the events or after the insider facts have been disclosed to the public.

III. Exercise of Stock Options

The exercise of stock options is generally "plain sailing" under the insider trading law. However, in order to be safe, it is advisable to prepare a stock option plan to introduce automatic standards defined in advance that largely reduce the beneficiary's discretion. It should be stipulated that the options may be exercised only during certain time periods (exercise periods), for example within 3 weeks of the presentation of a business or interim report, a balance sheet press conference, or the like, i.e. at a time the up-to-date economic data on the issuer of the options are also available to other market players.

IV. Sale of Shares

A sensitive matter under the insider trading law is the sale of the shares if the seller is aware of negative insider facts. However, there are various ways to limit the possibility to sell the shares acquired by the beneficiary: First, the beneficiary may employ a third person who must not be bound by instructions to manage the shares. Second, the company may give very narrow standardised instructions to the beneficiary for the sale of the shares, providing him with only a very limited discretionary scope. Third, companies are well advised to maintain a degree of transparency beyond the minimum statutory requirements.

V. Harmful Effect on the Company's Reputation Because of the Appearance of Insider Trading

It would be very damaging to a company's reputation for the impression to be given that the beneficiaries enjoyed special advantages in connection with a stock option plan. It is therefore advisable for companies to set clear criteria and fixed standards in the stock option plan.

E. Reporting Obligations Under Securities Regulations

In Germany, persons holding stock options or similar options are subject to reporting obligations under the EU Regulation No. 596/2014 (Market Abuse Regulation, *Marktmissbrauchsverordnung, MarktmissbrV)*. Reporting obligations apply if such persons' conduct constitutes directors' dealings or if the number of stock options or similar options exceeds certain thresholds as stipulated in the *MarktmissbrV*.

I. Directors' Dealings

According to art. 19 *MarktmissbrV* persons performing executive functions at an issuer of shares are obligated to notify such issuer and the competent supervisory authority, which in case of Germany is the Federal Supervisory Authority for Financial Services (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*), without undue delay but in any event within 3 business days in writing of any dealings (i.e. purchase or sale of shares of such issuer or of financial instruments relating to such shares) if the price of such financial instruments depends, directly or indirectly, on the price of the shares.

The *BaFin* considers, *inter alia*, the following types of financial instruments to relate to shares of the issuer: convertible bonds, convertible participation rights, warrants, call and put-options, stock options, stock appreciation rights and phantom stock plans.

Pursuant to art. 17 para. 2 *MarktmissbrV* such notifications have to be filed with the competent authority of the EU or EEA member state in which the issuer is registered; this would be the *BaFin* if the shares of the issuer are (1) admitted to trading at a German stock exchange or (2) admitted to trading at a foreign organised market, provided that such issuer has its corporate seat in Germany, or (3) shares of an issuer with its corporate seat outside the EU and the EEA if such shares were admitted to trading to an organised market at a German stock exchange.

Persons performing executive functions are considered to be: members of the management board, members of the supervisory board (*Aufsichtsrat*), shareholders

underlying a personal liability of such issuer and other persons who regularly have access to sensitive insider information and have authorisation to make material business decisions for such issuer, i.e. such person needs to be entitled to making strategic decisions for the issuer either on a stand-alone basis or as member of a board or other competent body alike (the "Executive").

For the sake of transparency, persons maintaining a close personal relationship with the Executive are also required to notify the issuer and the competent authority about dealings accordingly. Persons maintaining a close personal relationship are considered spouses, registered life partners, dependent children and other relatives, who have a common household with an Executive for at least 1 year prior to the dealings to be reported accordingly.

Further, legal entities, including foundations and partnerships, in which a person performs executive functions, who is considered either an Executive or a person maintaining a close relationship with such Executive, are also considered to be a person maintaining a close personal relationship.

In addition, legal entities, companies and institutions which are directly or indirectly controlled by either an Executive or a person maintaining a close personal relationship to an Executive, or which are established for such a person or whose economic interests largely correspond to the economic interests of such a person, are covered by the reporting obligations as well.

Finally, however, such reporting obligations do not apply if the total amount of dealings in shares or financial instruments relating to such shares does not reach 5000€ within a calendar year. Further exemptions apply if shares or financial instruments are indirectly held via investment funds or similar pools of different assets and the relevant shares or financial instruments represent less than 20% of the financial risk positions of such investment fund or asset pool.

II. Holding of Financial Instruments

A second reporting obligation may apply if the number of stock options or similar options held by an individual or a legal person exceeds certain thresholds. Any individual or legal person, whether a German or a foreign citizen or whether with a corporate seat in Germany or abroad, is required to notify an issuer of voting rights in shares and *BaFin* without undue delay, but no later than 4 stock exchange days, upon exceeding or going below the thresholds of 3, 5, 10, 15, 20, 25, 30, 50 or 75%, respectively. In general, the above reporting obligation applies only if the shares of such issuer are admitted to trading at a German stock exchange.

An individual or legal person holding, directly or indirectly, financial instruments which in connection with a legally binding agreement unilaterally grant such individual or legal person the right to purchase issued shares carrying voting rights, is obligated to notify the respective issuer of the shares and *BaFin* in writing without undue delay once the number of such financial instruments upon conversion into shares of such issuer, which are already issued, exceeds 3, 5, 10, 15,

20, 25, 30, 50 or 75%, respectively, of the share capital of such issuer, provided that Germany is the state of origin (*Herkunftsstaat*) for such issuer of shares. Germany will be the state of origin if the issued shares are either admitted to trading at a German stock exchange or at an organised market in the European Union or the European Economic Area, provided that the issuer has its corporate seat in Germany.

The above reporting obligation applies if the unilateral right to purchase issued shares carrying voting rights arises simply from a contract so no claim *in rem* is needed.

However, the fungibility of the issued shares is not a prerequisite for the above reporting obligation. Consequently, the reporting obligation arises if the financial instruments which provide for a unilateral contractual right for purchase of shares, relate to issued shares, which are not admitted to trading at a German stock exchange or an organised market in the European Union or the European Economic Area.

F. Tax Law Aspects

I. Employee Shares

If shares are issued to an employee for no valuable consideration, or for a price below the market price (so-called employee shares (*Belegschaftsaktien*)), then on the day the shares are made available a "monetary benefit" arises in the amount of the difference between the stock exchange price and the price actually paid by the employee. This benefit is subject to income tax because it is an income from non-self-employed work. However, it is worth noting that the Income Tax Act (*Einkommensteuergesetz, EStG, sec. 3 no. 39 EStG*) exempts benefits not exceeding 360€ per calendar year, provided that such shares are offered to all employees who have been employed for longer than 1 year.

II. Convertible or Option Bonds, Synthetic Options

1. Option Bonds, Synthetic Options

According to case law by the Federal Tax Court (*Bundesfinanzhof*) and the legal practice of the German Inland Revenue Office (*Finanzverwaltung*), no monetary benefit arises at the time the conversion or option rights or the "synthetic option" is granted. This is considered not to be a relevant monetary benefit, because the employee is not generally allowed to freely dispose of the option as such rights are usually strictly personal and non-transferable. Under the legal practice of the German Inland Revenue Office this also applies to transferable options that are not

regularly traded at a regulated market (i.e. a stock exchange). Therefore only the exercise of the conversion or option right itself is considered to be a monetary benefit. The monetary benefit is the difference between the strike price and the stock exchange price on the exercise day of the option. Such benefit is received by the holder of the option on the day the underlying shares are credited to his securities deposit account. If the performance of the option rights is limited to payment of the difference (as in case of synthetic options), the monetary benefit equals the proceeds, i.e. the amount being subject to income tax liability. In this case the taxable event and the moment of receipt is the day of the exercise of the option. These principles also apply to options settled by an exercise and sell procedure. As the due date to determine the monetary benefit is the exercise of the option, the employee might face very high taxes. If the value of the delivered shares subsequently decreases significantly, the employee might face the problem that the value of the shares is less than this tax liability. The employee's expenses in acquiring the options and or the exercise of the option are tax deductible.

2. Convertible Bonds

Convertible Bonds are generally regarded as constituting a monetary benefit at the date the bonds are acquired by the employee, because they are in general transferable and marketable securities which by law include the right of the bond holder to convert his bonds into shares, provided however, that a market where these instruments can actually be traded exists. In such case, the monetary benefit is the difference between the actual acquisition cost for the convertible bonds and their fair market value at the day of the acquisition. Otherwise, i.e. in case no such market exists, the same principles as described under item (1) apply. Please note that the German Inland Revenue Office regularly assumes that no such market exists for such convertible bonds. Consequently, under such practice the burden of proof for the existence of such market is on the taxpayer. Therefore in practice no material difference to non-transferable stock options exists.

3. Stock Appreciation Rights, Restricted Stock

Stock appreciation rights are generally agreements pursuant to which the employee is promised a certain number of shares at a fixed price once certain performance criteria are met. Restricted stocks are arrangements under which the employee receives a certain number of shares at a preferential price (or for free) but during the restriction period he cannot dispose of the shares, is not entitled to exercise any shareholder rights or receive dividends. Often in these arrangements the shares are held in trust accounts to secure the employee's claims for delivery after the expiry of the restriction period. The trust account is structured in such a way that the employees cannot dispose of the shares during the restriction period and the shares are delivered to the employee once the restriction period expires.

From a German tax perspective under the legal practice of the German Inland Revenue Office it is decisive for the question when and if the taxable benefit arises whether and when the employee becomes the economic (beneficial) owner of the shares. The economic ownership transfers to the employee the moment he is fully exposed to the risk and reward of the change in value of the shares, is entitled to exercise shareholder rights including the right to receive dividends and can dispose of the shares. In most cases the employees become economic owners of the shares only upon expiry of the restriction period, because after that moment they are fully exposed to the volatility of the share value and are entitled to exercise all shareholder rights, including the collection of dividends. Consequently, under the principles outlined above, the grant of the stock appreciation right as well as restricted stock is a mere chance for a future benefit, which is not taxable. The taxable event is the expiry of the restriction period, respectively the delivery of the shares without any disposal restrictions, as at this time the employees become economically the owners of the shares. The taxable benefit is the difference between the fair market value of the shares as of that date and the consideration (if any) paid for the shares. It is received by the participating employee at the moment in time in which the shares are credited to his securities deposit account respectively the disposal limitations on this account have been removed. Please note that in this context a mere contractual obligation not to dispose of the share is not sufficient. A disposal restriction as mentioned above requires that the employee is effectively excluded from disposal *in rem*.

4. Capital Gains

In addition to the taxation at the time of exercise of the option or at the time of the acquisition of the convertible bond, the employee must pay tax on the additional profit realised by selling the shares. When such gains are realised they are, in principle, subject to a final withholding tax at a rate of 25%, which is withheld by the bank at which the employee holds his securities account. In a situation where the average income tax rate of the employee is lower than 25% he may apply for taxation of such income as ordinary income. In this case the withholding tax will be credited against his income tax liability.

III. Simple Preemptive Rights

In principle, preemptive rights are not transferable. Simple preemptive rights ("Naked Warrants") are only regarded as transferable if they are actually listed and traded at a stock exchange. Naked Warrants used in stock option programmes do not meet this requirement, therefore the granting of a preemptive right does not constitute a monetary benefit. Only the exercise of the preemptive right results in a taxable monetary benefit. The decisive day to calculate the monetary benefit is the

day the shares are credited on the employer's securities account. The taxable monetary benefit is the difference between the strike price and the fair market value of the shares.

IV. Reserved Shares

If, in connection with an (initial) public offering, shares to be issued to the employees are reserved for subscription for a "preferential price", the difference between this "preferential price" and the actual subscription price is a monetary benefit generally subject to income tax liability, regardless of whether the employee is subject to a restraint on alienation or not. Profits from subscriptions, i.e. the difference between the subscription price and the actual stock exchange price, are subject to income tax as income from employment at the regular income tax rates. This benefit is, however, income tax free, provided that the benefit does not exceed 50% of the fair market value of the share and does not exceed 135€ annually.

V. Limitation of German Taxation on Monetary Benefits from Preemptive Rights and Similar Instruments, Taxable Income for Services Over Several Years

The above-mentioned taxable monetary benefits are regarded as income for the period between the grant of the preemptive right (or any other instrument which is treated like a preemptive right with regard to taxes) and the exercise of such right. With respect to Stock Appreciation Rights the relevant period is the time between the grant and the expiry of the restriction period. In the case where an employee receives income from employment during this period which is tax-exempt, pursuant to an applicable double taxation treaty, the taxable monetary benefit is subject to German taxation only on a *pro rata temporis* basis. These rules apply even if the employee is not subject to German income tax at the day of the exercise of the preemptive right. These principles also apply in case that during the periods mentioned above the participating employee worked for several companies within the same group in such a way that the cost of his employment has or should have been shared among them.

As mentioned above, such taxable benefits may qualify as remuneration for several years. Under the legal practice of the German Inland Revenue Office this requires that at the time of the taxable event (1) the participating employee was employed for longer than 12 months with the employer or a related entity and (2) that the vesting or the restriction period, respectively, is longer than 12 months. It is not required that the employment relationship still exists at the time of the taxable event. Sec. 34 *EStG* considerably softens the impact of the progression of the income tax rate on taxable income relating to services for several years.

However, in practice this rule generally benefits employees who have taxable income disregarding the monetary benefit received from the instruments discussed above of less than 52,882€ (singles) respectively 105,764€ (married couples filing a joint return).

VI. Wage Tax, Capital Gains

1. Wage Tax

Under German tax law the employer has to withhold income taxes due on the taxable income from employment of the respective employee. Under the legal practice of the German Inland Revenue Office the employer is not always the employer under civil law aspects, but also the so-called economic employer. This is the entity which (1) bears the cost of the employee's employment or (2) under the perspective of applicable double taxation treaties and transfer pricing principles should have borne such cost and in the business organisation of which the employee is integrated. As soon as the option is exercised, the difference between the strike price and the actual (higher) stock exchange value of the share constitutes a benefit for the employee which is subject to wage tax (*Lohnsteuer*) liability. The employer or principal must deduct the wage tax from the wages in the month in which this benefit arises. Although the benefit received by the employee constitutes a part of the wages, this obligation to retain the tax relates only to the cash wages. If this is not sufficient, the employer must demand that the employee himself provides the employer with the amount to be paid as a wage tax. If this is not done, the employer must inform the tax authorities in order to avoid any wage tax liability.

The obligation to retain tax always falls on the employer, even if the wages are paid by a third party. This is frequently the case where employee options are granted, for example, when the employees of a German company participate in a stock option plan of the foreign parent company. If the shares are then actually issued, the German subsidiary must either retain the wage tax or inform the tax authorities. In order to enable the employer to properly perform its obligation to withhold taxes on such monetary benefit, the employee is obliged to inform his (previous) employer about the exercise of such instruments and to provide the relevant data to calculate the taxes to be withheld. In order to facilitate the flow of the relevant information without having to rely on the participating employee performing his information obligation, the documentation on the stock option programme should provide the respective civil law and economic employers receive all tax relevant information in a timely manner.

2. Capital Gains

Any capital gain realised by a sale of these shares is subject to tax as income from capital investment (*Einkünfte aus Kapitalvermögen*) regardless of when such gain

is realised. Such income from capital investment is in principle subject to a final withholding tax of 25% on the capital gain. The tax is to be withheld by the bank at which the employee has his securities account. In case the actual average income tax rate of the employee is lower than 25% he may opt for a tax assessment of such income. In such a case the withholding tax will be credited against his income tax liability. The capital gain together with all other income from capital investment would then be subject to income tax at regular rates. Please note that in calculating such taxable income from capital investment, cost relating to such income is not deductible in the calculation of taxable income.

However, as the benefit in this case is not based on the employment or work contract, the employer or the principal is not obliged to retain and pay any wage taxes to the tax authorities. Instead, the profit must be included in the employee's income tax declaration.

G. Tax Deduction for the Cost of the Stock Option Programme for the German Employer

As a general principle all business related cost and expenses of the German employer are deductible items in the determination of the employers' taxable profits. This generally includes the cost of employment and consequently also cost and expense of a stock option programme. However, applicable double taxation treaties as well as transfer pricing principles limit this general rule. Under the legal practice of the German Inland Revenue Office, cost of employment of an employee would only have to be borne by the German employing entity (regardless whether a subsidiary or a permanent establishment) if under the assumption of independent third parties acting under the same economic circumstances a managing director of such entity acting diligently would have accepted such terms of employment as reasonable. In essence this means that the cost of employment of an employee is tax deductible and should have been borne by the (economic) employer to the extend the services of the employee are intended to further the business interest of such employer and to the extend such cost is comparable to that of local employees. To that extend the administrative cost of the stock option programme can be shared *pro rata* by the German employer. Please note that German transfer pricing rules require an agreement in writing in case the cost of the stock option programme initiated by the parent company is to be (partially) shared with other companies belonging to the same group of companies. However, with respect to cost and expenses relating to covering the delivery obligations of the issuer of the options under the legal practice of the German Inland Revenue Office it is not unambiguous whether such costs and/or expenses are tax deductible.

Under German accounting rules pursuant to the Commercial Code (*Handelsgesetzbuch, HGB*) the acquisition of own shares by the company is to be treated as a reduction of share capital and, to the extend the acquisition cost for such

shares exceed their respective nominal value respectively *pro rata* share in the stated share capital, also a reduction of the capital reserves. A subsequent sale of the shares respectively the transfer of the shares to a third party has the opposite effect. This means that these transactions are neutral with respect to the profit and loss statement. The legal practice of the German Inland Revenue Office follows such approach for tax accounting purposes as well. Therefore, in case the company uses its own shares to cover its delivery obligations under the stock option plan, the cost for the provision of such share would be non-deductible. However, in most cases, the shares of the parent company are subject to the stock option plan. Arguably these are not the own shares of the employing company so that from their perspective these shares are ordinary assets that have to be capitalised upon acquisition with the respective acquisition cost. The resulting cost once they are delivered to the participating employee upon exercise of his option should be tax deductible as part of the cost of employment.

H. Selection of the Most Suitable Model in Practice

In order to select the most suitable model for a stock option plan, it is necessary to compare the needs of the company with the benefits and disadvantages of each model.

I. Contingent Capital Increase

The contingent capital increase is the most common way to back-up a stock option plan. The main advantage is that the company does not have to spend money to acquire shares on the market but instead creates new shares. Once the options have been exercised the increase in share capital strengthens the company's equity capital. Compared to the authorised capital increase the contingent capital is not limited in time in the absence of a respective provision in the shareholders' resolution. However, the contingent capital increase has the disadvantage that its nominal amount may not exceed 10% of the nominal share capital that is available at the time of the resolution on the contingent capital increase. Moreover, the stake of the existing shareholders is diluted.

II. Authorised Capital

Authorised capital is also cost effective since no shares must be acquired on the market. Nevertheless, authorised capital is less favourable than contingent capital: First, there is a statutory time limitation of 5 years regarding the authorisation of the

board to create new shares. Hence, the stock option plan must also be limited to 5 years. Otherwise it might occur that the board is not able to serve the exercised options with shares (absent a new resolution by the shareholders' general meeting). Given the minimum statutory waiting period of 4 years, such a plan would most likely be rather unattractive. Second, the handling of the capital increase is complex because the board must always use its power to raise the capital whenever options are exercised. Moreover, authorised capital also results in dilution of the existing shareholders' stake.

III. Purchasing Own Shares

Unlike with contingent or authorised capital, the value of the existing shares is not diluted if the company acquires own shares for the stock option plan. But depending on the size of the stock option plan, the company's cash flow will be reduced. Moreover, the repurchase of own shares is limited to 10% of the registered share capital. However, if the stock options shall be granted merely to employees (including key employees) but not to board members, no resolution of the general meeting is required.

IV. Synthetic Options

The disadvantage of synthetic options is that under German GAAP (Generally Accepted Accounting Principles) they negatively affect the profit and loss account due to the high expenditures necessary to serve the options once they are exercised. However, in principle all stock option programmes will have such an effect on the profit and loss account under IFRS (International Financial Reporting Standards), which became compulsory in 2005 for companies listed on European stock exchanges. The existing shares are not diluted and no shareholders' resolution is necessary.

I. Key Aspects

- The implementation of stock option plans has to be consulted with the works council.
- If only managing directors and key employees are eligible, no consultation with the works council is required.
- When determining the eligible employees, employers should consider the principle of equal treatment and avoid discrimination issues. Options are typically

subject to tax at the time the options are exercised, not granted. Stock options also affect various corporate and securities laws.

- In case cost of stock option programmes are to be shared among related entities, applicable transfer pricing rules and regulations should be taken into account as well.

Chapter 26
Retirement and Occupational Pensions

Marco Arteaga

A. Introduction

In Germany, just as in most other European countries, the overall concept for retirement is based on the so-called "Three Pillar Model". This model suggests that for each individual the combined income during retirement should be derived from three types of sources:

- The first pillar is the statutory German Pension Insurance (*Deutsche Rentenversicherung*) which is compulsory for all employees[1] with very few exceptions (e.g. board members). For the average pension household this pension accounts for more than 70% of the overall retirement income. Its level depends on the number of years insured and the income level during this time. It is funded through equal contributions from the employer and from the employee, the latter deducted directly from the monthly payroll.
- The second pillar represents the occupational pensions, which in Germany comprise five different types of funding vehicles. All of these funding vehicles allow for any type of sole or joint funding by employer and employee. This variety of instruments has developed historically and each of them appreciates a different treatment with regard to accounting, tax and social security. Moreover, employees have the right to demand that a portion of their salary be converted into a deferred compensation plan (*Entgeltumwandlung*).

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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- The third pillar comprises any type of private retirement saving. It is entirely voluntary. Some specific types of pension savings products appreciate direct statutory subsidies predominantly aiming at lower incomes and families with children (*Riester-Rente*).

Providing a company pension plan can have significant advantages for employers as well if they are designed to reduce staff turnover costs and to encourage staff loyalty, which is particularly important with regard to highly qualified employees. Long vesting periods combined with a pension plan providing for progressively increasing pensions in line with the length of service can be used as a very powerful retention programme.

I. Sources

Any kind of benefit granted by an employer that aims at improving the (financial) well-being of an employee or his dependants in the event of old age, disability or death falls under the (mostly) binding rules of the Company or Occupational Pension Act (*Gesetz zur Verbesserung der betrieblichen Altersversorgung, BetrAVG,* often simply referred to as the *Betriebsrentengesetz*). It is irrelevant if the parties explicitly name a benefit an occupational pension. The determining factor is solely its purpose. The benefit can be an ongoing pension, a lump sum or even a non-monetary benefit.

The Occupational Pension Act was passed in 1974 to set basic rules for company pension plans. Up until then, and in the absence of specific legislation, this area was governed only by general civil law and the specific jurisdiction of the German Labour Courts. The Occupational Pension Act established provisions in three main areas that were of public concern:

- vesting rules
- indexation of ongoing pensions
- statutory insolvency protection.

It also listed the types of funding vehicles that had already existed at the time. These were:

- Direct Pension Promise (*Pensionszusage* or *Direktzusage*, a grant directly from the employer to the employee)
- Direct Life Insurance (*Direktversicherung*, a life insurance taken out by the employer on the employee's behalf)
- Support Fund (*Unterstützungskasse*, an external pension fund type vehicle that is mostly under the control of the employer)
- Captive Pension Insurance (*Pensionskasse*, an external, insurance type pension fund, typically an industry solution or for very large employers only).

The Occupational Pension Act also sets rules for the level of vested rights, settlements of pension entitlements and details for some very specific types of pension grants.

Next to the Occupational Pension Act the Income Tax Act (*Einkommensteuergesetz, EStG*) contains numerous rules of considerable importance for company pensions as do several other pieces of legislation, such as the Commercial Code (*Handelsgesetzbuch, HGB*) or the Insurance Supervisory Act (*Versicherungsaufsichtsgesetz*).

In case of disputes around company pension issues, the labour court system has nearly a sole competence to determine matters relating to occupational pensions or to the Occupational Pension Act. This includes matters relating to disputes between external pension providers or matters involving the Insolvency Protection Fund (*Pensions-Sicherungsverein a.G., PSVaG*) in the field of corporate insolvencies. Disputes regarding the mandatory contributions to the statutory Insolvency Protection Fund are dealt with at the Administrative Courts. Disputes regarding pensions for board members as well as pure insurance disputes are handled by the ordinary civil courts. As always in German employment and labour law, jurisdiction plays a major role in the field of occupational pension law, too.

II. Reform of the Occupational Pension Act

A significant reform of the entire Occupational Pension Act was introduced in 2002 by the General Act on Retirement Provisions (*Altersvermögensgesetz, AVmG*). The primary aim of this law was the promotion of private pension plans through direct subsidies (*Riester-Rente*), but company pension schemes were included in these promotional measures providing a tax and social security contributions relief particularly for deferred compensation plans. Another long awaited measure was the recognition of defined contribution schemes and the introduction of pension funds as a further funding vehicle for company pensions.

In 2015 a further debate for an extensive reform of occupational pensions started. The discussion aims at the establishment of large and cost-efficient, compulsory industry pension funds. The outcome of this debate is still uncertain as of the day this publication went into print. However, it appears that a new bill introducing fully fledged defined contribution plans and options for industry-wide or company-wide auto-enrolment mechanisms may pass the German *Bundestag* before mid 2017.

B. Basic Structural Elements of Occupational Pensions

I. Contractual Basis of a Pension Grant

Occupational Pensions are typically based on a contractual agreement which determines the details of the pension obligation. The legal definition contained in sec. 1 para. 1 of the Occupational Pension Act provides as follows:

> Once an employer has promised an employee to grant an old-age, disability or survivor's pension benefit in connection with the employment relationship (company pension grant) the provisions of this Act shall apply. The company pension grant may be executed directly through the employer or through one of the [external] pension providers described in section 1b paragraph 2 to 4. The employer is obliged to guarantee the fulfilment of the pension grant even if the plan is not executed directly by the employer.

Due to this definition the existence of an employment relationship is a general prerequisite for any company pension. However, in this context the term "employment" has a very wide bandwidth because it not only covers regular employees but also managing directors, board members and other individuals that work for the 'employer' who granted the pension benefit (e.g. as consultant, freelancer or commercial agent). However, the Occupational Pension Act does not apply to individuals who are the sole owners or the majority stakeholders of a business, e.g. of a limited liability company (*GmbH*) from which they received a pension grant.

II. Individual and Collective Pension Grants

Legally, a pension plan can be established as an individual grant or in the form of a collective grant based on an agreement with the works council or even in a collective bargaining agreement.

1. Individual Pension Grant

The classic form of an individual pension grant is a contract in which the employer promises the payment of a pension with further provisions and which the employee then accepts. Pension promises do not require to be in writing. The grants can also be given orally; however, they will only be recognised under tax laws if made in writing. This classic form of individual pension contract is commonly used to provide higher management staff, managing directors or board members with a pension.

a) Standard Contract (*Vertragliche Einheitsregelung*)

An employer can use a standard contract to individually address employees. This is a uniform pension promise which provides equal benefits to the whole workforce. Unlike the classic form of an individual pension contract, the standard contract is characterised by the intention to provide equal promises to a collective group of employees in the specific business, location or company. This is of particular importance if the content of the pension promise needs to be amended at a later point in time.

b) General Promise (*Gesamtzusage*)

As in the standard contract, a general promise provides employees with a uniform pension promise. For practical reasons the promise is not made in individual agreements with the employees, but through a more general means of communication such as a general notification on the business's notice board or a standard letter to all employees. As the pension promise is a unilateral benefit grant without any obligations on the part of the employees, the pension promise is binding for the employer without requiring any formal (written) consent from the employees. Employees are deemed to accept the promise if they do not object, and this is sufficient to make the general promise legally binding for the employer. Fortunately, in 2015 the Federal Labour Court has ruled that these types of grants can usually be changed later through works council agreements.

c) Operational Practice (*Betriebliche Übung*)

The repeated execution of a similar and/or standard practice by an employer may create a legal position in favor of the respective employees and establish the justified expectation that they will receive a similar benefit according to this practice also in the future. Such practises are known as standard operational practises and are mainly related to (voluntary) annual benefits such as a Christmas bonus. For example, employees were able to claim a pension in a company where it was a standard practice to award a pension to employees at the completion of 10 years of service.

d) Principle of Equal Treatment (*Gleichbehandlungsgrundsatz*)

The principle of equal treatment is a basic principle in German employment law and has been developed further by the adoption of the General Equal Treatment Act (*Allgemeines Gleichbehandlungsgesetz, AGG*). Employees can claim that they have to be given access to a company pension scheme if a comparable group of employees is collectively provided with such a benefit, provided there is no legal justification for the differentiation by the employer. A prime example of discrimination is a scheme allowing an earlier retirement age to female compared to male employees. By contrast, valid criteria for a justified differentiation in the area of pension plans are tenure, hierarchy levels, qualifications of employees or the requirement of permanent employment as opposed to employment based on fixed-term contracts.

2. Collective Pension Grant

In companies that possess a works council, the Works Constitution Act (*Betriebsverfassungsgesetz*, *BetrVG*) provides for co-determination by the works council with (nearly) all issues relating to social benefits or to the form in which remuneration is provided (sec. 87 para. 1 no. 8 and 10 of the Works Constitution Act). Only the decision whether or not a pension plan is installed as well as the financial volume of the plan is up to the employer without any co-determination. All inner rules of the plan, particularly the so-called pension formula falls under comprehensive co-determination.

In practise, many companies operate a pension scheme based entirely on collective agreements with the works council, the central works council or even, if applicable, the group works council. Such collective pension schemes apply to the individual as a direct entitlement and without any further contractual agreement being necessary.

Trade Unions can also enter into binding pension schemes in collective bargaining agreements but this option is not widespread; notable exceptions exist only in public service, the construction industry, the metal and electrical appliances industry and the chemical industry. A recent example of particular importance is a collective bargaining agreement in the metal and electrical appliances industry providing for annual pension contributions of at least 319.08€ per employee (Collective Bargaining Agreement on Retirement Related Benefits, *Tarifvertrag über altersvorsorgewirksame Leistungen*).

III. Defined Benefit and Defined Contribution Plans

As almost everywhere in the world the company pension plan can be arranged as a defined benefit plan (DB) or as a defined contribution plan (DC). In order to provide a reasonable benefit level coming from defined contribution plans, German law does not recognise ‘pure’ defined contribution schemes as pension plans. All plans need to entail some sort of minimum benefit level and must also cover at least one biometric risk. Nevertheless, during recent years a broad shift from DB to DC plans has also taken place in Germany just as in many other countries.

1. Defined Benefit Plans (*Leistungszusage*)

In the past, defined benefit plans were very common in Germany. In most plans benefits were granted as a fixed amount or as a percentage of pensionable salary and usually they were tied to tenure. For example, a common pension formula for middle management under a defined benefit plan could read as follows:

At your retirement, we shall provide you with a monthly company pension which shall amount to

a) 1.5 per cent of your last regular monthly salary up to the social security ceiling;
b) 3.0 per cent of your last regular monthly salary for those amounts of your salary that exceed the social security ceiling;
both multiplied with the years of service in our company up to a maximum of 20 years.

Under such a formula, an employee retiring in 2017 with a monthly salary of 6000€ and 20 years of employment in the company would be entitled to the following pension:

- The monthly social security ceiling in the pension insurance for 2017 is 6350€ for employees in Western German states
- His monthly pension would therefore amount to 20 years of service × 1.5% per year which would yield 30% of 6000€ or 1800€.

By comparison, a former executive retiring in 2017 with a monthly salary of 12,000€ and 20 years of employment in the company would be entitled to the following pension:

- 20 years of service × 1.5% per year which yields 30% of 6350€ or 1905€
plus
- 20 years of service × 3.0% per year which yields 60% of 5650€ or 3390€
- or in total a monthly pension of 5295€, respectively.

2. Defined Contribution Plans (*Beitragsorientierte Leistungszusage*)

In order to limit the financial risks stemming from occupational pension plans, many employers have changed their pension promises to a somewhat unique 'German version' of defined contribution plans. Below is a typical example of a pension formula as it might occur under such a 'defined contribution' plan:

We shall contribute to your company pension account once a month an amount of

a) 1.5 per cent of your monthly salary up to the social security ceiling and
b) 3.0 per cent of your monthly salary for those amounts of your salary that exceed the social security ceiling;

The total contribution for each year is converted into a pension grant according to the attached schedule (annual pension grant). The total of all annual pension grants will be your monthly pension payment at your retirement.

While the contributions under such plan define the employer's annual service costs, the financial uncertainties for the employer still remain in the pension conversion formula which therefore requires specific know-how by actuarial and insurance experts. In particular, the interest risk remains with the employer.

3. Defined Contribution with Guaranteed Minimum Benefit (*Beitragszusage mit Mindestleistung*)

This type of pension grant was introduced in 2002 and is custom tailored for the new pension funds that were introduced at the same time. Such grants limit the employer obligation (liability) to the contributions he promised to make along with the guarantee that at the time of retirement at least an amount equal to the aggregated employer's contributions will be available to be converted into a pension.

Compared to the other two types of pension grants described above in this version, the actual benefit level depends solely on the investment performance of the pension fund.

IV. Deferred Compensation

In 1999 the Pension Reform Act (*Rentenreformgesetz 1999, RRG*) formally recognised deferred compensation plans within the system of Occupational Pensions in Germany. Ever since, deferred compensation schemes must ensure that the pension granted is of equal cash value as the amounts deferred.

Also, employees can demand that a portion of their cash salary is converted into a pension. The advantage of deferred compensation schemes is that contributions are tax and social security exempt. Pension payments resulting from a deferred compensation scheme are later taxed at the individual tax rate, which for most people is significantly lower during retirement compared to their tax rate during active employment.

For example, in a typical deferred compensation pension scheme the employer agrees with an insurance company to set up a group life insurance arrangement for its employees and then offers to them to participate in the scheme. Employees signing up to the scheme agree that a certain percentage of their regular salary, annual bonus or a similar compensation component is taken out of their gross salary and transferred directly from the employer to the insurance accounts. Thus, the employer holds a life insurance contract in favour of the employee. The employee's entitlements vest immediately. The model is secure in case of insolvency of the employer.

C. Five Funding Vehicles for Company Pension Schemes

As mentioned above, today the Occupational Pension Act provides for five different types of company pension schemes:

- Direct Pension Promise (*Pensionszusage* or *Direktzusage*, a grant directly from the employer to the employee)
- Direct Life Insurance (*Direktversicherung*, a life insurance taken out by the employer on the employee's behalf)
- Support Fund (*Unterstützungskasse*, an external pension fund type vehicle that is mostly under the control of the employer)
- Captive Pension Insurance (*Pensionskasse*, an external insurance type pension fund, typically an industry solution or for very large employers only)
- Pension Fund (*Pensionsfonds*) which was first introduced in 2002.

The most common type of scheme is the direct pension promise which represents approximately 40% of all German company pension promises. Direct insurance contracts, support funds, captive pension insurance and pension funds account for the other 60%, whereby direct insurance has the widest spread and the pension fund, due to its relatively short history, has the lowest spread amongst existing schemes.

All types of pension schemes are subject to specific rules regarding administration, accounting, taxation, social security treatment and investment strategy. Therefore, the employer's choice for a pension scheme type is an important decision not only for its future obligations but also from the beneficiaries' perspective. The employer can also choose to combine different pension scheme types. It is also legally able to replace the funding vehicle with another one, although rules providing protection for accrued pension entitlements have to be observed.

I. Direct Pension Promise

1. Overview and Legal Structure

Under a direct pension promise the employee usually receives the pension payments directly from the employer (sec. 1b para. 1 Occupational Pension Act). Administration of the direct pension promise is uncomplicated and cost-efficient, as there is neither an external pension provider nor an external supervisor or regulator involved. Both defined benefits and contribution oriented benefits can be provided as a direct pension promise. However, a direct pension promise is not possible as a defined contribution with minimum benefit plan.

Even though direct pension promises are usually employer funded, it is also possible to operate a deferred compensation scheme as a direct pension promise. In the event of the biggest risk for the employee, the employer's insolvency, benefits are secured by the statutory Insolvency Protection Fund (*PSVaG*). Contributions to this fund are always provided by the employer on top of the funding costs for the direct pension promise.

2. Funding and Financial Implications

The rules for the direct pension promise do not contain any sort of funding obligation whatsoever. Although provisions have to be made on the employer's balance sheet there is no obligation to build any kind of plan assets. Ultimately, if the plan remains unfunded, there would be nothing more than the outflow of cash during the retirement phase of the beneficiary. If no plan assets are built up, the employer has to provide the payments from its cash flow and has to make corresponding adjustments in its balance sheet by releasing the respective provisions.

Many employers only set up the provisions on the balance sheet and use the thus retained profits for the general financing of their business (internal funding). Outside German accounting rules, many view this as an unusual way to provide for pension obligations. Thus, the balance sheets of German companies that contain pension provisions for unfunded pension liabilities are often misinterpreted by international analysts, which may cause severe detriments on the international finance market.

Some companies have therefore set up funding vehicles, called Contractual Trust Arrangements (CTAs), which allow them to use a trust structure as a separate legal entity to establish plan assets under IAS/IFRS or U.S.-GAAP that they can offset against these pension liabilities and thus remove the pension provisions from their balance sheet. Meanwhile this off-setting has also become possible under German GAAP. One should note, however, that these CTAs are not 'trusts' under UK or U.S. law.

3. Tax Implications

In terms of tax treatment, no income tax is levied on the accrual of the pension entitlement during active employment (sec. 11 Income Tax Act). The grant only becomes taxable when the actual payments are made, i.e. in the retirement phase and at the employee's individual tax rate. In turn, the employer is entitled to reduce its taxable profits by the necessary provisions based on an annual actuarial valuation (sec. 6a Income Tax Act).

II. Direct Life Insurance

1. Overview and Legal Structure

A direct life insurance pension scheme has a very simple legal structure: the employer arranges for a life insurance contract in favour of the employee to whom the pension promise is made. The employer provides the premiums to the insurance company. The employee receives a direct claim against the life insurance company.

A direct life insurance scheme can be used multifold. It can be used as a supplementary benefit sponsored by the employer or as an employee funded deferred compensation scheme.

It has a large relevance if the employer does not offer any type of deferred compensation on its own. In this case employees can demand to be provided at least with a deferred compensation direct life insurance.

2. Funding and Financial Implications

In the case of a direct life insurance, the asset management and the investment strategy lies entirely with the life insurance company. In practise, the only obligation for the employer is the timely payment of insurance premiums. The employer's supplementary guarantee for the pension payment as stipulated by the Occupational Pension Act is reduced almost to a mere theoretical notion. Given that the asset risk for the pension promise is assumed by the insurance company, the overall cost for the same pension benefit tends to be higher than in the case of internal funding.

3. Tax Implications

As employees receive a direct legal entitlement to the life insurance, contributions are subject to income tax at the time they are being made. However, a maximum amount of up to 4% of the social security ceiling can be provided tax free and social security exempt (sec. 3 no. 63 Income Tax Act). The later pension payments from such a direct life insurance are subject to taxation only with the earnings portion of the actual payment but with the individual tax rate of the beneficiary.

Older direct life insurance arrangements concluded prior to 2004 used a flat tax rate of 20% plus German reunification solidarity tax surcharge and church tax (sec. 40b Income Tax Act) up to a maximum contribution of 1752.00€ per year during the contribution phase. Up to this amount contributions were (are) exempt from social security contributions for these older contracts. Due to their taxation during the contribution phase the proceeds from the life insurance contract were tax free.

On the employer's side, all premiums paid by it to the insurance company are fully recognised as operating expenses.

III. Support Fund

1. Overview and Legal Structure

Another funding vehicle for occupational pensions in Germany is the support fund. Support funds are separate legal entities, often in the form of a registered association (*eingetragener Verein, e.V.*) or a limited liability company (*GmbH*). They can

be operated by one or more employers. In the latter case they are called multi-employer support fund (*Gruppen-Unterstützungskasse*).

The support funds in Germany developed historically. Originally, support funds were associations founded by the employer and/or the employees of a company to provide employees in need with a certain financial support. This dates back to the beginning of the industrialisation in the early nineteenth century. Later, the scope of benefits provided by the funds was expanded to employment related pension benefits.

A support fund pension grant can be employer funded or employee funded as a deferred compensation plan. It can be a defined benefit or a defined contribution type of plan. A common version of the traditional mostly unfunded support funds are so-called reinsured support funds, often set up by insurance companies which offer the administration of pension plans as a business service. They require full funding through life insurance contracts that are often referred to as 're-insurance' or 'back-to-back life insurance contracts'.

2. Funding and Financial Implications

Sufficient funds must be allocated to the support fund by the operating employers in order to enable the support fund to pay the benefits to the beneficiaries. However, the employer has a large bandwidth within which it can decide on the level and timing of funding.

However, in the case of the reinsured support funds mentioned above, the employer has to pay the premiums to the reinsurance company which releases the necessary payments to the support fund so the fund can meet its obligations towards the employees. Even though the reinsured support fund's liabilities are usually fully covered by the reinsurance agreement, it is also secured by the statutory Insolvency Protection Fund.

3. Tax Implications

Support funds are usually tax exempt, i.e. neither subject to corporate tax nor to trade tax. Contributions made by the employer to fund the pension scheme via the support fund are not considered immediate benefits to the employees covered and are therefore not subject to income tax at the level of the employee. Upon reception of the pension benefits employees have to pay income tax at their individual tax rate as pensioners (sec. 11 Income Tax Act).

One should note that the Income Tax Act limits tax effective contributions to the support fund by the employer. During active employment, contributions can only be made for each employee until a maximum of two annual pensions is reached. The full amount of the liability can then be contributed upon retirement of the employee.

In the case of the reinsured support fund, insurance premiums are recognised as operating expenses without limitation. Here, the deduction constraints are irrelevant.

IV. Captive Pension Insurance

1. Overview and Legal Structure

Very similar to the direct life insurance, a captive pension insurance is an external carrier that assumes both the administration and the asset management side of the company pension. They are non-profit entities operated by one or multiple employers that use the same carrier to arrange for their company pension schemes. The difference to an ordinary market participating life insurer lies in the fact that the captive pension insurance limits its business activities to the respective employer or employers.

Employers pay contributions to the captive pension insurance, which manages the accumulating assets and later pays out the pension benefits directly to the employees, exactly like a direct life insurance. Employees claim their pension against the captive pension insurance. Being an almost fully-fledged life insurance company that is actively being monitored by the financial supervisory authority (*Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin*), captive pension insurances are not obliged to make any contributions to the Insolvency Protection Fund (*PSVaG*) – identical to the direct life insurance. A captive pension insurance can potentially comprise many different types of plans (i.e. insurance products). Quite often these plans entail a joint funding by employee and employer.

2. Funding and Financial Implications

As mentioned before, the funding and the financial arrangements for a captive pension insurance are very similar to those of a direct life insurance. Asset management and investment rules for captive pension insurances are very strict and mostly limited to low risk investments, predominantly bonds. Being a legal entity of its own, the captive pension insurance naturally operates independently from the employer and has full control over its investments. The employer has to pay contributions and is released from all other liabilities except the omnipresent guarantee by the employer for all pension benefits as stipulated by the Occupational Pension Act.

3. Tax Implications

According to the Income Tax Act, the employer's contributions to a captive pension insurance are tax effective operating expenses. For the employee, contributions are basically considered to be part of the compensation package and therefore subject to income tax. Yet, just as in the case of the direct life insurance, an amount of up to 4% of the social security ceiling can be provided tax free and is also social security exempt.

V. Pension Fund

1. Overview and Legal Structure

Just like a captive pension insurance the pension fund is a legally independent institution that administers company pension schemes on behalf of one or several employers and that is also charged with the asset management. Unlike the captive pension insurance it is not tied to the restrictive investment rules that apply to insurance companies. Yet, the pension fund is legally in the proximity of life insurance companies which is best illustrated by the fact that its entire regulation is part of the Insurance Supervisory Act. It is also supervised by the Financial Supervisory Authority (*BaFin*). Due to this supervision, pension funds receive an 80% discount on their contributions to the Insolvency Protection Fund (*PSVaG*).

2. Funding and Financial Implications

The funding of a pension fund is similar to that of the captive pension insurance. The plan utilising a pension fund as a funding vehicle can be sponsored by both the employer and employee. But, as said before, the major difference are the investment rules that apply. The pension fund can invest very freely in the capital markets and thus potentially achieve a higher return on investments. But it also bears the risk of loosing funds that are required to meet the pension promises made. Thus, the need for insolvency protection exists, albeit at a lower premium.

3. Tax Implications

Tax regulations for pension funds are almost identical to those of the captive pension insurance and the direct life insurance. A major difference is the possibility to make lump sum contributions to a pension fund either by the employer or a support fund to fully fund the cash value needed for an ongoing pension, i.e. at or after the retirement date (sec. 3 no. 66 Income Tax Act). This unique tax advantage is a major area of business for existing pension funds.

D. Minimum Legal Protection for Occupational Pensions

I. Vesting of Occupational Pensions

The Occupational Pension Act provides that entitlements to occupational pensions vest if the beneficiary is at least 25 years old and if he was enrolled in the plan at least for 5 years on the day of the termination of employment (sec. 1b para.

1 Occupational Pension Act). With regard to deferred compensation schemes the Occupational Pension Act also clarifies that these pension rights vest immediately. As a consequence of the European Employee Mobility Directive which was adopted in Germany in 2015, the vesting of occupational pensions will come down to a minimum age of 21 and a minimum of 3 years of enrolment in the plan.

The vested fraction of the maximum pension possible under the plan is calculated simply on a pro-rata basis (sec. 2 para. 1 Occupational Pension Act). The employee leaving the employer prior to retirement retains a pension entitlement which equals the ratio of the actual duration of employment in the company to the potential full service duration up to retirement age.

II. Restrictions for Pension Settlements, Early Payouts and Transfer Rules

As a general rule, the employee cannot waive accrued pension benefits whether with or without compensation if the waiver is agreed in connection with the termination of employment. This prohibition persists until the beneficiary reaches his retirement age. The Occupational Pensions Act restricts the waiver as well as the early payout of accrued company pensions. Only very small monthly pension amounts (approx. 30€) are allowed to be cashed out. Pension entitlements with a higher value cannot be waived and paid out to the employee, even if such a payout were in the interest of the employee.

One should note that this tight restriction applies only if there is a context of the settlement or the waiver to the termination of the employment. By contrast, settlements can always be agreed during the ongoing employment relationship.

Furthermore, the Occupational Pensions Act provides restrictions for the transfer of vested pension rights after termination of employment. A transfer is permitted only if the pension scheme as such is continued by a new employer or if the new employer provides for an equivalent value of pension benefits within its own pension scheme.

In the case of a winding up of a (former) employer a transfer of the pension plan to a captive pension insurance or a regular life insurance company is possible. Quite often this is a considerable advantage in the liquidation process of companies. Any other form of post-termination transfer of pension entitlements is ruled out by law and will not be recognised legally.

III. Indexation of Ongoing Pensions

The Occupational Pension Act also contains rules for the minimum indexation (adjustment) of ongoing pensions. If there were no adjustments of ongoing

pensions, over time the inflation would reduce the purchasing power of the pension which could marginalise the intended benefit. Ongoing company pensions (i.e. post-retirement) must therefore be reviewed every 3 years and increased by at least the inflation rate or by the growth in net wages in comparable groups of employees within the company (sec. 16 Occupational Pension Act).

An adjustment can generally be omitted if the employer's financial situation so requires. However, an employer who intends to omit an adjustment has to inform all beneficiaries about the financial situation. Failure to inform the beneficiaries results in an obligation to make up for the omitted adjustments once its economic situation improves.

IV. Restructuring of Pension Schemes

As employment relationships are generally long-lasting agreements it is important that the conditions and obligations remain flexible over time. It is therefore logical that company pension schemes are not comprehensively protected against any future changes or restructuring needs. However, the relevance of the company pension for the individual implies that such measures require specific attention and according protection. The Federal Labour Court has developed a subtle set of rules that apply to the amendment and restructuring of company pension schemes that were established by means of a works council agreement. This set of rules is called the "Three Level Model" that grants different levels of protection depending on the degree to which the pension entitlement has already been earned in the past and thus deserves a higher level of protection:

Level 1: The highest level of protection. A reduction of company pension entitlements accrued in the past is possible only if such a reduction is legally justified. This is the case only if the employer is at risk of entering bankruptcy and once all other means of restructuring have been exhausted.

Level 2: By contrast, the reduction of accrued entitlements to future increases of a pension in salary related pension plans is possible if the employer has compelling reasons.

Level 3: The lowest level of protection applies to such pension entitlements that are not yet earned but which would be earned under future years of service (i.e. under the continued application of the pension formula). In this case it is sufficient if the employer has reasonable, justifying grounds to introduce plan changes that will only apply to future tenure.

For pension plans that were established through a legal instrument different from a works agreement these principles mostly apply in a similar way.

One very important message for employers is that despite these rules to amend existing plans any company pension scheme can be closed to new entrants at any time. Such a decision requires neither works council consent nor even works council participation. Thus, the employer can always avoid accruing more

liabilities in a difficult financial situation. Of course, closure of a pension plan typically does not lead to immediate savings. These usually develop over time as the number of beneficiaries declines.

V. Statutory Insolvency Protection for Occupational Pensions

In the case of insolvency of the employer the employees would lose not only their employment but also the provider of their company pension ("all eggs in the same basket"). The Occupational Pension Act therefore established a statutory, compulsory reinsurance arrangement which covers the financial consequences of an insolvency of the employer with regard to ongoing pensions as well as for vested entitlements.

The Insolvency Protection Fund (*PSVaG*) with its registered office in Cologne assumes the pension obligation if the employer operating the scheme becomes insolvent. The fund will guarantee:

- pre-retirement: all vested fractions of all affected company pension entitlements and
- post-retirement: all ongoing pension benefits.

In essence, the Insolvency Protection Fund distributes the total of damages that occur within a calendar year across all employers that entertain company pension plans that are considered prone to dropping out in the case of the employer's insolvency (direct pension promise, support fund, some types of direct life insurance, pension funds at a reduced rate). The average contribution to the Insolvency Protection Fund across the last 40 years was 0.3% of the defined benefit obligation (DBO).

E. Key Aspects

Any employer can grant a company pension promise through individual contracts or through collective agreements with the works council or a trade union. If a works council exists, any company pension scheme is subject to co-determination.

- The actual set-up of a pension scheme is often driven by tax advantages and capital allocation structures. An employer can choose a defined benefit plan, a defined contribution plan or a defined contribution plan with a minimum benefit guarantee.
- German occupational pension law allows for five different ways to fund a pension grant:
  - Direct pension promises where the benefit comes directly from the employer.
  - Direct life insurances where the actual benefit comes from a life insurance company.

  - Support Fund (*Unterstützungskasse*, an external pension fund type vehicle that is mostly under the control of the employer).
  - Captive pension insurances which are essentially life insurance companies that limit their service offering to one or multiple employers only.
  - Pension funds which are similar to captive pension insurances but that allow for much more liberal investments in the capital markets.

- Pension schemes can be amended, adopted or restructured according to the business situation of the company; however, the greater the intrusion into accrued legal positions is, the more complex requirements for changes become.
- In the case of employer bankruptcy the Insolvency Protection Fund will assume the pension obligation and provide for the later pension payments from vested entitlements as well as for the continuation of all ongoing pensions.

Chapter 27
Employee Co-Determination at Board Level

Michael Magotsch and Sascha Morgenroth

A. Introduction

German Labour Law provides for works council co-determination rights in accordance with the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*). This form of co-determination can be described as employee participation "from below" and has already been explained in detail above (see Chap. 21 on Employee Representation). This must be distinguished from co-determination at board level (*unternehmerische Mitbestimmung*), which can be described best as employee participation "from above," meaning monitoring the business management.

Germany has one of the most detailed and developed concepts of board level co-determination. There is a long history of board level co-determination governed by the Co-Determination Act for the Coal and Steel Industry of 1951 (*Montan-Mitbestimmungsgesetz, Montan-MitbestG*), the Co-Determination Act of 1976 (*Mitbestimmungsgesetz, MitbestG*) and the One-Third Participation Act of 2004 (*Drittelbeteiligungsgesetz, DrittelbG*).

To the surprise of many foreign companies, employees[1] in Germany may be entitled to up to 50% of the seats on the supervisory board. The employee co-determination laws, however, in general only apply to corporations, such as stock corporations (*Aktiengesellschaften, AG*) and limited liability companies (*Gesellschaften mit beschränkter Haftung, GmbH*). Around two-third of the

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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workforce in Germany are employed in companies without employee co-determination. In particular, partnerships (*Offene Handelsgesellschaft, OHG*), limited partnerships (*Kommanditgesellschaft, KG*) and sole proprietors are not subject to employee co-determination laws.

The co-determination laws only apply to domestic corporations (so-called territoriality principle) and not to foreign companies who have their management abroad (e.g. limited companies under UK law). Although controversial, in general the same principle applies to foreign companies that have their management officially abroad but are *de facto* managed in Germany.

B. German Co-Determination Law

I. General Principles

1. Two-Tier Corporate Management

In Europe there are two different systems of board level management.

In the UK, for example, corporations have only one management body (the board of directors), and employee representatives are therefore not directly involved in company management (so-called monistic system).

In Germany, on the other hand, in addition to the management board (*Vorstand* at *AG* or *Geschäftsführung* at *GmbH*) corporations may have a supervisory board (*Aufsichtsrat*) where the employee representatives are positioned (so-called dualistic system). The basic corporate entity of corporations is the general meeting/assembly of the shareholders (*Hauptversammlung* at *AG* or *Gesellschafterversammlung* at *GmbH*). It decides on the composition of the supervisory board (the election of the shareholder representatives), articles of incorporation, measures relating to the share capital, all other measures of fundamental importance, and approves the disposal of profits as well as confirms the actions of both the management board and supervisory board.

a) Management Board

The management board has unlimited statutory authority to represent the company and to enter into contracts binding upon it. It has the direct executive responsibility for the business of the company, is responsible for the day-to-day management of the company, and coordinates, structures and monitors all company activities. The management board is generally not subject to instructions by any third party, in particular the shareholders' meeting and/or the supervisory board.

b) Supervisory Board

The supervisory board is strictly separate from the management board. It consists of representatives elected by the shareholders and—if subject to co-determination laws—employee representatives elected by the staff, i.e. in most cases works councils and trade union members. The supervisory board monitors the managing directors and has the authority to appoint and withdraw management board members and to enter into and terminate their service contracts.

2. Constitutionality of Co-Determination Laws

Employee participation affects the basic constitutional rights of the companies (freedom of occupation), shareholders (freedom of property), and the employers' associations (freedom of coalition), but has nevertheless been regarded as clearly constitutional by the German Federal Constitutional Court (*Bundesverfassungsgericht, BVerfG*) if there is no unrestricted parity and shareholders in the supervisory boards maintain the right to the final entrepreneurial decision.

II. Co-Determination Statutes

The German statutory law on employee participation on supervisory boards is traditionally divided into three different systems depending on the legal form of the company, number of employees (>500 and >2000 employees) and—in the case of the coal mining and steel producing (*Montan*) industry—the industry sector of the company.

In companies with 500 or less employees there is no mandatory co-determination. However, one-third participation applies in small AGs with 500 or less employees founded prior to 10 August 1994 if they are not considered mere family businesses.

1. Co-Determination in Corporations of the Coal Mining and Steel Producing (*Montan*) Industry with >1000 Employees

The first German statute on employee co-determination at board level was the Co-Determination Act for the Coal and Steel Industry of 1951, which was the beginning of German co-determination legislation. In actual practice, its scope of application has become very limited. Understanding its regulations is, however, important for understanding German board level co-determination.

a) Almost Parity Co-Determination

Since 1951, stock corporations and limited liability companies in the coal mining and steel producing industry that have more than 1000 employees have "almost parity" co-determination due to the Co-Determination Act for the Coal and Steel Industry.

The supervisory board usually consists of 11 members ("*Elferrat*"); equally represented by shareholders and employees plus one "neutral" member. Shareholders and employees each appoint four members and one additional member. At least two employee members must be employed by the company. These are nominated for election by the works council after consultation with the labour union. The additional members must not represent any employers' association or labour union and must not work for the company. The "neutral" member is elected by the other supervisory board members. However, if the members of the supervisory board cannot agree on the "neutral" member, the shareholders have the final say. As a consequence, there is in fact no true parity.

Usual size of the supervisory board:
11 members
4 shareholder rep. + 1 member
4 employee rep. + 1 member
1 "neutral" member

In the case of companies with registered capital of more than 10,000,000€ the company's articles of association may provide for a larger supervisory board of 15 members. In the case of companies with registered capital of more than 25,000,000€ the supervisory board may have 21 members.

Possible size of the supervisory board according to the company's articles:	
Company capital	*Supervisory board members*
> 10 million €	15 members
> 25 million €	21 members

b) Scope of Employees

Employees of dependent group companies are not included in the calculation of the required staff size of usually more than 1000 employees. These employees may only vote for the group's supervisory board if the company, subject to the Co-Determination Act for the Coal and Steel Industry, is controlling the group and has a group works council.

c) Labour Director

According to the Co-Determination Act for the Coal and Steel Industry, a labour director (*Arbeitsdirektor*), entrusted with the human resources and social management, must be appointed as an equal member of the management board. The labour director may, however, not be appointed or withdrawn without the support of the majority of the employee representatives on the supervisory board.

d) Company Groups Controlling Corporations of the Coal Mining and Steel Producing Industry

The falling number of corporations subject to the Co-Determination Act for the Coal and Steel Industry of 1951 led to legislation aiming to uphold its scope. The Supplementary Co-Determination Act for the Coal and Steel Industry of 1956 provides for the same co-determination rules in parent companies controlling corporations of the coal mining and steel producing industry if there is sufficient contact to the coal mining and steel producing industry. The parent and dependent group companies, subject to co-determination in the coal and steel industry, must accrue at least one-fifth of the revenues and employ usually more than one-fifth of the employees of the group. If controlling companies themselves are not subject to co-determination, they only fall under the Supplementary Co-Determination Act if the controlled co-determined companies accrued more than 50% of the group's total turnover in the last 6 business years.

2. Co-Determination in Large-Scale Corporations with >2000 Employees

The Co-Determination Act of 1976 provides for co-determination in large-scale corporations with more than 2000 employees. The Co-Determination Act of 1976 applies to stock corporations (*AGs*), partnerships limited by shares (*Kommanditgesellschaft auf Aktien, KGaA*), limited liability companies (*GmbHs*), and cooperatives (*Genossenschaften, eG*).

Companies that serve directly or predominantly political, religious, charitable, educational, scientific or artistic purposes (*Tendenzunternehmen*) are excluded from the Act; these have so-called tendency protection (*Tendenzschutz*). European Companies (Societas Europaea, SE) do not directly fall under the Co-Determination Act of 1976 or any other German co-determination law. Here, the co-determination on board level follows a specific European legislation which stipulates a negotiated co-determination. Only in the event that negotiations remain unsuccessful the German national rules become applicable to a certain extent.

a) Parity Co-Determination

The Co-Determination Act of 1976 provides for parity co-determination (i.e. the supervisory board consists equally of shareholders and employee representatives). In contrast to the co-determination in companies in the coal and steel industry, there is no neutral member in the supervisory board.

The total size of the supervisory board depends on the number of employees as shown in the following chart.

Total size of the supervisory board	
Employees	*Supervisory board members*
$\leq$10,000 employees	12 members
$>$10,000 $\leq$ 20,000 employees	16 members
$>$20,000 employees	20 members

The supervisory board elects a chairman and a vice-chairman with two-third majority of its members. If the required majority is not reached by the elections, the chairman is elected by the shareholder representatives and the vice-chairman by the employee representatives, on a majority vote basis. Therefore, in practice, it is common for the chairman to be a shareholder representative. This results in a predominance of the shareholders, since only the chairman has two votes in the case of a deadlock.

b) Scope of Employees

The number of employees which determines the composition and size of the supervisory board generally is counted per capita (as opposed to full time equivalents).

Given the limits of the German legislation to German territory it is broadly held that only domestic employees are to be taken into account. Recently, a German court sought the view of the European Court of Justice (ECJ) as to whether this is compatible with EU law. On 18 July 2017 the ECJ held in the case Erzberger (C-566/15) that German laws on Employee Representation at Board Level do not violate EU law.

It concluded that excluding all employees of global group entities employed outside of Germany in participating in employee representatives elections does not result in discrimination on grounds of nationality. In addition, the freedom of movement for workers does not mean that employees outside Germany can claim rights that are only available under Germany's national laws. Co-determination laws and rules regarding the Employee Representation on Board Level are German corporate and collective employment law and therefore may legitimately be restricted to employees employed in Germany.

Executive employees (*leitende Angestellte*) are counted as employees; however, they are subject to different election and representation rights. According to a recent

judgment of the federal Labour Court, agency workers (*Leiharbeitnehmer*) are generally considered employees of the corporation for co-determination purposes.

In partnership companies with a *GmbH* as unlimited liability partner (*GmbH & Co. KG*), employees of the partnership are counted as employees of the *GmbH*, providing for indirect employee co-determination in the partnership.

In company groups, employees of companies controlled (controlling interest based on corporate law) by a corporation are counted as employees of the controlling corporation. This results in group-wide co-determination.

c) Labour Director

As in the case of co-determination in the coal and steel industry, a labour director, entrusted with the human resources and social management, must be appointed as an equal member of the board of directors. This does, however, not apply to partnerships limited by shares (*KGaA*). In contrast to co-determination in the coal and steel industry, the employee representatives have no particular influence on the appointment or withdrawal of the labour director.

3. Co-Determination in Other Corporations with >500 Employees

Under the One-Third Participation Act of 2004, which replaced the respective regulations of the former Works Constitution Act of 1952, in corporations with more than 500 employees and up to 2000 employees, the supervisory board consists of one-third employee representatives. The One-Third Participation Act applies to respective stock corporations (*AGs*), partnerships limited by shares (*KGaA*), limited liability companies (*GmbHs*), cooperatives (*eG*), and mutual insurance companies (*Versicherungsverein auf Gegenseitigkeit, VVaG*) that have a supervisory board.

If they are not considered family businesses (i.e., particularly, if a single individual is the sole shareholder) then stock corporations (*AGs*) with less than 500 employees that have been registered with the commercial register prior to 10 August 1994 fall under one-third participation.

Companies that serve directly or predominantly political, religious, charitable, educational, scientific, or artistic purposes are also excluded from the One-Third-Participation Act; this is so-called tendency protection.

a) One-Third Participation

In the scope of the one-third participation the supervisory board consists of three members unless the company articles provide for a higher number of members. The

number of members must, however, be divisible by three. The maximum number of supervisory board members depends on the company capital.

Maximum size of the supervisory board	
Company capital	*Supervisory board members*
≤Euro 1.5 million	9 members
>Euro 1.5 million	15 members
>Euro 10 million	21 members

b) Scope of Employees

In a company group structure, employees of dependant group companies are counted as employees of the controlling corporation (1) if a control agreement (*Beherrschungsvertrag*) exists or (2) if the dependant company is integrated in the controlling company, resulting in group-wide co-determination. Apart from that the same principles as for the count of the employees under the Co-Determination Act of 1976 apply.

Overview of German co-determination law			
	Co-Determination Act for the Coal and Steel (*Montan*) Industry (1951)	Co-Determination Act (1976)	One-Third-Participation Act
Legal forms of companies	*AG* and *GmbH* in the coal and steel industry	*AG, KGaA, GmbH, eG*	*AG, KGaA, GmbH, eG, VVa* G with supervisory board
Particular industry	Coal mining and steel producing industry	–	–
Tendency protection	Yes (particular industry requirement)	Yes	Yes
Registered office in Germany required	Yes	Yes	Yes
Required number of employees	>1000	>2000	>500 (and *AG* s < 500 employees registered prior to 10 August 1994 not considered family businesses)
Group-wide co-determination	Yes (pursuant to Supplementary Co-Determination Act for the Coal and Steel Industry of 1956)	Yes	Yes (in case of control agreement or integration of dependant company in controlling company)
Composition of the supervisory board	→ almost parity	→ parity 1/2 shareholder rep. 1/2 employee rep.	→ one-third-participation 2/3 shareholder rep. 1/3 employee rep.

(continued)

Overview of German co-determination law			
Supervisory board members	Usually 11 members: 4 shareholder rep. + 1 member 4 employee rep. + 1 member 1 "neutral" member	12, 16 or 20 members depending on the number of employees	3 members or higher number in company articles divisible by 3; maximum number of members: 9, 15 or 21 members depending on company capital
Number of employees		≤10,000:12 members >10,000:16 members >20,000:20 members	
Company capital	Increase to 15 or 21 members possible in company bylaws: >10 million €: 15 members >25 million €: 21 members		Maximum number of members: ≤1.5 million €: 9 members >1.5 million €: 15 members >10 million €: 21 members

C. EU Co-Determination Law

I. Co-Determination in the Societas Europaea

1. Societas Europaea

The so-called Societas Europaea (SE) is a European company regulated by Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company. The SE is a legal structure similar to a stock corporation that allows a company to operate in different EU countries under a single statute, as defined by EU law and common to all EU countries. It can be established (1) by so-called primary foundation, i.e. transformation, merger, or establishment of a joint holding or subsidiary company, or (2) by so-called secondary foundation of a subsidiary company of an existing SE. The corporate law rules on the establishment and the governance of the SE are supplemented in Germany by the Act on the Introduction of the European Company (*Gesetz zur Einführung der Europäischen Gesellschaft, SEEG*). Prominent examples of SEs established by German companies are *inter alia Allianz SE*, *BASF SE* and *Porsche Automobil Holding SE*.

2. Co-Determination

Employee co-determination in SEs in Germany is implemented in the separate German Act on Employee Participation in the European Company, based on the

Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees.

EU law generally allows companies to decide in their articles of incorporation for either of the two different legal concepts of employee co-determination in the member states: (1) only one management board (so-called monistic system)—like in the UK, or (2) a board of directors and a supervisory board (so-called dualistic system)—like in Germany.

Employee co-determination, however, must be negotiated prior to SE's constitutive registration. The employees of the companies founding the SE establish a special negotiation board (*Besonderes Verhandlungsgremium*) in order to negotiate a company-specific co-determination scheme with the management bodies of these companies. If co-determination has not been waived and negotiations about the co-determination scheme fail, then the statutory rules apply. According to the statutory rules, if companies with different national co-determination rules (applying to at least 25% respectively 50% of their employees) merge or establish SE Holdings or SE subsidiary companies, usually the highest co-determination standard amongst the involved companies apply to the SE. However, ultimately the special negotiation board may decide on the applicable co-determination rules.

Therefore, an SE with the participation of German companies that have extensive parity co-determination is, in general, less appealing. Establishing SE companies, however, may help to "freeze" co-determination in order to avoid future application of (stricter) co-determination rules. This might be of particular interest for German companies without co-determination or companies with German one-third participation, which might otherwise fall under (parity) co-determination due to later staff increases. However, such protection ends in case of later fundamental changes of the corporate structure.

II. Co-Determination in Cross-Border Mergers

On 29 December 2006, the Act on the Co-Determination of the Employees in Cross-Border Mergers (*Gesetz über die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Verschmelzungen, MgVG*) came into force, implementing art. 16 of the EU Directive 2005/56/EC of 26 October 2005 on Cross-Border Mergers of Limited Liability Companies. The main objectives of the EU directive are to facilitate cross-border mergers of corporations and to protect employee co-determination rights existing at the merging companies.

As a general principle, the national law—including co-determination law—of the EU member state applies where the merged company has its registered office. Thus, mergers into companies with a registered office in a member state without or with a lower standard of co-determination laws would result in the loss or reduction of the standard of co-determination previously applicable to employees of companies involved in the cross-border merger.

Therefore, the *MgVG* provides for a regulatory system similar to the Act on Employee Participation in the SE. The company management may negotiate with a

Special Negotiation Board on a co-determination model for the new company after the merger. If negotiations fail, mandatory statutory rules apply to the new company which follows the highest co-determination rules among the companies involved in the merger. In the 3 years post merger, the resulting co-determination cannot be changed to the employees' detriment. However, different from the SE, the companies involved in the merger may also determine the application of the statutory rules unilaterally without prior negotiations with the special negotiation board, provided that more than 33% of all employees are already subject to co-determination.

Also, these rules attract the interest of German corporations which may—by a simple cross-border merger of a fully owned affiliate (or shelf company), registered in an EU member state—"freeze" their actual co-determination status on board level. This effect ends with later domestic mergers.

D. Key Aspects

- German Co-Determination Law:
  - The German statutory law on employee participation on supervisory boards is traditionally divided into three different systems depending on the legal form of the company, number of employees (>500 and >2000 employees) and—in the case of the coal mining and steel producing industry—the industry sector of the company.
  - Stock corporations and limited liability companies of the coal mining and steel producing industry with usually more than 1000 employees are subject to "almost parity" co-determination. The shareholders have the final say in the event of dispute on the determination of the "neutral" member of the supervisory board.
  - In large scale corporations with more than 2000 employees there is parity co-determination, i.e. the supervisory board consists equally of shareholders and employee representatives.
  - In corporations with more than 500 and up to 2000 employees that have a supervisory board, the supervisory board consists of one-third employee representatives.
  - In companies with less than 500 employees there is no mandatory co-determination. There is, however, one-third participation in small *AGs* with less than 500 employees founded prior to 10 August 1994 if they are not considered mere family businesses.
- EU Co-Determination Law:
  - Prior to constitution of the Societas Europaea employee co-determination must be negotiated with a special negotiation board established by the employees of the founding companies. If negotiations fail, and co-determination rights have not been waived, usually the highest national co-determination standard among the involved companies applies. Similar rules apply in case of cross-border mergers within the EU.

Chapter 28
Court Proceedings

Pascal R. Kremp and Sascha Morgenroth

A. Introduction

In Germany, unlike many other countries, it is not unusual for an employer and employee to end up in court. In particular, if an employee's employment is terminated by the employer, they may be required to challenge the dismissal before the court in order to obtain a severance payment and avoid detriment in relation to unemployment benefits. The purpose of this chapter is to give an overview of the labour court system and court proceedings in Germany.

B. Labour Court System

I. Jurisdiction

1. Subject Matter Jurisdiction

The exclusive labour court jurisdiction, in principle, extends to all individual legal disputes between employer and employee[1] arising from the employment relationship or its termination. Thus, labour courts are usually not competent to hear legal

[1]The term "employee(s)" shall cover female and male employees, as far as not indicated differently.

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disputes between managing directors and management board members of incorporated companies (*juristische Personen*) or the respective companies. Further, labour courts also hear collective disputes, particularly between an employer and a works council.

2. Local Jurisdiction

Employers may be sued in their country of domicile and, if they are incorporated companies, where their registered office is located. The claimant may also choose to file a claim at the labour court of the district where a branch (*Niederlassung*) is located. Claims may be filed against the employer at the place of its business, as this is where the employees usually perform their work. Employees can also sue the employer in the court where the employee lives if they usually work from a home office. Employees may be sued in the place they are domiciled.

If the employer has its domicile or a branch in another EU country then the employee may, pursuant to a regulation on jurisdiction and the recognition of judgments in civil and commercial matters, choose to sue the employer in the employer's country of domicile, where the employer has a branch, or at the employee's permanent place of work. In cases where the employer has no domicile or branch within the EU, the labour courts will apply the above explained rules accordingly. Hence, the employee will generally be allowed to file a claim against the employer at his permanent place of work.

II. Hierarchy Levels

Cases are heard in the first instance by the Labour Court (*Arbeitsgericht, ArbG*). This court hears the case and tries to find the facts. Decisions of the labour court can be reviewed by the Higher Labour Court (*Landesarbeitsgericht, LAG*) on appeal. Appeals may be based on facts or on legal and procedural grounds. Labour court decisions may, however, only be appealed if the decision of the labour court itself explicitly allowed the appeal because of its fundamental significance, or if the matter value exceeds 600€. Furthermore, decisions of labour courts may always be appealed if they relate to the (non-)existence or termination of an employment relationship. Appeals must be filed within one month of receipt of the labour court decision and have to be substantiated within one further month of filing the appeal. Appeals against decisions of the higher labour courts are reviewed by the Federal Labour Court (*Bundesarbeitsgericht, BAG*). However, appeal to the Federal Labour Court must usually be allowed by the higher labour court's decision and is limited to legal and procedural grounds.

III. Court Composition

There are no jury trials before German labour courts. The first instance labour courts and the second instance higher labour courts are divided into chambers (*Kammern*), each of which are presided over by one professional judge who is supported by two lay judges, one from an employer and one from employee background, who contribute their business experience. The Federal Labour Court (*BAG*) is organised in senates (*Senate*), each presided by three professional judges and supported by two lay judges.

C. Labour Court Proceedings

Legal proceedings in labour and employment cases follow a strict and formal scheme according to the Labour Court Act (*Arbeitsgerichtsgesetz, ArbGG*) and the Civil Procedure Act (*Zivilprozessordnung*, *ZPO*). A party that intends to go to trial will usually discuss the issue with its legal representative, and provide him with the facts that support the claim. The legal representative then develops a basic pleading and submits it to the court. The basic pleading needs to address the court and parties clearly. It must name the parties' and their legal representatives' places of residence, their profession, and position in the trial. The pleading should also cover the claimant's application for relief, including the sum or content of the anticipated judgment. Furthermore, it must address the cause of action supported by the basic facts on which the alleged claim is based, with evidence to support the facts. The document must be signed by the party, or if necessary the party's legal representative. There are basically two types of proceedings under the Labour Court Act: individual disputes (I.) and collective disputes (II.).

I. Individual Disputes

The majority of cases relating to termination of an individual's employment go to court. More than 80% of these cases are, however, settled before the court, and only a minority of employment cases end with a court decision.

The course of labour court proceedings in cases of individual disputes, particularly in dismissal protection matters, is of special importance in practice and will therefore be explained in more detail below.

1. Filing of an Action

According to the Dismissal Protection Act (*Kündigungsschutzgesetz, KSchG*), an employee has to file an action against the termination of his employment within

3 weeks of the service of the dismissal letter in order to avoid his dismissal becoming effective.

2. Conciliation Hearing

The Labour Court Act does not provide for alternative dispute resolution. However, in cases where an action is filed before a labour court, e.g. by an employee based on the allegation of the wrongful termination of his employment contract, the court will determine a date for a compulsory conciliation hearing (*Güteverhandlung*). The conciliation hearing usually takes place within one or two months of the filing of the complaint. The parties may file written statements to the court in order to substantiate their pleadings in preparation of the conciliation hearing but there is no requirement for the defendant to do so. At the conciliation hearing the presiding judge will ask the defendant to explain its position and sometimes indicates his view at the case. In most cases, however, the judge asks the parties for options to settle the case.

3. Settlement Negotiations

The negotiation of the terms of a possible settlement, particularly regarding the amount of severance pay, constitutes the most important part of the hearing. In consideration for payment of the agreed amount of severance pay the employee agrees to the termination of the employment relationship. It should be noted that the amount of severance pay is freely negotiable by the parties but the court may suggest—on the basis of its preliminary assessment of the case and its possible result—an amount that can serve as a basis for negotiations. The amount of severance pay is usually based on a payment of between half a month's and one month's gross salary for each year of employment. Depending on the risk of litigation, the amount of severance pay may also be lower or substantially higher. However, the employee neither has a statutory claim for severance pay nor is he obliged to accept a severance pay offer by the employer according to the above formula.

4. Main Hearing

If the dispute is not settled or has otherwise ended, the presiding judge will hold a main hearing (*Hauptverhandlung*) to consider the case on its merits (*streitige Verhandlung*). The main hearing usually takes place 3 to 6 months after the conciliation hearing. The court will also determine a period of at least 2 weeks in which the defendant is required to state his defence in written form. Generally, the party that claims to have a right must prove it; in most cases it will be the claimant. However, in some cases the burden of proof is reversed by the law. There are five

kinds of permissible evidence: sensory perception, witnesses, expert witnesses, documents, and examination of the parties. The court is free in its decision as to how to evaluate the evidence.

In practice, the court provides the claimant with a period in which to reply to the defence ahead of the hearing. There is no pre-trial discovery. All the documents required to prove the case are collected in the court file and parties can ask for access to the court file. The parties also receive copies of their opponents' pleadings.

The main hearing itself commences with the filing of motions by the parties and is usually followed by a legal discussion of the case under the direction of the judge. If necessary for the court, in order to prepare its judgment, it will also take evidence on the matter; particularly it will hear witnesses presented by the parties. In practice, this rarely happens. Throughout the course of the main hearing the parties may still consider agreeing to a settlement of the case without a court judgment.

5. Decisions in Wrongful Dismissal Proceedings

If the case is not settled during the conciliation or main hearing, the court will deliver a decision at the end of the hearing, e.g. ruling if a dismissal is valid.

a) Continued Employment

During the dismissal notice period, in principle, the employee is obliged to continue to work and may claim his salary for the work performed. However, the employer may consider releasing the employee from work for a compelling interest, generally, under continued salary payment due to the employer's default in refusing to allow the employee to continue to work. If, however, the employer's dismissal notice appears invalid and the works council previously objected in a timely and proper way to the employee's dismissal, an employee who has filed a dismissal protection action may request continued employment and enforce this claim by filing an action for preliminary injunction with the labour court.

If the labour court finally considers a dismissal invalid, the employment will continue under the previous terms and conditions of employment. Even if the employer appeals the decision of the labour court in the first instance, the employer has to continuously employ the employee on the basis of the decision of the labour court until the higher labour court reaches a decision.

b) Dissolution and Severance Payment

Save for a few exceptions, labour courts may not order the termination of the employment relationship in consideration for payment of severance pay unless the parties have mutually consented to a specific amount of severance pay. However, if

the labour court concludes that the ordinary dismissal is not socially justified and that, therefore, the employment relationship is not terminated at the end of the applicable notice period, the labour court may—upon application of the employee—dissolve the employment relationship. The labour court at the same time will order the employer to make an adequate severance payment. An application for a dissolution decision requires that the continuation of the employment relationship is not reasonable for the employee, which will only be the case in rare circumstances. The continued employment of the employee, presumably for an indefinite time, must, at the time of the court's decision about the dissolution, be seen to result in detrimental conditions for the employee. However, contrary to the case of the employee's summary dismissal (Termination without Notice) (sec. 626 para. 1 *BGB*), in this case the Federal Labour Court does not demand cause.

In contrast, motions by employers for the dissolution of the employment relationship in return for a severance payment may be successful if a continued employment relationship beneficial for the purposes of the business can no longer be expected. The Federal Labour Court requires that the employer not only bases its dissolution application on the general perception of lost faith in the employee, but rather substantiates it with concrete facts. Contrary to the employee, the employer may only request the dissolution if the dismissal of the employee has been exclusively not socially justified. If the dismissal has been unlawful for other reasons, e.g. for failing to carry out the required prior consultation with the works council or failing to obtain the prior consent of the integration agency in the case of a severely disabled person, the employer may not apply for dissolution. With regard to executive employees, however, the application of the employer does not have to be supported by any reason at all.

In cases of dissolution decisions the labour court will set the termination date of the dismissal notice as the date for the dissolution of the employment relationship.

The severance payment amount to be set by the labour courts is limited by statute: the courts can award severance payments of up to 12 months gross salary, increasing to up to 18 months gross salary for employees aged 55 years and over who have been employed for at least 20 years. If the employee is aged 50 years and over and has been employed for at least 15 years, the court may set a severance payment of up to 15 months gross salary. Within these limitations, the labour courts have discretionary power to determine the amount of severance payment; particularly, the courts are not bound by the applications of the parties. They will set the amount considering the employee's seniority and age, and may also take into account the employee's opportunities in the job market, his family status, the number of persons entitled to maintenance by him, and the employee's health. The gross monthly salary as a basis for calculation includes all remuneration received by the employee for work done. However, supplemental pay, bonus payments, 13th/14th salaries, etc. have to be considered on a pro-rata-basis. In most cases the severance will be between half a month's and one month's salary per year of service.

In cases of summary dismissal only the employee may apply for the dissolution of the employment relationship. The employer may only request the dissolution if it also alternatively dismissed the employee with notice.

II. Collective Disputes

The parties to collective dispute proceedings are works councils (*Betriebsräte*), labour unions (*Gewerkschaften*), employers (*Arbeitgeber*), and employers' associations (*Arbeitgeberverbände*). The proceedings cover disputes arising out of the Works Constitution Act (*Betriebsverfassungsgesetz, BetrVG*), the Co-Determination Act (*Mitbestimmungsgesetz, MitbestG*), and the Collective Bargaining Agreements Act (*Tarifvertragsgesetz, TVG*). A particularity of collective dispute proceedings is that it is for the court to discover the facts relevant to the parties' applications, whereas in individual disputes it is up to the parties to present the facts to the court. Further, the court may, and in most cases will, set a conciliation hearing in order to assess if the parties are willing to settle the case without a decision. However, conciliation hearings are not obligatory in these cases. As with individual disputes, if the dispute has not been settled by the parties, at the end of the hearing there is a decision that may be appealed by complaint (*Beschwerde*) to the Higher Labour Court, irrespective of the value of the complaint. The complaint must be filed within 1 month of receipt of the decision and it must be further substantiated by its grounds within 1 month of filing the complaint.

D. Costs of Labour Court Proceedings

It should be noted that in proceedings before the labour court special rules apply concerning the costs of court proceedings. Collective disputes are generally free of charges in the labour court. In individual disputes before the labour courts of first instance recoverable costs are very limited. No legal fees are recoverable by the successful party from the losing party and no compensation for loss of salary is recoverable for the time spent before the court. An exception applies if a settlement was reached in which the parties agree to divide the costs differently. Otherwise, very few exceptions apply to this rule. Particularly, this limitation on the compensation of costs is excluded for proceedings before the higher labour courts and the Federal Labour Court. There, the losing party has to bear the costs, including the legal fees of the successful party.

Legal representatives are paid according to the Attorneys' Fees Act (*Rechtsanwaltsvergütungsgesetz, RVG*) or on an hourly basis according to an individual contractual fee agreement (*Honorarvereinbarung*). Thus, there are no contingency fees. In principle the losing party pays the prevailing party's attorney fees that arise pursuant to the Attorneys' Fees Act; exceeding attorney fees

(e.g. when paid on an hourly basis) remain with the prevailing party. As already mentioned above, in the first instance at the labour courts, every party has to pay for its own legal fees no matter if they are incurred in accordance with the Attorneys' Fees Act or on an hourly basis.

Parties that cannot afford to pay for the trial or their legal fees can receive financial aid awarded by the courts if the prerequisites of the Labour Court Act or the Civil Procedure Act are fulfilled. Particularly, the party has to show that there is sufficient evidence for a rational judge to decide the case in their favour.

E. Key Aspects

- Labour court proceedings are quite common in Germany; in particular, employees who have been dismissed often file a complaint challenging the effectiveness of the dismissal.
- Labour court proceedings usually take about 4–8 months in the first instance.

English Index

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Key English Terms

English Term	German Term/Translation
A	
Accident Insurance	Unfallversicherung
Act for the Regulation of a General Minimum Wage	Gesetz zur Regelung eines allgemeinen Mindestlohns (MiLoG)
Act on Control and Transparency within Companies	Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)
Act on Employee Inventions	Arbeitnehmererfindungsgesetz
Act on the Co-Determination of the Employees in Cross-Border Mergers	Gesetz über die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Verschmelzungen (MgVG)
Act Regulating Commercial Agency Work	Arbeitnehmerüberlassungsgesetz (AÜG)
Additional Parental Benefit	Elterngeld Plus
Affidavit	Eidesstattliche Versicherung
After Effect	Nachwirkung
Agency Worker	Leiharbeitnehmer
Agency Work (see "Leasing of Employees")	Arbeitnehmerüberlassung
Aliens Office	Ausländerbehörde
Annual Statement of Accounts	Jahresabschluss
Appeal	Berufung
Apprentice	Auszubildender
Apprenticeship	Berufsausbildung
Apprenticeship Act	Berufsbildungsgesetz (BBiG)
Asset Deal (see "Business Transfer")	Kauf einzelner Wirtschaftsgüter/Betriebsübergang
Attorney Fees	Rechtsanwaltsgebühren
Attorneys' Fees Act	Rechtsanwaltsvergütungsgesetz (RVG)

(continued)

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English Term	German Term/Translation
B	
Balance of Interests	Interessenausgleich
Basic Capital	Grundkapital
Basic Reference Letter	Einfaches Zeugnis
Basis Parental Benefit	Basiselterngeld
Benevolent	Wohlwollend
Blocking/Vesting Period	Sperrfrist
Block Model	Blockmodell
Boycott	Boykott
Break (see "Pause to Rest")	Ruhepause
Burden of Proof	Beweislast
Business Blockade	Betriebsblockade
Business Transfer	Betriebsübergang
C	
Capital-Forming Payments	Vermögenswirksame Leistungen
Capital Gain	Kapitalertrag
Captive Pension Insurance	Pensionskasse
Care Allowance	Betreuungsgeld
Central Works Council	Gesamtbetriebsrat
Chairman of the Management Board	Vorstandsvorsitzender
Chamber	Kammer
Civil Code	Bürgerliches Gesetzbuch (BGB)
Civil Law Partnership	Gesellschaft bürgerlichen Rechts (GbR) (see "BGB-Gesellschaft")
Civil Procedure Act	Zivilprozessordnung (ZPO)
Co-Determination Act	Mitbestimmungsgesetz (MitbestG)
Co-Determination Act for the Coal and Steel Industry	Montan-Mitbestimmungsgesetz (Montan-MitbestG)
Co-Determination at Board Level	Unternehmerische Mitbestimmung
Co-Determination Rights	Mitbestimmungsrechte
Collective Association Agreement	Verbandstarifvertrag
Collective Bargaining Agreement	Tarifvertrag
Collective Bargaining Agreement Act	Tarifvertragsgesetz (TVG)
Collective Bargaining Agreement on Retirement Related Benefits	Tarifvertrag über altersvorsorgewirksame Leistungen
Collective Company Agreement	Firmen-/Haustarifvertrag
Collective Social Plan	Tarifsozialplan
Commercial Code	Handelsgesetzbuch (HGB)
Commercial Register	Handelsregister
Commission	Kommission; Provision
Company	Unternehmen
Company Car	Dienstwagen
Company's Articles	Satzung
Company/Occupational Pension	Betriebsrente

(continued)

English Term	German Term/Translation
Company/Occupational Pension Act	Betriebsrentengesetz (BetrAVG) (see "Gesetz zur Verbesserung der betrieblichen Altersversorgung (BetrAVG)")
Company Pension Scheme	Betriebliche Altersversorgung
Company Transformation Act	Umwandlungsgesetz (UmwG)
Compelling Business Reasons	Dringende betriebliche Erfordernisse
Compensation Charge	Ausgleichsabgabe
Compensation Fund	Ausgleichsfonds
Compensation of Disadvantages	Nachteilsausgleich
Compensation Payment	Karenzentschädigung
Complaint	Beschwerde
Complaints Department	Beschwerdestelle
Conciliation	Schlichtung
Conciliation Committee	Einigungsstelle
Conciliation Committee Proceeding	Einigungsstellenverfahren
Conciliation Hearing	Güteverhandlung
Concurrency of Collective Bargaining Agreements	Tarifkonkurrenz
Conduct-Related Termination	Verhaltensbedingte Kündigung
Contingent Capital Increase	Bedingtes Kapital
Continuation of Remuneration Act	Entgeltfortzahlungsgesetz (EFZG)
Continued Payment of Salary	Lohnfortzahlung
Continuity Model	Kontinuitätsmodell
Cooperative	Genossenschaft (eG)
Copyright Act	Urheberrechtsgesetz
Costs of Court Proceedings	Gerichtskosten
Criminal Code	Strafgesetzbuch (StGB)
Criminal Procedure Act	Strafprozessordnung (StPO)
D	
Data Protection	Datenschutz
Default of Acceptance	Annahmeverzug
Deferred Compensation	Entgeltumwandlung
Defined Benefit Plan	Leistungszusage
Defined Contribution Plan	Beitragsorientierte Leistungszusage
Defined Contribution with Guaranteed Minimum Benefit	Beitragszusage mit Mindestleistung
Direct Life Insurance	Direktversicherung
Directive	Richtlinie; Weisung
Direct Pension Promise	Direktzusage
Disabled Persons	Schwerbehinderte
Dismissal (see "Termination")	Kündigung
Dismissal Protection	Kündigungsschutz
Dismissal Protection Act	Kündigungsschutzgesetz (KSchG)
Documentation Act	Nachweisgesetz
Double Taxation Treaty	Doppelbesteuerungsabkommen (DBA)

(continued)

English Term	German Term/Translation
E	
Economic Committee	Wirtschaftsausschuss
Election Board	Wahlvorstand
Election Regulation	Wahlordnung
Employee	Arbeitnehmer
Employee Invention	Arbeitnehmererfindung
Employee Liability	Arbeitnehmerhaftung
Employee Stocks	Belegschaftsaktien
Employer	Arbeitgeber
Employers' Association	Arbeitgeberverband
Employment and Labour Law	Arbeitsrecht
Employment Contract	Arbeitsvertrag
Employment Prohibition	Beschäftigungsverbot
Engagement (see "Recruitment")	Einstellung
Equal Treatment Principle	Gleichbehandlungsgrundsatz
EU Employment Directives	EU-Richtlinien zum Arbeitsverhältnis
European Company	Societas Europaea (SE)
European Court of Justice (ECJ)	Europäischer Gerichtshof (EuGH)
European Economic Area (EEA)	Europäischer Wirtschaftsraum (EWR)
European Union (EU)	Europäische Union (EU)
European Works Council	Europäischer Betriebsrat
European Works Councils Act	Gesetz über Europäische Betriebsräte (EBRG)
Executive Employee	Leitender Angestellter
Exemption Clause	Öffnungsklausel
F	
Family Nursing Care Act	Familienpflegezeitgesetz (FPfZG)
Federal Act on Tariff Unity	Tarifeinheitsgesetz
Federal Administrative Court	Bundesverwaltungsgericht (BVerwG)
Federal Constitutional Court	Bundesverfassungsgericht (BVerfG)
Federal Court of Justice	Bundesgerichtshof (BHG)
Federal Data Protection Act	Bundesdatenschutzgesetz (BDSG)
Federal Employment Agency	Bundesagentur für Arbeit (BA)
Federal Financial Supervisory Authority	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Federal Holiday Act	Bundesurlaubsgesetz (BUrlG)
Federal Labour Court	Bundesarbeitsgericht (BAG)
Federal Law	Bundesrecht
Federal Ministry of Labour and Social Affairs	Bundesministerium für Arbeit und Soziales (BMAS)
Federal Parental Allowance and Parental Leave Act	Bundeselterngeld- und Elternzeitgesetz (BEEG)
Federal Pension Insurance Department	Deutsche Rentenversicherung Bund
Federal Social Court	Bundessozialgericht (BSG)
Federal Tax Court	Bundesfinanzhof

(continued)

English Term	German Term/Translation
Fee Agreement	Honorarvereinbarung
Fixed-Term Employment Contract	Befristeter Arbeitsvertrag
Fixed-Term Employment for Cause	Sachgrundbefristung
Fixed-Term Employment without Cause	Sachgrundlose Befristung
Flash Mob	Flashmob
Forfeiture Clause	Verfallsklausel
Freelance Worker	Freier Mitarbeiter
Functional Succession	Funktionsnachfolge
G	
General Act on Retirement Provisions	Altersvermögensgesetz (AVmG)
General Data Protection Regulation (GDPR)	Europäische Datenschutz-Grundverordnung
General Equal Treatment Act	Allgemeines Gleichbehandlungsgesetz (AGG)
Generally Binding	Allgemeinverbindlich
General Meeting	Hauptversammlung
General Promise	Gesamtzusage
General Right of Information	Allgemeiner Unterrichtungsanspruch
General Terms and Conditions	Allgemeine Geschäftsbedingungen (AGB)
German Association for Trade Unions	Deutscher Gewerkschaftsbund (DGB)
German Constitution	Grundgesetz (GG)
Gratification	Gratifikation
Gross Negligence	Grobe Pflichtverletzung
Group Works Council	Konzernbetriebsrat
H	
Health Insurance	Krankenversicherung
Holiday	Urlaub
I	
Immigration Act	Zuwanderungsgesetz
Income Tax	Einkommensteuer
Income Tax Act	Einkommensteuergesetz (EStG)
Increase Amount	Aufstockungsbetrag
Industry-Wide Collective Bargaining Agreement	Branchentarifvertrag
Injunctive Relief	Unterlassung(sanspruch)
Insolvency Insurance	Insolvenzversicherung
Insolvency Petition	Insolvenzantrag
Insolvency Protection Fund	Pensions-Sicherungsverein a.G. (PSVaG)
Instruction (see “Directive”)	Weisung
Insurance Supervisory Act	Versicherungsaufsichtsgesetz
Integration Agency	Integrationsamt
Interim Reference Letter	Zwischenzeugnis
International Labour Organization (ILO)	Internationale Arbeitsorganisation

(continued)

English Term	German Term/Translation
J	
Job Sharing	Arbeitsplatzteilung
Joint Operation	Gemeinschaftsbetrieb
Jurisprudence	Rechtsprechung
L	
Labour Court	Arbeitsgericht (ArbG)
Labour Court Act	Arbeitsgerichtsgesetz (ArbGG)
Labour Court of Appeal	Landesarbeitsgericht
Labour Director	Arbeitsdirektor
Labour Union	Gewerkschaft
Leasing of Employees (see "Agency Work")	Arbeitnehmerüberlassung
Legal Person	Juristische Person
Legal Sources	Rechtsquellen
Liability	Haftung
Limited Liability Company	Gesellschaft mit beschränkter Haftung (GmbH)
Limited Liability Company Act	Gesetz betreffend die Gesellschaft mit beschränkter Haftung (GmbHG)
Limited Partnership	Kommanditgesellschaft (KG)
Limited Residence Permit	Aufenthaltserlaubnis
List of Names of Employees	Namensliste
Lockout	Aussperrung
Long-Term Account	Langzeitkonto
Loyalty to the Business	Betriebstreue
M	
Management Board	Vorstand
Managing Director	Geschäftsführer
Marginal Employment	Geringfügige Beschäftigung
Market Abuse Regulation	Marktmissbrauchsverordnung (MarktmissbrV)
Mass Dismissal	Massenentlassung
Maternity Allowance	Mutterschaftsgeld
Maternity Leave (see "Maternity Protection Period")	Mutterschaftsurlaub
Maternity Protection Act	Mutterschutzgesetz (MuSchG)
Maternity Protection Period	Mutterschutzfrist
Mediation Panel	Schiedsstelle
Medical Examination of an Applicant	Einstellungsuntersuchung
Member of the Management Board	Vorstandsmitglied
Minimum Wage	Mindestlohn
Minimum Wage Commission	Mindestlohnkommission
Modification Dismissal	Änderungskündigung
Mutual Insurance Company	Versicherungsverein auf Gegenseitigkeit (VVaG)

(continued)

English Term	German Term/Translation
N	
Non-Competition Clause	Wettbewerbsverbotsklausel
Notice Period	Kündigungsfrist
Notification of Elections	Wahlausschreiben
Nursing Care Leave Act	Pflegezeitgesetz (PflegeZG)
Nursing Insurance	Pflegeversicherung
O	
Occupational Integration Management	Betriebliches Eingliederungsmanagement
On-Call Service	Bereitschaftsdienst
One-Third Participation Act	Drittelbeteiligungsgesetz (DrittelbG)
Operation	Betrieb
Operational Change	Betriebsänderung
Operational Practice	Betriebliche Übung
Operational Shutdown	Betriebsschließung
Outsourcing	Auslagerung
P	
Parental Allowance	Elterngeld
Parental Leave	Elternzeit
Partial Retirement	Altersteilzeit
Partial Retirement Act	Altersteilzeitgesetz (AltTzG)
Partnership	Offene Handelsgesellschaft (OHG)
Partnership Company with a *GmbH* as Unlimited Liability Partner	Gesellschaft mit beschränkter Haftung & Co. Kommanditgesellschaft (GmbH & Co. KG)
Partnership Limited by Shares	Kommanditgesellschaft auf Aktien (KGaA)
Part of the Business Operation	Betriebsteil
Part-Time and Fixed-Term Employment Act	Teilzeit- und Befristungsgesetz (TzBfG)
Part-Time Employment Contract	Teilzeitarbeitsvertrag
Pension Fund	Pensionsfonds
Pension Insurance	Rentenversicherung
Pension Office	Versorgungsamt
Pension Reform Act 1999	Rentenreformgesetz 1999 (RRG)
Personnel File	Personalakte
Person-Related Termination	Personenbedingte Kündigung
Persons Similar to Employees	Arbeitnehmerähnliche Personen
Plurality of Collective Bargaining Agreements	Tarifpluralität
Post-Contractual Non-Competition Clause	Nachvertragliche Wettbewerbsverbotsklausel
Posted Workers Act	Arbeitnehmerentsendegesetz
Preliminary Injunction	Einstweilige Verfügung
Principle of Favourability	Günstigkeitsprinzip
Principle of Parity	Prinzip der Kampfparität
Principle of Proportionality	Verhältnismäßigkeitsgrundsatz

(continued)

English Term	German Term/Translation
Priority Principle	Vorrangprinzip
Priority Review	Vorrangprüfung
Probationary Period	Probezeit
Professional Association	Berufsgenossenschaft
Profit Sharing Bonus	Tantieme
Proxy	Prokura
Proxy Holder	Prokurist
Q	
Qualified Reference Letter	Qualifiziertes Zeugnis
R	
Readiness to Work	Arbeitsbereitschaft
Reasonable Discretion	Billiges Ermessen
Recruitment (see "Engagement")	Einstellung
Reference Clause	Bezugnahmeklausel
Reference Letter	Zeugnis
Registered Association	Eingetragener Verein (e.V.)
Regular Termination (see "Termination with Notice")	Ordentliche/Fristgemäße Kündigung
Regulation	Verordnung
Reinstatement	Wiedereinstellung
Relative Peace Obligation	Relative Friedenspflicht
Release from Work	Freistellung
Release Period	Freistellungsphase
Remuneration	Vergütung/Arbeitslohn
Remuneration During Suspension for Maternity	Mutterschutzlohn
Remuneration Transparency Act	Entgelttransparenzgesetz
Reservation of Revocation	Widerrufsvorbehalt
Reservation of Voluntariness	Freiwilligkeitvorbehalt
Residence Act	Aufenthaltsgesetz
Residence Permit	Aufenthaltstitel
Resolutory Condition	Auflösende Bedingung
Rest Break (see "Break")	Ruhepause
Rest Period	Ruhezeit
Restraint on Alienation	Verfügungsbeschränkung
Revision	Revision
Revocation Right	Widerrufsrecht
Right of Instruction	Weisungsrecht des Arbeitgebers
S	
Salary Extortion	Lohnwucher
Scope of Application	Anwendungsbereich
Secondment	Entsendung
Secondment Certificate	Entsendebescheinigung
Selection Policy	Auswahlrichtlinie

(continued)

English Term	German Term/Translation
Self-Functioning Unit	Funktionseinheit
Senate	Senat
Service Contract	Dienstvertrag
Settlement Agreement	Abwicklungsvertrag
Severance Payment	Abfindung
Severely Disabled Persons Representatives	Schwerbehindertenvertretung
Share Deal	Anteilskauf
Shareholder	Anteilseigner
Short-Time Allowance	Kurzarbeitergeld
Short-Time Work	Kurzarbeit
Sick Pay	Krankengeld
Sit-In	Betriebsbesetzung
Slowdown Strike	Bummelstreik
Social Justification	Soziale Rechtfertigung
Social Plan	Sozialplan
Social Security Code	Sozialgesetzbuch (SGB)
Social Security Contribution Ceiling	Beitragsbemessungsgrenze
Social Security Insurance	Sozialversicherung
Social Security Insurance Contributions	Sozialversicherungsabgaben
Social Security Insurance Identity Card	Sozialversicherungsausweis
Social Selection	Sozialauswahl
Specific Works Contract	Werkvertrag
Spin-Off	Abspaltung/Ausgliederung
Spokesman of the Management Board	Vorstandssprecher
Spokespersons Committee	Sprecherausschuss
Spokespersons Committee Act	Sprecherausschussgesetz (SprAuG)
Standard Contract	Vertragliche Einheitsregelung
State Authority	Landesbehörde
Status Clearance	Anfrageverfahren
Status Report	Lagebericht
Stock Corporation	Aktiengesellschaft (AG)
Stock Corporation Act	Aktiengesetz (AktG)
Stock Option Plan	Aktienoptionsplan
Stock Options	Aktienoptionen
Strike Ballot	Urabstimmung
Strikebreaking Premium	Streikbruchprämie
Strike Pay	Streikgeld
Superiority Principle	Rangprinzip
Supervisory Board	Aufsichtsrat
Supplemental Pay	Zuschlag/Zulage
Support Fund	Unterstützungskasse
Supporting Strike	Unterstützungsstreik

(continued)

English Term	German Term/Translation
T	
Tariff Unity	Tarifeinheit
Tax	Steuer
Tax Law	Steuerrecht
Telecommunications Act	Telekommunikationsgesetz (TKG)
Termination (see "Dismissal")	Kündigung
Termination Agreement	Aufhebungsvertrag
Termination Date	Beendigungszeitpunkt
Termination for Business/Operational Reasons	Betriebsbedingte Kündigung
Termination for Good Cause	Kündigung aus wichtigem Grund/Außerordentliche Kündigung
Termination for Suspicion	Verdachtskündigung
Termination Notice	Kündigungsschreiben
Termination with Notice (see "Regular Termination")	Ordentliche/Fristgemäße Kündigung
Termination without Notice	Fristlose Kündigung
Territoriality Principle	Territorialitätsprinzip
Trade Regulation Act	Gewerbeordnung (GewO)
Trade Supervisory Department	Gewerbeaufsicht
Transfer	Versetzung
Transfer Company	Transfergesellschaft
Transfer of Functions	Funktionsübertragung
Transformation	Umwandlung
U	
Unemployment Insurance	Arbeitslosenversicherung
Union (see "Labour Union")	Gewerkschaft
Unrestricted Settlement Permit	Niederlassungserlaubnis
V	
Vested Entitlement	Unverfallbare Anwartschaft
W	
Wage Tax	Lohnsteuer
Waiting Period	Wartezeit
Warning	Abmahnung
Warning Strike	Warnstreik
Working Hours Act	Arbeitszeitgesetz
Working Period	Arbeitsphase
Work on Demand	Arbeit auf Abruf
Workplace Protection Act	Arbeitsschutzgesetz
Works Agreement	Betriebsvereinbarung
Works Constitution Act	Betriebsverfassungsgesetz (BetrVG)
Works Council	Betriebsrat
Wrongful Termination/Dismissal	Ungerechtfertigte Kündigung
Y	
Years of Service	Betriebszugehörigkeit

Key German Terms

German Term	English Term/Translation
A	
Abfindung	Severance Payment
Abmahnung	Warning
Abspaltung/Ausgliederung	Spin-Off
Abwicklungsvertrag	Settlement Agreement
Änderungskündigung	Modification Dismissal
Aktiengesellschaft (AG)	Stock Corporation
Aktiengesetz (AktG)	Stock Corporation Act
Aktienoptionen	Stock Options
Aktienoptionsplan	Stock Option Plan
Allgemeine Geschäftsbedingungen (AGB)	General Terms and Conditions
Allgemeiner Unterrichtungsanspruch	General Right of Information
Allgemeines Gleichbehandlungsgesetz (AGG)	General Equal Treatment Act
Allgemeinverbindlich	Generally Binding
Altersteilzeit	Partial Retirement
Altersteilzeitgesetz (AltTzG)	Partial Retirement Act
Altersvermögensgesetz (AVmG)	General Act on Retirement Provisions
Anfrageverfahren	Status Clearance
Annahmeverzug	Default of Acceptance
Anteilseigner	Shareholder
Anteilskauf	Share Deal
Anwendungsbereich	Scope of Application
Arbeit auf Abruf	Work on Demand
Arbeitgeber	Employer
Arbeitgeberverband	Employers' Association
Arbeitnehmer	Employee
Arbeitnehmerähnliche Personen	Persons Similar to Employees
Arbeitnehmerentsendegesetz	Posted Workers Act

(continued)

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German Term	English Term/Translation
Arbeitnehmererfindung	Employee Invention
Arbeitnehmererfindungsgesetz	Act on Employee Inventions
Arbeitnehmerhaftung	Employee Liability
Arbeitnehmerüberlassung	Agency Work/Leasing of Employees
Arbeitnehmerüberlassungsgesetz (AÜG)	Act Regulating Commercial Agency Work
Arbeitsbereitschaft	Readiness to Work
Arbeitsdirektor	Labour Director
Arbeitsgericht (ArbG)	Labour Court
Arbeitsgerichtsgesetz (ArbGG)	Labour Court Act
Arbeitslohn (see "Vergütung")	Remuneration
Arbeitslosenversicherung	Unemployment Insurance
Arbeitsphase	Working Period
Arbeitsplatzteilung	Job Sharing
Arbeitsrecht	Employment and Labour Law
Arbeitsschutzgesetz	Workplace Protection Act
Arbeitsvertrag	Employment Contract
Arbeitszeitgesetz	Working Hours Act
Aufenthaltserlaubnis	Limited Residence Permit
Aufenthaltsgesetz	Residence Act
Aufenthaltstitel	Residence Permit
Aufhebungsvertrag	Termination Agreement
Auflösende Bedingung	Resolutory Condition
Aufsichtsrat	Supervisory Board
Aufstockungsbetrag	Increase Amount
Ausgleichsabgabe	Compensation Charge
Ausgleichsfonds	Compensation Fund
Ausländerbehörde	Aliens Office
Auslagerung	Outsourcing
Außerordentliche Kündigung (see "Kündigung aus wichtigem Grund")	Termination for Good Cause
Aussperrung	Lockout
Auswahlrichtlinie	Selection Policy
Auszubildender	Apprentice
B	
Basiselterngeld	Basis Parental Benefit
Bedingtes Kapital	Contingent Capital Increase
Beendigungszeitpunkt	Termination Date
Befristeter Arbeitsvertrag	Fixed-Term Employment Contract
Beitragsbemessungsgrenze	Social Security Contribution Ceiling
Beitragsorientierte Leistungszusage	Defined Contribution Plan
Beitragszusage mit Mindestleistung	Defined Contribution with Guaranteed Minimum Benefit
Belegschaftsaktien	Employee Stocks

(continued)

German Term	English Term/Translation
Bereitschaftsdienst	On-Call Service
Berufsausbildung	Apprenticeship
Berufsbildungsgesetz (BBiG)	Apprenticeship Act
Berufsgenossenschaft	Professional Association
Berufung	Appeal
Beschäftigungsverbot	Employment Prohibition
Beschwerde	Complaint
Beschwerdestelle	Complaints Department
Betreuungsgeld	Care Allowance
Betrieb	Operation
Betriebliche Altersversorgung	Company Pension Scheme
Betriebliche Übung	Operational Practice
Betriebliches Eingliederungsmanagement	Occupational Integration Management
Betriebsänderung	Operational Change
Betriebsbedingte Kündigung	Termination for Business/Operational Reasons
Betriebsbesetzung	Sit-In
Betriebsblockade	Business Blockade
Betriebsrat	Works Council
Betriebsrente	Company/Occupational Pension
Betriebsrentengesetz (BetrAVG) (see: Gesetz zur Verbesserung der betrieblichen Altersversorgung (BetrAVG))	Company/Occupational Pension Act
Betriebsschließung	Operational Shutdown
Betriebsteil	Part of the Business Operation
Betriebstreue	Loyalty to the Business
Betriebsübergang	Business Transfer
Betriebsvereinbarung	Works Agreement
Betriebsverfassungsgesetz (BetrVG)	Works Constitution Act
Betriebszugehörigkeit	Years of Service
Beweislast	Burden of Proof
Bezugnahmeklausel	Reference Clause
BGB-Gesellschaft (see "Gesellschaft bürgerlichen Rechts (GbR)")	Civil Law Partnership
Billiges Ermessen	Reasonable Discretion
Blockmodell	Block Model
Boykott	Boycott
Branchentarifvertrag	Industry-Wide Collective Bargaining Agreement
Bürgerliches Gesetzbuch (BGB)	Civil Code
Bummelstreik	Slowdown Strike
Bundesagentur für Arbeit (BA)	Federal Employment Agency
Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)	Federal Financial Supervisory Authority

(continued)

German Term	English Term/Translation
Bundesarbeitsgericht (BAG)	Federal Labour Court
Bundesdatenschutzgesetz (BDSG)	Federal Data Protection Act
Bundeselterngeld- und Elternzeitgesetz (BEEG)	Federal Parental Allowance and Parental Leave Act
Bundesfinanzhof	Federal Tax Court
Bundesgerichtshof (BGH)	Federal Court of Justice
Bundesministerium für Arbeit und Soziales (BMAS)	Federal Ministry of Labour and Social Affairs
Bundesrecht	Federal Law
Bundessozialgericht (BSG)	Federal Social Court
Bundesurlaubsgesetz (BUrlG)	Federal Holiday Act
Bundesverfassungsgericht (BVerfG)	Federal Constitutional Court
Bundesverwaltungsgericht (BVerwG)	Federal Administrative Court
D	
Datenschutz	Data Protection
Deutsche Rentenversicherung Bund	Federal Pension Insurance Department
Deutscher Gewerkschaftsbund (DGB)	German Association for Trade Unions
Dienstvertrag	Service Contract
Dienstwagen	Company Car
Direktversicherung	Direct Life Insurance
Direktzusage	Direct Pension Promise
Doppelbesteuerungsabkommen (DBA)	Double Taxation Treaty
Dringende betriebliche Erfordernisse	Compelling Business Reasons
Drittelbeteiligungsgesetz (DrittelbG)	One-Third Participation Act
E	
Eidesstattliche Versicherung	Affidavit
Einfaches Zeugnis	Basic Reference Letter
Eingetragener Verein (e.V.)	Registered Association
Einigungsstelle	Conciliation Committee
Einigungsstellenverfahren	Conciliation Committee Proceeding
Einkommensteuer	Income Tax
Einkommensteuergesetz (EStG)	Income Tax Act
Einstellung	Engagement/Recruitment
Einstellungsuntersuchung	Medical Examination of an Applicant
Einstweilige Verfügung	Preliminary Injunction
Elterngeld	Parental Allowance
Elterngeld Plus	Additional Parental Benefit
Elternzeit	Parental Leave
Entgeltfortzahlungsgesetz (EFZG)	Continuation of Remuneration Act
Entgelttransparenzgesetz	Remuneration Transparency Act
Entgeltumwandlung	Deferred Compensation
Entsendebescheinigung	Secondment Certificate
Entsendung	Secondment
EU-Richtlinien zum Arbeitsverhältnis	EU Employment Directives

(continued)

German Term	English Term/Translation
Europäische Datenschutz-Grundverordnung	General Data Protection Regulation (GDPR)
Europäische Union (EU)	European Union (EU)
Europäischer Betriebsrat	European Works Council
Europäischer Gerichtshof (EuGH)	European Court of Justice (ECJ)
Europäischer Wirtschaftsraum (EWR)	European Economic Area (EEA)
F	
Familienpflegezeitgesetz (FPfZG)	Family Nursing Care Act
Firmen-/Haustarifvertrag	Collective Company Agreement
Flashmob	Flash Mob
Freier Mitarbeiter	Freelance Worker
Freistellung	Release from Work
Freistellungsphase	Release Period
Freiwilligkeitvorbehalt	Reservation of Voluntariness
Fristgemäße Kündigung (see "Ordentliche Kündigung")	Termination with Notice
Fristlose Kündigung	Termination without Notice
Funktionseinheit	Self-Functioning Unit
Funktionsnachfolge	Functional Succession
Funktionsübertragung	Transfer of Functions
G	
Gemeinschaftsbetrieb	Joint Operation
Genossenschaft (eG)	Cooperative
Gerichtskosten	Costs of Court Proceedings
Geringfügige Beschäftigung	Marginal Employment
Gesamtbetriebsrat	Central Works Council
Gesamtzusage	General Promise
Geschäftsführer	Managing Director
Gesellschaft bürgerlichen Rechts (GbR) (see "BGB-Gesellschaft")	Civil Law Partnership
Gesellschaft mit beschränkter Haftung (GmbH)	Limited Liability Company
Gesellschaft mit beschränkter Haftung & Co. Kommanditgesellschaft (GmbH & Co. KG)	Partnership Company with a *GmbH* as Unlimited Liability Partner
Gesetz betreffend die Gesellschaft mit beschränkter Haftung (GmbHG)	Limited Liability Company Act
Gesetz über Europäische Betriebsräte (EBRG)	European Works Councils Act
Gesetz über die Mitbestimmung der Arbeitnehmer bei grenzüberschreitenden Verschmelzungen (MgVG)	Act on the Co-Determination of the Employees in Cross-Border Mergers
Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)	Act on Control and Transparency within Companies
Gesetz zur Regelung eines allgemeinen Mindestlohns (MiLoG)	Act for the Regulation of a General Minimum Wage
Gesetz zur Verbesserung der betrieblichen Altersversorgung (BetrAVG) (see "Betriebsrentengesetz (BetrAVG)")	Company/Occupational Pension Act

(continued)

German Term	English Term/Translation
Gewerbeaufsicht	Trade Supervisory Department
Gewerbeordnung (GewO)	Trade Regulation Act
Gewerkschaft	Labour Union
Gewerkschaft	Union (see “Labour Union“)
Gleichbehandlungsgrundsatz	Equal Treatment Principle
Gratifikation	Gratification
Grobe Pflichtverletzung	Gross Negligence
Grundgesetz (GG)	German Constitution
Grundkapital	Basic Capital
Günstigkeitsprinzip	Principle of Favourability
Güteverhandlung	Conciliation Hearing
H	
Haftung	Liability
Handelsgesetzbuch (HGB)	Commercial Code
Handelsregister	Commercial Register
Hauptversammlung	General Meeting
Honorarvereinbarung	Fee Agreement
I	
Insolvenzantrag	Insolvency Petition
Insolvenzversicherung	Insolvency Insurance
Integrationsamt	Integration Agency
Interessenausgleich	Balance of Interests
Internationale Arbeitsorganisation	International Labour Organization (ILO)
J	
Jahresabschluss	Annual Statement of Accounts
Juristische Person	Legal Person
K	
Kammer	Chamber
Kapitalertrag	Capital Gain
Karenzentschädigung	Compensation Payment
Kauf einzelner Wirtschaftsgüter/Betriebsübergang	Asset Deal (see “Business Transfer”)
Kommanditgesellschaft (KG)	Limited Partnership
Kommanditgesellschaft auf Aktien (KGaA)	Partnership Limited by Shares
Kommission	Commission
Kontinuitätsmodell	Continuity Model
Konzernbetriebsrat	Group Works Council
Krankengeld	Sick Pay
Krankenversicherung	Health Insurance
Kündigung	Dismissal (see “Termination”)
Kündigung	Termination (see “Dismissal”)
Kündigung aus wichtigem Grund (see “Außerordentliche Kündigung”)	Termination for Good Cause
Kündigungsfrist	Notice Period

(continued)

German Term	English Term/Translation
Kündigungsschreiben	Termination Notice
Kündigungsschutz	Dismissal Protection
Kündigungsschutzgesetz (KSchG)	Dismissal Protection Act
Kurzarbeit	Short-Time Work
Kurzarbeitergeld	Short-Time Allowance
L	
Lagebericht	Status Report
Landesarbeitsgericht (LAG)	Labour Court of Appeal
Landesbehörde	State Authority
Langzeitkonto	Long-Term Account
Leiharbeitnehmer	Agency Worker
Leistungszusage	Defined Benefit Plan
Leitender Angestellter	Executive Employee
Lohnfortzahlung	Continued Payment of Salary
Lohnsteuer	Wage Tax
Lohnwucher	Salary Extortion
M	
Marktmissbrauchsverordnung (MarktmissbrV)	Market Abuse Regulation
Massenentlassung	Mass Dismissal
Mindestlohn	Minimum Wage
Mindestlohnkommission	Minimum Wage Commission
Mitbestimmungsgesetz (MitbestG)	Co-Determination Act
Mitbestimmungsrechte	Co-Determination Rights
Montan-Mitbestimmungsgesetz (Montan-MitbestG)	Co-Determination Act for the Coal and Steel Industry
Mutterschaftsgeld	Maternity Allowance
Mutterschaftsurlaub (see "Mutterschutzfrist")	Maternity Leave (see "Maternity Protection Period")
Mutterschutzfrist	Maternity Protection Period
Mutterschutzgesetz (MuSchG)	Maternity Protection Act
Mutterschutzlohn	Remuneration During Suspension for Maternity
N	
Nachteilsausgleich	Compensation of Disadvantages
Nachvertragliche Wettbewerbsverbotsklausel	Post-Contractual Non-Competition Clause
Nachweisgesetz	Documentation Act
Nachwirkung	After Effect
Namensliste	List of Names of Employees
Niederlassungserlaubnis	Unrestricted Settlement Permit
O	
Öffnungsklausel	Exemption Clause
Offene Handelsgesellschaft (OHG)	Partnership
Ordentliche Kündigung (see "Fristgemäße Kündigung")	Regular Termination (see "Termination with Notice")

(continued)

German Term	English Term/Translation
P	
Pensionsfonds	Pension Fund
Pensionskasse	Captive Pension Insurance
Pensions-Sicherungsverein a.G. (PSVaG)	Insolvency Protection Fund
Personalakte	Personnel File
Personenbedingte Kündigung	Person-Related Termination
Pflegeversicherung	Nursing Insurance
Pflegezeitgesetz (PflegeZG)	Nursing Care Leave Act
Prinzip der Kampfparität	Principle of Parity
Probezeit	Probationary Period
Prokura	Proxy
Prokurist	Proxy Holder
Provision	Commission
Q	
Qualifiziertes Zeugnis	Qualified Reference Letter
R	
Rangprinzip	Superiority Principle
Rechtsanwaltsgebühren	Attorney Fees
Rechtsanwaltsvergütungsgesetz (RVG)	Attorneys' Fees Act
Rechtsquellen	Legal Sources
Rechtsprechung	Jurisprudence
Relative Friedenspflicht	Relative Peace Obligation
Rentenreformgesetz 1999 (RRG)	Pension Reform Act 1999
Rentenversicherung	Pension Insurance
Revision	Revision
Richtlinie	Directive
Ruhepause	Rest Break/Break
Ruhezeit	Rest Period
S	
Sachgrundbefristung	Fixed-Term Employment for Cause
Sachgrundlose Befristung	Fixed-Term Employment without Cause
Satzung	Company's Articles
Schiedsstelle	Mediation Panel
Schlichtung	Conciliation
Schwerbehinderte	Disabled Persons
Schwerbehindertenvertretung	Severely Disabled Persons Representatives
Senat	Senate
Societas Europaea (SE)	European Company
Sozialauswahl	Social Selection
Soziale Rechtfertigung	Social Justification
Sozialgesetzbuch (SGB)	Social Security Code
Sozialplan	Social Plan

(continued)

German Term	English Term/Translation
Sozialversicherung	Social Security Insurance
Sozialversicherungsabgaben	Social Security Insurance Contributions
Sozialversicherungsausweis	Social Security Insurance Identity Card
Sperrfrist	Blocking/Vesting Period
Sprecherausschuss	Spokespersons Committee
Sprecherausschussgesetz (SprAuG)	Spokespersons Committee Act
Steuer	Tax
Steuerrecht	Tax Law
Strafgesetzbuch (StGB)	Criminal Code
Strafprozessordnung (StPO)	Criminal Procedure Act
Streikbruchprämie	Strikebreaking Premium
Streikgeld	Strike Pay
T	
Tantieme	Profit Sharing Bonus
Tarifeinheit	Tariff Unity
Tarifeinheitsgesetz	Federal Act on Tariff Unity
Tarifkonkurrenz	Concurrency of Collective Bargaining Agreements
Tarifpluralität	Plurality of Collective Bargaining Agreements
Tarifsozialplan	Collective Social Plan
Tarifvertrag	Collective Bargaining Agreement
Tarifvertragsgesetz (TVG)	Collective Bargaining Agreement Act
Tarifvertrag über altersvorsorgewirksame Leistungen	Collective Bargaining Agreement on Retirement Related Benefits
Teilzeitarbeitsvertrag	Part-Time Employment Contract
Teilzeit- und Befristungsgesetz (TzBfG)	Part-Time and Fixed-Term Employment Act
Telekommunikationsgesetz (TKG)	Telecommunications Act
Territorialitätsprinzip	Territoriality Principle
Transfergesellschaft	Transfer Company
U	
Umwandlung	Transformation
Umwandlungsgesetz (UmwG)	Company Transformation Act
Unfallversicherung	Accident Insurance
Ungerechtfertigte Kündigung	Wrongful Termination/Dismissal
Unterlassung(sanspruch)	Injunctive Relief
Unternehmen	Company
Unternehmerische Mitbestimmung	Co-Determination at Board Level
Unterstützungskasse	Support Fund
Unterstützungsstreik	Supporting Strike
Unverfallbare Anwartschaft	Vested Entitlement
Urabstimmung	Strike Ballot
Urheberrechtsgesetz	Copyright Act
Urlaub	Holiday

(continued)

German Term	English Term/Translation
V	
Verbandstarifvertrag	Collective Association Agreement
Verdachtskündigung	Termination for Suspicion
Verfallsklausel	Forfeiture Clause
Verfügungsbeschränkung	Restraint on Alienation
Vergütung (see "Arbeitslohn")	Remuneration
Verhältnismäßigkeitsgrundsatz	Principle of Proportionality
Verhaltensbedingte Kündigung	Conduct-Related Termination
Vermögenswirksame Leistungen	Capital-Forming Payments
Verordnung	Regulation
Versetzung	Transfer
Versicherungsaufsichtsgesetz	Insurance Supervisory Act
Versicherungsverein auf Gegenseitigkeit (VVaG)	Mutual Insurance Company
Versorgungsamt	Pension Office
Vertragliche Einheitsregelung	Standard Contract
Vorrangprinzip	Priority Principle
Vorrangprüfung	Priority Review
Vorstand	Management Board
Vorstandsmitglied	Member of the Management Board
Vorstandssprecher	Spokesman of the Management Board
Vorstandsvorsitzender	Chairman of the Management Board
W	
Wahlausschreiben	Notification of Elections
Wahlordnung	Election Regulation
Wahlvorstand	Election Board
Warnstreik	Warning Strike
Wartezeit	Waiting Period
Weisung	Instruction (see "Directive")
Weisungsrecht des Arbeitgebers	Right of Instruction
Werkvertrag	Specific Works Contract
Wettbewerbsverbotsklausel	Non-Competition Clause
Widerrufsrecht	Revocation Right
Widerrufsvorbehalt	Reservation of Revocation
Wiedereinstellung	Reinstatement
Wirtschaftsausschuss	Economic Committee
Wohlwollend	Benevolent
Z	
Zeugnis	Reference Letter
Zivilprozessordnung (ZPO)	Civil Procedure Act
Zuschlag/Zulage	Supplemental Pay
Zuwanderungsgesetz	Immigration Act
Zwischenzeugnis	Interim Reference Letter