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CONTENTS

THE TERMINATION OF EMPLOYEES BASED ON THE CREATION OF EMPLOYEE AGE GROUPS

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As of late, many German companies have been forced to terminate employees for business or financial reasons, otherwise known as terminations for "operational reasons"—*e.g.*, a company is suffering financial losses, it has lost a number of significant customers to foreign competition, etc. For the reasons highlighted below, terminations for operational reasons are vastly different, from a legal perspective, from terminations due to an employee's conduct (*e.g.*, inexcusable absenteeism) or for reasons related to the personal characteristics of an employee (*e.g.*, extensive absenteeism due to illness).

As opposed to the situation in the United States, German employers are required by law to consider employees' ages as part of the process of termination for operational reasons; specifically, employers must consider the "social characteristics" of employees who are comparable in terms of skills and know-how, then terminate those employees who are less in need of protection against termination before terminating those in greater need. The employees' ages, years of service, number of dependents, and any disability constitute their respective "social characteristics."

As opposed to the situation in the United States, German employers are required by law to consider employees' ages as part of the process of termination for operational reasons. Employers must consider the "social characteristics" of employees who are comparable in terms of skills and know-how, then terminate those employees who are less in need of protection against termination before terminating those in greater need. The employees' ages, years of service, number of dependents, and any disability constitute their respective "social characteristics."

By way of example: A 25-year-old childless employee with two years of service with a company is generally "less in need of protection against termination" than a 48-year-old employee who has been with the company for 22 years and has three dependent children living at home. As long as these two employees are "comparable" in terms of skills and know-how, and the terminations are being issued for operational reasons, the employer would be required to terminate the younger employee before the older employee. If the employer fails to take the employees' social characteristics into consideration correctly, or ignores them altogether, the validity of the termination will be jeopardized.

However, an employer may not only "exempt" certain employees from termination because of special skills or know-how, but it may also protect particular employees from termination to ensure that it can "maintain a balanced workforce" (to use the wording of Germany's Termination Protection Act) from an age perspective. Two points: (i) It will be interesting to see how much weight German employers may (or may be required to) put on employees' ages once the antidiscrimination statutes play a more central role in German employment law, and (ii) employers are well advised to proceed with caution when deciding to exempt certain employees from termination to maintain a balanced workforce with regard to age.

Although the right to maintain a balanced workforce was codified into German law only recently, it has been a source of discussion among German labor courts for some time. The extent to which an employer may exempt particular employees from termination is a serious issue, because if a company has already gone through several waves of terminations for operational reasons and the employer executed these terminations based purely on the above-referenced social characteristics, the workforce of that company is likely to be relatively old. This, of course, does not bode well for the employer, since the next generation of employees developing their skills at the company will be limited in number.

For this reason, it may very well be in the employer's interest to seek a balanced workforce from an age perspective; *i.e.*, once the employer decides that it must terminate employees for operational reasons, that employer should

create age groups within the company and compare the social characteristics of the employees only within those age groups, rather than comparing all of the employees against one another in the aggregate. Since the employer will not then be required to favor the older employees over the younger, it is a given that particular younger employees will be protected to some extent against termination. This in itself, however, raises the question as to what types of age groups German courts will accept.

The Federal Labor Court decision of April 20, 2005, brought some clarity to this issue. Whether a certain employer may maintain a balanced workforce with regard to age may be answered only by reviewing the particularities of the company at issue and, to the extent applicable, how a company executes such a plan. It is quite clear from the Federal Labor Court's decision that employers are given a bit of leeway when creating age groups; however, they must be prepared to accept an inevitable increase in the workforce's average age as the result of terminations for operational reasons. Employers may not pursue a youth craze, but they are not required to have only "Methuselahs" at the workplace.

The Federal Labor Court also confirmed that the selection process for terminating employees based on their social characteristics may be skewed from an age perspective because the employer is permitted to exempt from termination those employees with special skills or know-how. At first blush, this may seem obvious; however, when going through the termination process, an employer cannot repeat this fact often enough to works council members or, for that matter, to judges who may have a soft spot for employees.

The Federal Labor Court's decision also brings additional clarity with respect to procedural matters that a defendant company should keep in mind if an employee challenges the validity of a particular termination. The employer should by all means specifically present the argument that it would be harmed if it were forced to execute terminations for operational reasons based purely on the traditional social characteristics. This "harm" would include the above-mentioned fact that an inordinate number of employees would be quite senior and that there would be a relatively low number of employees who have the opportunity to work their way up the ranks over the years. Also, a fundamental aspect of the German economy—the apprenticeship periods that young employees must pass through before becoming full-fledged employees—would suffer, as there would no longer be a gradual introduction of new, young employees.

To buttress its argument for having created "acceptable" age groups, the Federal Labor Court recommends that employers not only calculate the percentage of employees who fall into the various age groups the employer created before issuing termination notices, but also determine how the terminations were divided among these various age groups. This, the Federal Labor Court believes, will facilitate the lower-level labor courts' efforts to determine whether the employer executed its goal of maintaining a balanced workforce in a legally acceptable manner. If a labor court concludes that the employer did not execute the process correctly, then the terminations will be invalid.

The Federal Labor Court decision actually continues with an already established line of cases without adding any significant detail. However, what has now become clearer is that the greater the number of "comparable" employees, the easier it is to create a greater number of "acceptable" age groups (*e.g.*, a five-year age group was used in the cited Federal Labor Court decision). If there are relatively few "comparable" employees, and the employer creates a large number of age groups, this would open the door to the argument that the employer is actually engaged in gerrymandering by trying to do nothing more than targeting specific employees for termination.

Employers are well advised to keep in mind the right to form age groups when terminating employees for operational reasons. It is unlikely that an employer will be able to backtrack by terminating only more senior employees once it discovers that it has too many senior employees on staff. Statutory law and case law both make clear that employers may create age groups as discussed above only for the purpose of *maintaining* a balanced workforce; they may not create age groups to *reintroduce* or to *create* a balanced workforce.

VALIDITY OF SEVERANCE AGREEMENTS AS PART OF A PENDING TRANSFER OF THE BUSINESS

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The Federal Labor Court recently held that a severance agreement concluded in connection with the sale of a business is valid as long as the agreement sets forth that the employee has been terminated definitively from that particular company. A severance agreement concluded as part of the sale of a business that contemplates that the employee may enter into a different employment agreement with the buyer, however, is invalid because it is deemed to be an attempted circumvention of Section 613a of Germany's Civil Code. Pursuant to Section 613a of the Civil Code, all employment relationships in effect at the time of the sale of a business automatically transfer from the seller to the buyer by operation of law.

The Federal Labor Court's decision, however, has limitations because it ruled that severance agreements that contemplate the conclusion of a new employment agreement with the buyer—with less favorable terms than the original employment agreement—may indeed be valid if there are justified grounds, from an objective viewpoint, for the less favorable terms. Such terms often arise if an employee enters into an employment agreement with so-called Employment Promotion Companies, sometimes also referred to as "Nonprofit Companies." Employment Promotion Companies were the brainchild of the German government a number of years ago. They have met with only mixed success for a variety of reasons. The idea of the Employment Promotion Companies is to retrain employees who would otherwise lose their jobs immediately—and very possibly be unemployed as a result—for a period of up to 12 months at the expense of both the state and the employer.

In the case heard recently before the Federal Labor Court, the employees had each concluded a three-party agreement with the former employer as well as an Employment Promotion Company. The agreement called for the employment relationship with the former employer to end and the creation of a new temporary employment relationship with the Employment Promotion Company. The employees feared that the former employer was going to file for bankruptcy, and so, to avoid becoming creditors of this bankrupt company, and possibly becoming unemployed, many employees decided it would be safer to conclude an employment agreement with the Employment Promotion Company. As it turns out, the company for which the employees formerly worked did not file for bankruptcy; instead, it was sold and the buyer continued to operate this company. The employees filed an action with the labor court to determine whether their employment relationships had automatically transferred to the buyer as a result of Section 613a of the Civil Code rather than to the Employment Promotion Company, as their agreements had not called for a definitive end to their employment relationships. Though the employees won the case before the lower courts, the Federal Labor Court overturned the court of appeals ruling that the employment agreements with the Employment Promotion Company were valid.

YOU THINK IT IS A GOOD IDEA TO PROVIDE BENEFITS OR PERKS TO WORKS COUNCIL MEMBERS? YOUR LOCAL CRIMINAL PROSECUTOR MAY THINK OTHERWISE

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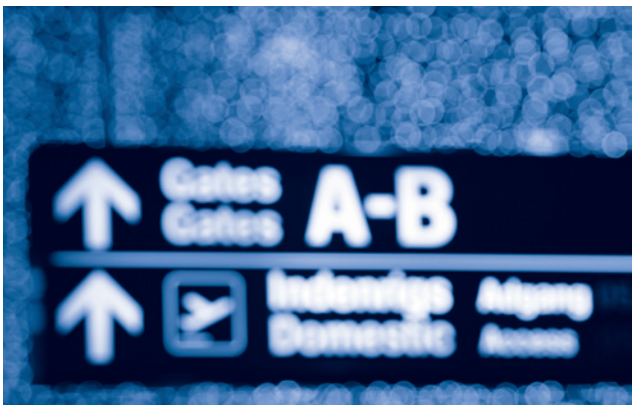
A number of recent news reports discussed the issue of German companies providing benefits or perks to works council members in violation of German law. The most well known of these cases is Volkswagen. According to reports, Volkswagen—as well as criminal prosecutors—is in the midst of investigating the extent to which VW paid for works council members' luxurious trips to faraway places, vacation rental homes, and "business expenses" that were subject to little or no scrutiny. There have also been reports that this investigation will lead to Volkswagen's former head of human resources, who had resigned a couple of months ago after news of the investigation broke.



Based on case law, illegal benefits or perks that management has provided to works councils in the past have included permitting works council members to fly first or business class on business trips while other employees were required to fly economy, giving works council members access to luxury suites at soccer stadiums for personal use, granting loans to works council members (or their spouses) under favorable terms, permitting and paying for works council members to attend seminars or conferences unrelated to their work, or just simply giving them gifts.

Why such an investigation is important from VW's point of view is clear. According to initial reports, works council members as well as various members of management had apparently been defrauding the company.

However, why criminal prosecutors would also get involved may not be so clear. The answer lies in Germany's Labor-Management Relations Act. According to this statute, individuals—typically management—may not discriminate against or give preferential treatment to works council members as a result of their status as members of the works council. The purpose of this provision is twofold: (i) to ensure that employers do not take retribution against works council members for performing their works council obligations, and (ii) to ensure that the works council members are independent vis-à-vis management when performing their duties. A violation of this provision of the Labor-Management Relations Act is subject to criminal prosecution. However, there is one important exception to this rule—management may provide perks or benefits to a works council member as a gesture of appreciation if and to the extent benefits or perks of the type given are not unusual in the company—and not just to other works council members, but to the other employees in general.

Before considering how giving illegal preferential treatment to works council members may play out from a practical perspective, it is important to remember that works council members, unlike union representatives, are employees of the company. They are not paid specifically to perform their works council duties; instead, they are relieved of their normal work obligations, either in whole or in part, so that they can perform their obligations as works council members. Works council members continue to receive their salary throughout their tenure as works council members. Their duties include reviewing whether the company should hire or terminate a particular individual, ensuring that the employer abides by the terms of any collective bargaining agreement, ensuring that the employer adheres to safety and health as well as environmental protection provisions, overseeing the equal treatment of men and women at the workplace, overseeing the integration of disabled employees, negotiating the terms of a mass layoff, overseeing the introduction of technical improvements at the company, etc. Many of the issues negotiated with the works council are then set forth in a binding written works agreement entered into by the works council and management.

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A specific example: If a mass layoff is pending at a particular facility, management will need to agree with the works council as to "why, when, and how" the mass layoff will be implemented and the amount of severance to be paid to the affected employees. Pending such an agreement between the works council and management (or, in some cases, the decision of a so-called conciliation board), management will not be able to begin implementing the mass layoff. If the negotiations with the works council come to a stalemate, or management sees that the negotiations are not proceeding as desired, as a last-ditch effort management may threaten to inform the other employees that particular works council members—or maybe even all works council members—had no problems accepting certain benefits from management in the past. This, of course, will not meet with favor among the employees, as they will see the works council as having sold out precisely those people the council was elected to represent—the employees.

Of course, a situation like the above scenario will not occur every time, but it is clear that providing even small perks initially may—whether quickly or only over time—eventually spiral into real trouble for management, to the point where criminal charges may be filed. The Volkswagen case is an excellent example, as criminal charges have been, or will soon be, filed against a number of VW works council members (for criminally defrauding VW), and possibly also against particular members of management (for illegally providing certain benefits to works council members).

Interestingly enough, only works council members, the employer, or a union may seek to have a criminal prosecution initiated for providing illegal benefits to works council members. The penalty is a prison sentence of up to one year or a fine. In the VW case, the CEO of VW and the new general works council chief jointly initiated the action once they discovered that certain members of management had apparently been involved in creating a slush fund to pay for the benefits of certain works council members.

At the outset, employers may feel that a certain benefit is warranted as a sort of thank-you because a particular works council member, or maybe even the entire works council, went above and beyond the call of duty. For example, the works council may have been extremely diligent, responsive, and helpful in avoiding what could have been a long-winded, acrimonious, and expensive dispute between management and the employees, to the satisfaction of everybody concerned. After resolution was reached between the works council and management, management may decide that it would like to show its appreciation for the works council's efforts, *e.g.*, by treating the works council to dinner at a nice restaurant.

However, a word of caution to employers: It is precisely these little "thank-yous" that can eventually lead to trouble. Invariably, the time will come when management will want to "remind" the works council members of some of these perks; *i.e.*, what started out innocently enough as a reward for a job well done may subsequently turn into a "I rub your back, you rub mine" relationship and possibly lead to criminal charges thereafter.

EMPLOYERS MAY ALSO BE REQUIRED TO PROVIDE THE SUBSTANCE OF AN INTERVIEW TO THE WORKS COUNCIL WHEN MAKING A HIRING DECISION

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In a case heard before the Federal Labor Court, a works council had refused to give its consent to the hiring of a certain individual, arguing that the employer was violating the company's policy of positive action towards women (or, to use the American parlance, "affirmative action" in relation to women) by deciding to hire a male. Under German law, the employer must consult with the works council before hiring any applicant or terminating any employee. The German Federal Labor Court overturned the decision of the district court and the court of appeals, each of which had approved the hiring of the male applicant. The Federal Labor Court held that the employer had failed to provide to the works council all the information required by statute, since German law requires that the employer provide to the works council not only information about the skills necessary for the position, but also information about the personal qualifications sought.

If the employer used the personal interview as part of the hiring decision—as can only reasonably be assumed—then the employer must also provide to the works council the content of that interview. The works council has a right to know whether the employer adhered to the requirements of this policy. The Federal Labor Court added that, in certain cases, the employer must provide the works council with the points discussed during an interview, even if the works council does not specifically request this information. This was precisely the point in this instance—the employer was required to prove that it considered the company's positive-action policy with respect to the female applicant as part of its decision-making process.

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