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GERMAN LABOR AND EMPLOYMENT NEWS

EMPLOYEES' COMPENSATION—FEDERAL LABOR COURT ADDS SOME INSIGHT

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DECREASING AN EMPLOYEE'S SALARY AFTER THE TRANSFER OF AN UNDERTAKING

Section 613a of Germany's Civil Code, commonly referred to in the European Union as the Transfer of Undertakings (Protection of Employment) Regulations or "TUPE," states that employees are automatically transferred from the seller of a company to the buyer upon the "transfer of the undertaking" (typically an acquisition by way of an asset deal). This sounds simple enough. Yet the transfer-of-undertaking rules are in constant flux, even though Section 613a was enacted decades ago.

The European Court of Justice and Germany's Federal Labor Court routinely grapple with Section 613a. In this short article, we will discuss a November 7, 2007, Federal Labor Court decision involving "compensation agreements" with employees in connection with Section 613a.

May an Employer Reduce an Employee's Compensation?

The black-letter law of the November 7, 2007, decision stated that "Section 613a does not prohibit a buyer of an undertaking and an employee from reducing the

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The purpose of Section 613a is to protect not only the employment relationship per se, but also the terms of that employment relationship. Taking this into consideration, it has long been argued that a buyer is prohibited from agreeing with the employee to less favorable terms of employment (*e.g.*, reduced salary), unless there is a sound legal basis for the less favorable terms.

employee's compensation subsequent to the transfer of the undertaking."

For a long time it has been unclear whether Section 613a should be viewed as a "static" provision, *i.e.*, whether a buyer could agree with the newly transferred employee to reduce the employee's salary. The purpose of Section 613a is to protect not only the employment relationship per se, but also the terms of that employment relationship. Taking this into consideration, it has long been argued that a buyer is prohibited from agreeing with the employee to less favorable terms of employment (*e.g.*, reduced salary), unless there is a sound legal basis for the less favorable terms.

Germany's Federal Labor Court Responds

The Federal Labor Court, however, ruled otherwise. The Federal Labor Court opined that Section 613a does not *add* any restrictions to the parties' ability to change the terms of employment; *i.e.*, Section 613a does not create any additional impediments to amending the terms of an employment relationship.

It is very important for the parties to observe the letter of Section 613a. For example, for a period of one year after the transfer of the undertaking, the employer may not revoke employment terms which had previously applied to the employees collectively (*e.g.*, agreements with the works council or collective bargaining agreements) but which upon consummation of the transfer apply to the employees individually. Further, an employee is not required to accept less favorable terms of employment as proposed by the employer; such terms are contingent upon the employee's "freely given" consent. Finally, the employer may not circumvent Section 613a. Other than these general restrictions, Section 613a is not meant to add any additional restrictions to the parties' freedom to contract.

IS A BONUS DUE EVEN THOUGH THE PARTIES FAILED TO ESTABLISH PERFORMANCE GOALS?

Performance-based bonuses are popular tools for motivating employees. Under the typical scenario, an employee receives a bonus if he meets the goals agreed upon with the employer. Unfortunately, practice has shown that employment agreements often refer to performance-based bonuses only in general terms, with the parties failing to subsequently agree on the specifics. This then raises the question: Does an employee have a claim to payment—either in the form of a bonus or monetary damages—if the parties do not set forth the specific terms, and if so, for what amount?

This precise issue was presented to the Federal Labor Court late last year. The court held as follows:

- A bonus provision can be established in one of two ways: Either (i) the parties conclude a written agreement setting forth the specific goals and the amount of the bonus for which the employee is eligible (these performance goals are generally not subject to a test of reasonableness, nor are they subject to court approval), or (ii) the employer sets forth in the employment agreement the employee's goals only in general terms (here the employer unilaterally sets forth the goals; however, they are subject to a reasonableness test and may be subject to a court's approval if the employee subsequently challenges their reasonableness).

Finally, because the burden is generally on employers, they should not only initiate discussions with their employees regarding the establishment of performance goals but also document the fact that they have in fact initiated such discussions.

- If the employer reserves the right to establish the goals unilaterally, then it must, in fact, establish those goals. If the employer fails to meet this obligation, the employee may file an action for breach of contract.

- If the bonus is to be based on mutually agreed-upon goals but the parties fail to set forth those goals, it is unclear whether the employee may file a claim seeking payment of the bonus, and if so, for what amount. It is interesting to note that the Federal Labor Court did not take the initiative of describing the goals for the parties as "reasonable." Accordingly, it would seem that the employee may not make a claim for the original bonus, but instead may seek only monetary damages.

- Whether an employee may claim damages for the failure to establish performance goals depends on why these goals were not set forth. If the employer breached his obligation of initiating negotiations with the employee, then the employer's failure to act will generally permit the employee to seek damages. The same applies if the employee unsuccessfully sought to enter into negotiations with the employer when the duty to initiate negotiations did not clearly lie with the employer.

- Depending on the terms of the employment agreement and the employee's conduct, the employee may be held responsible for failing to reach agreement with the employer on the performance goals. If the employee is indeed held responsible, then he may have no claim at all. This would be the case if the employee refused, for whatever reason, to comply with the employer's attempts to enter into such negotiations.

- If the employment agreement sets forth a specific date by which the parties must establish the performance goals, then the employer carries the burden of initiating the negotiations.

- If the employment agreement does not clearly state that the employer must initiate the negotiations, then the employer does not have the sole burden of initiating the discussion. To avoid being held contributorily liable, the employee must be able to prove that he sought such discussions with the employer.

- The amount of damages the employee may claim depends on the employee's lost profits. The Federal Labor Court will determine the level of lost profits by assuming "reasonable" performance goals. Except under special circumstances, the Federal Labor Court will assume that the employee satisfied the goals.

To avoid the uncertainties associated with performance goals, employers should always make an effort to reach a specific agreement with their employees. In particular, attention should be paid to the precise wording of the performance goals. Finally, because the burden is generally on employers, they should not only initiate discussions with their employees regarding the establishment of performance goals but also document the fact that they have in fact initiated such discussions.

UNSUCCESSFUL CLAIM FOR DAMAGES UNDER THE GENERAL EQUAL TREATMENT ACT

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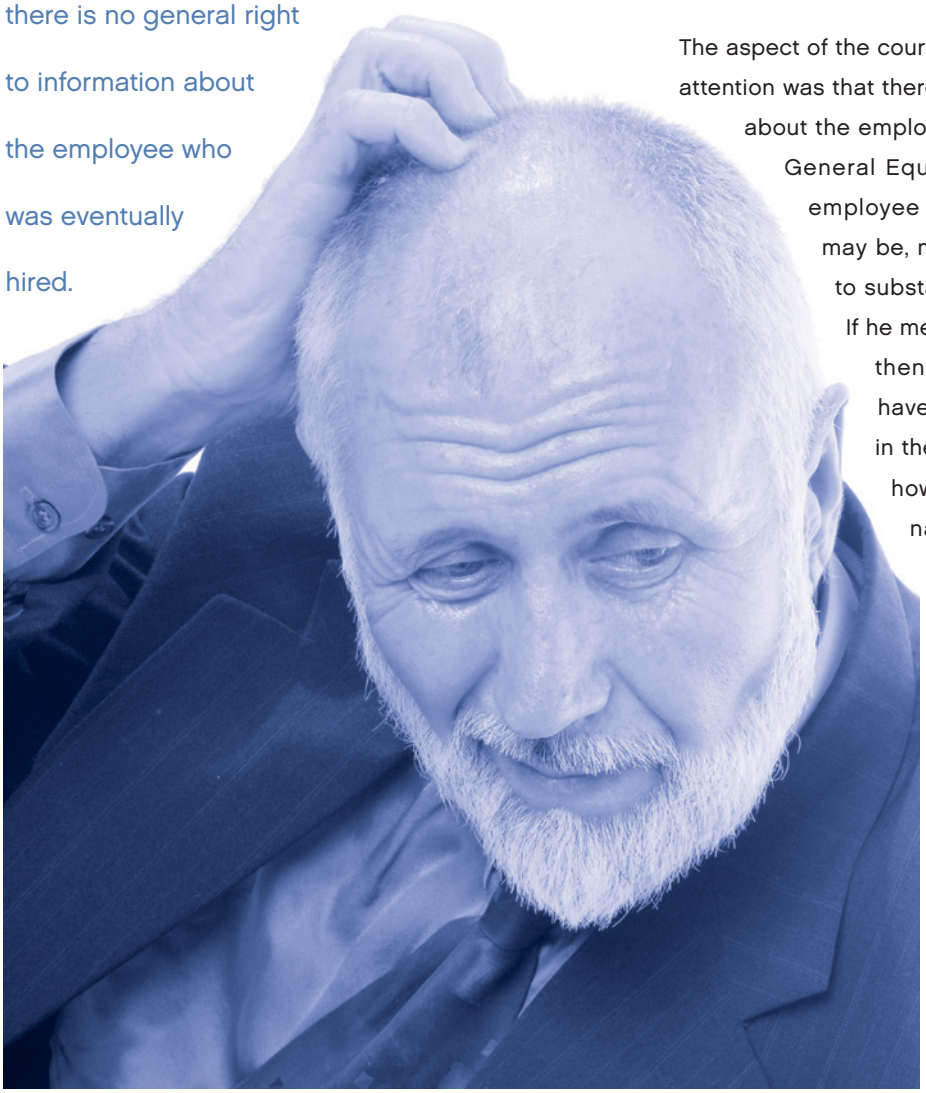
The Labor Court of Appeals in Hamburg recently opined on the award of monetary damages to a job applicant who had not been hired.

In that case, the employer decided against hiring a particular applicant without having conducted an interview. The applicant sued under the General Equal Treatment Act, claiming that she met all of the job requirements set forth in the job description. This led her to argue that the only reason she had not been offered the job (or even granted an interview) was that she is a foreigner and was 45 years old at the time. As far as she was concerned, these "preliminary indications" of discrimination gave her the right to require the employer to provide her with information about the individual who had eventually been hired.

The Hamburg Labor Court of Appeals disagreed. It ruled that the rejected applicant had neither a right to demand information about the individual who had been offered the position nor a claim to monetary damages, since there was no evidence of discrimination.

There is no principle based on experience regarding applicants who have the requisite qualifications but have not been invited to interview due to certain characteristics (*e.g.*, age, gender, and national origin). In particular, employers are not required to interview all applicants who have the requisite job qualifications.

The aspect of the court's decision that gathered the most attention was that there is no general right to information about the employee who was eventually hired.



The aspect of the court's decision that gathered the most attention was that there is no general right to information about the employee who was eventually hired. The General Equal Treatment Act states that the employee or applicant, whichever the case may be, must present preliminary evidence to substantiate his claim of discrimination. If he meets this burden, the employer must then either disprove the allegation or have a legal basis for having engaged in the disparate treatment. The plaintiff, however, cannot support his preliminary evidence of discrimination by demanding information about the individual hired.

The plaintiff filed an appeal with the Federal Labor Court. We will keep our readers apprised of the developments in this case.

SMOKING IN THE WORKPLACE—A CONSTANT EVOLUTION

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"No Smoking!" Since the beginning of 2008, this sign has become a common sight in the German states that have codified the recent prohibition on smoking in various locations, including restaurants and bars. Anybody who visited Germany prior to this year knows that smoking in restaurants and bars was once very common (just as bringing dogs and other pets into these locations still is today).

Not surprisingly, banning smoking in restaurants and bars has led to heated discussions; on the one side are those who argue that breathing second-hand smoke is just as dangerous as actually smoking, while others argue that prohibiting smoking is an infringement on an individual's fundamental right to freedom.

Prohibiting smoking in the workplace has also been a source of argument. The Act on the Protection Against Risks of Second-Hand Smoke (the "Act") entered into effect on September 1, 2007. The essence of this statute is that people may no longer smoke in various federal buildings or on public transportation. In addition, the Act amended the Workplace Regulation by adding language that "to the extent necessary," employers are required to prohibit smoking in the workplace or introduce special smoking rooms.

IS THERE A REQUIREMENT TO HAVE A SMOKE-FREE ENVIRONMENT?

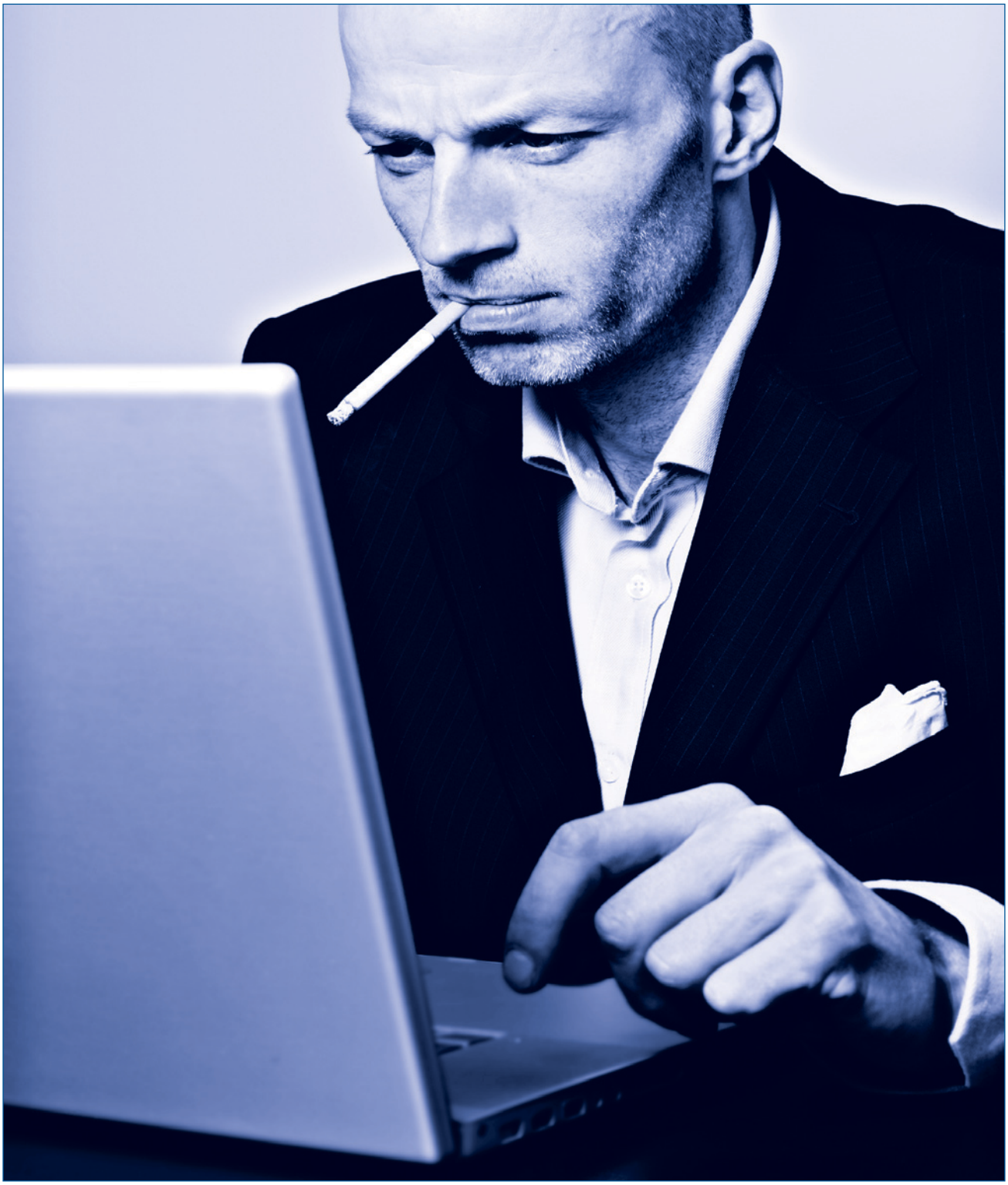
There is no general statutory provision in Germany that prohibits smoking in the workplace. Instead, the above-mentioned Workplace Regulation protects smokers from second-hand smoke. Even before this provision entered into effect, however, employers were required to "take appropriate measures" to reduce health risks to nonsmoking employees.

As is seen from the above discussion, German law provides limited protection in the workplace, in that it protects only the nonsmoking employees. Employees who smoke, employers, and third persons who are not on company premises to work (such as customers and employees' families attending company sporting events) are not protected by the provision.

The question, however, remains: **When must an employer take action with respect to smoking in the workplace?**

The question, however, remains: When must an employer take action with respect to smoking in the workplace? One of the stated purposes of the Workplace Regulation is to protect employees from the health risks posed by passive smoking. This, of course, does not mean that each nonsmoking employee must evidence actual health risks before the employer is required to take action. The prescribed approach is actually more reasonable (at least from the nonsmoker's perspective)—any exposure to passive smoking is deemed to constitute a health risk, and the employer must take action if any employees wish to smoke in the workplace.

Action taken by the employer must be reasonable. This means that the employer must ask not only whether the proposed action protects nonsmoking employees, but also whether it unreasonably infringes upon the smokers' personal freedom. The employer is given some leeway when



considering alternative actions; however, an employer that wishes to impose an outright ban on smoking in the workplace may not pass the reasonableness test.

Nonsmoking employees are protected not only by the Workplace Regulation, but also by Germany's Civil Code. The Civil Code provides that an employer must maintain a workplace that does not pose a risk to the employees' life or health. This provision, which is buttressed by the Workplace Regulation, provides for a smoke-free environment only in the precise locations where the employees spend a significant amount of time while at work. The result is that an individual employee may not demand an entirely smoke-free environment.

On the one hand, the words "to the extent necessary" are certainly not meant to restrict an employer's ability to take action with respect to smoking in the workplace. Conversely, the new language does not specifically prohibit the taking of any action that was previously permitted.

WHAT ARE EFFECTIVE NONSMOKING POLICIES?

An employer may introduce a smoking policy by agreeing to such with the works council by means of a works agreement. This, of course, is possible only where there are no statutory provisions that already require a smoke-free environment (due, for example, to hazardous working conditions) or a collective bargaining agreement that does not provide any leeway.

As long ago as 1999, the Federal Labor Court established that management and the works council are generally permitted to agree on nonsmoking policies in the workplace. The Federal Labor Court added that nonsmokers generally have the upper hand over smokers in terms of negotiating the precise policy. This means that the employer is not necessarily required to maintain a smoking room at the request of the smokers. As a result of the above, it would seem that the most effective way to introduce a smoking policy in the workplace is for management to conclude a works agreement with the works council.

CONSEQUENCES OF THE AMENDMENT TO THE LAW

The introduction of the above-referenced language does not seem to have resulted in any real change in the application of the Workplace Regulation. On the one hand, the words "to the extent necessary" are certainly not meant to restrict an employer's ability to take action with respect to smoking in the workplace. Conversely, the new language does not specifically prohibit the taking of any action that was previously permitted. According to the legislature's official statement, the new language is only intended to make clear that "in particular, a general nonsmoking policy for the entire facility or for only specific locations of the workplace can be an acceptable policy within the meaning of the Regulation." However, as already stated, an absolute ban on smoking in the workplace may not necessarily pass muster under the reasonableness test.

NEW CASE LAW ON THE TRANSFER OF UNDERTAKINGS

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The European Union took the position many years ago that an employee should not lose his job just because the facility in which he was working was sold as part of an asset deal. In an asset deal (as compared to a share deal), every asset is sold and transferred separately. If these individual sales of assets, taken as a whole, result in the transfer of an "economic entity" that essentially retains its identity (see below) after being transferred, a "transfer of an undertaking" is said to have occurred. Under German law (like that of other EU jurisdictions), the employment relationships of those employees that are "tied" to those particular assets being transferred are automatically transferred to the acquirer.

The European Court of Justice has set forth seven factors that must be considered when determining whether the transfer of a stable economic entity has taken place (and thus whether the employment relationships are automatically transferred):

- The type of undertaking or business;
- Whether tangible assets (such as buildings and movable property) have been transferred;
- The value of the intangible assets at the time of transfer;
- Whether the majority of the seller's employees have been assumed by the new employer;
- Whether the seller's customers have been transferred;
- The degree of similarity between the activities performed before and after the transfer; and
- The period, if any, during which those activities were suspended.

Despite these quite specific criteria, European and German courts have struggled to identify a reliable formula for determining whether a transfer of an undertaking has taken place. A couple of recent German decisions may help clarify this situation.

WHEN DOES A TRANSFER OF AN UNDERTAKING EXIST?

Distinguishing a transfer of an undertaking from other transfers is often difficult. It may be helpful to look at past cases in which what appeared to be a transfer of an undertaking turned out not to be one.

To begin, merely outsourcing functions to a third party does not in itself constitute a transfer of an undertaking because it does not include the transfer of a stable economic entity. In a published court opinion, a company that had been performing facility management services for a hospital lost the customer after the hospital decided to transfer a good portion of its contract work to a different, larger entity. Even though this larger entity assumed a number of the original company's employees to perform the same services as before, the larger company generally used its own material and personnel to perform the work. The Federal Labor Court held that because the original employees were integrated into the new structure and a larger workforce, a transfer of an undertaking had not taken place. As a result, those employees who had not been taken over by the larger company could not claim that their employment relationships had actually been automatically transferred to the larger company.

Similarly, the bankruptcy trustee of a bankrupt roofing company had sold the assets of the company to two separate roofing companies. Each of the buyers also hired a few of the bankrupt company's employees. The Federal Labor Court held that because the assets—as well as the employees—had been split between the two different buyers, a transfer of an undertaking had not taken place because these assets and employees did not exist as separate units prior to being acquired.

In essence, German law prohibits the termination of a transferred employment relationship *as the result of* the transfer of an undertaking, yet an employee may still be terminated on other grounds.

In a third case, a buyer had assumed only the customers of a warehousing company. Not surprisingly, the Federal Labor Court held that this, in itself, did not constitute a transfer of an undertaking.

TRANSFERS OF UNDERTAKINGS AND TERMINATION PROTECTION

If a transfer of an undertaking takes place, either the seller or the buyer must provide information in writing to the employees about the transfer. The employees must also be informed that their employment relationships will be automatically transferred to the buyer unless the employees exercise their right not to have their relationships transferred, thereby causing the employment relationships to remain with the "former" employer.

However, what happens if the new employer, *i.e.*, the buyer, terminates a transferred employee before the employee actually objects to the transfer? A court in Cologne held that this termination is valid. It stated that this termination is actually to be treated as a termination by the former employer, provided that the former employer approves this termination through its conduct. This creates a situation where a termination is effective even though neither the employee nor the current employer issued a notice of termination. This, however, is a logical result of the above-referenced transfer of the employment relationship and the right to object to such transfer. Even if the employee exercises his right to object to the transfer of his employment relationship, this does not expunge the termination that had been issued by the new employer. In essence, German law prohibits the termination of a transferred employment relationship *as the result of* the transfer of an undertaking, yet an employee may still be terminated on other grounds.

The situation becomes even more complicated when the employee's right to object to the transfer conflicts with termination measures taken by the former employer. When an employer terminates an employee for operational reasons,

German law requires the employer to take the employee's "social characteristics" into consideration. This is to ensure that the person most in need of protection against losing his job (due to his age, any disability, number of dependents living at home, and years of service) is in fact the least likely to be terminated. However, would it not make more sense for an employee who objected to the transfer of his employment relationship to be first in line to be terminated, regardless of that employee's social characteristics? This approach could be seen as appropriate in some instances; indeed, until recently, the Federal Labor Court held in some cases that employees who objected to the transfer of their employment relationships are to be excluded from the social selection process merely because they objected to the transfers.

The court held that the added protection under the Termination Protection Act was not transferable; instead, only the employee head count at the current employer determined whether the Termination Protection Act applied.

In a recent decision, the Federal Labor Court held that due to a change in statutory law, the reason for an employee's objection should no longer be taken into consideration and that as a result, even though an employee may exercise his right to object to the transfer of his employment relationship, he should be included in the social selection process. Therefore, an employee who has been issued a notice of termination for business reasons will be included in the social selection process. Of course, this will be relevant only if the former employer continues to operate any remaining part of his business. If not, he does not need any employees, meaning any social selection process would be superfluous.

The Federal Labor Court took a slightly different stance in another decision that it issued last year. In that case, an employee who had originally worked for a company that was large enough to be subject to the Termination Protection Act (*i.e.*, had more than 10 employees) became, by virtue of the transfer of the undertaking, an employee of a small company that was not subject to this statute. The essence of the Termination Protection Act is that an employee cannot be terminated unless there is a "particular reason" for the termination, *e.g.*, the employee's personal conduct or a restructuring of the business. The employee was subsequently terminated by his new employer. The employee argued that this termination was invalid since his rights under the Termination Protection Act "traveled with him" to his new employer.

The employee was unable to convince the Federal Labor Court of this opinion. The court held that the added protection under the Termination Protection Act was not transferable; instead, only the employee head count at the current employer determined whether the Termination Protection Act applied. This meant the termination was valid.

EXPANDED EMPLOYEE INFORMATION REQUIREMENT

German law requires either the seller or the buyer to provide information in writing to the employees who will be transferred. This must include the "legal, economic and social consequences" of the transfer.

This requirement to inform has evolved over the years in terms of putting a greater burden on the employer, as was underlined by a recent decision. The information must include whether the buyer will be acquiring the movable assets of the business without the real property. If there is no operational change in the business (*e.g.*, the buyer is leasing the real property), such information may seem to be irrelevant to the employees. However, the new decision confirms the general notion that the transfer of an undertaking may result in the ownership of assets to be split between the operating company and the asset management company; regardless, the employees are entitled to detailed information even if they are not directly impacted by any operational change.

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