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GERMAN LABOR AND EMPLOYMENT NEWS

CONTENTS

RECENT FEDERAL LABOR COURT DECISIONS REGARDING EMPLOYEE STOCK OPTION PLANS

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Employee stock option plans have long served as a tool to strengthen the connection between employer and employees while allowing the employees to benefit from the company's success. The employer typically grants stock options directly to the employees; however, options may also be granted by an affiliated company (in particular, the parent corporation). Which entity is ultimately responsible for performing the obligations associated with the stock options vis-à-vis the employee depends on which entity granted the options.

2003 FEDERAL LABOR COURT DECISION SERVES AS PRECEDENT

The Federal Labor Court held in 2003 that stock options do not constitute a facet of the employment relationship if the parent corporation rather than the direct employer granted the options. If the parent company of the employer granted the stock options, then the employee can make claims arising from those options only against the parent corporation.

Also in 2003, the Federal Labor Court opined as to what happens to stock options granted by the parent corporation if the nongranting employer is involved in a

If the employer and employee enter into an agreement whereby the employer is involved with the affiliated company's stock option program, the employer is also obligated to ensure that the employee's rights are observed.

"transfer of undertaking" (*e.g.*, the acquisition of a business by way of an asset deal). Jones Day represented the buyer in that case, not only with respect to the acquisition itself, but also in the ensuing litigation concerning the stock options. Specifically, the German subsidiary of a Finnish corporation had been acquired. An employee whose employment relationship had transferred to the acquiring entity subsequently filed an action against his new employer, arguing that the stock options granted by the Finnish parent corporation must now be granted by his present employer or, at the very least, that he should be compensated for the loss of his options. The plaintiff-employee lost his case at the trial-court level, as well as in the court of appeals and the Federal Labor Court. Both the court of appeals and the Federal Labor Court held that the stock options, as granted by the parent corporation, were separate and distinct from the employment relationship. Accordingly, the stock options were not subject to the "transfer of undertaking" rules, which state that all aspects of an employment relationship are automatically transferred from the seller (the former employer) to the buyer (the new employer). Stock options granted by an affiliated company are not deemed to be an aspect of the employment relationship.

TWO 2008 FEDERAL LABOR COURT DECISIONS

The Federal Labor Court specifically confirmed this 2003 decision in a January 2008 decision. The court added, however, that even when an affiliated company grants the stock options, there are certain circumstances under which an employee may make a claim against the (nongranting) employer. If the employer and employee enter into an agreement whereby the employer is involved with the affiliated company's stock option program, the employer is also obligated to ensure that the employee's rights are observed. It may be that the employer's obligations are expressly set forth in a written agreement; it may also be that the employer's obligations arise as a result of the employer's actions. Because the latter was a distinct possibility in the January 2008 case, the Federal Labor Court remanded the matter to the court of appeals. There was some evidence that the (nongranting) employer, on several occasions, had discussed the parent corporation's stock options with the employee during the hiring process and had described the stock options as an additional aspect of the employee's compensation. As a result, it was quite possible that both the parent corporation and the employer had become responsible for ensuring that the employee could participate in the stock option program. Whether the court of appeals will reach this conclusion remains to be seen. One point, however, can already be made with certainty: Employers need to be cautious about discussing an affiliated corporation's stock option plan with employees, during both the hiring process and the employment relationship. If it is subsequently determined that the (nongranting) employer also promised the employee that he could participate in the stock option program, and the terms of the stock option are not satisfied, the employee may be able to make a claim against the employer that includes monetary damages.

In the Federal Labor Court's decision of May 28, 2008, there was no dispute that the employer—without the parent corporation's involvement—had promised to obtain the stock options for the employee for a certain price, even though the options concerned stock in the parent corporation. The dispute before the court was not whether the employer had agreed to become involved with the parent corporation's stock option program but whether this obligation ceased to exist once the employment relationship ended.

STOCK OPTIONS AS A FINANCIAL RISK

Stock option plans often include a clause that requires a certain connection by the employee to the employer through a specific date. If this condition is not satisfied—*e.g.*, if the employer terminates the employee—the employee may not exercise the stock options. The Federal Labor Court has explicitly held that case law concerning benefits, as it has evolved over the years, particularly in relation to bonus payments, is not to be applied on its face to stock option plans. This is because stock options differ fundamentally from conventional benefits, primarily with respect to the risks involved.

As has become abundantly clear over the last few months, an employee cannot assume that stock options will retain their value over time, even when both the employee and the company perform well. Factors that neither the employee nor the company can influence may also play a role, *e.g.*, the state of the economy and interest-rate policies. In extreme cases, as mentioned by the Federal Labor Court, "the stock options may lose their entire value within the course of one day." A mere possibility of financial gain should not be compared to more conventional and less risky employee benefits, at least from an employment-law perspective. It is for this reason that the Federal Labor Court has permitted relatively long vesting periods before an employee may exercise his stock options. A two-year vesting period for the initial vesting of stock options is expressly required under Germany's Stock Corporation Act as long as it concerns purely the granting of stock options to employees or management. Conversely, German law does not prescribe a maximum vesting period. Without taking a formal stance on this issue, the Federal Labor Court did say, however, that a vesting period of up to five years is reasonable.

Because of the inherent financial risks associated with stock options, the Federal Labor Court agreed that an employee's right to exercise his stock options may lapse once the employment relationship ends. This is the case not only if the employment relationship ends during the vesting period, but also if the vesting period has already expired. The Federal Labor Court added that it recognizes that this may lead to a financial burden on employees. Regardless, it is not an unreasonable burden, because the employee merely lost an opportunity to reap a financial windfall; he did not take a direct financial hit.

A WORKS COUNCIL'S RIGHT OF CODETERMINATION WITH RESPECT TO AN ETHICS CODE OF CONDUCT

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Corporate adoption of Ethics Codes of Conduct has become increasingly common over the years. One question that has arisen in connection with these Codes of Conduct, however, is whether a works council has the right to be involved with the preparation and implementation of such a Code. This question becomes even more complicated when a foreign parent company wishes to implement a uniform, global Code of Conduct; subsidiaries in other countries do not want to be placed in the unenviable position of deviating from the parent company's instructions or guidelines because of local law requirements.

PURPOSE OF A CODE OF CONDUCT

An Ethics Code of Conduct is a document that sets forth a company's policies, particularly with respect to how employees and management are to behave or proceed with regard to such matters as competition, the protection of company assets, conflicts of interest, and legal issues. The essence of an Ethics Code of Conduct is to ensure that the company operates responsibly and with integrity. The purpose is for the company to be able to minimize its risks and ensure that it benefits from its positive reputation. A relatively recent trend has been for multinational corporations to have a uniform Ethics Code of Conduct for all affiliated entities; this stems in large part from the Sarbanes-Oxley Act, which requires U.S. publicly held companies to have Ethics Codes of Conduct in place.

Accordingly, Code of Conduct provisions intended to prevent discrimination in the workplace within the meaning of Germany's General Equal Treatment Act are *not* subject to the works council's right of codetermination.

INTRODUCTION OF AN ETHICS CODE OF CONDUCT

In a recent case before the Federal Labor Court, a German subsidiary of Honeywell introduced a "Code of Business Conduct" at its facility. This Code of Conduct included provisions for dealing with employee behavior in various areas, specifically equal treatment in the workplace, avoiding discrimination and conflicts of interest, and protecting corporate assets. It also introduced a whistleblower procedure.

The court held that Honeywell's works council in Germany had a general right of codetermination if Honeywell's management intended to introduce measures concerning rules in the workplace. However, the court added, the fact that a Code of Conduct is subject to a works council's general right of codetermination does not mean the right of codetermination applies to the Code of Conduct in its entirety. Instead, each specific provision of the Code of Conduct must be reviewed to determine whether it is subject to a right of codetermination. Though the employer will need to take time at the outset to determinine which provisions must be discussed with the works council, the employer benefits overall, since the Code provides it with the opportunity to separate the provisions that are subject to codetermination from those that are not.

CODETERMINATION VS. NO CODETERMINATION

The Federal Labor Court emphasized that provisions that merely substantiate the performance of employees or deal with matters already governed by legal provisions are not subject to a right of codetermination. Accordingly, Code of Conduct provisions intended to prevent discrimination in the workplace within the meaning of Germany's General Equal Treatment Act are *not* subject to the works council's right of codetermination.

Not surprisingly, there is often a fine line between provisions that constitute workplace procedures—subject to a works council's right of codetermination—and provisions that merely affirm the General Equal Treatment Act.

BUT SARBANES-OXLEY REQUIRES CODES OF CONDUCT (AND WHISTLEBLOWER PROVISIONS)

In the case at hand, the court reasoned that only German and EU law are to be taken into consideration, as only these laws are binding in Germany. As a result, the fact that foreign laws may require the introduction of an Ethics Code of Conduct, as does Sarbanes-Oxley for U.S. publicly held corporations as well as their U.S. and foreign subsidiaries, does not mean the works council in Germany has no right of codetermination with respect to particular provisions of the Code of Conduct as they are to be implemented at the German subsidiary. This means, for example, that management's argument that a non-U.S. corporation will be subject to U.S. sanctions if the Code of Conduct is not implemented as directed by the U.S. parent corporation will not hold water in Germany.

This recent Federal Labor Court decision is actually in line with a few earlier whistleblower cases. In those cases, the Federal Labor Court also held that the works council has a right of codetermination even though Sarbanes-Oxley requires U.S. publicly held corporations—and their German subsidiaries—to introduce whistleblower procedures.

The Federal Labor Court's decision means that each clause of an Ethics Code of Conduct must be reviewed as to whether it is subject to the works council's right of codetermination. So to facilitate discussion with the works council, employers should separate those provisions that are subject to codetermination rights from the provisions that are not. This will hopefully cause the works council to focus only on those provisions, rather than on the entire Code of Conduct.

VIOLATION OF A WORKS COUNCIL'S RIGHT OF CODETERMINATION AND THE FRUIT OF THE POISONOUS TREE

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In a December 13, 2007, decision, the Federal Labor Court opined on how to treat information that an employer had obtained illegally as part of a wrongful-termination action. In this case, the employer, a drugstore operator, had searched an employee's briefcase and locker; the search revealed that the employee had stolen a tube of lipstick. However, the search had not been performed in accordance with the works agreement that management and the works council had concluded. The employee was terminated for cause and filed a lawsuit claiming wrongful termination.

This case is noteworthy because (i) it confirms that the theft of a low-value item may indeed be grounds for termination for cause; and, more controversial, (ii) even though the employer violated the terms of the works agreement regarding employee searches, it was still able to present the evidence that it had gathered.

Principle of Validity Requirements

Many jurisdictions subscribe to the "fruit of the poisonous tree" doctrine. This doctrine essentially holds that illegally obtained evidence may not be presented in court as evidence. German law does not follow this doctrine, meaning that in Germany, the results may be different than in other jurisdictions.

First, an action that violates an employee's constitutional rights does not automatically result in the exclusion of illegally obtained evidence. Second, the Federal Labor Court pointed out that there may indeed be violations of constitutionally protected rights that can result in the exclusion of evidence.

Germany subscribes to the principle of "validity requirements." Under this principle, an employer's actions against an employee may be illegal if the action is subject to a works council's right of codetermination when there is no applicable works agreement in place, or if the action taken was not in accordance with an applicable works agreement. Searches by employers clearly fall within the purview of codetermination because they involve employee behavior in the workplace, a fundamental aspect that is subject to the right of codetermination.

Based on the above, it would seem reasonable to conclude that the Federal Labor Court would *not* take into consideration the evidence gathered from the illegal search. Surprisingly, however, the court did accept this evidence. The employee claimed that from a *procedural* aspect, the court should not permit the introduction of the evidence, but she never disputed that the stolen item (the lipstick) was found in the jacket she had kept in the searched locker. Under these circumstances, the Federal Labor Court held that it would not be right to prohibit the employer from referring to the undisputed facts.

INTRODUCTION OF ILLEGALLY OBTAINED EVIDENCE

The court added that illegally obtained evidence could be excluded as evidence only if so permitted by statute or if recognition of the evidence violated one of the employee's constitutional rights. The Federal Labor Court held that neither of these two situations existed in this case. The court also stated that a distinction must be made between the illegal obtaining of evidence and its use from a procedural perspective; only if the use of the evidence constituted the "continuation of the violation of a right" must the evidence be excluded.

Though this reasoning may not be entirely transparent, the Federal Labor Court held that the principle of validity requirements does not bar the procedural recognition that the employee had a tube of lipstick in her pocket. German constitutional law holds that every individual has "personal rights," meaning a person cannot be subjected to actions that violate his dignity as a human being or his basic human rights. In the case of the stolen lipstick, the employee's personal right had clearly been affected and had potentially even been violated. But the court did not see it this way, concluding that the search was not severe enough to warrant suppression of the evidence. (The court did not address whether the outcome would have been different if the employee had objected to the search from the outset.)

CONSEQUENCES OF ILLEGAL SEARCHES

What does all of this mean? First, an action that violates an employee's constitutional rights does not automatically result in the exclusion of illegally obtained evidence. Second, the Federal Labor Court pointed out that there may indeed be violations of constitutionally protected rights that can result in the exclusion of evidence.

The German media recently reported on cases in which employees of discount grocery stores were illegally subjected to video surveillance. Commentators debated amongst themselves whether the results of that surveillance could be introduced in court. It is easy to imagine that the Federal Labor Court would conclude that an employer could not introduce such evidence. Along the same lines, an employer could be prevented from introducing as evidence emails or other electronic communication found on an employee's computer unless the employer had clearly and emphatically prohibited the private use of the company's communication system. Cases such as these will undoubtedly be presented to the Federal Labor Court in the not too distant future.

While putting together the terms of the works agreement, the conciliation board had to observe Germany's Federal Data Protection Act (as the surveillance of employees using video cameras is specifically governed by this statute). It also had to weigh the interests of the two sides: the employer's need to keep mail from being lost, stolen, or damaged; to protect customers' and suppliers' property; and to ensure that mail remained unopened (as required by law) against the employees' constitutional right of having their personal rights protected in the workplace, *i.e.*, their right of not having their privacy invaded.

"SPYING" ON EMPLOYEES IN THE WORKPLACE—NOT WITHOUT THE WORKS COUNCIL'S INTERVENTION

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The extent to which an employer may monitor employees using electronic technology has received a great deal of attention, whether such monitoring involves reviewing employees' emails, monitoring employees' telephone calls, or using recording devices to engage in employee surveillance. A recent decision by the Federal Labor Court provides some additional insight into the measures an employer may take to monitor employees. This case specifically concerned the video-recording of employees.

USE OF VIDEO CAMERAS IN THE WORKPLACE

The employer was operating a large mail-sorting service in northern Germany. During a 10-month period, 250 customers had filed complaints against this mail sorter, as their mail had not been delivered. The employer concluded that a few employees were stealing mail—the only question was, which ones?

On a previous occasion, the employer had agreed with the works council to install a hidden camera because the employer had reasonable information that specific employees were stealing mail. This suspicion was confirmed when these individuals were caught stealing on camera. That situation was distinguishable from the case at hand, however, since the employer in this case did not have any indication of which employees were responsible for the thefts.

INVOLVEMENT OF WORKS COUNCIL AND CONCILIATION BOARD

The employer contacted the works council about setting up video cameras in the workplace to assist it in catching the culprits. The employer was required to contact the works council because under German law, the works council has a right of codetermination with respect to "the introduction and use of technical equipment that is used to monitor the behavior or performance of employees." Without a doubt, the use of video cameras to determine whether—and which—employees were stealing mail constituted the "use of technical equipment."

The employer and works council were not able to agree on the specific use of such video equipment, so the matter was brought before a "conciliation board." In Germany, if the employer and the works council are unable to come to terms on a matter, they may call upon a conciliation board (comparable, in many respects, to arbitration). The conciliation board comprises individuals appointed by the works council and the employer in equal numbers, plus a chairperson mutually selected by the works council and employer. (If they are unable to agree on the chairperson, the respective labor court will make the selection.)

CONCLUSION OF WORKS AGREEMENT

The conciliation board put together a specific works agreement setting forth guidelines for the employer's use of the video cameras. These guidelines included the following:

- The purpose of installing the video cameras was to minimize the employees' theft of mail, as this was ruining the employer's reputation. The video cameras were to be used only to identify the employees who were stealing the mail and to prevent continued theft.

- The 13 video cameras were to be installed in specific locations; also, the cameras were not to include audio recorders.

- The equipment for adjusting the operation of the cameras was to be stored in a safe that could be opened only with two keys; one of the keys was to be in the employer's possession, while the other was to be in the works council's possession. This was to prevent the employer from unilaterally changing the location or number of cameras.

- The use of the cameras was to be stopped as soon as the culprits were identified.

- All recordings were to be deleted within 60 days unless such recordings were needed for evidence to prosecute the culprits.

- The employees were to be informed of the use of the cameras; any newly hired employees were to be informed of the cameras by receiving an information sheet.

While putting together the terms of the works agreement, the conciliation board had to observe Germany's Federal Data Protection Act (as the surveillance of employees using video cameras is specifically governed by this statute). It also had to weigh the interests of the two sides: the employer's need to keep mail from being lost, stolen, or damaged; to protect customers' and suppliers' property; and to ensure that mail remained unopened (as required by law) against the employees' constitutional right of having their personal rights protected in the workplace, *i.e.*, their right of not having their privacy invaded. This balancing test could be satisfied only if the principle of reasonableness was observed.

PRINCIPLE OF REASONABLENESS—ACTION TAKEN MUST BE SUITABLE, NECESSARY, AND PROPORTIONATE

How can an employer be certain that it satisfies the principle of reasonableness? The employer must ensure that (i) the action to be taken (using video cameras to engage in employee surveillance) is a suitable measure for attaining the sought-after goal (ensuring that mail does not disappear), and the parties must be given a bit of leeway to determine whether a measure is indeed "suitable"; (ii) the action is necessary (an action is deemed to be "necessary" if no less-intrusive measures are available); and (iii) the action is not disproportionately intrusive, taking the totality of the circumstances into consideration. Though the court held that one aspect of the works agreement drawn up by the conciliation board did not satisfy the principle of reasonableness, it concluded that overall, the works agreement did satisfy this test, and accordingly, the employer was permitted to use the video cameras to monitor the employees.

If an employer wishes to monitor its employees through the use of electronic equipment, it must remember that it may not take an action unilaterally; the works council has a say in such matters. Also, any measure taken by employers must be reasonable and proportionate and must take into consideration the employees' constitutionally protected personal rights. In all likelihood, failure to observe these fundamental obligations will not only cause the employer to be called before a labor court, but also subject the employer to a fine for violating statutory obligations—most notably the Federal Data Protection Act and the Labor-Management Relations Act.

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