Employment Law Information in a Nutshell (No. 16 / 2010)

Introduction to German employment law – overview of general principles of German employment law

The following article shall provide an overview of general principles of German employment law and could be of particular interest for foreign companies having a subsidiary or branch in Germany.

I. Hiring Procedure

General Act on Equal Treatment

Regarding the hiring procedure, the provisions of the General Act on Equal Treatment (*Allgemeines Gleichbehandlungsgesetz* – AGG) have to be observed. This Act has been in force since August 18, 2006 and implements EU Directives on anti-discrimination. The Act shall prevent or stop discrimination, among other things in the area of employment, on the grounds of race or ethnic origin, gender, religion or belief, disability, age or sexual orientation.

Carefully handle job advertisements

Companies have to observe the ban on discrimination in particular when publishing job advertisements as well as during the hiring procedure. Furthermore, the company's employees are entitled to be protected against discrimination in existing employment relationships. They may assert a claim for compensation of immaterial and/or material damages and file a complaint about discrimination with their employer. For this purpose, a complaints unit has to be established at all companies and the employees have to be duly notified about its existence.

Risk of compensatory claims

Employer's obligation to take reactive and preventive measures

Employers have to ensure that discrimination does not take place. Furthermore, they are obligated to take measures against employees who discriminate against others. The possible measures for this purpose range from an assignment to another job over a reprimand up to the termination of employment.

Given this background, it is important to avoid "pitfalls" by preparing the business organization for these challenges (e.g. by the establishment of rules of conduct) and taking preventive measures (e.g. training of the employees) at an early stage.

II. Employment Conditions

Employment Contract

If an applicant receives and accepts an offer, a written employment contract is signed in most instances. Many employers prepare and use model contracts for their employees, which should be regularly checked and updated since legislation and relevant court rulings could change. Furthermore, the contract should fit the particular needs of the individual employer's business.

Main topics

The main topics to be covered in the contract are: job description and responsibilities, working hours, reporting requirements, salary and other monetary benefits, vacation entitlement, contract's term and notice periods, probationary period, and non-competition (if required). These areas are described in more detail below.

Sources of law

The conditions of employment are primarily determined by law including statutes and court rulings, collective bargaining agreements (*Tarifverträge*), and by individual contract. An employer can be bound by collective bargaining agreements if either (i) the company is a member of an employers' association or has signed an agreement with a union, or (ii) a specific collective bargaining agreement has been declared to be generally applicable by the Labour Minister, or (iii) the em-

ployment contract stipulates that specific collective bargaining agreements shall apply to the employment. Furthermore, practices and procedures regularly applied by the employer may create legal rights of the employees. If the employees of a business have established a works council (*Betriebsrat*), employment conditions may also be determined by works agreements (*Betriebsvereinbarungen*) entered into by the company and the works council.

No agreements conflicting with mandatory law

Thus, issues not addressed in the employment contract itself have to be determined by checking the sources of law mentioned above. In addition, the company has to make sure that the employment contract does not conflict with mandatory law; many rules of employment law supersede deviating individual agreements

The following issues are of particular interest:

1. Contract's term, probationary period

Limitation of the contract's term – permissible only under specific conditions

Most employment contracts are entered into for an indefinite term. Even though German law generally allows the parties to freely decide for how long they wish to be bound by a contract, courts have derived from the rules of the Protection against Dismissal Act (*Kündigungsschutzgesetz*) a general principle invalidating clauses providing for the automatic termination of the contract due to the expiry of the contractual term, unless the limitation is justified by a material reason. This condition is usually met if an employee is hired for a specific project or as substitute for an employee who is temporarily absent (e.g. parental leave, extended illness). If the contract is entered into only for a limited period of time and there is no material reason for the limitation, the employment is permanent.

Justified by material reason

No material reason required for newly hired employees

An exception applies, however, pursuant to section 14 para. 2 Part-Time and Time-Limited Employment Act (*Teilzeit- und Befristungsgesetz*): Under this Act, employment contracts can be entered into for a limited period of time even without a material reason – up to a maximum total of two years (including up to three agreements on the extension of the contract's term) –, provided that the employee concerned has never been employed (as employee) by the employer before.

Probationary period – permissible maximum of 6 months

Regardless whether an employment is entered into for an unlimited or limited term, employer and employee may agree that the first six months (= permissible maximum) of employment shall be treated as probationary period. Thereby, the employer is given the opportunity to get to know the employee and evaluate his/her performance and conduct on the job. During the probationary period, the applicable statutory notice period can be reduced to a minimum of two weeks, except as otherwise provided in other applicable regulations (e.g. a collective bargaining agreement).

2. Working Hours

Duration– to be agreed

Unless otherwise stipulated in an applicable collective bargaining agreement, employer and employee are free to agree on the duration of the working time. In practice, they very often agree on a workweek of 40 hours.

But: statutory limits

However, they have to observe the mandatory legal provisions set forth in the Working Time Act (*Arbeitszeitgesetz*): The maximum daily working time is generally 8 hours; however, it could be extended to a maximum of 10 hours if an average workweek of 48 hours (from Monday to Saturday) is not exceeded within a period of 6 months or 24 weeks. The Act also provides for further regulations (e.g. regarding rest periods, prohibition to work on Sundays with specific exceptions).

Allocation of working time – decision of employer

The allocation of the working time is generally subject to the employer's reasonable discretion, however – if the employees have established a works council – it is subject to the works council's co-determination right.

Special classes of employees may be subject to special rules (e.g. juvenile employees, pregnant women).

3. Remuneration

Base salary

The base salary is usually stated in the employment contract and specified as a gross monthly figure, to be payable at the end of every calendar month.

Additional payments

Employers often pay a 13th monthly salary in November or December, or a Christmas bonus and/or a holiday allowance (payable in May or June). Other employers pay a bonus which is newly determined every year and depends on the performance of the company. Employment contracts may also provide for special types of remuneration such as sales commission or other incentive pay.

4. Other benefits

Social security contributions

Many benefits that are agreed as individual specific items in countries like the U.S.A. are mandatory in Germany and are therefore not expressly mentioned in the employment contract. This is true, in particular, for the contributions to the statutory pension, unemployment, health and nursing care insurance as well as disability insurance.

Employer and employee each bear 50%

Generally, employer and employee each pay 50% of the accruing contributions (with just a few exceptions). The employer is legally obligated to withhold the employee's share from his/her salary and to pay it to the social insurance carrier. The employer has to pay the employer's share at his own expense. The applicable rates of contribution and income limits for the assessment of contributions may vary from year to year as determined by the legislative body in Germany.

Additional benefits

Additional benefits may be individually agreed upon. They are customary only for specific types of employees (such as sales staff who may have company cars and special agreements on reimbursement of expenses) or for senior executives (who are often granted individual insurance coverage or reimbursement of extra insurance costs).

5. Holiday

Statutory minimum holiday

According to the Federal Holiday with Pay Act (*Bundesurlaubsgesetz*), employees are entitled to an annual minimum holiday of four weeks (20 working days in case of a workweek of 5 days, 24 working days in case of a workweek of 6 days).

Holiday entitlement in practice

However, the minimum entitlement is rarely agreed in practice. Most employers grant five or six weeks of holiday; Saturdays, Sundays, and public holidays are not included.

Carry-forward of holiday entitlement

The employment contract often stipulates that holiday which was not taken by the end of the calendar year may be carried forward to the first quarter of the subsequent calendar year.

6. Pension Benefits

Statutory pension insurance

Since the state of Germany provides for a mandatory pension program to which employer and employee have to contribute, many companies do not grant any pension rights in addition to the statutory programme. Generally, additional benefits are customary only in large companies or if individually agreed, usually by senior executives.

Additional company pension scheme

There are several options to arrange for the company pension, e.g. a covenant by the employer to make specific payments upon the employee's retirement (respective provisions are made and shown in the company's balance sheet), a direct insurance policy or a pension fund.

Company Pension Act

If a pension plan or an individual pension arrangement exists, the rights and obligations of the parties are governed by the Company Pension Act (*Gesetz zur Verbesserung der betrieblichen Altersversorgung*). Among other things, this Act stipulates that an employee who has achieved the age of 25 and participated in the pension scheme for at least five years obtains a vested pension right that he/she may not abandon upon the (premature) termination of his/her employment - not even by agreement and in return for payment of the pension benefits' cash value, except for very minor amounts. Based on the vested pension right, the employee has enforceable rights against the company if and when he/she reaches retirement age. However, if the employee's employment terminates prior to his/her reaching retirement age, the benefits are proportionally reduced.

Vested pension rights

Protection against insolvency

Pension rights are insured against the company's insolvency by a national fund created under the Company Pension Act and funded by all companies that have adopted a pension scheme (Pension Security Association – *Pensionssicherungsverein*).

7. Illness

Continued payment of salary in case of illness

The Act on Continued Payment of Remuneration (*Entgeltfortzahlungsgesetz*) provides for the employer's obligation to continue to pay 100% of the employee's regular remuneration for a period of up to 6 weeks in the event of the employee's absence due to illness, provided that the employee is not responsible for the illness. Since this is mandatory law, employment contracts do not need to address this issue.

Employee's duties to inform and submit certificates

If the employee is unable to work, he/she has to immediately inform the employer about the inability to work and its anticipated duration. Furthermore, in case of illness exceeding three calendar days, the employee has to provide a medical doctor's certificate with regard to the disability to work and its anticipated duration on the following working day at the latest. However, the employer has the right to demand a certificate already earlier.

8. Inventions and works

Individual authorship

Inventions made and works created by employees in connection with their employment do not automatically accrue to the employer. German law is based on the general principle that authorship is individual, not corporate.

Employees' Inventions Act

However, the Employees' Inventions Act (*Gesetz über Arbeitnehmererfindungen*) requires the employee to notify the employer of any patentable invention or technical improvement made on the job. The invention is deemed to be claimed by the employer (against payment of adequate compensation), unless he releases

the invention within a period of four months. The Federal Ministry of Labour has issued guidelines on the assessment of the compensation. If the employer claims the invention in this way, all rights thereto accrue to him and he may apply for any national or foreign patent registration or other protection available. The filing for national protection is mandatory.

Copyright Act

While these rules apply to inventions covered by the Employees' Inventions Act, they do not extend to works that are governed by the Copyright Act (*Urhebergesetz*). Therefore, the employer is well advised to agree with the employee in writing that the employee is obligated to assign all related exclusive use and exploitation rights to the employer; the contract may also provide for the respective assignment itself (regarding any works created in the future) but this clause requires to be quite detailed.

9. Prohibition of competition

Prohibition during the contract's term

German law provides for the employee's obligation to refrain from any competitive activities during the term of the employment (Section 60 Commercial Code – *Handelsgesetzbuch*).

Prohibition after expiration of employment

A post-contractual prohibition of competition (that shall apply after the employment has expired), however, is enforceable only if it is expressly agreed in writing. In addition, a number of essential requirements have to be met. The prohibition of competition is enforceable only to the extent that it is reasonable with regard to territory, term (maximum of two years) and subject matter. Furthermore, it has to be unconditional and combined with the employer's obligation to pay a waiting allowance (compensation) in the amount of at least 50% of the annual remuneration (not only base salary!) last received by the employee for each year of the prohibition's term.

Waiver of employer's rights – statutory notice period of 1 year

The employer may waive his rights under the post-contractual prohibition of competition at any time prior to the expiration of the employment contract, however, a notice period of one year has to be observed; thus, in case of a waiver, the employee will be released from the post-contractual competition ban as soon as the employment has expired, however, the employer will be released from the obligation to pay the waiting allowance not earlier than one year after notification of the waiver. Therefore, if the employment expires earlier than the one-year period, the employer has to pay the waiting allowance even though the employee is already allowed to work for a competitor.

III. Termination of employment

There are two different types of termination: "regular termination" and "termination for good cause / important reason". The requirements for a valid termination are different depending on the type of termination.

1. Termination for good cause (important reason)

Important reason: Serious violation of essential obligations

Under German law any long-term agreement may be terminated for an important reason at any time (termination for good cause). In employment law, the employer who wants to terminate the employment for an important reason has to prove that the employee seriously violated essential obligations. To name a few examples, this may include criminal offences, conduct that is directed at harming co-workers, defamatory statements regarding a superior, etc. Generally speaking, the em-

ployee has to behave in such a way that the employer cannot be reasonably expected to continue the employment until the regular notice period expires.

Quick reaction required – cut-off period of 2 weeks

Whenever an incident that may give rise to a right of termination for an important reason comes to the employer's attention, the employer must act quickly. Pursuant to Section 626 para. 2 Civil Code (*Bürgerliches Gesetzbuch*), a notice of termination for good cause has to be given to and received by the employee within a period of two weeks; this cut-off period commences as soon as the employer obtains knowledge of the facts that give rise to the right of termination; if the cut-off period is not observed, the notice of termination for good cause is invalid, regardless whether or not there was an important reason for termination or not.

2. Regular termination

Application of the Protection against Dismissal Act depends on the size of the business

The regulations on regular termination differ substantially depending on the size of the permanent work force of the business. In businesses with not more than 10 employees the termination of employment must comply with statutory and contractual notice periods; if the business has more than 10 employees, the Protection against Dismissal Act applies in addition (part-time employees are counted as follows: regular workweek of up to 20 hours – 0.5; workweek of more than 20 up to 30 hours – 0.75; workweek of more than 30 hours – 1.0).

Statutory minimum notice periods

The statutory basic notice period for employer and employee is four weeks, taking effect either on the 15th or at the end of a calendar month. The day on which the other party receives the notice of termination is not taken into account for the calculation of the notice period. The employer may have to observe extended notice periods, depending on the employee's years of service, as follows:

Years of service (completed)*	Notice period (months) taking effect at the end of a calendar month
2	1
5	2
8	3
10	4
12	5
15	6
20	7

Violation of European Law

* Pursuant to the current version of section 622 para. 2 Civil Code, years of service prior to the age of 25 shall not be taken into account in this regard. However, this provision has been declared null and void by the European Court of Justice since it discriminates younger employees. Therefore, all years of service - irrespective of the employee's age - have to be taken into account.

Employer and employee may agree on extended notice periods

Since these extended notice periods are mandatory minimum notice periods, the parties may extend them in the employment contract. They could even agree that a notice of termination shall take effect, e.g., only at the end of a calendar quarter. However, the notice period to be observed by the employee must not be longer than the notice period which the employer has to apply. If the statutory notice period is different from the contractual period, the employer has to observe the notice period that is more favorable to the employee, i.e. longer.

What happens after notice of

After notice of termination has been given, the employment contract continues in its current status up to the date when the notice takes effect and the employment

contract expires. Accordingly, the employee is required to work and the employer has to pay the regular salary and other contractual or statutory benefits until the employment expires. In practice, the employer often does not want the employee to continue to work. Please see the additional comments below with regard to the employer's right to release the employee from his/her work duties (garden leave) and the employee's right to work.

termination has been given?

A difference has to be made between salary payments due to the employee under the terms of the contract until the employment expires and a severance pay which is paid as compensation for the loss of employment (for more details please see the comments below on severance pays).

Salary payments in contrast to severance pay

3. Protection against dismissal

If the employment of an employee working in a business with more than 10 employees and having been employed for more than six months shall be terminated, additional requirements as stipulated in the Protection against Dismissal Act have to be met.

Requirements for protection against dismissal

Any regular notice of termination given to an employee who is covered by this Act is only valid if the termination is "socially justified". This condition is fulfilled if the termination of employment is supported by reasons relating to the person to be dismissed (e.g. frequent periods of health-related absenteeism) or the employee's conduct, or by business reasons. Typical business reasons are reduction of staff, lack of work, and change of job description due to technological or other developments.

Social justification – person-, conduct-, or business-related reasons

To justify the termination of employment for business reasons, the circumstances have to be severe and of some urgency. Thus, it is not sufficient that the termination of employment is merely reasonable. In addition, if the employment shall be terminated for business reasons, the employer has to carefully select the "right" employee to be laid-off among the comparable employees of the business, considering the following social criteria: age, length of service, maintenance obligations and severe disability. In order for the termination to be legally effective, the "social selection" has to be reasonable. Furthermore, the employer has to check whether there are any job vacancies within the company (either at the same hierarchical level or at a lower level) that allow the employer to continue the employment with the employee – with amended employment conditions, if need be.

Termination for business reasons requires social selection

Social criteria: age, length of service, maintenance obligations, severe disability

4. Legal proceedings and severance pay

The relevance of employment protection legislation cannot be fully assessed without considering its procedural aspects. To contest the validity of a notice of termination, the employee has to file a complaint with the labour court within three weeks from receipt of the notice of termination. If the employee does not file a complaint or misses the deadline, the notice is deemed to be valid by operation of law.

Statutory period for filing an action: 3 weeks

In adjudicating on the legal effectiveness of a termination of employment, the labour court will always attempt, and in fact is required by law, to settle the legal dispute in an amicable way. This task is made easier by the fact that the validity of many notices of termination remains doubtful. If the notice of termination is contested, the labor court will fully investigate all facts to determine whether or not the termination was legally effective, in particular socially justified. Thus, there is no such concept as judicial restraint in reviewing the management's assessment of the employee's performance, business reasons, or social selection. If due to the relatively stringent standards applied the legal effectiveness of the notice of termination is not evident, management will often be inclined to settle the case against

Amicable settlement

Settlement: Severance pay in return for acceptance of termination of

the payment of a severance pay rather than to litigate the matter to the end.

employment

If the labour court arrives at the conclusion that the notice of termination was invalid but that the dispute is so severe that the employee may not be reasonably expected to return to work, the court has power to cancel the employment contract at the employee's request and to order the employer to pay an adequate compensation for the loss of employment of up to 12 times the employee's monthly remuneration (depending on the employee's age and length of service, the amount may increase up to a maximum of 18 times the monthly remuneration). The same applies at the employer's request if there are reasons why a reasonable continuation of the employment in the future cannot be expected. The practice of the labour courts is to award a compensation of approx. 50% of the employee's monthly remuneration per year of employment.

Cancellation of employment by the labour court: at the employee's or employer's request under specific conditions

This power of the courts has led to a common practice among parties to legal proceedings regarding protection against dismissal to quickly turn towards negotiations about severance pay, using the above regulations as a guideline, even where the matter is not yet before the court. In fact, discussions on an amicable termination often focus on severance pay from the outset and never reach the stage where notice of termination has to be given.

Voluntary negotiations about severance pay

One has to keep in mind, however, that contrary to the assumption of many German employees, severance pay in principle is due only where the notice of termination is invalid or where there is no sufficient reason to give a valid notice of termination and the employee's consent to a contractual termination is indispensable. Laid-off employees have no automatic right to claim severance pay simply because of the termination as such. On the other hand, if a notice of termination is invalid and the employee is not willing to accept any severance pay in return for his/her acceptance of the termination of employment, the employer is generally obligated to continue to employ the employee (unless the employer has sufficient reason to apply for the cancellation of the employment contract by the court in return for a compensatory payment as described above, i.e. if the employment relationship has irretrievably broken down).

No legal claim for severance pay

Continuation of employment if notice of termination is invalid

To attempt to amicably resolve a legal dispute regarding the termination of employment, the labour court always schedules an oral hearing before the professional judge, which is usually held within a rather short period from filing suit. Only if the matter cannot be settled at such hearing will the court order the parties to give detailed statements within specified deadlines and fix a second court hearing; this hearing is held before all judges (the presiding professional judge and two lay judges). Many legal disputes regarding the termination of employment are settled out of court or at an early stage of the legal proceedings.

Procedure in case of an unjust dismissal suit

5. Works council's rights regarding the termination of employment

In businesses that regularly employ at least five employees, the employees have the right (but not the obligation) to establish a works council (*Betriebsrat*). If they have made use of this right, the process regarding the termination of employment is somewhat modified. A detailed description of these particularities would go beyond the scope of this overview of general principles. One has to keep in mind, however, that a works council has specific rights of consultation in any termination process. The employer must strictly comply with the relevant regulations since a failure may render the notice of termination invalid on merely formal grounds. This can be particularly embarrassing if the cut-off period of two weeks to be observed in case of a termination of employment for good cause has expired. It is then too late to consult the works council and it is not possible to issue a second notice of termination for good cause on the same grounds after the cut-off period has expired.

Failure to observe the participation rights of the works council renders notice of termination invalid

6. Special protection against dismissal

Special protection of specific groups

Specific groups of employees (e.g. severely disabled persons, pregnant women, members of the works council) enjoy even greater protection under the applicable laws and may not be dismissed at all except in very narrow limits and subject to certain procedural or administrative requirements defined by law.

7. Special regulations applying to legal representatives of the company

Double status as legal representative and employee

Double status:
Legal representatives of a German company (e.g. a managing director – *Geschäftsführer* – of a limited liability company or a member of the board of directors – *Vorstandsmitglied* – of a stock corporation) have a double status: On the one hand, they are the legal representatives of the company and as such have duties and responsibilities defined by corporate law. On the other hand, they are usually employed by the company and therefore have an employment contract as well.

Different degree of protection against dismissal

Reduced protection:
However, there are still substantial differences between the legal status of regular employees and legal representatives. In general, legal representatives enjoy less statutory protection than regular employees. This is true, in particular, in two areas: ban on competition and termination of employment.

No protection against unfair dismissal

Whereas the statutory notice periods usually apply to legal representatives as well, they do not enjoy the protection against unfair dismissal granted to regular employees. In this regard, the law considers them as employer rather than employee. Accordingly, regular notice of termination may be given to them under observance of the statutory and contractual notice periods; the termination of their employment does not require to be socially justified. With regard to the termination of employment for good cause, however, the same conditions apply as to the termination of the employment of other employees (e.g. cut-off period of two weeks). It has to be carefully checked which corporate body is legally authorized to terminate the employment of a company's legal representative.

Issued in June 2010 by

Kanzlei für Arbeitsrecht Schweier

Kanzlei für Arbeitsrecht Schweier
Residenzstr. 23
80333 Munich
Germany
Phone +49 (0) 89 / 23 24 94 50
Facsimile +49 (0) 89 / 23 24 94 51
office@german-employment-law.com
www.german-employment-law.com