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# Focus German Employment Law



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## Editorial

### DEAR READER

at the end we are glad to send you another edition of our „Focus on German Employment Law“, which shall give you an overview on topics which are of relevance for foreign investors in Germany. Next year in Germany new works councils are elected which have in various aspects significant consultation and co-determination rights. An interesting issue is in this context, to which extent foreign owners of German entities are obliged to establish a so-called “Konzernbetriebsrat” or groups works council. Further, we see that foreign investors take the opportunity to acquire business units which belong to enterprises undergoing bankruptcy proceedings. Even in case of an acquisition from a bankruptcy receiver, employment relationship may be transferred in an asset deal. This is shown in our report on a recent decision by the German Federal Labour Court. Another issue which is quite often of importance is, to which extent employers may withdraw from so-called “Christmas payments” (“Weihnachtsgeld”) which in many companies in Germany are business practice.

We hope that you find the articles interesting.

We wish you “Frohe Weihnachten und ein gutes neues Jahr”.

YOURS SINCERELY  
DR. CHRISTIAN BLOTH



MANNHEIMER  
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# Group-level Works Councils

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## KONZERNBETRIEBSRAT

Besides collective bargaining (“*Tarifvertrag*”) by unions and codetermination by employees’ representatives on corporate supervisory boards (“*Aufsichtsrat*”), works councils (“*Betriebsräte*”) – provided with various legally mandatory codetermination rights – are the most important elements of employees’ consultation and co-determination rights in daily practice. This instrument is not restricted to local work units (“*Betriebe*”). In contrary, works councils are arranged hierarchically into three levels. At the local business level, works councils are directly elected by local employees and responsible for local execution of such rights. At corporate-level a joint works council (“*Gesamtbetriebstrat*”) is formed, if various local works councils exist. Such councils are formed by delegates from the local works councils. At the top, a group works council (“*Konzernbetriebsrat*”) deals with broad matters pertaining to the entire group (“*Konzern*”), if a “group” consists of various legal entities with various joint – and local works councils.

Apart from the initial establishment of a works council, what can be done at any time, every four years employees are voting for new members of the works council. In spring 2010 next regular elections will take place. Various new group works councils will be established in this course.

It is interesting to know for foreign groups acting in Germany, when and to which extent they are obliged to accept group works councils, if they run their business in Germany by various legal entities. What, if there is no ultimate owner of such entities in Germany? What if the ultimate owner is a German holding company, but decisions regarding the various legal entities are made abroad, the German holding itself is restricted to mere “holding” of shares?

According to Section 54 Works Constitution Act (*Betriebsverfassungsgesetz*, BetrVG), a group works council can be established, if this is requested by the joint works councils of subsidiaries employing more than 50 % of the group’s workforce. In addition, the shareholder/owner has to be a corporate group according to Section 18 Stock Companies Act (*Aktiengesetz*, AktG). As soon as a legal entity owns the majority of shares (“dominating company”/“*herrschendes Unternehmen*”) of a dependent company (“*abhängiges Unternehmen*”), a legal presumption rule in Section 18 AktG applies and a group is deemed to exist.

Transferring these facts to typical constellations in context of internationally acting groups, the question arises, whether joint works councils of German subsidiaries can establish a group-level works council with their e.g. UK or Swedish parent company? Focusing on the mere wording of provisions stated in the BetrVG and AktG this could be the case, if a foreign company owns the majority of shares of several German subsidiaries.

On 14 February 2007 the Federal Labour Court (*Bundesarbeitsgericht*, BAG 7 ABR 26/06) however answered this question – as earlier – in the negative. Requirements resulting from the German Works Constitution Act could not be binding for a foreign company, even if it is based within the European Union. The principle of territoriality (*Territorialitätsprinzip*) according to which the German

legislature is restricted to the territory of the Federal Republic of Germany limits such establishments. Group works council can therefore not be established with foreign parent companies owning shares in German units. However, this does not mean that international groups, acting also in Germany, do not have to anticipate group works councils within their corporate structure at all.

Many international groups – due to reasons of taxation benefits – organize their corporate structure within Germany in a way that one holding company owns the shares of all subsidiaries in Germany. In terms of German corporate law, this group has then established a “group within the group”, with the consequence that a group works councils can be established on the level of the German holding company.

Often however, holding companies do not operate any business apart from administrating their German subsidiaries. They have often no employees but one managing director – often acting from abroad – and do not have any works organisation. In the lack of any decision-making power, a works council on this level seems not to be reasonable, since decisions, which could subject to a meaningful consultation and/or codetermination process are taken abroad. Therefore, the next question arises: How can one prevent such an establishment of a group-level works council in a German holding company?

The answer can be found in the conclusion of a domination agreement (*Beherrschungsvertrag*) between the respective foreign group company making the decisions and its German subsidiaries.

Such an agreement may disprove the legal presumption rule of an existing group, as stated in Section 18 AktG, if it proves that the management of the foreign company is empowered with the actual control over specific subsidiaries in Germany. According to the domination agreement, which has to be subject to German law, the German holding company has to be obliged to execute its shareholder rights as requested by the parent company. Furthermore, the parent company has to enter into loss compensation agreements with its German subsidiaries.

In its decision of 14 February 2007, the BAG has confirmed that these regulations provide sufficient evidence for the transfer of actual control to a foreign group company. Thus, the German holding company cannot make any autonomous decisions in personnel, social or economic matters. In consequence, the presumption rule of a “group within the group” does not apply in this case and the basis for a group-level works council for German subsidiaries ceases to exist.

This concept should give rise to reconsider the structure of German groups owned by foreign ultimate shareholders, in particular if a German “holding company” is established, but is in reality a finance vehicle only.

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## Insolvency proceedings and a temporary interruption of business do not exclude transfer of employees in asset deals

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Under many European jurisdictions, the opening of insolvency proceedings automatically exclude automatic (mostly unwanted) transfers of employment relationships in case of acquisition of a business by an asset deal. The legal provisions related to transfer of employment relationships in course of a business transfer are quite similar in all member states of the European Union. Because of requirements of mandatory European Law, a business transfer usually causes under the respective national laws automatic transfers of employment contracts (with all rights and obligations included therein) to any purchaser of a business or parts thereof. However, investors are often not aware, that the member states are allowed to opt whether rules on business transfer shall apply on acquisitions from bankruptcy receivers. Whereas e.g. in Sweden such an acquisition cannot fall under these rules, it can in Germany.

In Germany, the Federal Labour Court (Bundesarbeitsgericht) recently confirmed once again that the provisions of business transfer

nonetheless continue to apply within insolvency proceedings and might lead to (unwanted) transfers of employees and their employment contracts, even if the employer or the bankruptcy receiver decided to close down the business and gave notice to all employees. In this case an investor took over the already for some weeks closed down business at a time, when notice periods were still running. In contrast, the acquisition of a finally closed-down business generally excludes any transfer of employment, regardless whether the business was closed within insolvency proceedings or before.

German Labour courts apply quite strict criteria to deem a close-down to have taken place, but – following trends of European Law – very often deem business transfers to have taken place for the benefit of the transferred employees. In this context, transfers are not limited to the typical sale of assets by the insolvency receiver, but also may include quite untypical situations and circumstances: In a recent decision of the Federal Labour Court (Bundesarbeitsgericht, judgement dated 22 October 2009, reference number 8 AZR 766/08) the business of a butcher shop was closed down by the butcher due to insolvency. The premises of the butchery had been rented from a third person. 14 days after the close-down, the insolvency receiver of the butcher terminated all employment contracts by statutory notice to the remaining employees and terminated the lease contract for the shop. As the butcher was not able to pay further wages, the Federal Employment Office paid the employees' wages until the date of expiry of the termination period. However, another butcher rented the premises and carried out his business before the date of



expiry, of all notice periods, but after several weeks of shops of the business. He continued to use the old telephone and telefax numbers, some inventory, the former name of the butchery (with small-printed clarification that he became current owner) and employed seven of eleven former employees of the former butcher.

Notwithstanding that the business was interrupted for six weeks, the Federal Labour Court decided that these facts were sufficient to lead to a business transfer, as the new butcher had not waited until the termination period expired, additionally used the relevant inventory, name of the shop, took over customers etc. The butcher had to reimburse the amounts of the wages paid by the Federal Employment Office, as the courts regarded a business transfer to have taken place. The six-week interruption of business was found to be not sufficient to effect a final close-down, notwithstanding the insolvency proceedings and the intention of the former butcher and insolvency receiver to close down the business.

The recent decision of the German Federal Labour Court once again confirms the necessity of a careful examination in case of any changes of ownership of assets of business units, regardless if bought, rented or subject to other contractual arrangements.

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## Will Santa Claus bring a Christmas Payment for 2009?

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Christmas is coming up and the holiday spirit brings out the generosity in most of us. However, for economic reasons a number of employers might nevertheless have to consider whether they can afford the payment of a Christmas payment or gratification to their employees in 2009. It is quite typical in Germany, that employment contracts provide for a Christmas payment (“Weihnachtsgeld”) or a 13th monthly income to be paid out with the November monthly income. In other companies such payments may not be stated in contracts, but are made on a voluntary basis, but based on an established practice.

Whether an employer can refrain from such payment depends on whether the employees have a legal claim to a Christmas bonus. This article shall throw a light on this issue and will at the same time show how an employer should act when he pays out a Christmas payment for the first time but wants to remain flexible in future.

The parties to an employment agreement can agree on a Christmas payment already in the employment agreement itself. In this case, the employee of course has a contractual claim to a Christmas bonus and the employer can only eliminate this claim by giving a so called notice of termination with the option of altered conditions of employment ("Änderungskündigung") or by mutual agreement with the employee. Any such reason must be "socially justified" according to the Act against Unfair Dismissal. Since such a termination effects a shortage of income, requirements on social justification are high. Any such termination regarding reduction of income is difficult to prove, simply expressed – the employer has to show, that this is the last remedy to avoid bankruptcy proceedings.

As far as there is no such provision in the employment agreement, it is decisive if and how the employer has paid out a Christmas bonus in the past.

If the employer has in fact made a Christmas payment in the past, but has also – when making the payment – in wise foresight expressly declared that such payment was a voluntary payment which did not establish any legal claim for the future, he is free to decide whether to make a Christmas payment this year and if so, to which extent. However, the employer is well advised to check whether the declared reservation of voluntariness ("Freiwilligkeitsvorbehalt") was given in a legally valid manner and as far as a Christmas payment is made for the first, second or third time, it can pay off for the employer to seek legal advice with regards to the wording of a reservation of voluntariness. German legal practice is quite strict in demanding a very clear and comprehensive wording in order for such reservations to be legally valid.

Another – perhaps easier way to handle such payments – is a declaration in the employment contract of a reservation of repeal ("Widerrufsvorbehalt"). The employee has gained a legal claim but the employer may – under certain circumstances to be described by the contract – refrain from the Christmas payment again in following year. Before making such decision, the employer should check whether the reservation of repeal made in the past is legally valid, since German legal practice has set out strict requirements for the correct wording of such reservations.

A reservation of repeal must be worded so concretely that the employee without any doubt can make out what he is in for – meaning when he can expect such payment and when not. For this, we recommend seeking legal advice in order to avoid making expensive mistakes.

If the employer has made a Christmas payment to employees three times without giving any reservation, a so called business unit practice ("betriebliche Übung") has been created. This means that the employer is contractually obliged to grant a Christmas payment to the employee also in future. The practice has become part of the employment agreement.

Earlier, legal practice had accepted that such a practice could be eliminated through an opposite business practice ("gegenläufige betriebliche Übung"). If after three consecutive payments without any such reservation, payments have not been made over a certain period of time, legal practice assumed an "opposite business practice", which excluded the employee from any such future payments. This approach had been often criticised in the employment law literature. The Federal Labour Court already in 1999 set up stricter requirements for an opposite "business practice" and in its judgment of 18 March 2009 (10 AZR 281/08), it took the reform of the German Civil Code ("Gesetz zur Modernisierung des Schuldrechts") as inducement to give up its past jurisprudence on this issue. This means that even if the employer had not made payments to the employee – without objection on the employer's side – this will no longer lead to a loss of a contractual claim of the employee to a Christmas payment. From a legal point of view – and especially in legal relations with consumers – silence principally cannot be interpreted as a declaration of intention. Therefore an employee's silence cannot be seen as the acceptance of a possible offer of the employer with regards to the legal quality of the Christmas payment. As far as a company practice has already been established, the employer therefore has no choice but to give notice of termination with the option of altered conditions of employment or to make an express mutual agreement with the employees, if he wants to free himself of the obligation to pay a Christmas payment.

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