

# Focus German Employment Law

**MANNHEIMER SWARTLING  
FOCUS GERMAN  
EMPLOYMENT LAW**

**CONTACT**

Dr. Christian Bloth, Fachanwalt für  
Arbeitsrecht, Frankfurt (Editor)  
Roland Weiss, Frankfurt  
Bettina Kreimer, Frankfurt  
Thereze Falkjær Jensen, Berlin  
Dr. Kerstin Kamp-Wigforss,  
LL.M., Stockholm

MannheimerSwartling  
Focus@msa.se

**MANNHEIMER SWARTLING**

**FRANKFURT AM MAIN**

Bockenheimer Landstraße 51-53,  
60325 Frankfurt am Main,  
Phone: +49 69 974 01 20  
Telefax: +49 69 974 01 210

**BERLIN**

Mauerstraße 83-84  
10117 Berlin  
Phone: +49 30 22 66 990  
Telefax: +49 30 22 66 9910

**STOCKHOLM**

Norrländsgatan 21  
Box 1711, 111 87 Stockholm  
Tel +46 8 595 065 00  
Fax: +46 8 595 065 01

[www.mannheimerswartling.de](http://www.mannheimerswartling.de)

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## Dear Reader

We hope that 2009 – despite of the economic crisis – has started well for you. We hereby present our first edition of 2009 of our “FOCUS on German Employment Law”, which shall give you – as foreign observer on developments in Germany – some in-sights in German Labor Law.

This edition focuses on reactions on the employer’s side with regard to labor costs in times of an economic crisis. Well established guidelines like “Kurzarbeit” (“Short time work”), “forced” vacation periods but also guidelines on “how to give” notice are described. In our day to day practice it is our experience that several of our clients have unfortunately already to consider such measures as we also know from the media when it e.g. comes to the German car manufacturers. Our next edition will therefore also deal with the instrument of an “Interessenausgleich und Sozialplan” (“balancing of interests and social plan”), which has to be negotiated with “Betriebsrat” (“works council”), if a “not insignificant restructuring” of business is planned, which may lead to a not insignificant loss of work places.

This edition contains as well the final and third chapter of our article on the employment relationship with Managing Directors (“Geschäftsführer”) in Germany.

We hope very much indeed that this FOCUS is interesting for you. Please do not hesitate to contact us, if you have any additional questions or we can be of any assistance for your German business.

*Kind regards,  
Dr. Christian Bloth*



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# Terminating Employment Relationships under German Law – Avoiding Expensive Mistakes

Termination of employment on the part of the employer is subject to numerous legal restrictions and mistakes are often made. As many of these mistakes are avoidable, the following shall provide some general guidelines to be considered. Thereby, we shall focus only on the rules on “ordinary” termination of employment, not taking into account terminations subject to negotiation of a social plan.

The first hurdle to be cleared is the written form requirement for the notice letter (Sec. 623 German Civil Code). The letter, which must explicitly state that the employer puts an end to the entire employment relationship, has to be signed by the person(s) able to legally represent the employer. Most often this will be the managing director(s) of the company. If another person shall sign, a power of attorney is required and must be attached to the declaration. All signatures must be in original, which means that notice of termination cannot be given by e-mail or fax.

Secondly, the employer should deliver the termination notice in such way that he can prove receipt. The best way to do so is to hand over the notice letter in person and ask the employee to confirm receipt on a copy. If this is not possible, a courier should deliver the notice letter and make a protocol of delivery. Please note that the courier must be able to confirm what he delivered, i.e. the courier must be aware and have seen with his own eyes that the notice letter was in the delivered envelope. For this reason, delivery by registered mail (“*Einschreiben*”) is insufficient. It is hard to believe but true that it has happened more than once that an employee confirmed receipt of a registered letter, but claimed that the envelope was empty or contained something else than the notice letter.

According to Sec. 622 German Civil Code, the general notice period is four weeks, effective as of either the 15th or the end of a calendar month. As of two years of employment, the notice period is one month to the end of a calendar month; as of five years it is two months; as of eight years, it is three months; and so on up to a notice period of seven months after twenty years of employment.

In case a works council (“*Betriebsrat*”) is established, it has to be consulted before issuing the termination letters. Any termination is invalid if it has not been presented properly and complete to the works council prior to issuing. The works council has to be informed about the person concerned and the reasons for the termination. The works council has one week time to make its statement on the intended termination, but does not have to give a statement at all. The works council is entitled to object to a termination for a limited number of reasons. Such objections, however, do not prevent the employer from giving notice.

In case a higher number of employees shall be dismissed, it must be checked, whether the company is obliged to notify the employment agency (“*Agentur für Arbeit*”) before the dismissal as there are several rules to be adhered before a so called mass dismissal may be executed by issuing termination notices.

The Unfair Dismissal Act (“*Kündigungsschutzgesetz*, KSchG”) grants termination protection to all employees who have been working for six months in a business which regularly employs more than

ten people (for employment contracts entered into before 1 January 2004, applicability of the Act is subject to an employment of more than five employees). Employees are not counted per capita, but per working-time. An employee working 50 % is counted as “0.5” employee.

According to Sec. 1 KSchG, any termination not “socially justified” – as it is put by the Act – is regarded as unlawful. Social justification in this sense can be based on the employee’s person or conduct or on compelling business requirements. A termination for business reasons can become necessary due to certain business needs, such as the introduction of new technology, closing down of a division, restructuring measures or reduced sales and offers in times of economic crisis. Such circumstances should be carefully documented, as – in general – the employer is obliged to prove these if a dispute arises.

Even if business considerations require the dismissal of one or more employees out of a certain staff group, the termination may still be invalid in case the employer has not duly taken into account the relevant social aspects when selecting the employee(s) to be dismissed among the respective group of employees (“*Sozialauswahl*”). In general, the employer is obliged to choose employees who are least severely socially affected by the termination, with due regard being paid to, inter alia, age, length of service, disability and number of dependants.

Besides the outlined general restrictions imposed by the Unfair Dismissal Act, there is special protection e.g. for pregnant women, disabled employees and members of the works council and employees in civil service.

In all cases, the employee is entitled to challenge the validity of any termination in the labor court. Invalidity under the Unfair Dismissal Act can only be invoked if the complaint is filed within three weeks after notice of termination was given. The action of the employee – according to law – is not directed on damages or any other kind of compensation, but on declaring the dismissal invalid with the effect that the employee returns to his work place in case he wins.

In Germany, the outcome of such disputes is often said to be unpredictable due to not very specific legal provisions and a comparatively intensive court practice. However, at least with the ambition to avoid unnecessary mistakes and to be in a solid negotiation position a careful preparation is necessary.

In practice, however, it is not uncommon that the parties enter into a settlement under which the employer obliges himself to pay compensation to the employee. There are no rules as to the compensation amount, but generally speaking an amount of 30 to 100 %, but even more in specific branches, of the monthly gross salary per completed year of employment is common. Certain individual factors can de- or increase the amount.

Dr. Christian Bloth, [cbi@msa.se](mailto:cbi@msa.se), Ulf C. Lohrum, [ucl@msa.se](mailto:ucl@msa.se)



## “Forced” Vacation in Times of Crisis

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In times of decreasing business and a decreasing number of orders, employers have to react to the new economic situation. Most often this means to reduce production and as a consequence also workforce. Thereby, the termination of employment contracts is only one possibility to reduce costs, but is also connected to a loss of qualified workforce which may be needed if business is coming back. In case the order situation is expected to improve again in the foreseeable future, alternatives, which keep skilled and experienced workers within the company, have to be found.

One way to achieve this aim is the compensation of accumulated overtime hours with a work lay-off. Since this approach is limited to a short period of time and may be imposed only to such employees, who accumulated overtime hours in the past, there will soon be need for further actions. Such overtime should be granted as spare time.

A next step could be to impose the order to take on the vacation in the course of a temporary close-down of business. This order may be issued for the entire firm or be restricted to particular production units. Employers will still be obliged to pay the monthly salaries (only reduced by additional payments like overtime or night premiums), but they ensure that the entire workforce is available once the economy has revived again. Costs are reduced due to the fact that production is not running.

Even though this seems to be a suitable approach to manage the crisis in an efficient way to a certain extent, several rules and regulations have to be considered in this context.

Under German employment law, as a matter of principle, vacation has to be granted in line with employees' requests (Section 7.1 of the Federal Law regarding Worker's Vacation, BUrlG). Exceptions are only permitted if urgent operational reasons (*“dringende betriebliche Gründe”*) compel the employer to disregard the employee's wishes in order to ensure the company's continuity. In view of the current economic crisis this is applicable, when a company experiences a serious drop of its order volume, which might result in financial difficulties

or even insolvency should no counter measures be initiated. Only then, employers have the right to reject applications for leave and unilaterally determine the dates of a close-down of business as the new general vacation period.

It is important to note that it is not possible to deplete all the employees' annual vacation days in this manner. As a guideline, the Federal Labour Court (*“Bundesarbeitsgericht”*) has indicated in the past that only up to three fifth of the annual vacation may be determined by a vacation close-down.

In case a works council (*“Betriebsrat”*) exists in the company, it has to codetermine the stipulations of the vacation close-down (Section 8.1 No. 5 German Works Constitution Act, BetrVG). This means, the works council has to approve the implementation, the duration, and the dates where employees shall be “forced” to go on vacation. In case the works council withholds its approval, an arbitration committee (*“Einigungsstelle”*) can reach a decision on behalf of both parties. However, once the works council has given its approval, legal requirements like the urgent operational reason become less important for the implementation of the vacation plan.

Finally, it has to be taken into account, that an employer can only force personnel to go on vacation, if the employees still have vacation days left. In case one employee has used his entire annual vacation, the only chance of the employer is to temporarily release him while paying full remuneration. In this context, it also has to be mentioned that employers are not allowed to cancel vacation times, which he and the respective employee have already agreed on. The trust of employees in approved vacation promises is protected by law. However, this is not relevant to vacation requests which the employer has not yet confirmed. Such requests can be rejected by the company and be adjusted to the general vacation close-down.

*Therese Falkjær Jensen, tfj@msa.se, Ulf C. Lohrum, ucl@msa.se*

# In Focus: Short-time work

## (“Kurzarbeit”)

As already shown in the previous article, instruments to reduce the HR costs are lifted into focus in times of economic difficulties. In German enterprises, another one of these instruments is the introduction of short-time work (“Kurzarbeit”).

Purpose of such short-time work is a temporary economic relief of the company by reduction of personnel costs without dismissals. Thus, employment is maintained.

With introduction of short time work, either the regular work-time is decreased or the effected employees are completely laid-off for a certain period of time. After such period, employees return to their regular work as defined in their (original) employment agreement. The short-time work can be introduced for the entire business or restricted to certain divisions.

The employer is not in a position to unilaterally introduce short-time work. If collective bargaining agreements apply, they often provide regulations as regards short-time work, on which the employer can base the introduction. Otherwise, short-time work may be introduced by way of an agreement with the works council, if any. Even if collective bargaining agreements apply, the information rights of the works council (if any) must be taken into account at an early stage in order to avoid a postponement of the measure, and details of the short-time work should be stipulated in a works agreement.

If no collective bargaining agreement applies and no works council has been established in the company, the short-time work can only be introduced by way of individual agreement with each affected employee. If no such agreement can be reached between the employer and the employee, the employer may try to impose the short-time work by issuing terminations with the option of altered employment conditions (“Änderungskündigungen”), forcing the employee to choose between a final termination on the one hand and short-time work on the other hand. However, such kind of termination may often be considered invalid by the relevant labour court.

The employees’ salary is lowered according to the reduction of work-time. In order to balance the negative effect this has on the employees’ income, the employer or the work council (“Betriebsrat”) may apply for the payment of a so-called short-time allowance (“Kurzarbeitergeld”) at the competent employment agency. Depending on the marital status of the employee, the short-time allowance amounts to 60 respectively 67 % of the difference between the employee’s last net salary and the salary paid during short-time work.

The employment agency only grants short-time allowance if certain criteria are met. The affected company or division must be affected by a considerable lack of work (“Arbeitsausfall”) with respective salary loss (“Entgeltausfall”). A considerable lack of work is only considered if it has been caused by unavoidable, temporary economic reasons or an inevitable event. Further at least one third of the employees of the respective business must be affected by a loss of their gross monthly salary of at least 10 %. Naturally, the employment agreement must be in existence at the time the lack of work begins and employment must be intended to be continued after the lack of work.

Although the affected employee is the title bearer regarding the short-time allowance, the employer is obligated to ensure the realisation of the claim, i.e. register a respective application with the employment agency.



In the application form, the employer has to substantiate the circumstances justifying the payment of short-time allowance by presenting respective documentation, as for example details of the order situation or an agreement with the works council regarding the short-time work. Based on this information, the employment agency will decide, whether the allowance will be granted. After the employment agency has issued its decision, the employer has to file separate payment claims for each affected employee with the employment agency.

The short-time allowance may regularly be granted for a period of up to eight months. However, in order to encourage the companies to use the instrument of short-time work instead of issuing terminations during the present economic situation, the Federal Ministry for Labour and Social Affairs has increased this period to up to 18 months for the year 2009.

Taking especially this extended period into account, it can be stated that in case a company in Germany is affected by the downwards trend in orders due to the worldwide economic situation, the introduction of short-time work should be considered as an alternative to the (final) reduction of the work force. By choosing introduction of short-time work over dismissals, long-time trained qualified personnel is maintained, while economic needs are met until the order situation improves.

Bettina Kreimer, bek@msa.se

# Employment of Managing Directors of affiliated GmbHs

## PART 3: REVOCATION OF APPOINTMENT AND DISMISSAL

The legal position of a Managing Director (MD) of a German affiliated GmbH of a foreign parent company will be, if not stipulated otherwise, generally governed by German law. MDs are generally not subject to protection by the Act against Unfair dismissal (see part 1/Focus August 2008), but the regulations of German contract and company law govern the service contract between the MD and the company (see part 2/Focus November 2008, available on our homepage [www.mannheimerswartling.de](http://www.mannheimerswartling.de)). This part 3 provides a short overview of revocation of appointment and dismissal of MDs, based on numerous reasons, e.g. a change of control of a subsidiary company after a sale and purchase, lack of performance or contractual violations of the MD.

Revocation from office and dismissal are independent acts to be separated strictly. The revocation affects the position of the MD as institution of the company. Rights and duties of a MD are ruled by company law (German Limited Liability Company Law, "*GmbH-Gesetz*"), particularly the external relationship (e.g. unlimited power of representation on behalf of the company). Company law contains detailed provisions required for a valid revocation. The dismissal concerns the contractual, internal relationship between MD and the company and is ruled by civil (contract) law. The MD is at the same time both, institution of the company and party of a service contract. A revocation thus does not lead automatically to a cancellation of the contract, and a dismissal on the other hand does not affect the legal position under company law. Generally, validity or invalidity for whatever reasons of one position therefore does not affect validity or invalidity of the other.

The revocation of appointment may only be decided upon by within a formal shareholders' resolution. Third persons or a further MD are generally not entitled to declare a valid revocation. If GmbHs, as in the majority of cases, are not subject to rules under German co-determination rules of employees representation (threshold: 500 or 2000 employees respectively), the shareholders' meeting may revoke the appointment as MD at any time. The revocation has not to be based on specific, justified reasons. Even different opinions on business strategies are sufficient.

Regarding the second "pillar", the termination of the MD's service contract, the shareholders' meeting has exclusive competence. As the revocation, the dismissal is subject to a shareholders' resolution. Employment protection law is generally not applicable and a prior warning before dismissal, as normally required, thus not necessary. Nonetheless, contractual provisions and obligations are neither affected by a revocation of appointment nor does such revocation automatically constitute a contractual or extraordinary reason for dismissal. The service contract of the MD will rather continue as long as it is not terminated separately. It has to be determined by contract law whether a dismissal is reasonable (i.e. sufficient) and enables the company to issue a notice –maybe even a notice for termination based on important reasons ("*außerordentliche Kündigung*"). In the latter case notice periods would not have to be observed. However, in this case it is recommendable to issue alternatively ("*hilfsweise*") and in addition a notice with period at the same time for the case of insufficiency. A time-limitation of the service contract of MD is a third possibility which might sometimes avoid difficult legal evaluations (e.g. sufficiency of MD's contractual violations). But if MD's service contract has been concluded time-limited without containing any further provisions, it generally can just be terminated for important reasons without notice, but not regularly with notice, but without cause. Thus, such time-limited contract should explicitly state a list of reasons which enable a contractual termination.

For practical reasons, revocation and appointment usually are declared at the same time, as both require a shareholders' meeting as well as a resolution. Strict formal rules apply. The above stated dismissal without notice for important reasons and alternatively with notice period requires that the topics are included in the meetings agenda and must be clearly stated in the shareholder's resolution. Please observe, that notice of the employment contract is signed by the legal representative of the shareholder of the company, not an additional MD or the person the MD reports to in the group, a frequently made mistake.

*Dr. Christian Bloth, [cbl@msa.se](mailto:cbl@msa.se), Andreas Karl, [krl@msa.se](mailto:krl@msa.se)*

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