Redundancy and work force restructuring in Germany – a practical overview

EMPLAWYERS

There are numerous reasons which might motivate the management of a company to reorganise the company or to restructure the work force external reasons such as an economic crisis, the appearance of new competitors, new customer demands and / or the requirements of capital markets often force a change in strategy. Internal reasons for a reorganisation might be the closure of subsidiaries or entities, the outsourcing of tasks or departments, the relocation of a unit to another (foreign) place of business or structural changes within the company to adopt to national or international requirements. A further reason might be the preparation for an acquisition or sale of business units or the company as a whole.

In such a situation it can often be seen that a lot of time, money and resources are spent on business consultants, which provide glamorous business plans with attractive options while completely ignoring the requirements of labour and employment law. It is a frequent observation that budgets are exceeded and timelines must be extended.

As far as a restructuring project includes changes of the work force it is essential for the company's management to think about the requirements of labour and employment law in the first place.

Content

Phase 1: Development of a feasible concept

The initial phase of a restructuring project usually starts with a full analysis of the business situation and all relevant legal issues.

It is important to include employment law considerations as well as potential alternatives right at the beginning of phase 1.

Often HR issues are not the prime focus of a company restructuring. Financial aspects, tax considerations, corporate law and cross border planning might be the trigger for such project. In any case a coordination and efficient project management is essential to guarantee the success of any complex project. It is a common mistake to initially ask business consultants, tax advisors or financial experts to prepare a concept and only later ask for legal comments from employment law experts on an already existing business plan. In Germany labour and employment law issues determine to a large extent the content, timing and costs of the project and often a reduction of the work force is a core element for success.

Labour and employment law due diligence

First of all a clear analysis of the legal situation of the entities / unit concerned is necessary. Among others following questions need to be addressed:

- Are collective bargaining agreements or shop agreements applicable?
- Have employee representative bodies such as a works council been established?
- Have there been any reconciliation of interests and social plans in the past?
- Which employment contract templates are used (e.g. in respect of the relocation of employees, notice periods, restrictive covenants)?
- How many employees are working at the unit / entity and how many of them will be affected by the restructuring project?
- How does the HR structure of the unit / entity look like, which employees are essential?

A thorough labour and employment law due diligence will determine the parameters of the further process.

Confidentiality

While developing the concept of a restructuring project and discussing the available alternatives it is most essential to keep all deliberations as confidential as possible. To achieve

this goal the outsourcing of planning tasks to one or more advisors is a common approach, which prevents rumours among the work force or questions raised by employee representatives. Under German employment law the consultation process with employees or their representatives must start once a concept has been developed and generally been adopted by the management of the company. In order to maintain flexibility it is necessary to keep all information and considerations as confidential as long as no specific project plan has been decided. Even in companies without employee representation confidentiality is key for the success of the project, since suspicion o f such a project might trigger works council elections complicating matters significantly. Further it might be worth considering to engage a media consultant to cope with any eventual disruption caused by public discussions about the layoffs.

At the end of Phase 1 a clear definition of the purpose of the project and a clear fixation of the management decision has been taken.

Phase 2: Planning

In a second phase, the planning phase, a concise timetable is worked out. It needs to clearly state what has to be done when and how long each step will take.

Timeline

Labour and employment law factors play a decisive role. This applies both to individual labour law issues such as notice periods, special protection against dismissal, the notification of mass dismissal, the possible duration of court and other official proceedings and - if a works council exists - also to collective law procedural requirements such as the information of the economic committee and hearings of the works council on dismissals.

If co-determination plays a role, a restructuring for companies regularly means negotiating a reconciliation of interests and social compensation plan. It is therefore important to clarify some preliminary questions of labour law in advance:

- Does the planned project constitute a change in operations within the meaning of the Works Constitution Act, which triggers the obligation to negotiate a reconciliation of interests and to conclude a social compensation plan?
- If so, which employee body is responsible (works council, general works council and/or group works council)? This question is not trivial. If negotiations are conducted with the wrong body, the legal effectiveness of all measures is at stake.
- In some cases a trade union also takes on the role of negotiator and negotiates a so-called social collective bargaining agreement. In this case, special attention must be paid to coordinating all parties involved on the employee side.

In addition to managing expectations vis-à-vis management and shareholders, it is also a question of financial consequences, as time is money in the sense of the word.

Budget

Budget planning is inextricably linked to the planned timeline. The following aspects must be taken into account:

- Salaries for affected employees payable because the intended notices cannot yet be issued due to requirements of the works constitution law ("delay costs"),
- Expense resulting from obligations under the social compensation plan, i.e. primarily severance pay
- Legal costs, including any additional severance payments, in the event of employment court claims for unfair dismissal by affected employees,
- Costs for employees and service providers who are entrusted with the preparation, implementation and handling of social plans within the company, and
- External consultants, expenses for both collective partners (employer/ works council)
- In rare cases, strike-related absences or other forms of collective stoppages may occur, in which case appropriate precautions must be taken (outsourcing to other companies, temporary work, etc.)

Social selection process

The Dismissal Protection Act stipulates that the employees affected by dismissals for operational reasons must be determined according to the principles of social selection. The relevant criteria are age, time of service, and social obligations towards dependents (spouse / husband, children), and disability. This is often perceived as a major obstacle in the context of restructuring and dismissals for operational reasons. From a company's point of view, it would be disastrous to have to dismiss top performers simply because they are younger than other employees or have been recently hired.

If it is established during the planning phase - as is regularly the case - that staff reductions in accordance with the principles of social selection do not lead to the desired results, alternative concepts must be examined. Here, so-called voluntary redundancy programmes have proved particularly effective. These have undeniable advantages, such as speed and less effort, but also inherent risks, such as the risk of losing or at least demotivating the "wrong" employees and the creation of a correspondingly high standard of expectation for future restructurings; moreover, there is no guarantee of achieving the objectives. Other possible alternatives are the exemption of essential employees from the social selection process, which is permitted under certain circumstances, and the securitization of the current age structure of the workforce, which allows the dismissal of older/ longer serving employees.

Motivation

On a regular basis, it is of considerable importance for the continued existence of the company and for the implementation of the strategy that **top performers** remain on board. Measures must therefore be developed to prevent key personnel from leaving the company and/or to provide incentives to stay with the company (e.g. retention bonus).

On the other hand, the motivation of employees, who are supposed to be dismissed is rapidly declining. It can be expected that employees to be dismissed will only be available for operational activities to a limited extent (e.g. due to illness or job search). Accordingly, the continuation of relevant processes, projects and work tasks must be ensured at an early stage.

In addition, it is advisable to actively communicate a positive outlook to the remaining workforce in order to counter eventual internal depression and voluntary resignations.

Phase 3: Negotiations with employee representatives

Thorough preparation is essential for negotiations with the works council or trade union. First of all, the employee representatives must be given comprehensive information. A clear presentation of the company's exact business (restructuring) plan is useful here, as this documentation can be used to inform the employee bodies (economic committee and works council). In fact, it is regularly recommended to provide rather more than too few documents.

The information is immediately followed by negotiations. Even some practitioners are -however- not sufficiently sure about the distinction between reconciliation of interests and social compensation plan.

Reconciliation of interests

A reconciliation of interests is a special type of collective agreement which cannot be enforced by the works council and which is intended to regulate whether, when and how a change of operation is carried out. However, it is legally required that the employer attempts to reach a reconciliation of interests. It is important to note that case law only recognises such an attempt if the entire procedure has been completed up to the establishment of the failure of negotiations dissuasion in a conciliation board.

It is important for the timing purposes to know that the implementation of the operational change may only be started after the reconciliation of interests procedure has been completed, i.e. a reconciliation of interests has been signed or the failure of the negotiations in the conciliation board has been established. No implementation measures may be commenced before that time, in particular no dismissals may be executed. Starting the measure without consultation may result in a stop order issued by a court. In addition, employees may be entitled to additional compensation for eventual disadvantages.

The best solution from an employer's point of view is to conclude a reconciliation of interests with a list of names of employees to be dismissed. In this case, the social selection process and result will only be reviewed by labour courts for gross errors. It is – however - extremely rare that works councils agree to such list unless they receive huge advantages in exchange (such as a lengthy workplace guarantee for the remaining staff).

Therefore, general selection guidelines, age grouping and point schemes for dismissals can be helpful.

However, the requirements of case law regarding the content of such guidelines must be observed. In addition to creativity, precise knowledge of case law is essential.

Social plan/social collective bargaining agreement

In contrast, the social plan/social collective bargaining agreement regulates the compensation or mitigation of the economic disadvantages of the operational change for the workforce. The social compensation plan includes, for example, claims for severance payments or other cash benefits such as relocation allowances or outplacement services. It is important that a social plan can be enforced by the works council within the framework of a conciliation board, as such but this does not mean a specific content can be demanded. The core element of many social plans is the payment of severance to employees who have been made redundant. Such severance payments are often calculated according to a formula that takes into account the company economies performance and current status, salary and length of service of the employees. Payments are often also made for children or for other social obligations and disability.

Tactical Considerations

Although the reconciliation of interests and social plan are legally independent of each other, they are regularly negotiated in parallel. Since the works council only delay matters, but can ultimately not prevent the measure from being implemented, it is a usually successful approach to offer favourable terms for the social compensation plan in exchange for a quick signature of the works council.

The means available to the works council to delay the reconciliation of interests procedure can be differentiated according to the stage of the negotiations, ranging from extensive requests in the information phase to the involvement of experts and (pretended) scheduling problems for meetings. Thus it is advisable for companies to be prepared for all conceivable delaying tactics by consulting experienced practitioners in advance.

The tendency is that the sooner the reconciliation of interests is to be achieved, the more attractive the social plan must be. With a well-endowed social compensation plan or concessions elsewhere - in particular employment guarantees for the remaining workforce - the company ultimately "buys" the works council's quick approval of the reconciliation of interests and thus the possibility to

start implementing all measures without delay.

However, a lot also depends on the current situation of the company. The more credibly an economic emergency can be presented, favourable negotiations might be possible. Good preparation is essential; balance sheets, financial statements, reports from auditors and tax consultants are important tools. A works council that is aware that there is little time and money available to save the remaining jobs is much more willing to compromise than in companies with a well-filled "war chest". It is therefore necessary to decide in advance which tactic will achieve the goal, there is no golden middle way here ("it's not quite as bad for us, but we don't have a lot of money either" is not an effective statement).

In this context, it is also important to know all available social security laws, such as e.g. transfer short-time work benefits. This allows risks and burdens to be mitigated without placing an excessive financial burden on the company. Those who do not know the funding pools will ultimately pay too much.

Companies without a works council are in a comparatively comfortable situation. Although the same social selection criteria must also be considered, the entire negotiation process can be omitted, so that it is possible to act much more quickly. Nevertheless, mistakes must be avoided, otherwise there is a considerable risk of litigation losses and/or high severance payments in the court settlements.

Phase 4: Implementation

In addition to the described obligations to negotiate with employee representatives, the company must also comply with a complex notification procedure to the German Federal Employment Agency in the case of so-called mass dismissals. Companies must proceed with particular caution and care. The procedure is very formal and prone to errors. It is divided into two parts: the first part is the consultation with the works council and the second part is the actual notification to the responsible employment agency.

Consultation procedure

If there is a works council, the consultation procedure must be carried out first. It should give the works council the opportunity to prevent or limit mass redundancies through constructive proposals, or to mitigate their consequences through accompanying social measures.
It is permissible and advisable to combine the consultation procedure with the reconciliation of interests negotiations. However, special care must then be taken to ensure that the works council is able to recognise that the consultations taking place also serve to fulfil this specific duty of consultation; the dual function should therefore be documented in writing.

Notification procedure

All employers (including those without a works council) are obliged to report in writing (preferably on the official form) to the relevant employment agency before making large-scale redundancies. Dismissal in this sense means any form of termination that occurs against the employee's will, i.e. ordinary notices of termination and termination agreements initiated by the employer.
The relevant point in time ("dismissal") is the receipt of notice of termination or the conclusion of the termination agreement (not the expiry of the notice period).

The obligation to notify depends on the size of the company concerned and the number of employees to be dismissed.

A period of 30 calendar days from the day of the first relevant discharge must be considered. Dismissals that were not originally notifiable may become notifiable at a later date as a result of new dismissals. For this reason, the period of past 30 calendar days must also be considered.

An omitted/wrongful notification regularly leads to the invalidity of all dismissals under the measure, which can be an extremely costly mistake.

By their very nature, the rules on works council participation do not apply to companies without a works council. No substitute procedure is to be followed either. The notification of mass dismissal can be made as described before.
After receipt of the effective notice of dismissal by the Federal Employment Agency, the employer has 90 days to carry out the notified dismissals (there is a ban on dismissals of one month from the date of notification, but this is only relevant in the case of very short periods of notice) - otherwise a new notification is required.

Statement of termination

Once negotiations with the works council on the social plan and reconciliation of interests have been concluded and, if necessary, the notification of mass dismissal has been submitted, the dismissals must be initiated.

After the quite demanding preparation of the restructuring, the drafting and signing of the dismissal letters seems rather simple. However, it is precisely here that caution is called for, e.g. when hearing the works council on each individual dismissal or obtaining the consent of the labour inspectorate in the case of maternity and parental leave and the integration office in the case of severe disability.

In the worst case, the notices of termination may be null and void due to formal errors, such as the signature of a not duly authorized employee. In case of any formal mistake the notice of termination may have to be issued again (possibly by repeating the mass dismissal notification procedure as well), which can lead to considerable additional costs due to missed deadlines.

The notice procedure is also a logistical task, especially if a large number of employees are affected.

Employment court proceedings

No matter how well designed the social selection has been and perfectly prepared dismissals are, it is almost impossible to avoid labour court cases.

Even if a social plan exists, the incentive for legal action is huge. The severance payment from the social plan is the secure starting point for the employee. There are always imponderables and scope for discretion, so there is a real chance of achieving a higher severance payment in court. It is particularly important for employers to keep an overview of all cases in order to avoid (expensive) precedents.

Summary

A thorough status analysis and precise planning of measures are essential for a legally compliant design and smooth implementation of a staff reduction or restructuring. Therefore, before any restructuring of the workforce a tailor-made concept must be developed. Companies avoid litigation risks and thus reduce restructuring costs by including labour law aspects and a holistic approach at an early stage. The more thoroughly the restructuring is planned, the less likely it is that legal errors will be made during implementation, which will cost time and money.

Taking into account on both labour and employment law and strategy aspects restructuring measures can be successfully implemented within a given time not exceeding a given budget. Ultimately, it is planning and organization that are decisive for the perfect implementation of operational changes.

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