Agenda 2010: Reform of German Labour Law: Impact on Hiring and Firing Staff

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[*Editors' Note*: The contemporary debate about enhancing and consolidating sustainable development in worldwide democracies has long ceased to be an academic affair. In many states, we can witness intensive political discussions over the chances and limits of providing for a more efficient legal framework that could allow for an adequate adaptation of labour market and social welfare frameworks for the 21st Century. At the same time, the necessity to ensure economic growth in today's globalized and integrated markets puts pressure on any reform proposals that aim at a historically informed and contextualized law making agenda. The German government's announcement of the Agenda 2010 on 14 March 2003 can be read as a sweeping attempt to address the paining issues of labour market reform, social protection and economic growth. The following report gives a brief overview of some of the central elements in the Government's recent labour law legislation.]

A. Introduction

With its "Agenda 2010", the German Government aims at a comprehensive reform of the German labour market. With regard to labour law, changes are planned notably concerning the protection against dismissal and limited-term employment contracts. For the first time, there will be a standard statutory claim to a severance payment (under certain circumstances) in the case of dismissals for operational reasons (redundancies).

As part of Agenda 2010 the *Bundestag* (federal parliament) passed legislation on labour market reform on 26 September 2003. As amended by the *Vermittlungsausschuss* (a joint reconciliation committee of the *Bundesrat* and the *Bundestag*), the law has come into force already on 1 January 2004.[1] The key element of the new regula-

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[1] *See „Gesetz zu Reformen am Arbeitsmarkt"*, *Bundesgesetzblatt* (Federal Gazette) *I (BGBl. I) of 30 December 2003, p. 3002.*

https://doi.org/10.1017/S2071832200012311 Published online by Cambridge University Press

tions is a reform of dismissal protection legislation in order to create more transparency and legal security for companies in the event of dismissals for operational reasons and to reduce restrictions on new hires. This involves re-introducing numerous provisions to the German Dismissal Protection Act (*Kündigungsschutzgesetz*) which following the change of Government in 1998 were deemed 'anti-social' and repealed.

B. The Legislative Changes

*I. Dismissal Protection Act (*Kündigungsschutzgesetz – KSchG*)*

1. "Small Business Clause"

Until now, companies had to adhere to the Dismissal Protection Act only if they employed more than five members of staff. In the future, only employees in operations with more than ten employees are entitled to protection against unfair dismissal.[2] However, employees in small businesses who were already entitled to protection prior to 2004, will continue to remain protected.

2. Social Factor Test

For redundancies, the social factor test applied to determine which employees are dismissed is often fraught with practical difficulties. In the interests of a high level of legal security, the social factor test should therefore be restricted to four criteria in the future – namely the number of years of service, age, maintenance obligations and the seriously disabled of an employee.[3] Moreover, it should also be made easier for the employer to exclude top performers from the social factor test completely. Until now, this has been possible only if retaining an employee is vital for the existence of the company. By contrast, "legitimate operational interests" are to suffice in the future. Such interests are deemed to exist notably if the social factor test secures the existing staff structure of the company or if individual employees possess particular expertise, skills and performance. The employer and the works council may specify the weighting of the social aspects in a works agreement. If this is the case, a labour court can review the social factor test only with regard to gross defects.

3. List of Names in the Event of Collective Dismissal

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[2] *Cf.* Sec. 23 Para 1 KSchG new version.

[3] *Cf.* Sec. 1 Para 3 KSchG new version.

If in the event of a corporate change a reconciliation of interests ("*Interessenausgleich*") and a social plan ("*Sozialplan*") are concluded, the employees to be dismissed may, with the common consent of the employer and the works council, be named in the reconciliation of interests. For these employees, it is then assumed by law that their dismissal is justified by urgent operational requirements.[4] The social factor test applied can be reviewed by the labour court only with regard to gross defects. However, this does not apply if the factual situation materially changes after the agreement of the list of names (e.g. a so-called "white knight" unexpectedly saves company from closing). For the employer, the list of names is an important means of maintaining legal security with regard to the terminations pronounced in the event of major reorganisation measures. However, works councils are likely to demand higher social plan payments in return for consent to a list of names.

4. Statutory Claim to a Severance Payment?

In the future, employers will be able to offer their employees a severance payment when giving them their notice. If the employee then refrains from filing a complaint, he or she will have a claim to the severance payment.[5] This is conditional on the employer expressly basing the termination on operational reasons and expressly referring to such severance payment in the termination letter. The severance payment envisaged by the legislator is fifty percent of gross monthly salary payments per year of service; periods of more than six months are to be rounded up to a full year. The practical use of this provision is highly questionable, since it was already no problem to offer employees a severance payment when giving them notice. Pursuant to the new legislation, the employer is also completely free to decide whether it offers a severance payment or not. For example, it is conceivable that parties might – as is already the case – agree on a severance payment only in the framework of a court dispute, or that the employer might make the employee an out-of-court offer in any amount after pronouncing termination. As a result, one cannot refer to a "statutory" claim to a severance payment. This means that standard practice with regard to negotiating and concluding termination agreements is unlikely to change significantly in the future.

5. Uniform Period within which to File Complaints

To date, employees merely had to assert the lack of social justification within a three-week set period. In the future, a uniform period of three weeks for the asser-

[4] *See* Sec. Sec. 1 Para 5 KSchG new version.

[5] *Cf.* Sec. 1a KSchG new version.

tion of claims before the courts regarding the legal validity of a dismissal is to be introduced.[6] This excludes the possibility of the employee – without having filed a complaint in good time – invoking any defects such as the lack of a works council hearing or power of representation, or the termination being invalid for reasons of form, etc. months after pronunciation of the termination. The law also stipulates that the employee can only invoke the three-week period if the termination was made in writing (which is a legal requirement anyway). An exception is made for the case of pregnancy, where a complaint can also be filed retroactively if the employee in question through no fault of her own learns of the pregnancy only after the expiry of the period for filing complaints. The provision was necessary to maintain the protection against extraordinary termination for pregnant employees.

*II. Act on Part-Time Work and Fixed-Term Employment (*Teilzeit- und Befristungsgesetz – TzBfG*) - Limiting the Term of Employment Relationships*

The changes will make it easier for start-up companies and those setting up businesses to limit the term of employment relationships. In the first four years after establishment of the company, they can limit employment relationships up to a total term of four years without requiring any objective reason for doing so.[7] Until now, limitations without an objective reason were subject to a general maximum limit of two years. The provision can also be used by companies which have existed for less than four years when the legislation comes into force. However, it does not apply if companies and/or groups which already exist are merely restructured. This prevents the provision from being abused.

III. Third Book of the German Social Security Act (Sozialgesetzbuch III - SGB III)

A surprising change has been made to the arrangements for refund of unemployment benefits which older employees receive, which is particularly relevant for employers in the context of early retirements. The new provisions below were publicised only one day before the reform law was passed.

1. Temporary Tightening of Employers' Reimbursement Obligation pursuant to Sec. 147 a SGB III

In the future, the reimbursement obligation will already apply if the dismissal takes place after the employee has reached the age of 55; the borderline was previously

[6] *Cf.* Sec. 4 KSchG new version.

[7] *See* Sec. 14 Para. 2a TzBfG new version.

56. In such cases, the unemployment benefit is to be reimbursed already once the employee reaches the age of 57 – instead of 58, as was previously the case. Furthermore, the employer may have to reimburse the employee for the entire period during which unemployment benefit was drawn, up to 32 months, and no longer for a maximum of 24 months. In addition, the elements of exemption set forth in Sec. 147 a Para. 1 No. 1 and No. 6 have been altered in terms of content.

The provision of Sec. 147 a SGB III, old version, only applies if the claim to unemployment benefit arose by 31 December 2003 or the employer terminated the employment relationship by the date the law was passed (26 September 2003).

2. Gradual Repeal of Employers' Reimbursement Obligation pursuant to Sec. 147 a SGB III

Independent of the initial tightening of the reimbursement obligation, the new legislation ultimately provides for the complete repeal of the reimbursement obligation, by gradually shortening the applicable period over which unemployment benefits can be drawn (see under 3.) . However, following complicated transitional provisions, this complete repeal will take effect in 2006 at the earliest.

3. Unemployment Benefit

The duration of the claim to unemployment benefits as a rule will be limited to 12 months. In the future, only employees over the age of 56 will be able to claim for a maximum period of 18 months. This relieves the Federal Employment Agency of a considerable financial burden. For constitutional reasons, a transitional provision will be introduced for employees who already have a claim to unemployment benefit or corresponding expectancy rights. This means that the reform will not take full effect until the second half of 2006.

IV. Working Hours Act (Arbeitszeitgesetz – ArbZG)

Following the recent rulings of the European Court of Justice on the classification of standby time as working hours[8], the Government introduced various "last-minute" changes to the Working Hours Act to the legislative procedure, which were passed with the reform discussed above as part of the Agenda 2010.[9] Pursuant to this, annual average working hours, including standby service, may not exceed 48 hours

[8] ECJ, C-151/02 "*Jaeger*", of 9 September 2003.

[9] *Cf.* Art. 4 Law Reforming the Labour Market (*Gesetz zu Reformen am Arbeitsmarkt*) *(supra* note 1*)*.

per week unless the employee has given his or her consent to this (which he or she can withdraw at any time).

1. Extension of Working Hours Compensated by Time Off, without Consent

In a collective agreement or in a works or service agreement based on a collective agreement, working hours can also be extended to over ten hours per working day if the working hours regularly include a considerable amount of time when the employee is on duty or standby service. In this context, employees are deemed to be "on duty" (*Arbeitsbereitschaft*) if they must be present at the workplace and, although they are not required to perform all their regular working duties, they have certain control and monitoring duties and without further instruction can begin working at any time if they so wish. Employees are deemed to be on "standby service" (*Bereitschaftsdienst*) if for operational purposes they must stay in a certain place determined by the employer in order to begin working at their full capacity where necessary when called. However, in the future such alternative extension of working hours must be compensated by time off.[10] The time must be taken off such that the working hours do not exceed 48 per week in average over twelve months.[11] Both standby time and periods on duty must be fully included in the calculation of maximum weekly working hours. If more than twelve hours are worked on any one day, the employee must be granted a period of rest of at least eleven hours immediately after such working stint.[12]

2. Extension of Working Time not Compensated by Time Off, with Consent

In a collective agreement or in a works or service agreement based on a collective agreement, working hours can in the future also be extended to over eight hours without any time off in return (without observing a maximum limit!) if the working hours regularly include a considerable amount of time on duty or standby service and the employer ensures by special provisions that the health of employees is not put at risk.[13] An effective extension of working hours is subject to the written consent of the employee in question. The employee can withdraw such consent at any time on one month's notice. The employer may not prejudice the employee if the

[10] *See* Sec. 7 Para. 1 No. 1 ArbZG new version.

[11] *Cf.* Sec. 7 Para. 8 ArbZG new version.

[12] *See* Sec. 7 Para. 9 ArbZG new version.

[13] *See* Sec. 7 Para. 2 a ArbZG new version.

latter refuses to consent to the extension of working hours or subsequently withdraws his or her consent.[14]

3. Maximum Working Hours

In exceptional cases where working hours are extended on the basis of permission by the authorities pursuant to Sec. 7 Para. 5 ArbZG, working hours may not exceed 48 per week on average over six calendar months. This maximum limit also applies for the extension of working hours in extraordinary cases pursuant to Sec. 14 ArbZG.

4. Obligation to Furnish Proof

In the future, the employer must keep a record of which employees have consented to an extension of their working hours. This record is to be kept by the employer for at least two years.[15]

[14] *Cf.* Sec. 7 Para. 7 ArbZG new version.

[15] *Cf.* Sec. 16 Para. 2 ArbZG new version<