

EMPLOYMENT BENEFITS UPDATE

European HR Management in Troubled Times: Cutting Down Labor Costs in Germany

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Fueled by the current historic economic crisis and alarmist predictions for 2009, companies around the globe are looking for possibilities to cut costs. HR managers are being confronted with managements' demands for proposals to reduce labor costs or adapt capacities both on national and international scales, in order to prepare their respective companies for the challenges of the rough seas of global recession. To accomplish these goals in Germany, a whole range of instruments is at the HR management's disposal. This Client Alert offers a cursory overview of these instruments and is meant to serve as a basis for further considerations in the context of the individual circumstances.

Cutting direct personnel costs

The most immediate cost-cutting measures relate to direct costs for wages, salaries, bonuses and fringe benefits. From a German HR management perspective the following legal instruments can be available.

- **Collective bargaining:** In Germany, the level of fixed remuneration and fringe benefits is often directly or indirectly determined in union tariff agreements. In an agreement with the respective union, the related costs can be reduced quite effectively. Our recent experience shows that unions are increasingly prepared to grant concessions tailored for the individual business in times of crisis (e.g.: suspension of tariff salary increases,

waiver of one-off tariff payments). Transparency and creativity at the negotiation table are key for a considerable result in this respect.

- **Individual agreements:** In principle, employer and the individual employee can agree on the reduction of remuneration and benefits. In these times of crisis, the willingness of individual employees to agree to reductions in return for a safe job is increasing. The downside of this instrument obviously is, that agreement must be reached with all employees individually. Moreover, an individual reduction of salary entitlements which are based on collective bargaining agreements or works council agreements is not possible without the union or works council approval as a general rule.

- **Unilateral cutback of variable payments:** Variable payments that are subject to specific levels of target achievement are likely to be lower in times of poor economic results. German law also recognizes the possibility to unilaterally shorten variable payments if the underlying promise is subject to voluntariness or so-called revocation caveats. The legal requirements for such caveats are strict. It must be crystal clear for the employee that the variable payments are voluntary payments by the employer which are not a direct compensation for work.

- **Unilateral cutback of fixed payments:** If employer and individual employee cannot agree on a salary reduction, the employer may consider to unilaterally reduce the salary or other payments by way of a so-called “dismissal for change” (*Aenderungskündigung*). Validity of such dismissal for change must be based on solid grounds. The requirements are strict. In practice, the unilateral reduction of compensation must, in most cases, be inevitable to avoid the employer’s financial collapse.

Cutting pension costs

A material portion of labor costs often results from pension promises given to employees. The financial exposure may be reduced by cutting existing entitlements and/or by restructuring the applicable pension schemes.

- **Reducing pension entitlements:** In Germany, pensions can be promised either on individual or collective basis. As a general rule, pension promises may only be shortened by using the same legal basis on which the original promise has been given (e.g. promises based on works council agreements may only be reduced by means of a new works council agreement). Any detrimental change of existing pension promises requires a justifying reason. Broadly speaking, the more far-reaching the envisaged reduction, the stronger the requirements for the justifying reason. A cut of past-service entitlements will only be possible if the company is on the edge of insolvency.
- **Restructuring pension schemes:** In addition to reducing existing promises, the entire scheme can be restructured. Closing a scheme for new hires is generally possible at any time without the need for a justifying reason. To the extent that a scheme restructuring affects already existing promises, the principles outlined above apply. It can be possible, however, to reduce pension costs without reducing benefit levels by making

use of recently introduced scheme structures, which put a stronger emphasis on the contribution side than – as traditionally was the case in Germany – the benefits side.

Adapting working time

Another screw that can be turned to reduce costs is the adaptation of capacities. In this respect, HR managers in Germany might consider the following:

- **Using flexible working time schemes:** Times of a reduced demand for labor offer the option to dissolve existing overtime accruals on working time accounts. Flexible working time schemes can also provide for possibility to accrue considerable time debts without the need for any immediate compensatory measures. Introduction and amendment of flexible working time schemes are subject to mandatory co-determination by works councils; however, as the financial impact for employees is limited and such scheme is an enduring measure to meet the negative effects of the crisis, our experience shows that works councils are ready to consent to flexible working time provisions.
- **Short-time work:** Lately, Germany has seen an increasing number of companies fighting the economic crisis by implementing short-time work schemes. As an alternative to a mere reduction of working hours, German law recognizes the possibility of subsidized short-time work (“*Kurzarbeit*”) in case of significant but temporarily reduced work load. Under such scheme, employers may be granted supplement payments from the Employment Agency if a few formalities are respected. Once the introduction of subsidized short-time is agreed with the works council or the individual employees (if no works council exists), working time may even be reduced to zero. The Employment Agency will compensate the employees for the hours not worked with a maximum of roughly

two thirds of their last net income. The employer must bear both employer and employee contribution to the statutory social insurance scheme. Works councils and/or unions quite commonly tie their approval to short-time work on additional ramp-up payments by the employer. In order to increase the attractiveness of subsidized short-time work and avoid redundancies, the German legislator has now increased the maximum duration of state-subsidized short-time work to 18 months. Furthermore, a revision of the employer's "social-insurance-burden" is underway.

- **Extended plant holidays:** In principle, employers in Germany can impose collective plant holidays, subject, however to the rules of the German Holiday Act and to adherence with statutory co-determination rights of the works council.

Adapting workforce

Adapting the size of the company's workforce can be viewed as the "last resort" of personnel related cost cutting measures. Depending on the circumstances it can be a material and fast element of an effective cost reduction strategy.

- **Temporary staff/contract workers:** An easy way to reduce a workforce is to terminate contracts with lease employee providers and to refrain from renewals of fixed-term contracts. For the latter the strict rules of the Part-Time and Fixed-Term Employment Relationships Act must be observed.

- **Outsourcing:** Outsourcing of certain functions, business or production processes can well be used as a means to reduce labour costs. In order to achieve this objective the German law implementing the EU Acquired Rights Directive must be carefully considered both in respect of the provider selection and the contractual implementation of the outsourcing as such.

- **Redundancies:** As ultima-ratio, a reduced work load may lead to redundancies and mass dismissals. German statutory law sets high standards for the validity of dismissals for redundancy reasons. Further restructuring obstacles may arise e.g. from union tariff agreements. If the planned redundancy measure constitutes a material change of operations, an agreement with the works council must be negotiated and measures to mitigate hardships for the affected employees must be agreed. The latter may significantly delay the redundancy procedure and enhance implementation costs.

As a matter of course, the above can only give you a rough idea regarding the alternatives and options you might consider in respect of labour costs in your German businesses. Your business has an unique environment which will present individual opportunities from the HR management perspective. No doubt, you will profit from a careful analysis to find the best of those opportunities for your business in Germany.

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