

## I. Restructuring and M&A

### 1. Key terms

In order to understand the employment law aspects of restructuring projects, it is essential that you are familiar with the **key employment law terms**, especially as there are terms and distinctions in Germany that may seem somewhat peculiar to a foreign observer. For example, one important distinction is that between an **operation** and the **company**. Also, the question of whether someone is an **employee** or an **independent contractor** can play an important role in a restructuring project. 1

#### 1.1 Employers and employees

The parties to the employment contract are the employer and the employee and the contract is binding on them together. 2

##### (a) Employee

An employee is defined as any person who provides services to another person or a company and in doing so is **personally dependent**. Personal dependency is usually deemed to exist when the employee must perform his work in accordance with **instructions** from the employer and within the employer's work organisation (for details of the differences between an employee and an independent contractor, see I. 1.1 (b) below). 3

An employment relationship is always based on an **employment contract**. 4 In practice, there should always be a written employment contract. However, an employment contract can come into existence without there being any written agreement, for example if the contract is concluded orally. In fact, an employment contract can come about based solely on the parties' behaviour, for example if the employee actually commences work with the employer's knowledge and intent.

Employment contracts usually contain **clauses** on the following aspects of 5 the employment:

- the name and the address of the employee and the employer;
- the commencement date of the employment;
- the place of work;
- a short description of the employee's duties or position;
- the remuneration, including other benefits such as bonuses or other elements of remuneration (e.g. company car) and the date they are due/payable;
- the (weekly/monthly) working time;

- the number of days of annual holiday;
- the notice period;
- a probation period;
- in some cases, a general reference to collective bargaining agreements.

- 6 **Members of the management board** of an AG and **managing directors** of a GmbH are not considered to be employees. They are considered to be part of the employer. In Germany, **independent contractors** (for details, see I. 1.1 (b) below) are not considered to be employees, either.
- 7 These groups of persons **do not enjoy protection against unfair dismissal** under the KSchG, as this only applies to employees. It is therefore not necessary for any reasons to be stated to terminate a service contract with a management board member, a managing director or an independent contractor. Their contracts can be terminated subject to the contractually agreed or statutory notice period without stating any reason. By contrast, termination of an employment contract must be justified by a reason – either an operational reason or a reason relating to the employee's person or behaviour – providing the conditions for the applicability of the KSchG are met (for details on this, see I. 2.1 (d)).

**(b) Difference between employees and independent contractors**

- 8 In Germany, the distinction between employees and independent contractors (e.g. freelancer) is particularly important.
- 9 The question of whether a person is an employee or an independent contractor is decisive as regards **protection against unfair dismissal**. Unlike employees, independent contractors are not protected under the KSchG. Therefore, no particular reason is required to terminate an independent contractor's service contract. This means that the distinction between employees and independent contractors can play a key role when restructuring involves a headcount reduction.
- 10 In addition, the question of whether someone is an employee or an independent contractor also affects how **statutory social security** and **wage tax** is handled. For an employee, the employer must transfer the statutory social security contributions and wage tax to the competent authority. An independent contractor, on the other hand, does not have to pay any statutory social security contributions and it is not the employer that is responsible for transferring the income tax, but the independent contractor himself.
- 11 The central factor defining an independent contractor is that he performs the agreed services **working independently**. By contrast, an employee is characterised by his personal dependency on the employer. An employee performs his work in accordance with the employer's **instructions** and within its work organisation.

Check list – independent contractor vs. employee	12
--	----

The following criteria are decisive for a contract to be considered a service contract with an independent contractor:

- No content-related orders or instructions regarding the way in which tasks are completed:** the independent contractor relationship is characterised by the independent contractor having to perform (contractually agreed) services but being free to decide how this is done.
- Free to decide when and where services are provided:** typically, an independent contractor can decide for himself when and where he performs his contractual obligations.
- No obligation to devote entire work capacity:** as a self-employed person, an independent contractor can work for several clients/customers.
- No obligation to perform the services himself:** employees are obliged to perform the contractual service themselves. If a contractor is able to delegate tasks to his own employees, this is a sign of being self-employed.
- Not closely integrated within the operation's organisation:** typically, classification as an independent contractor requires that the independent contractor is not closely integrated within the employer's operation's organisation.
- No agreement on protective provisions under employment law:** an independent contractor does not benefit from the same social protection as an employee. This means that he receives his fee only for services actually rendered (i.e. receives no remuneration for holiday or illness, for example).

---

It is not the content of the contract that is decisive, but rather **how the contract is actually performed**. If the content of the contract contradicts performance of the contractual relationship in practice, it is the actual performance of the contract that is decisive. Contracts of independent contractors must thus **be implemented as such** in practice. The company must depart from the provisions of the contract when employing the independent contractor; otherwise there is a risk of the latter actually being considered as an employee.

### (c) Executive employees

Executive employees are a special group of employees, with several aspects under employment law applying specifically to them. An employee must perform entrepreneurial managerial duties in order to be classified as an executive employee.

- 15 Pursuant to sec. 14 para. 2 KSchG, an executive employee is an employee who
  - is authorised to hire and dismiss employees employed at the operation without consultation; or
  - has a general power of attorney or special commercial power of attorney; or
  - regularly carries out other duties, for the most part without instructions, which are of significant importance for the existence and development of the company or an operation.
- 16 Executive employees do not participate in works council elections. They are entitled to form their own, independent, representation of interests – an **executive employees representative committee**.
- 17 Furthermore, under the KSchG they enjoy only **limited protection against unfair dismissal**. In a court proceeding on the validity of a dismissal, the employer can apply to the court, without giving reasons, for the employment relationship to be terminated. By the judicial decision, the employment relationship is then terminated against **severance payment**.
- 18 The court can determine an amount of up to 12 monthly incomes as a severance payment. If the employee is 50 years old or older and the employment relationship has existed for at least 15 years, the court can determine a severance payment of up to 15 monthly incomes. If the employee is 55 years old or older and the employment relationship has existed for at least 20 years, the court can determine a severance payment of up to 18 monthly incomes.

#### (d) Employer

- 19 The term “employer” is much easier to explain than the term “employee”: an employer is a person or a **company** employing at least one employee. For example, a **GmbH or an AG** are legally classified as employers if one or more employees are employed with them.

### 1.2 Operation, company and group

- 20 Under German employment law, the terms **operation, company and group** describe defined types of organisation. A distinction must be made between these types of organisation, as they can lead to differing legal consequences in the event of a restructuring.

#### (a) Operation/part-operation

- 21 German case law defines an operation as an organisational unit within which the proprietor, acting alone or together with his employees, continuously pursues a certain work-related objective using tangible and in-

## Key terms

## Rz. 27 I 1

tangible assets. The main defining feature is that the operation must have a **common organisation**. It must have a **management panel** which can make significant decisions on staffing and social matters independently. Part-operations are different from operations, as they do not have an independent management panel.

As a rule, an operation can be deemed to be **offices** or a **factory** of the company. For example, if a company has its headquarters in Frankfurt and also has a production site in Hamburg (with an independent management panel), from a legal perspective the company has two operations. 22

The term “operation” is important within the context of establishing **works councils**. It is also extremely relevant in the area of protection against unfair dismissal, as the KSchG only applies to operations which normally have more than 10 employees. 23

#### (b) Company

As regards employment contracts, the term “company” has the same meaning as the term **“employer”**. An employment contract is always concluded between the employee and the company, not the operation, i.e. the company is the AG or GmbH. One company can comprise several operations. This means that the company is a larger organisation than an operation. A company works council must be established at company level if the company has more than one operation that has a local works council. 24

#### (c) Group

A group is formed when one or several legally independent **companies are combined** under a common management of a controlling company. For example, two GmbHs can be combined under the common management of an AG. In employment law, the term “group” is primarily important for the establishment of supervisory boards. Group works councils can also be established. 25

### 1.3 Works council and works council agreements

Essentially, employees' co-determination rights are exercised by the works council, which in Germany is the employees' representative body at operation level. 26

#### (a) Establishing works councils

Works councils are established **at operations** (for further information on the term “operation” see above I. 1.2 (a)). The prerequisite is that at least **five employees** are normally employed at the respective operation (sec. 1 para. 1 s. 1 BetrVG). The works council is elected by the employees at the 27

operation. Once the works council has been established, works council elections are held regularly **every four years**.

- 28 The employees of an operation are not legally required to establish a works council. However, **works council elections** can be initiated by only a few employees, or by a trade union. Even if the majority of employees at an operation are against the establishment of a works council, they are ultimately not in a position to prevent this from happening.
- 29 The works council is made up of employees at the operation. The **number of members of the works council** depends on the number of elective employees employed at the operation. For example, the works council of an operation which normally has 50 elective employees has three members. If the operation has 8,000 employees, the works council comprises 35 members (sec. 9 BetrVG).
- 30 At company level, a **company works council** must be established if there is more than one works council within the company. The works councils delegate members to the company works council. However, the company works council does not perform the tasks of the works councils. It is responsible only for matters relating to the entire company or to more than one operation that cannot be dealt with by individual works councils within their operations. In this respect, it is also responsible for operations which do not have a works council.
- 31 In addition, a **group works council** can be established. However, establishing a group works council is not mandatory under the BetrVG. The responsibility of the group works council is governed by the same principles as that of the company works council, i.e. it is responsible for matters which relate to the entire group or to more than one group company and cannot be dealt with by individual company works councils.

#### **(b) Responsibilities of the works council**

- 32 The works council's co-determination rights and participation rights are set out in the **BetrVG**, which confers upon the works council extensive co-determination rights in social, personnel and economic matters.
- 33 **Social matters:** The works council has substantial rights with respect to social matters unless statutory provisions or collective bargaining agreements apply. The employer cannot implement any changes or measures with regard to these social matters without the works council's consent. According to sec. 87 BetrVG, 13 issues are deemed to be social matters. The following matters are important in practice:
  - The general order of the operation and the conduct of the employees in the operation;
  - The beginning and end of the daily working hours;

Key terms	Rz. 39 <b>I 1</b>
-----------	-------------------

- A temporary extension or reduction of normal working hours in the operation, e.g. the implementation of short-time work;
- The implementation of technical devices suitable for monitoring employees' conduct and performance;
- The basic rules on remuneration, in particular implementation of new remuneration plans or policies.

If an agreement cannot be reached between the employer and the works council with regard to such topics, both can appeal to the conciliation board. This board is composed of an equal number of employer's and works council's representatives with a neutral chairman. The decision of the conciliation board is binding on both parties. 34

**Personnel matters:** By law, the company must inform the works council about all general and individual personnel matters (such as personnel planning, manpower requirements and individual measures). If the company has more than 20 employees, the consent of the works council is required to **hire or transfer** an employee. If the works council refuses to grant consent, the employer has to apply to the labour court. The court can issue a decision in lieu of consent by the works council. According to sec. 102 BetrVG, the works council has to be consulted on individual dismissals (for details, see I. 2.1 (a)). 35

**Economic matters:** The works council's co-determination rights for economic matters are of particular importance for restructuring measures. In companies that normally have more than 20 employees, the works council has co-determination rights in the event of **changes to the operation**. If the prerequisites are met in such cases, the works council can demand that the employer negotiates a reconciliation of interests and a social compensation plan (for details, see I. 6.2 and 6.3). 36

Additionally, the works council has certain statutory tasks, such as monitoring the company's compliance with statutory labour law requirements and dealing with individual complaints. The employer has to inform the works council and provide all relevant documents so that the works council may carry out its responsibilities under the BetrVG properly. 37

### (c) Co-determination via works council agreements

Works council agreements are an important instrument by which co-determination rights can be exercised (sec. 77 BetrVG). They are agreements between the employer and the works council documenting the results of their negotiations. 38

Works council agreements apply **directly and mandatorily** to the employees at the operation. They can establish direct claims of employees against the employer. Works council agreements must be documented in writing by the works council and the employer and must be signed by both parties. They must be displayed in a suitable place at the operation. 39

**(d) Expenses of the works council**

- 40 The members of the works council are not entitled to any additional remuneration. They receive remuneration in line with that of comparable employees at the operation. However, works council members are entitled to be **released from their duty to work** when they have to fulfil tasks and duties in their capacity as works council members (sec. 37 BetrVG).
- 41 Additionally, the employer is obliged to bear **all costs** in connection with the works council's tasks and to reimburse the works council and its members for necessary expenses. In general, reimbursement is due for all costs and expenses which are necessary to enable the works council to perform its tasks properly. Expenses of the works council's activities to be borne by the employer include the following:
- Office premises, materials (e.g. desk, paper, pens, computer, telephone) for meetings, consultations and day-to-day management;
  - Training courses (often provided by trade unions) for the training of works council members;
  - Lawyers' fees incurred in connection with the fulfilment of works council's tasks.

**1.4 Co-determination at company level**

- 42 In addition to the co-determination rights of employees exercised through the works council, the company works council and the group works council pursuant to the BetrVG, there is an additional form of co-determination by employees in Germany – membership on the **supervisory board**.
- 43 However, not every company necessarily has a supervisory board. This depends on the **type of company** and the **number of employees** who work there.

**(a) Supervisory board pursuant to the DrittelnG**

- 44 The DrittelnG applies only to companies which are constituted, for example, as an AG, a GmbH or a KGaA (partnership limited by shares). Another prerequisite is for the company to regularly employ more than **500 employees**.
- 45 Pursuant to the DrittelnG, **one third** of the supervisory board is made up of employee representatives, who are elected by the employees. It is this proportion (one-third) which gives the DrittelnG its name.

**(b) Supervisory board pursuant to the MitbestG**

- 46 Alternatively, the supervisory board can be formed pursuant to the MitbestG. The MitbestG applies if the company regularly employs more than

Key terms	Rz. 52 <b>I 1</b>
-----------	-------------------

**2,000 employees** and is constituted, for example, as an AG, a GmbH or a KGaA (partnership limited by shares).

Unlike under the DrittelbG, **50 %** of the members of a supervisory board formed pursuant to the MitbestG are **employee representatives**, who are elected by the employees or delegates. The other half of the members of the supervisory board is made up of shareholder representatives. However, the MitbestG provides that in the event of a stalemate, the supervisory board chairman has a double voting right. In the event of a dispute, the supervisory board chairman is elected exclusively by the shareholder representatives. As a result, this makes it possible for the interests of the shareholders to be enforced in the supervisory board even against the votes of the employee representatives. 47

### 1.5 Trade unions, employers' associations and collective bargaining agreements

In practice, collective bargaining agreements play a key role in determining the terms and conditions of employment, also in connection with restructuring measures. 48

**Collective bargaining agreements** are agreements between a trade union and an individual employer (company collective bargaining agreement) or between a trade union and an employers' association. Collective bargaining agreements can contain comprehensive provisions governing the conditions of employment of the employees (e.g. salary, working hours, holiday, notice periods). In addition, collective bargaining agreements can also be concluded for specific situations. For example, a collective bargaining agreement ruling out dismissals for operational reasons for a certain period can be concluded to safeguard employment. Within the context of restructuring projects, collective bargaining social compensation plans can also be significant (for details, see I. 6.3 {f}). 49

**Trade unions** are associations of employees who join together in an organised union in order to represent the interests of the employees against employers and employers' associations. Trade unions are industry-specific and focus on specific areas of the economy. For example, in Germany the trade union for the metalworking industry is *IG Metall* and the trade union for the service industry is *ver.di*. 50

An **employers' association** is an association of different employers within a certain industry in order to ensure their interests are represented against the trade unions. For example, the employers' association *Gesamtmetall* is the counterpart to the trade union *IG Metall*. 51

The main task of the trade unions is to conclude collective bargaining agreements with the employer or an employers' association. To encourage an employer or employers' association to conclude a collective bargaining

agreement, the trade union can call on employees to fight for their rights as employees, for example by going on **strike**. Strikes are also possible in the context of restructuring projects, particularly to bring about a collective bargaining social compensation plan (cf. I. 6.3 (f) below).

## 2. Basics of a dismissal

- 53 The process of restructuring can frequently lead to **dismissals for operational reasons**. Therefore, a fundamental understanding of dismissals procedures is one of the basic requirements for any consultant or human resources manager dealing with restructuring.

### 2.1 General requirements

- 54 To understand the specifics of a dismissal due to operational reasons (see following I. 2.2), it is essential to be familiar with the general requirements of a dismissal.

#### (a) Hearing of the works council

- 55 In operations where a works council exists, the works council must be notified in advance about the intended dismissal (sec. 102 BetrVG). The employer has to **inform the works council** about all relevant facts with regard to the dismissal and the affected employee (e.g. name, age, years of service, severe disability, alimony obligations, applicable notice period, intended termination date, reasons for the dismissal). Above all, the employer has to provide the works council with comprehensive information about the circumstances upon which the intended dismissal is based. It is strongly recommended to conduct the works council hearing in writing in order to prove that the works council was properly informed.
- 56 Subsequent to notification by the employer about the intended dismissal, the works council can give its comments on the reasons for the dismissal within one week. If the employer does **not duly observe** the notification process, the dismissal is **legally void** if the employee challenges the validity of the dismissal before a labour court.
- 57 If the works council is **properly informed** by the employer, the works council can respond in different ways:
- The works council can **give its consent** to the dismissal or take no action within the one week period. If the works council takes no action during the one week period, its consent to the notice of termination is deemed to be given by operation of law. Nevertheless, even if the works council gives its consent, the validity of the dismissal is subject to the decision by the labour court if the employee files a law suit to challenge the dismissal.

## 6.6 Sample employment documents

### (a) Reconciliation of interests

#### 299 Interessenausgleich

zwischen

der A GmbH, vertreten durch ihre Geschäftsführer Herrn X und Herrn Y, Bahnhofstr. 1, 60329 Frankfurt

– im Folgenden „Gesellschaft“ –

und

dem Betriebsrat Frankfurt der A GmbH, vertreten durch den Vorsitzenden des Betriebsrats, Herrn Z, Bahnhofstr. 1, 60329 Frankfurt

– im Folgenden „Betriebsrat“ –

#### Präambel

Am 10. Mai 2011 wurde den Mitarbeitern der Gesellschaft bekannt gegeben, dass das Management der Holding AG beschlossen hat, die Produktion von optischen Medien zum 31. August 2011 aufzugeben.

In der Niederlassung Frankfurt ist von dieser Entscheidung die Abteilung OM betroffen. Die Gesellschaft hat mitgeteilt, dass es unvermeidbar ist, diese Abteilung infolge der Entscheidung der Holding AG stillzulegen.

Deshalb wird folgender Interessenausgleich geschlossen:

#### § 1 Stilllegung der Abteilung OM

(1) Zwischen den Betriebspartnern besteht Einigkeit darüber, dass die Abteilung Optische Medien (OM)

#### Reconciliation of interests

between

A GmbH, represented by its managing directors, Mr X and Mr Y, Bahnhofstr. 1, 60329 Frankfurt

– hereinafter “Company” –

and

the Frankfurt works council of A GmbH, represented by the chairman of the works council, Mr Z, Bahnhofstr. 1, 60329 Frankfurt

– hereinafter “Works Council” –

#### Preamble

On 10 May 2011 it was announced to the employees of the Company that the management of the Holding AG decided to abandon the production of optical media as of 31 August 2011.

At the Frankfurt branch this decision affects the OM department. The Company informed that it is unavoidable to close this department as a result of the decision by the Holding AG.

For this reason, the following reconciliation of interests is concluded:

#### Sec. 1 Closure of OM department

(1) The Company and the Works Council agree that the Optical Media (OM) department of the Com-

- except for pension scheme attached in an appendix no other pension schemes apply to the employees to be transferred;
- the seller has no disputes with trade unions or works councils, neither are there any existing or imminent disputes with the employees to be transferred except for the pending legal proceedings with the employees to be transferred listed in an appendix;
- the seller has fulfilled all obligations in connection with this transaction under German employment law, in particular all obligations under the BetrVG and under collective bargaining agreements.

#### 7.4 Sample employment documents

##### (a) Due diligence request list – employment matters

No.	Question	Document/ Information not available	Comment
1	Number of employees per end of 2011; an overview indicating their allocation to the various operations of the companies in Germany		
2	List of all employees (including executive employees) in the various companies, indicating their age, date of first employment, function, nationality (if applicable: residence and/or working permit status), gross remuneration during the previous calendar year, working hours (full-time/part time), accrued flexi-time accounts, unused vacation for previous years, temporary employees, employees with limited term contracts, trainees and employees in maternity leave		
3	Service agreements (including amendments, side letters and other agreements e.g. post-contractual non-compete covenants) of the managing directors, other managers and key employees whose gross annual remuneration exceeds EUR 100,000		
4	Any documentation regarding the remuneration system (fix/variable/employees covered), information on any other incentive or recognition system		

329

## Glossary

### English

Act against Unfair Dismissal  
 Act for Co-determination of Employees on Supervisory Boards  
 Act for One-Third Participation of Employees on Supervisory Boards  
 Act on Limited Liability Companies  
 affiliate/affiliated company  
 alimony obligation  
 appeal  
 application  
 assignment of other duties or responsibility  
 authorised officer  
  
 bailiff  
 blocking period  
 breach of contract  
 business secrets  
  
 cancellation agreement  
 case law  
 chairman of the conciliation board  
 to challenge the validity of a dismissal  
 al/to file/bring an action against dismissal  
 change in (legal) form  
 change to the operation  
 Civil Code  
 civil court  
 claim  
 claim for damages  
 Code of Civil Procedure  
 co-determination at company level  
  
 co-determination rights  
 collective bargaining agreement

### German

Kündigungsschutzgesetz  
 Mitbestimmungsgesetz  
 Drittelpartizipationsgesetz  
 GmbH-Gesetz  
 Verbundenes Unternehmen  
 Unterhaltpflicht  
 Berufung  
 Anwendung  
 Versetzung  
 Prokurst  
  
 Gerichtsvollzieher  
 Sperrzeit  
 Pflichtverletzung  
 Geschäftsgeheimnisse  
  
 Aufhebungsvereinbarung, -vertrag  
 Rechtsprechung  
 Vorsitzender der Einigungsstelle  
 Kündigungsschutzklage erheben  
  
 Formwechsel  
 Betriebsänderung  
 Bürgerliches Gesetzbuch  
 Amtsgericht  
 Klage  
 Schadensersatzanspruch  
 Zivilprozeßordnung  
 Mitbestimmung auf Unternehmensebene  
 Mitbestimmungsrechte  
 Tarifvertrag