

A Trap for Employers: The Post-Contractual Effect of Voluntary Works Agreements

Problem

Last year the Federal Labor Court handed down several decisions that more and more limited the options of employers to make the terms and conditions of employment more flexible, options that are urgently needed in particular at the present time. We had previously reported on problems related to the structuring of individual employment agreements in our Newsletter of 4/08. However, even employers who agreed to discretionary payments under the terms of a works agreement under the assumption that they would be able to unilaterally terminate such payments if needed are now experiencing a bad surprise.

When works agreements on discretionary payments are introduced, the amount of funds available for such discretionary payments is not subject to co-determination by the works council, whereas the determination of the allocation standards is subject to compulsory co-determination. Thus, the "whether" and "how much" of such a works agreement is not subject to co-determination, while the "how" is.

For the termination of partly co-determined works agreements, such as works agreements providing for bonus payments, this meant -- as such agreements were interpreted in the past -- that they could be fully terminated without any post-contractual effect. This past consensus has now been nearly turned on its head by the Federal Labor Court: Now, this consensus holds only if the employer is subject to a collective bargaining agreement and has agreed to discretionary payments in addition to those provided for in the collective bargaining agreement.

Federal Labor Court decision of August 26, 2008 (1 AZR 354/07)

The employer in this case had entered into a works agreement which provided, among other things, for payment of an annual bonus (Christmas bonus) under certain conditions. The works agreement was terminated on December 31, 2001. Thereafter, the employer no longer paid a Christmas bonus. The Labor Court and Regional Labor Court denied a complaint for payment of a Christmas bonus for the year 2005.

Both courts reasoned that such a works agreement providing for discretionary payments by the employer involved a so-called "partly co-determined" works agreement, for which the employer can determine the amount of funds available without co-determination by the works council and for which only the specific structure, i.e., the allocation and payment schedule, is subject to compulsory co-determination under Labor-Management Relations Act § 87 (1) number 10. They found that under Labor-Management Relations Act § 77 (6), only compulsory works agreements have post-contractual effect until they are replaced by other agreements.

Accordingly, partly co-determined works agreements could -- under past case law -- be fully eliminated by termination, because the employer's determination of the amount of funds available for discretionary payments had no post-contractual effect and the question of allocation standards, which is subject to co-determination, no longer arose once there no longer was any amount to be allocated. If, however, the amount of funds avail-

able for discretionary payments was reduced by the employer in a way that affects the allocation principles for such funds did the matter continue to be subject to co-determination, allowing the works council to enforce its right to determine the allocation of the reduced budget, if necessary before a labor-management reconciliation board.

This allowed employers to fully terminate works agreements on discretionary payments at any time, without any post-contractual effect.

Now, the Federal Labor Court however differentiates between employers subject to a collective bargaining agreement and employers not subject to a collective bargaining agreement. Because employers subject to a collective bargaining agreement can enter into works agreements in any event only with respect to discretionary payments in addition to those provided for in the collective bargaining agreement, the Court held, employers may also fully eliminate such additional payments by terminating the works agreement. In this case, termination eliminates in its entirety those compensation components that are subject to co-determination in the first place.

The matter is different, according to the Federal Labor Court, if employers are not subject to a collective bargaining agreement: In this case, employers are, under applicable labor law, free to determine, and make future changes to, the entire volume of compensation paid to employees, without co-determination. Absent a collective bargaining agreement, all compensation components paid by such employers are, for labor law purposes, "discretionary," i.e., the employer is not obligated to make such payments (under a collective bargaining agreement or works agreement). As long as an employer pays any compensation at all -- which the employer will always be obligated to do under the terms of its employment agreements with individual employees -- the employer has not fully eliminated all discretionary payments from a labor law perspective, so that termination of a partly co-determined works agreement amounts to a change in the compensation structure. For this reason, such a works agreement now has post-contractual effect. According to the Federal Labor Court, this applies at least under circumstances where discontinuation of a particular type of payment would result in a change of the company's compensation structure.

Change in allocation standards

Whether a partly co-determined works agreement is actually eliminated by termination or has post-contractual effect therefore depends on whether termination of this works agreement changes the allocation standards of the company. This is not the case if all compensation components paid to employees uniformly change as a result of the discontinued payment, leaving unchanged the relative amounts of compensation paid to employees. If, for example, a works agreement simply provided for payment of a 1/13 monthly salary to each employee and (only) this additional salary payment were now discontinued, this would result in no changes in the compensation structure because the compensation of all employees would be reduced by exactly 1/13. In the case decided by the Federal Labor Court, the terminated works agreement however also provided for the payment of certain absolute amounts (vacation pay), with the consequences that discontinuation of the compensation components

Is post-contractual effect also a trap for employers subject to a collective bargaining agreement?

provided for in the works agreement would have entailed a change in the relative amounts of compensation paid to employees.

When differentiating between employers subject to a collective bargaining agreement and employers not subject to a collective bargaining agreement, the Federal Labor Court assumed that termination of the works agreement would put an end to all compensation components not provided for in a collective bargaining agreement. Because the Federal Labor Court distinguishes between compensation provided for in a collective bargaining agreement and compensation not provided for in a collective bargaining agreement, even employers subject to a collective bargaining agreement should make sure that termination of a works agreement will leave intact the relative amounts of compensation not provided for in a collective bargaining agreement. If there were, for example, separate works agreements on vacation pay and Christmas bonuses, and vacation pay involved an absolute amount, whereas the Christmas bonus was proportionate to the monthly income of each employee, elimination of one of the two works agreements would amount to a change in the compensation structure not subject to the collective bargaining agreement and thus trigger the post-contractual effect. The post-contractual effect of a collective bargaining agreement can therefore also trap employers that are subject to a collective bargaining agreement.

Practical recommendations

Employers subject to a collective bargaining agreement can extricate themselves relatively easily from the trap of the post-contractual effect by first terminating all works agreements on payments not provided for in collective bargaining agreements as of a certain cut-off date and subsequently renegotiating such payments. If, for example, an employer that is subject to a collective bargaining agreement and has entered into a works agreement providing for vacation pay of €500.00 across-the-board, as well as into an additional works agreement providing for a Christmas bonus in the amount of a 1/2 monthly salary, wanted to eliminate only one of these works agreements, the employer should, in light of the new case law, terminate both works agreements and then offer the works council to renegotiate one of them.

Because the post-contractual effect can be excluded by mutual agreement in a works agreement, employers not subject to any collective bargaining agreement, in particular, should in the future make absolutely sure that they agree to discretionary payments only if the works council agrees, in exchange, to the express exclusion of any post-contractual effect of the works agreement. This should not present a problem when new compensation components are introduced. The matter will be more difficult for existing works agreements, for which -- based upon past case law -- no exclusion of the post-contractual effect was deemed necessary. These works agreements can be eliminated only by replacing them with new works agreements, the terms and conditions of which may have to be decided by a labor-management reconciliation board.

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