Redundancy under German Labour Law

An Overview
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Hogan Lovells

Contents

Introduction

This memorandum provides an overview of the general labour law situation and the potential pitfalls with respect to substantial redundancies. It is not a substitute for a thorough legal evaluation of an intended restructuring in a particular case. Special requirements which may arise from applicable collective bargaining agreements or existing works council agreements cannot be taken into account.

Regarding the preconditions and legal consequences of the employer's decision to reduce personnel, a distinction must be made between collective labour law (employer-works council relationship – cf. no. 1) and individual labour law (employer-employee relationship – cf. no. 2).

1. Collective Labour Law

1.1 Co-determination of the works council

In companies with more than 20 employees, certain reorganizations (operational changes - *Betriebsänderungen*) require (i) the notification of the works council, (ii) an amicable reconciliation of interests (*Interessenausgleich*) and (iii) an agreement on a social plan (*Sozialplan*).

The works council must be notified in advance of any substantial operational changes which may negatively affect all or a significant part of the workforce, sec. 111 Works Constitution Act (*Betriebsverfassungsgesetz – BetrVG*). Such events notably include the cut-back or closure of an operation or a significant part thereof, for instance the closure of a department within the operation. Furthermore, the mere retrenchment of personnel (by either dismissal or by amicable termination) may constitute an operational change if a significant proportion of the total workforce is affected. However, both the closure of a part of an operation and the mere retrenchment of personnel, will only be considered as an operational change if a significant number of employees are affected by the relevant measure. The following thresholds are used to determine whether or not an operational change within the meaning of sec. 111 *BetrVG* exist:

- in an operation with generally at least 20 but fewer than 60 employees, more than five employees regularly employed in the operation are affected,
- in an operation with generally at least 60 but fewer than 500 employees, either 10% of the employees regularly employed in the operation or more than 25 employees are affected,
- in an operation with generally at least 500 employees, 30 employees regularly employed in the operation are affected.

In small businesses with up to 20 employees, at least six employees must be affected.

Employees who are prompted by the employer either to resign or to leave by way of a cancellation agreement are also counted for these purposes.

The following remarks are based on the assumption that (i) the planned downsizing of personnel is to be qualified as a substantial change of operation in the meaning of sec. 111 BetrVG and (ii) that a works council has been established in the operation concerned.

1.2. Reconciliation of interests

(a) Content and steps in the negotiation

The competent works council must be informed comprehensively about the envisaged measures. Employer and works council have to consult with each other in order to try and find amicable solutions to the social and personal matters related to the downsizing. This negotiation, should cover **issues such as timing, extent and alternatives** to all or parts of the planned reorganization. As a reconciliation of interests may have a considerable impact on the reorganization itself and as it remains (at the end of the day) the exclusive decision of the employer how to run the business and which reorganization to carry out, a reconciliation of interests cannot be enforced by the works council. The works council can only demand to be properly informed and consulted with.

However, as a consequence of this co-determination right, the works council has considerable means to delay the negotiations, e.g. by means of information requests or involving external experts. The effort for the employer in connection with such information requests etc. can be enormous.

The employer **must not start any actions** that could be regarded as the implementation of the planned changes (e.g. termination of

employment contracts), unless either a reconciliation of interests with the works council has been concluded or at least all statutorily required negotiation steps with the works council have been completed in order to reach such a reconciliation of interests.

These steps of negotiation are the following:

To begin with

- the works council and management must seriously discuss timing, extent and alternatives to all or to parts of the planned operational change.

If no agreement can be reached

- the works council or management can ask the president of the Federal Labour Office (*Bundesagentur für Arbeit*) to act as a mediator in the discussion (this step is optional and will usually not be taken).

If no agreement can be reached

- the works council or management can request that a conciliation board (*Einigungsstelle*) be established.

If no agreement on the line-up and the chairman of the conciliation board can be reached

- either party can file an application to the labour court requesting the appointment of a chairman and the determination of the size of the conciliation board by the labour court.

The conciliation board consists of an equal number of members nominated by the employer and the works council, respectively, and an external chairman, who is usually a labour court judge. Once the chairman has been appointed and the conciliation board has been set up, it will hold one (or most likely several) meetings at which the parties must argue their standpoint before the board.

Negotiations before the board are not considered to have failed until the chairman of the conciliation board confirms the final failure of the negotiations. This confirmation is recognized as the completion of the mandatory negotiation steps.

As a result, and because there is **no statutory maximum time limit for** such negotiations, this process can take **several months** (maybe up to six months or - in extreme cases - even longer), of course only if no agreement with the works council can be reached. However, if there is a good relationship with the works council or if the employer is willing to offer a generous social plan (see 1.3 below), this can be a **much quicker** process though.

(b) Consequences of a breach of the obligation to negotiate

If the employer is considering carrying out the intended reduction of the workforce without reaching an agreement on the reconciliation of interests (and social plan), the employer must be aware of the potential legal consequences of a "premature" implementation of the downsizing. There are three consequences to consider:

- **Preliminary injunction**

  It is disputed in German judicature whether or not a works council has the right to stop the redundancy process if a reconciliation of interests has not yet been negotiated. Some German labour courts grant preliminary injunctions to works councils; while others reject such applications. So it depends very much on the respective labour court competent to deal with the injunction whether or not the application of the works council will be granted or not. This must be verified in each particular case. If the labour court grants the preliminary injunction, the employer will be hindered from implementing the redundancies for a considerable period of time. This period can be one to three months if the injunction contains a "blocking period". In order to continue with the implementation process, the chairman of the conciliation board must confirm that negotiations have failed (see 1.2 (a) above).

- **Compensation for suffered hardship**

In case of a premature implementation of the downsizing plans, each affected employee is entitled to a compensation for hardship suffered as a result of the implementation, i.e. his or her dismissal (*Nachteilsausgleich*). The amount of the individual entitlement is limited by law. Each employee is entitled to a maximum of 12 months' gross salary. Older employees with many years of service can claim up to 18 months' gross salary.

Nonetheless, if a social plan regarding the downsizing is concluded at the same time (or later), the severance payments deriving from the social plan will usually be set off against the compensation for suffered hardship.

- **Regulatory offence**

  The infringement of the works council's co-determination rights may constitute a regulatory offence for which a fine of up to EUR 10,000.00 may be imposed on the employer.

1.3 Social plan

In addition to the reconciliation of interests, the employer and the works council must negotiate a social plan. In practice, the social plan is very closely linked to the reconciliation of interests. The purpose of the social plan is to ease the hardship suffered by the employees concerned as a result of the employer's redundancy plans by providing for financial compensation. Although the employer and the works council are generally free to agree on the details of such a social plan, it will certainly include for severances for the employees to be dismissed.

(a) Enforceability

In contrast to the balance of interests, the parties are not only obliged to negotiate, but **must also agree on both the overall budget of the social plan and on the criteria for distributing this budget** among the dismissed employees.

If the operational change only consists of a mere reduction in workforce without any other measures such as the closure of a department, a social plan will only be enforceable if a certain number of employees are made redundant. The relevant thresholds are met if

- in an operation with generally fewer than 60 employees, 20% of the employees regularly employed in the operation but at least six employees are made redundant for operational requirements,
- in an operation with generally at least 60 but less than 250 employees, either 20% of the employees regularly employed in the operation or at least 37 employees are made redundant for operational requirements,
- in an operation with generally at least 250 employees, but fewer than 500 employees, either 15% of the employees regularly employed in the operation or at least 60 employees are made redundant for operational requirements,
- in an operation with generally at least 500 employees 10 % of the employees regularly employed in the operation but at least 60 employees are made redundant for operational requirements.

(b) Formulas and criteria for severance payments developed in practice

Statutory law does not provide a formula on for calculating the total budget or for criteria for distributing the budget among the affected employees. However, practice has developed two standard formulas.

A usual formula taking into consideration age, seniority and monthly salary of the affected employees is as follows:

$$\frac{\text{Age x years of service x monthly gross salary}}{\text{[divisor]}}$$

The divisor usually ranges between 25 and 90, depending on the financial background of the employer, the severance payment level in former social plans (if any), the negotiating power of the

parties, the employer's ambition with regard to timing etc.

Alternatively, many social plans provide for a basic severance payment in accordance with the following formula:

Length of service x gross monthly salary x [factor]

Depending on the industry sector, the region, the economic situation of the employer and the negotiating power of the parties, the factor may vary between 0.3 and 2.5.

Furthermore, it is common that additional premiums are paid for disabled employees and for employees with alimony obligations. Therefore, the exact costs of a social plan cannot be predicted beforehand.

(c) Decision of the conciliation board

If the works council and the employer cannot agree on a social plan, the **conciliation board will determine both the budget and the criteria for the distribution**. If the board cannot reach a majority vote, the chairman has a casting vote. In addition to the customary calculation methods mentioned above (see above 1.3 b), statutory law gives certain guidelines for the conciliation board on how to determine the overall funding. *Inter alia*, the conciliation board must consider the following aspects:

- It must balance the social needs of the employees facing dismissal on the one hand and the economic justifiability for the company as a whole on the other hand.
- It must take into account the labour market prospects of the employees to be made redundant and must exclude employees from compensation payments who are offered continued employment under acceptable and reasonable conditions in another operation of the company or another company of the group and who reject such offer.
- When determining the overall funding, the conciliation board must not endanger the remaining jobs, e.g. by deciding on a social plan which puts the company at a realistic risk of bankruptcy.

(d) Transfer Company

Recently, it has become quite common to agree on outplacement measures in the event of major redundancies. German social law allows for the implementation of business reorganizations by transferring the affected employees to a so-called "transfer company" (*Transfergesellschaft*). Such a transfer company can either be set-up by the employer or, more commonly, the employer can make use of an existing transfer company.

The purposes of such a transfer company are as follows :

- The transfer of the affected employees to a transfer company brings along financial and administrative advantages for the employer by avoiding lawsuits. This is due to the fact that employees wishing to transfer to a transfer company have to enter into tripartite (voluntary) agreements, thereby accepting the termination of their employment with their former employer. As a result, the employees cannot challenge their dismissal in the labour courts. In addition, the employer can usually transfer the employees to the transfer company without having to observe the employees' notice periods which leads to a faster reduction of the workforce.
- During the term of the employment with the transfer company, the affected employees will be trained with regard to potential future jobs and will benefit from outplacement support.
- The affected employees will receive a monthly salary during the term of their employment relationship with the transfer company. In order to cover these costs (in particular the employees' salaries) the transfer company will be funded partly by the Labour Office (*Agentur für Arbeit*) and partly by the

former employer. The Labour Office pays an amount of between 60% and 67% of the last regular net monthly salary (up to a certain limit). Usually the employer pays an additional amount (e.g. the gap between the state benefits and 80% of the employee's last monthly salary). The state benefits granted by the Labour Office are limited to a maximum period of one year.

(e) Risk of Strikes

In Germany, a strike is only legally permitted if the subject matter can be part of a collective bargaining agreement (*Tarifvertrag*), i.e. an agreement between an employer/ employers' association and a trade union. **Works councils cannot call for a strike.**

Until recently, it was unanimously agreed that the restructuring of a company could not be regulated by a collective bargaining agreement as such restructuring merely falls within the competence of the works council(s) and not of the unions.

In recent years, however,, the unions have developed a strategy of responding to such redundancy programmes with strikes. In recent decisions of the Federal Labour Court this strategy was accepted as legally permissible. The competent union may thus organize a strike in order to force the employer to conclude a collective bargaining agreement containing provisions similiar to a social plan (*Tarifsozialplan*). Such collective bargaining agreements usually result in higher redundancy payments for the employees concerned.

2. Individual Labour Law

It is important to keep in mind that the employee's individual rights are not necessarily affected by the negotiations with the works council. In other words, any dismissed employee can sue the employer individually and challenge the validity of the dismissal by filing an unfair dismissal claim with the competent labour court. When filing a claim for unfair dismissal, the employee may, in particular, address the following legal issues:

2.1 Notification of the Labour Office

The employer is obliged to notify the Labour Office of an intended mass dismissal (*Massenentlassungsanzeige)*, if certain statutory thresholds are met. These thresholds correspond to those mentioned in 1.1 above, however, with the notification obligation only applying to operations with more than 20 employees.

According to the current legal situation, a failure to comply with the statutory notification obligations will lead to the invalidity of the dismissals in question. However, a senate of the Federal Labour Court has recently announced that it intends to reconsider this position, so it remains to be seen whether the current, legally very serious consequence will remain in place.

(a) Information of the works council

Before notifying the Labour Office, the employer must inform the works council in writing, in particular about:

- the reasons for the planned redundancies,
- the number and the occupational groups of the employees to be made redundanct,
- the number and the occupational groups of the employees regularly employed,
- the period of time over which the redundancies are to take place,
- the intended criteria for selecting the employees to be made redundant, and
- the criteria for calculating of any severance payments.

A copy of this written information must be sent to the Labour Office. The employer and the works council must discuss ways of preventing or limiting redundancies and mitigating their consequences. This can also be done when negotiating the reconciliation of interests and the social plan.

(b) Notification to the Labour Office

The notification to the Labour Office has to be in writing and must contain the information required by law such as, for instance, the reasons for the planned redundancies, the number of employees affected and the occupational group of the employees to be dismissed.

It is advisable to **use the forms provided by the Labour Office**. The notification must also include the comments of the works council regarding the dismissals. If the works council does not make any comments, the employer must be able to prove that the works council was duly informed at least two weeks before the notification was filed. The employer must also provide information on the progress of discussions with the works council.

2.2 General protection against dismissal

In general, any employee who has been employed for more than six months in an operation with more than 10 regularly employed employees enjoys protection against dismissal under the Dismissal Protection Act (*Kündigungsschutzgesetz - KSchG*). According to this Act, an ordinary termination must be "socially justified" to be valid. Such social justifications are:

- personal grounds
- mal-performance or mal-conduct
- business reasons.

The downsizing of an operation can justify a **termination for business reasons**. However, such a termination is only valid if the employer can demonstrate and prove that either external circumstances (such as reduction in turnover or profit, lack of incoming orders) or an internal decision of the management to reorganize the company structure leads to the elimination of jobs in the operation. The business decision itself, e.g. the employer's decision to downsize the operation, is generally not reviewed by the labour courts.

In addition, there must be **no other vacancies** for the employees within the entire company. Otherwise, such positions must be offered to the employees facing redundancy. If such a vacancy is not offered, the dismissal is invalid. In principle, vacancies in other companies in the (wider) group do not have to be considered. This means that employees can be asked to apply for such positions but there is no obligation on the part of the employer to offer these positions before giving notice.

However, even if the employer can prove the deletion of certain positions, he cannot automatically dismiss the persons working in these positions. The validity of a notice of termination due to business reasons requires a so-called **"social factor test"** (*Sozialauswahl*). This means that social criteria, i.e. age, years of service, disability and alimony obligations, must be taken into account in order to select which employees within a group of comparable employees will have to be dismissed. Comparable employees in this sense are those employees who can be instructed by the employer to replace another employee without altering his or her employment conditions. Moreover, only those employees are comparable who have the occupational competence to work on the remaining position after a short job-training (max. three to four months).

Furthermore, the employer and the works council can, along with the negotiation of a reconciliation of interests, agree upon a **list of names** of those employees to be dismissed. In this case the *KSchG* presumes that the dismissal of the listed employees is justified by operational reasons. Moreover, the correctness of the social factor test carried out by the employer and the works council is then subject to a judicial review of a very limited extent only. However most works councils are reluctant to agree to such a list of names for precisely these reasons or will demand a substantial increase in the social plan budget in return for their consent to such a list.

2.3 Special protection against dismissal

Some groups of employees enjoy special protection against dismissal. Notice of termination is invalid for **women during pregnancy** and for four months after childbirth, for employees on **parental leave** during such leave, or to **disabled employees** with a degree of disability of at least 50 (30 in some cases), unless **prior government approval** has been obtained. This process takes between one and three months, depending on the individual case and the area in which the application for consent is filed. Therefore, the delay in giving notice to these employees will be significant.

Works council members also enjoy special protection against dismissal. They can only be dismissed by extraordinary notice for cause and only with the agreement of the works council or the labour court. An exemption to this rule exists if the operation in which the works council member is currently working will be shut down completely. In case of a shutdown of an entire department, a works council member can be dismissed if the works council member cannot be transferred to another department for business reasons.

2.4 Notice periods

The applicable notice period depends on the individual employment contract. Most employment contracts refer to the statutory notice periods set out in sec. 622 of the German

Civil Code (*Bürgerliches Gesetzbuch – BGB*). The statutory minimum notice period is four weeks effective the 15th or the end of a calendar month. This means that there must be a period of at least four weeks between the effective date of termination (always the 15th or the last day of a calendar month) and the date on which the notice of termination is served on the employee. After a certain period of service with the same employer, the basic statutory notice period is extended as follows:

- one month's notice must be given after two years of employment,
- two months' notice must be given after five years of employment,
- three months' notice must be given after eight years of employment,
- four months' notice must be given after ten years of employment,
- five months' notice must be given after twelve years of employment,
- six months' notice must be given after fifteen years of employment and
- seven months' notice must be given after twenty years of employment.

In all such cases, notice of termination will always take effect at the end of a calendar month.

Individual employment contracts or applicable collective bargaining agreements may provide for **longer** notice periods.

2.5 Hearing of the works council

In addition to the negotiations with the works council on the reconciliation of interests and the social plan, and the information of the works council in the course of the mass dismissal proceeding, the works council also has to be heard with regard to each individual redundancy.

This means that the works council must be **informed comprehensively** about the facts leading to the planned **dismissal of the individual employee**. In order to be able to prove that the works council has been properly heard, it is advisable to effect the hearing (at least partially) in writing.

After the works council has been informed about the planned redundancy, it has the opportunity to comment on the reasons for the termination presented to the employer within one week.

If the works council does not react in due time, its consent to the notice of termination is deemed to be given. If the works council expresses doubts or objections to the notice of termination, the notice of termination can still be given. However, the arguments in the works council's objection will be taken into consideration by the labour court if the employee challenges the termination in court. Failure to inform the works council properly (e.g. by withholding relevant information) will also mean that the dismissal is invalid.

2.6 Court review

In practice, a high number of dismissed employees will file a lawsuit and **contest the validity of the termination** in order to obtain a (higher) severance payment or to continue their employment with the employer. The dismissed employee must file such a claim for unfair dismissal within three weeks after the receipt of the termination letter. Otherwise he or she will lose the statutory protection under the *KSchG*.

Unless the employer can establish and prove a more or less airtight case (which is difficult in practice), he will usually not risk to go through court litigation which can take two to three years at most. The financial risk for the employer is high, as in the event of a loss he would have to re-instate the employee and pay the outstanding salaries. To avoid this risk, **employers tend to settle cases for (higher) severance payments**.

Such settlements can be reached out of court through termination agreements (*Aufhebungsvertrag*) or in court (*gerichtlicher Vergleich*). Any settlement requires the consent of both parties; only in very exceptional cases can

the court impose a binding decision on the parties regarding a severance payment.

The agreement on a reconciliation of interests or on a social plan does not affect the right of each employee to contest the notice given to him or her. However, under certain legal requirements it is possible to conclude an agreement with the works council providing for special financial benefits for employees who waive their right to sue their employer because of the dismissal.

2.7 Termination agreements

The parties to an employment contract may terminate the employment relationship at any time by mutual agreement. As part of a settlement, the employee is usually paid reasonable compensation for the loss of his or her job. Again, the amounts may differ according to the reasons leading to the cancellation and the parties' potential prospects of success in a subsequent dismissal lawsuit.

Contacts

Dusseldorf

Dr. Tim Gero Joppich
Partner
T +49 (211) 1368 451
tim.joppich@hoganlovells.com

Stefan Richter
Counsel
T +49 (211) 1368 451
stefan.richter@hoganlovells.com

Dr. Justus Frank
Counsel
T +49 (211) 13 68 494
justus.frank@ hoganlovells.com

Frankfurt

Dr. Kerstin Neighbour
Office Managing Partner
T +49 (69) 96236 358
kerstin.neighbour@hoganlovells.com

Dr. Sabrina Gäbeler
Counsel
T +49 (69) 96236 358
sabrina.gaebeler@hoganlovells.com

Hamburg

Dr. Eckard Schwarz
Partner
T +49 (40) 41993 224
eckard.schwarz@hoganlovells.com

Matthes Schröder
Senior Counsel
T +49 (40) 41993 0
matthes.schroeder@hoganlovells.com

Munich

Dr. Hendrik Kornbichler
Partner
T +49 (89) 29012 227
hendrik.kornbichler@hoganlovells.com

Bernd Klemm
Partner
T +49 (89) 29012 171
bernd.klemm@hoganlovells.com

Moritz Langemann
Partner
T +49 (89) 29012 0
moritz.langemann@hoganlovells.com

Dr. Silvia Tomassone
Counsel
T +49 (89) 29012 0
silvia.tomassone@ hoganlovells.com

Dr. Lars Mohnke
Counsel
T +49 (89) 29012 480
lars.mohnke@ hoganlovells.com

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