

Covid – 19 update

Reduction of variable remuneration in respect of the Covid-19 pandemic – Questions we are being asked in Germany

October 2020

The Covid-19 pandemic has caused immense economic damage. During the first quarter of 2020 only, German economic output dropped by 10.1%, leading to considerable revenue losses for German companies. This puts companies under pressure to identify and exploit savings potential. In this context, the idea of reducing bonus payments is discernible, as bonuses are regularly linked to the success of the company. But which legal guidelines must be observed when reducing bonus payments? How should the works council be involved in this context? Under which circumstances can bonus parameters be adjusted unilaterally or with the works council? And how can companies adjust their bonus plans to prepare for future crises? The following Q&A provides an overview regarding the most important questions.

Question	Answer
What are the general legal principles to be observed when reducing bonus payments due to poor company results?	<p>There are basically two different types of bonuses that are agreed in Germany, a target based bonus and a bonus payment based on the employer's discretion.</p> <p>a) A target based bonus is subject to the achievement of specific targets to be met. Agreed targets on which the bonus depends are in general company targets as well as personal targets. In case targets have been agreed for one bonus year, the bonus calculation is based on the target achievement of the agreed parameters. This may also include chances for the employer reducing a bonus payment in case of specific circumstances, for example due to poor company results, but only in case this is clearly defined in the bonus agreement. If not, the employer can in general not deviate unilaterally from the agreed parameters, which form the evaluation framework for the assessment.</p>

Question	Answer
	<p>b) In case that a discretionary bonus payment has been agreed, the legal basis for the determination of the bonus amount is section 315 of the German Civil Code. The employer is free to define the criteria according to which the bonus is to be determined but the determination of concrete values must be based on the principle of <i>reasonable discretion</i> ('<i>billiges Ermessen</i>'). A valuation of the bonus complies with the principle of reasonable discretion if it takes into account all relevant aspects and circumstances and balances the interests of both parties appropriately. The most important factors to be included in this valuation process are those deriving from the bonus and target agreements, as these are the factors that bind the exercise of the employer's discretion.</p>
<p>Is there specific German case law that provides for more details in case of poor company results?</p>	<p>In the wake of the financial crisis of 2008, the German Federal Labour Court ('<i>Bundesarbeitsgericht</i>') issued several rulings assessing the impact of extraordinary economic crises on bonus payments. In principle, a reduction due to poor company results is possible when exercising <i>reasonable discretion</i> according to section 315 of the German Civil Code, as long as the general limitations are observed (see above). Critical cases, however, are those where employees achieve their personal targets, but the determination of the company factor results in no bonus being paid out or where no bonus funds are made available at all.</p> <p>According to the German Federal Labour Court ('<i>Bundesarbeitsgericht</i>') a full bonus reduction ('<i>Null-Bonus</i>') can be considered by the employer if exceptional circumstances apply. Such exceptional circumstances apply if the continued existence of the company during the fiscal year was threatened by circumstances beyond the control of the employer and its employees. In this context, the court did not consider a loss of EUR 300 million to be exceptional. According to the case law from the financial crisis, exceptional circumstances can only be assumed from a value of EUR 1 billion upwards. The courts also took into account whether the respective banks had made use of massive financial government support during that time.</p>
<p>Can the effects of the Covid-19 pandemic be used as justification for the (full) reduction of the bonus?</p>	<p>In our opinion, the case law from the financial crisis can be applied with good arguments to the economic crisis caused by the Covid-19 pandemic. If a company gets into considerable economic imbalance due to the pandemic, this is, like the financial crisis, an event beyond the company's control. For a full reduction of the bonus, the employer must establish that the loss of sales actually threatened the existence of the company. However, this is not the case if this financial year ends with losses but next year profits can be expected again. To prove this, it may be argued under certain circumstances that the company benefited from government support programs. On the one hand, these can be direct</p>

Question	Answer
	government support programs that the company used. On the other hand, the use of government-subsidised short-time working (<i>'Kurzarbeit'</i>), can have similar effects as Covid-19 related direct subsidies if it applied for a considerable time and to large parts of the workforce.
What special limitations do apply to banks?	In principle, the same rules and limits for the exercise of discretion in determining the bonus also apply in banks. However, the systemic importance of the capital market will have to be taken into account when balancing the mutual interests (cf. section 7 of the Remuneration Regulation for Institutions). This applies in particular if the existence of the bank is threatened. For this reason, the European Central Bank and the European Banking Authority have already called on the institutions they supervise to be conservative with bonus payments for the 2020 fiscal year.
How must short-time work (<i>'Kurzarbeit'</i>) be taken into account in the exercise of the employer's discretion?	<p>In addition to considering massive government-subsidised short-time work (<i>'Kurzarbeit'</i>) as a reason for the (full) reduction of the bonus, short-time work (<i>'Kurzarbeit'</i>) may also have to be taken into account in the employer's discretion.</p> <p>Under certain circumstances, the employee may not have been able to achieve his or her personal performance targets due to the short-time work (<i>'Kurzarbeit'</i>). In practice, this will be the case in particular if the valuation in the target agreement is linked to the achievement of numerically specified targets (e.g. sales of certain quantities, billing of certain number of hours, etc.).</p> <p>In such cases, in our view, it is advisable to adjust these target achievement thresholds pro rata temporis.</p>
In which cases can the bonus parameters be adjusted unilaterally by the employer or in cooperation with the works council?	<p>The criteria on which the bonus is based can no longer be changed unilaterally by the employer if they are agreed-on in the employment contract or a works agreement. However, the alteration of the criteria may be desirable if the employer's discretion is limited – for example by a minimum bonus guaranteed in the target agreement.</p> <p>In theory, it is possible to dismiss the employee with an option to continue employment with altered conditions (<i>'Änderungskündigung'</i>). However, this is usually not feasible in practice due to the high requirements for these dismissals established by case law.</p> <p>If necessary, however, the criteria can be adjusted in cooperation with the works council. In practice, this will often only be possible if the employer offers the works council something in return. In times of crisis it is conceivable, for example, that the employer may, in return, refrain from dismissals for operational reasons for a certain period of time.</p>

Question	Answer
What provisions should be included in the bonus agreements in order to prepare for future crises?	<p>In order to prepare for future economic crises, employers are well advised to evaluate and adjust current bonus policies. In this course, employers must comply with the co-determination rights of the works council.</p> <p>Ideas for provisions to adopt could be the following:</p> <ul style="list-style-type: none">– <i>Establishing of rules on when the bonus parameters will have to be re-negotiated with the works council due to poor performance of the company</i>– <i>Establishing of rules for dealing with short-time work and its impact of the individual performance during the valuation process</i>

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