

Risks of "Split Pension Formulas" – New Case Law of the Federal Labor Court

<p>Issue</p>	<p>Corporate pension plans often provide for a so-called "split pension formula." This means that for purposes of calculating pension benefits, pension plans provide for benefits at a higher rate for that portion of an employee's pension-eligible wages or salaries that <u>exceeds</u> the social security income limit (in the statutory pension insurance) than for the portion <u>up to</u> that social security income limit. The reason for the split is generally to compensate for the fact that the portion of wages or salaries exceeding the social security income limit does not entitle employees to collect pension benefits in the statutory pension insurance.</p> <p>Under German Social Security Code VI § 159, the social security income limit is generally subject to an annual increase corresponding to the rate at which gross wages/salaries per employee in the preceding year have increased from gross wages/salaries in the calendar year before the preceding year. In 2003, however, there was an unscheduled increase of the social security income limit as part of an effort to restore the fiscal health of German public pension funds. Effective as of January 1, 2003, the social security income limit was raised from €4,500.00 per month to €5,100.00 per month in all pre-unification States (see Social Security Code VI § 275c). Generally applicable law would have called for an increase to only €4,600.00 per month. This "leap" continues to have repercussions to this very day, because it provided a starting point for subsequent increases. For pension plans using a "split pension formula," this unscheduled increase of the social security income limit in the statutory pension insurance, in effect, reduces the pension claims of employees. In April 2009 this situation was addressed in two separate cases by the Federal Labor Court (BAG), whose full-text decisions have recently become available.</p>
<p>Federal Labor Court Decision dated April 21, 2009, Case no.: 3 AZR 695/08</p>	<p>In both cases decided by the Federal Labor Court, the pension-eligible plaintiffs successfully sued their employers for increased corporate pension benefits. In case 3 AZR 695/08, the company offered a pension plan in the form of a so-called general undertaking by the employer (<i>Gesamtzusage</i>). Because the pension plan provided for a "split pension formula" the unscheduled increase of the social security income limit in 2003 resulted in a substantial reduction of the plaintiff's pension benefits: While his pension benefits in the <u>statutory</u> pension insurance increased by €18.05 per month, his <u>corporate</u> pension benefits decreased by €240.00 a month.</p> <p>The Federal Labor Court agreed with the plaintiff that his monthly corporate retirement benefits should be increased.</p>

	<p>At the heart of the Court's reasoning was an interpretation of the existing pension plan: The court held that the unscheduled increase of the social security income limit in 2003 was unforeseeable and that, therefore, it was fair and reasonable to assume that, had the parties foreseen this scenario, they would have agreed on pension provisions under which unscheduled increases of the social security income limit would be disregarded for purposes of calculating corporate pension benefits. To calculate the plaintiff's corporate pension benefits in that specific case, the Federal Labor Court assumed that the social security income limit for 2006, "adjusted" for the leap in 2003, would have been €4,750.00 per month (instead of the 06 social security income limit in the amount of €5,250.00 per month provided for by law in 2006 (West)). As a result, the employer was required to pay corporate pension benefits in the amount of €873.92 per month to the plaintiff instead of the €633.92 per month previously paid.</p> <p>In its decision the Federal Labor Court however also clarified that any additional pension benefits in the statutory pension insurance received by an employee as a result of the unscheduled increase of the social security income limit would be credited against the employee's claim for additional corporate pension benefits. In that particular case, the plaintiff's claim for additional corporate pension benefits was therefore reduced by €18.05 per month.</p>
<p>Federal Labor Court Decision dated April 21, 2009, Case no.: 3 AZR 471/07</p>	<p>In a very similar case decided on the same date (3 AZR 471/07), the Federal Labor Court further clarified that the principles established in the prior case also apply if the pension plan at issue takes the form of a works agreement.</p>
<p>Practical Advice</p>	<p>The above case law by the Federal Labor Court should prompt employers to review their own pension plans to determine whether they provide for a "split pension formula" as described above. If so, employers should review in detail whether there is any need to amend or modify their pension plans and whether any additional costs may be incurred as a result of the new case law. In most cases, the fact that additional pension benefits in the statutory pension insurance will be credited will do little to reduce any such additional costs.</p> <p>In addition, the cited case law should also be taken into consideration when negotiating and drafting new pension provisions, whether in works agreements or individual employment agreements. We recommend to draft pension provisions with utmost clarity so as to obviate any need for a court to interpret and amend pension provisions later on as occurred in the above cases.</p>
<p>Contact Person</p>	<p>Dr. Henning Reitz (h.reitz@justem.de) Dr. Barbara Geck (b.geck@justem.de) www.justem.de</p>