

## Composite Special Payments – The End of Effective Date Clauses?

### INTRODUCTION

In many companies, the Christmas season brings special payments for employees. In practice, this was and is often contingent on uninterrupted, ongoing employment to the end of the year. To ensure that this reciprocity does not backfire on the employer, it is necessary that a recent decision by the Federal Labor Court (BAG) be taken into account. This judgment, which as yet has only been announced in a press release (judgment of November 13, 2013 - 10 AZR 848/12), has once more ruled on the lawfulness of these types of cut-off date provisions in pre-worded employment contracts and reaffirmed the unchanged case law of the last few years. The following comments take this judgment as an opportunity to discuss the development of the case law on the lawfulness of cut-off date clauses for special payments in employment contracts.

### THE FACTS OF THE JUDGMENT OF NOVEMBER 13, 2013, 10 AZR 848/12

The suing employee was employed as of 2006 at his employer as a controller and received his annual bonus each year with his November salary, which, starting in 2007, was called a "Christmas bonus". The bonus was paid on the basis of the defendant's guidelines, which provided for 2010 that payment would only be made if the employment relationship continued until December 31, 2010 without notice having been served by either side. If an employment relationship was not established until after the year had begun, the employee was to receive a pro-rated Christmas bonus; this also applied for those employees who, in the meantime, did not receive any wages. The employment relationship with the employee in question ended due to his termination on September 30, 2010. With his complaint, he demanded a pro-rated (9/12) Christmas bonus. After the lower courts had dismissed the complaint, the BAG ruled in favor of the employee.

The decisive element in the ruling of the 10<sup>th</sup> Senate at the BAG was the mixed nature of the bonus. In the view of the Court, this bonus was, indeed, meant to honor company loyalty and create a bond between the employee and the company. On the other hand, however, it was supposed to represent remuneration for performed work, as the pro-rated bonus for newly hired employees and the link to the months of paid work show. Special payments to employees of a composite nature may not, however, be made dependent on the continuation of the employment relationship because, in this way, the employee is denied wages he has already earned. This is in contravention of the fundamental principal of Section 611 (1) German Civil Code. The clause is thus void

under Section 307 (1) Sentence 1, (2) No. 1 German Civil Code.

### DEVELOPMENT OF THE BAG CASE LAW

With this judgment, the 10<sup>th</sup> Senate of the BAG continues with the rulings signifying a change in its thinking concerning this subject over the last few years. It expands these rulings with respect to the issue of whether special payments with remunerative elements can be made dependent on effective dates within the compensation period.

Originally, the BAG had deemed cut-off date clauses for special payments of a mixed nature to be lawful even if they were linked to the continuation of the employment relationship on a certain date (BAG, judgment of March 28, 2007 – 10 AZR 261/06). In that context, a cut-off date within the compensation period was not deemed to be an unreasonable disadvantage for the employee in the case of special payments of a composite nature (BAG, judgment of May 6, 2009 - 10 AZR 443/08).

Under the modified case law of the BAG, however, it is now of governing importance for the validity of cut-off date clauses whether or not the special payment can – at least also – be qualified as remunerative in nature. Accordingly, cut-off date clauses are lawful, provided only company loyalty is to be rewarded. In these cases, it does not constitute an unreasonable disadvantage in the opinion of the Court, if the continuation of the employment relationship on the date of payment, unaltered by a notice of termination, is set down as a requirement for the claim (BAG, judgment of January 18, 2012 – 10 AZR 667/10). However, if one facet of the special payment is – at least partially – remunerative in nature, it is deemed to be earned compensation for work which is earned in the relevant calendar months of the compensation period and is then paid out on a due date once a year. This cannot be made dependent on the continuation of the employment relationship because this is not compliant with the principle of Section 611 German Civil Code. In this regard, the 10<sup>th</sup> Senate had already ruled in 2012 that a payment of this kind could not be made dependent on the ongoing status of the employment relationship on a date outside of the compensation period (BAG, judgment of January 18, 2012 – 10 AZR 612/10). Nor is it possible to subject this kind of special payment to the condition subsequent that an ongoing employment relationship exists on a certain cut-off date after the period of performance has expired (BAG, judgment of April 12, 2011 – 1 AZR 412/09).

How to classify a cut-off date clause was unclear, however, if the date on which the employment relationship had to be continuing to receive the bonus, was within the compensation period. The Hessian Superior Labor Court, with reference to the decisions of the BAG from 2007, assumed that this kind of cut-off date clause was valid as long as the special payment was not paid exclusively for work that had already been performed (judgment of April 19, 2012 – 7 Sa 1232/11). Cut-off date clauses for composite special payments would thus be acceptable if the cut-off date was within the performance or compensation period. However, the 10<sup>th</sup> Senate of the BAG did not concur with this argument in the most recent decision. A special payment which an employee not only receives to foster a bond with the company and reward his company loyalty, but which also constitutes compensation for work performed over the course of the year, cannot be attached to a valid cut-off date clause. Rather, this constitutes an unreasonable disadvantage for the employee so that this clause is unlawful. This applies irrespective of whether or not the cut-off date is during or outside of the compensation period.

#### PERSPECTIVES AND RECOMMENDATIONS FOR ACTION

As was the case in the rulings handed down in 2012, the recent decision by the 10<sup>th</sup> Senate has significant meaning for company practices. In future, cut-off date clauses will only have a very narrow scope of application. Composite special payments or special payments of a purely remunerative nature may no longer be legally accompanied by cut-off date clauses. This applies irrespective of whether the cut-off date is within or outside of the com-

penetration period. If an employer merely wants to reward company loyalty or pursues other purposes, he must clearly state this and disengage the amount of this special payment from work performance. In doing so, he must take in account, however, that the 10<sup>th</sup> Senate applies a broad standard for the definition of the term “remuneration” and not only takes into account a link between the payment and the personal performance of the employee, but also deems that a link to company results is sufficient. (BAG, judgment of January 18, 2012 – 10 AZR 612/10). This case law will also have to be taken into account in the future for performance-related remuneration defined under a works agreement (cf. also BAG, judgment of June 7, 2011 – 1 AZR 807/09 and judgment of April 12, 2011 – 1 AZR 412/09). ■

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