Again: Federal Labor Court Tightens Rules for Performance-Related Payments

INTRODUCTION

As is generally known, the repeated and uniform payment of annual one-time payments such as Christmas bonuses constitutes a company practice and thus a duty to permanently make such performance if the payment is not owed under either the individual employment contract or under collective bargaining and provided the employer does not explicitly advise of the voluntary nature of the payment each time before the payment is granted (reservation of voluntary payment). One important criterion in the past, however, was the collective nature of a payment, that is, that a larger number of the members of the workforce received the payment.

A company practice would not be created, however, where an annually repeated payment is provided to the workforce, but where the amount of the payment varies from year to year (Federal Labor Court, judgment of February 28, 1996 – 10 AZR 516/95). In these cases payments could be discontinued at will and without prior notice, even if a reservation of voluntary payment had never been declared.

In its decision of May 13, 2015 (10 AZR 266/14), the 10th Senate of the Federal Labor Court has now closed this loophole, and moreover, not just in cases of company-wide payments, but also for those cases in which an annual payment was only paid to individual employees in varying amounts.

THE FACTS

The matter at issue in the judgment of May 13, 2015 concerned the following facts: An employee who earned a monthly gross salary of approximately € 5,000 had received additional one-off payments labelled as 'bonus' in January of each following year without reservation and without any designation as a performance-related bonus, which amounted to € 10,000 for 2007 and € 12,500 for each of 2008 and 2009. No written employment contract had been executed.

The issue in dispute was whether the employee could also claim a bonus for 2010 even though his employment had terminated prior to the end of the year, namely on November 19, 2010.

The employer claimed to have revisited the decision to make payments each year because the payments were dependent on financial results while the Court of Appeal, on the other hand, inferred from the due dates of the payments that they must be contingent on the continuation of the employment relationship to the end of year. Both of the lower instances had dismissed the claim.

DECISION OF MAY 13, 2015

What makes this judgment so noteworthy is the amount of major legal inferences the 10th Senate of the Federal Labor Court felt itself able to make from this seemingly innocuous situation, namely:

- If an employer pays a one-off payment in addition to the negotiated monthly salary, one must first determine through interpretation if he only wanted to make a specific payment that is for the given year, or if he also wanted to promise payments for the future.

- A permanent obligation can arise from conduct constituting a declaration of intent such as company practice. Even if no company practice exists - because the employer has only made payments to individual employees – a claim may still have been created through the mere grant of payment.

- As far as the substance of a permanent obligation formed in this way is concerned, this follows from the purpose that is being pursued by the payment, which, for its part, is derived from an interpretation of the contractual arrangements that have been made. The following tests have insofar been developed by the 10th Senate:

  1. The nature as remuneration which is owed as consideration for performed work is unequivocal if the payment is linked to the achievement of quantitative or qualitative targets.

  2. The same will hold true if the payment constitutes a major portion of the employee's total compensation. A payment can be deemed to be a major portion already if it constitutes about 15 % of overall compensation for the year in question.

  3. If payment is made without any precondition, this is also an indication that the payment is owed as consideration for work performance.

  4. The same applies if the amount of the payment is dependent only on financial results.

5. On the other hand, if the employer wants to pursue objectives other than providing compensation for work performance and is particularly awarding the employee for his or her loyalty to the company – only for the latter flexible contractual arrangements such as effective date/cutoff clauses can be agreed validly while in all other cases the payment must be made also in the year of entrance and exit on a prorated basis, regardless whether or not a bad leaver clause has been agreed which is also invalid when it comes to performance-related pay –, this must be clearly evident from the underlying contractual arrangement, which can have also have been reached by implicit agreement.

6. Only those payments that exclusively honor company loyalty can be subject to flexible arrangements, while this is already not possible any more if the payments are *also* provided as consideration for performed work (so-called blended payments).

On the basis of these principles, the 10th Senate concluded in respect of the facts before it that the employee had acquired a claim to a prorated bonus for calendar year 2010 and that the amount was to be determined by the employer at its reasonable discretion.

According to the 10th Senate, it was thus up to the *employer* to substantiate whether and, if necessary, what the amount of the employee's claim to a bonus for part of 2010 was by naming any *mutually agreed* criteria. Should the employer not be able to substantiate or prove that he entered into either an express or implied agreement with the employee on how to determine the amount of the bonus with the effect that the paid amount – in this case: zero – could be determined as reasonable, the court will determine the amount payable in its own right (Sec. 315 para. 3 sent. 2 German Civil Code).

PRACTICAL SIGNIFICANCE

The judgment of the Federal Labor Court of May 13, 2015 is of high practical relevance for several reasons. First of all, it is noteworthy that principles that apply to company practice are now also transferable to cases without any collective element, that is, when only one single employee is affected.

It is also new that regular annual one-time payments in completely varying amounts can form the basis for a claim to the permanent grant of such bonuses, at least in principle.

Of extreme relevance is also the statement that both one-time payments without a particular purpose and one-time payments that are solely dependent on financial results are to be deemed to be consideration for work performance. The application of effective date/cutoff clause – aside from the indeed very rare cases of bona fide retention incentives – might indeed be limited now to Christmas bonuses only.

We doubt whether it will still be possible to avoid an obligation to permanently grant performance-related pay through a reservation of the voluntary nature of payment and/or by limiting the payment merely to one single calendar year.

Finally, special attention must be given to the procedural significance of the judgment. Instead of first seeking a judgment ordering the disclosure of information and then filing an action in stages to demand payment, the 10th Senate of the Federal Labor Court now allows a newly developed principle of a scaled burden of substantiation and proof so that the employee may immediately sue for payment without being forced to first embark on an action in stages, which can be a risky matter.

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