Bad advice can be expensive – Employer liability for giving incorrect advice to employees

INTRODUCTION

As a contractual relationship entered into for a sustained period, an employment relationship can give rise to any number of questions over the course of time from its signing to its termination, including many legal questions. These types of questions often pile up during negotiations on a termination of employment by separation agreement. The understandable worries of the employee regarding unemployment, possible disadvantages regarding the eligibility to unemployment benefits, the consequence of the separation agreement with regard to retirement claims and, generally, the financial and tax ramifications of a separation agreement give rise to many questions in this final phase of the employment relationship. Service-oriented HR departments understand their function in these kinds of situations to include support for employees as their inhouse „clients“ by finding answers for these questions.

A look into recent case law shows, however, that it would be wise to proceed with caution, at a minimum, but with the greatest care if employer representatives provide legal advice to an employee. If this advice proves to be false, the employer may be liable for the damage caused by the incorrect advice. The courts have already had to deal with such cases on several occasions. Recently, the Superior Labor Court of Baden-Württemberg passed a judgement in this context:

FACTS OF THE DECISION OF THE SUPERIOR LABOR COURT OF BADEN-WÜRTTEMBERG (JUDGMENT OF NOVEMBER 5, 2020 – FILE NO. 17 SA 12/20)

In the case under decision, the plaintiff had been in the employ of the defendant or its legal predecessors since 1979. Starting in September, 2016 the plaintiff and the defendant initiated negotiations for a separation agreement. The negotiations on behalf of the company were conducted by the head of HR. Following lengthy talks, the exact progress and content of which are contested, the plaintiff entered into a separation agreement which provided for a termination of the employment relationship as of November 31, 2016.

From the beginning, the separation agreement and the prior draft agreements contained a clause in which the plaintiff was advised that only the tax office or the social security office of jurisdiction could provide binding advice on the tax and social security consequences of the separation agreement.

With regard to the disbursement of the settlement, the parties agreed that part of the settlement was to be paid out with the final payroll in November of 2016 and that a second, larger portion would be paid at the beginning of 2017. The plaintiff alleged that the head of HR had recommended this during the negotiations and/or advised him to divide up the payments this way.

It became clear after the fact, however, that it would have been significantly more advantageous for the plaintiff from a tax standpoint if the entire settlement had not been paid out until 2017. The plaintiff therefore filed for damages because of the incorrect advice given by his employer when the separation agreement was executed.

THE DECISION OF THE COURT

The complaint remained unsuccessful before both the local labor court and the Superior Labor Court of Baden-Württemberg. The labor court of first instance reasoned basically in its dismissal of the complaint that the plaintiff had always been advised in the draft agreements that only the tax office could give reliable information on the tax effects of the agreement. If the plaintiff failed to inquire there or ask a tax accountant, the loss he incurred ultimately fell within his sphere of risk.

The complaint also failed before the superior labor court. In the view of the superior labor court, the reason for this was, on the one hand, that the Plaintiff had not complied with the waiting periods applicable for his damage claim but was also due to the fact that the plaintiff had not conclusively presented his claim.

Even if the claim of the employee in this specific case was denied, some of the comments by the court still give reason for companies to apply caution: The court clearly noted that employers are, of course, obliged to protect their employees from harm. The court further stated that, although employers are not subject to a general duty to protect the financial interests of their employees and advise them in such matters, if advice is nevertheless provided beyond the existing duties, this advice must be unequivocal, correct and complete. If it is not, an employer may be liable for all of the damages whose cause is attributable to the faulty advice! The court also emphasized that employees may generally rely on the accuracy of the recommendations made by their employers.

PRACTICAL CONSEQUENCES OF THE DECISION

Several practical consequences can be derived from the decision, which is in keeping with the previous rulings of the labor courts: It should first be noted that, in order to avoid damage claims, it can be meaningful and helpful to include a clause or instruction in a separation agreement that refers to the situation that only the tax office or social security office of jurisdiction can ultimately provide binding advice on the tax and social security consequences of a separation agreement, particularly if an employee is not represented by legal counsel. It is thus recommended that such wording be included as a standard clause in inhouse templates for a separation agreement.

However, this kind of wording will not fully rule out claims based on incorrect advice. For example, if an employer gives advice on practical details concerning the payment of the settlement or on questions regarding waiting or blocking periods regarding the entitlement to unemployment benefits and should these recommendations prove to be incorrect, the employer may still be liable.

Generally speaking, the judgment should thus be taken as a warning to refrain from advising employees on legal matters or to at least apply a large degree of caution in doing so. The issues surrounding the tax and social security ramifications of a separation agreement have become very complex. This certainly applies to the issues related to (company) pensions. Even though an orientation to serving employees is certainly positive, the people acting for a company must always bear in mind that they will be standing on thin ice if they provide single-handed advice on these questions. One should be aware that this type of wrong advice can quickly result in significant damage claims (one only needs to think of faulty advice regarding a company pension).

There is no reason to be afraid of or have an oversized respect for these questions, but it is to be recommended that additional internal or external legal advice is obtained before advice is given to an employee or that even the appropriate government agencies are consulted to answer questions. With this approach, liability risks can be minimized.

Should you have questions related to this topic, please feel free to contact us at any time. We look forward to assisting you.

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