



Demystifying Severance in Germany: Key Strategies for Smooth Exits

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Navigating severance in Germany can be challenging for U.S. employers, as it involves strict legal frameworks, works council negotiations, and potential financial risks. While severance pay isn't automatically guaranteed, understanding when it's required — and how to calculate it — is essential for compliance. This practical guide breaks down the key rules, severance formulas, and communication strategies to help international employers handle terminations smoothly and avoid costly missteps. Here's how to stay informed and ensure your business is prepared for the complexities of Germany's employment laws.

Overview

Contrary to a widespread assumption, employees in Germany do not have a legal right to automatic severance pay upon termination of employment. However, there are exceptions where such payments may be claimed:

- Severance entitlements can be found in social plans, collective bargaining agreements, management contracts, or even individual employment contracts.
- Additionally, both parties can voluntarily agree on severance in a termination or settlement agreement.

Severance Claims under the Protection Against Dismissal Act (KSchG)

A severance claim may arise under §1a of the Protection Against Dismissal Act (KSchG) if the following conditions are met:

- The employer issues a redundancy notice.
- The notice explicitly states that the termination is due to urgent business reasons and informs the employee that they can claim severance after the three-week period for filing a dismissal protection claim.
- The employee does not file a claim within this period. In such cases, the employee is automatically entitled to severance equivalent to half a month's salary per year of employment

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Severance After Filing a Dismissal Protection Claim

A dismissal protection lawsuit does not automatically entitle the employee to severance, as its goal is to declare the termination invalid. However, since the process encourages amicable settlements, around half of dismissal lawsuits in 2014 ended in a settlement. The stronger the employee's case, the more likely the employer will offer severance to avoid litigation risks. Long proceedings can force employers to pay back wages if the employee wins.

Although rare, the court may order severance under §§ 9, 10 KSchG if the termination is deemed invalid and it is unreasonable for the employee to continue working, such as in cases of derogatory statements made by the employer during the process.

Severance Calculation

The amount of severance proposed by a labor court depends primarily on the lawsuit's chances of success, the employee's tenure, and their salary. Typically, severance ranges from half to a full month's gross salary per year of service, but in some cases, higher amounts can be negotiated.

Severance payments generally do not affect unemployment benefits, except in cases where they are agreed upon as part of a termination or settlement agreement. In such cases, a blocking period for unemployment benefits may apply.

Key Takeaways for American Companies Operating in Germany

1. Understand Local Rules

Severance in Germany is governed by strict legal frameworks, often negotiated with the works council. Awareness of these rules is essential to reduce the risk of lawsuits.

2. Prepare for Additional Costs

German severance payouts come with tax and social security implications, which should be incorporated into your financial planning.

3. Clear Communication with the Works Council

Transparent communication fosters trust and leads to smoother negotiations. Ambiguity can prolong disputes or escalate tensions. When it comes to restructuring or downsizing your workforce in Germany, navigating the local legal landscape can be complex, especially for foreign companies.

Germany's employment laws differ significantly from those in the U.S., particularly regarding **severance payments** and the role of **works councils**. We'll walk you through the basics of

Severance payments and the role of works councils. We'll walk you through the basics of estimating severance costs and provide strategies for effective communication with works councils.

How to Estimate Severance Costs in Germany: Severance payments for mass terminations in Germany are typically governed by a “social plan” (Sozialplan), a mandatory agreement negotiated between the employer and the works council during layoffs. This plan governs compensation for job losses, and severance amounts are based on an employee’s salary, tenure, age, and any special circumstances (e.g., disabilities).

Here are two common methods for calculating severance:

1. Severance Formula Approach

A straightforward method is to use a formula based on an employee's gross monthly salary and length of service. The typical formula is:

- Severance amount = Gross monthly salary x 0.5 x Length of service

Example: A 45-year-old employee earning €3,000 gross per month with 12 years of service would receive: $€3,000 \times 0.5 \times 12 = €18,000$

2. Point System Method

In some cases, a point system is used, particularly for larger layoffs. Points are assigned based on factors like age, years of service, family obligations, and disabilities. The total severance budget is divided by the total points for all affected employees.

Example: If a company allocates €100,000 for severance and the total points for all employees equal 100, each point is worth €1,000. An employee with 8 points would receive €8,000, while one with 15 points would receive €15,000.

Why Accurate Estimates Are Crucial: Severance calculations in Germany come with additional costs, including taxes, social security contributions, and potential impacts on the employee’s unemployment benefits. Misjudging these costs could lead to financial shortfalls or non-compliance with German law. Foreign employers should consult legal and financial experts to ensure accurate estimates and compliance with German labor laws.

Communicating with the Works Council: Transparency vs. Flexibility

Severance negotiations in Germany often involve discussions with the works council (Betriebsrat). How you communicate your plans can significantly impact the negotiation process. Should you share conditional information, such as “We’ll try Plan B, but layoffs may still be necessary”?

Building Trust: In Germany, maintaining a trusting relationship with the works council can

streamline negotiations. Being upfront about possible alternatives, like layoffs, can foster goodwill and cooperation. On the other hand, withholding too much information can create suspicion and lead to conflicts.

Best Practice – Opt for Transparency: German labor culture values openness. Clear communication about potential outcomes, even if layoffs are uncertain, will generally lead to better negotiations. But the works council will always try to keep jobs and negotiate in this direction, or try to negotiate high severance packages. Transparency demonstrates good faith and helps avoid disputes, allowing both parties to work toward fair solutions. By taking a structured approach to severance planning and maintaining transparent communication with works councils, your company will be better equipped to handle restructuring in compliance with German laws while minimizing risks.

Conclusion

Successfully navigating severance and terminations in Germany requires a thorough understanding of local laws and cultural expectations. U.S. employers should prioritize legal compliance, transparent communication, and strategic planning to manage risks effectively.

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