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## News from the German Federal Labor Court on the (In-)effectiveness of Target Agreement Clauses (Federal Labor Court, Judgment of 03.07.2024 - 10 AZR 171/23)

Dear Reader,

Today we would like to inform you about a recent decision of the Federal Labor Court (judgment of 03.07.2024 - 10 AZR 171/23), which is likely to be of considerable practical and economic importance for most employers:

### I. Background

The agreement of variable remuneration enables employers to incentivize employees through additional remuneration in the form of bonuses.

Clauses that provide for an agreement on objectives are common, but if they fail, they entitle the employer to set objectives unilaterally at its reasonable discretion.

One such regulation was put to the test in the judgment of the Federal Labor Court discussed here.

### II Decision of the Courts of First Instance

The subject of the legal dispute between the employee and his employer, a ship holding company, was the effectiveness of the agreed handling of variable remuneration. The employment contract between the parties dated February 2020 provided for the payment of a bonus, the amount of which was to depend on the achievement of targets, "the three essential criteria of which shall be agreed between the employee and the company each year, for the first time at the end of the probationary period". In the event that no target agreement could be concluded, the employment contract stipulated the following: "If the three criteria are not agreed between the employee and the

company, the company shall determine them at its reasonable discretion."

At the end of the three-month probationary period, the employee asked the employer - in vain - to negotiate the target agreement with him. The latter sent him her proposed targets, which the employee rejected as unreasonable. The employer also rejected his counter-proposal and then - with reference to the above provision - unilaterally set targets at its discretion.

The employee terminated the employment relationship on December 31, 2020 and subsequently filed a claim for damages, claiming that the - now former - employer had withheld bonuses of around EUR 97,000.00 for 2020.

The Hamburg Labor Court upheld the claim in full. Although the Hamburg Regional Labor Court dismissed part of the claim in the amount of EUR 14,000.00, it awarded the plaintiff the rest of the damages sought.

The defendant employer appealed against this decision.

### III. Decision of the Federal Labor Court

The Federal Labor Court dismissed the defendant's appeal as unfounded.

The Federal Labor Court held that the defendant was liable for damages in the full amount. It had culpably failed to reach an agreement with the plaintiff employee on a target agreement.

In particular, the defendant was not entitled - despite a corresponding provision in the employment contract - to unilaterally set targets for the plaintiff. The corresponding provision in the employment contract constituted an unreasonable disadvantage for the employee and was invalid pursuant to Section 307 (1) sentence 1, (2) BGB.

The Federal Labor Court justified the inappropriate discrimination as follows:

On the one hand, the employer could unilaterally undermine the contractually agreed order of precedence of target agreement and target setting, as the clause at issue practically always enables it to unilaterally set the targets as a result. Thus, the employer could simply refuse or break off negotiations on a target agreement without reason in order to subsequently unilaterally specify and weight the targets to be achieved.

In addition, such a provision prevents the employee from freely negotiating the targets, as he would always be at risk of the employer breaking off the negotiations for no reason or declaring them to have failed. In this way, the provision creates inappropriate pressure on the employee in advance to accept the employer's proposals for a target agreement, even if the employee's own ideas deviate from them.

According to all of the above, the defendant would have been obliged to conduct further negotiations with the plaintiff on a target agreement and to conclude such an agreement. It should not have been allowed to unilaterally set the targets - not even on

the basis of the allegedly failed negotiations.

The defendant culpably breached these obligations under the employment contract, which is why it is liable for damages. When assessing the claim for damages, it should generally be assumed that an employee would have achieved agreed objectives, unless special circumstances preclude this assumption.

#### **IV. Practical Significance**

The Federal Labor Court sets very high requirements for the employer's obligation to negotiate a target agreement, which in practice may often be difficult to achieve. It is therefore advisable to continue not to use the widespread clause in the future and to rely solely on target setting clauses instead.

The target agreement clauses in old contracts should be amended accordingly if the opportunity arises.

Feel free to contact us! Our employment law team will be happy to answer any questions you may have on the topic of legally compliant bonus and bonus arrangements.

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**Labor law**

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