EMPLOYEE LEASING IN GERMANY: THE HIRING OUT OF AN EMPLOYEE AS A TEMPORARY WORKER

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"Beware and Take Care of the Bight of Benin; There's One Comes Out for Forty Goes in," Stephen chanted.

(from Patrick O'Brian, *The Commodore*, 1994)

Employee leasing is one tool for reducing costs. As a tool, it is rather simple to handle, especially after the reform from 2004 onward—at least much easier than "real" outsourcing. But the legal framework for employee leasing in Germany is a bit complicated. It is, in fact, a rather dangerous environment with many hidden risks for those transgressing. This article intends to explain this framework and the risks.

I. LEGAL EMPLOYEE LEASING

The Employee Leasing Law (Arbeitnehmerüberlassungsgesetz, AÜG) has determined the framework for legal commercial employee leasing in Germany since 1972. It specifies the licensing prerequisites, the special regulations for employment relationships, and the Social Security laws. It also contains certain exceptions for particular leasing situations.[1]

Employee leasing is still restricted in Germany. From 2004 onward, there is no time limit for leasing, but the basic rules remain unchanged. Thus, trespasses beyond the borders may have surprising

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1. Sandmann & Marschall, Commentaries to the AÜG, loose leaf; ULBER, AÜG, (2nd ed. 2002); SCHÜREN, AÜG (2nd ed. 2003).

consequences. Although professional job placement services are permitted and legal employee leasing is now possible for up to two years and from 2004 without time limit, those who venture on employee leasing without license take serious risks. They are punished and face fiscal liabilities, subsequent Social Security and health insurance payments, plus unemployment taxes that can endanger a company's existence. Therefore, it remains important to watch out for the boundaries between legal and illegal employee leasing.

A. Development

The time frame for legal, i.e. licensed, employee leasing has undergone a long range of extensions since 1972.[2] Since January 2002, the maximum duration of legal employee leasing is 24 months and from 2004 onward, there is no time limit.[3] There are some admissible forms of free, unlicensed employee leasing. These are, in particular, the leasing out of employees among small companies to avoid layoffs and, more importantly, inter-corporate employee leasing. The sharp sanctions for employee leasing without permission (illegal employee leasing, fake subcontracting) have hardly changed.

B. Basic Structures of Employee Leasing

1. Employee Leasing as a Three Party Contract

All forms of employee leasing are conducted as a three party contract, in which the lessor, the lessee, and the "leased person" are involved. The basis is the employee leasing contract: the lessors commit themselves to provide the lessee with a suitable "leased employee," without the lessee becoming the leased employee's employer (§ 1, ¶ 1, AÜG). The lessor remains the employer of the leased employee, even during the leasing period. The legal bond between the lessor and the lessee is not a contract of employment (see below). It is a contract under civil law.

The leased employee works for the lessee like any other employee following the lessee's instructions. He is legally obligated (liable) to the lessee with respect to any work violations that may occur.

2. Arbeitnehmerüberlassungsgesetz, BGBI. I, 1393 (Aug. 7, 1972). For more on the history of employee leasing *see* Sandmann & Marschall, *id.* at Introduction 25ff; Ulber, *id.* at Introduction B.

3. Art. 64, No. 6e, Arbeitsförderungsreformgesetz, BGBI. I, 594 (Mar. 24, 1997); for history *see* SCHÜREN/BEHREND, NZA 521 (2003).

2. Employee Leasing vs. Short-Term Job Placement

Employee leasing must be distinguished from job placement. Employment or job placement agencies serve to provide companies with personnel the companies hire. The job placement agent is not an employer, unlike the lessor; their economic service is the mediation of the contract. With employee leasing, however, the lessor's economic goal is to obtain a profit by leasing out its own employees.

Occasionally, job placement is camouflaged as a legal employee leasing agreement or as a contract for work and services. That occurs if the enterprise wants to avoid the hiring of personnel. The lessor acts as a dummy who disburses the wages. A fake employee leasing contract is characterized by hiring out a person just once without the intent of doing it repeatedly.[4]

The Employee Leasing Law specifies in § 1, ¶ 2, that job placement is assumed if lessors do not fulfill their obligations as employers. The lessor has to contradict the assumption and must prove that he is leasing out an employee.

3. Maximum Duration of Legal Commercial Leasing

In 2003, the maximum time a leased employee can work for one lessee is 24 months. After 12 months, the leased employee must be paid exactly the same wage and fringe benefits as other employees of the lessee's enterprise (§ 10, ¶ 5, AÜG).

4. 2004—The New System

From 2004 onward there is no time limit, but the remuneration has to be either on the basis of a valid collective bargaining agreement or "equal pay" as mentioned above.[5] Right now—June 2003—the first real collective bargaining is taking place in the industry. The trade unions have agreed to rather low wages to increase employment opportunities.[6]

4. Behrend, *Die Vermutete Arbeitsvermittlung im AÜG*, BB 2641 (2001); Behrend, *Scheinwerkverträge bei Bestehender Arbeitnehmerüberlassungserlaubnis*, (unpublished dissertation) (2001).

5. Schüren/Behrend, *supra* note 3, at 521, 524.

6. *Id.*

C. Legal Relationship Between the Lessee and the "Leased Person"

The "leased person" is the employee of the lessor. Only if the lessor does not have a license, § 9, No. 1, AÜG rules the leasing contract void and creates an employment relationship between the lessee and the leased person (§ 10, ¶ 1, sent. 1, AÜG).

During the hiring out term, the leased person works for the lessee. The contract of employment is, therefore, a contract for the benefit of a third party in accordance with § 328, ¶ 1, BGB (Civil Code), which constitutes a primary obligation of the employed person to work for the respective lessee.[7]

The leased person works for and under the instruction of the lessee and so the lessee is obliged, like an employer, to abide by all the on-the-job safety regulations. A quasi-contractual relationship,[8] which has labor law characteristics,[9] is thus established.

D. Legal Relationship Between the Lessor and the "Leased Person"

1. Working for Different Lessees as the Content of the "Leased Person's" Contract of Employment

The employment relationship between the leased person and the lessor should be an employment relationship for an unlimited amount of time.[10] The employment contract designates the kind of jobs the employee has to perform. The employee has to work for a chain of third parties and under their instruction. The lessor decides for whom the leased person has to work and the duration of the leasing periods. The lessor carries the economic risk if there is no opportunity to hire out. Naturally, there is a tendency to shift this risk to the employee by synchronizing the hiring out periods with the employment contract.

The hours of work must, due to practical reasons, depend on the needs of the lessee's enterprise. In the lessee's company, the working hours are usually regulated by a collective bargaining agreement (i.e., a works agreement negotiated by the works council and the employer), in accordance with § 87, ¶ 1, No. 2, BetrVG (Betriebsverfassungsgesetz, Works Constitution Act). The leased person is therefore represented, at least in part, by the works council of the lessee's company. The leased person has a right to vote for the

7. *See* WALKER, ACP 295 (1994).
8. MünchKomm-Gottwald, § 328-24.
9. *Cf.* WINDBICHLER, ARBEITSVERHÄLTNISSE IM KONZERN 83 (1989).
10. *Cf.* § 9, No. 2, AÜG.

works council of the lessee's company in accordance with § 7, sent. 2, BetrVG. This shows the kind of interaction that is enforced.

2. Wages

As employer, the lessor is responsible for paying the leased person, not only for the duration of the leasing period, but also for unproductive, intermittent periods (see below). The amount of wages allocated is based on the employment contract or an existing collective bargaining agreement (*Tarifvertrag*).

From 2004 onward, the lessor is obliged to pay the leased person the same wages the leased person would receive as an employee of the lessee—if there is no collective bargaining agreement. This is a new law, which (with good success) enforces collective bargaining threatening with equal treatment. "Equal pay" would be rather difficult to handle as it is, in fact, equal treatment and includes all kinds of fringe benefits.

3. Minimum Wage According to the Law of Wages for Interstate Employment (*Arbeitnehmerentsendegesetz*, AEntG)

Section 1, AEntG (Remuneration for Interstate Employment), determines the minimum wage for leasing contracts in the construction industry. In fact, commercial employee leasing is forbidden in the main area of the construction industry, in accordance with § 1b, AÜG.[11] But some types of work, in particular, that of electricians, are exempt.[12] For this small group, § 1, ¶ 2a, AEntG, requires the lessor to pay the co-workers the "obligatory minimum wage" of construction workers for the duration of the leasing period. These minimum wages are determined in a generally binding collective bargaining agreement.

4. Paid Sick Leave and Paid Vacations

The lessor is responsible as employer. In case of sickness, the employee is entitled to paid sick leave for a maximum of 6 weeks. Leased employees, like all employees, have a right to an annual minimum 4-week vacation. Paid vacation means that they are paid on the basis of their average earnings of the last 13 weeks. Collective bargaining agreements usually give 5 to 6 weeks of paid vacation.

11. *See* Sandmann & Marschall, *supra* note 1, § 1b-1ff.
12. *Id*. § 1b-8.

5. Protective Legislation for Working Parents and Parental Leave

The rights of exemption and the right to benefits, as well as the other regulations concerning the protection of employees before and after the birth of a child, and the regulations concerning parental leave favoring fathers and mothers, apply without reservation to leased employees. The lessor must also consider the pregnant employee's right to protection against (unlawful) dismissal, in accordance with § 9, MuSchG (the prohibition of employment for expectant mothers and the rights of work exemption regulated by the Maternity Protection Act).

E. Inherent Obligations

Since the leased employee regularly performs his work in the enterprise of a third party, the mutual fiduciary duty and the duty to give social and medical assistance are differently distributed than in a normal employment relationship. However, with respect to content, special features hardly result.

1. Inherent Obligations of the "Leased Person"

During the leasing relationship, the leased employee has a duty of good faith to the lessor and the lessee, simultaneously. This implies a continuing obligation of non-disclosure after the leasing period has ended. This covers all guarded business or trade secrets and other information whose secrecy protects an essential interest of the lessee.

Contractual agreements between leased employees and lessors not to terminate their contracts and to seek employment with the lessee are ineffective, according to § 9, No. 5, AÜG.[13] The idea behind this rule is to improve the chances for leased employees to get regular jobs.

2. Inherent Obligations of the Lessor and the Lessee

As the employer, the lessor is obligated to provide welfare and social services for the leased employee. Substantial extensions of the mandatory welfare service are guaranteed for all businesses, according to §§ 81-84, BetrVG, even those without a works council.[14] The lessor must inform leased employees about all relevant circumstances

13. *See* Schüren, *supra* note 1, § 9-144ff. For the ineffectiveness of a corresponding liability of the lessee out of the leasing contract, *see* Schüren, *supra* note 1, Introduction-329, § 9-137ff.

14. Richardi, § 81-1, BETRVG.

regarding the amount of work done (work performed) (§ 81, BetrVG), and disclose information concerning their earned income and vocational development possibilities (§ 82, exp. 2, BetrVG). The lessor must be open for suggestions and complaints made by leased employees (§ 82, exp. 1; § 84, BetrVG) and, if necessary, actively remedy their concerns.[15] Leased employees are allowed access to their personnel files (§ 83, BetrVG).

F. Job Security, Prohibited Synchronization Between Contracts of Employment and Leasing Agreements, and Allocation for Collective Bargaining

When the laws concerning employee leasing were drafted, the legislature stressed the importance of the employees' social protection. The leased employee's unlimited employment relationship with the lessor was intended as a basis. The lessor should continually lease the employee to various lessees.

Lessors have a strong economic interest not to pay the leased employee during unproductive periods. Unproductive periods are those without leasing opportunity and times where the leased employee is not available (i.e. during periods of vacation, illness, parental leave, and training sessions). To reduce costs, lessors, therefore, have a tendency to hire their employees only for the time of the actual hiring out term or use prefabricated termination agreements. This is called "synchronization." Sometimes, the idea is to cover up those intermittent periods by using up unemployment benefits.[16]

1. Prohibited Synchronization

The law tries to counteract this—not very successfully—using the AÜG. So-called synchronization is prohibited (§ 3, ¶ 1, No. 3 and 5; § 9, No. 2, AÜG). Time limits in a contract of employment are void if they are used for the second time to synchronize, and there is a rather complicated rule that the termination of an employment contract is void if the same person is hired again after a period of less than three months. In these cases, it is essential carefully to check the agreement in order to determine whether it was done solely in the interest of the leased employee—in this case it is valid—or whether it was done to "synchronize" the leasing relationship—in this case it is void.

15. *See* Schüren, *supra* note 1, § 14-110ff.
16. *See* 8 *Erfahrungsbericht*, 13/5498 BT-DRUCKS 19.

From 2004 onward, it is just the general regulations for protection against dismissal, especially the Protection Against Dismissal Act (Kündigungsschutzgesetz), that cover leased persons. As these rules are rather strict, there is not much change.[17] Any termination of the employment relationship, by notice from the employer, must be based either on redundancy or on some other reasonable cause, for instance, breach of contract.

2. Allocation for Collective Bargaining

The works council of the lessor represents the leased employee. But as the leased employee is integrated into the lessee's business by working there, the lessee's works council has to also protect the interests of the leased person (§ 14, ¶ 2, AÜG). After a three-month employment period, the leased employee receives the active right to vote in the lessee's company (§ 7, sent. 2, BetrVG). Therefore, the leased employee can vote twice: for the works council in his "home company," and for the works council of his workplace.

The participation of the lessee's works council is of great practical importance (§ 99, BetrVG) when using leased employees.[18] The works council must always be informed before leased personnel are used and it also has to approve it.[19] If there is a strike or a lockout in the lessee's business, leased employees may remain neutral and refrain from working.

G. Legal Relationship Between the Lessor and the Lessee

1. Leasing Contract

The leasing contract is just a leasing contract. The leased good—and that makes it special—is a human being that the lessee is going to use as part of his workforce. The lessor owes the lessee an employee for the agreed time and the lessee agrees to pay the leasing remuneration. The leased employee has to be capable and willing to work, otherwise he'll be returned (similar to a defective machine).

The lessor owes the leasee, but not in the actual performance of the work; this is the obligation of the leased employee. While actually working, the leased employee is, therefore, not a vicarious agent of the lessor, and the lessor is not responsible for his bad performance.

17. *See supra* note 3, at 521, 522.
18. ErfK-Hanau & Kania, § 99-8, BetrVG.
19. BAG of Jan. 31, 1989, AP No. 33 to § 80, BetrVG (1972).

Only if the employee is unable or unwilling to work (like a defective machine), a liability of the lessor exists, as selecting and supplying the lessee with a suitable employee is the lessor's contractual duty.

2. Pirating Leased Employees

The leased employee is often interested in an employment relationship with the lessee at the end of the leasing contract—usually wages are higher and job security is better there. This carries substantial economic disadvantages for the lessor, but § 9, No. 4, AÜG, makes opposing agreements in the leasing contract ineffective. The lessee may thus offer a leased employee a position after the ordinary completion of the leasing relationship. Thus, the leasing relationship becomes a trial period. Some lessors agree with the lessee on a fee for supplying a suitable employee. Only the request to break the contract of employment with the lessor without terminating it first would be a violation of the leasing contract.

H. Commercial Permits for Employee Leasing

Commercial leasing may only be performed with a license granted by the state employment agency. The distribution of leasing licenses is regulated in § 2, AÜG. Lessors can only be independent companies who lease their own employees to third parties.[20] "Leasing oneself" would simply be fake self-employment.

The leasing license is conceived as a preventive prohibition and it is subject to revocation. The lessor has a right to the license if he fulfills the legal prerequisites—the rejection criteria are outlined in § 3, AÜG.

The leasing license can be obtained from the state employment agency for a fee.[21] The license is granted for one year at first. Only after three limited licenses have been granted can an unlimited license be approved. The license can also be given under conditions and obligations, and is subject to revocation. The state employment agency thus is allowed flexible moderate reactions to the lessor's deficits.

20. For design of a "direct employment relationship," *cf.* Marschall, §172-11ff, MünchArbR.
21. *Cf.* § 2a, AÜG and AÜGKostV, BGBI. I, 1327 (June 23, 1982 and June 15, 1999).

I. Liability Based on Legal Employee Leasing

In the three party relationship between lessor, lessee, and leased employee, there exist three bilateral obligations. The relationship between the leased employee and the lessor is a contract for employment and is thus subject to special liability limitations. These liability limitations for work-related negligence also apply to the relationship between the lessee and the leased employee. The leasing contract, however, is a contractual relationship between business enterprises where the liability for primary and inherent obligations is not reduced.

J. Social Security (Health, Accident, and Retirement) with Legal Employee Leasing Contracts

The leased employee should receive Social Security benefits as a regular full-time employee of the lessor. Here, the general regulations apply. A limited absorption liability for the lessee is added. It is enforced when the lessor does not fulfill his Social Security obligations as employer. The basic standard is outlined in § 28e, ¶ 2, sent. 1, SGB IV (Social Security Code), which justifies the lessee's direct guarantor liability for the lessor with respect to health, retirement, unemployment, and accident insurance.

K. Interstate/Transnational Employee Leasing

When leasing employees from foreign lessors out of the European Community, the AÜG contains express regulations (§ 3, ¶ 2-5). The foreign lessor needs both the employee leasing license of his native country and that of Germany.[22] His obligations as an employer with respect to his leased employee depend on his native country in which the enterprise has its principle place of business and the country in which the employment relationship is fulfilled. Lessors with a registered place of business outside of the EEC may not operate leasing companies that provide services within Germany, following § 3, ¶ 2, AÜG.

II. LEGAL LEASING OUT OF EMPLOYEES WITHOUT LICENSE

The AÜG has few exceptions from its strict license prerequisite; the most important one is inter-corporate leasing.

22. *See* Schüren, *supra* note 1, § 3-181.

A. Inter-Corporate Leasing

The regulations of the AÜG do not apply to temporary inter-corporate employee leasing, except to companies in the construction industry. The leased employee must have an employment relationship with an affiliated company. A leasing agreement is "temporary" only if the employee's return to his or her old job, or at least to the previous place of employment, is intended from the onset. Excluded from the privileges, therefore, are leasing subsidiaries that only lease employees.[23] They do not provide a position to which the leased employees can eventually return. From 2004 onward, there is no limitation for inter-corporate leasing with a regular license under a valid collective bargaining agreement.

B. Employee Leasing Under the Same Collective Bargaining Agreement

Following § 1, ¶ 3, No. 1, AÜG, the AÜG should not apply if employees are leased between employers of the same industry in order to avoid a shortening of working hours or layoffs, and if this is regulated in a collective bargaining agreement (*Tarifvertrag*) that is applicable to the lessee, as well as to the lessor. These conditions must all be present.

The affiliation to an industry is determined according to the enterprise's purpose, which both the lessor and the lessee pursue. Real rental businesses do not fall under No. 1, AÜG, because they never belong to the lessee's industry.[24] The leased employees must be threatened with dismissal or a shortening of working hours in the sense of § 169ff, SGB III. The employee leasing must be suitable to avoid these.

C. Leasing Out Among Small Companies Instead of Laying Off

Section 1a, AÜG grants privileges to so-called "colleague aid" by not requiring a license for this form of employee leasing. Colleague aid is designed for small companies (having less than 50 employees), who lease out employees to each other in order to avoid layoffs. Instead of a license, it is sufficient when the enumerated conditions listed in ¶ 1 are submitted to the state labor office in written form. The announcement must compromise the requirements laid out in ¶ 2.

23. *Id.* § 1-750; 10/3206 BT-DRUCKS 33.
24. *See* Schüren, *supra* note 1, § 1-644ff; *see also* Ulber, *supra* note 1, § 1-226.

Following § 1a, AÜG, the cases of § 1, ¶ 3, No. 1, AÜG, only permit such leasing when it is done in order to avoid layoffs or a shortening of working hours.

D. Delegation of Employees to a Team

In accordance with § 1, ¶ 1, sent. 2, AÜG, the delegation of employees to a team is not restricted and needs no license. Teams are established by companies that have taken over larger projects together. Section 1, ¶ 1, sent. 2, AÜG, additionally requires that all members of the team (*Arbeitsgemeinschaft* or ARGE) work under the same collective bargaining agreement.[25]

III. ILLEGAL EMPLOYEE LEASING USING FAKE SUBCONTRACTING AGREEMENTS

A. Legal Consequences of Fake Subcontracting

1. Consequences Under Labor Law

The consequences of illegal leasing activities, as far as labor law is concerned, are regulated in § 9, No. 1 and § 10, ¶ 1, AÜG. The contract for employment between the lessor and the leased person is void and an employment relationship between the lessee and the illegally leased employee is established by law. This makes the lessee, as employer, liable for wages and Social Security benefits based on the regular wages in his company. The illegal lessor and the leased person are connected by a void contract for employment. This void contract makes the lessor liable for unpaid wages and unpaid Social Security benefits, as long as the parties act on it.

The employment relationship with the lessee is established when the employee starts working. It does not depend on any kind of agreement among the parties as it is not a contract, but an employment relationship by law. This relationship is not easily terminated as full job protection applies.

2. Consequences Under Social Law

Due to labor laws that apply, illegal employee leasing contracts contain two different employment relationships (§ 9, No. 1, AÜG and § 10, ¶ 1, AÜG). On the one hand, there is a fictitious employment

25. 10/4211 BT-DRUCKS 33.

relationship between the leased employee and the lessor in accordance with § 10, ¶ 1, AÜG. It is frequently limited to the duration of the intended leasing period. On the other hand, there is the continuous (illegal) employment relationship that exists without interruption, even when the leased employee is not working in another company, between the leased employee and the illegal lessor.

Both employment relationships exist simultaneously when the leased employee is leased to a company and the lessor pays his wages. When the employee is not leased to another company, only the continuous employment relationship to the lessor exists. Under social insurance law, the illegal employment relationship is, as a paid employment relationship, the legal basis for the liability of the lessor to pay Social Security benefits.

The lessee, as the legal employer of the leased employee, has to pay wages too. As long as the lessor pays, the lessee is only liable for the wage difference. If the lessor does not pay, the lessee is liable for the full wages. When these wages (or just the wage difference) are paid, he is also liable for Social Security benefits and taxes.

3. Consequences Under Tax Law

The special regulations concerning fiscal consequences of illegal employee leasing are not simple to apply, but, in the end, the lessor and the lessee are liable for the unpaid taxes. They are joint debtors. So, fake contracts of service always lead to liability of both lessor and lessee. The lessee runs extreme economic risks, in cases where the lessor uses fake independent contractors, which are, in reality, employees. In this case, if the lessor goes into bankruptcy, the lessee will have to pay all Social Security benefits and all taxes for the entire time the leased employee worked for him.

4. Liability According to Civil Law With a Void Leasing Contract

The illegal leasing contract is void, so there is no contractual duty of care and no contractual liability. Both parties are liable under the law of torts and the possibility of liability remains in accordance with § 311, ¶ 2, BGB (Civil Code).

5. Criminal and Administrative Applications

Illegal employee leasing is an administrative offense of the lessor, according to § 16, ¶ 1, No. 1, AÜG, and of the lessee too (§ 16, ¶ 1, No. 1a, AÜG), but not of the leased person. If combined with a little

bit of wage-dumping, both parties are punished in accordance with § 15, § 1a, AÜG, under criminal law. Hiring and leasing foreign employees without work permits is a criminal offense. The fines for administrative offenses can be as much as €25,000, but, more importantly, there are unlimited punitive damages that are liberally applied.

B. Practical Applications of Fake Subcontracting Agreements

Illegal employee leasing exists in most enterprises, almost solely in the form of fake subcontracting agreements; employee leasing is covered up as work performance. The legal consequences have been described above: The employee leasing contract (fake subcontracting agreement) is ineffective. If the lessor has a leasing license in his back pocket, he can avoid that once, but he will subsequently lose his license.

The law assumes job placement instead of employee leasing when certain requirements are not fulfilled. When the fake contractor only hires personnel to work for another company, he is no lessor because he does not employ these employees in order to lease them out to different customers.

IV. SUMMARY

For a maximum of two years, and from 2004 onward without a time limit, employee leasing agreements make it possible to cover personnel requirements by leasing employees from a licensed lessor. The leased employees are full-time employees of the lessor. They are used by the lessee in the same way as the lessee's own personnel. Violations of the law within the area of employee leasing are punished strictly and are linked to serious economic risks. So it is not as dangerous as the Bight of Benin was in the early 19th century, but beware! The German system is, in fact, rather liberal from 2004 onward, but it is still very dangerous and expensive to transgress its limits. So any foreign investor is well advised to watch out for these limitations.