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Customer Liability under the Minimum Wage Act

Recommendations for Reducing Liability Risks

OVERVIEW

Since the start of the year, companies have been grappling with letters from their clients (customers), in which these customers are demanding compliance with the Minimum Wage Act (MiLoG), referencing their own potential statutory liability and urging their contractors to assume additional liability on the basis of “supplemental agreements”.

Many companies have not yet developed a consistent strategy for handling the potential liability arising from the Minimum Wage Act. These companies generally face the following questions:

How should companies acting in the contractor role handle these situations? To what extent should they accept such agreements? What obligations should companies acting in the customer role impose upon their own contractors? What opportunities are there to limit the liability risks under the Minimum Wage Act?

YOUR KEY CONTACT

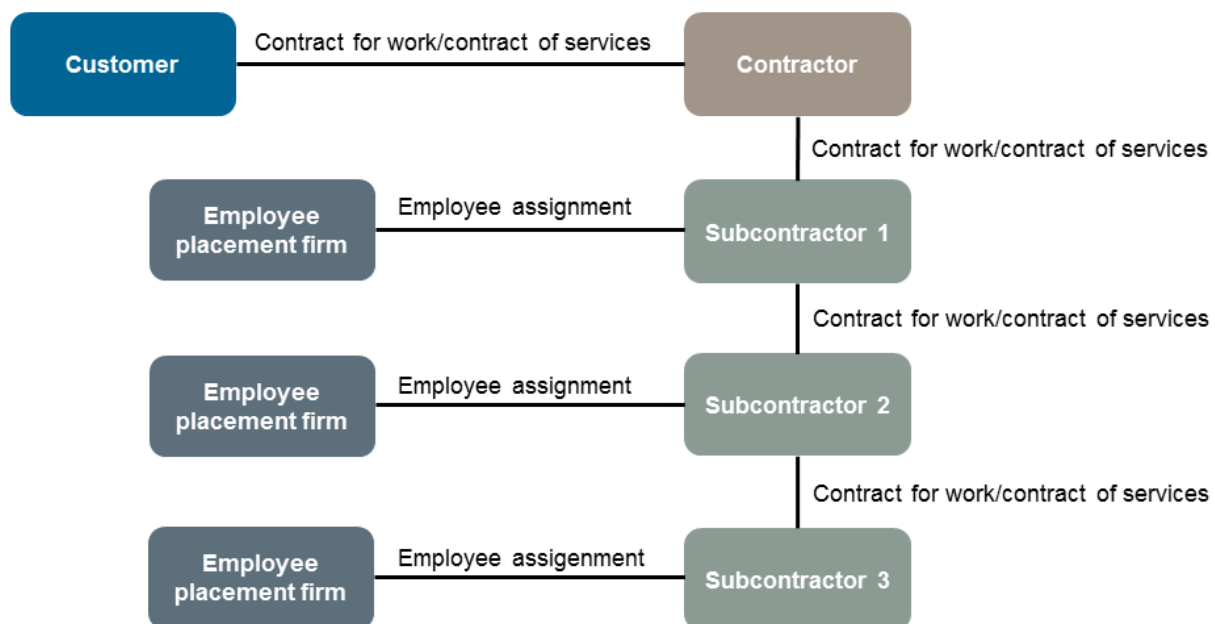


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Statutory rule

On 16 August 2014, the German law for strengthening scaled wage autonomy entered into force; its core component is the Minimum Wage Act (MiLoG). Under this legislation, a nationwide minimum wage of EUR 8.50 was enacted as of 1 January 2015. Of great significance for practical business purposes is the requirement that companies must bear the responsibility not only for paying the statutory minimum wage **to their own employees**, but also for ensuring that the minimum wage is **paid by any subcontractors**.

Under the statutory rule, a business enterprise, which engages another business enterprise to create a work product or perform a service, is liable to the extent the latter business enterprise, a subcontractor or an employee placement firm [*Verleiher*] (which is authorised by such business enterprise or subcontractor) does not pay the statutory minimum wage to its employees (sec. 13 MiLoG combination with sec. 14 of the Act on Mandatory Employment Terms and Conditions for Cross-Border Postings of Employee (AEntG)). According to the language of the statute, the customer is responsible for ensuring that all downstream companies in the supply chain comply with the MiLoG. The customer is liable to the impacted employee in the form of a surety which has waived its legal defence to compel the obligee to first proceed against the principal obligor. This means that an employee who incurs wage deficiencies may assert his or her claim directly against the customer of his or her employer, without having to first enforce its claims against the employer itself.



The customer's liability for ensuring compliance with the Minimum Wage Act extends to all employees of his contractor and to the employees of all subcontractors and of all employee placement firms.

These new statutory provisions are particularly alarming for the customer because they establish a **standard of strict liability** (the customer does not need to be at fault). Accordingly, the customer cannot escape liability by furnishing evidence that it lacked affirmative knowledge or that its subcontractor was grossly negligent in failing to discover a violation of the minimum wage requirements. Thus, any proof that the customer had carefully selected its subcontractor or that it had relied on the subcontractor's "good reputation" will be of no help. Moreover, the liability also **extends down**

the subcontractor supply chain. This means that the customer will likely also be liable if the contractor, which it has engaged, engages a subcontractor that does not pay the minimum wage. This situation can result in extensive liability on risks that are very difficult to identify. The questions about whether the liability should be limited to “general contractors” and about which companies in that case would be excluded from liability are still unresolved; as long as the higher courts have not provided some case law guidance, there will remain a high degree of legal uncertainty in this area.

Liability and indemnity claims of the customer

The impacted employee has the option of asserting his or her claim for the payment of the minimum wage shortfall either against his own employer or against the customer. If the employee proceeds against the customer - perhaps because his own employer cannot or will not pay - than it will be obligated to pay the full amount of the outstanding net salary (in other words, excluding taxes and social security contributions). **The customer is fully liable to the employee.**

It can also be assumed that the Federal Employment Agency [*Bundesagentur für Arbeit*] can obtain indemnity from the customer in the event that there are payments of insolvency-triggered employment benefits [*Insolvenzgeldzahlungen*].

If the customer has paid the impacted employee, it may thereupon **seek full recourse against the employer who violated the MiLoG** (sec. 774(1), sentence 1 of the German Civil Code). In such cases, however, the customer faces a risk that there may be “nothing left to get” from the employer - otherwise the employee would have demanded the outstanding wage from that employer right from the outset. This risk for the customer is mitigated if, in addition to the customer which actually paid the employee, there are other enterprises in the supply chain. In that case, the customer may demand **indemnity** from these interposed business enterprises (sec. 774(2), 426 of the German Civil Code), yet the indemnity will not be full but instead **limited to the prorated amount**. In the alternative, the customer may - even prior to making a payment to the employee - demand **a proportionate indemnity** from the other customers *inter se*. This right to indemnity does not change the fact, however, that the customer remains obligated, as against third parties, to pay the full amount to the employee.

Recommendations for customers

Even though statutory indemnity and compensatory claims exist, the liability under the MiLoG harbours a large risk for customers. In the subcontractor supply chain, there is a potentially large number of unidentified employees who could enforce payment claims against the customer. If it discharges its existing payment obligation, then it will always run the risk that it cannot recover the amount (or at least not the entire amount).

Business enterprises which operate in industries where there can be a long supply chain should be particularly vigilant about taking **precautionary measures to minimise the risk**. These measures could include:

- **Conducting a careful selection of the subcontractors.** In this regard, for example, the solicited offers could shed some light on whether the obligation to pay minimum wage has been factored into the calculation.
- **Obtaining contractual representations and warranties regarding the subcontractor’s payment of the minimum wage, if necessary with effect for the additional subcontractors and employee placement firms**

that are engaged downstream from the subcontractor. Although such contractual clauses do not change the customer's liability if the contractor or downstream subcontractor nevertheless fails to pay the minimum wage, it will create certain pressure. Also, if an agreement is reached at the same time requiring the submission of evidence that the minimum wage has been paid (e.g., by submitting payroll statements of the engaged employees - with personal data redacted - and records logging the number of hours worked), then the customer will be able to review whether the contractor has indeed met its obligations under the MiLoG.

- **Agreeing to a (extraordinary) right of termination for the customer and to the payment of a contractual penalty [*Vertragsstrafe*] in the event that the contractor does not (in a timely manner) pay the minimum wage due or does not discharge the obligations agreed to in this connection.**
- **Imposing an obligation on the subcontractor to perform the agreed work solely by itself.** Another alternative, which could be considered, is to condition the engagement of an additional subcontractor upon the customer's consent or at least upon giving prior notice to the customer. In any case, the contractor should be obligated to carry out a careful selection of its subcontractors.
- **Requiring the provision of financial security due to the accumulated liability risk.**
- **Requesting an agreement (as is often done) which provides that the contractor will indemnify the customer *inter se* if employees of subcontractors in the supply chain should assert a claim against the customer for payment of the minimum wage (letter of indemnity).** Nevertheless, many customers will not be prepared to undertake such an extensive shift of liability.

If a contractor refuses to provide the customer with an adequate degree of security, then the latter should consider engaging a different company after having considered all the facts and circumstances of the individual case. In this regard, the customer must also remember that the engagement of a subcontractor, whose minimum wage violation the customer negligently failed to recognize, constitutes a petty administrative offence [*Ordnungswidrigkeit*] which will be prosecuted by the customs office [*Zollverwaltung*]. In the event that there has been a petty administrative offence, the offender could be subject to a fine and could also be excluded from the public tendering process.

Recommendations for contractors

- **Contractors, which comply with the obligations under the MiLoG and do not engage any other subcontractors themselves, could commit to making (their own) payment of the minimum wage under a supplemental agreement, without thereby incurring any other potential liability.**
- **Contractors, which do in fact engage other subcontractors, should generally review whether they can or would wish to enter into the obligations requested by the customer.** In this regard, the contractor should consider that when it itself is acting in the role of customer, it could be exposed to the claims asserted by the employees of its subcontractors. This existing liability risk could be broadened even further if it concludes a supplemental agreement which is requested by the customer and which provides for it to fully indemnify the customer with respect to all third party claims. Whether or not the contractor should take on such additional liability risk should be decided upon on a case-by-case basis.
- **Before the contractor assumes additional obligations vis-à-vis the customer, it should seek assurances from its own subcontractors.** Accordingly, it should enter into supplemental agreements (if possible, with the same scope of coverage) with its subcontractors which should, in turn, obligate their own subcontractors accordingly.

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