

### One Man's Blessing, Another Man's Curse

### Linking Clauses in Employment Contracts with Managing Directors

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Corporate law makes a distinction between a managing director's position as officer of a company and the employment relationship under the employment contract with the managing director. Accordingly, the recall of a managing director will regularly have no effect on the underlying employment contract, i.e., the employment relationship will regularly remain intact if the managing director is recalled, which is possible at any time without providing any reason (except in cases in which articles of association require 'good reason' for recall). Summary dismissal without notice will come into question only rarely since a 'good reason' for termination will exist only under exceptional circumstances. In particular, recall does not as such constitute good reason for termination of an employment agreement without notice. It will, however, regularly not be in the interest of a company to remain bound to an employment agreement with a managing director that has been recalled, which means that it is advisable to link employment agreements with managing directors with the officership. This can be achieved through the use of 'linking clauses'. For example, it is possible to stipulate that recall constitutes termination of the employment relationship. It is also conceivable to have termination of the officership operate as a resolutive condition that annuls the employment agreement. Although linking clauses are generally considered permissible, a few pitfalls do exist.

#### Implications for practice

When relying upon a linking clause, it is necessary to take into account the fact that according to prevailing opinion the legal periods of notice pursuant to § 622(1) and (2) of the Civil Code (*Bürgerliches Gesetzbuch* – BGB) must be applied accordingly since a managing director would otherwise 'perceive' termination under a linking clause as summary dismissal. Legal periods of notice must also be respected when a linking clause makes provision for operation of recall as a resolutive condition in respect of an employment relationship.

Executive employment agreements with limited terms, which are often encountered in practice, call for special attention. In order to ensure that a linking clause included in an employment agreement with a limited term is valid, the employment agreement should make provision for termination with notice (which of course defeats the purpose of the fixed term of the employment from the perspective of the managing director). According to overriding opinion, linking clauses would otherwise regularly be meaningless in the case of agreements with limited terms due to the absence of the possibility of termination with notice.

Another typical constellation of problems also arises when contractual periods of notice are shortened by a linking clause. It is not unusual to make provision for periods of notice in employment contracts with unlimited terms with managing directors that are longer than the legally prescribed periods in order to give managing directors longer-term prospects. In such cases, a linking clause would mean that a significantly shorter period of notice could apply for the company due to analogous application of legal periods of notice under the linking clause (possibly only one month's notice) than for the managing director. This result could constitute a violation of § 622(6) of the German Civil Code. The period of notice for an employee may not be longer than that agreed for the employer. However, the analogous application of this provision to executive employment agreements has not yet been conclusively clarified.

Linking clauses must also comply with the provisions of law governing general terms & conditions since managing director usually qualify for treatment as consumers. For example, linking clauses may under certain circumstances be considered unusual (§ 305c of the Civil Code) or unreasonably disadvantageous (§ 307(1) of the Civil Code) and accordingly invalid. The standards to be met in this regard by linking clauses contained in agreements with limited terms are especially stringent.

## Conclusions

From the point of view of companies, the use of linking clauses is advisable since it is not in the interest of a company to continue to employ a managing director who has been recalled; from the point of view of managing directors, such clauses can on the other hand be extremely disadvantageous. However, linking clauses should be formulated with extreme care and tailored to the specific circumstances. This will regularly apply in the case of executive employment agreements with limited terms.

## Note

This overview is solely intended for general information purposes and may not replace legal advice on individual cases. Please contact the respective person in charge with GÖRG or respectively the author Pia Pracht on +49 221 33660-524 or by email to ppracht@goerg.de. For further information about the author visit our website [www.goerg.com](http://www.goerg.com).

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