Legal Update
Labour and Employment

Federal Labour Court revises its case law on the treatment of the "jump" in the contribution ceiling for company pension plans

Dr. Frank Wilke
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Headnote

The one-time € 500.00 increase in the contribution ceiling in the year 2013 cannot be ignored in the case of pension commitments involving a "*split pension formula*". Correction is possible only if the pension shortfall is so significant that recipients of company pension plans cannot be reasonably expected to accept the agreement in place (Federal Labour Court, judgment of 23 April 2013 - 3 AZR 475/11).

Facts

The plaintiff was a retiree who had been promised benefits under a company pension plan by his employer. The amount of the company pension was to be calculated on the basis of what is referred to as a "*split pension formula*", which means that the benefits to be provided by the company for that part of the employee's income lying above the contribution ceiling for the governmental retirement insurance would be higher than the retirement benefits for the part lying below the ceiling. It is not unusual for benefits under company pension plans to be determined in this fashion. On the one hand, the "split" makes it possible to make up for the shortfall that results from the fact that employees receive no benefits from the governmental retirement insurance scheme for that part of their income lying above the contribution ceiling; on the other hand, employers also remit no social security contributions for that part of their employees' income lying above the contribution ceiling, which is why they are willing to invest this "saving" in higher benefits under company pension plans.

The contribution ceiling is normally adjusted each year to take into account the country-wide increase in gross monthly wages and salaries. With effect as of 1 January 2003, however, the legislature raised the ceiling by a one-time *"jump"* in the amount of € 500.00 to help close the financial deficit in the governmental retirement insurance scheme. From the point of view of recipients of company pensions, this jump had a negative effect as regards calculation of retirement benefits on the basis of a "*split pension formula*" since it also entailed a

reduction in the amount of income lying above the contribution ceiling.

In two judgments dated 21 April 2009, the Federal Labour Court issued landmark decisions, ruling that recipients of company pension benefits must not absorb the entire effect of the jump in the contribution ceiling. The prevailing opinion at the time was that company pensions should therefore be calculated as though the one-time increase in the contribution ceiling had not taken place.

Decision

This case law met with virtually unanimous criticism in the scholarly literature as well as by a series of lower courts, and the Federal Labour Court has now revised its opinion. Consistent with prevailing opinion, the Senate has now adopted the position that the jump in the contribution ceiling must also be taken into account for the purposes of calculation of company pension benefits using the *"split pension formula"*. Recipients of company pension benefits must accept the negative impact.

Adjustment is required only if the jump in the contribution ceiling results in such a significant decrease in benefits that the employees affected cannot be reasonably expected to accept the agreement. The Federal Labour Court gave no indication – at least not in the press release it issued – as to where the threshold of significance might lie. Although the benefit shortfalls in the cases decided here were of an order of magnitude of between 5% and 10%, the Federal Labour Court saw no need for any adjustment.

Comments

The Federal Labour Court implemented the desired change in its previous case law by making a complete about face with its new decision, evidently adopting the convincing arguments advanced in the scholarly literature and the findings of various lower courts. The previous case law, according to which the sudden increase in the contribution ceiling revealed an omission in the guidelines for retirement benefits that had to be filled through supplementary interpretation of underlying agreements, was justifiably criticized on the grounds that the only change involved the abrupt increase in the contribution ceiling used as a reference There was therefore never any omission in the guidelines for retirement benefits, but only an unexpected change in external circumstances. The law recognizes the notion of interference with the underlying basis of a transaction for the purposes of rectification in such cases. However, the corresponding mechanisms are not triggered by just any disturbance of parity, but can be resorted to only if unexpected occurrences make it unreasonable to expect one of the two parties to an agreement to continue to honour that agreement. The Federal Labour Court was correct in changing its position to reject modification of the guidelines for retirement benefits in cases in which the benefits shortfall does not exceed reasonable limits.

This decision will come as welcome relief for employers whose guidelines for retirement benefits make provision for what is referred to as a "*split pension formula"* since they can now continue to apply their formulas as planned. It is likely to be necessary to adjust the pension formula to mitigate the one-time effect of the jump in the contribution ceiling only in the case of significant reductions in benefits, i.e., in excess of 10%.

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 himself: Dr. Frank Wilke on +49 221 33660-534 or by email to fwilke@goerg.de. For further information about the author visit our website www.goerg.com.

Our office

GÖRG Partnerschaft von Rechtsanwälten

BERLIN
Klingelhöferstraße 5, 10785 Berlin
Tel +49 30 884503-0, Fax +49 30 882715-0

COLOGNE
Kennedyplatz 2, 50679 Köln
Tel +49 221 33660-0, Fax +49 221 33660-80

ESSEN
Alfredstraße 220, 45131 Essen
Tel +49 201 38444-0, Fax +49 201 38444-20

FRANKFURT AM MAIN
Neue Mainzer Straße 69 – 75, 60311 Frankfurt am Main
Tel +49 69 170000-17, Fax +49 69 170000-27

HAMBURG
Dammtorstraße 12, 20354 Hamburg
Tel +49 40 500360-0, Fax +49 40 500360-99

MUNICH
Prinzregentenstraße 22, 80538 München
Tel +49 89 3090667-0, Fax +49 89 3090667-90