

SUMMARY

2016/13 Compensation for wrongful dismissal includes loss of equity income (LU)

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Facts

The claimant had worked for 17 years in an auditing firm, where he had advanced quickly in his career. He had started working as an auditing assistant and, step by step, had become an 'equity partner'. The published judgment does not reveal the exact status of an equity partner, but it is most likely that the claimant acted in two capacities: he was an employee and held a certain percentage of his employer's share capital, on which he received dividends. His total

remuneration averaged in the region of € 930,000 per year. The claimant was dismissed with immediate effect for alleged misconduct. He brought a claim for unlawful dismissal. In an interim judgment, the Court of Appeal found that the claimant had been dismissed unlawfully and that he was therefore entitled to compensation. The issue before the court was how to calculate the compensation. The claimant, who was 44 at the time of his dismissal, argued that he was unable to find a new equivalent job following termination of his employment contract because his former employer had made negative statements about him in order to protect the firm's image and had blamed the employee for everything that had gone wrong. Although the claimant had found a consulting position for a particular project and had set up a business of his own, on balance he earned much less than he had earned before. The claimant also argued that the dismissal had caused him to lose, not only his salary with the defendant, but also the profit share he received as an equity partner, which he considered to be part of his remuneration.

Judgment

The Court of Appeal began by reiterating the legal doctrine that compensation for material damage should be as complete as possible. According to this doctrine, the employee can only be indemnified for damages that have a direct causal link with the dismissal. The losses incurred must relate to the period that is reasonably necessary to find an equivalent position (the so-called 'reference period'), taking into account that the employee is obliged to make all possible efforts to find a new job.

In this case, the Court of Appeal found that there was a direct link between the dismissal and the loss claimed by the claimant. The employer had responded that the claimant could have tried to work for another firm instead of setting up his own business with a poor turnover. However, the Court of Appeal ruled that an employee is free to choose to create his own business rather than seeking a new, similar job. It took into account that an employee who is dismissed after 17 years of work, after having invested a lot of energy in his career at the expense of his health and his personal life, need not necessarily search for a new job immediately after having been dismissed. Further, the Court considered that his acceptance of a consulting job and the fact that he set up his own business showed that the employee had not remained inactive after his dismissal. With regard to the amount of the loss, the Court of Appeal rejected the employer's objection that the employee's errors had to be taken into account when determining the loss. According to the Court, if a dismissal is considered unlawful, the employer must bear the consequences, in other words, it is obliged to pay full compensation. The Court of Appeal considered that the profit share that the claimant received as an equity partner was part of his income and its loss must be compensated for. The Court of Appeal did not agree with the employer's view that the employee's removal as an equity

partner must be distinguished from his dismissal as an employee. In the Court's view, the removal as an equity partner and the dismissal were closely linked. The dismissal procedure had started on the same day as the decision to remove the employee from his position as an equity partner was taken. Taking into account the nature and quality of the position as an equity partner, in this particular case, the Court of Appeal estimated that the reference period was 18 months. This period, multiplied by the balance of lost and actual earnings, led to an award of over one million Euros. In addition, the claimant was awarded € 25,000 in moral damages.

Commentary

This decision attracts attention because of the exceptional amount that the employer had to pay its former employee for unlawful dismissal. It gives us the opportunity to explain some particularities of Luxembourg law and to reflect on the financial costs of dismissal for employers.

In Luxembourg, an employer can dismiss an employee without initially giving reasons. However, upon request, the employer must provide the reasons for the dismissal within one month. At that point, the employee has two options: (i) he can challenge the grounds of his dismissal within three months after receipt of the reasons, in which case he has one year to launch proceedings against his former employer for unlawful dismissal; or (ii) he can directly bring a claim to the Labour Court within three months after the receipt of the reasons, to examine whether they are well-founded. In both cases, if the court finds that the reasons are not serious, real, precisely formulated and proven, the dismissal is considered to be unlawful. In such a case, the Court, under certain conditions, will order the employer to pay the employee compensation for the material and moral damage suffered. The Court will examine if there is direct causal link between the dismissal and the damage alleged. In this context the employee has to prove that he has made all possible efforts to find a new job. Having established the causal link between the dismissal and the alleged damage, under Luxembourg law, compensation for unlawful dismissal is calculated as follows. First, the court determines the 'reference period'. This is the length of time that the employee reasonably needs to find an equivalent job. This time depends on a number of variables, such as age, qualifications and the condition of labour market. The second step is to estimate the balance between (i) what the employee would in all likelihood have earned during the reference period had he kept his job and (ii) what he has actually earned and/or is likely to earn during that period. In other words, in order to determine the amount of the material damages, the Court will compare the employee's new financial situation with what his financial situation would have been if the employment contract had been maintained. In the judgment commented on here, two elements led to the high amount of compensation: the judge fixed a long reference period – 18

months – that exceeds the 6 to 12 months that are normally considered necessary to find an equivalent job, and the judge considered the profit shares that the employee received as an equity partner as part of his remuneration. It seems that considering profit shares as part of the remuneration is not a new development, but apparently employers tend not to be fully aware of it when dismissing employees in senior positions.

This decision provides the following lesson to employers and their counsel: the determination of the amount of damages (material and moral) is delicate. In order to assess the financial risk, the employer must take into account the entire remuneration, including any additional benefits. Therefore, employers should be cautious before dismissing an employee in a senior position who is entitled to valuable benefits. In some cases, a settlement may be preferable, in order to avoid legal action for unlawful dismissal.

Comments from other jurisdictions

The Netherlands (Peter Vas Nunes): How to calculate compensation for unlawful or unfair dismissal? Is it possible to answer this question without first identifying the reason why an employee who has been dismissed (fairly or not) should be paid anything at all? Dutch courts and scholars have debated this fundamental, almost philosophical question for decades without reaching consensus, and it is not my intention to summarise the debate in this commentary. The reason I mention it is that the debate was reignited, with a new twist, as a result of a change of law that took effect on 1 July 2015.

Under the old law, it was more or less up to the courts' discretion whether to award compensation to an employee whose contract had been or was about to be terminated and, if so, how much. An award of one million Euros, as in this Luxembourg case, would not have been exceptional for a 44 year old employee with 17 years of service and an annual income of € 900,000.

Barring a few exceptions, the new law entitles every employee who loses his or her job involuntarily to a 'transition award', based on a certain formula (around a third and one half of one month's average salary for every year of service). The courts may not award more than this unless the employer is guilty of 'seriously reprehensible' conduct. In such a case, the employer may be ordered to pay additional compensation. The law does not specify what such additional compensation aims to compensate, let alone how to calculate it. This was purposely left vague. Some argue that the aim of additional compensation cannot be to compensate for lost income as a result of the termination, because that is what the transition award is meant to do. However, if this is so, what is additional compensation for? Is it, perhaps, to compensate, not for the termination as such, but for the unfairness of the termination? The

problem with this theory is that the compensation would basically be for immaterial loss, such as damaged reputation or injured feelings, and Dutch courts tend to be reluctant to award serious sums for such immaterial loss. A third theory holds that an award of additional compensation is essentially a punitive award. The problem with this theory is that, although punitive damages are not wholly unknown in Dutch law, the concept of punitive damages is generally seen to be alien to Dutch law and practice. In brief, nobody knows for sure what an award for unfair dismissal aims to compensate.

Subject: unlawful dismissal

Parties: unknown

Court: Cour d'appel (Court of Appeal)

Date: 3 December 2015

Case number: 38355

Publication: not openly accessible

Creator: Cour d'appel (Court of Appeal)

Verdict at: 2015-12-03

Case number: 38355