EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

SUMMARY

2014/32 Severance Pay is Salary (LA)

<p>Severance compensation paid to an employee pursuant to section 112 of the Latvian Labour Law (e.g. where an employment contract is terminated on account of a headcount reduction) is covered by the concept of “work remuneration” (hereinafter “salary”) as defined in section 59 of the Labour Law, being “any other remuneration in relation to work”. This means that wrongly paid severance compensation can only be reclaimed on the basis of section 78 of the Labour Law and not on the basis of the general provisions of civil law. According to a recent Supreme Court decision, this in turn means that an employer cannot recover severance compensation paid to an employee based on a court judgment that has been enforced despite appeal and later overturned.</p>

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Severance compensation paid to an employee pursuant to section 112 of the Latvian Labour Law (e.g. where an employment contract is terminated on account of a headcount reduction) is covered by the concept of “work remuneration” (hereinafter “salary”) as defined in section 59 of the Labour Law, being “any other remuneration in relation to work”. This means that wrongly paid severance compensation can only be reclaimed on the basis of section 78 of the Labour Law and not on the basis of the general provisions of civil law. According to a recent Supreme Court decision, this in turn means that an employer cannot recover severance compensation paid to an employee based on a court judgment that has been enforced despite appeal and later overturned.

Facts

The plaintiff in this case was an employer, the limited liability company "Union Asphalttechnik". It terminated its employment contract with one of its employees - the defendant - in the course of a workforce reduction operation. As required by law, it paid the employee severance pay (the "severance compensation"). The severance compensation was paid on 25 May 2009.

The employee challenged the legality of his employment termination in court. The court of first instance ruled in his favour, ordering the employer to reinstate him in his previous position and pay him salary for the whole period of forced absence from work. The court also stated that the judgment must be executed with immediate effect[1]. Pursuant to the judgment the employer reinstated the employee and, on 4 November 2009, paid him the compensation (the "absence salary").

The employer appealed with success. The Court of Appeal held that the termination had been perfectly legal and valid, thus, the court of first instance had wrongly ordered reinstatement. This meant that there should have been no need to make the absence salary payment. The Court of Appeal's judgment was final.[2] Meanwhile, the employee had been validly dismissed again.

The above can be summarised by the following diagram:

[for diagram, see pdf, ed.]

The original period of employment E1 ended on date A, following which the employee was paid a lump sum by way of severance compensation. The employee was reinstated on date B, following which the employer paid him an amount basically equal to his salary for the "absence" between the end of the original period of employment and the beginning of the second period of employment.

The employer brought new proceedings. He claimed repayment of the absence salary as well as severance compensation. In these new proceedings, the Court of Appeal turned down the claim for repayment of the absence salary and awarded the claim for repayment of the severance compensation.

The Latvian Law on Civil Procedure prohibits courts from reversing a court judgment in which an employer is ordered to pay an employee "salary". It is not possible for an employer to claim repayment of salary from an employee that was paid pursuant to an enforced court order, unless the court order was based on false information or forged documents submitted by the employee. For this reason, the court had to turn down the claim for repayment of the absence salary.

As for the claim for repayment of the severance compensation, the Court of Appeal, following previous Supreme Court case law, found that this compensation did not qualify as "salary" within the meaning of the Law on Civil Procedure. Hence, the normal rules governing payments of sums not owed applied, rather than the special rules governing salary. On this basis, the Court of Appeal ordered the employee to repay the severance compensation.

Judgment

The issue before the Supreme Court was whether the severance compensation constituted "salary" within the meaning of the Labour Law. This was relevant for the following reason. Under the normal rules of Latvian civil law, a sum of money that is paid without there being legal grounds for it must be repaid. Thus, if those general rules applied, the employee would need to repay the severance compensation payment, given that - under the ruling of the court of first instance - there had been no valid termination and hence no reason to pay severance compensation. However, if that payment qualified as salary, the relevant rules were those provided under the Labour Law, rather than the civil law rules. Those special rules provide that an employee who has incorrectly been paid by his employer need not repay unless:

the payment was made as a result of an error by the employer; and
the employee was, or should reasonably have been, aware of the error, or the payment was made in circumstances in which the employee carries responsibility.

At the moment of paying the severance compensation to the employee, the employer was fully willing to make the payment and followed the provisions of the Labour Law obliging it to do so, as the termination was by reason of workforce reduction. Therefore, there is no reason to consider that the payment was made in error and it follows from that that the employee could not have been aware of something that did not exist. Thus, if the Labour Law applied, the employee was not under an obligation to repay.

Section 59 of the Labour Law defines salary. The definition includes as salary "any other remuneration in relation to work" performed by an employee. The Supreme Court analysed this definition in light of three ECJ judgments: *Barber* (ECJ 17 May 1990, case C-262/88), *Gewerkschaftsbund*(ECJ 8 June 2004, case C-220/02) and *Maruko* (ECJ 1 April 2008, case C-267/06). It concluded, overturning its own previous jurisprudence, that compensation for severance of an employment contract qualifies as "salary" within the meaning of the Labour Law.

The Supreme Court went on to explain that, as severance pay is part of salary, then the provisions of the Labour Law regulating how (and when) the employer can claim back

wrongly paid amounts from the employee must also apply in this case. It clarified that there were no legal grounds to apply the general provisions of civil law to the case.

Commentary

One thing about this judgment is that the Supreme Court applied case law of the ECJ and changed its previous practice in order to comply with it. The most interesting issue, however, is not that employers must now follow a complicated procedure in order to claim back wrongly paid severance compensation, given that there are not many cases when the employer pays the employee the severance compensation by mistake (and if there has been an obvious error in calculating the correct amount of the severance compensation the employer still has a realistic prospect of proving that even in the light of this judgment). The most important change brought by this court judgment, which states that the compensation payment is covered by the concept of the "salary", is that from now on it will not be possible for the employer to recover such a payment in the event it was paid on the basis of an immediately enforceable court judgment (e.g. where there is a dispute over the amount of the severance pay or over whether or not the employee is entitled to severance pay) and the court of appeal decides the case differently.

In addition, this court judgment makes highly questionable the current practice of the Latvian courts which, when deciding on the amount the employee is entitled to for the period of forced absence from work in cases of illegal employment termination upon the employer's request, reduce that amount by the sum the employee received in the form of severance compensation. The rationale behind this approach is that, as the employment termination has been declared unlawful, the employee has no legal basis for keeping the severance compensation. However, this approach does not seem to be compatible with the present judgment.

Comments from other jurisdictions

The Netherlands (Peter Vas Nunes): A Dutch court would probably have ruled differently. The claim for repayment of the absence salary would have been awarded, given that – in hindsight – the employee was not employed during the absence period and that, therefore, there was no basis for that payment. On the other hand, the employee would not have had to repay the severance compensation, because – also in hindsight – the original employment period (E1) ended on date A.

Admittedly, there is case law protecting employees against unreasonable salary repayment claims, but that case law would not have come into play in a case such as this, where the employee must have been aware that the payment of salary for his period of absence was

subject to appeal litigation.

United Kingdom (Sarmed Khalid): The facts of this case are unlikely to arise in the UK. Employees who are dismissed, including for economic reasons such as workforce reduction (redundancy) are able to challenge their dismissal by bringing a claim for 'unfair dismissal' in the Employment Tribunal, provided they have had at least two years' continuous service before dismissal. If the employee's claim is successful, by far the most common remedy awarded by the Tribunal is compensation, which is largely calculated by reference to the employee's likely future loss of earnings (capped at the lower of 52 weeks' pay or £76,574).

If the employee requests it, instead of awarding compensation, the Tribunal may make an Order for the employee to either be reinstated into their role with the employer, or re-engaged by the employer into a similar role together with compensation for lost salary and benefits for the period between dismissal and returning to work for the employer. Such Orders (which are made under sections 114 and 115 of the Employment Rights Act 1996 (ERA) are extremely rare, and the Tribunal will not grant the Order if it is not practical for the employee to return to work for the employer. If the Tribunal does make the Order, when deciding the amount of compensation to be awarded for the period the employee was out of work, it can discount payments made by the employer to the employee. The employer will wish to argue that the compensation should be reduced by the amount of any redundancy pay paid to the employee.

A more common situation giving rise to issues similar to this case might be if an employer pays an employee too much redundancy pay by mistake. Statutory redundancy pay is based on a set formula which takes into account the employee's age, length of service and weekly pay. Employers might offer more generous contractual redundancy pay, which may also be based on a formula. If an employer gets the calculation wrong and pays too much, will it be able to deduct the amount of the overpayment from any further wages due to the employee?

There are limitations on what deductions an employer can make from an employee's wages under Part 2 of the ERA. The general position is that the employer will not be able to make the deduction, unless there is a clause in the contract of employment which allows it. Without such a clause, a deduction will still be possible under section 14 of the ERA if the deduction relates to an overpayment of "wages". However, section 27 of the ERA expressly excludes redundancy pay from the definition of "wages" and therefore section 14 cannot be relied on by the employer to recover overpaid redundancy pay. If the employer makes the deduction in breach of Part 2 of the ERA, the employee can bring a claim, recover the amount of the unlawful deduction and the employer will then be debarred from recovering the money any other way.

A practical problem is that redundancy pay will usually be paid alongside the final payment of wages due to the employee, and if that happens, there will be no opportunity to deduct overpaid redundancy pay in the future. The employer's only option will be to bring a claim in the civil courts (rather than in the Tribunal) to recover the overpayment. Due to the cost and time involved, it would rarely be worthwhile for the employer to bring the claim unless the amount of the overpayment was significant. Even then, an employee may not be required by the court to repay some or all of the overpayment if it would be unjust for them to do so (for example, if they had already spent the money in good faith).

Subject: Definition of salary

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