

THE NETHERLANDS INTRODUCES COMPENSATION REGULATION TO DISCOURAGE “DORMANT EMPLOYMENT”

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INTRODUCTION

Companies that employ staff in the Netherlands have a statutory obligation to continue salary payments when employees are absent on sick leave. Paid sick leave can extend up to 104 weeks, a full two years. During the entire period, the employer and employee are required to meet reintegration obligations designed to plan for the employee's return to work. If the employer fails to observe the statutory reintegration obligations the paid sick-leave period can be extended by an additional 52 weeks.

After 104 weeks, the employer may request permission from the Employee Insurance Agency (“U.W.V.”) to terminate the employment contract. If instead the employer does not opt for termination of the employment contract and has observed its reintegration obligations, after the end of the 104th week, the employee is no longer entitled to salary payments for the remainder of the sick leave. Because the employment contract remains valid, the post-payment period is generally referred to as “dormant employment.”

With the overhaul of dismissal laws in 2015, the Netherlands introduced a statutory transition fee due upon termination of an employment contract in certain circumstances. The transition fee offers financial compensation for the loss of a job and promotes employability. It enables the transition from one employment arrangement to another. The transition fee is essentially a form of legally mandated severance in a case of forced dismissal. When the employer opts for termination after 104 weeks of sick leave, it is deemed a forced dismissal and the employee is entitled to the transition fee.

The transition fee is not payable if the employee resigns or if the parties come to a mutual agreement on the termination of the employment contract. Under an exception applicable to older employees, the transition fee is also not payable if the employee has reached the state pension age. Since its implementation in 2015, many employers keep employment contracts dormant to circumvent the obligation to pay the transition fee.

This article will address recent changes to the rules that control the payment of transition fees intended to break the stalemate in the employment situation that has arisen from dormant contracts:

- The Dutch parliament has enacted legislation, known as the “Compensation Regulation,” that offers employers the opportunity of being reimbursed by the Dutch government for a transition fee paid in relation to a dismissal of an employee for reason of continued sick-leave after 104 weeks. This regulation is effective as of April 1, 2020. The regulation has retroactive effect and

will cover terminations due to long-term sick leave and corresponding paid transition fees from July 1, 2015, onwards. This is discussed in greater detail below, under **The Compensation Regulation**.

- In addition, the Supreme Court of the Netherlands recently ruled that the practice of dormant employments must come to an end. If the employee wants a termination of a contract after 104 weeks of sickness – viewed under prior law as a voluntary termination instead of a unilateral forced termination – the employer has the obligation to terminate the employment contract and pay the transition fee, making the termination involuntary.

The termination fee, employer compensation mechanism, and relevant court cases are discussed in detail below.

CALCULATING THE STATUTORY TRANSITION FEE

July 2015 – December 31, 2019

With the introduction of the transition fee effective July 1, 2015, the calculation was as follows. Note, the transition fee is calculated as of the formal termination date of the employment contract (*i.e.*, years of employment includes sick leave).

Years of Employment	Remuneration for Every Six Months
0-10 years	1/6 monthly gross salary
10+ years	1/4 monthly gross salary

A more generous calculation applied to employees age 50 or older with at least ten years of service:

Years of Employment if Age 50+	Remuneration for Every Six Months
0-10 years	1/6 monthly gross salary
10+ years	1/2 monthly gross salary

The transition fee was capped at (i) €75,000 gross (for 2015) or (ii) one year’s salary if the employee earned more than €75,000 gross per year.

January 1, 2020 and Beyond

Effective January 1, 2020, Dutch labor legislation underwent yet another set of significant changes with the implementation of the so-called Labor Market in Balance Act (*Wet Arbeidsmarkt in Balans*). This act implements various changes, including changes to the calculation of the transition fee.

The law now stipulates that the amount of the transition fee is as follows:

The transition fee is equal to one third of the monthly wage for each calendar year that the employment contract lasted and a proportional

part thereof for a period that the employment contract has lasted for less than a calendar year. Further rules concerning the method of calculating the transition fee may be laid down in a separate order.

The simplest way to calculate the transition fee is in two steps: by month and by day. Take the following example:

An employee worked at a company for nine years and five days. The gross monthly salary was €3,000 on the basis of a 40-hour work week and an hourly wage of €20. How much is the transition fee?		
Step 1:	Calculate the transition fee for the full nine years of service	$9 \times (1/3 \times €3,000) = €9,000$
Step 2:	Calculate the transition fee for the five days	$40 \times €20 = €800$ $(800/3000) \times ((1/3 \times 3000)/12) = €22.22$
The transition fee is €9,022.22 gross.		

The gross monthly salary is based on the most current salary that the employee receives including holiday allowance. If the employee is on sick leave and receives a lower amount, the calculation still takes into account the higher salary that the employee received prior to the sick leave. Furthermore, the monthly salary includes the average of fixed and variable compensation that was paid out to the employee, such as bonus payments.

The transition fee is capped at €83,000 gross (for 2020) or one year's salary if the employee earns more than €83,000 gross per year. The maximum amount is adjusted annually in January to reflect inflation.

Significant Difference in Outcome

The calculation method of the new transition fee has resulted in a huge difference in outcomes for employees age 50 and older who have more than ten years of service with a company. Sometimes they are eligible for only half of the amount that they would have received prior to the new legislation. Take the following example:

An employee born on January 1, 1960, was employed with a company since January 1, 2000. His gross monthly salary was €3,000. What is the transition fee?	
Contract Terminated on December 31, 2019:	$[20 \times (1/6 \times 3,000)] + [20 \times (1/2 \times 3,000)] = €40,000$
Contract Terminated on January 1, 2020:	$20 \times (1/3 \times 3,000) = €20,000$

The portion of the monthly salary that forms the base of the transition fee remains flat, at one-third, irrespective of the employee's age.

SICK LEAVE IN THE NETHERLANDS

Dutch law provides that during the first 104 weeks of sickness or disability, the employer must continue to pay the employee a minimum of 70% of the salary (capped at €219.28 per day as of January 2020). It is common that in individual employment contracts or in collective bargaining agreements, employers pay a greater percentage, often up to 100% of the contractual salary for the first 52 weeks of sick leave.

During sick leave, both employer and employee should (demonstratively) make the best effort to ensure that the employee can recover and resume work. These are the re-integration obligations mentioned above. If both parties have observed their respective re-integration obligations well, the employer can stop paying salary after 104 weeks. The governmental agency U.W.V. then takes over the re-integration obligation, and the employee is entitled only to long-term sickness benefits per state rules. If the employer failed to observe its statutory re-integration obligations, U.W.V. can determine that the salary payment must continue for a maximum of 52 weeks, resulting in the continuous payment of salary for a total of three years of sickness.

For the period in which the employer has the obligation to continue salary payments, there is a strict prohibition against terminating employment during sick leave (*opzegverbod*). This means that during a period of two or potentially three years (the “Sickness Period”), the employer may not terminate the employment contract.

After the Sickness Period, the obligation to continue salary payments and the prohibition against termination cease to exist. If the employer does not opt for termination under one of the statutory forms of legally valid termination, the employment contract remains in a dormant state.

Since the introduction of the transition fee in 2015, there has been a tendency among employers to keep employees who are on long-term sick leave “on the books.” Employers experience that the transition fee, when combined with salary payments during the Sickness Periods and the costs of reintegration efforts, is problematic and unjust because of the financial burden it entails. As long as the employment contract is not terminated, the transition fee is not due.

THE COMPENSATION REGULATION

In the period leading to enactment of the Compensation Regulation Transition Fee Act (*Wet Regeling Compensatie Transitievergoeding* or the Compensation Regulation), it was estimated that there were thousands of dormant employment contracts in the Netherlands. The Dutch parliament concluded that the number of dormant contracts was undesirable. All employees, including long-term sick employees, are entitled to a transition fee when their employment contract is terminated by the employer. At the same time, the Dutch parliament acknowledged that the transition fee places a burden on employers. In order to encourage employers to terminate an employment contract after the Sickness Period runs out, the Compensation Regulation was adopted with an effective date of April 1, 2020.

As of that date, an employer can submit an application to U.W.V. requesting compensation for transition fees paid to employees once the Sickness Period runs out. The Compensation Regulation will cover employment contracts that have been

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terminated from July 1, 2015, onward. Please refer to the two situations (old and new) described below.

The Compensation Regulation passes some or all of the transition fee from the employer to the government. In order to receive compensation, the employer must meet two conditions. First, the transition payment must be due were the contract terminated with U.W.V.'s permission or via the courts. Second, the payment of the transition fee is related to the termination of the contract due to the employee's long-term sickness.

We can differentiate two situations where employers would be eligible to apply for compensation:

Applications Based on "Old Situations"

- The employee's contract was terminated in the period between July 1, 2015 – March 31, 2020.
- The transition fee was paid to the employee before April 1, 2020.
- The application to U.W.V. can be submitted in the period April 1, 2020 – October 1, 2020.

Applications Based on "New Situations"

- The employee's contract is terminated on or after April 1, 2020.
- The transition fee has been paid in full.
- The application to U.W.V. must be submitted within six months from the date of payment of the transition fee.

There are some limitations as to the amount of compensation that the employer will receive:

- In principle, the compensation may not be greater than the actual amount of transition fee paid to the employee.
- The compensation may not be greater than the transition fee calculated at the time the employee was on sick leave for 104 weeks. If a higher fee is paid because the employment agreement is terminated at a later date, *i.e.*, because the employment was left dormant or the employer was ordered by U.W.V. to continue payment for another 52 weeks, the compensation is still capped at the transition fee payable after the initial 104-week Sickness Period.
- The compensation may not be greater than the salary amount that the employer paid to the employee during the Sickness Period. This amount is the gross salary excluding the employer's costs. If the employer paid more than the statutory minimum of 70% of the salary, these costs will generally be greater than the transition fee. The Minister of Social Affairs is investigating whether certain state benefits and subsidies impact the compensation as mentioned under this point.

A possible consequence of these limitations is that an employer may force an employee to agree on a payment that is not higher than the compensation the employer

will receive from U.W.V. If the transition fee is higher than the compensation due to the limitations described above, the employer can threaten not to terminate the contract, leaving the employment dormant.

CASE LAW: LOWER COURTS

Prior to the introduction of the Compensation Regulation, case law in the lower courts showed that it was almost impossible for an employee on long-term sick leave to force termination on an employer by initiating a court proceeding. Courts generally ruled that, according to Dutch law, no legal obligation was imposed on an employer to terminate an employment contract after the Sickness Period. The courts also did not consider this to violate good employment practices.

Despite the introduction of the Compensation Regulation, many employers remain unwilling to terminate dormant employment contracts. However, case law has been divided on whether dormant employments are allowed after adoption of the Compensation Regulation. To illustrate, one district court ruled that continued employment under a dormant contract was not contrary to the practice of good employment. In comparison, another district court ruled in a comparable situation that the continuation of a dormant contract was contrary to the standard of good employment practice. This employer was instructed to terminate the contract. In the second case, the district court took into account the Compensation Regulation, and on that basis, the district found that no justification existed for the employer to keep the employment dormant.

THE SUPREME COURT AND DORMANT EMPLOYMENTS: “WAKE UP AND PAY UP!”

In light of these divisions, the Supreme Court issued a preliminary ruling on November 8, 2019, on questions of law regarding the termination of dormant employments.

The Supreme Court does not share the view of some lower courts that keeping employees in a dormant employment status is allowed. With the introduction of the Compensation Regulation, employers will be compensated for the costs they incur in terms of the payout of the transition fee. Consequently, they are no longer confronted with an unreasonable financial burden on top of their reintegration obligations and continued salary payments during the 104-week period. Moreover, it is clear that the Dutch parliament intended to reduce the number of dormant employment contracts as much as possible. The principle of good employer conduct implies that a dormant employment agreement should, in principle, be terminated if the employee desires termination and the employer does not have any reasonable or legitimate interest in continuing the employment agreement.

The employer may have a legitimate interest if, *inter alia*, realistic re-integration opportunities exist for the employee. Denying termination because the employee will soon reach pensionable age – resulting in a termination of the employment contract by operation of law without entitlement to the transition fee – is not considered to be a legitimate interest. The main principle remains that the transition fee is payable once the Sickness Period runs out and the employee has requested a termination of the employment contract.



IMPLEMENTATION OF THE SUPREME COURT RULING: PRACTICAL TIPS AND TRICKS

In principle, employers are not obliged to take the initiative to terminate dormant employments. The Supreme Court only adopted an obligation for employers to agree to a request from the employee on long-term sick leave to terminate the employment contract and pay the transition fee.

While the notion of a dormant employment may still sound attractive to employers, certain risks exist when dormant contracts are allowed to continue. As long as the employment is dormant, the employer has the duty to phase the employee into the work force once the employee is at least partially recovered, provided that realistic opportunities exist. At some point, a recovered employee can claim reinstatement and continued payment of salary. If the recovered employee is fulfilling a suitable other position for a period of four weeks or longer, the entitlement to the Sickness Period starts anew, exposing the employer to continued salary payments.

Moreover, the transition fee is calculated as of the formal termination date of the employment contract. The Compensation Regulation creates the possibility to be compensated for the transition fee, but that compensation is not greater than the transition fee calculated at the time the employee was on sick leave for 104 weeks. The difference between the actual transition fee that must be paid to the employee (*i.e.*, as of the formal termination date of the employment contract) and the compensation that the employer will receive from U.W.V. (*i.e.*, the transition fee payable after the 104 weeks of sick leave) remains for the account of the employer.

In view of the potential risks as well as the continued accrual of the transition fee, we recommend starting discussions with employees on long-term sick leave and agreeing on a mutual termination of their employment after the Sickness Period. If the employee rejects the offer, the employer cannot be viewed to have neglected the principles of good employer conduct. As in many aspects surrounding a disputed termination of employment, the employer must carefully record its negotiation position with the employee on a contemporaneous basis. The employer then has the choice of maintaining a dormant contract. Should the employee have a change of mind and request a termination offer, it is prudent for the employer to offer an amount that is equal to the anticipated compensation under the terms of the Compensation Regulation. In this way, the employer clearly will have followed the letter of the law, and it is expected that the difference between the actual transition fee at the time of termination and the compensation that will be received from the Dutch government will not have to be paid by the employer directly after 104 weeks of sick leave.

Alternatively, the employer can request permission from U.W.V. to terminate the employee's contract. The cost of the transition fee is then equal to the compensation under the Compensation Regulation.

CONCLUSION

The stalemate generated by dormant contract arrangements has come to an end as a result of the Compensation Regulation. The Compensation Regulation calls for payment of transition fees following the end of an employee's Sickness Period

that will be reimbursed entirely or mostly by the by Dutch government. In many, if not most, situations the Dutch government will bear the cost of the transition fee on a deferred basis. Aside from timing and professional fees incurred, this appears to be a win-win situation for both parties to the employment contract.

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