

The Spanish Labour Reform and the Courts: Employment Adjustment and the Search for Legal Certainty

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Abstract: Legal uncertainty over the fair reasons for redundancy and for substantial modifications of working conditions is an important factor explaining some of the worst imbalances of the Spanish employment relations system. In 2012 the Spanish legislature has passed a comprehensive labour reform, a fundamental part of which attempts to overcome that uncertainty. After identifying the main causes of legal uncertainty, this paper asks if the new role assigned to the labour courts will serve the purpose of the reform and if eventually this will succeed in bringing legal certainty to the realm of employment adjustment measures.

Key Words: Labour courts, dismissal, modification of working conditions, labour reform, legal certainty.

I. Introduction

The labour courts have played a central role in the Spanish employment relations system. It is impossible to understand its major institutions —such as termination of employment, internal flexibility and collective bargaining— without extensive reference to the decisions of the labour courts. On the one hand, the courts have had the final say on the meaning of the legal reasons for dismissals and for unilateral substantial modifications of working conditions (one of the legal techniques enabling internal flexibility). On the other hand, judicial litigation has been much more important than mediation and arbitration when interpreting all kinds of collective and workplace agreements on any matter (compensation, working hours, etc.).

The centrality of the labour courts, especially in collective matters, relates in part to their historical development during Francoism: the dictatorship (1939-1975) adopted an interventionist approach towards employment relations as a means of repression of collective action; active state intervention in all kinds of employment disputes, especially through the courts and the labour administration, was a key feature of the industrial relations system just before the Constitution (1978). Hence, alternative, private dispute resolution procedures remained fully undeveloped in the realm of employment relations. This state of affairs has only begun to change for collective disputes: during the 1990s a number of autonomous bilateral bodies (e.g. the SIMA, which is the cross-industry body for mediation and arbitration) were established by national and regional agreements on collective dispute resolution (e.g. the ASAC, which is the agreement on autonomous resolution of labour disputes). However, alternative dispute resolution is virtually nonexistent for individual claims, especially for dismissal cases or for cases of unilateral substantial modifications in working conditions.

The judicialization of the Spanish labour market has made it impossible to properly assess its functioning without considering judicial interpretation and enforcement of the law. After the most comprehensive labour reform in decades (the 2012 labour reform, approved in February by Decree-

Law 3/2012 and finally in July by Law 3/2012), one of the pertinent questions to address is the new role of the labour courts. In this paper I confine my attention to the question of the legal reasons for dismissals and unilateral substantial modifications of employment conditions. What I show is the complex interaction between the law and the courts on an issue that is critical to employers (labour flexibility) and employees (employment protection), and to the very characterization of the Spanish employment relations system. I focus here on the matter of litigation over dismissals and unilateral substantial modifications of working conditions because it has had the most profound effects on the functioning of the Spanish labour market and has given major support to those who argue that the level of employment flexibility in Spain is low. As a leading judge has recently put it, the crucial issue raised by the 2012 labour reform is to define the scope of judicial review and the limits of the powers of management¹.

For the most part, legal uncertainty as to what constitutes a fair reason for dismissal or for substantial modification explains the fact that over the last few decades Spanish companies have apparently underused both economic dismissals and unilateral substantial modifications of working conditions. In their stead, they have overused fixed-term employment contracts and unfair individual dismissals (so-called “express dismissals”). The result has been inequitable both to many employees (especially new hires and young people, who experience chronic precariousness) and to some employers (especially the many small companies that provide the vast majority of jobs in the Spanish economy, compelled either to pay relatively high severance costs for labour adjustments or to adopt a low-road strategy through temporary employment). Hence, it is critical to determine whether the 2012 Reform brings legal certainty to this fundamental area of employment practice.

I begin in Section 2 by briefly summarizing how the Spanish legislation has traditionally defined the fair reasons for dismissals and unilateral substantial modification of working conditions. In Section 3, I present the main changes introduced by the 2012 Reform. Section 4 describes the courts’ role in interpreting fair reasons for dismissals and modifications, which has been the main source of legal uncertainty. Sections 5 and 6 discuss the main alternatives pursued by firms in their search for legal certainty. Sections 7 and 8 show how the legislature has attempted to provide legal certainty first in 2010 and then in 2012. Finally, I provide some concluding remarks.

II. Legislation dealing with the fair reasons for dismissals and substantial modifications before the 2012 Reform

In the important debate over the optimum balance between labour flexibility and employee security, the dismissal regime and the regulations on unilateral substantial modifications of employment conditions are among the main concerns. According to the Spanish Workers’ Statute, employers must have a good cause both for dismissals and for unilateral substantial modifications of employment conditions². This causal requirement entails the employee’s right to lodge a claim with a labour court in the case of dismissal or substantial modification to her working conditions. For the employee, this is a reasonable avenue to be pursued, especially in dismissal situations: litigation costs are very low for employees, and the difference between the compensation initially received from the employer and that originating in a judicial declaration of unfair dismissal (plus interim salary³) could be large.

The causal requirement established by the law has traditionally been fairly complex. Indeed, it was made up of three distinct elements: a factual component, a causal link, and a functional requisite.

¹ P. ARAMENDI (2012): “el gran debate que se avecina a partir de ahora radicarà en la delimitación de hasta donde llegan los poderes del empresario y hasta dónde éstos van a poder ser fiscalizados judicialmente”.

² Dismissals on business-related grounds are regulated in articles 51 (“collective dismissals”), 52 and 53 (“individual dismissals”) of the Workers’ Statute (*Estatuto de los Trabajadores*: Royal Legislative Decree 1/1995). Unilateral substantial modifications of working conditions are regulated in article 41 of the Workers’ Statute and, if they affect employment conditions established in a formal, normative collective agreement, in article 82 of the same Statute.

³ Interim salary may be defined as the employee’s salary from the date of termination through the date on which the court’s judgment is notified. On average, interim salary could amount to 3 to 6 months of salary.

First, the causal requirement entailed the actual existence of a fact, which could be of an economic, technical, organizational or production (i.e. market-related) nature: a technological change, a decrease in consumer demand, financial losses, etc. Second, the law called for a “causal link” between that fact and the dismissal (or substantial modification), so that the latter could be said to be triggered by the former. Third, the law also demanded the court to apply a “functional test”, which was expressed by the law as a purpose requirement: the dismissal must serve the goal of improving the company’s situation or outlook.

It was the employer’s burden to gather and present before the court compelling evidence of the facts, causal links and purpose requirements that justified the employer’s decision of dismissal or substantial modification. Moreover, the employer was expected to put forward convincing arguments, not mere facts, concerning the reasons for the dismissal or the modification. Hence, the employer bore the greatest legal burden, not only of proving that something was true (financial losses, technological change, etc.), but also of persuading the court that the dismissal or the modification was the right decision given an intricate state of affairs. It was the court’s function to ascertain the existence and substance of the alleged fair cause, both as a matter of fact and law. Setting aside the difficulties related to proving some facts before a labour court (e.g. proving a decrease in consumer demand by means of the kind of evidence admissible in court), the main problem faced by employers was that the court could determine that the cause did not exist as a matter of law.

Since 1994, the legal wording stated that both dismissals and substantial modifications must be based on economic, technical, organizational or production reasons. Moreover, in order to be legally justified, any dismissal or substantial modification must be the proper measure to be taken in order for the company to get over a negative financial situation or to ensure its own viability or its level of employment. Hence, the legal test was, at a minimum, double in practical terms: there had to be a reason of an economic, technical, organizational or production nature, and there had to be a very clear relationship between the dismissal or the substantial modification of employment conditions and the company’s outlook. Thus, the labour courts were required not only to confirm the existence of the fair reason for dismissal or for substantial modification, but also to consider the business rationality of the measure that was being judged, be it in terms of competitiveness or in terms of the company’s very continued existence. And it could indeed happen that even though the company had proven a sharp and persistent decrease in sales (e.g. -24,55% between 2009 and 2010; -29,68% between 2010 and 2011) and in net income (e.g. -457,18% between 2009 and 2010; -262,37% between 2010 and 2011), these facts were not considered enough to justify the dismissal, since the company had not clearly shown, for instance, in what way the dismissal could help in correcting the negative evolution of the company’s situation.⁴

It is obvious that the problematic question was determining the exact legal meaning of these reasons in practice. As expected, one could easily provide a definition, by way of explanation, for each sort of reason. In fact, there were a lot of definitions in the legal literature, with not very much divergence among them. The broad consensus over the definition of these reasons was apparent in the Supreme Court’s case law⁵, which eventually was codified by the legislature in the 2010 Labour Reform (first by the Royal Decree-Law 10/2010 and subsequently by the Law 35/2010). As a result of this reform (Law 35/2010), the economic, technical, organizational and production reasons for dismissals were defined as follows:

⁴ Superior Court of Justice of Galicia, Judgment (*Sentencia*) 1749/2012 of 22 March 2012. A similar judgment is that of the Superior Court of Justice of Castile – La Mancha 250/2012 of 6 March 2012, in which a small company has a decrease in sales (from €171,581 in 2009 to 149,364 in 2010) and still cannot justify the dismissal: the Court argues that the company has not proven that the dismissal is a reasonable measure in order to safeguard employment or enhance its competitiveness.

⁵ A good example is the Supreme Court’s judgment of 10 May 2006 (appeal 725/2005).

Economic reasons	They exist when the company's economic results reveal a negative financial situation, such as the existence of current or anticipated loss or a persistent decline in revenue that may affect its viability or its ability to maintain employment. To this end, the company must prove the alleged results and substantiate the reasonableness of the decision taken based on them in order to preserve or advance its competitive position in the market.
Technical reasons	They exist when changes to the means or instruments of production are introduced.
Organizational reasons	They exist when changes to work methods are introduced.
Production reasons	They are based on changes in the demand for the goods or services the company intends to sell.

As for the fair reasons for unilateral substantial modifications of working conditions, the law provided that the employer must show an economic, technical, organizational or production reason. When it came to giving details of the meaning of these reasons, the law used to say, before the 2012 Reform, that the employer should demonstrate that by modifying certain working conditions the company's resources would be better managed and the company's future would be brighter, with an enhancement of its competitive position. In practical terms, this legal wording did not help much to clarify what amounted to a fair reason for implementing substantial changes to working conditions. Indeed, it was extremely difficult for any legal practitioner to issue accurate forecasts about judicial decisions on these matters.

III. The main changes introduced by the 2012 labour reform

The 2012 Labour Reform (Law 3/2012) has maintained the fundamental requirement that both dismissals and unilateral substantial modifications of employment conditions be based on a good cause. However, it has attempted to dramatically change the way in which the labour courts must deal with the good cause requirement: first, by giving a more precise definition of the reasons that sustain a fair dismissal; second, by eliminating the part of the causal requirement related to the company's prospects ("reasonableness test"), thus restricting judicial latitude; third, by expanding the causes for substantial modifications; and fourth, by setting up an alternative dispute resolution procedure for modifications affecting conditions established by the vast majority of collective agreements with the status of law⁶.

In the first place, the Law 3/2012 maintains the old definitions of economic, technical, organizational or production reasons, except that: (1) economic reasons now comprise not only a persistent decline in revenue, but also a persistent decline "in sales"; (2) the persistent decline in revenue takes into account only "ordinary income", leaving out extraordinary income; (3) a "persistent decline" is deemed to exist where it has lasted at least three consecutive quarters, comparing three given quarters to the same quarters of the previous year; and (4) organizational reasons include the idea of changes in the way the production process is organized.

In the second place, the 2012 Reform eliminates what I have called the "functional test": the courts are no longer called upon to consider whether or not the dismissal serves the goal of improving the company's situation or prospects. As we shall see below, this is a potentially ground-breaking development in our employment relations system.

In the third place, as to the fair reasons for unilateral substantial modifications of working conditions, the law provides that the employer must show an economic, technical, organizational or production reason. It does not provide any definition of these reasons, nor does it require any longer that the employer demonstrate that by modifying certain working conditions the company's resources would be better managed and the company's future would be brighter as a result of the enhancement of its

⁶ Most collective agreements in Spain have the status of law: they are binding not as contracts but as mandatory legal provisions. Hence, they are officially published and the labour administration may sanction firms for noncompliance with the applicable collective agreement.

competitive position. The current legal wording has been changed, so that the law now plainly says that fair reasons for unilateral modifications are deemed to exist where they relate to such broad concepts as “competitiveness, productivity, or technical and work organization in the firm”.

Finally, the Reform has tried to solve the long-standing problem posed by firms seeking to opt out of industry-wide collective agreements. Though a workplace agreement is initially required, a lack of agreement may eventually be overcome through arbitration: the firm willing to opt out and thus modify certain working conditions regulated by the industry-wide agreement (or even by a company-level agreement) may unilaterally refer the matter to arbitration. This arbitration service will be provided by a public tripartite body called the national advisory committee on collective bargaining (“Comisión Consultiva Nacional de Convenios Colectivos”). Hence, once settled by arbitration, this kind of dispute over modification of working conditions will not be fully reviewable by any labour court, since arbitration decisions may be challenged before a court only on very limited grounds.

It is apparent that the legislature’s intent has been to simplify the good cause requirement for redundancies and substantial modifications of employment conditions. The legislature has without doubt eliminated legal wording that required the labour courts to deliberate about such problematic questions as the consequences of dismissals or substantial modifications for the future of the company. However, it is debatable whether the government will attain the desirable goal of legal certainty concerning the fair reasons for economic dismissals and substantial modifications of working conditions.

IV. The courts’ role in interpreting the fair reasons for dismissals and modifications

As explained, the labour courts have played a dominant role in defining the practical meaning of the legal reasons for dismissals and modifications. In a system where the definition of most legal concepts and institutions results from a permanent interaction between the legislature and the courts, the latter’s role depends on the precision of the language in the statutory descriptions. If the statutory description of the fair reasons for dismissals and modifications is vague, then the courts’ power is almost unlimited with respect to its ability to declare the dismissal or the substantial modification of employment conditions as fair or unfair. Indeed, the article defining the fair reasons for dismissals and modifications prior to the 2012 Reform was described by a judge as a veritable “blank check” (BELTRÁN ALEU, 2006, 152).

Moreover, in practical terms, this enormous power mainly rests with the lower instances of the labour courts. Thus, each first-instance labour court (*Juzgado de lo Social*), where only one judge sits, assumes considerable power. On the one hand, first-instance labour courts have almost complete control over the determination of the facts (here, judges are professional triers of fact) from the admissible evidence (witnesses, experts, documents, etc.) brought before them. On the other hand, the study of judicial cases over the last fifteen years warrants the important conclusion that the various labour courts (*Juzgados*) have applied very different criteria for reviewing dismissals. This holds true as well for litigation on substantial modifications of working conditions. In both areas, it has been extremely difficult to settle uniform case law: by their very nature, the solutions of these cases have hinged on casuistic reasoning rather than on general principles or rules, thus making it difficult for the regional Superior Courts (*Tribunales Superiores de Justicia*), let alone the Supreme Court (*Tribunal Supremo*), to establish harmonized criteria to be followed by the *Juzgados*. These lower courts have been able to maintain differing standards in key aspects of the litigation over the fairness or unfairness of economic dismissals and modifications: e.g., as to the evidence admissible to prove economic, technical, etc. reasons, or as to the assessment of the connection between the dismissal (or modification) and the legal aim of improving the company’s negative situation or its future prospects.

It goes without saying that this has resulted in widespread legal uncertainty. This is the basic legal reality that has enormously conditioned labour flexibility in Spain over the last few years. It is scarcely relevant that not all courts have been overprotective of employees,⁷ as employers tend to stress

⁷ I point out the authoritative opinion of J.M. GOERLICH PESET (2005): “The interpretation of a part of the labour courts, induced by their previous experience of judicial review of disciplinary dismissals, has been based on demanding stringent standards of proof of the causes of restructuring, up to the point of requiring something impossible to satisfy” (p. 252, f.n. 53).

the risk of obtaining unfavourable judgments. And unfavourable judgments have meant, at a minimum, significant additional liabilities: e.g. interim salary (sometimes in amounts larger than unfair dismissal compensation). As a result, many employers have made a strategic business decision to simply avoid litigation over these matters. The main three alternatives they have chosen have been overuse of fixed-term employment, overuse of unfair dismissals, and productivity coalitions with employee representatives. This reality is a specific reason, among many other more general reasons, for employers to have taken a negative attitude towards the Labour courts.

V. The search for legal certainty (the individual approach): employer's overuse of fixed-term employment and unfair dismissals.

Legal uncertainty related to dismissals and internal flexibility (substantial modifications of working conditions) has been a major cause of two distinct features of employment relations in Spain: a high rate of fixed-term employment and a disproportionate use of express dismissals as a means of terminating permanent employees without litigation. In turn, both features have reinforced each other, resulting in a distorted labour market, one in which numerical flexibility has tragically pushed out other forms of labour flexibility more favourable to human capital development.

Temporary employment has been the alternative preferred by employers to enhance both numerical and internal flexibility and at the same time avoid litigation. It is a well known fact that among OECD countries Spain stands out for the highest rate of temporary employment. Over the last two decades, this rate has fluctuated between roughly 25 and 35 percent (see Figure 1). Temporary employees are generally more prone to conform and to accept company-imposed changes, and also less inclined to sue during the employment relationship. Moreover, temporary employees are synonymous with numerical flexibility: as is clear from Figure 2, termination of fixed-term contracts has constantly been the most used mode of termination of employment. Indeed, Figure 2 most probably underestimates termination of fixed-term contracts, because the data are derived from applications for contributory unemployment benefits, and only employees who have been insured at least one year are entitled to these benefits (fixed-term employees are less likely to meet this requirement than permanent ones). This mode of termination not only entails a low monetary cost in terms of severance compensation (until 2011, just 8 days' salary per year of work), but also a very low risk of litigation.

Figure 1. Temporary employment rate. (Source of data: Encuesta de Población Activa).

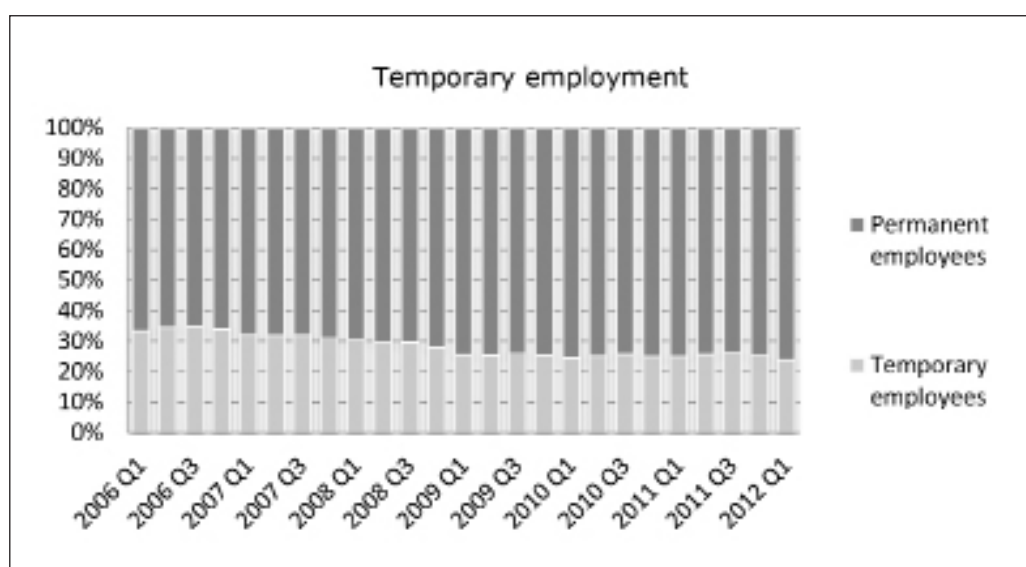
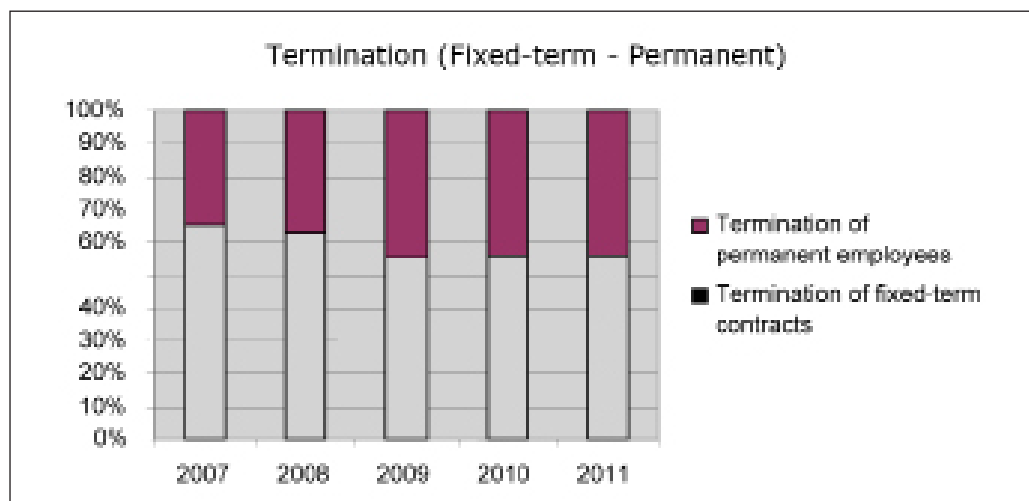


Figure 2. (Source of data: Ministerio de Empleo y Seguridad Social).

For permanent employees, the adjustment solution preferred by companies has been express dismissals, that is to say, instant, summary dismissal (disciplinary dismissal) followed immediately by the employer's admission of its unfair nature and the payment of the resultant severance compensation (45 days' salary per year of employment up to a maximum of 42 months' salary). As is clear from Figure 3, this has been the most common mode of terminating permanent employees, especially before the economic crisis that began in 2008. During the years prior to the 2009 recession, express dismissals accounted for 75 percent of all terminations of permanent employees. Before 2008, individual redundancies (causal dismissals for reasons not inherent to the employee) accounted for less than 10 percent of all terminations of permanent employees: given the thorough scrutiny applied by the labour courts, this sort of dismissal was hardly practical unless the company was in a negative financial situation (losses). Over the last few years (2008-2011), individual redundancies have been on the rise; a plausible explanation for this is the genuine economic crisis of many companies. It is important to note that individual redundancies (unless declared unfair by a labour court) entail a severance compensation of 20 days' salary per year of employment up to a maximum of 12 months' salary (in fact, companies with less than 25 employees receive a subsidy of up to 40 percent of that amount). Hence, the difference between the cost of unfair dismissal and the cost of (fair) redundancy is substantial.

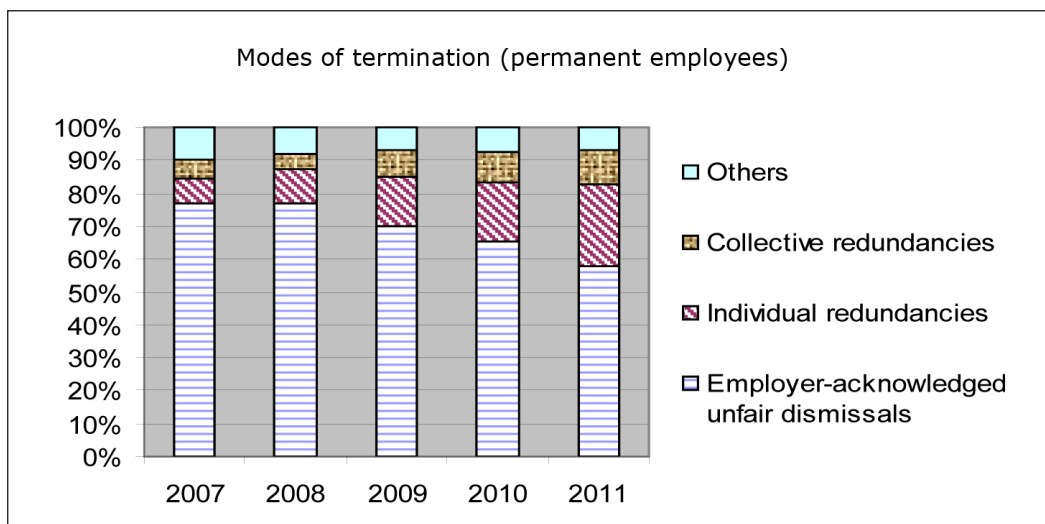
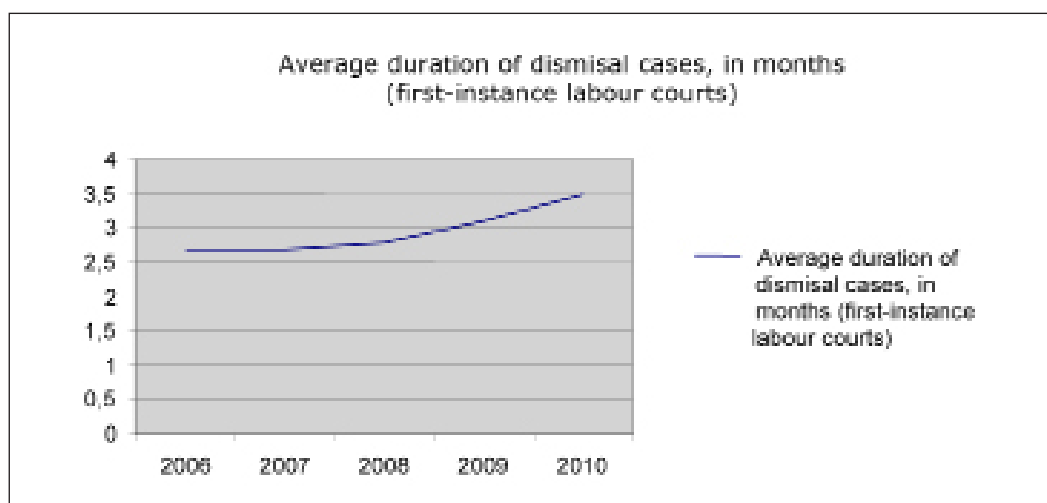
Figure 3. (Source of data: Ministerio de Empleo y Seguridad Social).

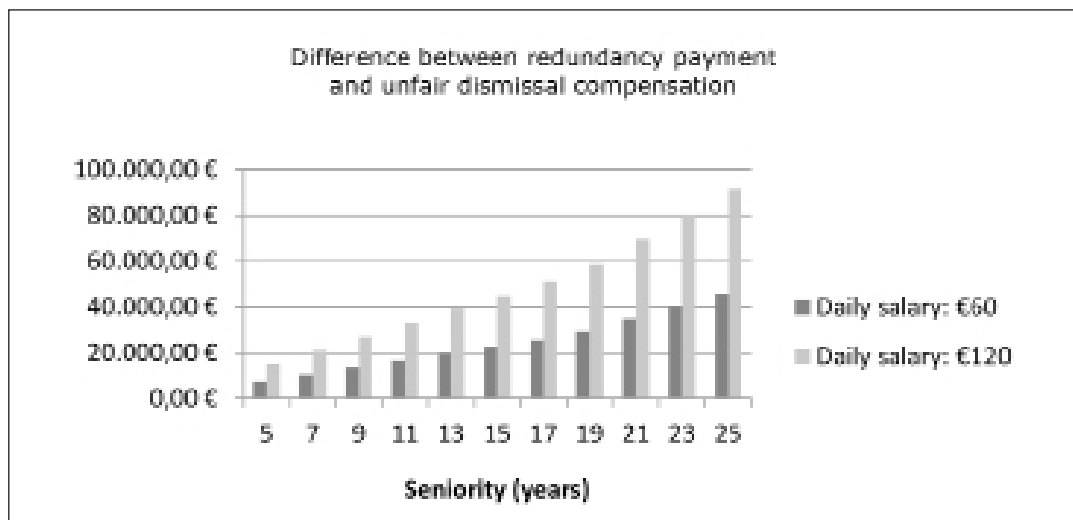
Figure 4. (Source of data: Consejo General del Poder Judicial, La Justicia Dato a Dato, 2010).

If the severance cost difference is substantial, why would any rational employer acknowledge a dismissal as unfair, instead of trying to maintain in court that the dismissal was objectively based on economic, technical, organizational and production reasons? Since employee access to the labour courts is relatively easy and inexpensive, any company, no matter how large or small, may logically expect that the employee will claim unfair dismissal. The costs associated with the proceedings are interim salary and litigation costs. Interim salary is the salary from the date of dismissal to the date on which the court's judgment is notified (on average three to six months' salary, though it has risen since 2008 due to the judicial overload aggravated by the economic crisis; see Figure 4). As to the litigation costs (lawyer's fees, travel expenses, time spent by different persons, expert witness fees, etc.), they will not be paid by the employee even if the employer wins the case. Accordingly, a company trying to defend the fairness of the dismissal will bear in any event the costs of litigation, and furthermore it may end up paying the full compensation for unfair dismissal as well as interim salary.

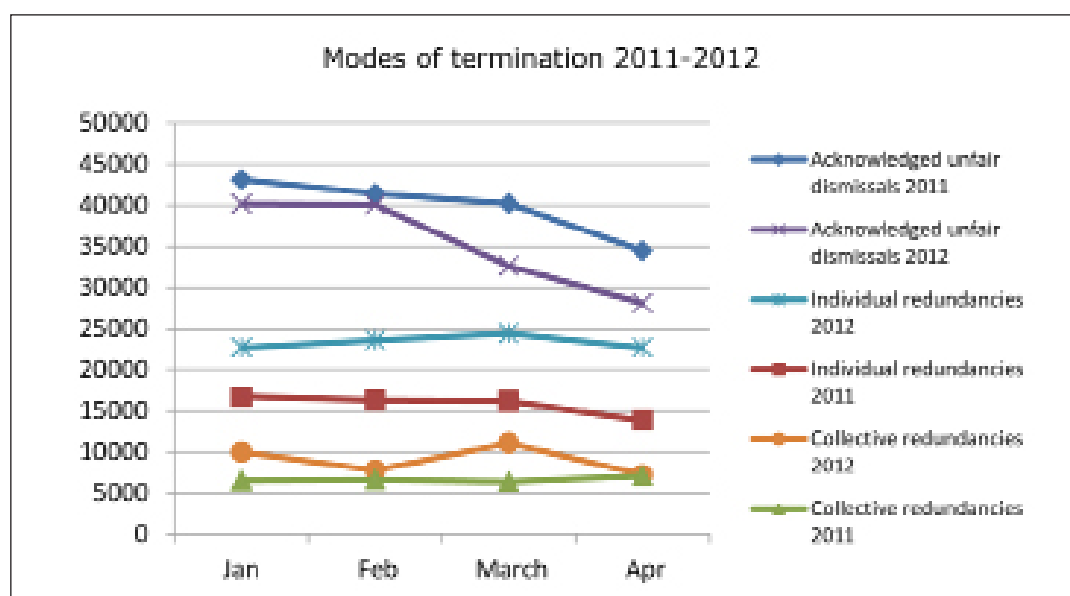
In many cases, however, the severance cost difference is more than the litigation costs associated with pursuing a causal dismissal. Take an employee with low seniority (say seven years) and an under-average salary (say €20,000 per annum): the difference between the unfair dismissal compensation (€17,260) and the redundancy payment (€7,671) would clearly exceed the typical cost of litigation in most cases. If the company employs less than 25 employees, that difference would be even larger, since the State ("Fondo de Garantía Salarial") subsidizes up to 40 percent of the redundancy payment (in this example, the subsidy would be €2,755, thus reducing the redundancy payment borne by the employer to €4,916). As you would expect, if you take an employee with more seniority and salary, the difference between unfair dismissal compensation and redundancy payment increases, so that, for instance, for an employee earning daily €120 and with 15 years seniority, that difference would be €45,000 (see Figure 5).

In view of this substantial difference, it would be rational to take the risk of having to pay interim salary as long as there existed a good chance of obtaining a favourable judgment from the labour court. The official statistics show that in 2009 (before the 2010 Labour Reform) 50,000 judgments were favourable to the dismissed employee, and only 13,419 were favourable to the employer⁸. It is obvious that the difficulty of obtaining favourable review of individual redundancies and the uncertainty of the regulation of their fair reasons explain why employers prefer to acknowledge up front that the dismissal is unfair. The risk of having to pay interim salary is alone insufficient to explain this marked preference. Indeed, although the 2012 Labour Reform (in force since 12 February 2012) has eliminated interim salary in most

⁸ This may have to do with the fact that "judges' decisions tend to be particularly favourable to workers when unemployment is high" (MARTIN / SCARPETTA, 2011, p. 3).

Figure 5.

cases (for dismissals declared unfair by the labour courts), many companies still prefer to acknowledge up front that the dismissal is unfair. The latest statistical data over the period of February to April 2012 show a comparatively slight decline in the number of employees applying for unemployment benefits (regarding the same period of 2011) after having been dismissed with the employer's acknowledgement of unfairness. Admittedly, it is too early to draw any firm conclusions from these data, but our conjecture is that an important explanation for the only slight decline in unfair dismissals may be legal uncertainty over the consequences of the employer's unilateral acknowledgement of unfair dismissal (e.g. tax effects) rather than the employers' confidence in the new legal framework for individual and collective redundancies. The provisional conclusion is that even without the risk of interim salary, a large number of companies prefer unfair dismissals (high severance payment) over redundancies (low severance payment): the data for April, 2012 (which reveal terminations of March and April for the most part, that is to say a period in which there has been no risk of having to pay interim salary) show 28,089 individual dismissals acknowledged as unfair, almost the same number as individual and collective dismissals in total (29,874).

Figure 6. (Source of data: Ministerio de Empleo y Seguridad Social).

It is clear, therefore, that there has been an excessive use of unfair dismissals by Spanish employers. Still, this is not in itself the problem, but rather the symptom of a truly acute underlying problem (DESDENTADO / DE LA PUEBLA 2010: 69): the legal definition of the fair reasons for redundancy (and substantial modifications of employment conditions as well) is “confusing, contradictory and hardly realistic” (DESDENTADO / DE LA PUEBLA, 2010: 74).

VI. The search for legal certainty (the collective approach): fair reasons and productivity coalitions with the employee representatives

The 2010 Labour Reform introduced a new mechanism to reduce the legal uncertainty surrounding the fair reasons for substantial modifications of employment conditions. In cases of collective modifications (defined at that time as any substantial modification affecting working conditions established in workplace agreements or other terms collectively applied within the company, and now defined as any substantial modification affecting at least a given number of employees relative to the firm’s workforce size), the law requires the employer to negotiate the projected substantial modification with the employee representatives. If both parties reach an agreement, the law presumes that a fair reason exists for the modification. This presumption of fairness introduced by the 2010 Reform entails that the modification is presumed to be based on a fair reason as long as it has been agreed by the employee representatives. Thus, the party challenging the modification must prove either the abusive nature of the agreement or that it was reached through coercion, deceit or fraud. By any standard, this requirement of proving coercion, fraud or deceit places an extremely heavy burden on the party wishing to challenge the modification before a labour court.

Accordingly, the new provision brought in by the 2010 Labour Reform encourages “negotiated flexibility”, and, at the same time, tactfully redefines the role of the labour courts. The practical outcome is that the labour courts cannot examine the reasons for the substantial modification of employment conditions once they have been agreed by employee representatives. Consequently, the effect is the substitution of the employee representatives for the court: the function of examining and reviewing that the company has a fair reason for bringing about substantial changes in working conditions is performed in the first instance by the employee representatives; if the flexibility measure is agreed, the court’s role is negligible. Naturally, if the measure is not agreed, but rather unilaterally imposed by the company without the employee representatives’ consent, then the court may eventually examine the reasons alleged by the company and declare the substantial modification void or unjustified.

This mechanism introduced in 2010 has been a valuable tool for promoting “negotiated internal flexibility”. It may in fact reinforce a business strategy uncommon among large companies and extremely rare among small employers and medium-sized companies: a long-term strategy based on a continuous process of dialogue between labour and management. However, this mechanism has never been applicable either to individual redundancies or to individual modifications of working conditions. Collective redundancies did not pose the same problems at that time, as they required prior authorization by the labour administration: in practice, the public administration required that the collective dismissal be agreed by employee representatives, and the chances of successfully challenging such administrative decisions before an administrative court were extremely low. Hence, legal uncertainty remains as to the definition of fair reasons for redundancies or for individual modifications as well as for collective modifications not agreed by employee representatives. Both the 2010 and the 2012 Labour Reforms have tried to address this critical and complex issue.

VII. The search for an exact definition of the fair reason: round one (2010).

As explained, the causal requirement established by the law has traditionally featured three elements: a fact, a causal link and a functional test. Under these requirements, the courts’ role was not

confined to merely verifying the existence of the fact—a task which in itself entailed a certain degree of autonomy—but extended to deciding whether the dismissals were causally linked to that underlying fact and reasonably appropriate to overcome the company's negative situation. Hence, Spanish companies were required to prove not only the existence of an economic (or technical, etc.) reason for dismissal (or for substantial modifications of employment conditions), but also a close relationship between that reason, the dismissal (or modification) and the effect of the latter on the company's future or outlook (the so-called functional test). In June, 2010 the Royal Decree Law 10/2010 established that the company had to prove just a "minimal" connection between the dismissal and the company's future: provided the economic, technical, etc. reason for dismissal existed in fact, the dismissal would be fair if the employer could show that the dismissal was *minimally* reasonable in order to improve the company's situation or to prevent a future negative evolution. The inclusion of the word "minimally" in the legal text supplied the legal basis to argue that the new enactment's purpose was to lighten judicial enquiry, so that economic dismissals would eventually be subject to less intense judicial scrutiny. However, the word "minimally" was removed from the legal text just a few weeks later: the final version of the 2010 Labour Reform, passed as Law 35/2010 in September, 2010, restored the previous wording: economic dismissals could therefore be subject to intense scrutiny by the labour courts, requiring employers to continue to prove a close relationship between the underlying reason for dismissal and the favourable effect of the dismissal on the company's situation.

While the final version of the 2010 Labour Reform did not reduce the courts' autonomy regarding the functional test, it did provide a new definition of "economic cause". Under the previous wording, economic cause was identified with a financially "negative situation", basically financial losses. In September 2010, two significant amendments were introduced. First, the phrase "negative situation" was redefined as including not only actual losses, but also expected losses. Second, the economic cause was identified not only with a negative situation (losses), but also with a persistent decrease in revenue. Hence, as a result of these innovations, a company generating profits could dismiss employees on economic grounds.

The new definition of the economic cause in September 2010 was extremely controversial but scarcely useful in practice. Indeed, many labour courts derided the very concept of "expected losses" as purely conjectural ("a fact of the future") and opposed the idea of validating redundancies on such speculative facts: for example, the Superior Court of Justice of Madrid affirmed in a recent judgement: "the new wording [that of September, 2010] does not lead to complete certainty as to its interpretation and application by the courts. To begin with, the existence of expected losses is an inconsistency, since what one foresees in the future does not currently exist and thus it is impossible to prove"⁹. As to the concept of a "persistent decrease in revenue", it was too vaguely expressed to be able to create an adequate degree of certainty. In any case, even though a company could come up with compelling evidence pointing to "future losses," the court could always declare the dismissals unfair by arguing that a workforce reduction was not the appropriate response in order to improve the company's prospects. Certainly, there is a glaring inconsistency in deriding a legal concept as conjectural and at the same time defending that the courts should judge and have full authority and ample scope to substitute their judgment as to the best interests of the company for that of the employer. In both instances (how to anticipate losses or how to improve the company's outlook), the judgment does not entail legal reasoning, but pure "business" foresight and anticipation. In sum, this is a question of expectations and probability, which creates an inadequate setting for thorough judicial scrutiny: by contrast, employee representatives are better placed to examine and discuss the business restructuring plan, and therefore should be granted more decisive power.

The amendments introduced both by Decree-Law 10/2010 and Law 35/2010 turned out to be short-lived regulations, and for this reason they cannot be empirically evaluated in an adequate manner. Nevertheless, one thing is clear: the key objective of legal certainty was not attained, with an apparent division within the courts as to how the new legal wording should be construed and applied. This relentless legal uncertainty is the main driver of the amendments made by the latest Labour Reform.

⁹ Judgement 228/2012 of 9 March 2012.

VIII. The search for an exact definition of the fair reason: round two (2012).

The 2012 Labour Reform (Law 3/2012) aims directly at the standard of judicial review in redundancy cases. The Reform tries to get to the root of the problem here identified as legal uncertainty regarding the fair reasons for redundancies and substantial modifications of employment conditions. Thus, although it also makes some changes to the definition of economic cause, the major innovation occurs in the technical details of the judicial process: what the Legislator now seeks is a judicial process where the court must focus on the existence of the facts, not on the adequacy of the employer's decision regarding the best course to improve the company's future.

Admittedly, the Reform also makes changes in the definition of economic cause: first, it adds the word "sales" to the phrase "persistent decrease in revenue," so that a persistent decrease in sales is in itself a cause of redundancy, even though there is no decrease in revenue; second, it also adds the word "ordinary" to qualify the revenue which must be taken into account when measuring the decrease; and third it tries to respond to the critical lack of precision of the previous wording by providing a numerical definition of "persistent": from now on, a decrease must be considered persistent if it has lasted three consecutive quarters by comparison with the same period of the previous year.

The exact definition of the facts justifying redundancies or modifications is now significant, since the law clearly requires the labour courts to confine themselves to carrying out a sole function: they must verify the existence of the facts alleged by the company to make employees redundant. It would not be an easy task to find another passage in our employment legislation delivering such an unambiguous message. The explanatory statements of the Law 3/2012 level serious criticisms of a legal framework which allowed the labour courts to substitute their own view (judicial discretion) for the employer's (company discretion) regarding the management of the company, and conclude that from now on it should be clear that the labour courts' sole role is to review the parties' evidence as to the facts that legally justify redundancies.

This intended transformation of the role of the labour courts in redundancy cases is revolutionary in Spain. As with most revolutions, there is a clash of principles and interests here. As expected, workers' unions have mounted vehement opposition to the new legal framework, but some judges have also expressed bitter criticism. Thus, two judges of the Superior Court of Justice of Catalonia have published an article in which they uncover the reasons why the legislature's choice is "unacceptable" (MARAGALL / SERNA, 2012). Furthermore, in a most unusual action, "*Jueces para la Democracia*" (hereinafter JD), one of the three main national associations of Spanish judges, issued a document only a few days after the entry into force of the Decree-Law 3/2012. In the first paragraph of this document¹⁰ JD portrays the new enactment literally as "one of the most important attacks on labour law" since the restoration of democracy, and depicts the reform as "offensive, regressive, reactionary, and utterly unfair." Regarding the more specific issue of the reasons for redundancy, JD considers that "the new regulation intends to limit, once again, the courts' authority to judge the purpose and reasonableness of redundancies by removing the finalistic-cause components." For JD, this entails the breakdown of the requirement for justification of dismissals, which is contrary to the constitutional right to work and to ILO Convention 158. In view of the above, JD proclaims that "our duty as judges who must guarantee workers' fundamental rights is to continue applying labour laws in accordance with constitutional principles and values, and thus to bring to an end the potential abuses that may arise from the considerable powers granted to employers." Their final remark is striking: "We will continue along this line, dismissing the signs of distrust from the legislature apparent in the amendments to the procedural regulation."

The most important constitutional principle concerning judges and courts is the rule of law: as article 117.1 of the Constitution says, judges are "subject only to the rule of law"; and article 117.4 of the Constitution makes clear that judges shall not exercise any powers other than those expressly allocated to them by the law. A court cannot decide not to apply the law even if it considers the law unconstitutional: all it can do is to bring the matter before the Constitutional Court (article 163 of the Constitution). Naturally, the courts must construe any law in accordance with constitutional principles and values, and

¹⁰ <http://www.juecesdemocracia.es/txtComunicados/2012/16febrero12.htm> [Date of access: 31 May 2012]

they must read any statute so as to conform to fundamental rights. But this interpretive function must be carried out within the limits reasonably allowed by the statutory language. Judicial activism is a positive thing only if not taken to the extreme in which the courts' discretionary powers replace the democratic legislature's will: as expressed by Lord BINGHAM, "*judicial activism, taken to extremes, can spell the death of the rule of law*" (Lord BINGHAM, 9).

Indeed, the ILO Convention 158 (1982) —an instrument ratified by only 9 EU states (Spain, France and Portugal among them), and not ratified by important European countries such as Germany, Austria, Denmark, Italy, Belgium, the Netherlands, and the United Kingdom— does not prevent any country from establishing a standard of judicial review as that provided for by Law 3/2012. Article 9.3 of this Convention says: "In cases of termination stated to be for reasons based on the operational requirements of the undertaking, establishment or service, the bodies referred to in Article 8 of this Convention [court, labour tribunal, arbitration committee or arbitrator] shall be empowered to determine whether the termination was indeed for these reasons, *but the extent to which they shall also be empowered to decide whether these reasons are sufficient to justify that termination shall be determined by the methods of implementation referred to in Article 1 of this Convention* [laws, regulations, collective agreements, arbitration awards or court decisions or in such other manner as may be consistent with national practice]." Presently, in a country like Sweden which has ratified the Convention, "the courts *do not examine business assessments made by employers which lead to decisions to reduce their workforce*, unless there is reason to suspect that a given dismissal is due not to business considerations in the sense envisaged by the Employment Protection Act but to reasons which in reality relate to the individual employee concerned" (T. SIGEMAN, 269). In the same vein, ILO Recommendation 119 (1963) states that the power to examine the reasons given for the termination of employment does not imply that the neutral body should be empowered to intervene in the determination of the size of the work force of the undertaking, establishment or service (5.2).

The real issue is whether the new legislation leaves the interpretation of the fair reason for redundancy to the labour courts' discretion. The new legislation provides that a decrease in sales or ordinary revenue over a period of three consecutive quarters is a fair reason for redundancies. Does this wording leave any margin of interpretation? The answer is clearly in the affirmative: how large the decrease must be is just a doubt among many others raised by the new legal wording. Therefore, the question relating to the existence of a margin of interpretation has to be answered in the affirmative.

Moreover, though the law does not mention the requirement of reasonableness and in fact intends to prohibit courts from substituting their own assessment of the rationality of the dismissals for the employer's assessment, the labour courts may legitimately resort to other legal concepts, such as the general legal ones of abuse of rights (in the sense of the antisocial exercise of one's own rights) and evasion of the law ("*fraude à la loi*", "*fraude de ley*"). Admittedly, these general legal concepts should be used only in extraordinary circumstances: the case law states that either the abuse of rights or the "*fraude*" cannot be ordinarily presumed. Nevertheless, our provisional finding must be that it is far from clear that the 2012 Labour Reform will fully achieve its objective of ensuring legal certainty regarding the definition of fair reasons for redundancies.

The intended transformation of the role of the labour courts in redundancy cases goes along with another important legislative decision. As a matter of principle, the labour courts in charge of determining in the first instance all kinds of labour claims are the one-judge courts established in every provincial capital and, additionally, in larger towns and cities (*Juzgados de lo Social*). This has been the general rule for decades, with very few exceptions justified on the grounds that the territorial scope of the claim exceeded that of the province or district (e.g. a union disputing an employer's interpretation of a nation-wide collective agreement must lodge the claim with a court with national jurisdiction). Hence, it is particularly striking that the 2012 Labour Reform provides that *all* collective claims challenging collective dismissals will be lodged not with the one-judge courts (*Juzgados*), but with the higher courts established in every Autonomous Community (Superior Court of Justice) or with the so-called "*Audiencia Nacional*," which is a labour court with national jurisdiction. This is a modification of the previous general rule, because even if the collective dismissal occurs in a company with a sole establishment

within the jurisdiction of a “Juzgado,” the claim against the company must be lodged with the Superior Court of Justice of the Autonomous Community in which that establishment is located.

There are several plausible explanations as to why the Government has decided to modify the traditional allocation of judicial functions among the different kinds of labour courts. However, since there is no formal statement on this particular subject, we do not have any “official” explanation; hence, we cannot affirm that any of these plausible explanations is the one that has in fact motivated the legal modification.

One plausible explanation is that the Government has tried to avoid different ways of interpreting the law. As of 1 January 2010, there were 331 one-judge labour courts (“Juzgados”) in all of Spain. By contrast, there are noticeably fewer higher labour courts with first-instance functions: 21 “regional” labour courts and 1 national labour court. By allocating collective dismissal cases directly to these regional and national courts (skipping the “Juzgados”) the Legislator reduces the chances of ending up with different ways of interpreting the law. However, this numerical reduction by itself does not mean that the 22 labour courts will reach the same conclusions about the meaning of the law; indeed, it is a virtual certainty that the 22 labour courts will hold mixed opinions. This means that any decision taken by the 22 labour courts in collective dismissal cases may be appealed to the Supreme Court. By skipping the “Juzgados,” the new legislation not only makes possible for the Supreme Court to produce “binding” case law in a relatively short period of time (in 2013 there may already be a few Supreme Court decisions interpreting fair reasons for redundancy), but also makes it possible for the Supreme Court to review *all* collective dismissal cases, as long as the party who has lost in the first instance lodges an appeal. This latter aspect is clearly the most important: if the law had established the Juzgados’ jurisdiction over collective dismissal cases, the appeal to the Supreme Court would be extremely difficult in practical terms.

For all the changes introduced to the system of adjudication of collective dismissal cases, the issue of “judicial activism” by the “Juzgados” remains in force for “individual redundancies” or, for that matter, for substantial modifications of employment conditions. Individual employees affected by individual redundancies (“despidos objetivos”) may challenge the dismissal before a one-judge labour court. If we take a look at Figures 3 and 6 (above), we can confirm that the incidence of “individual redundancies” is greater than that of “collective redundancies.” Moreover, individual redundancies have higher incidence in smaller companies by comparison with larger ones: the legal threshold for a collective dismissal is at least 10 employees (or at least 6 employees if the company is shutting down all its activities); therefore, small companies with less than 25 employees are not likely to use the collective dismissal procedure. The one-judge labour courts may exercise an enormous degree of discretion when examining the fair reason for individual redundancy alleged by the employer; and though their decisions may ordinarily be challenged before the Superior Court of Justice and even reach the Supreme Court (especially through the newly enacted prerogatives of Public Prosecutors regarding appeals in cases involving the interpretation of legal provisions which at the time legal proceedings begin in the first instance have been in force less than five years), first-instance decisions produce immediate effects that may be detrimental to companies, even though the decisions may eventually be overruled by the higher courts.

IX. Conclusion

The traditional Spanish employment relations system concerning firm adjustment may be described as uncertain, unbalanced and individualistic. Legal uncertainty over fair reasons for redundancies and substantial modifications of employment conditions remains even after the 2012 Labour Reform. The system continues to be unbalanced, both from the perspective of employers and from that of employees. Small employers can hardly manage to gather the paperwork and other kind of evidence needed at trial to prove a dismissal case or a unilateral substantial modification of employment conditions (e.g. a decrease in sales). Temporary employees, who in practice face hyper flexible employment conditions and employment at will, compensate smaller employers for this rigidity. These are well-known facts among specialists and practitioners. A less commented part of this story is the individualistic approach

to employment protection. The collective protection that unions and other employee representatives (works councils, etc.) can provide (social plan, labour market services, etc.) covers a small fraction of the workforce: thus, for most employees the only protection is a lump sum payment followed, if the individual has worked a sufficient amount of time, by unemployment benefits. The protection that the courts can provide is strictly limited: unless the dismissal is void because of discrimination, harassment, retaliation, or some other reasons, the court can only raise the amount of the lump sum payment from 20 days' salary per year of work to 45 (or 33) days' salary per year of work.

It is possible to think of a better use for these financial resources. The innovation introduced by the 2010 Labour Reform restricting the ability of the labour courts to invalidate the substantial modifications of employment conditions agreed with the employee representatives should be extended to collective dismissals. Thus, the law would provide a strong incentive to building "productivity coalitions" by companies and employee representatives (DUBIN, 2012). The result would be an increase not only in procedural simplicity but also in fairness: those companies that invest in employee participation and conclude agreements for substantial modifications or redundancies should not have to prove their business reasons before a court. Furthermore, the collective and bilateral administration of the employment adjustment process can design more efficient ways of compensating employees who end up losing their employment. A large fraction of the redundancies and dismissals related to productivity reasons have taken place without any collective involvement on the part of employees. This happens at the cost of paying high severance compensation (it used to be 45 days' salary per year of work, but for contracts entered into after 12 February 2012 it will be 33 days' salary per year of work) to individuals who are left unemployed and largely on their own in search of new employment opportunities.

Over the last few decades, it has been quite difficult to justify or get approval for dismissals based on business-related reasons (entailing a severance payment of 20 days' salary per year of work up to a maximum of one year's salary). At the same time, it has been extremely easy to dismiss employees through the so-called "express dismissal procedure" (with much higher cost: 45 days' salary per year of work up to a maximum of 42 months' salary). This historical experience led to the reasonable conclusion that termination costs in Spain were far above the European average, which in turn has paved the way for a reduction in unfair dismissal compensation. Moreover, legal uncertainty as to the construction of the fair reasons for dismissals and substantial modifications has encouraged firms to seek alternative, distinctly sub-optimal paths to flexibility (eg. temporary employment).

Even though express dismissals have been a prevailing trait of our employment relations system, Spain ranks second (after Germany) among OECD countries in terms of contested dismissal cases (VENN, 2009, 33). Over the past few decades, the employment courts have had a leading role in determining the possibilities and costs for employers of adjusting employment to actual business needs. Thus, the high rate of individual dismissals acknowledged as unfair by employers (express dismissals), along with an OECD-leading rate of fixed-term employment, have been the by-products of a legal system unable to adequately deal with workforce restructuring. Setting aside the long-standing problem of a dual labour market, the high rate of individual unfair dismissals has led to at least two negative consequences. First, employers have faced huge costs of restructuring, disproportionately high for small companies: instead of severance payments of 20 days' salary per year of work, they have faced unfair dismissal compensation of 45 days' salary per year of work. These huge costs, in turn, have often resulted in decisions to postpone restructuring or simply no restructuring at all. Second, employees unfairly dismissed on an individual basis have lacked union representation, collective control of employer decisions, and also the kinds of social measures that typically go along with collective dismissals (retraining, outplacement, etc.).

It is clear that the Legislator's intent in 2012 is to discontinue the practice of express dismissals and to make firms use individual and collective redundancy procedures for all business-related dismissals. But this objective is contradicted by the simultaneous decision to reduce compensation for unfair dismissals. Moreover, the new legal framework is likely to lead to more litigation. On the one hand, firms no longer have the clear incentive to avoid litigation they used to have in the past (saving interim salary). On the other hand, after the new law, severance compensation for unfair dismissals is not exempt from taxation unless the dismissal is agreed after the employee has filed a lawsuit. The same conclusion

(more judicialization) may be reached regarding collective dismissals. Until the Decree-Law 3/2012, collective dismissals required authorisation by the labour authority. In practice, the labour authority typically issued the authorisation in order to approve the prior agreement reached by the employer and the employee representatives; it was generally quite difficult to obtain administrative authorisation without such prior collective agreement. Generally, the agreement was concluded at the cost of offering employees at least the unfair dismissal severance compensation. Overall, the system was expensive but reliable: if there was agreement, the labour authority granted the authorisation, which, in turn, was almost impossible to challenge before an administrative court. Now, however, as the 2012 Reform has abrogated administrative authorisation, collective dismissals may be challenged before a labour court. The employer continues to be required to negotiate in good faith with employee representatives before announcing its decision: if the employer and the employee representatives conclude an agreement, the employer's decision to dismiss based on the terms of the agreement is still subject to possible (and likely) lawsuits both from the individual employees affected and from any unions which did not sign the agreement. As expected, both individual and collective lawsuits are possible (and likely) where the employer, after fruitless negotiations with the employee representatives, unilaterally makes the decision to dismiss a number of workers. Though the legislature provides a technical mechanism ensuring that all these possible collective and individual lawsuits against a collective dismissal receive a unitary response from the labour courts, the basic problem still lies in the uncertainty surrounding the interpretation of the fair reasons for dismissal.

Thus, it seems that much of the game surrounding dismissals and modifications will continue to be played out in the labour courts. If this interpretation is correct, then the 2012 Reform may fail in its attempt to reduce legal uncertainty. But this may be inevitable if along with a more flexible legal design of employment adjustment measures the legislature does not try to strengthen social dialogue at the workplace level.

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