LEGAL UPDATE ARBEITSRECHT

Cologne, 20/03/2025

Change in case law: Invalidity of lapse clauses in the case of virtual option rights

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Employee share programmes, in particular in the form of virtual option rights, are an important method of incentivising staff and managers. If employees are participating in a company's success this would encourage long term commitment to the company. However, this raises the question of to what extent such option rights remain after the end of the employment contract and to what extent they are permitted to be the subject of lapse clauses.

In its recent judgment the Federal Labour Court (Bundesarbeitsgericht, BAG) held that in General Terms and Conditions a lapse clause which envisages the immediate lapse of vested option rights after an employee has resigned represents an unreasonable disadvantage in accordance with section 307 (1) sentence 1 and section 307 (2) no. 1 BGB (Press release BAG judgment dated 19 March 2025 – 10 AZR 67/24). The BAG also held that the same applies to a clause which stipulates that at the end of the employment contract vested virtual option rights lapse twice as fast as the vesting period.

Facts of the matter

The claimant was employed by the respondent from 1 April 2018 to 31 August 2020. The employment contract was terminated by the employee giving notice of his resignation. The respondent granted the claimant virtual option rights in 2019. Under the terms of the respondent's employee share programme the requirement for exercising these virtual options, which may result in a claim to payment against the respondent, is the expiry of the vesting period as well the occurrence of a particular event (such as a floatation on the stock market, for example). The assigned virtual options are exercisable staggered within a four-year vesting period with a minimum waiting time of 12 months. However, the vesting period is suspended for times where the employee is released from his obligation to perform work without a claim to payment.

At the time of his resignation 31.25 per cent of the virtual options assigned to the employee were vested, i.e. were actually exercisable. However, according to the employee share programme, options lapse if the employment contract is ended by the employee resigning. Otherwise the options could be gradually exercised within two years of the termination of the employment contract.

In his letter dated 2 June 2022 the claimant asserted his claim to these vested options which the respondent refused, stating that they had lapsed. The claimant argued that the lapse

clauses were invalid as the options were a fundamental component of his remuneration package. He claimed that he earned his options through performing work during the vesting period whereby the incentive function had already been satisfied.

The respondent did not agree, stating that the virtual option rights should represent a reward for company loyalty. In the respondent's opinion, the options should not be seen as a fixed component of the employee's remuneration, but rather merely as an opportunity to earn remuneration. The lapse of the options at the end of the employment contract was therefore lawful.

The decision

The previous instances dismissed the claimant's claim for declaratory judgment, however the appeal on a point of law to the BAG was successful. The court held that the vested virtual options had not lapsed. The terms of the employee share programme would qualify as General Terms and Conditions, which did not stand up to the reasonableness of content test in section 307 (1) sentence 1 and section 307 (2) no. 1.

The BAG held that the vested virtual options represented consideration for the work performed during the vesting period. This follows, in particular, from the terms contained in the employee share programme which suspend the vesting period during times when the employee has no right to remuneration. The immediate lapse upon the employee's resignation was an unreasonable disadvantage and contradicts the rationale of section 611a (2) BGB. In addition, it made ending the employment contract disproportionally more difficult as the employee feels compelled to remain with the company for fear of financial losses until the uncertain event to exercise the options happens.

The court also declared that the clause about staggering the lapse of options was invalid. The lapse provisions stated that options lapsed twice as fast as they were vested. It thus does not take into consideration the time the employee spent in performing his work for the exercisable option rights, without this being justified by the legitimate interests of the employer.

Practical relevance

The BAG changed its previous case law with this decision (BAG, judgment dated 28 May 2008 - 10 AZR 351/07), where it held that the immediate lapse of previously vested options was lawful. Due to the extremely speculative character of share options, the principles established in case law for the lawfulness of commitment periods and lapse clauses for special payments, bonuses in particular, cannot be carried over to share options without restriction.

With this decision the BAG seems to now have acknowledged the comparableness of share options and traditional special payments.

It therefore has wide-reaching consequences for companies with employee share programmes based on virtual options. The decision made it clear that vested options are not permitted to automatically lapse upon the end of the employment contract as they represent consideration for work already performed. Employers should therefore take the opportunity to examine their employee share programmes and the claims of employees that could potentially result from them.

Note
This overview is solely provided for information purposes and should not replace professional legal advice. In case of any queries, please get in touch with your designated GÖRG contact person or the author Pia Pracht on +49 221 33660 524 or ppracht@goerg.de. Information about the author is available on our website www.goerg.de.

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