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Client Alert

Corporate

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For more information, contact:

Dr. Peter Memminger
+49 69 257 811 051
pmemminger@kslaw.com

Benjamin Koepple
+49 69 257 811 053
bkoepple@kslaw.com

Dr. Peter Stainer
+49 69 257 811 052
pstainer@kslaw.com

King & Spalding

Frankfurt
TaunusTurm
Taunustor 1
60310 Frankfurt am Main
Germany
T. +49 69 257 811 000

VSOPs – The End of Bad Leaver Clauses in Germany?

Virtual Stock Option Plans (VSOPs) are a common tool used by companies to incentivize employees by linking part of their compensation to the company's long-term success. Unlike traditional stock options, VSOPs do not grant actual shares but provide a financial benefit if the company achieves specific milestones, such as a sale or an IPO. These plans typically include a "vesting period", during which employees "earn" their options staggered over time. The goal is to reward loyalty and performance while aligning employees' interests with the company's growth.

In a landmark decision dated 19 March 2025, the German Federal Labor Court (*Bundesarbeitsgericht*, "BAG") ruled that certain bad leaver clauses in VSOP agreements are invalid under German law if they inadequately disadvantage employees. This is the case if the bad leaver clause results in the forfeiture of already vested options or in an accelerated expiration of vested options after the end of the employment.

The full text of the ruling has not yet been published, but following key takeaways should already be considered:

Summary of the court decision:

The case involved an employee who resigned after working for a company from 2018 to 2020. During his employment, he was granted 23 virtual stock options, 31.25% of which had vested (i.e., became exercisable) by the time he left. The company's VSOP terms stipulated that vested options would be forfeited in case of a resignation by the employee (immediate forfeiture clause).

The BAG ruled that such clauses are unenforceable under Section 307 of the German Civil Code (BGB), which prohibits standard terms that inadequately disadvantage the other party, i.e. in this case, the employee. The BAG emphasized that once options have vested, they represent compensation that is already earned through the employee's work during the vesting period. Forfeiting these vested rights solely due

to the resignation by the employee unfairly deprives the employee of earned benefits. According to the ruling of the court, this also applies to VSOP provisions that accelerate the expiration of vested options after the end of the employment. The BAG ruled that a provision that results in an expiration of a vested option in half the time it took for the option to vest is also not enforceable.

Key legal reasoning:

The court highlighted that VSOPs are not merely potential rewards but part of an employee's compensation package. Once options vest, they are considered "earned compensation", and employers cannot retroactively cancel vested options without a legally justified reason. The BAG also highlighted that such provisions result in an unfair barrier to terminate the employment, discouraging employees from resigning in contradiction to the legal concept of Section 611a para. 2 BGB. With this decision, the BAG explicitly overturned its previous decision from 2008 that allowed similar clauses. The decision indicates the BAG's stricter approach to protecting employees' rights in connection with VSOP/ESOP agreements in the future.

Outlook: Implications for Bad Leaver Clauses in VSOP/ESOP agreements governed by German law:

This ruling requires companies to carefully review their VSOP/ESOP agreements, particularly clauses tied to termination of employment. Employers will no longer be able to enforce terms that:

1. immediately cancel vested options when an employee resigns, unless there is a specific, justified reason (e.g., gross misconduct); and/or
2. accelerate the expiration of vested options post-employment in a way that disproportionately shortens the exercise period compared to the vesting period.

Moving forward, companies must ensure that bad leaver clauses take into account the legitimate interests of both parties. For example, a gradual expiration period aligned with the original vesting schedule (e.g., a four-year post-employment exercise window after a four-year vesting period) will most likely remain enforceable. However, terms must reflect the employee's contributions during the vesting period. Employers should also avoid linking forfeiture solely to voluntary resignation without considering the employee's earned rights.

This decision underscores the importance of drafting VSOP/ESOP agreements transparently and carefully.

Whether it has an impact on bad leaver clauses in physical ("real") share based employee participation programs must be carefully considered once the full decision is available.

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