

Germany: Expiry Clauses in ESOP/VSOPs

The German labour court ruled in March 2025 that general terms and conditions in option arrangements that provide for the immediate expiry, on the termination of employment, of already vested virtual option rights, are invalid. This is because such clauses are inappropriately disadvantageous to the employee beneficiary.

Even if the clause in question does not provide for the immediate expiry of the option rights, but instead provides for their expiry at a faster rate than the options took to vest within the vesting period, it may still be invalid for the same reason.

The court's full reasoning for this decision is not yet published but it will be of particular relevance to expiry and bad leaver clauses in ESOP and VSOP schemes and employee bonus schemes, on exits.

This ruling will clearly impact existing schemes and should be taken into account when establishing new schemes.

Effect on Private Equity Transactions

The question then arises, will this ruling have an impact on German private equity transactions?

Equity based management incentive programmes are obviously common in PE transactions. Will other German courts follow this ruling into PE schemes, possibly affecting particularly bad leaver arrangements?

Clearly, this remains to be seen but there are differences which may suggest this labour court ruling will not reach across to other courts.

The differences:

1. Usually it is only managing and board directors that participate in PE incentive schemes. These people do not qualify as employees under German labour law and therefore the German labour courts are not the courts of competence on these matters.
2. The participating management teams are employed by a separate employing entity and not by the PE entity. The relationship with the PE entity is purely corporate. The risk that a court will treat the potential financial benefit as employee "remuneration" is low. The team's labour service is provided to the employing entity and not the PE vehicle.
3. Participation involves a monetary investment giving rise to a right to share in the proceeds of a successful exit. This success may not wholly depend on the individual performance of the participant but on multiple factors, and therefore cannot directly be treated as "earned".
4. The tax advantage motive of PE participation is inconsistent with the notion that participation is part of the participant's remuneration.

Nevertheless, this court ruling and its implications should be taken into account when structuring German PE transactions, and appropriate steps taken to minimise the risk of the labour court ruling applying.

This is a high level general update only. Legal advice should be obtained on specific circumstances.