

Stock Options for Works Council Members in Germany

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A recent judgment of the federal labor court underlines again how important it is that the right legal entity within a group of companies grants stock options and that no misleading representations are made to the employees in this context. As the following case demonstrates, failure to sufficiently take these requirements into account can lead to unexpected financial consequences that can be substantial.

The plaintiff started employment in 1999 with a German company that was owned by a U.S. corporation. In 2000 and 2001 he received a total of 5,000 stock options from the U.S. parent corporation. In 2001 he became a member of the company's works council. He was subsequently elected chairman of the works council and released from his obligation to work. German statutory law provides that in operations that regularly employ at least 200 employees, a certain number of works council members have to be released to enable them to fully engage in works council activities. These works council members are nevertheless entitled to the same pay and benefits as comparable employees and even take part in pay increases. This is intended to ensure that they suffer neither financially nor with respect to their professional development from their works council membership.

It probably does not come as a surprise that the plaintiff in this case did not receive any stock options from 2002 to 2005, while an employee whom the parties had agreed was comparable to the plaintiff did receive such options. The employee claimed the options from the German subsidiary in court, but lost in the first two instances.

The federal labor court set the appeal court judgment aside and remanded the case to the appeal court for further investigation. It held that the pay and benefits that works council members are entitled to may also include stock options. The court also made clear that payments and benefits that are provided by a third party and not by the employer, for example by another group company, are not to be taken into account in this context. In principle, only pay and benefits provided by the employer on the basis of the employment contract count. This applies even if the third-party payment or benefit is motivated by the employment contract, as is typically the case with stock

options granted by a parent entity. However, the court acknowledged that the employer and the employee can agree that a third party provides pay and/or benefits instead of or in addition to the employer's pay and benefits, and in doing so, the third-party pay and/or benefits become part of the employment contract between the employer and the employee. In this event the employer may be held liable if the third party does not deliver.

In this case, the U.S. parent corporation had gotten nearly everything right. The stock options had been granted by the parent corporation, and the employment contract between the German subsidiary and the employee did not include any stock options. Such clear distinction is also helpful from a conflict-of-laws point of view. While a choice of law with respect to employment contracts is possible only to a limited extent and employment contracts, as a minimum, are subject to the mandatory provisions of the laws of the country in which the employee usually works, there is no such limitation with respect to other types of agreements. Therefore, a choice of law in a stock option agreement in favor of U.S. state law, e.g., Delaware law, is usually enforceable.

The reason, however, why the federal labor court nevertheless set aside the appeal court judgment was that the appeal court had not sufficiently taken into account the plaintiff's submission that in his job interview, the German subsidiary had presented the stock options as an additional pay component. According to the court, this could mean that the U.S. parent entity's stock options were benefits in addition to the regular remuneration agreed upon between the parties that could establish the employer's secondary liability in accordance with the terms and conditions of the stock option agreements. What exactly had been said in the job interview and how it has to be construed will now have to be determined by the appeal court.

The judgment underlines that it is not sufficient to have the right paperwork in place in order to ensure that the employment relationship and the grant of stock options remain separate legal relationships and are not mingled. It is also necessary to clearly distinguish, in any oral communication to the employees, between employer pay and benefits on the one hand and any third-party benefits such as stock options that are to be granted by another group company on the other. Any misrepresentation in this respect may have the effect that third-party benefits become part of the employment contract and are thereby subject to German employment law, with unforeseen legal and financial consequences as in this case. □

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