Chapter 14

Succession in Family Businesses – Legal Frameworks

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Abstract

The chapter deals with the interface between the law of succession and corporate law and explains the completely different objects of these two fields of law. Succession law tries to shift and contribute assets to the successors, whereas corporate law focuses on the well-being of the company. However, in a family business, it is necessary to find legal, social, and psychological techniques to combine these two areas and to establish strong and binding relations. This is the function of shareholder agreements and family constitutions.

Keywords: Family constitution; shareholder agreement; succession law; company law; succession; corporate succession

14.1. Family Business

The economic importance of family businesses must not be underestimated in Europe. In the German-speaking world (in particular Germany, Austria, and Switzerland) 80% to 90% of all businesses are family businesses; they employ 70% of the working population. Looking at Europe, about 60% of all businesses can be qualified as family businesses; the global numbers range between 65% and 80%

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(Kalss, 2017a, p. 383; Lieder & Hoffmann, 2020, p. 10 ff.). These figures show the prevalence of family businesses.

However, no clear-cut definition of family businesses exists. For obvious reasons, it is not important how big or small a family business is or how it is legally organized. Conversely, a definition should not focus on quantitative aspects, but rather on the special nature of family businesses, the most characteristic attribute being the connection between a business and a family (Kalss, 2017b, p. 5; Lieder & Hoffmann, 2020, p. 12 f.). According to the European Commission, in a family business, the majority of the decision-making rights remain in the possession of the natural persons who have established the business or at least one representative of the family is involved in the governance of the business. In addition, listed companies can be family businesses when 25% of the decision-making rights are possessed by the persons and their families who have established or acquired the enterprise (European Commission, 2009, p. 9 f.). The European Group of Family Businesses (GEEF) follows this definition of family businesses.[1] Another starting point is the three-circle model, which shows that family, ownership, and business are three respective circles that overlap and in which the common ground is the family business.[2]

It makes sense to extend these definitions in order to obtain the following wording (Kalss & Probst, 2013a, p. 115):

A family business is a business of any size where

1. *the majority or all family members are authorized to make decisions,*
2. *and are committed to a "family charter" which is*
3. *designed to last for an indefinite period of time and which can only be*
4. *altered with the consent of a qualified majority or by unanimous decision.*

When it comes to succession in family businesses, both company law and succession law are applicable. The interfaces and conflicting goals of these two legal areas become apparent when family businesses are transferred to a new generation.

14.2. Interfaces Between Company and Succession Law

The lifespan of human beings is limited. This is one difference between natural persons and entities with legal personality. The death of a natural person triggers succession law mechanisms. In connection with businesses, succession law issues arise only when a company is held by natural persons and not solely by legal entities (in particular companies, institutions, or foundations). Nevertheless, the death of shareholders or dominant directors entails far-reaching questions regarding succession in family businesses.

Succession law is closely connected to the question of private ownership of businesses or shares in businesses – especially when agreements regarding succession to these assets are linked to the death of the entrepreneur or the owner of shares in a business.

[1] <http://www.europeanfamilybusinesses.eu/family-businesses/definition> (16.3.2018).
[2] <http://johndavis.com/three-circle-model-family-business-system/> (16.3.2018).

Recent surveys have revealed that during the period of 2012 to 2021, around 33% of all family businesses (or SMEs) are expected to be passed on to the next generation (Kalss & Probst, 2013a, p. 115; Lieder & Hoffmann, 2020, p. 19). As a result, complicated legal questions will arise in most family businesses. Therefore, the transfer is the crucial point in securing the survival of family businesses. This insight is important not only for the individual businesses, but also for the economy as a whole.

The succession law-based inheritance of shares in businesses or of corporate assets is marked by some special features. Several fundamental considerations support treating corporate assets differently in the context of succession. Thus, when the assets are transferred to the legal successors, the enterprise or the shares in a business should not simply be equated with other assets. The considerations supporting special treatment of corporate succession apply from the perspective of company law in the case of succession by intestacy, by will, or when the relevant affairs are arranged by contract in advance. Alongside these typical forms of succession law transfer, also other – company law – transfer mechanisms exist and thus take effect parallel to succession law or even circumvent it.

Four material aspects ought to be mentioned here (Kalss, 2017b, p. 8 ff.; Kalss & Maier, 2020, p. 203 ff.):

1. Succession law is the law of *passing* on and of *distributing* assets – company law is the law of *organizing* and keeping assets together;
2. Ownership of corporate shares not only involves property but also property rights and rights of control;
3. Corporate succession not only affects the heirs and by-passed heirs but also other groups of persons;
4. Corporate property is different than other property; it constitutes special property.

14.2.1. The Respective Tasks of Succession Law and Company Law

Company law and succession law are not in a hierarchical relationship with one another. Neither succession law nor company law has precedence over the other field of law (Schauer, 1999, p.339 f.; 2010, p.990 f.; Wiedemann, 1999, p. 1310). Rather, they exist side by side and rank equally. They also fulfill different regulatory tasks (Kalss, 2010, p. 1036):

The law of succession has the *function of transfer and distribution*. It determines who ought to receive the property of the testator (Schauer, 2010, p. 991; Wiedemann, 1999, p. 1310 f.). Company law, on the other hand, has the task of governing, in accordance with the law and the respective company articles, which rights and legal relationships can be passed on in the first place, i.e., determining whether membership can be inherited at all and be passed on (Kalss & Probst, 2013b: no 20/8; Schauer, 2010, p. 991). Company law is the law of organization, which is directed at the efficient cooperation of the shareholders. Company law aims to secure the existence of the enterprise and to regulate, first, the legal relationships amongst members (vis-à-vis the company) and, second, the legal position of members in relation to third parties. It is about ensuring effective cooperation and a balancing of interests

(Goetz & Windbichler, 2013, p. 1 f.; Kalss et al., 2008: no 1/3). This can obviously result in tension between the principle of distribution (succession law) and the principle of concentration and predominance of business (company law).

14.2.1.1. Distribution and Equality

In a nutshell: Succession law is the law of **distribution** (Kalss, 2017b, p. 12), whereas company law is aimed at the continued existence of the enterprise and its efficient management. The **distributive effect** of succession law is demonstrated in intestacy rules, in which typically family members, divided according to circles of relationships or *parentelae*, are invoked as the fundamental statutory model. People within the same generation are treated equally, which is how the distributive effect comes about. Ultimately, each family member of the same generation should get the same amount according to these dispositive intestacy rules. Succession law does not distinguish in terms of age, qualifications, or interests of the individual in relation to the property transferred; each receives the same per head. The pertinent qualification is the relationship. Each child receives the same portion. Often, however, talents and interests are not divided equally among all heirs – especially when it comes to corporate property. This, however, leads to unqualified and non-professional ownership and, as a result, may endanger the equilibrium of power and influence in a company.

Succession law is therefore characterized by "distributive equality." This can be justified by the principle of the equality of every human being, but at the same time, this can be quite harmful to a business. The distributive effect increases over time, because every death of a natural person triggers the same consequences and – over time – leads to an increasing fragmentation of ownership. This can be shown by the following graphic (Fig. 14.1):

14.2.1.2. Reserved Portion

This distributive effect is even more obvious when it comes to the reserved portion requirements, above all, regarding the provisions entitling certain individuals to compulsory reserved shares. The progeny of the testator is typically entitled to such. This means that claims of certain persons must be fulfilled in any case, even if the testator does not mention them in his will. The law of the reserved portion, therefore, restricts testamentary freedom. Under Austrian

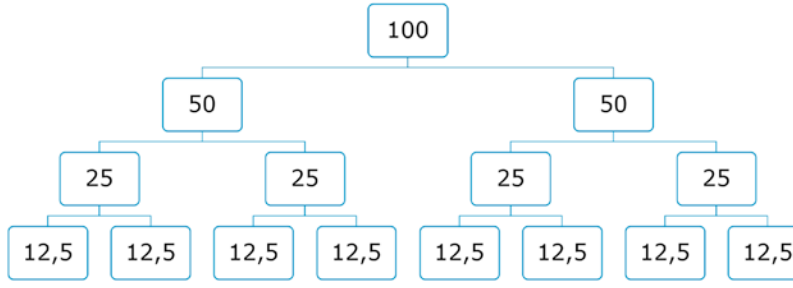

Fig. 14.1. Fragmentation of Ownership.

law and in many other legal systems, the testator's progeny and spouse have a mandatory right to at least half of the succession. Except for England and the USA, almost every national legal system provides for a reserved portion (Kalss, 2015a, at footnote 58; Schauer & Baldovini, 2020, p. 214 ff.). In general, as for instance in Germany, the Netherlands, Poland, Switzerland, Greece, and Austria, the marital spouse and the children get half of the succession. The special nature of this portion lies in the fact that it often consists of a right under the law of obligations, measured in money against the legacy or the succeeding heirs. The necessity to pay out the cash often means that enterprises or shares must be sold so that the heir is in a position to fulfill this entitlement. In addition, only limited possibilities to disinherit a beneficiary exist. While the enterprise or company is not directly affected, the corporate property is often the only or at least the material property of the testator, so that the heir is obliged to take recourse to this business property in order to satisfy his obligations. The simple distribution of dividends is usually insufficient for this purpose.

Frequently, enterprises must be – at least partially – sold in order to be able to pay out the reserved portion, or the enterprise itself must pay out a substantial special dividend so that the shareholder can actually satisfy his succession law obligations.

While company law is thus generally aimed at the continued existence and efficient functioning of the company, succession law has a restricted transfer function with a distributive effect, resulting in an ongoing tension between succession law and company law. Given these two different legal influences and the fact that distribution can endanger the necessary financial and personnel conditions for the continued existence of the company, company law is deployed in order to secure the financial basis of the company. However, also the personnel-related qualifications and manageability of the enterprise can hold back this distributive effect of succession law to a certain extent – regardless of whether the effect is achieved by direct transfer to certain persons or by mechanisms having the same function.

14.2.1.3. Communities of Heirs

An important consequence of the principle of distributive equality is the promotion and existence of communities of heirs. Communities of heirs are of particular importance, such as the community of heirs (*Erbengemeinschaft*) under the German Civil Code (BGB) or the joint ownership community (*Miteigentumsgemeinschaft*) under the Austrian Civil Code (ABGB). Both are characterized by the fact that a legal act by just one member can break up the community. The respective instrument is an action for annulment or partition.

The successors of a person have the same right to joint ownership regarding each physical object, but also in respect of rights such as shares or other memberships of companies. They are obliged to exercise their shareholder rights or partnership rights together. Consequently, they must find a way to agree upon different measures and find a common position. The law requires unanimity for important measures. Therefore, the danger arises that one single member will block all the others. In the second step, it becomes clear that the community is then unstable and permanently endangered.

The community of heirs exists regarding each physical object – as long as it is not annulled by a partitioning of the inheritance. Each co-heir can seek annulment before or after the transfer of the property to the heirs; however, it will not be effective in rem before the transfer. The partition of the inheritance, like the division of a community of joint ownership in general, is carried out in accordance with § 841 ABGB either by an agreement on partition of inheritance (*Erbteilungsübereinkommen*) or – if no agreement is reached – by action for partition (*Erbteilungsklage*) along with the resulting judgment.

14.2.2. Ownership Involves Controlling Rights and Property Rights

Ownership of an enterprise or of corporate shares not only involves property rights but also rights of control and influence (Dutta, 2014:34 ff.; Kalss, 2017b, p. 10; Kormann, 2017, p. 271 ff.). These two aspects must be distinguished clearly. They may in general be exercised or held by different people and may thus also be transferred and allocated separately in the course of passing on and distributing in the context of legal succession. Although they can and must be distinguished, it must be clear that these two aspects influence each other. The more influence a shareholder has, the higher the value and the price of the share become (e.g., double-voting rights, shareholder agreements).

Property rights are economic claims and include, for example, the simple ownership of a stake and thus the benefit deriving from added value. However, above all, they also include the right to dividends; the right to settlement in the case of transfer, merger, or change of legal form; or the yields of the sale if such a share is sold. Rights of control or influence, in other words, the option of exercising power in a company and over its assets, include for instance a voting right at the shareholders' meeting (general meeting or assembly) and the taking on of a management function or office in the supervisory board as the fundamental supervisory committee of an enterprise.

As property rights and rights of control can be separated, they may also be transferred separately in cases of legal succession upon the death of the holder. The separate, but nonetheless proportionate, transfer of these different components of the share secures the succession law participation of all successors in the company. This means that, on the one hand, the succession law principle of distribution and, on the other, the necessity for a concentration of the decision-making processes within a company in order to safeguard efficient management, which is the object of company law, can both be achieved. Property rights can be allocated to particular heirs or legal successors, likewise the rights of influence at the shareholders' meeting or the entitlement to take part in certain executive bodies of the company. The option of separating rights of control and influence is often the key to legal succession in an enterprise in accordance with the corporate need for concentration of influence and efficient management. As a rule, only the invocation of the law of succession and the acceptance of the inheritance and subsequent takeover are necessary for the transfer of property rights. The allocation and takeover of rights of control requires somewhat more, specifically suitability and in many cases qualifications which allow the individual to manage and

control the enterprise in a sustainable and successful manner (Cf. Kalss & Probst, 2013b, p. 672 ff.). Apart from a person's individual qualifications, it is necessary to ensure that the decision-making processes are run efficiently both at the operative management level and at the supervisory and ownership level.

14.2.3. Different Interests Affected

When it comes to the succession to corporate property, it is not only the heirs and legal successors (as well as the bypassed heirs, i.e., the non-inheriting children) that are affected. In fact, multiple other groups of people are also impacted. The following interests may be at issue after the death of a shareholder or owner (Kalss & Probst, 2013b, p. 655; Schauer, 2010, p. 989 ff.):

- The interest of the *testator* in preserving his freedom of testation and his unhindered ability to dispose over his own property including shares;
- The interest of the heir(s) in receiving and freely disposing over the property inherited;
- The interest of those entitled to reserved portions in receiving at least a certain part of the value of the net inheritance;
- The interest of the other shareholders in being able to acquire the share of the deceased party or at least to be able to influence the selection of any new shareholder(s); since they may wish to continue the company either alone or with the new shareholders;
- The interest of the enterprise in efficient, decisive management processes and administration; this refers to, on the one hand, the management of the company, but on the other hand, all employees of the company.

The other shareholders have an interest in knowing and influencing who will take the place of the deceased shareholder, i.e., with whom and with how many new shareholders they will have to collaborate in the future. The company itself, represented by the management and the employees, is directly affected. Both groups are interested in the continued existence of the company under reasonable conditions feasible for them. The public, in turn, is interested in the company continuing to exist and continuing to offer people work so that the region profits and value can be achieved in the country. Thus, there is overall public financial interest in the continued existence of the company under feasible conditions in the case of succession. Therefore, not only must there be a balancing of interests between heirs and non-heirs of the deceased party, but it is, moreover, also necessary to balance the interests of a far greater number of people. This is a much wider-ranging task.

14.2.4. Corporate Property as Special Property

"Property" is not "property." Rather, different types of property can be distinguished. These range from money and jewellery, to real estate, to a picture or an art collection, and on to companies. In respect of these different types of

property, different needs and justifications may be elaborated for different forms of transfer. At this point, it makes sense to highlight the difference between a simple sum of money and corporate property.

- Corporate property, i.e., companies or corresponding corporate stakes in companies, differs from other property as its value is more *volatile* – it can change more easily and quickly (Dauner-Lieb, 1998, p. 29 f.). This is a marked difference to a sum of money, for example, which only changes due to reasons such as inflation.
- Enterprises, which are *divided up* are often worth less than the original entire enterprise. While a sum of money even if divided up still totals the original sum (e.g., 30 + 30 + 30 = 90), this is not necessarily the case when corporate property is split up. Typically, the value depends on the entire enterprise. Divisions and split-offs may increase a company's value, but this is not the typical consequence of distribution.
- The value of corporate property changes – almost daily – due to the *market environment*. For instance, a company may lose buyer segments because another enterprise has used technology that is more efficient or has recognized a new trend sooner and implemented a new business model faster.
- Ultimately, the value of an individual enterprise depends significantly on *people's management* of the enterprise and thus the entrepreneurial performance of the owner (Fleischer, 2015, p. 728 f.). The development of a company, therefore, largely depends on the individuals acting on behalf of the company.

The continued operation of the enterprise also involves substantial entrepreneurial risks, including the risk of total loss or at least the loss of a material part of the inherited asset after the takeover. Someone who had his reserved portion paid out in cash is no longer exposed to this risk as soon as he has received the money. Insofar, this person clearly has a privileged position compared to the heir taking over the company in terms of risks. This means that this person is entitled to a sum of money either immediately or due very soon, without being exposed to any risk of a change in value and earnings on the part of the enterprise or risks of generating the amount to be paid out. Thus, the notion of compensating risk would support a different and special succession rule regarding corporate property.

These different special features of enterprises, even more particularly of corporate assets organized as companies, show why it makes sense – and is sometimes necessary – that corporate assets should not be subject to the same general rules of succession law. By contrast, other alternative means of transfer should be investigated, both within and outside the boundaries of succession law.

14.3. Special Rules for Agricultural Enterprises

In several countries, such as Poland, Germany, and Austria, there are special rules for corporate succession regarding farming and forestry enterprises (Kalss, 2015a, Fn. 303; Probst, 2018, p. 123 ff.; Schauer & Baldovini, 2021, p. 2020).

The justification for establishing special rules in the area of farming and forestry enterprises is macroeconomic in nature and thus founded in the public interest. The existence of farming and forestry enterprises ought not to be jeopardized by simplistic distribution, especially as a certain size is essential in order to secure the feasibility of the enterprise. At the same time, it ought to be ensured that only the most qualified successor obtains and continues the farming enterprise. This is the only way to safeguard the existence of such enterprises and in consequence the supply of food. Therefore, these farming or forestry enterprises ought not to be distributed and split into too many small sub-enterprises.

- Since the aim is that the substance of farming and forestry enterprises should not be hollowed disproportionally, the legal rules for farming and forestry enterprises strongly undermine the entitlement to a reserved portion. The reserved portion, therefore, does not correspond as usual to half of the succession; rather, when it comes to corporate succession in a farming or forestry enterprise, the person entitled to a reserved portion receives only a share which measured against the earnings of the enterprise does not in any way endanger the functioning of the enterprise.
- The continued existence and efficient management of a farming or forestry enterprise are secured by the rule that only one heir of several possible heirs comes into the inheritance, specifically the best qualified heir and thus the one who has the necessary training or in some other way the best qualifications. This is not automatically the oldest son or the oldest daughter. The primary overall consideration is that the existence of the enterprise ought to be secured because a country needs a certain number of feasible farming and forestry enterprises in order to supply the public with food (Probst, 2010, p. 114 ff., 2018, p. 123 ff.).
- Finally, an incentive is provided for long-term continuance as the special succession law rule applies only when the enterprise is continued for 10 years; if it is sold prior to this, the proceeds from the sale must be divided and are subject to the general succession law rules.

14.4. Replication of These Rules by Contract

The macroeconomic importance of appropriate rules for corporate succession is not limited to farming and forestry enterprises. For instance, an empirical study for Austria shows that about 6,800 corporate successions are implemented each year (KMU Austria, 2014; Lieder & Hoffmann, 2020, p. 19 ff.). Therefore, a value of macroeconomic proportions is certainly at issue when it comes to the continued existence of these enterprises. Not only farming and forestry enterprises have significant macroeconomic value; in general, enterprises offer jobs, create value, secure livelihoods, and thus, are extremely important when it comes to securing the lives of a country's population. Hence, there is a macroeconomic interest in securing the existence of such enterprises and making sure they are not broken up when it comes to succession because of the distribution provided for under the rules on intestacy or the necessity to satisfy heirs' entitlements. The continuance of the enterprise means creation of value beyond the enterprise.

Above all, the jobs dependent on the enterprise can be preserved, not only in economically strong regions and in urban areas but also in regions where jobs are more rare. The importance of enterprises in such regions is even greater in macroeconomic terms.

In practice, appropriate solutions balancing the interests of all stakeholders involved, from the entrepreneur, to the person handing over the business, his children, and the enterprise itself, are found in accordance with the applicable law on the basis of an analysis of all these interests and by means of contractual arrangements. These arrangements aim at securing the existence of the enterprise and affordability for the entrepreneur who continues the enterprise. They also aim at providing an appropriate financial settlement for those entitled to a reserved portion. It is vital to ensure that the parents handing over are provided for. In practice, therefore, various arrangements often supply solutions. Nonetheless, a statutory rule is desirable and advisable, as accidents and other unforeseen events often occur where there is as yet no will or contractual arrangement.

The notion of special rules and the justification for special succession rules for farming and forestry enterprises can be applied to other fields of enterprises as well. The issue here is recognizing the feasibility of the enterprise by concentrating the inheritance on one suitable successor and by determining the reserved portions according to the earnings of the enterprise and by determining the affordability out of the corporate earnings. Thus, it would certainly be reasonable from a legal policy perspective not only to open up the option but also to provide for a general special law for corporate succession (Probst quoted in Kalss, 2015b, p. 52). From today's perspective, this is legitimate not only in securing the farming and forestry enterprises which supply the population's needs but also as regards service enterprises, for instance in the tourism sector or in respect of industrial manufacturing enterprises. The total lack of special rules regarding succession in family businesses other than farming and forestry enterprises leads to tensions between the distributing effect of succession law on the one hand and the interest in the continued and stable existence of the business as a whole.

In any case, the existence of enterprises should be secured in order to secure the economic power exercised in the macroeconomic interest. This should make it possible to concentrate the inheritance of a business in one person. In the case of corporate succession, the reserved portions should not be determined according to the market value at the time of the testator's death but instead in relation to the earnings over the last ten years. If the earnings turn out to be unexpectedly higher, then there should be a retrospective duty to make payment to the other heirs if – within the 10 years following the inheritance – the enterprise is sold for a higher price. Thus, when the value of the enterprise is subsequently higher, the heirs who were already paid a sum can participate and profit once again. This model would provide incentives and also secure the continued existence of the enterprise in order to continue creating value within the family, for the workforce of the enterprise, and for its business partners. Alongside civil law considerations arising out of the law of succession, tax law provisions must be introduced. For example, reserved portions paid out by an entrepreneur must be recognized as business expenses; conversely, the entitlement to reserved portions should be taxed at half the rate of other incomes in order to balance the interests involved from a tax law perspective.

Finally, the organization of succession in family businesses might also include the creation of foundations or trusts in order to secure payment of family maintenance by family-owned businesses. Such foundations exist in various jurisdictions, including Austria, the Netherlands, Greece, Finland, Italy, and Switzerland.

14.5. Succession Law Arrangements Already Possible Under the Applicable Law

Under the applicable law, it is already possible to find suitable arrangements. It must, however, be borne in mind that due to company law, a company's statutes can usually only be amended unanimously, i.e., with the consent of all other shareholders. Last wills and testaments, on the other hand, can be made by the testator acting alone and can also be changed unilaterally at any time up to his death. Thus, from a succession law point of view, the freedom to organize one's affairs (testamentary freedom) is greater than under company law.

Firstly, one very important flexible aspect of succession law is the ability to render only one person the corporate successor, either by will or by anticipated succession, thus securing efficient corporate management and continuance tailored to this one person (Holler, 2020, p. 1195 ff.; Kalss & Maier, 2020, p. 206 ff.; Oberhumer, 2020, p. 760 ff.). Many laws of succession allow for not having to pay out the reserved portions in cash straight away, instead delaying this for several years. Even more important is the option of being able to grant other assets in lieu, particularly shares in the enterprise that only grant dividend rights but no influence, e.g., preferred shares without voting rights, profit participation rights (*Genussrechte*), sub-shares, or other rights based on the earnings of the enterprise. In this respect, it is necessary to make both contractual and company law arrangements in order to bring about a supplementary or necessary succession law transfer of assets as intended. Thus, for instance, the future Austrian law of succession allows participation rights (*Genussrechte*), silent partnerships, and other stakes in companies without rights of influence – precisely for the purpose of securing efficient decision-making structures in enterprises (Kalss & Cach, 2015c, p. 675 ff.). Dutch law makes it possible to issue special certificates to satisfy reserved portion rights (Burgerhart & Verstappen, 2015). Deviating from statutory succession law always requires certain legal dispositions and usually consensual settlements.

Another – and rather old fashioned – model is the *fideicommissum* for real estate and industrial assets, allowing the testator to determine the heirs to his estate for generations in advance. However, the general attitude toward binding property for more than one generation is rather hesitant – mainly because of the lack of freedom of disposition and the exclusion of market forces.

14.6. Possible Company Law Arrangements

14.6.1. Partnerships

When considering the special nature of corporate assets, the macroeconomic justification for special rules, and the effectiveness of arrangements, it becomes clear that in company law there are some legally recognized arrangements which

organize succession in an enterprise differently from other types of succession. It may be said that will substitutes play a much more significant role in the company law context than in the case of other assets. The law on partnerships in Germany and Austria, for instance, already offers numerous ways and means via company law to decide on material issues as regards corporate succession.

In this context, it is important to distinguish between (a) gaining the status of partner and (b) the entitlement to be compensated for value. In any case, there are company law options that aim at not including heirs or particular legal successors as members of the company. Thus, these heirs are refused succession to the real corporate value of the enterprise or a share therein, and they are instead granted compensation for value. Sometimes, there are even company law options going beyond this, actually reducing this compensation for value or even excluding it, for example excluding the settlement in favor of the other shareholders and at the expense of the heirs (see on this Kalss & Probst, 2013b, p. 662; Oberhumer, 2020, p. 763 ff.; Schauer, 2010, p. 999 ff., 2018, p. 1221 ff.).

In what follows, specific company law options are presented. The statutory starting point is the dissolution of the company with the possibility of continuing the enterprise with the heirs. Arrangements deviating from this must be provided for in the company statutes accordingly.

- A *continuation clause* sets out that upon the death of one of the partners, the other partners in a partnership can continue the company together. The company is simply continued – without being dissolved. The heirs of the deceased partner are neither entitled nor obligated to take his place in the company. In lieu of a share in the company, the entitlement to a settlement is inherited. Due to the continuation clause, therefore, the partners can prevent unwanted or unsuitable people from entering the company. Thus, certain people are excluded by company law from taking a share in the business, but they at least have a succession law right to compensation for the value. These include both heirs by intestacy rules and heirs by will, as well as those entitled to a reserved portion. As a right to a settlement in principle falls due in place of a share in the company, there is a risk related to capital flow in favor of the heirs of the deceased shareholder. In principle, the right to a settlement must be estimated according to the value of the enterprise, and on this basis, the deceased shareholder's share should be calculated as one piece of a whole cake. According to this mechanism, the real value is calculated according to the relevant substance or earnings value which is not the book value.[3]
- It is also permissible to combine a *continuation clause* with a *settlement exclusion clause*. Such contractual arrangements are also binding for the heirs, for instance, an agreement to use an evaluation method provided for by company law, e.g., a book value clause. In particular, the right to a settlement on the

[3] Kalss and Probst (2013b: 662); Schauer (2010: 1002); Schauer (2018: 1221 ff); on the aspects of the piece of cake, Fleischer (2015: 728 f.).

part of a partner in a general partnership or of a general partner (*Komplementär*) can, in the event of his leaving the company due to death, not only be reduced but also completely excluded in the company statutes. Such a clause is admissible because the interests of the heirs play no role from a company law perspective. The testator can, after all, freely dispose over his property during his lifetime. The continuation clause with exclusion of settlement must apply mutually among all partners. Therefore, this is a donative transaction involving a monetary interest, and it is effective vis-à-vis all partners and their heirs. Hence, it is not only the continued existence of the company that can be secured using just such a continuation clause working in favor of the other partners and prohibiting other undesired partners from entering; the financial substance of the company can also be fully secured in favor of the other partners.

- A *successor clause* is a provision in the company statutes according to which the company is not dissolved upon the death of one of the partners but is instead continued with the heirs of the deceased partner. This means the legal consequence of dissolution is inhibited and the flow of assets due to the right to a settlement is prevented. The problem with this, however, is that a simple successor clause allows each heir to enter the company; thus, undesired and unsuitable heirs could also become partners. It is merely their status as heir that is decisive. Preventive measures can and should be taken by corresponding provisions in the company statutes, for example by extinguishing certain management or representation rights or by admitting only one statutory heir. However, it is also permissible to draft a contractual combination with a termination clause to eliminate shareholders (*Hinauskündigungsklausel*). This means that the other partners have the right to terminate the membership of the heir(s) within a certain time or if certain circumstances occur. The company law admissibility of this unilateral exclusion clause, which can be exercised by the other partners, derives from the special case of succession by inheritance (Kalss & Probst, 2013b, p. 736).
- The *qualified successor clause* is a rule in the company statutes providing that only individuals who fulfill certain requirements can be admitted as partners. The company statutes can even name a particular person or set out detailed qualification criteria, such as previous education or being part of the family. The qualified successor clause ensures that people also desired by the other partners take the place of the deceased among the partners. Nonetheless, the new partners and successors must have the status of heirs – there needs to be an interplay of company law rules and succession law dispositions (Kalss & Probst, 2013b, p. 664; Oberhumer, 2020, p. 763 ff.; Schauer, 2010, p. 1018, 2018, p. 1221 ff.).
- An *entry clause* in the company statutes grants a third party the right to take the place of a deceased partner in the company upon the death of this partner. This third-party right is based upon the company statutes, not on succession law. The right of entry offers the entitled party a particularly strong position since it takes effect regardless of succession. The company and the

other partners are dependent on the decision of the entitled party in the case of this company law arrangement. Thus, if there are doubts regarding this clause, it is to be construed as a successor clause. This strengthens the position of the partners and is in the interest of the continued existence of the company and its partners. If the entitled party decides not to enter into the company, the planned corporate succession is frustrated. Therefore, drafting an entry clause must be carefully considered. Moreover, if the entry right is not exercised by the entitled party, the settlement amount must be paid out by the company in favor of the deceased partner's estate. In the case of an entry clause, the legal position of those entitled to a reserved portion is thus dependent, firstly, on whether the entitled party enters the company and, secondly, when the person desists from entering the company, on how the settlement amount is calculated. From a company law perspective, an entry clause makes sense only if already known candidates are to be admitted into the company and the continued existence of the company can thus be secured. The material difference between an entry clause and a successor clause is that entry based on an entry clause depends solely on the company statutes and is in general independent of the succession law position (Oberhumer, 2020, p. 763 ff.; Schauer, 1999, p. 618 f.; 2010, p. 1022; 2018, p. 1224). The entitled party acquires the right to membership upon the death of the deceased partner not by inheritance under succession law and thus not on the basis of a title under succession law, but directly from the other partners on the basis of the contractual provision (Schauer, 1999, p. 630). By contrast, the successor clause requires that a successor and that certain persons, whether on the basis of intestacy rules or testamentary succession, do in fact succeed. Specifically, if a person is not ultimately an heir in the case of a successor clause, its succession law effect, namely the *ex lege* transfer of the right to the named successor, cannot ensue with the devolution of the property.

This shows that company law and succession law, depending on the choice of a clause and the wording of the clause in the company statutes, interact in different ways and that company law can completely set aside the succession law transfer of property or can coordinate it with succession law dispositions. This depends on the specific contractual provisions.

14.6.2. Law on Corporations

Within the field of the law on corporations, there are less far-ranging preformed contractual arrangements. Unlike the law on partnerships, it is not possible to provide in advance in the company statutes that an heir is not allowed to participate at all in the corporation, but that the relevant share falls directly to other shareholders or other third parties. Within the field of corporation law, the interface between company law and succession law is even clearer. Nevertheless, it is also possible within the field of corporation law to make far-reaching arrangements in order to replicate mechanisms in the company statutes similar

to those in partnerships. This is true especially when combined with an obliging "putting" clause in the company statutes, i.e., a clause setting out a duty of the heir to transfer the share to the other shareholders or a third person as soon as he has acquired it *de lege* by universal succession or by another succession law inheritance. At the same time, the share price can also be significantly reduced in respect of the inheritance. Finally, the heir does not acquire membership in the company or at most only temporarily. Under the law of corporations, it is also possible to substantially reduce compensation for the value of the shares in question. Depending on the specific provision, such contractual rules affect not only the position of the direct heir and temporary shareholder but also the legal position of other bypassed children and legal successors of the deceased shareholder – because their reserved portions are also determined by such provision in relation to the company successors. While this means the transfer cannot be governed by the company statutes alone under the law of corporations, the same function is accomplished through a combination of succession law transfer and the company law duty to transfer along with corresponding valuation rules.

Very often shareholders' agreements are used in order to organize a family's role in the family business. These multilateral contracts may include rules regarding the transfer of shares or parts in a company, but they may also govern the family's stake in the management of the company. Additionally, the voting behavior of family members may be restricted and the distribution of profits organized in an efficient manner. Such contractual agreements are especially useful when the family business is owned by more than one family or family line. However, shareholders' agreements can only be concluded within the boundaries of mandatory rules of company law as well as the company's statutes.

14.7. Summary

The special nature of corporate property justifies separate succession rules that secure the efficient continuation of the company and the existence of the enterprise. This position is supported by the various interests affected, the volatility of the enterprise's value, the difficulty in measuring it and the risks assumed, the lack of feasible divisibility, and ultimately the necessity for long-term creation of value. The necessity for long-term creation of value forms the core of the macroeconomic argument and represents the public interest in special rules for corporate succession. Under the applicable law, provisions can, to a large extent, already be constructed in the company statutes, so that only certain persons can become members of a company; other than that it is possible to substantively determine and to usually reduce the amounts of compensation for value and thus any reserved portions. The above-mentioned legal instruments aim to balance the long-term continuation and development of the business with the claims of the business owner and other descendants. Insofar, the provisions in the company statutes can affect the testamentary freedom of disposition substantially and materially influence it.

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