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## Will-Substitutes from the Perspective of Business Owners

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SUSANNE KALSS

### I. Interfaces Between Company and Succession Law

The lifetime of human beings is limited. This is a difference between natural persons and entities with legal personality. The death of a natural person triggers succession law mechanisms. It follows that succession law is only applicable to companies when they are held by natural persons, and not by legal entities such as companies or foundations.

Succession law is closely linked to the issue of private ownership of businesses and the private ownership of shares in businesses. It is also connected to the issue of private arrangements governing succession upon the entrepreneur's or shareholder's death.

Inheritance of company shares or of corporate assets is currently characterised by specific features. However, several fundamental considerations support the idea of a distinct procedure for the treatment of corporate assets when these are transferred via succession. The company itself or its shares should not be simply equated with other assets. These fundamental considerations are applicable from the perspective of company and corporation law for cases where succession is governed by wills, intestacy or contractual arrangements. Therefore, it is possible, and can make sense, to use company law mechanisms to regulate the succession in the company or its shares, which take effect parallel to traditional forms of succession mechanism, or may even circumvent them.

Four material aspects ought to be mentioned here to clarify the special techniques of the transfer of corporate assets:

1. Succession law is the law governing *inheritance* and *distribution* of assets on death of a person – company law is the law governing the *organisation* and *continuation* of a company.
2. Ownership of corporate shares not only involves assets but also property rights and control rights.

3. Corporate succession not only affects the heirs and potential by-passed heirs, ie, children neglected by the testator and therefore excluded from the inheritance, but also several other groups of persons.
4. Corporate property differs from other property; it constitutes special property.

### A. Tasks of Succession Law and Company Law

Company law and succession law do not form a hierarchical relationship. Neither succession law nor company law takes precedence over the other field of law.<sup>1</sup> Rather, they coexist with equal rank. They are also used for the performance of distinct regulatory tasks:<sup>2</sup> the law of succession has the *function of distributing and transferring assets*. It determines who is entitled to the testator's property.<sup>3</sup> By contrast, company law governs which rights, relationships and memberships (if at all) can be passed on in accordance with the law and the company articles.<sup>4</sup> The object of company law is to ensure efficient shareholder cooperation and the continued existence of the business, as well as to govern the legal relationships among its members, and that between the company and third parties. It ensures effective cooperation and balance of interests.<sup>5</sup>

#### i. Distribution and Equality

Succession law is the law of distribution. Its distributive effect is apparent in intestacy rules, pursuant to which the family, whose members are divided into circles of relationships or *parentelae*, is typically invoked as the fundamental statutory model. Family members belonging to the same generation are usually treated equally, which causes the distributive effect. For example, if the longer living parent is survived by three children, according to Austrian law and the law of many other jurisdictions, each child inherits a proportional share, that is one-third of the estate. Dispositive intestacy rules provide that each family member of the same generation should ultimately inherit the same amount. Succession law makes no distinction in terms of age, qualifications or individual interests in the transferred

<sup>1</sup> M Schauer, 'Nachfolge im Recht der Personengesellschaften' in M Gruber, S Kalss, K Müller and M Schauer (eds), *Erbrecht und Vermögensnachfolge* (Vienna, Springer, 2010) § 31 para 2, 988, 990 f; M Schauer, *Rechtsprobleme der erbrechtlichen Nachfolge bei Personengesellschaften* (Vienna, Verlag Österreich, 1999) 399 f; H Wiedemann, 'Zum Stand der Vererbungslehre in der Personengesellschaft' in U Hübner and W Ebke (eds), *FS Großfeld* (Heidelberg, Verlag Recht und Wirtschaft, 1999) 1309, 1310.

<sup>2</sup> S Kalss, 'Unternehmensnachfolge in Kapitalgesellschaften' in M Gruber, S Kalss, K Müller and M Schauer (eds), *Erbrecht und Vermögensnachfolge* (Vienna, Springer, 2010) § 32 para 2, 1033, 1036.

<sup>3</sup> Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, § 31 para 2, 991; Wiedemann, above n 1, 1310 f.

<sup>4</sup> Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, § 31 para 2, 991; S Kalss and S Probst, *Familienunternehmen: Geschäfts- und zivilrechtliche Fragen* (Vienna, Manz, 2013) no 20/8.

<sup>5</sup> S Kalss, C Nowotny and M Schauer, *Österreichisches Gesellschaftsrecht* (Vienna, Manz, 2008) no 1/3; C Windbichler, *Gesellschaftsrecht* (Munich, Beck, 2013) 1 f.

property. Often, however, talents and interest are not distributed equally among all heirs; in particular, this applies to corporate property.

#### ii. Reserved Portion

This distributive effect is particularly apparent in the provisions determining which requirements must be fulfilled in order for a person to be entitled to a reserved portion. The testator's descendants are typically entitled to a reserved portion, regardless of any mention in the will, as many civil law jurisdictions provide for forced heirship.<sup>6</sup> Under Austrian law, and the law in many other European legal systems, the testator's descendants and spouse have a mandatory right to at least half the estate. For instance, in Germany, the Netherlands, Poland, Switzerland, Greece and Austria, the marital spouse and the children receive half of the estate. The special nature of this portion lies in the fact that it often consists of a right to money, the sum of which is a proportionate share as measured in comparison to the estate in its entirety and to the position of testate heirs. In order to make this money available, and to enable the heir to satisfy this debt, enterprises or shares must often be sold. While the enterprise or company is not directly affected, the corporate property is often the testator's only property, or at least the only material property, forcing the heir to take recourse to this corporate property. The distribution of dividends is usually insufficient for this purpose.

Frequently, entire enterprises, or at least a stake in them, must be sold in order to facilitate payment of the reserved portion. In other cases, enterprises distribute substantial special dividends to enable an heir of the deceased shareholder to actually satisfy his obligations arising under succession law.

While company law is generally aimed at the continued existence and efficient functioning of the company, succession law has a *restricted transfer function* with distributive effect. This contrast gives rise to constant tensions between succession law and company law. Given the fact that these conflicting legal influences and the distribution can jeopardise the existence of the company (problems concerning finance and personnel), company law is applied in order to secure the financial basis of the company, the qualification of the personnel and the manageability of the enterprise. This is achieved by restricting the distributive effect of succession law, whether by direct transfer to certain persons or other mechanisms fulfilling the same function.

#### iii. Communities of Heirs

The existence of communities of heirs such as the community of heirs (*Erbengemeinschaft*) under the German Civil Code (*Bürgerliches Gesetzbuch*) as

<sup>6</sup> S Kalss, 'The Interaction Between Company Law and the Law of Succession – A Comparative Perspective' in S Kalss (ed), *Company Law and the Law of Succession – General Report* (Heidelberg, Springer, 2015) fn 58.

well as the joint ownership community (*Miteigentumsgemeinschaft*) under the Austrian Civil Code (*Allgemeines Bürgerliches Gesetzbuch*, hereafter ABGB) is an important consequence of the principle of distributive equality. Both are characterised by the fact that a legal act of just one member of the community (eg, filing for an action for annulment or partition) can lead to its dissolution.

The joint ownership extends to physical objects, as well as rights, such as shares or other company memberships. Successors are obliged to jointly exercise their shareholder or partnership rights. In order to do so, they must find a way to agree upon various measures and to establish a common position. The law requires unanimity for important measures, which means that individual members are in a position to block one another. As a result, the entire community becomes unstable and is permanently exposed to the risk of paralysed and decreasing companies.

The community of heirs, as known by German law, exists with regard to each physical object, provided that the inheritance is not partitioned. Partition would lead to the annulment of the community of heirs and can be sought by each co-heir before or after the property is transferred to the heirs. However, prior to the transfer, it is not effective *in rem*. In the same way as a community of joint ownership is divided, under Austrian law an inheritance is partitioned, pursuant to § 841 ABGB, either by an agreement on inheritance partition (*Erbteilungsübereinkommen*) or, if no agreement is reached, by an action for partition (*Erbteilungsklage*) and a subsequent judgment.

## B. Ownership Involves Controlling Rights and Property Rights

There are two central aspects, which need to be clearly distinguished, in the context of owning an enterprise or corporate shares. These two aspects of ownership involve property rights and also rights of control and influence,<sup>7</sup> which may be exercised or held by different people. Consequently, they may also be transferred and allocated separately on death of the owner. Even though these two aspects can – and must – be distinguished, it must be emphasised that they influence one another. The larger the extent of the influence that can be exerted by an individual shareholder (eg, through double-voting rights or shareholder agreements), the higher the value and the price of the share.

Property rights over enterprises or corporate shares include the ownership of a stake and the benefit derived from added value. Moreover, this ownership also entitles to dividends, a right to settlement in the event of transfer, the option to merge the company or to change its legal form, as well as the yields generated by selling the share. Rights of control or influence, that is to say the option of exercising power in a company and over its assets, include the right to vote at

shareholder meetings (general meeting or assembly), as well as managerial positions or incumbency in the supervisory board, such as the supervisory committee of an enterprise.

As property rights and control rights can be separated, they may also be transferred separately in the event of legal succession upon the holder's death. The separate, but nonetheless proportionate, transfer of these different components of the share in the corporate property secures participation of all successors in the company as provided for by succession law. This means that two things can be guaranteed: on the one hand, the succession law principle of distribution and, on the other, the concentration of decision-making processes within a company to safeguard efficient management, as intended by company law. Property rights as well as the rights of control and influence at the shareholder meeting, or the entitlement to positions in certain executive bodies of the company, can be allocated to specific heirs or legal successors. Separating rights of control and influence is often the key mechanism for the implementation of legal succession in an enterprise in a manner that is conducive to securing the corporate need for a concentration of influence and efficient management. As a rule, only the invocation of succession law and the acceptance of the inheritance with its subsequent takeover are necessary for the transfer of property rights. In many cases, the allocation and takeover of control rights require specific suitability, ability and qualifications for managing the enterprise and exercising control in a manner which guarantees sustainable success.<sup>8</sup> Apart from the person's individual qualifications, it is necessary to ensure that the decision-making processes are managed efficiently so that this efficiency is reflected at the operative management level, as well as at the supervisory and ownership levels.

## C. Divergent Interests

Succession to corporate property affects primarily the legal successors and the bypassed heirs. However, several additional groups of people are also affected. The following interests may be at stake after the death of a shareholder or owner:<sup>9</sup>

- The *testator's* interest in preserving his testamentary freedom and the ability to freely dispose of his own property, including shares.
- The interest of the heir(s) in receiving and freely disposing of the inherited property.
- The interest of those entitled to reserved portions in receiving a certain part of the net inheritance value.

<sup>8</sup> cf. Kalss and Probst, above n 4, 672 ff.

<sup>9</sup> Kalss and Probst, above n 4, 655; Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, § 31, paras 1 ff, 989 ff.

<sup>7</sup> A Dutta, *Warum Erbrecht? – Das Vermögensrecht des Generationenwechsels in funktionaler Betrachtung* (Tübingen, Mohr Siebeck, 2014) 32 ff.

- The interest of the other shareholders in being able to acquire the share of the deceased party, or at least being able to influence the selection of any new shareholder(s), if they wish to continue the company either alone or with new shareholders.
- The interest of the business in efficient and decisive management processes and administration; this applies also to the managers of the company as well as to the employees of the company.

The other shareholders have an interest in knowing and influencing who replaces the deceased shareholder, ie, with whom and with how many new shareholders they will have to collaborate in the future. The company itself, represented by the management and by the employees, is directly affected. Both groups are interested in the continued existence of the company under reasonable and feasible conditions. The public, in turn, is interested in the continuing existence of the company, as it guarantees employment, which in turn generates profits in the region and value in the country. Thus, the public has a financial interest in the (feasible) continuation of the company in the event of succession, which means that the interests of the deceased party's heirs and bypassed heirs must balance against those of the public. This is a situation that affects a large number of people and can entail significant consequences.

#### D. Corporate Property as Special Property

'Property' is not 'property'. Rather, there are various types of property, ranging from money and jewellery, real estate, a picture or art collection, to companies. These different types of property necessitate the development of corresponding means and justifications for their transfer. The following illustrates the difference between a sum of money and corporate property:

- Corporate property (ie, companies or corresponding corporate stakes in companies) differs from other property in that its value is more *volatile*, in the sense that it is easily susceptible to rapid changes.<sup>10</sup> This is a marked difference from a sum of money, for example, which only changes due to inflation, etc.
- The value of an enterprise that has been fragmented among heirs is often diminished in comparison to the value of the original enterprise in its undivided state. While a sum of money maintains its original total sum upon division (30 + 30 + 30 = 90), this is not necessarily applicable to the division of corporate property. Typically, the value depends on the entire enterprise. Divisions and split-offs can increase value, but not typically as a consequence of distribution.

- The *market environment* gives rise to almost daily fluctuations of the value of corporate property. A possible example is the loss of buyer segments due to the employment of more efficient technologies, the earlier recognition of new trends and the prompt implementation of a new business model by another enterprise.
- Ultimately, the value of an individual enterprise depends materially on the way it is managed, and on the entrepreneurial performance of the owner.<sup>11</sup>

The continued operation of the enterprise also involves substantial entrepreneurial risks, including the risk of total loss or that of a material part of the inherited assets upon takeover. Once the transfer of the sum has been effected, the recipient of a reserved portion in cash is no longer exposed to this risk, which puts him in a privileged position *vis-a-vis* the heir of the company. He is entitled to a sum of money either immediately or soon after the death of the testator, without being exposed either to the risk of fluctuation in value, or in company earnings. Thus, the notion of compensating this risk would support a different and special succession rule as regards corporate property.

Given the various distinct features of enterprises, it is desirable and sometimes necessary to explore alternative procedures for the transfer of corporate assets. In particular, this is true for the transfer of corporate assets organised as companies. These transfer procedures may be governed by the general rules of succession law or may lie outside the bounds of succession law.

## II. Special Rules for Agricultural Enterprises

In Poland, Germany and Austria there are special rules for corporate succession in farming and forestry enterprises.<sup>12</sup> The justification for establishing special rules in this sector is macroeconomic in nature and founded upon the need to protect the public interest. The existence of farming and forestry enterprises ought not to be jeopardised by 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 facilitated and ensured that only the most qualified successor obtains and continues the farming enterprise, which is essential to safeguard its existence and the production of food. Therefore, the distribution of such farming or forestry enterprises and the subsequent creation of many sub-enterprises are to be avoided:

- Since the applicable legal rules aim to prevent erosion of the substance of commercial farming and forestry enterprises, they impose substantial limits

<sup>11</sup> H. Fleischer, 'Unternehmensbewertung im Personengesellschafts- und GmbH-Recht' in H. Fleischer and R. Hüttermann (eds), *Rechtshandbuch Unternehmensbewertung* (Cologne, Otto Schmidt, 2015) 707, 728 f.

<sup>12</sup> Kalss, 'The Interaction Between Company Law and the Law of Succession', above n 6, fn 303.

<sup>10</sup> B. Dauner-Lieb, *Unternehmen in Sondervermögen* (Tübingen, Mohr Siebeck, 1998) 29 f.

on the entitlement to a reserved portion. As a consequence, a forced heir does not receive half or another portion of the estate, but a share that, measured against the generated earnings, is certain to pose no risk to the sustained continuation of the enterprise.

The continued existence and the efficient management of the farming or forestry enterprise are secured by the rule that the person with the best qualifications and training prevails as heir over other potential candidates. The principal factor is not the age of the heir, but the desire to secure a feasible amount of functioning farming and forestry enterprises in order to supply the public with food.<sup>13</sup>

Finally, the application of the special succession law rule to cases where the enterprise is continued for another 10 years serves as an incentive for long-term commitment; if it is sold prior to the expiry of 10 years, the division of the proceeds of the sale is governed by general succession law rules.

### III. Private Replication of these Rules

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 some 6,800 corporate successions take place each year.<sup>14</sup> Therefore, a value of macroeconomic proportions is certainly at issue when it comes to the continued existence or the discontinuation of these enterprises. It is not only farming and forestry enterprises that have significant macroeconomic value. Enterprises generally offer jobs, create value and are therefore extremely important for securing the livelihood of the population. Hence, there is a macroeconomic interest in securing the existence of such enterprises and in ensuring that they do not fragment when distribution occurs, as provided for under the rules of intestacy or forced heirship. The continuation of the enterprise means creation of value for larger regional units and society at large. 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 employment opportunities are scarce. The importance of enterprises in such regions is all the greater in macroeconomic terms.

In practice, appropriate solutions balance the interests of all involved parties (the entrepreneur, the person handing over the enterprise, his children and the

enterprise itself). They are based on an assessment of these interests in compliance with the applicable law, and are usually implemented through contractual arrangements between these parties.

These arrangements are aimed not just at securing the existence of the enterprise, and its affordability for the entrepreneur, who continues the enterprise, but also at providing an appropriate financial settlement for those entitled to a reserved portion. It is also vital to ensure that the parents who pass on the enterprise are supported and cared for. In practice, therefore, arrangements often provide solutions to these needs. Nonetheless, a statutory rule is desirable and advisable to regulate cases where there is no will or contractual arrangement, and accidents or other unforeseen events have occurred.

The notion of special rules and the justification of special succession rules for farming and forestry enterprises can also be applied to other business sectors. The techniques are: concentrating the inheritance in the hands of one suitable successor, and determining the reserved portions on the basis of the earnings of the enterprise, and the extent to which it is affordable for the company to provide the portion from its corporate earnings. Thus, from a legal policy perspective it would certainly be reasonable not only to provide greater private autonomy, but also to establish a special set of rules applicable to all companies.<sup>15</sup> From a modern perspective, this is not only legitimate in order to secure farming and forestry enterprises, but should also apply to service enterprises, for instance, in the tourism sector or in industrial manufacturing. In any case, the existence of enterprises should be secured in order to preserve economic strength in the macroeconomic interest. Laws should make it possible to concentrate the inheritance in the hands of one person. In the case of corporate succession, the reserved portions should be determined on the basis of the earnings of the last 10 years, instead of on the basis of the market value of the whole company at the time of the testator's death. If the earnings are unexpectedly higher, then there should be a duty to pay where the enterprise is sold for a higher price within 10 years after the inheritance. If a higher value of the enterprise is subsequently established, the heirs who had received a sum can once again participate in the profits. This model would provide incentives and would also secure the continued existence of the enterprise in order to continue creating value within the family, the workforce of the enterprise and its business partners. Succession law aside, tax law provisions must also be considered. For example, reserved portions bequeathed by an entrepreneur should be recognised as business expenses, whereas the entitlement to reserved portions should be taxed at half the rate of other incomes in order to balance the interests involved.

<sup>13</sup> S Probst, 'Anerben- und Höferecht' in M Gruber, S Kalss, K Müller and M Schauer (eds), *Erbrecht und Vermögensnachfolge* (Vienna, Springer, 2010) 113, 114 ff.

<sup>14</sup> KfW Austria, *Übergabepotenzial in Österreich. Studie im Auftrag der Wirtschaftskammer Österreich* (2014).

<sup>15</sup> S Probst quoted in S Kalss, 'Überlegungen zur Gestaltung der Unternehmensrechtsnachfolge im Zuge der laufenden Erbrechtsreform' (2015) *Osterreichische Notariatszeitung* 50, 52.

#### IV. Succession Law Arrangements Already Possible Under Applicable Law

Under Austrian law and also under the law of other jurisdictions, it is already sometimes possible to find suitable arrangements. It must be borne in mind that company law rules usually require unanimity on the part of the shareholders for their amendment, whereas last wills and testaments can be made by the testator alone and can be unilaterally changed at any time prior to his death. Thus, succession law offers greater freedom for the individual to organise his affairs.

First, one very important area of flexibility in succession law is the ability to nominate, either by will or by anticipated succession, a single person as the corporate successor. In doing so, it is possible to secure efficient corporate management and continuance tailored to this one person. Many laws of succession allow for a delayed payment in cash of reserved portions for several years.<sup>16</sup> The option of being able to grant other assets *in lieu*, particularly shares in the enterprise that only grant dividend rights, but no influence (eg, preferred shares without voting rights, profit participation rights (*Genussrechte*), sub-shares or other rights based on the earnings of the enterprise), is even more important. In this respect, it is necessary to make both contractual and company law arrangements in order to effect a supplementary or necessary succession law transfer of assets as intended. The future Austrian law of succession allows participation rights (*Genussrechte*), silent partnerships or other stakes in companies without rights of influence – precisely for the purpose of securing efficient decision-making structures in enterprises.<sup>17</sup> Dutch law makes it possible to issue special certificates to satisfy reserved-portion rights.<sup>18</sup> The shareholders need to remember to harmonise the rules governing the company's articles and succession law dispositions (wills or contractual arrangements).

#### V. Possible Company Law Arrangements

##### A. Partnerships

The assessment of the special nature of corporate assets, the macroeconomic justification for special rules, and the effectiveness of private arrangements show

that company law offers a tradition of specific and legally recognised private arrangements, which can be employed for the organisation of succession within an enterprise. Furthermore, it seems to be the case that will-substitutes play a much more significant role in the company law context than in scenarios involving other types of assets. For instance, German and Austrian company law governing partnerships already offer a broad array of methods and means to decide on material issues in the context of corporate succession.

In this context it is important to distinguish between (a) gaining the status of partner and (b) the entitlement to be compensated. In any case, there are company law options which are aimed at excluding heirs or particular legal successors from becoming members of the partnership. In other words, they are refused succession to the real corporate value of the enterprise, or a share therein, and are instead granted compensation. Sometimes, there are even more far-reaching company law options that actually reduce this compensation or exclude it, by prohibiting the settlement in favour of the other partners, and at the expense of the heirs.<sup>19</sup>

In the following, specific company law options are presented. The statutory starting point is the dissolution of the partnership with the possibility of continuing the business with the heirs. The partnership articles must therefore provide for any arrangement.

A *continuation clause* sets forth that, upon the death of one of the partners, the other partners to the partnership can continue the business, without it being dissolved.<sup>20</sup> The heirs of the deceased partner are neither entitled nor obligated to take his place. *In lieu* of a share in the partnership, the entitlement to compensation is inherited. Due to the continuation clause, the partners can therefore prevent unwanted or unsuitable people from entering the partnership. Thus, certain people are excluded by company law from taking a share in the business, while nevertheless maintaining entitlement to compensation for the value under succession law. This entitlement applies to intestate as well as forced heirs. Therefore, there is a risk related to capital flow in favour of the heirs of the deceased partner. In principle, the right to compensation must be estimated based on the value of the enterprise, and the deceased partner's share should be calculated on this basis as one proportionate part of the whole. According to this mechanism, the substance or the value of the earnings is material for the calculation of the real value, not the book value.<sup>21</sup>

It is also admissible to combine a *continuation clause* with a *settlement exclusion clause*. Contractual arrangements based on this combination are also binding on the heirs; for instance, a book value clause, which is an evaluation method

<sup>19</sup> See on this Kalss and Probst, above n 4, 662; Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, § 31, paras 10, 990 f, 999 ff; M Schauer, *Rechtsprobleme der erbrechtlichen Nachfolge in Personengesellschaften* (Vienna, Österreich, 1999) 84.

<sup>20</sup> See chs 6 and 8 above.  
<sup>21</sup> Kalss and Probst, above n 4, 662; Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, 1002; on the aspect of the proportionate part of the whole: Fleischer, above n 11, 728 f.

<sup>16</sup> See P Barth and U Pesendorfer, *Erbrechtsreform 2015* (Vienna, Manz, 2015) 101 quoting paras 766 ff ABGB.

<sup>17</sup> S Kalss and C Cäch, 'Unternehmensnachfolge "neu" – Was bringt die Erbrechtsreform 2015?' (2015) *Steuer- und Wirtschaftskartei* 659, 675 ff.

<sup>18</sup> W Bürgerhart and L Verstappen, 'Company Succession in the Netherlands' in S Kalss (ed), *Company Law and the Law of Succession* (Heidelberg, Springer, 2015) 347.

provided for by company law. However, the right of an heir to compensation can be excluded by the articles of the partnership. Such a clause is admissible because the heir's interests play no role from a company law perspective. The testator may 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 money interest. It is effective *vis-a-vis* all partners and their heirs. Hence, not only can the continued existence of the partnership be secured by employing a continuation clause which favours the other partners and prohibits other undesired partners from entering the partnership, the financial substance of the partnership can also be fully secured in favour of the other partners.

A *successor clause* is a provision in the partnership articles, according to which the partnership remains undissolved upon the death of one of the partners, but instead continues with the heirs of the deceased partner. This means that the legal consequence of dissolution is inhibited and the flow of assets (due to the right to compensation) is prevented. However, this can give rise to the problem that a simple successor clause allows each heir to enter the partnership; thus, undesired and unsuitable heirs could also become partners. Merely their status as heirs is decisive. Preventive measures can and should be taken in the form of corresponding provisions in the partnership articles, for example, by cancelling certain management or representation rights, or by admitting only one statutory heir. However, it is also admissible to include a termination clause to get rid of partners (*Hinauskündigungsklausel*), which accords the other partners the right to terminate the membership of the heir(s) within a certain time, or if certain circumstances occur.<sup>22</sup>

The *qualified successor clause* is a rule in the partnership articles which provides that only individuals who fulfil certain requirements can be admitted as partners. The partnership articles can even name a particular person or determine specific qualification criteria, such as prior education and family membership. The qualified successor clause ensures that people also approved of by the other partners take the place of the deceased. Nevertheless, the new partners and successors must have the status of heirs, guaranteeing the interplay between company law and succession law rules.<sup>23</sup>

An *entry clause* in the partnership articles grants a third party the right to take the place of a deceased partner within the partnership upon the death of such a partner. This right of the third party is based on the partnership articles, not on succession law. The right of entry offers the entitled party a particularly strong position since it is admissible regardless of succession. The partnership and the other partners are dependent on the decision of the entitled party when such company law arrangements occur. Thus, in the interests of the continued existence of

<sup>22</sup> Kalss and Probst, above n 4, 736.

<sup>23</sup> Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, 1018; Kalss and Probst, above n 4, 664.

the partnership, and in order to secure the interests of the other partners, as well as to strengthen the position of the partners, a contractual clause is always to be construed as a successor clause, and not as an entry clause. If the entitled party decides to refrain from entering, the planned corporate succession is frustrated. Therefore, drafting an entry clause must be considered carefully. Moreover, if the entry right is not exercised by the entitled party, the settlement amount must be paid out by the partnership in favour of the deceased partner's estate. The legal position of those entitled to a reserved portion is thus dependent on the occurrence of an entry clause. First, depending on whether the entitled party enters the partnership and, second, when he desists from entering the partnership, on how the settlement amount is calculated. From a company law perspective, the entry clause only makes sense if previously known candidates are to be admitted into the partnership, and the continued existence of the partnership can be secured. The material difference between an entry clause and a successor clause is that the entry based on the entry clause depends solely on the partnership articles and is generally independent from succession law.<sup>24</sup> The party entitled to enter 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.<sup>25</sup> By contrast, the successor clause requires that there really is a legal successor, and that certain persons, whether on the basis of intestacy rules or testamentary succession, do in fact succeed. Specifically, if a person ultimately cannot assume the position of an heir, due to a successor clause, its succession law effect, namely the *ex lege* transfer of rights to the named successor, cannot ensue from the devolution of the property.

This shows that, depending on the choice of clause, and its wording in the partnership articles, company law and succession law interact in different ways. Company law can completely set aside the succession law transfer of property or can be coordinated with succession law dispositions, depending on the specific contractual provisions.

## B. Corporate Law

Within the field of corporate law, pre-formed contractual arrangements are less comprehensive. In contrast to the law on partnerships, it is impossible to provide in advance in the company articles that an heir is prohibited from participating, but that the relevant share is to fall directly to other shareholders or third parties. Within the field of corporate law, the interface between company and succession

<sup>24</sup> Schauer, 'Nachfolge im Recht der Personengesellschaften', above n 1, 1022; Schauer, *Rechtsprobleme der erbrechtlichen Nachfolge in Personengesellschaften*, above n 19, 618 f.

<sup>25</sup> M Schauer, *Rechtsprobleme der erbrechtlichen Nachfolge bei Personengesellschaften* (Vienna, Österreich, 1999) c 630.

law is even clearer. It is also possible within the field of corporate law to make comprehensive arrangements in order to replicate mechanisms in the company articles similar to those of partnerships. This is true especially when combined with a corresponding clause in the company articles, 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 another form of succession law inheritance. At the same time, the share price can also be significantly reduced through inheritance. Finally, the heir does not acquire membership in the company or only acquires temporary membership. Under corporate law, it is also possible for the compensation of value to be substantially reduced. Depending on the specific provision, this contractual rule not only affects the position of the direct heir and temporary shareholder, but also the legal position of the bypassed children and legal successors of the deceased shareholder, because their reserved portions are also determined by the whole assets—including the shares—of the deceased. While this means that under the law of corporations the transfer cannot be solely governed by the company articles, the combination of succession law transfer and company law duty to transfer, along with corresponding valuation rules, accomplishes the same function.

## VI. Summary

The special nature of corporate property justifies separate rules that secure the efficient continuation of the company and the existence of the enterprise. In companies there arise various interests, the enterprise's value is quite volatile and very difficult to measure; often it is not feasible to divide the assets without destroying their value. The necessity for long-term value creation forms the core of the macroeconomic argument and reflects the public interest in a special rule for corporate succession. According to applicable law, extensive private provisions can be included in the company articles, ensuring that only certain persons can become members of the company; additionally, it is possible to materially determine and to reduce amounts of the compensation, which in turn entails a reduction of reserved portions. Therefore, the provisions in the company articles can substantially affect and materially influence the freedom of testamentary disposition. The articles of the company are not will-substitutes in the strict sense, but they share the feature that they can be applied to avoid the mechanisms of the general rules of succession law.