manual

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Preface

In October 2018, Vienna University of Economics and Business (WU) launched a new English-taught Bachelor's Programme in Business and Economics (BBE), which aims in particular at international students interested in receiving a profound interdisciplinary education in business and economics.

The course 'Governance and Legal Environment' forms part of this programme. Understanding the legal framework of business activity has become indispensable. Therefore, WU decided to make BBE students familiar with legal determinants for successful business activities from the very beginning of the academic curriculum. Naturally, this course cannot cover the legal system in its entirety but will deal with some core issues, such as the influence of law on decisions in enterprises as well as the European, international, and constitutional background of the law governing business activities. At a later stage of their studies, BBE students will have the opportunity to choose special courses in business law, European and international economic law, tax law, and labour law.

This is the second edition of the manual for the course 'Governance and Legal Environment'. Its purpose is to introduce students to those key aspects of the legal framework that will be most relevant for their studies in business and economics. Its contents are primarily based on relevant European and international legal standards and, where useful, on a comparison of national legal systems. Additional materials will be made available at WU's learning and communication platform learn@wu.

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Vienna, October 2019 Christoph Grabenwarter, Erich Vranes, Martin Winner

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Unit 1: Business Organisation – Basic Concepts

A. Purpose of this Unit

In this unit, you will obtain an **overview of company law**. We will start by explor- **1**
ing reasons for setting up a company, some basic concepts of company law and the purpose of company law. We will continue by providing a brief overview of types of partnerships, companies and other forms of business associations. Then, we will explore the sources of company law – specifically, the interplay between national and European legislation. Finally, we will look at the different types of conflicts of interest company law has to deal with, namely, those between shareholders and managers, those between majority and minority shareholders and those between the company and other stakeholders, such as creditors or employees. The overview will provide the basis for the following four chapters, which will address some of these issues in more detail.

B. Companies and Company Law

I. Reasons for Incorporation

There are a number of **reasons** why an entrepreneur may decide to carry on her/ **2**
his business not alone, *i.e.* as a sole proprietor or sole trader, but together with others. Entrepreneur, Anna, for instance, may need specialised skills to carry out her business, which she herself does not possess; let us assume that Anna encounters a specialist, Peter, who, however, is not willing to enter into a labour contract with Anna, but wants a share in the profits. Anna and Peter thus enter into an agreement specifying their respective rights and duties, *e.g.* their influence on business operations or their share in the profits and losses. That contractual relationship will result in a partnership or company being formed.

Alternatively, Anna may have the know-how, but may be **lacking the financial** **3**
resources necessary for the business she has in mind. Peter may have the money, but may not be willing to engage in the day-to-day business. Peter could provide a loan to Anna, which would lead to Anna paying interest irrespective of the profit she makes (of course, Peter will be paid only as long as Anna is not insolvent); any profits exceeding the interest payable will accrue to Anna. On the other hand, Peter may wish to participate in the profits on an equal footing, whilst Anna may want to avoid payments to Peter if the business does not make any profits. To achieve this, Anna and Peter can found a partnership or company; instead of a loan, Peter can provide finance via equity. As a holder of equity, he will be able to capture a share in any gains made by the business, but will also be subject to a higher risk of loss than a holder of debt.

4 The provision of **equity finance** is a core reason for setting up a company. It is no coincidence that the rise of the modern company went hand in hand with the heyday of railway construction in the 19th century, for which individual investors could not provide the necessary capital. Rather, companies raised equity from numerous small investors, who then became shareholders in the company. Legislators had to respond by introducing codes on company law dealing with these new challenges.

5 Skip back to the present, and there are obviously further reasons for setting up a company, a topic we cannot explore in depth here. Let us just consider some **additional issues**. It is of course possible to organise a business venture to a large extent via contracts of exchange. Let us look at a typical production process with cutlery as an end product. The producer of the knives and forks needs machines and steel; both can be bought from specialised firms. Electricity will have to be supplied by a utility provider. The list of course goes on. At some stage, it may make more sense to integrate all or at least some of these processes: the producer of cutlery may want to produce its own machinery (or, of course, the other way around). In order to do that, the two businesses will have to be merged, which can be done either by setting up a common business or by buying the machinery venture from its proprietor. In the first case, a company will be set up; in the second case, the producer of cutlery may need external funding. If it is provided in the form of equity, the entrepreneur will come into contact with company law too. The process of integration is thus an important reason for setting up a company. Of course, integration is not an issue in all industries. On the contrary, many activities necessary for running a business are currently being outsourced, as external providers can supply them in a better way. Insourcing processes nevertheless constitute an important driver for the foundation of companies.

II. Reasons for and Types of Company Law

6 So far, we have gained an understanding of the partnership or company as a contract. Indeed, the company is generally defined as a voluntary and contractual association of individuals in some form of organisation for a common purpose. To that extent, we may wonder about the **role of company law**. Why do we need a body of provisions laying down rules for companies if their members can solve these issues by stipulating contractual provisions among themselves? There are at least two answers to that question.

7 First, many rules of company law are what lawyers call **default rules**. Such rules will only apply as long as the company's members have not stipulated otherwise; they serve as a fall-back option. In this way, parties may find rules which are adequate for their specific purposes and circumstances. Generally, the parties to a contract are in the best position to do so, as long as they are rational, have a clear and adequate picture of the background circumstances and are not restrained in their decision-making. However, they do not have to find such rules, since the default rules provide a subsidi-

ary body of law regulating their relationship ('standard form contract'). The founders may decide not to bother and thus save costs. Even more importantly, they may have overlooked an issue. Such a mishap can easily happen when setting up a company, as this is not a one-off exchange like a sales contract, but the basis for an ongoing relationship, which ideally reaches far into the future. Hence, when forming the company, the founders cannot have a precise idea about future developments. For that reason, company statutes are, to a large extent, incomplete contracts which do not foresee all future contingencies. Default rules have an important gap-filling role in such a setting. Ideally, they should contain rules which the majority of founders would have chosen in the first place. A typical example for such a default provision could be the one share-one vote principle (see Unit 4 at m.n. 219), according to which each Euro invested procures the same voting rights. Parties can draft contracts that dodge that principle, *e.g.* by issuing shares without voting rights.

8 Second, many rules of company law are **mandatory**, that is parties cannot design contracts with rules of their choosing. This has a number of reasons. On the one hand, the rules applicable to the company affect not only the members but also third parties, especially creditors and employees. If the members were completely free to draft the rules applicable to the company, this would likely result in a set of rules detrimental to these other constituencies. On the other hand, even between the members, there may be some who are less able to protect their position, *e.g.* because they are in a minority position; some rules of mandatory company law are designed to protect these members. Finally, there may be a need for standardisation, *e.g.* in accounting, as the annual accounts of different companies should be easily comparable.

9 Of course, this does not mean that there is a single solution to the issue of mandatory law. The **approach varies widely**, both between different forms of company and between different legislators. The Anglo-Saxon company law systems tend to be less rigid and contain more default rules, while continental European systems feature compulsory requirements to a larger extent. The latter is especially true for company forms designed to attract investors, like the German or Austrian *Aktiengesellschaft* (*AG*), while with partnerships or company forms for smaller businesses, like the German or Austrian *Gesellschaft mit beschränkter Haftung* (*GmbH*), members have more leeway when negotiating the contents of the statutes. This freedom, however, tends to be greater where rules only affecting the members are concerned. For instance, members of a *GmbH* have wide discretion as to how to distribute voting power or accrued profits among the members. On the other hand, company law rules affecting third parties, like creditors, tend to be mandatory even with partnerships or the *GmbH*.

III. Purpose of Company Law

10 At a normative level, company law has to serve the interest of society as a whole. According to most scholars, this means maximising the aggregate welfare of all indi-

viduals coming into direct or indirect contact with the company. This includes shareholders, creditors, employees, as well as local constituencies and the public at large. Views, however, differ widely on the question of how to achieve this aim, with the narrowest being that company law should help shareholders to maximise their wealth and that this factor by itself will be sufficient to advance overall welfare ('**shareholder value view**'). According to this view, the protection of other interest groups is achieved indirectly, as shareholders will, in their self-interest, attempt to have other interest groups willing to interact with the company. Any constraints in corporate actions should not be imposed by company law mechanisms but by other fields of law, such as environmental law or tax law. Closely connected to this approach is the postulation that a company should be run for the benefit of its shareholders and not for creditors or even society as a whole.

11 According to others, company law should regulate not only in the interest of shareholders but also of other stakeholders. It has to strike the proper balance between conflicting interests. This is certainly a more realistic way of describing what company law actually does, at least in the European tradition. First, company law tries to facilitate the profit-maximizing endeavours of the shareholders. Second, it is designed to protect certain interest groups who may otherwise be subject to unfair treatment by the shareholders as ultimate decision-makers in the company, *e.g.* by protecting creditors against actions by the shareholders impairing the economic value of their claims. Third, modern company law in many instances pursues broader social aims, *e.g*. by imposing reporting requirements on companies as to the sustainability of their actions or by stipulating gender quotas for board positions in order to promote gender equality. Of course, if company law tries to pursue diverse and partially conflicting aims at the same time, it is very hard to measure if it is successful. In the same vein, most European company law takes a so-called enlightened shareholder approach, according to which the directors run the company in such a way to promote the success of the company for the benefit of all of its shareholders, and in doing so, pay regard to the interests of its employees, to the need to foster the company's business relationships with suppliers, customers *etc.* and, to the impact of the company's operations on the community and the environment ('**enlightened shareholder view**').

C. Partnerships and Companies

I. Definitions and Topics of the Text

12 When German lawyers use the term *Gesellschaftsrecht,* this is not equivalent to the English language term 'company law' or its synonym 'corporate law'. A company (British terminology) or a corporation (US) is a legal entity with delegated management. The company's members are the residual claimants as to the company's surplus, and not personally liable and – at least in principle – can transfer their shares freely. A

company is thus something different than a partnership, which typically lacks most of these features. On the contrary, the German term *Gesellschaft* covers both **partnerships and companies**.

This text will primarily look at companies as understood in the English legal language. These forms of business organisation today are far more important than partnerships, especially because of the member's limited liability for the company's debts. However, before going into a more detailed discussion of the position of creditors, of the management and of members in the following units, we will start by providing a brief overview of the different legal forms available when an entrepreneur has to decide how to organise his or her business. The following rough **overview** cannot examine special features these forms may have under national rules, but by necessity, may only provide a very limited introduction to general features of the most common forms of business organisation. **13**

One final preliminary remark: in contract law, parties can generally invent types of contracts not anticipated by the law. That is, individuals can create new types of agreements more suited to their specific requirements than those codified in law. Two important examples are leasing contracts and franchising agreements, which have been invented by business practice, and indeed in many legal systems, these agreements have not been codified at all. The reason for this liberal approach is that the contents of the agreement only affect the parties. That is different for partnerships or companies, as these contractual relationships between the partners or shareholders are also of relevance to creditors (including the tax and social security authorities) and employees. Hence, in partnership and company law, the partners or members **cannot create new types of business associations** (so-called *numerus clausus*); rather, they have to make use of the types foreseen by the law and try to have them accommodate their special needs, *e.g.* by making use of the leeway resulting from default rules. **14**

II. The Business Register

From the outset, a brief look is required at an important institution for commercial activity: the business register. It is designed to make certain **facts or legal relationships public** if they are of interest not just to the entrepreneur but to third parties as well. It is accessible for everyone, usually at a small charge. Interested parties do not have to give reasons for wanting to access this information. **15**

As an example of the purpose of such a register, let us assume that Anna has employed Peter as an agent. Anna has given him a general power of representation for her business. But how can third parties be sure that the **power of representation** actually exists? Do they have to get into contact with Anna? Then they could enter into the contract with her in the first place. Can they rely on a document signed by Anna stating that Peter is her representative? What if the power has been revoked, but the document has not been returned? To solve this and similar issues, most jurisdictions have introduced a **16**

business register, into which such powers of representation can be entered. Anyone can ascertain via the electronically accessible register whether Peter actually has a power of attorney.

17 Of course, the business register is not only about the power of representation. Generally, such registers encompass all commercial companies which can enter into a contractual relationship with third parties. From the register, one can ascertain the **members** of the company (with the exception of the public limited company whose shareholders may change regularly – think of a company whose shares are listed on the stock exchange) or its **directors** and members of the board of supervisors (if any). Via the register, third parties can also check the statute of a company or (at least for large companies) its **annual accounts**.

18 Generally, entry into the register is **mandatory** for sole proprietors if certain types of business are carried out or if the business fulfils certain size requirements as determined by law. Companies have to be registered in order to come into existence. At least under Austrian and German law, there is no such thing as an unregistered company. For partnerships, this is not a general rule, but depends on the type of partnership and national legislation.

III. Partnerships

19 The oldest form of business association still in use today in all European legal systems is the **general partnership** (*Offene Handelsgesellschaft* or *Offene Gesellschaft* in German, *société en nom collectif* in French); as a general rule, general partnerships are entered into the business register. Usually, all partners are active in the management of the business, although this is not mandatory. Under most legal systems, however, third parties cannot manage the partnership, but can only act under instructions of the partners (usually as salaried employees). The partners have to provide material contributions according to the partnership contract and are residual claimants. The latter means that once the creditors (including the employees) have been paid, any residue or surplus belongs to the partners; conversely, they have to bear any losses, which actually will diminish the value of their share in the partnership.

20 The most salient feature of the partnership is the **unlimited liability** of all partners for the business's debts. This can be achieved in various ways. In some legal systems, the business's debts are automatically the debts of all the partners. A creditor enters into a contractual relationship with each partner. In other legal systems, the partnership has a separate legal personality, which means that the partnership as such (and not the partners themselves) enters into contracts with third parties. Hence, under such a system, the debts are debts of the partnership, for which, however, the partners are liable; this liability is generally joint and shared among several parties, which means that each partner will be liable for the entire debt and not just for the part corresponding to her/his share in the partnership.

As a result, each partner is liable for the entire business debts. Additionally, under many legal systems, as a default rule, each partner **can enter into contractual relationship on behalf of the partnership** on her/his own, *i.e.* without the consent of the other partners. Hence, the contract will be binding upon the partnership even without the consent of the other parties. This will hold true even if, as against the other partner, the acting partner may be under an obligation to act only with that partner's consent. If the transaction turns out to be detrimental to the partnership, the other partners may only claim damages against the acting partner. Partners thus have to trust each other. That is the reason why a transfer of the share in the partnership is only possible with the consent of the other partners. For the same reason, the share cannot be inherited; rather, the partnership will be dissolved upon the death of one partner. However, the partnership contract may provide otherwise, both for transfers by contract and by inheritance. Similarly, the remaining partners can opt to continue the partnership with a new member. **21**

Of course, unlimited liability represents a risk. Most people will only be willing to run that risk if they can directly influence the business operations. Providers of equity finance frequently do not have intimate knowledge of the business they want to invest in; similarly, the investor may have money but not time to manage the business. For these and similar instances, partnership law provides the **limited partnership** (*Kommanditgesellschaft* or *KG* in German, *société en commandite* in French). As in a normal partnership, there are general partners who are responsible for running the business and whose liability is unlimited. However, additionally, there are one or more limited partners whose liability is limited to a certain amount; if that amount is fully paid up, they are not personally liable at all, but in the worst case, may lose their investment. As a general rule, they are not responsible for running the enterprise and do not take part when normal business decisions are taken; again, this can be stipulated otherwise in the partnership agreement. For core decisions, the general partners need the consent of the limited partners; the precise definition of these core decisions (in so far as they are not contained in the partnership agreement) varies between jurisdictions. **22**

However, there is one major disadvantage associated with a limited partnership, at least under Austrian and German law: the limited partner is disclosed in the business register. Primarily in order to avoid this publicity, business practice makes use of another type of business association, the **silent partnership** (*Stille Gesellschaft* in German, *société en participation* in French). It is not entered into the register at all, but exists only between the parties. The silent partner's contribution becomes sole property of the entrepreneur, who may be an individual or another company; the silent partner will receive a share in the profits and will usually have to bear part of the losses as well. The silent partnership neither has a separate legal personality nor will it appear in commercial intercourse; only the entrepreneur enters into contact with third parties, who as a general rule, will not know about the silent partnership at all. **23**