Prof. Dr. Christoph Teichmann

Chapter 1: **Introduction**

Please listen to the **Videotape** on "**Terminology**" before you start reading this Chapter.

1. Terminology and Sources of Company Law

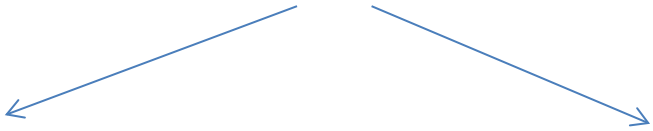
The basic definition of "Gesellschaft" can be found in § 705 BGB: Several persons agree in a contract to promote the achievement of a common purpose.

The concept of "Gesellschaft" implies the following elements:

- several persons
- conclude a legally binding agreement
- on the achievement of a common purpose
- which each party will help to achieve by making specific contributions

In German law, the term "Gesellschaft" covers two different types of organisations, "Personengesellschaft" and "Kapitalgesellschaft", with different subtypes.

"Gesellschaft"



„Personengesellschaft": Gesellschaft bürgerlichen Rechts (GbR), Offene Handelsgesellschaft (OHG), Kommanditgesellschaft (KG)

Kapitalgesellschaft: Gesellschaft mit beschränkter Haftung (GmbH), Aktiengesellschaft (AG)

The term „Personengesellschaft" can be translated as „*partnership*".

The term „Kapitalgesellschaft" can be translated as „*company*"

Please note: English law is based on the distinction between partnerships and companies without using a general term covering the two of them. The German term "Gesellschaft" is therefore difficult to translate into English. In the following paper we will use either the word "partnership" for the first group (= "Personengesellschaft") or "company" for the second group of organisations (= "Kapitalgesellschaft").

The legal basis for partnerships can be found in the German Civil Code (Bürgerliches Gesetzbuch) and in the German Commercial Code (Handelsgesetzbuch). A partnership is also governed by the partnership agreement. This is the contract concluded by the partners when they create the partnership. The contract may be amended, but this usually requires the consent of all the partners (unless the contract itself provides otherwise).

The legal basis for companies can be found in two different acts: The Law pertaining to private companies (GmbH-Gesetz) and the Law pertaining to public companies (Aktiengesetz). A company is also governed by its articles of association. The articles are by their legal nature basically also a contract, since at the time of creating the company, every founder has to approve the articles of association. For later amendments of the articles, however, company law follows the majority rule: A majority of the members can change the articles which will be binding afterwards even for those members who did not accept the amendment.

Please note: The clear distinction between GmbH and Aktiengesellschaft with separate legal acts for each type (GmbH-Gesetz and Aktiengesetz) is a typical feature of German law. English law and some other European jurisdictions are based on the idea that there is one basic category: "the company". Therefore English law is only based on the "Companies Act" and not on two different acts. Private and public companies, in English law, are simply subtypes of the company. The shareholders have to decide in the articles of association whether their company is a "private" or a "public" company; only the shares of a "public" company can be listed at the stock exchange.

2. Classification of Companies

Under the umbrella of the general term „Gesellschaft" German law distinguishes between Personengesellschaft and Kapitalgesellschaft. The following features of "Personengesellschaft" and "Kapitalgesellschaft" will show that the first is similar to the English "partnership" and the second to the English "company".

a) Personengesellschaft (partnership)

- The partnership is based on a contract between the partners. Some partnerships are also registered in the commercial register. But this registration is not a legal requirement for the existence of the partnership.

  Whether the partnership has a legal capacity in its own used to be highly debated (see below). For practical purposes it is sufficient to know that a partnership can have its own assets and can acquire legal rights and duties.

  Contractual freedom: The contract is the legal basis of the partnership. The law does not restrict the freedom of the partners to regulate their internal affairs. They may introduce in their partnership agreement, for instance, a majority rule, a right of individual partners to object certain decisions, a formal procedure for accepting new partners, rules for the distribution of profits, management responsibilities etc.

- There are also legal provisions on partnerships (Civil Code and Commercial Code). But most of these legal rules are default rules: They only apply if the contract does not provide otherwise.

Example: By law, the partners are jointly entitled to manage the business of the partnership; for each transaction the approval of all partners is required (sec. 709 (1) BGB). The partnership agreement may stipulate otherwise, for example introduce an individual right of a partner to manage the affairs of the partnership without having to ask the other partners for consent.

The legal rules frame the partnership as a particular type of organisation with specific features ("gesetzliches Leitbild"): The law assumes that there is a strong personal commitment of each partner to the purpose of the partnership and a close personal relationship to the other partners.

- The membership in a partnership cannot be simply transferred. It requires a change of the partnership agreement. Therefore all the partners have to agree if one partner wants to leave the partnership and to transfer his position to another person not belonging to the partnership.
- The partnership is jointly managed by the partners and jointly represented by the partners.

Example: Three partners A, B and C create a partnership. In the partnership agreement they provide that the partnership will be represented by at least two of the partners. Some months later, partners A and B decide to acquire an expensive car to the expense of the partnership. Partner C objects this decision. Notwithstanding this objection, the two partners sign the contract with the car seller. Since the partnership, as a legal rule, is represented by all the partners, the contract is not valid and the seller has no claim against the partnership to pay the price for the car. The result would be different in a case where the partners have stipulated in the partnership agreement that each partner may represent the partnership alone.

- In a partnership there is usually full personal liability of the partners for the debts of the partnership.

There is one exception to this principle. In the Kommanditgesellschaft ("limited partnership") there are two types of partners. The "Komplementär" ("general partner") is fully liable for the debts of the partnership whereas the "Kommanditist" ("limited partner") may limit his or her liability to a certain amount to be disclosed in the commercial register.

b) Kapitalgesellschaft (company)

- The contract between the founders is not sufficient to create a company. It will not come into existence before it has been entered in the commercial register. At this occasion, the registrar will check whether all the requirements for creating a legal person have been fulfilled. By registration, the company becomes a legal person.
- At the stage of foundation all the founders have to agree on the contract. Later on the contract can be amended by majority decision. The idea of a contract which presupposes the consent of all the parties involved, is therefore no longer appropriate for describing the legal basis of the company. What starts as a contract will soon be an organisational statute which is called "Satzung" in German and "articles of association" in English.
- Like the partnership the company is usually formed by several persons. But in the late 20th century it became possible to have a company with only one member even though this is contrary to the basic concept of "Gesellschaft" (as explained above). But since

the company is a legal person in itself it can function without having recourse to the members. They are not necessarily managing the company and they are not personally liable for its debts.

- The company needs to have capital. The amount of capital has to be stipulated in the articles of association. Moreover, the articles have to determine the amount of the capital to be contributed by each shareholder.
- The members of the company have no legal right to manage the company. They only come together in a general meeting where they are appointing the persons who shall manage and represent the company ("directors" in a GmbH and "management board" in an AG).
- The membership in a company can be transferred to third parties. Unlike in a partnership, where joining or leaving the partnership requires a change in the contract, the articles of the company will not be affected by a change in membership. The transfer of membership is, in principle, a simple transaction between the member of the company and the third party acquiring the membership. The membership is called "share" in order to reflect the fact that it is a legally defined good which can be transferred to third parties.