manual

GRABENWARTER | VRANES | WINNER

Governance and Legal Environment

2nd revised edition

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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.

The authors would like to thank Sophie Bohnert, Peter Thalmann, and (for language assistance) Jennifer Marie Schneider Granić as well as our publisher Facultas for their valuable support in the preparation of the second edition of this manual.

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

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Table of Abbreviations

Art.	Article
AG	*Aktiengesellschaft*
AktG	*Aktiengesetz*
BaFin	*Bundesanstalt für Finanzdienstleistungsaufsicht*
BGBl	*Bundesgesetzblatt*
BVG Neutralität	*Bundesverfassungsgesetz über die Neutralität Österreichs*
B-VG	*Bundesverfassungsgesetz*
CEO	Chief Executive Officer
CERD	Convention on the Elimination of All Forms of Racial Discrimination
CFO	Chief Financial Officer
CFR	Charter of Fundamental Rights of the European Union
CFSP	Common Foreign and Security Policy
CJEU	Court of Justice of the European Union
Coreper	Comité des représentants permanents
COO	Chief Operating Officer
CRC	Convention on the Rights of the Child
D&O	Directors & Officers
e.g.	for example
EAC	European Atomic Energy Community
EBITDA	Earnings before Interest, Taxes, Depreciation and Amortisation
EC	European Community
ECB	European Central Bank
ECHR	European Convention on Human Rights
ECJ	European Court of Justice
ECSC	European Coal and Steel Community
ECtHR	European Court of Human Rights
EEC	European Economic Community
EEIG	European Economic Interest Group
EFTA	European Free Trade Area
EMU	Economic and Monetary Union
EP	European Parliament
EPC	European Political Community
ESMA	European Securities and Markets Authority
et seq.	and what follows
etc.	*et cetera*
EU	European Union
FDI	Foreign Direct Investment
FMA	*Finanzmarktaufsicht*
FTA	Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GmbH	*Gesellschaft mit beschränkter Haftung*
GmbHG	*Gesetz über Gesellschaften mit beschränkter Haftung*

ICC	International Criminal Court
ICCPR	International Covenant on Civil and Political Rights
ICESR	International Covenant on Economic, Social and Cultural Rights
ICJ	International Court of Justice
ICTR	International Criminal Tribunal for Ruanda
ICTY	International Criminal Tribunal for the Former Yugoslavia
i.e.	*id est*
IFRS	International Financial Reporting Standards
IO	International Organisation
JHA	Justice and Home Affairs
KG	*Kommanditgesellschaft*
ltd	limited company
M&A	Mergers & Acquisitions
MEE	Measure having equivalent effect
m.n.	marginal note
NATO	North Atlantic Treaty Organisation
NGO	Non-Governmental Organisation
N.Y.	New York
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Cooperation
OGH	*Oberster Gerichtshof*
OSCE	Organisation for Security and Cooperation in Europe
para.	paragraph
PJCC	Police and Judicial Co-operation in Criminal Matters
plc	public limited company
ROI	Return on Investment
SCE	*Societas Cooperativa Europaea*
SE	*Societas Europaea*
SEA	Single European Act
SMEs	small and medium sized entreprises
SPA	share purchase agreement
StGG	*Staatsgrundgesetz*
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UG	*Unternehmergesellschaft*
UK	United Kingdom
UN	United Nations
US	United States
VfGH	*Verfassungsgerichtshof*
WTO	World Trade Organisation

Unit 1: Business Organisation – Basic Concepts

A. Purpose of this Unit

1 In this unit, you will obtain an **overview of company law**. We will start by exploring 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

2 There are a number of **reasons** why an entrepreneur may decide to carry on her/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.

3 Alternatively, Anna may have the know-how, but may be **lacking the financial 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.

Second, many rules of company law are **mandatory**, that is parties cannot design **8**
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.

Of course, this does not mean that there is a single solution to the issue of man- **9**
datory 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

At a normative level, company law has to serve the interest of society as a whole. **10**
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.

21 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.

22 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.

23 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.

24 Finally, all legal systems have to provide a partnership form that covers all associations of individuals that cannot be otherwise subsumed. Imagine that Anna and Peter join their talents and financial resources together for a common purpose but without explicitly entering into an agreement, much less specifying the type of company they want to set up. In some countries, especially Anglo-Saxon ones, Anna and Peter may have founded a general partnership as described above. Generally, continental European jurisdictions provide another form, generally referred to as **partnership under civil law** or with an equivalent term (*Gesellschaft bürgerlichen Rechts* in German, *société civile* in French). It is not entered into the business register and under many jurisdictions, does not have legal personality, such as in Austria. It is, however, a legal entity under German law it does if it participates in commercial intercourse; in Austria, each partner is an agent of the others, who will become jointly and severally liable for the business debts. The partnership under civil law can be founded without any formalities, indeed even by tacit agreement (as in our example). Obviously, the ease of foundation comes at the price of less publicity, as third parties cannot ascertain via the register whether the partnership exists at all. However, all jurisdictions have to provide provisions for situations in which people come together for a common (business) purpose without applying for registration. Many jurisdictions force partnerships to apply for entry into the register if they exceed a certain size.

IV. Companies

25 A business association is called a company if it fulfils certain criteria. Generally, **five criteria** are named: legal personality, limited liability, transferability of membership, management not directly by the members and investor ownership. We will explore each of these concepts before briefly looking at different types of companies in Europe.

26 A company has a **legal personality** independent of its members. Hence, the company and not its various members are parties to the company's contracts; in other words, the company runs the business. As a legal entity, the company can sue and can be sued in court. The company survives even if its shareholders do not; its contractual relations remain valid even after a complete change of members. Crucially, the company (and not its members) is the owner of the corporate assets. Having said that, a company is not a person in the same way a human being is; personality is bestowed upon it by law and not by nature. One should therefore beware of a common pitfall: the fact that the company has a legal personality does not imply that it should be treated like a natural person in all circumstances. Equally important, when analysing the company, one always has to look at the constituencies behind it; *e.g.* when determining 'the company's interest,' one has to examine the interests of the different stakeholders and then decide which interest should take priority.

27 Members' **liability** for the company's debts is generally said to be **limited**. Insofar as personal liability is concerned, this is misleading, as a member is not liable for the

company's debts at all. She/he is only liable towards the company for the contributions she/he has promised to make; in the worst case, she/he will lose these contributions if the company becomes insolvent. However, her/his patrimony is shielded against the company's creditors; only her/his share in the company will be left without value in case of the company becoming insolvent. In this sense, limited liability is a necessary prerequisite for diversification, as, shareholders can invest in thousands of companies without putting their personal property at risk; due to the cap on potential losses (by the sum invested), shareholders do not need to constantly monitor corporate actions. As the risk to shareholders is lower, they will also be satisfied with smaller returns. In practice, limited liability is probably the main reason for choosing the corporate form; we will look more closely at the issue in Unit 2 m.n. 67 *et seq*.

It is not the company's members who manage the company but a specialised body, **28** which is usually called a board of directors; **management** is **delegated**. This is not to say that these managers cannot be shareholders. In fact, for most small companies, the members or at least some of them are very often also directors. Yet in contrast to partnerships, managers can be non-shareholders, which is especially important for companies with fluctuating membership. The directors represent the company, enter into contracts on its behalf and decide on the use of the corporate assets. This is not to say that the members have no say on these issues; the amount of their influence actually varies between jurisdictions and between different types of companies (see Unit 3 at m.n. 139 *et seq.*), with the most fundamental decisions usually requiring shareholder approval. However, in all cases, running the day-to-day business is left to managers.

Shares in a company are **transferable**, usually without the consent of management **29** or the other shareholders. This is a default rule, as for most if not all company types, the transfer of shares can be made subject to approval by the company or by the other shareholders, either in the statute of the company itself or in a separate agreement between the shareholders. Remember that limited liability is an important precondition for free transferability without the company's consent; if liability were unlimited, the company's creditworthiness would depend upon the identity of its shareholders. As a result of free transferability, by simply selling the share, a shareholder as (partial) owner of the company can subsequently transfer this position as a residual claimant for all its assets, liabilities and contractual relations. Compare this to the situation in which a sole proprietor wants to sell her/his business and the huge advantages of incorporation will become immediately apparent. A sole proprietor may transfer her/his assets and assign her/his claims, but cannot pass liabilities or contractual relationships to the buyer without the consent of the contractual partner. That is different if the single shareholder sells her/his share in the company: the debtor of the company's debts and the party bound by the company's contracts remains the company. It follows then, that the consent on the part of creditors or parties to contracts is not required. Of course, this is a default rule since credit agreements or other contracts may contain so-called 'change of control' clauses, according to which, the company's counterparty may terminate a contract if the controlling shareholder of the company changes. For more details on the transferability of shares, see Unit 4 at m.n. 263 *et seq*., for details on structures of M&A-transactions see Unit 5 at m.n. 281 *et seq*.

30 Finally, companies are organised in a capitalistic manner, which is also referred to as **investor ownership**. By this, we mean that both the influence of the shareholders and the returns due to them, all depend on the contribution they have made. Contributions typically have to be made in cash or in kind (*i.e.* by contribution of things other than money); the contribution of services, especially labour, is (in contrast to partnerships) not sufficient. As a default rule, the number of votes is divided among the shareholders according to the proportional contribution each of them has made; returns are distributed in the same way. When articles deviate from this principle, *e.g.* for start-ups, they generally do this by modifying this principle to some extent, but normally do not abolish it in favour of a principle of equality of members irrespective of their contribution.

31 Having said that, in most legal systems, there are **different forms for companies**. A typical distinction in many legal systems distinguishes between a form for smaller businesses and a form for businesses that seek a listing on a stock exchange. However, this is by no means universal. While, according to English law, there is a distinction between public companies ('public limited company' or 'plc') and private ones ('private company limited by shares' or 'ltd'), both are regulated in the same act and do not differ in principle but in (albeit important) details.

32 In most continental legal systems, the most important form by numbers is the '**private limited company**'. It is called *Gesellschaft mit beschränkter Haftung* (*GmbH*) in German and *société à responsabilité limitée* (*SARL*) in France. It is usually more flexible than the public form, especially as far as the relationship between the shareholders is concerned. In this respect, the German and Austrian acts mainly contain default rules. In many legal systems, the influence of its members on business operations is stronger than that of shareholders in a plc. This reflects the fact that typically the number of members is small and most, if not all of them, are entrepreneurs involved in the running of the business. In many cases, the limited company has only one member and has been set up to make use of the privilege of limited liability. Where the single member is a natural person, she/he almost always serves as the director as well. Summing up, the private limited company emphasises flexibility and is designed for small and medium-sized enterprises, even though, in practice, this type of corporation is used for all types of business.

33 In contrast to the private limited company, the '**public limited company**' (*Aktiengesellschaft* in German, *société anonyme* in French) is generally subject to a more concise set of rules, which, under many legal systems, are largely mandatory. Entrepreneurs aspiring to be listed on the stock exchange have to use the public limited company; its primary purpose is to facilitate the collection of funds from numerous investors. However, in reality, public limited companies are not only used for publicly listed companies but also in other situations, in which the prestige and trustworthiness of this type of company amount to an issue. One major difference lies in a fact indicated by the French term: the shareholders are not known to the public (as they are not entered into the business register) and (at least in principle) not even to the company in the case of the company issuing bearer shares, which means that the company has to treat the bearer of the share as a shareholder. However, this principle has come under attack in recent times in the wake of the fight against terrorism, organised crime and tax evasion. On the one hand, in many legal systems, companies are generally required to issue registered shares, where shareholders are registered in a ledger kept by the company. On the other hand, at least in the European Union, new registers for 'people with significant control' over companies have been introduced recently, which are designed to make control over companies more transparent.

We see that legislators have **typical constellations** in mind when regulating certain company types. In reality, however, there is some overlap. We can encounter some private limited companies which are widely held, *i.e.* with a dispersed membership. We nevertheless also see public limited companies which are closely held, *i.e.* by a small number of individuals, or that even have only one shareholder. As a result, not all public limited companies are listed on a stock exchange or use the capital market in another way. 34

Finally, not all shareholders are individuals, but shares can be held by other companies (or partnerships) as well. If one company can control another one via its shareholding, these two companies form a **group of companies**, with a subsidiary and a parent company. Such a group is not a legal entity; rather, both companies maintain their separate legal personalities. As a result, the parent company is, as a rule, not liable for the subsidiary's debts. By setting up a subsidiary, a parent company can thus partition off risk into another entity, *e.g.* for running a potentially profitable but risky business venture. If the venture fails, the parent company stands to lose its investment only, but its other patrimony is not at stake. All legal systems accept this in principle. However, this act of partitioning off can be dangerous for creditors. 35

This can be illustrated by the case of a cab business which sets up a separate company for each cab. Should a driver have an accident, the debtor for the damages is the respective subsidiary, which means that at a maximum, the business will lose this cab but not the rest of its assets.

Minority shareholders can be similarly affected by the setting up of a group. This is one of the thorniest issues for company law with little international convergence concerning solutions.

V. Hybrids

As we have seen, limited liability is a major driver for incorporation. However, this benefit comes at a price, namely that the company is treated as a separate entity not just in company law but also for **taxation** purposes. As a result, corporate profits are taxed twice: once at the level of the company and then (if the profits are actually distributed) 36 as income of the shareholders via their personal tax declarations. Compare this with the tax treatment of partnerships: here the partnership is not taxed at all, but profits and losses are proportionally attributed to the shareholders ('flow-through' or 'pass-through taxation'); the partnership's losses can be deducted from the partner's income from other sources and alleviate her/his tax burden. It is not surprising that entrepreneurs try to combine the advantages of limited liability with the tax treatment of partners. Two different approaches can be observed:

37 Some jurisdictions have directly introduced a form combining these advantages. Some typical labels are '**limited liability company**' or for free professions, like auditors or lawyers, sometimes 'professional limited liability company' (US), 'limited liability partnership' (UK). Details vary between jurisdictions, such as whether the body is a legal entity or whether the death of a member leads to the dissolution of the organisation.

38 In other jurisdictions, among them Austria and Germany, another solution is common. Above we state that entrepreneurs have to make use of the forms of companies and partnerships provided by the legislator and cannot invent new forms. Entrepreneurs can, however, equally combine existing forms. The most typical combination is a limited partnership where the general partner is a company, usually a private limited company; the members of the private limited company are at the same time the limited partners in the partnership. It is easy to see that this so-called *GmbH & Co KG* combines the advantages of **direct taxation and limited liability**. That is, as limited partners, the entrepreneurs are taxed directly, while their liability is limited. Although the general partner's liability is unlimited, this does not affect the entrepreneurs themselves as they in turn are shielded from liability for the company's debts by company law. Although this result seems to be at odds with partnership law, namely, unlimited liability of individuals, it is a direct result of the fact that a company is a legal entity and as such, can enter into any contractual relationship; this includes setting up a partnership. Additional advantages are the possibility to delegate management of the partnership to third parties, as the general partner is a company with delegated management, and the fact that the company cannot decease, therein avoiding dissolution of the partnership.

VI. Other Legal Entities

39 Of course, numerous other types of legal entities with voluntary membership exist. We cannot explore all of them in detail, but would like to mention some of the more important ones for business life:

40 A **cooperative** (*Genossenschaft* in German, *coopérative* in French) is an entity whose main purpose is to further the economic interest of its members; its primary purpose may not be commercial. Typical examples for cooperatives are agricultural cooperatives providing common services for its members (*e.g.* common machinery for harvesting) or building societies/housing cooperatives providing accessible living to its members. Historically, cooperative banks and retail cooperatives also played an important role. The liability of the cooperative's members is usually limited to a certain amount; the cooperative is a legal entity, which is, however, managed by some of its members, which in practice, means that directors have to become members before taking up their position.

An **association**, club or society (*Verein* in German, *association à but non lucratif* in French) is a legal entity set up by its members for a common but non-commercial purpose. It is one of the most prevalent forms of legal entities. Typical examples are philatelic societies, football clubs or trade unions (the latter at least under Austrian law). As non-commercial organisations, they are not entered into the business register but into separate registers. Unregistered associations exist, but generally are not legal entities. At first glance, due to their non-commercial nature, associations seem to be of little interest for the study of business law. However, in order to achieve its primary, non-commercial purpose, the association may run a business aimed at making a profit. As a result, associations are often important participants in business life, as can be evidenced by many sports clubs (however, most professional football clubs today are in fact companies, while their amateur activities continue to be pursued by associations). 41

Foundations (*Stiftung* in German, *fondation* in French) are legal entities set up for philanthropic or charitable purposes; they are typical for countries following the traditions of civil law (*e.g.* Germany, France or Italy), while common law countries like the UK or the US make use of another and, to some extent, comparable instrument, the charitable trust. Foundations do not have members in the sense of owners of shares but founders or benefactors. The rules for the acquisition of legal personality vary, but usually require some act of registration. In some countries like Austria, foundations may also be set up for private purposes. Such 'private foundations' are often made use of by successful entrepreneurs in order to guarantee the future existence of the business, while providing maintenance to one's descendants. These descendants may be mere beneficiaries without influence on the foundation's management, but may also have the right to change or even revoke the foundation. 42

D. Company Law between National and European Law

I. Sources of National Law

At its core, **company law is national law**. Although structurally, the solutions are similar, the differences between national regulations concern more than just details, but start *e.g.* with the issue of which bodies actually steer a given company, with some systems following the one-tier approach with just one board of directors, while others separating supervision from management into two separate bodies (two-tier approach). Of course, legal systems that are generally close to each other show more similarities (*e.g.* common law systems or countries following the German legal tradition). For the 43 analysis in the following units, we will take Austrian law as a starting point. For most issues, the solutions of German company law are very similar; however, we will mention some of the most important differences. Our primary aim, however, is not knowledge of rules, which is necessary, but rather, an understanding of the issues and the different interests involved.

44 Generally, company law is **codified law**, as almost all core issues are contained in legal statutes, which, in Austria and Germany, are primarily the Stock Corporation Act (*Aktiengesetz* or *AktG*) for the public company and the Act on Limited Liabilities Companies (*Gesetz über Gesellschaften mit beschränkter Haftung* or *GmbHG*) for private companies. However, in practice, the statutes do not solve all legal problems; as a result, court decisions are important guidelines for legal practice, as courts generally tend to follow precedents even though they are not legally binding. Generally, company law is not applied by authorities, which act *ex officio*, *i.e.* on their own initiative (so-called public enforcement) but by courts; action is thus only taken if a private party brings a claim (private enforcement).

45 Besides company law in the narrow sense of the word, **other sources of norms** are extremely important for corporate practice. A few practical examples have to suffice in the present context:

46 First, one has to mention **securities law** (synonym: capital markets law), which is applicable to companies listed on the stock exchange or to those which have sold their securities to the public. Securities law primarily focuses on the protection of investors via adequate information and the prohibition of certain dealings. For that purpose, it puts additional obligations on companies, *e.g.* (1) the duty to prepare a detailed information prospectus when offering shares for sale to the public and (2) the continuous duty to publish information of material interest to investors since it may affect the share price. Additionally, takeover bids, such as, for example, an offer to the public to buy shares, have to follow certain rules. To that extent, any person acquiring a controlling holding in a listed company has to make a mandatory offer to other investors to acquire their shares at a fair price. Summing up, listed companies have to comply with several additional rules which drive up costs and limit flexibility; in some cases, this is a deterrent to making use of the capital markets for raising equity/debt, or a reason for 'going private', *i.e.* taking the company from the market.

47 Second, although there are few additional company law rules for listed companies, they have to pay attention to a body of soft law, the so-called **Corporate Governance Codes**. These codes are developed by non-statutory bodies and (insofar as they do not simply repeat the contents of legal norms) are non-binding to the companies. However, they have to declare publicly whether they comply with these recommendations and in case of non-compliance, explain their reasons ('comply or explain'). These recommendations thus have a practical impact as companies tend to comply in order to avoid burdensome explanations to their investors.

Third, for companies in financial difficulties, **insolvency law** (or bankruptcy law) is an important issue. A company is insolvent if it (1) cannot clear its debts due or (2) the liabilities surpass the assets on the company's balance sheet (*i.e.* its equity is negative) and there are no positive prospects for the company's survival. Under these circumstances, the company's purpose changes: it is no longer run for profit maximization in the interest of its shareholders but rather in order to maximise the proceeds of liquidation in the interest of its creditors. This process is supervised by a court and in most cases, run by an insolvency administrator instead of the company's managers. In order to avoid the destruction of viable businesses (with the consequent loss of employment) as much as possible, insolvency proceedings very often do not lead to liquidation of the company, but to a restructuring wherein the creditors agree to obtaining a certain quota of their receivables and the company (hopefully!) again becomes fit for business. Especially smaller enterprises, however, typically declare insolvency at a very late stage, in which case, the assets do not even cover the costs of the insolvency proceedings; in such cases, the company is removed from the commercial register without going through a liquidation procedure. In such cases, creditors may try to recover their losses from the administrator or the shareholder(s) if the insolvency was brought about intentionally or negligently, or if administrators do not apply for the opening of insolvency proceedings in time. **48**

II. Company Law in the European Union

Currently, there is **no concise body of European company law**. This is not to say that there are no harmonisation measures by the European Union. However, they only deal with specific issues of company law; furthermore, most European regulation only affects public companies. As a result, to a large extent, company law remains national law even within the European Union. If we compare this with the United States, we see that this is not exceptional: the US does not regulate company law at the federal level, but regulation remains within the competence of the states. **49**

European company law has three different pillars. First, **primary law**, especially the Treaty on the Functioning of the European Union, covers companies (see below Unit 7 at m.n. 449 *et seq.*). They can rely on its provisions on freedom of establishment and free movement of capital. **Freedom of establishment**, as interpreted by the Court of Justice of the European Union (CJEU), gives entrepreneurs the right to choose the company law of another Member State (but not that of a third country) other than the one of the seat of the company. This holds true even in the absence of any real connecting factor. That is, an Austrian entrepreneur carrying out business in Austria may incorporate a private limited company in the Slovak Republic (if the Slovak Republic permits such letterbox-companies). Such companies are called pseudo-foreign corporations, as they purport to be Slovak entities despite the fact that all other connecting factors point to Austria. Although Austria may be interested in applying its own company law **50** in such a situation and thereby its own standards of protecting creditors, according to primary law, it has to accept the incorporation abroad. Today, this issue is settled for incorporation. Currently, the discussion has shifted to the issue of reincorporation, *i.e.* whether the shareholders of an Austrian *GmbH* can decide to change the applicable law at a later stage by reincorporating in the Slovak Republic. Although the CJEU holds that the freedom of establishment protects such reincorporations, a reliable procedural framework for such transactions is still lacking; this can only be provided by the European legislator.

51 Primary law is also important in other areas: the CJEU holds that the **free movement of capital** puts a limit on golden shares held by Member States. Such golden shares give the Member State special rights in the company. The German federal state of Lower Saxony held such shares in *Volkswagen*, for example, giving it the right to nominate members of the supervisory board and providing for a voting cap of 20 percent (this means that no shareholder can exercise more than 20 percent of the votes even if she/he holds more shares). This provided Lower Saxony with a disproportionally high degree of influence in *Volkswagen*. As this made *Volkswagen* and similar companies less attractive to (foreign) investors, the CJEU held that, under certain circumstances, such rules infringe on the free movement of capital within the union. Clearly, the CJEU plays an important role in company law.

52 Second, the European Union tries to **harmonise** national company laws via Directives. They cover such important issues as limits to legal personality, the raising and maintenance of capital in public companies, or shareholder rights in listed companies, which we will touch upon in the course of the following chapters. Especially important is the harmonisation in the field of restructurings (see Unit 5 at m.n. 281 *et seq.*), i.e. mergers, wherein two separate legal entities are merged into one. Then there are the cross-border mergers, wherein a company from Member State A is merged into a company in Member State B, and divisions, whereby a legal entity is split up into two new companies. Equally important – although not a core topic of our book – is harmonisation in accounting, as this makes the accounts of companies in different Member States comparable, which is an important issue for both creditors and investors who are active across the European Union. However, even with public companies, European law does not deal with most issues of company law. This is especially true of the field of the internal organisation of a company, which belongs to the realm of Member States. Accordingly, we find huge variance between different countries. As already mentioned, the private company is indeed not covered by most harmonisation measures at all.

53 Third, the European Union has introduced **separate company forms**. The most important example is the European Company (*Societas Europaea* or SE), a form of public company available to European entrepreneurs. On the formation of an SE, some cross-border element has to be involved, *e.g.* two companies from different Member States intending to merge. After a difficult start, the SE has found some acceptance and currently more than 3,000 SE seem to be registered in Europe. Of course, compared to national company forms, this is very few. Unfortunately, in spite of a number of attempts, the European Union has not achieved something similar for the private company, which could be especially important for small and medium-sized enterprises (SMEs). There is, however, a European Cooperative and a European Economic Interest Grouping, the latter being a type of partnership designed to facilitate cooperation between independent enterprises from different Member States.

Fourth, **securities law** is harmonised to a large extent in the European Union. This is because harmonised capital markets law facilitates investment across borders. Additionally, supervision is to some extent centralised with a specialised European body, the European Securities Markets Authority (ESMA), although national authorities, like *BaFin* in Germany or *FMA* in Austria, continue to play an important role. **54**

E. Principal-Agent Conflicts

I. Introduction

Company law has to solve conflicts and avoid potential conflicts between different interest groups in the company. It has to provide a set of rules which reduces the costs of organising the common entrepreneurial activities in the legal entity. However, in order to understand how company law achieves that, it is necessary to look at the **types of conflicts** most typically encountered within a company. **55**

Today, economists and lawyers alike usually employ ‘agency theory’ as a conceptual framework for analysing such conflicts. A so-called ‘**principal-agent problem**’ arises when one person’s welfare (the principal’s) depends on actions taken by another person (the agent). Obviously, there is a danger that the agent acts in its own interest and not in the best interest of its principal, either by employing less time and thus being less diligent, or by directly diverting part of the proceeds of its actions directly into its own pockets. The situation is even more dangerous to the principal in case of a situation of asymmetry of information, where the principal finds it difficult to assess the agent’s performance due to a lack of information. To overcome that problem, principals have to spend money on monitoring the agent (‘agency costs’) or else factor in their expectations regarding the agent’s self-serving behaviour into the remuneration they are willing to provide. **56**

Company law tries to **reduce agency costs**. It can do so in various ways, *e.g.* by setting the right incentives for an agent to act in the best interest of the principal or by providing the principal with the information necessary to evaluate the agent’s performance. We will deal with these issues in the following units. First, however, we have to look at the most important types of principal-agent conflicts in companies. **57**

II. Shareholders and Management

58 The most obvious principal-agent relationship exists between shareholders and management. As already mentioned, a company is not necessarily managed by its members and even less so by all of its members; rather, **management by third parties** is the norm. As a result, shareholder wealth is directly affected by the manager's actions. Shareholders will receive a smaller dividend or their share will lose value if the managers do not fulfil their role properly.

59 Managers are bound by fiduciary duties to the shareholders, *i.e.* they are obligated by law to act in their best interests. The main problem for shareholders, however, is to ascertain whether managers actually comply with this duty. This is comparatively easy if there are a few shareholders or just one of them. Presumably, such shareholders will be willing to incur **monitoring costs** as the results of the monitoring activities will affect their bottom line to a large extent. In a company of numerous shareholders with smaller holdings, the situation is different. As each shareholder is affected by the results of monitoring activity only to a small extent, none of them may be willing to bear the corresponding costs. Rather, each shareholder may prefer to benefit from monitoring activities carried out by other shareholders (so-called free riding). If all shareholders act this way, no one ultimately monitors management. In such a situation of high information and coordination costs, company law has to provide solutions for effective monitoring, such as specific monitoring institutions (*e.g.* the Austrian and German board of supervisors or UK independent directors on the board of directors) or by facilitating challenges to ineffective managers from outside (*e.g.* via a so-called hostile takeover, which leads to managers being ousted).

60 Following from the above, the relative importance of rules dealing with principal-agent conflicts between managers and the shareholders depends entirely on the **pattern of corporate ownership** in each jurisdiction. If ownership in a specific jurisdiction is typically dispersed among many shareholders with small holdings each (*i.e.* if companies are widely held), dealing with this type of conflict of interest becomes a main priority for company law. If, on the other hand, ownership is concentrated in the hands of few shareholders per company, control of management can be carried out quite efficiently even in the absence of specific legal rules addressing the issue. It follows then, that, with most private companies, control of management is not the primary focus of the legislator in company law.

61 Traditionally, **patterns of share ownership** in public companies **have varied widely across countries**. Widely held companies are typical for the more developed capital markets in the US and the UK, as share ownership by retail investors was the norm. In contrast, companies in continental Europe – especially in Austria and in Germany – typically have a concentrated ownership structure, even if they are incorporated as a public and not as a private company. This is even true of companies listed on the stock exchange, which very often have a controlling shareholder (*e.g.* an individual, the state

or members of a family, who act as a group), who is in a position to carry out monitoring activities. Having said that, in recent decades, patterns of share ownership seem to converge to some extent. On the one hand, in the area of Anglo-Saxon capital markets, retail investors are increasingly crowded out by institutional investors, *e.g.* pension funds, insurance companies and vehicles for collective investment. This has led to increased concentration in ownership. However, institutional investors are not always willing or able to bear the costs of monitoring management. This has become an important issue in company law. On the other hand, in Austria and even more so in Germany, the concentration of ownership has decreased, in part also due to institutional investors who have been increasingly investing worldwide in order to spread their risk via diversification. Nevertheless, considerable differences in patterns of share ownership persist.

III. Majority and Minority Shareholders

This does not mean, however, that principal-agent conflicts do not exist in **closely-held companies**. Rather, there is a shift in who is principal and who is agent: principals are the minority shareholders, as their welfare depends on the actions of the majority shareholder(s), who can then control the company's actions. 62

The issue is especially salient with **subsidiaries** in a group of companies if the subsidiary has minority shareholders. Not surprisingly, the subsidiary is run in the group interest and as a result, most probably in the interest of the (ultimate) parent company. Minority shareholders face a multitude of dangers. The parent company may, *e.g.* set transfer prices for transactions within the group that are unfavourable to the subsidiary, who, in turn, is setting prices above market value for the subsidiary's purchases from the parent, and prices below market value when the purchaser is the parent. Such an exchange is illegal under most company law regimes, but is difficult to discern for minority shareholders without deeper insight into the running of the company. A more subtle approach would be to divert corporate opportunities from the subsidiary to the parent, *e.g.* by instructing the subsidiary not to enter certain profitable markets. 63

It is not surprising that jurisdictions with a prevalence of closely-held companies put special focus on the **protection of minority shareholders** against partial or full expropriation by the majority. This can be done *e.g.* by curbing the influence of shareholders on management in the first place. Under Austrian and German company law, shareholders in a public company cannot give binding instructions to the managers on the running of the company's business. For decisions in the general meeting, the law may require a supermajority for certain decisions of fundamental importance. Under Austrian or German law, minority shareholders may even challenge certain types of majority shareholder decisions if they are unjustified. In other jurisdictions, instead of this variation, shareholders may instead have a right to exit the company against adequate compensation in such circumstances (*e.g.* the remedy against 'unfair prejudice' in the UK for private companies). 64

IV. Shareholders and Other Stakeholders

65 Finally, the company interacts with various other stakeholders, such as employees and creditors. **Employees** are protected by labour law. The role of company law in their protection is limited, normally to rights to receive certain information. However, German and Austrian company law provide employees (or rather their representatives in the works council and, in Germany, also the trade unions) with a seat on the supervisory board and thereby representation in the decision-making bodies of the company.

66 On the flipside, the protection of **creditors** is one of the core issues of company law. At the core of the problem lies the fact that creditors have claims against the company, but under normal circumstances, cannot influence the running of the business at all. On the other hand, the shareholders – who can influence corporate decisions via their influence of management – are not liable for the company's debts. In that situation, the danger arises that shareholders will use their influence to gain an advantage to the detriment of the creditors. This is the issue we will turn to in the next unit.

Relevant Literature and Further Reading

Armour/Enriques et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd edn., 2017) 1–47.

Davies, Introduction to Company Law (2nd edn., 2010) 1–35.

Questions

1. Describe some reasons for incorporating an enterprise.
2. Explain the differences between and the respective functions of default and mandatory rules.
3. Is the company run for the benefits of its shareholders only?
4. What are the functions of a business register?
5. Explain some core differences between partnerships and companies.
6. What is a silent partnership? What is a partnership under civil law?
7. Explain the core characteristics of a company.
8. Why do we have different company forms in Austria and Germany?
9. What is a group of companies?
10. What are hybrid company forms?
11. Explain the role of the EU's freedom of establishment in company law.
12. Do we have a 'European company law'? If yes, to what extent?
13. Explain the concept of principle–agent conflict.
14. Are there principal-agent conflicts between shareholders and management?
15. Is there a principal-agent conflict between majority and minority shareholders? Why?

Unit 2: Limited Liability and Creditors

A. Purpose of this Unit

In this unit, we will explore the **relationship between the company and its creditors**, starting from the observation in Unit 1 that the company is an agent for its creditors. We will start by revisiting limited liability, and examine creditor self-help and some exceptions to limited liability. We will then look at a **set of rules designed to protect creditors**, namely those concerned with the legal capital. Finally, we will explore the rights of creditors once it becomes clear that the company will not be able to fulfil its liabilities, that is, if it becomes insolvent. After having studied this unit, you should understand the major rules and strategies which the legal system employs to regulate the principal-agent conflict between the shareholders and the company's creditors. **67**

B. Limited Liability

I. Rationale and Dangers to Creditors

Historically, limited liability was introduced to **facilitate the accumulation of capital for large infrastructure projects** in the 19^{th} century, especially railways. We outlined in Unit 1 that limited liability enables investors to buy shares without monitoring the company's activities, as their wealth (apart from their investment in the company) is not at risk. Furthermore, limited liability is a prerequisite for diversification that constitutes numerous small investments in different companies in order to spread the risk. Without limited liability, investors would have to closely monitor all companies which they have invested in, which would put a limit on the degree of diversification possible. In order to avoid the risks associated with unlimited liability, investors in such a world would have to advance loans to the company instead of buying shares. This, however, would put additional cash-flow burdens on the company, as interest on a loan has to be paid regardless of whether the company makes a profit. In short, limited liability helps companies to raise equity from the general public (or from specialised vehicles for investment, like pension funds) and facilitates public markets in shares. **68**

This nevertheless fails to explain why limited liability today is **available to companies with few shareholders** or even with only one shareholder able to monitor the company and who (if he or she is an individual and not another company) will indeed often be the sole manager of the company. Limited liability for these companies can be explained by the risk aversion of most individuals. As potentially successful business ventures typically feature risks, individuals might be reluctant to commit their entire personal resources to such a venture. Limited liability provides them with the opportu- **69** nity to dedicate a certain amount of assets to such a venture without putting their entire property at risk.

70 Yet, not just individuals but likewise other companies may be shareholders. In corporate groups, the parent company may have hundreds, if not thousands of subsidiaries. The risk to individuals is not an issue in such a situation, as they are already protected by their limited liability for the debts of the parent company. Rather, limited liability enables the parent company to **allocate certain types of risks to separate legal entities**, therein reducing the risks for the group as a whole. The parent company can, for instance, set up a subsidiary for a certain profitable but risky venture and dedicate funds to it; if that venture fails, the other fields of business of the parent company are (at least as a general rule) not at risk.

71 Limited liability is **both dangerous and beneficial for creditors**. Let us start with the benefits. First, we must understand that the separate legal personality of the company means that the shareholder's creditors do not compete with the company's creditors for its assets. Crucially, the company (and not its members) is the owner of the corporate assets. For this reason, the corporate assets are not available for the satisfaction of the shareholder's personal creditors. The company's creditors therefore have prior access to the company's assets. Should the shareholder default on his or her personal creditors, they can only seize the property of the shareholder, *i.e.* the shares in the company, which will not have any value once the company's creditors have seized all the company's assets. As a result, the assets of the company are shielded against the shareholder's creditors. Additionally, in case of default by a shareholder, its creditors cannot terminate the company and claim a share of the company's assets. Assets can thus be transferred to a newly-founded company with the result that the company's creditors gain exclusive access to these assets and the shareholder's creditors become structurally subordinated.

72 There are additional advantages for the company's creditors. First, it is easier for them to **assess the value of their claim**, as they only have to evaluate the business of the company and not the credit-worthiness of the shareholders, since they do not compete with the shareholders' creditors. Second, the company's creditors only need to monitor the development of the company's assets in order to properly assess whether the company will be able to meet its debts. This will reduce monitoring costs. Finally, limited liability is not only important for the shareholder, but also for his or her creditors; they do not face competition from the company's creditors for the shareholder's assets (with the exception of his or her share in the company, which is of no value once the company's creditors seize its assets).

73 Limited liability is dangerous, since the shareholders control the company, but (apart from the loss of their initial investment) are **not responsible for the company's debts**. This is less of a problem in the case of shareholders holding only a small percentage of the shares, as such shareholders are usually passive and cannot influence the destiny of the company. However, if control is vested in few or even in one shareholder, the dangers of limited liability become more apparent. Two typical cases are:

- the corporate group, where the parent has complete control of the subsidiary via its holding and the fact that they form a single business entity, and
- the small incorporated business, where the single shareholder is usually also the single director and thus controls not only strategic decisions but also the day-to-day management of the company.

How exactly can shareholders act to the detriment of the creditors? First, they (or the company's directors) can simply **overstate the corporate assets when entering into a contractual relationship** with a creditor, such as a loan agreement with a bank. After briefly looking at other cases of shareholder opportunism, we will examine the accounting rules designed to combat such misrepresentation *ex ante*. Additionally, all companies have to signal to the market the limited liability of their shareholders by including in its name, the jurisdiction's label for the type of company or a corresponding suffix ('*AG*' or '*GmbH*' in Germany and Austria, 'plc' or 'ltd' in the UK). 74

Second, the company can engage in various forms of ***ex post*** **opportunism**, *i.e.* actions detrimental to creditors once they have taken the decision to grant the company credit. Shareholders could simply take assets out of the company, which increases the risk of insolvency ('siphoning-off of assets'); this can be done directly or via a hidden distribution, such as the subsidiary paying above market value when acquiring goods from the parent company. Alternatively, shareholders could increase the company's risk through a shift in business strategy. This is important, as creditors (at least professional ones) take the risk involved with the company's business into account both when deciding whether to advance credit at all or when deciding on the conditions they are prepared to offer. For instance, banks offer floating rate loans at an interest of a (floating) base rate at which they refinance themselves, plus a (fixed) margin, which is, to a large extent, determined by the risks associated with the debtor. Finally, the company can take up additional debt, which means that creditor competition for the company's assets increases. Of course, whether this is problematic will depend upon the use made of the funds received. If the asset base is broadened accordingly (*i.e.* if the moneys are used to acquire assets), the former creditors will not suffer a disadvantage. But if the money is spent on wages or other expenditures, the creditors will be impaired if these expenditures do not lead to higher income in the future. 75

II. Information *ex ante*

Ex ante **opportunism** on the part of the shareholders can occur when potential creditors decide whether to advance credit to the company. In order to arrive at an informed decision, creditors need adequate and reliable information about the company's assets and liabilities. Accounting rules are designed to provide such information (for a second function of accounting rules see below at m.n 77 *et seq.*). There is an ongoing debate on whether accounting rules primarily serve the self-information of shareholders and the management or the information of creditors. Although the focus is different depending 76 on the jurisdiction, in substance, accounting helps both interest groups, with continental European Member States traditionally putting creditor protection to the fore. In any case, the balance sheet and the profit and loss account are published via the business register and are therefore available to the creditors and to the general public.

77 At a meta-level, **accounting rules** provide standardisation for the way companies report both their assets and liabilities (balance sheet) and their profit and losses (income statement/profit and loss account) on a yearly basis. This does not only refer to the method of presentation but also to substantial issues, *e.g.* the valuation of assets and liabilities or whether provisions have to be made for liabilities of uncertain timing or amount (such as a potential obligation to pay damages). A brief look at the valuation of assets will show the importance of the issue. That is, the value of an asset determines the amount of equity in the balance sheet. This is due to the simple fact that equity and liabilities always must add up to the value of the assets. Ergo, if assets increase and the liabilities remain the same, equity will rise by necessity. Higher equity implies increased creditworthiness of the company in the eye of creditors, as equity provides a cushion for the liabilities. Any losses will then diminish the value of the equity and the creditors will have to bear the losses only once equity is wiped out. Standardised accounting rules determining the valuation of assets will therefore help creditors assess the relative creditworthiness of companies.

78 At a more factual level, there are **different sets of accounting rules** which companies in the European Union have to adhere to. First, all companies have to comply with European accounting rules on a single-company basis. That means that even in a group of companies, each company has to prepare its own separate accounts. Second, groups of companies (except small groups) have to prepare consolidated accounts for information purposes, wherein the business is treated as if it were carried out by one single legal entity. Finally, companies listed on regulated markets on the stock exchange have to prepare the consolidated accounts according to different standards, the International Financial Reporting Standards (IFRS). These standards are designed to make accounts internationally comparable in order to facilitate the globalisation of capital markets.

79 The annual accounts have to be checked by **independent auditors**. Small private companies are, however, generally exempt from this requirement. The auditors have to verify that the accounts are prepared in accordance with the applicable accounting rules and that they present a true and fair view of the company's financial position. Auditors are so-called 'gatekeepers' since, without their verdict, the company cannot fulfil its duty to publish its annual accounts. In order for auditors to fulfil their function, they have to be independent from the company and have to be properly incentivised for carrying out their duties in the interest of all stakeholders and not just of the company. Their efficacy has indeed been cast into doubt by a number of corporate scandals (*e.g.* Enron in the US or Parmalat in Italy), in which auditor misconduct presumably played some role. Regulation over the last 20 years has increasingly focused on this aspect of their work, *e.g.* by toughening rules for safeguarding independence or by adjusting auditor liability.

Of course, **professional creditors** do not rely solely on the accounts, as they do not provide them with current information. They are only prepared once a year and published with a time lag after the end of the business year (*e.g.* nine months in Austria). Additionally, the accounts are backward-looking in that they contain the results of the business activities of the past, not the developments expected for the future. Rather, banks carry out additional screening and monitoring activities before advancing credit, such as analysing the company's forward-looking business plan or asking for more detailed information on the past than the published accounts provide. Sometimes, major creditors are even offered a seat on the supervisory board in order to facilitate monitoring. Banks thus invest significant sums in getting to know their debtors. Once these initial expenses have been recovered, such 'house banks' often enjoy a cost-advantage over their competitors and can offer better terms to companies ('relationship banking'). This is typically the dominant form of debt financing by small- and medium-sized companies, which is one explanation (apart from the disproportionate cost burden) for why such companies are exempt from some accounting and auditing requirements. **80**

However, for debt taken up by **less professional creditors** (such as terms of credit by suppliers) or by many small creditors (such as bonds issued to the public via capital markets), the annual accounts are considerably more important. To overcome the accounts' inherent limitations, these creditors may make use of credit rating agencies which evaluate the financial prospects of debtors. While they provide valuable services to creditors, their reputation has been damaged by the financial crisis from 2007 onwards, as they failed to properly evaluate the risks associated with mortgage-based financial products. Additionally, if bonds are offered to public as part of securities law, the issuer must publish a prospectus containing detailed information on the risks associated with these securities. **81**

III. Creditor Self-Help and Its Limits

Perhaps you're asking, what help is this plethora of information to creditors anyway? What steps can they take to **protect themselves**? First, they can opt out of limited liability. Second, creditors can bargain for contractual covenants protecting them against opportunistic behaviour *ex post*. We will deal with each of these issues before exploring the limits to creditor self-help. **82**

Limited liability is a default rule. Contractual creditors can always refuse to give credit without a personal guarantee by the shareholder(s). For banks dealing with smaller private companies, it is almost standard practice to require either a shareholder guarantee for repayment of the loan or some personal property of the shareholder as collateral (or possibly a combination of both). Creditors can and thus do opt out of limited liability through private ordering. **83**

Obviously, this is not feasible for companies with many shareholders without a substantial interest in the company, as these shareholders would lose the protection of lim- **84** ited liability, without which they would not have invested in the company in the first place. For such companies, creditors could ask the company for **collateral**, which means that, in the case of insolvency, some of the company's assets are sold and the proceeds are used to pay the creditor. This features the additional advantage that such assets cannot be taken out of the company without creditor consent. Of course, collateral for one secured creditor means that fewer assets are available for satisfying unsecured creditors.

85 Additionally, both banks and bondholders protect themselves by so-called **covenants**, that is, by bargaining for contractual clauses requiring the debtor to fulfil certain conditions (*e.g.* maintaining a certain ratio of debt to equity or certain minimum levels of liquid funds) or prohibiting certain behaviour (*e.g.* paying out dividends to shareholders above a certain level, selling off certain assets or using them as collateral for other debts). Such covenants restrict the debtor's freedom in favour of the lender and protect the latter against opportunistic behaviour by restricting the company's ability to engage in actions harmful to the lender. In effect, the creditor gets a vote on certain aspects of business operations. Typically, the debt is accelerated when a condition is not fulfilled, which means that all future payments fall due immediately. On the one hand, this gives the creditor information in advance about material changes, as the debtor typically will not risk such potentially disastrous consequences without creditor consent. It thus helps to alleviate monitoring costs. On the other hand, as the creditor can usually waive the application of the covenant unilaterally, it can evaluate the proposed measure and if need be, renegotiate the conditions of the loan.

86 From this conclusion, one could be tempted to assume that creditors need no protection by law, as they can protect themselves by private ordering. In principle, such contractual and therefore tailor-made solutions tend to be superior to legal protection mechanisms, which tend to follow a 'one size fits all' approach. However, even though **private ordering** might well be **a viable solution for some contractual creditors**, this is by no means the case for all creditors.

87 First, some creditors may **lack the bargaining power** or the experience to protect themselves via private ordering. This is the case for small trade creditors, *e.g.* suppliers who grant credit by offering the usual trade terms instead of insisting on immediate payment for their delivery. The same is true of employees, who are also creditors insofar as their performance is carried out before being paid their wages, or of consumers, who may have paid part of the purchase price or the fee for services up front. Such parties usually can only react by not contracting at all or limiting the sum at risk – if they can assess the risk at all.

88 Second, another group of creditors **do not even have the theoretical possibility to protect themselves by private ordering** as they do not enter into a contractual relationship with the company at all. They are called 'involuntary' or 'non-adjusting' creditors (the latter as they cannot adjust the terms of their claim to the risk involved). The typical examples are creditors out of tort, that is creditors, who have been unlawfully damaged by the company and therefore have a right to receive damages. Limited liability to some extent undermines an important function of tort law, namely preventing actions resulting in damage by forcing the tortfeasor (the person causing damage) to bear the costs of her/his behaviour via the payment of damages to the victim; especially in case of the company being undercapitalised, the controlling shareholders of the company do not have to bear the full cost of their actions.

An example is a well-known US case from the New York Court of Appeals from the 1960s (*Walkovszky v. Carlton* 223 N.E.2d 6 (N.Y. 1966)). A group of companies was running a cab business. In order to minimise the risk from tort actions (in case of accidents), the group set up a company for each taxi without other assets than the vehicle. Each company only took out the (then) minimum liability insurance of $10,000 per cab. The risk posed by tort was thus limited to the assets of each company, as only that company was liable and not the group as a whole.

In a similar vein, sometimes a business is split up into two companies, one holding the assets and the other carrying out the business and paying its fellow subsidiary for the use of the asset. If the company running the business becomes insolvent, the assets are not at risk – unless contractual partners have negotiated for guarantees by that company.

In the New York case, the group could, at worst, lose one cab in case of an accident. The court held in a judgement on the claim of a victim of tort against the shareholder that he could rely on limited liability even though he intentionally undercapitalised each company in order to minimise liability risks. Irrespective of what you think of the judgement (which, by the way, led to an increase of minimum liability insurance in New York), the example illustrates the point: the controlling shareholder had fewer incentives to take appropriate precautions (*e.g.* regularly checking the cabs for mechanical failure) and to bear the corresponding costs.

Another involuntary creditor is the **state**, in so far as the company is a debtor of tax **89** or social security contributions and other regulatory claims. Of course, the state can try to properly monitor its debtors and to take timely enforcement measures. However, practice, at least in Austria, shows that the state is often a major creditor in corporate insolvencies.

In the following two sub-chapters, we look at two measures which legal systems **90** take in order to minimise potentially detrimental consequences of limited liability. These **legal measures** are not just targeted at weak or involuntary creditors, but **protect all creditors**. Of course, strong creditors still take additional measures via private ordering as discussed above.

IV. Limits to Limited Liability

Before turning to these issues, we briefly discuss whether limited liability of the **91** shareholders has **limits** – apart from the cases of private ordering, which we addressed above. Our first question is whether a shareholder can become liable for all the company's debts. This issue is generally addressed under the heading of 'piercing the corporate veil' or 'veil piercing'. In most countries, it is very rare for such veil piercing to happen, as, otherwise the shareholders would be deprived of the benefit of limited liability to a large extent.

92 In Austria (and indeed Germany), **veil piercing** is not a phenomenon foreseen in written law at all. Courts tend to be reluctant to adjudicate in favour of shareholder liability in all but the most extreme cases. One generally accepted case is the intermingling of company and private assets, which sometimes happens in companies with a single shareholder, typically in connection with highly inadequate or missing accounting. One practical justification for veil piercing is that in such situations, it is not possible to determine which assets are those of the company in the first place. Similarly, for Germany, it has been clarified that the shareholder becomes liable if she/he diminishes corporate assets without compensation and this causes the company's insolvency. The courts so far, however, have not pierced the veil if the company was founded with insufficient resources ('undercapitalisation'), as long as the legal capital was paid in. This is, of course, similar to the decision of the New York Court of Appeals in the taxi case.

93 The question of **who can bring such a claim,** moreover, is another issue entirely: each creditor on its own or the company. This has not been clarified in Austria. Direct claims of each creditor have the advantage of easy and faster procedures. If it is within the company's competence, the insolvency administrator will be in charge of pursuing the claim in the case of bankruptcy. This will, in turn, lead to equal treatment of all creditors (more on insolvency proceedings below at m.n. 124 *et seq.*).

94 Second, shareholder **liability directly against creditors** can arise because of an action by the shareholder which gives a creditor a claim in tort. This is generally not an issue of company law but of other fields of law. We will deal below (at m.n. 135 *et seq.*) with liabilities that arise out of insolvency law, *e.g.* if – under the influence of its shareholder(s) – the company continues to trade after it has become insolvent. Additionally, shareholders can become liable for certain actions against the company, *e.g.* if they have taken out corporate assets; this is an issue of the capital maintenance regime (see below at m.n. 96).

95 Finally, we would like to note that we have been discussing the **liability of shareholders** – not of directors, which is a completely different issue (see Unit 3 at m.n. 200 *et seq.*). Of course, in small companies, shareholders are often also directors, in which case, both liability regimes are applied.

C. Legal Capital

I. Rationale

96 The main strategy employed by Austrian (and indeed German) company law rests on the idea that, in order to incorporate a business, the company's founders have to **put a certain amount of money into the company** and, afterwards, can only withdraw funds if the company has made a profit. The corresponding rules are commonly referred to as rules on legal capital. They deal with the minimum amount of equity capital shareholders have to invest in the company, the manner in which such capital can be raised, and the rules on capital maintenance, *i.e.* on the (restrictive) conditions under which distributions can be made to the shareholders. These rules are harmonised to a large extent for public companies (*i.e.* 'plc' or '*AG*'), but not for private company forms, where we will encounter greater variance within the European Union. Legal capital provisions are mandatory in the sense that shareholders cannot deviate from them.

Before analysing this in detail, we have to identify the **various meanings of capital**. **97**
In its widest sense, the term refers to the money at the disposal of the company, without looking at its provenance. In this sense, the company's capital may be raised via loans or from shareholders. A narrow usage refers only to the consideration given by shareholders in exchange for receiving shares, that is, as equity. We will use the word 'capital' in this sense.

Let us start by briefly sketching out the Austrian **rules on minimum legal capital**, **98**
assuming, at this stage, that all contributions are made in cash (for contributions in kind see below at m.n. 108 *et seq.*). The minimum capital for an *AG* is € 70,000, for the *GmbH* € 35,000 (Austria) or € 25,000 (Germany). Of course, a company can set a higher figure, which for some lines of business, like banking or insurance, is even mandatory. If you divide this legal capital by the number of shares to be issued, this will result in the so-called 'par value' of each share. With an *AG*, at least a quarter of this par value plus the full share premium, if any, has to be paid in before founding; thus, in sum, a quarter of the legal capital has to be raised immediately. For a *GmbH,* the minimum total payment is at least € 17,500, irrespective of the capital figure the founders have chosen. Additionally, each shareholder has to pay in at least a quarter of the proportional capital for her/his shares. The company can then use these assets for business operations.

The **share premium** is the part of the issue price of the shares above the par value. If a **99**
share with a par value of 100 is issued at 150, the premium is 50. Such an issue 'above par' will especially take place when the capital of a company that already exists is raised, because then the value of the share will have risen above the fixed par value, at least if the company has been managed successfully and has increased in value.

This legal capital **remains fixed** over the lifetime of the company and is part of the company's equity. It can only be altered by an increase or decrease in legal capital, that is by taking up fresh capital in the manner regulated by company law. The results of normal business activity do not affect the legal capital. If the company is profitable and the profits are retained, *i.e.* not distributed to the shareholders, equity will rise in the amount of the retained profits. However, they do not become part of legal capital, but can be found as a separate item of equity below the legal capital. If, however, the company is unprofitable at some stage, equity will be diminished and can even become negative (if the liabilities surpass the assets); again, this will not affect the fixed legal capital.

Higher capital protects creditors to some extent, at least initially. That is because **100**
the company's capital serves as a cushion for the creditors against the risk of default by

the company. As the losses first have to be borne by the shareholders, higher capital can only be wiped out by correspondingly higher losses. However, legal capital is a historical figure of sorts. It tells the reader of the balance sheet exactly how much money was paid in at some moment in the (probably distant) past. It cannot be understood to mean that the company actually has these funds at the moment the annual accounts are drawn up as the capital is used in the course of business and may have been lost.

101 For that reason, legal capital has been **criticised as meaningless regulation**. First, a fixed amount of minimum legal capital does not take the varying capital needs of different lines of business into account; € 70,000 may be a lot for many of them, but very little for others, especially if the business involves high risks. Second, for many businesses, an initial outlay of at least € 17,500 may be a real barrier for access to limited liability. It may even serve to dampen the entrepreneurial spirit, especially in countries with little tradition in this respect. Third, legal capital is meaningless as an information tool for creditors as, for the reasons explained above, it is not concerned with the current status of the enterprise.

102 On the **plus side**, however, legal capital can provide some type of barrier to access to the corporate form by prescribing a meaningful initial outlay of funds. This certainly will not be an issue for bigger ventures, but rather for businesses of the corner shop variety. For them, access to limited liability is coupled with an initial investment. From that point of view, minimum legal capital can serve as a very rough proxy for reputability. Hence, a high capital figure also has a signalling function insofar as the entrepreneur shows that she/he is willing to dedicate a certain amount of funds to the company. Of course, any business needs capital for operating anyway and this funding has to be done to some extent by the entrepreneur her/himself in any case. Yet doing this by raising a higher amount of capital signals that the entrepreneur intends to dedicate these funds to the company for an extended period of time, as the money cannot be withdrawn easily at a later stage.

103 You are invited to draw your own conclusions on this contentious issue. In any case, these criticisms have moved many legislators to introduce corporate forms providing limited liability at a lower price. In the UK, a **private limited company** can be set up with an initial investment of only £1; of course, this does not mean that this is the entire initial cost, as one has to add registration fees, fees for (legal) advice, *etc.* The CJEU's reading of the freedom of establishment (see Unit 1) has nevertheless motivated many Austrian and German businesses to register in the UK in order to achieve cost advantages, especially in the early 2000s. In the meantime, it has become clear that these initial advantages do not compensate for costs that arise at a later stage and, more generally, the disadvantages of not being incorporated at your place of business – a number of companies have reincorporated in Austria.

104 The **German legislator** has also provided a new corporate form, the '*Unternehmergesellschaft (haftungsbeschränkt)*' or '*UG (haftungsbeschränkt)*,' which can be translated roughly as 'entrepreneurial company (with limited liability)'. This *UG* is basically a *GmbH* with a minimum legal capital of just € 1. To compensate the lack of capital, a quarter of the annual profits cannot be distributed to the shareholders, but must be put into a legal reserve until capital and reserves together reach the figure of € 25,000.

Although Austria has the highest minimum legal capital in the entire European Union, the figure of € 35,000 has not been lowered. However, **for the first ten years,** the legal capital may be lowered to **€ 10,000**, 50 percent of which has to be paid via a cash payment before registration. After ten years, the legal capital has to be raised to the normal figure. This is intended to make initial access to limited liability easier for start-ups. However, it is hard to see the justification for subsequently raising this figure, as most corporate insolvencies – against which minimum legal capital supposedly provides some type of barrier – happen precisely in the first years after incorporation. **105**

II. Raising of Capital

Obviously, if legal capital is supposed to be meaningful, the law cannot stop at fixing a number, but must also **specify how such capital must be raised** in order to guarantee that the company actually receives the funds. To that extent, Austrian (and German) law contains elaborate on rules for the raising of capital which are applicable both to the foundation of the company and to any subsequent capital increases. In the first place, one has to distinguish between cash considerations and considerations in kind. A consideration in kind is any consideration given in exchange for shares other than cash, *e.g.* real estate, receivables against third parties or intellectual property rights. **106**

With **cash considerations**, the problems are manageable as cash has a nominal value; this has to correspond to the par value of the shares, plus any share premium. Company law only has to make sure that the company actually receives these funds and that its directors can use them freely. For these reasons, Austrian law requires that upon applying for registration, the directors declare that they can freely dispose of the funds; this has to be attested by a bank certificate. If the declaration is missing or manifestly incorrect, the registrar will not incorporate the company. However, if the registrar does not realise that the declaration is erroneous, the company will be registered and subsequently, liability will be assigned to the directors and the bank if they acted negligently or wilfully. Additionally, in most cases, the shareholder will be deemed not to have performed her/his obligation and will have to pay the consideration again – even in case of the insolvency of the company. **107**

The issue is more difficult for **considerations in kind**, as they do not have a nominal value and in most cases, their value is not easy to ascertain. Think of the value of an unlisted business; probably, different valuation experts will arrive at different estimates of the business's value. Overvaluation of contributions in kind is dangerous to creditors because the legal capital has never been contributed by the shareholders. Hence, the legal cushion for creditors fails to kick in effectively, nor can the figure be used as a proxy for the entrepreneur's commitment. **108**

109 Austrian company law does not prohibit contributions in kind with two exceptions. First, the promise of future services cannot be contributed in exchange for shares. Second, contributions in kind are not possible if the *GmbH* is founded with a capital of only € 10,000. Apart from these instances, contributions in kind are accepted, but have to be conducted before registration. However, **various mechanisms** are designed **to mitigate the dangers** attached to the overvaluation of such assets:

110 First, in Austria, the shareholder who has made the contribution in kind will become **liable for the difference** between the issue price for the shares and the value of her/his contribution. This liability only applies if the company is registered despite the overvaluation; the registrar will not register the company if she/he learns of this irregularity, which, however, is not very likely. The shareholder will incur liability irrespective of whose fault it is, for the simple fact that although she/he has delivered the promised contribution, her/his contribution did not cover the issue price. Additionally, for a *GmbH,* the other shareholders will become proportionally liable if the shareholder who has made the contribution does not make up for the deficit; this liability of shareholders who are not responsible for the shortfall is an often-overlooked pitfall of the *GmbH*.

111 Second, in order to facilitate control of the raising of capital by the registrar, the valuation of the contribution in kind has to be checked by an **independent court-appointed expert**, especially with the *AG*. The corresponding declaration has to be filed with the court when applying for registration. If the expert declares the contributions to be overvalued, the registrar will not incorporate.

112 Third, an independent **expert opinion** is **not required with the *GmbH*** under certain circumstances. The reason is that the *GmbH* path is supposed to be available to smaller businesses; for these, requiring an expert report would introduce significant cost barriers. In Austria, this exception is applicable to contributions in kind which do not exceed 50 percent of the legal capital; any excess has to be subject to a report. However, there is a second exception if the *GmbH* continues a business that has been in existence for five years. This covers situations where the owner of a business decides to incorporate in order to avail her/himself of limited liability; she/he can do so without an expert report.

Let's say, for instance, that a company's legal capital totals € 100,000 and € 50,000 are to be raised by contributing some real estate, € 20,000 by contributing a delivery van and the rest in cash. Under Austrian law, the real estate is covered by the 50 percent rule. Hence, only the delivery van has to be evaluated by the expert. If € 50,000 corresponds to a business which has been in existence for five years, no expert report has to be put together at all.

113 These rules try to **find a compromise between protection of creditors,** on the one hand, and **flexibility,** on the other. Although we have not explained them in full detail, you probably will have found them complicated, which is only partially due to the fact that they are new to you. For businesses, they are cumbersome, costly and time-consuming, especially the need to have an expert report prepared. Entrepreneurs thus sometimes try to avoid the application of these rules. A shareholder may, for instance, make her/his contribution in cash (without any need for valuation). The company then buys a piece of property or a receivable from the shareholder with the cash it has received. This is not advisable as courts, at least in Austria, will hold that the shareholder has not made a proper contribution in cash but a **hidden contribution in kind**; she/he will then have to make her/his contribution in cash again (*i.e.* twice!) – even in case of the company's insolvency, which means that the money goes directly to the creditors.

III. Maintenance of Capital

Legal capital would be meaningless if the contributions could be returned to the 114
shareholders easily. Company law therefore contains rules on the **maintenance of capital** which aim at ensuring that only profits can be distributed to the shareholders. The basic idea is the following: if at the end of the year, all the company's assets minus its liabilities exceed the company's legal capital plus so-called fixed or non-distributable reserves, then the company can pay a dividend. Otherwise, this is not the case.

Such non-distributable reserves are usually mandated by law; for instance, the entire share premium, *i.e.* any part of the issue price above the par value, has to be put into a fixed reserve. Sometimes the statute of the company provides for fixed reserves as well, which can serve as a signal of financial stability to the creditors.

For that reason, it is important to determine how to arrive at these figures. This is the 115
second function of accounting rules in Austria (and indeed Germany), apart from the information of creditors. As a qualitative assessment, one can say that these accounting provisions are rather conservative in the sense that they limit distributable profits to a larger extent than in many other legal systems. In this sense, accounting rules are geared towards protecting creditors.

One important **example** for this is the **valuation of fixed assets**. Under Austrian 116
accounting rules, their maximum value is fixed at the moment of acquisition (but not its minimum value as assets will have to be depreciated for a loss in value). If, for example, the company acquires a piece of real estate for € 100,000, this will be its maximum book value, irrespective of whether its value subsequently increases. Once the company sells the real estate, any positive difference between the price paid by the purchaser and the property's book value, then increases the company's profits, but only after that point in time and not before. Hence, outside of the sale of an asset, an increase in its value will not increase its book value or, correspondingly, the amount that can be distributed to the shareholders.

This aim is in some **conflict** with the other purpose of accounting rules mentioned 117
above, namely, the **information for creditors** as to the company's creditworthiness. A balance sheet prepared according to this and similar conservative rules, systematically understates the value of the company's assets. Conversely, the company has to carefully include all debts on the balance sheet even if it is not certain but only likely that they will arise (so-called accruals or provisions). Other accounting systems are more permissive and allow so-called 'mark-to-market' accounting, which means that the as-

set value on the balance sheet is determined by the asset's current market price. This will in turn lead to higher profits if the prices go up, but comes at the price of increased profit volatility as a fall in asset prices and the resulting depreciation of the assets in the balance sheet immediately reduces profits. We have already mentioned the IFRS accounting for groups of companies with a listing on the stock exchange. This is a parallel system of accounting for information purposes only and is much more concerned with giving the interested public a 'true and fair view' of the company's financial situation. Even if the profits shown in IFRS accounting are higher than under Austrian accounting rules, these additional profits cannot be distributed to the shareholders.

118 Before going on, we would like to briefly clarify a common misunderstanding, namely that the company will have **liquid funds** available to pay a dividend if the balance sheet shows a profit. In reality, these two issues are completely separate. Balance sheet profits only show whether revenues have exceeded costs, but tell us nothing about whether the company's assets are held in cash – which can be distributed easily – or in other less liquid assets, *e.g.* real estate. Liquidity and profits have nothing in common. It may well be that the company cannot pay a dividend due to lack of liquid funds or can only do so if it takes up a bank loan (and will, in later periods, have to service that debt).

119 Of course, paying dividends is not the only way to make payments to shareholders. We would like to briefly mention two additional methods before turning to more problematic cases. First, the company's shareholders may decide to **decrease** the company's legal capital (as long as it remains above minimum legal capital requirements). However, before distributing money to the shareholders, the company either has to satisfy creditors or to provide them with adequate collateral upon their request. Second, the company could **acquire its own shares** from shareholders, which results in a repayment of the contribution; as a general rule, such an acquisition is not permitted. There are nevertheless numerous exceptions, especially for companies listed on the stock exchange, which may acquire shares of up to 10 percent of the share capital if this has been authorised by the shareholders and if the purchase price for the shares is covered by distributable profits.

120 Apart from that and a few other instances, our company law forbids distributions to shareholders. That is not to say that they do not happen in reality. If they do, they are normally not made openly but in the form of **'hidden' or 'disguised' distributions**. This is one of the most important company law issues in practice. Such hidden distributions can take numerous forms; here, two examples will suffice:

Within **corporate groups**, numerous contractual relationships exist between legally independent but economically joined companies. For instance, the parent company may buy sports equipment from its subsidiary producing in Austria and then distribute these goods to two different subsidiaries, one German and one Austrian, therein running the company's retail outlets in these two countries. Obviously, the parent company can increase its profits by paying low prices to its producer subsidiary and pass the equipment to the retail subsidiaries charging high prices. However, such actions can be hidden distributions by the subsidiaries to its parent company if the transactions are not entered into based on terms acceptable to independent third parties (so-called transactions '**at arm's length**'). The question is always the same: would the subsidiary enter into the transaction on the same terms if the counterparty were not its parent company but a third party? In our example, this will depend on whether the services actually provided by the parent company to its subsidiaries actually justify the price spread which it charges.

In a more modest setting, imagine that a single shareholder owns a private company operating a restaurant. In order to provide his wife with an income and to give her pension claims upon retirement (based on the Austrian and German systems, wherein the predominant compulsory pension system is run by state agencies), the company and the wife enter into an **employment contract** even though she does not actually provide any services to the company. This, in effect, is a hidden distribution as the company has entered into the contract only due to the fact that its counterparty is the shareholder's wife. Hidden distributions do not have to be made directly to the shareholder, but can also benefit third parties close to him, such as family members or other companies under his control.

The consequence of any illegal distribution to a shareholder is simple: upon the **121**
company's request, the shareholder has to **pay back the money**, return any other consideration received, or, if the latter is not possible, compensate its value. This duty of payment arises even if the money could have been distributed via dividends. This means that the company cannot distribute funds freely, but must always comply with the formalities for paying out dividends, in particular, a shareholder vote and even distribution among the shareholders – the latter being especially important if the company has minority shareholders who typically do not benefit from a hidden distribution, which is generally extended to the dominant shareholder only.

Details are hotly disputed amongst lawyers but not of interest in the present context. **122**
However, it is important to point out a key difference between an *AG* and a *GmbH* in Austrian law: while with the *AG,* only the shareholder who has received the distribution is liable for repayment, in a *GmbH,* this **liability applies to the other shareholders** as well if the receiving shareholder does not make the repayment and if (slightly simplified) the repayment was made from funds that could not have been distributed to the shareholders.

You may have noted that it is not very likely that such a claim will be brought by the **123**
dominant shareholder, as in this case the one who has received the illegal distribution also controls the company. Managers do not usually sue the dominant shareholder of the company they are managing – if they did, they would probably find themselves out of a job. That does not mean that the rules on illegal distribution are trivial, as, there are at least **three situations** in which such **liability may become a real issue**. First, minority shareholders can bring a claim for repayment under certain circumstances; this nevertheless rarely occurrs due to the fact that they hardly will have sufficient knowledge of hidden distributions to bring a claim. Second and more importantly, if the company becomes insolvent, the insolvency administrator will manage the company's business in the interest of its creditors and will not be restrained by considerations for the shareholder's interest. Third, if the company's shares are sold to a third party, the new shareholder – upon inspection of the company's affairs – may decide to sue the

former incumbent in order to maximise her/his returns from the company. As a result, the severe consequences of illegal distributions are an important issue in practice and are often taken very seriously indeed. That is essentially due to the fact that violations may result in the shareholder having to pay funds into a vessel which is already sailing under a different flag, namely the flag of the new shareholder or of the creditors represented by the insolvency administrator.

D. Creditor Protection through Insolvency Law

I. Purposes of Insolvency Law

124 We have touched on **insolvency** in various instances. It is now time to further explore this issue. At some stage, it may become clear that the company will not be able to service its debts in full. As the shareholders are only residual claimants – *i.e.,* they receive returns or liquidation proceeds only if all creditors have been fully satisfied – at this moment, they have lost their entire stake in the company. Rather, the company's purpose shifts since, in the future, it will not be run for profit maximisation in the interest of the shareholders, but instead, in pursuit of satisfying creditor claims at the best possible rate. This usually means that the company's assets will be sold either piecemeal or in their entirety and that the proceeds of this sale will be distributed to the creditors, who will then receive a certain percentage of their original claim as an insolvency dividend. As a result, the company will be liquidated and removed from the register. It becomes non-existent. Insolvency law thus fulfils an important economic function by making sure that structurally unviable businesses are taken out of the marketplace in an structured way and by enabling basically viable businesses to continue trading with the approval of a creditor majority.

125 In practice, however, a complete liquidation is often not in the best interest of the creditors. A better result, *i.e.* a higher quota, can possibly be achieved if creditors forego part of their claims and permit the company to continue trading after necessary restructurings. Such **restructurings** can be achieved either within formal insolvency proceedings or by contracts between the company and (each of!) its creditors. The latter is usually called a 'pre-packaged' insolvency and is easier to achieve with fewer creditors as coordination difficulties become more salient with higher numbers of claimants. Additionally, the survival of the corporate entity may also be in the interest of the economy as a whole, as this can help to avoid job losses and the corresponding burden on the public coffers and, at the end of the day, possibly on the taxpayer.

II. Grounds for Insolvency

126 Austrian insolvency legislation provides two grounds for the opening of insolvency proceedings. First, the company is insolvent if it is **unable to pay its debts when they**

become due. This cash-flow test does not cover mere delays in payment or a lack of willingness to pay – in which case the creditor will have to enforce his claim – but only a permanent illiquidity. This generally means that the company has structural problems as otherwise it will be able to generate liquidity by *e.g.* taking out a bank loan or – if such a bank loan fails – successfully negotiate for an extension.

Second, even if the company is still liquid, it will be '**balance-sheet insolvent**' or 'over-indebted' if the value of its net assets falls below zero. This means that its debts exceed its assets or, in other words, that its equity has been wiped out. This balance-sheet test incorporates all debts, irrespective of whether they are due. However, as we have seen, the maximum valuation of assets is severely restricted by accounting rules. The purchase price sets the cap for the valuation of fixed assets even though they may be sold on the market at a higher price. Even structurally sound enterprises may thus fall foul of a balance-sheet test. For that reason, an additional test must be run: will the business – in spite of the negative balance-sheet test – be able to continue operating successfully? If the answer is in the affirmative, the company is not insolvent. **127**

In theory, the balance-sheet test should kick in earlier than the cash-flow test as it includes debts that will fall due in the (probably distant) future. However, in practice, the results of the system are not very encouraging as for many businesses, especially small ones, **insolvency procedures are not opened at all** because such companies often cannot even raise the funds to cover the costs of the insolvency proceedings themselves, *i.e.* court fees and the remuneration of the insolvency administrator. In this case, the company is simply deleted from the register; creditors lose their entire claim. Obviously, this means that insolvency proceedings are instigated too late, even though in many cases, the company may have been in a crisis for some time. One important reason for that is that the debtor may be tempted to gamble his/her way out of debt. That is, since the insolvency equity will have already been wiped out, further losses are borne by the creditors and not by the shareholder(s). There is thus no downside for the shareholders if the company continues trading, but a (however remote) upside nevertheless, that somehow things will magically turn for the better at some later stage. This seems to be an important factor for late filing, especially in companies with a dominant shareholder, who may try to influence managers not to file. **128**

III. Overview of Insolvency Proceedings

When a company becomes insolvent, the directors have to **file for insolvency with the commercial court without delay**. If directors and shareholders try to reorganise the company outside of official insolvency proceedings, they can postpone the filing for up to sixty days in Austria (incidentally, the maximum period of three weeks, in the case of Germany, is considerably shorter). If the company is illiquid, creditors can file for insolvency as well. **129**

130 Once the court opens insolvency proceedings, two important consequences arise. First, the company's management **loses the right to represent the company**; to that end, and for the purpose of liquidating the business, the court will usually appoint an insolvency administrator who will run the enterprise not in the interest of its shareholders, who are relegated to a secondary role, but in the interest of the creditors. The administrator is charged with maximizing the return to the creditors. The directors – who have probably been the source of the mismanagement in the first place – are effectively side-lined.

131 Second, **creditors cannot enforce claims individually**; rather, the insolvency administrator will liquidate the business and then distribute the proceeds to the creditors in an organised proceeding, which, at least in principle, is designed to achieve equal treatment of all creditors, *i.e.* each creditor receives the same quota of her/his claim. The insolvency law therein avoids a creditor run on the company's assets, as normal enforcement procedures would leave those whose claims are adjudicated first with full satisfaction of their claims, while late movers would be left with empty hands if the remaining funds were already paid out.

132 Of course, not all creditors are actually treated equally. First, some claims are given **priority**, essentially those that arise after the opening of the insolvency proceedings, such as court costs, the remuneration of the insolvency administrator and any costs for proceeding with the business (*e.g.* wages which fall due after the opening of the insolvency). These outlays should be in the best interest of the creditors anyway as they must be instrumental for maximising creditor return; otherwise, the administrator should have refrained from entering into these contracts. Second, some creditors may have been **secured** before insolvency via some type of collateral, *e.g.* a mortgage on company real estate, a right of lien attached to movable property or a retained title to goods acquired through a credit purchase by the company. This will give them a right to separate satisfaction from the proceeds of the sale of the property. Of course, the position of such secured creditors is very different to junior or unsecured creditors, as their claims will be met as long as the value of the collateral is sufficiently high.

133 During the insolvency proceedings, it may turn out that creditors will be better off with a **settlement** which involves foregoing part of their claims and allowing the company to continue trading. The debtor company has to credibly demonstrate that it is willing to pay a quota of its debts; the minimum permitted by law is payment of 20 percent of the outstanding debt over the following two years. If unsecured creditors agree by majority (of both the number of creditors and the total amount of claims) and the court sanctions the rescue package, then it will become binding on both the debtor and the creditors, even in case of those who dissent. Once the debtor pays the promised quota, she/he will be discharged of the residual debt. Viable businesses can thus be rescued. The opportunity to push a rescue package through by a majority vote in insolvency proceedings also helps in the process of consensus finding for reorganisation of companies in crisis outside of insolvency. Creditors will be more willing to compromise as they must be aware that, even though they have to consent to any plan organised individually outside of an insolvency, in an insolvency proceeding, they can nevertheless be potentially outvoted.

Finally, instead of appointing an **insolvency administrator,** the management of an insolvent company may be allowed to retain its position if the company offers a quota of at least 30 percent of the outstanding claims over the following two years ('debtor in possession'). First, this economises on the costs. Second, making use of management's intimate knowledge of the company helps speed up insolvency proceedings. The danger of retaining a potentially inept or conflicted management team is combatted by judicial oversight of the reorganisation, again mediated by an administrator. **134**

IV. Liability Issues

Finally, we have to briefly touch on the **liability issues** for the various stakeholders involved in the running of the company. We cannot go into any details, but will provide a brief overview of some central instruments. **135**

First, **directors** normally do not face criminal sanctions if their company becomes insolvent unless they have been grossly negligent. They may, however, lose the authorization to pursue further business activities for three years if the insolvency proceedings have not been opened due to a lack of funds to cover the costs of the proceedings. As far as civil liability is concerned, directors who neglect their duty to open insolvency proceedings in due time may become personally liable towards creditors for damages. Creditors whose claims antedate the insolvency generally receive a lower quota if proceedings are not opened in time, while creditors whose claims have only arisen at a later date, would not have entered into a contractual relationship with the company at all, had they known of the illiquidity or over-indebtedness. A liability of up to € 100,000 may arise if the director has not taken adequate reorganisation measures despite the auditor having advised him/her that certain key management ratios indicate a crisis. This is supplemented by special rules for tax and social security debts. Insolvency law tries to incentivise directors to file for insolvency even though shareholders might pressure them to hold back. Obviously, this can hardly work if the same individual is both shareholder and director, a typical situation for many small and even medium-sized enterprises. Similarly, liability is an empty threat if the director has few assets. **136**

Second, **shareholders** are protected by limited liability, especially when it is most important – in insolvency. We have already seen two instances in which shareholders cannot rely on that tenet of company law – namely, in the rare cases of veil piercing and the practically important issue of hidden distributions – which do not result in direct liability to the creditors, but in an obligation to return the distribution to the (insolvent) company. A similar aim is pursued by fraudulent conveyance rules according to which, the insolvency administrator can claim back certain payments made to shareholders, *e.g.* payments made within the last two years before filing for insolvency if said pay- **137** ments were to the detriment of creditors and if the shareholders should have known that they were made with the intent to defraud creditors.

138 Third, **fraudulent conveyance rules** (also known in continental Europe as the *actio pauliana*) are not only an issue for shareholders but also for third parties and creditors. A bank entering into a contract with a visibly distressed company will have to ascertain whether any actions taken by the debtor do not impair creditors, as, otherwise, the bank cannot rely on the validity of the contract. In that sense, the bank is employed as a kind of gatekeeper. Similarly, inside creditors may seek to get preferential treatment, *i.e.* payment of their debts or collateral in the period immediately before corporate insolvency. Under fraudulent conveyance rules, such actions may be contested by the insolvency administrator. Meanwhile, the creditor who has received preferential treatment will have to return the payment or give up the collateral. By these and similar means, insolvency law tries to ensure equal treatment of all creditors, especially those without a close relationship – business or otherwise – to the debtor.

Relevant Literature and Further Reading

Armour/Enriques et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd edn., 2017) 109–143.

Davies, Introduction to Company Law (2nd edn., 2010) 53–102.

Questions

1. Why does a company pose dangers to the creditors? Are there advantages as well?
2. Explain the function(s) of accounting.
3. What does creditor self-help mean? Can all creditors help themselves?
4. What does ‘piercing the corporate veil’ mean?
5. Does (minimum) legal capital help creditors?
6. Why are contributions in kind dangerous for creditors? What countermeasures has the legislator taken?
7. What does the concept of capital maintenance mean?
8. Do you see a problem if a parent company sells goods to its subsidiary above the market price? What are the consequences?
9. Who brings a claim for the repayment of hidden distributions in practice?
10. What does it mean if a company is insolvent?
11. What are the aims of insolvency proceedings?
12. How does an insolvency proceeding function?
13. Will shareholders and/or directors be liable for the company’s debts in insolvency?

Unit 3: Management of Companies

A. Purpose of this Unit

In this unit we look at basic issues of **management of companies**. To that end, we first deal with board structures, both internationally and in Austrian company types. Then, we briefly look at a technical but very important issue, namely, the company's representation against third parties. We continue by examining the appointment and removal processes for directors in Austrian companies before dealing with the issue of who decides on management issues. We conclude with an overview of director liability. After studying this unit, you should have a general idea of the most important issues in management and of the complex interplay between members, supervisors and directors. **139**

B. Overview

I. Recapping Principal-Agent Theory

Let us start by briefly recapping some central themes of principal-agent theory already touched upon in Unit 1 (at m.n. 55 *et seq.*). The main principal-agent relationship is the one **between shareholders and management**, as (larger) companies are usually not managed by their members but by third parties. As a result, the shareholders' wealth is directly affected by the manager's actions. That is, they will receive a smaller dividend or their share will lose value if the company is mismanaged. There is thus a need for supervising the full-time managers. We will see that different legal systems have settled on different solutions to this issue. **140**

A second important issue is the **influence of members on the management** of the companies. In this context, there is huge variance in legal systems and also in the different company forms within a legal system. Of course, the stronger the shareholder influence, the more salient another principal-agent conflict will become, namely, the one between majority and minority shareholders. For our purposes in this unit, we will assume that all shareholders have the same interest as against management; in other words, we will focus on the principal-agent issues between management and the members in their entirety. In Unit 4 at m.n. 243 *et seq.,* we will examine conflicts between majority and minority shareholders. **141**

Along these lines, there are **three core topics** which we address in this chapter. The first is the distribution of decision-making powers between managers and shareholders; certain fundamental decisions are always left to the shareholders. The second is the oversight of management; we will see that this can be carried out by the members **142** themselves, by the management body, or by a specialised board. The third is indirect incentivisation of management to act in the best interest of the shareholders. This can be achieved *e.g.* via remuneration rules or the threat of liability.

II. Board Structures in International Comparison

143 Typically, we distinguish between **two different types of board systems** in international comparison; this distinction refers to the **supervisory function**. We should nevertheless bear in mind that in most small companies, the members themselves supervise third party managers. This is comparatively easy in companies with few members, as the latter are usually willing to incur the requisite monitoring costs; this is because the results of the monitoring activities affect their wealth to a large extent. Such companies therefore usually have only a board of directors responsible for the management of the company, while the members themselves supervise managers and very often take on all material decisions themselves. Indeed, in a typical situation, the single member is also the single director; supervision is no issue at all, at least not on behalf of the shareholders.

144 In companies involving **many shareholders** with small(er) holdings, however, the situation is different. Such shareholders are frequently unwilling to carry out monitoring activities. Company law therefore has to provide solutions ensuring that supervision will take place. Company laws across the world do this in two different ways.

145 In a **one-tier structure,** a company only has one board of directors. On the one hand, this board takes the central business decisions, while the day-to-day running of the company is left to corporate officers or managers. Typically, some of the top-level managers will also be board members. On the other hand, the board of directors' other function is supervision. For that purpose, not all board members are fully employed managers, but some of them are so-called 'outside,' 'independent,' or 'non-executive' directors. The non-executive director's income is usually not dependent on the business's success to the same extent as the income of full-time managers, whose remuneration packages often depend on the company's fortunes to a large extent. The independent directors' monitoring abilities are thus not compromised by having a huge stake in the company's success. Additionally, some decisions have to be taken by board committees composed in their entirety of independent directors, such as the auditing and compensation committees in US-American corporations. The one-tier structure (or unitary board) is typical for Anglo-American legal systems as well as for the systems in, for example, Switzerland or Japan.

The auditing committee is responsible for the corporate accounts, while the compensation committee determines the remuneration package for corporate managers.

146 Companies with a **two-tier structure** operate with two different boards. The board of directors is composed of (full-time) top-level managers and is responsible for tak-

ing management decisions and running the company. A separate body, the supervisory board, carries out the monitoring function. Its members cannot be managers. Management and monitoring are thus formally separated. This solution is, *inter alia*, typical for Austria and Germany. Other countries, such as France or Italy, offer companies a choice between the one-tier and the two-tier models – as does the European Union for the *Societas Europaea* (for this European company see Unit 1 at m.n. 53).

Of course, this schematic description can only be a rough approximation to reality. **147**
The two legal systems may share the two-tier approach, but they may nevertheless have different rules as to the precise functions of that body or its composition. One important example for such differences is the fact that in some countries, like Austria or Germany, **employees may appoint some members of the supervisory board** (so-called board level employee representation; see below at m.n. 155 *et seq.*) while in other countries, shareholders have the exclusive right to appoint members.

Common to all systems is the fact that non-executive directors carry out supervision, **148**
whether in a separate body or not. This is also mandated by corporate governance codes (for these Codes see Unit 1 at m.n. 47), which typically contain soft-law rules on the number and role of independent directors, at least for companies listed on the stock exchange. On the issue of **independent directors**, we would like to make three remarks.

First, non-executive directors typically have less **knowledge** of and insights into **149**
the company, at least in comparison to the executive managers they are supposed to supervise. Overcoming this barrier of asymmetrical distribution of information is crucial for successful management control. Similarly, at least some non-executives have substantially less knowledge of the company's field of business. This lack of expertise is deemed to have played a role in the financial crisis of the 2000s. This is why the issue of competence has come to the forefront especially in financial industries lately, such as in banking or insurance, but also in general company law.

Second, when talking about independent directors, we have to clarify who it is ex- **150**
actly that they should be independent of. On the one hand, **independence from management** is essential for supervising. This is the only topic with widely-held companies. For that reason, directors cannot sit on the board of supervisors. This prohibition also extends to persons who depend on directors, such as the company's employees (with one important exception explored below at m.n. 155 *et seq.*), or directors of its subsidiaries. Another important issue in this context is whether retired managers can become supervisors immediately or whether they should observe a cooling-off period, as, otherwise, they may *e.g.* be called upon to question their own past decisions. For listed companies, a maximum of one member may have been director within the last two years. A former director of a bank cannot become chairman of the board of supervisors until two years have passed after retirement.

On the other hand, we may also think of **independence from any major share-** **151**
holder. From this point of view, independent directors may be charged with monitoring the company's activities for the benefit of minority shareholders. This is taken up by

the Austrian Corporate Governance Code for companies with a free float of more than 20 percent or 50 percent of the share capital. Such companies should have at least one or two members of the supervisory board who are independent from major shareholders.

152 Third, a word of warning is apposite: it is easy to postulate that somebody should be **independent**, but **hard to determine** whether this is actually the case. After all, independence is an inner state of mind that is impossible to measure. The legal order can only make use of proxies, such as family ties or financial dependence. 'Soft factors' such as gratitude towards a person for nomination for a board position can, of course, influence persons, but cannot be factored into the system easily. Similarly, even a close friendship may not compromise a virtuous person's inner independence. Summing up, independence is a difficult concept to define.

III. Board Structure of an Austrian *AG*

153 We will start by examining the structure of an Austrian *Aktiengesellschaft*. As you already know, such a company has both a board of directors (*Vorstand*) and a board of supervisors (*Aufsichtsrat*), the one being responsible for running the company, the other for monitoring management. This organisation is mandatory. The **board of directors** may have one or more members. Typically, Austrian boards of directors have several members, one of which will be the Chief Executive Officer (CEO; *Vorstandsvorsitzender* in German). It is important to understand as a starting point that directors in an Austrian (or indeed German) *AG* are not subject to directions by the shareholders in the exercise of their duties. Rather, they manage the company independently and under their own responsibility. To some extent, this insulates them from the influence of dominant shareholders who may pursue their own agenda and not necessarily act in the best interest of the company as a whole. Managerial independence is therefore also an instrument for the protection of minority shareholders.

154 Apart from the monitoring function as such, the **board of supervisors** has a number of additional tasks. For example, it appoints the members of the board of directors (see below at m.n. 171), has to approve certain crucial management decisions (see below at m.n. 158), and establishes the annual accounts once they have been prepared by the board of directors. Supervisory boards can range from quite small (minimum: three members) to very large (maximum: 20 members). Of course, large boards will often become less effective in performing their monitoring role as coordination between the members becomes more difficult, while smaller boards may lack expertise in certain matters. The Austrian Code of Corporate Governance recommends a maximum of ten members.

155 However, in reality, the board of supervisors can have up to 30 members – although few boards actually comprise such an excessive number. This is due to the fact that in Austria, **for each two board members** representing the shareholders, **the works coun-**

cil (*Betriebsrat*) **appoints one member**. These members must be company employees and cannot be trade union officials.

This is different in Germany, where a certain percentage of board members representing employees must be trade union officials. This is an important difference as the company's employees will have more shop-oriented aims than union officials, who may pursue wider political goals.

Via this system of **codetermination** or 'board level employee representation' employee interests are not just represented at the plant level (via the works council), but also in the decision-making bodies of the company, albeit not in management but at the level of supervision. To that extent, the company's employees under the German and Austrian systems play an important role in the overall management of the company. They can influence the composition of top management and have a direct say in decisions of vital importance as these issues pass through the board of supervisors. Internationally, this system of codetermination is an outlier, as most other countries and even most Member States of the European Union know no or only mild variations of codetermination. **156**

IV. Board Structure of an Austrian *GmbH*

In comparison to that, the structure of a typical *GmbH* is simple. The GmbH features **directors** who manage, and **members** who take core decisions and monitor. This is due to the fact that a *GmbH* typically has fewer members than an *AG*. **157**

The *GmbH's* statute **may provide for a board of supervisors**. If it does so, the board has to consist of representatives of both members and employees with a ratio of 2:1. Apart from the appointment of directors and establishing the annual accounts – both of which are done by the *GmbH's* members themselves – its tasks are the same as with an *AG*, namely, monitoring and approving core management decisions. A board of supervisors, moreover, is **mandatory** in two cases: first, if the company has more than 50 members and capital of more than € 70,000 (a rare occurrence), and, second, if the *GmbH* – either directly or through subsidiaries – employs on average more than 300 people (this simplifies the rules to some extent, but captures the core of the issue). From this point, one can deduce that the supervisory board is not just a monitoring body (which is in most cases superfluous if there are few members), but also pursues social objectives, namely giving employees a say in the management of the company. The employee position is nevertheless weaker than in an *AG,* as the board of supervisors of a *GmbH* does not appoint the company's directors. **158**

V. Board Structure of a *Societas Europaea*

159 Let us briefly mention the situation in the *Societas Eurpaea* (see above at m.n. 53). Here, the founders have a **choice** between the local two-tier system with managers and a board of supervisors and the one-tier system with a board of directors fulfilling both a management and a supervisory function. We will not address this in detail.

C. Management and Third Parties

160 Before going into details of the internal structure, we touch briefly on another topic, namely the **representation of the company** towards third parties. This is a crucial issue since, unlike a natural person, a company cannot act by itself, but, instead always needs to act via representatives. How can a third party know that the company will be bound by the actions of a specific person? Austrian company law, as indeed all modern company laws, makes use of the instruments of transparency and standardisation.

161 Standardisation features two aspects, namely, who can represent the company and what the limits are to the power of representation. Power of representation generally lies with the **directors**, both in an *AG* and a *GmbH*. They can enter into contracts, fulfil such contracts and take legal action, all on behalf of the company. Only very limited exceptions to this rule enter into the equation. Contracts of employments or personal services with directors are entered into by the board of supervisors (in an *AG*) or the members (in a *GmbH*) as, otherwise, directors would be acting both on behalf of the company and in a personal capacity.

162 As far as the **limits of the power of representation** are concerned, they cannot be determined by the shareholders, but are standardised. There are a number of core decisions defined by law which must be taken or at least ratified by the shareholders: directors *e.g.* cannot increase the company's capital, merge the company with another entity or sell all the company's assets. Apart from that, the power of representation of directors is unlimited. Hence, third parties wanting to enter into a contract with a company do not have to worry about whether a contract signed by the directors will actually be binding on the company. This will also apply in case of a transaction not being covered by the business purpose of the company, in case of an important contract being entered into despite the lack of the board of supervisors' approval or in case of a piece of real estate being sold contrary to directions by the members of a *GmbH*. This protection of third parties eases business relations and lowers transaction costs as third parties do not have to conduct extensive research into the powers of directors in every single case. In egregious cases, however, where the third party has actual knowledge that a transaction is not in the best interest of the company or that internal approval is still missing, the company will be released from its contractual obligations under the concept of 'collusion'. There is no justification for protecting third parties not in good faith.

Turning from standardisation to transparency, we have to look at the role of the **business register**. First, third parties can easily determine who is a director and may thus represent the company by consulting the register. Even if the entry happens to be wrong, either because it was incorrect in the first place or because it has become outdated – *e.g.* in case of dismissal of a director – third parties still can rely on it and the company will be bound by any contract entered into by the professed director. 163

Second, the register will also tell a third party how directors can represent the company in case of a **plurality of directors**: each on her/his own, only all of them together, or any two of them. Company law does not mandate a specific form of representation, but leaves the choice to the company. As a mere default rule, it provides that all directors have to act jointly in order to legally commit the company. For practical purposes, this means *e.g.* that a written contract will have to be signed by all directors, albeit not at the same time. Obviously, giving each director the possibility to act on her/his own provides the company with more flexibility. This, however, goes hand in hand with greater dangers to the company as the actions of one director are not scrutinized by others. For that reason, in some critically important industries, such as banking and insurance, the law mandates joint representation by at least two directors. In any case, a look at the business register is sufficient for third parties when determining the applicable rules for representation. 164

Of course, most companies are not only **represented by** the directors but also by others, typically some of its **employees**. If you change your mobile phone provider, for example, your contract will typically not be signed by a director but by subordinate employees. Such powers of representation are not an issue of company law but of a branch of contract law called agency law. For our purposes, it suffices to say that ultimately all agents of the company have to be empowered, directly or indirectly, by the company's directors. 165

Finally, we dealt with attribution of legal acts to the company only. **Attribution is also an issue in other fields of the law**, *e.g.* in tort law, as in most cases, individual fault is a prerequisite for an award of damages. What does 'fault' mean, however, in terms of legal entities? Or in other words, under what circumstances can the individual fault of natural persons be imputed to the company? We can only draw your attention to the issue and make a couple of general and, therefore, necessarily simplifying remarks. The fault of directors can always be imputed to the company. Their fault can lie either in direct actions or – more important for practice – in the lack of supervision of subordinate employees. The fault of other persons will be attributed to the company if they have been given substantive power to act independently or if the company uses them for the discharge of contractual duties against the damaged party. A similar issue is knowledge. When does a company 'know' something for legal purposes? This issue is far from clarified, apart from the fact that knowledge on the part of directors is usually treated as knowledge of the company. 166

D. Appointment and Removal of Board Members

I. *Aktiengesellschaft* (Public Limited Company)

1. Members of the Board of Supervisors

167 The **general meeting** – that is, the shareholders – generally elects members of the board of supervisors of an Austrian *Aktiengesellschaft*, with the exception of course of the employee representatives discussed above (at m.n. 155 *et seq.*). Members are elected for a period of approximately five years by ordinary majority. This means that the shareholder majority decides on the composition of the board of supervisors. In practice, however, in line with the Austrian Code of Corporate Governance, the boards of most companies listed on the stock exchange comprise one or two representatives of minority shareholders. In contrast, for unlisted companies, the law contains (ineffective) provisions designed to establish at least one representative on the board for shareholders with one-third of the votes. Additionally, the statutes may provide that up to half (in unlisted companies) or up to a third (in listed ones) of the members are directly appointed by certain shareholders without a shareholder vote. This is sometimes used to guarantee adequate representation on the board to shareholders without an absolute majority. Similarly, the majority shareholder can promise a strong minority shareholder representation on the board in a shareholder agreement which is not part of the company's statute, but entered into separately.

168 The board of supervisors as a whole has to have the **qualifications** necessary to fulfil its monitoring functions. The general meeting has to ensure a balanced composition with respect to the structure and the business of the company. Individual members have to state their qualifications and any circumstances likely to cast doubt on their independence (as to the issue of independence, see above at m.n. 150). In order to guarantee that the member can dedicate adequate time, the law stipulates a maximum number of board seats one person can hold, which is between eight (for listed companies) and ten seats. This shows that membership of the board of supervisors is not supposed to be a full-time job; rather, renowned and/or experienced persons shall devote part of their time to the monitoring of the company.

169 Another important issue of board composition is **diversity**, the most topical of which involves gender balance. Currently, women are underrepresented both in the managing and monitoring functions of companies. While there are no rules for the board of directors, the supervisory boards of listed companies and companies with more than 1,000 employees have to meet a quota of at least 30 percent for each gender if the board has at least six members representing shareholders (*i.e.* nine in total) and at least 20 percent of the company's employees are female. Not surprisingly, such provisions are contentious as, at least to some extent, the legislator pursues wider political and social objectives at the price of limiting the freedom of shareholders to decide on the identity of the monitors. Our judgments will depend on the value each of us puts on the aim of gender

equality. On the other hand, although the final verdict remains outstanding, some indications show that diversity on the board helps to improve the quality of board decisions and is thus in the best interest of the company. This is not, however, – and according to some not even primarily – just a gender issue. Rather, the board has to be composed taking into account various dimensions of diversity.

Just as important as the power to appoint board members is the **power to remove** **170**
them. This power also lies with the general meeting, albeit with a higher majority of three quarters of the votes cast in favour of removal. The general meeting does not, however, have to present any cause for its vote. Clearly, this means that in public companies with a controlling shareholder with the requisite shares, board members hold their mandate at that shareholders' whim. Similarly, members who have been appointed by a single shareholder (as explained above at m.n. 167) can be recalled by that shareholder at any time without a vote. This is certainly important if the board member does not carry out her/his functions properly, but may also mean that the member cannot act independently from the shareholder that has the power of removal – unless the member is ready to accept the loss of the position (and remuneration) in case of insubordination. On the contrary, in companies without such a controlling shareholder, board members may be hard to remove in practice unless a coalition of shareholders is formed (in extreme cases, a minority of 10 percent can apply to the court to remove a board member with cause, but this has very limited importance in practice).

2. Directors

Appointment and removal of members of the supervisory board is important for **171**
the appointment and removal of directors since under Austrian law, the **supervisory board appoints** them. The board resolution needs a double majority of both the board in its entirety and of the shareholders' representatives. This considerably weakens the position of employee representatives on the board as they cannot appoint managers by forming a coalition with a minority of the shareholders' representatives. Directors may not be appointed for more than five years. This is due to the fact that removal during their period of office is cumbersome if not outright impossible (see below at m.n. 174).

There are no legal rules on the qualification of managers, at least not for companies **172**
in most lines of business. In regulated industries, however, such as banking or insurance, prudential authorities, such as the Austrian Financial Market Authority (*FMA*, ***Finanzmarktaufsicht***), check directors' qualifications before appointment. Additionally, the statutes may contain further rules. In practice, the appointment of directors is a crucial task on the part of the board of supervisors. Typically, the selection of candidates is prepared in the context of a special nomination committee of the board of supervisors and, especially in large companies, frequently with the help of external advisors. In companies with a dominant shareholder, however, this shareholder's decision on the appointment may only be rubber-stamped by the board of supervisors.

173 Apart from the appointment, as such – conferring the power to act on behalf of the company –, the company – represented by the board of supervisors – and the director will also enter into a **contractual agreement** regulating the rights and duties and the remuneration (see below at m.n. 182 *et seq.*). This is usually a free service contract (*freier Dienstvertrag*). As the director is not subordinated to other players in the company, she/he does not enter into an employment contract and the protective provisions of labour law do not apply.

174 **Removal of directors** is difficult before their term of office ends. The board of supervisor can only remove a director for good cause, *e.g.,* for grave violation of duties or for inability to perform a director's duty properly. This is meant to bolster the independence of directors against the supervisory board and against the shareholders. Until a reappointment becomes imminent, the director should not have to pander to their wishes in order to retain the position (for director's independence see in detail above at m.n. 150 *et seq.*). However, this idea is considerably weakened by the fact that a loss of confidence by the shareholders (via a resolution in the general meeting) is considered to be good grounds for removal unless the loss of confidence is overtly unjustified. This gives the shareholders considerable power. Although formally, the board of supervisors does not have to follow up on such a shareholders' resolution by removing the director in question, it almost invariably does so, as otherwise the members of that board risk removal by shareholder vote.

175 Such a removal nevertheless **does not automatically affect** the director's **free service contract**. Whether that contract can be dissolved depends on its contents, especially whether it contains a clause linking its validity to the position as board member. Obviously, this will be in the best interest of the company, but may be hard to achieve if the prospective board member is in a strong bargaining position. Otherwise and in the absence of good cause for dissolving the contract, the company will have to bargain with the director for a consensus on termination of the contract. In practice, this usually means a compensation package to the manager for the loss of income. In such situations, the board of supervisors will probably not remove the director in the first place, but try to achieve a negotiated agreement covering both the service contract and the board position, which, can of course be terminated at an earlier stage by mutual agreement as well.

176 We see that the appointment and removal of members of both the board of supervisors and the board of directors is regulated by a complex interplay of various provisions which are designed to balance the positions of the various actors. Power to appoint and remove managers is thus given to the supervisory board, which acts as a trustee for the shareholders. The independence of the managers is protected by the prohibition of removal without cause. Even though a loss of shareholder confidence is a reason for removal, this is mitigated by the fact that the decision for removal is not made directly by the shareholders (*i.e.* the majority shareholder) but by the board of supervisors, which has to act in the best interest of the company as a whole. Yet, this seemingly well-bal-

anced system favouring management stability probably works best for companies with a dispersed ownership structure despite providing directors with sometimes excessive independence. With concentrated ownership and the ensuing powerful shareholders, managerial independence is very difficult to safeguard in practice.

II. *GmbH* (Private Limited Company)

The appointment and removal process for directors of a *GmbH* differs considerably from this model. Most notably, members have a much stronger role in the entire process. This fits in conveniently with the fact that members of a *GmbH* generally have more direct influence on the company than shareholders in an *AG*. **Directors** are usually **appointed and removed by the general meeting** by simple majority. Removal is thus possible without cause and by a simple decision by the members. As a result, directors in a *GmbH* depend upon the goodwill of the members to a large extent. In any case, it is important to realise that in private companies, directors are frequently also members. As such, they can vote on any resolution concerning their own directorship. 177

This procedure is nevertheless **not mandatory**. Rather, the statutes can stipulate differently – as we have seen in Unit 1 at m.n. 32, when naming the increased flexibility as a main distinction between an *AG* and a *GmbH*. For instance, certain members can be given the right either to appoint directors directly or to nominate candidates, who then have to be approved by vote by the other members unless they are manifestly unsuitable. Similarly, the statutes can increase the majority for removal. That is, a minority member holding, *e.g.,* 30 percent can protect her/his candidate (or even herself as a director) against removal by a simple majority by means of requesting that the requisite majority be three quarters of the total number of members present. However, in all cases, (minority) members can bring a lawsuit against the company requiring removal of a director with good cause. This is important, as otherwise a majority member could block the removal of a director indefinitely – especially if the director has been distributing assets to that member to the detriment of the minority, *e.g.* by transfer pricing. 178

As far as the **directorship of certain members** is concerned, the appointment can be included **directly in the statutes** (*e.g.* 'Mr. X is a director as long as he holds any shares.'). In this case, protection against removal can be achieved in various ways via the company's statutes: by increasing the requisite majority, by requiring good cause for removal or by conferring upon the member the directorship as a personal privilege, which means that she/he cannot be removed by resolution but only by a court decision based on important grounds. This puts the member in a very strong position as the other members have to establish good cause for removal as claimants in a lawsuit. 179

As with the *AG*, we have to distinguish between the appointment as a director and the **contractual relationship** between the company (in this case represented by the members) and the individual, which *inter alia* stipulates remuneration. The director of a *GmbH* is frequently subject to directions by the members, especially if she/he is a mi- 180 nority member or not a member at all. In this case, labour law regulations apply to the contractual relationship, which typically further complicates dissolution of the labour contract. This is especially true if the contract has been entered into for a fixed term, as, in this case, dismissal must be justified by exceptional reasons.

181 If the *GmbH* has a **board of supervisors** (see above at m.n. 158), its members are appointed by a resolution of the members. Additionally, the works council appoints one employee representative for each two representatives of members. The provisions for appointment and dismissal are very similar to the *AG*.

III. Remuneration

182 The remuneration of directors is a core issue, both in practice and in public perception. For a ***GmbH***, the members fix executive compensation via a resolution. Its amount and structure is an issue of private autonomy. There is, however, one important issue resulting from the fact that managers are very often also members. The members can decide whether to remunerate such directors via executive compensation (which has to be paid even if no profits are made and reduces taxable income) or via dividends. However, if the remuneration is above market level (no transaction at arm's length), we speak of a hidden distribution with all the negative consequences mentioned in Unit 2 at m.n. 120 *et seq.* In addition, for tax purposes, the excess amount above the market rate is treated as a distribution and therefore not deductible from taxable income.

183 **Public discussion focuses on big companies** and therefore mainly on the *AG*. The board of supervisors sets executive compensation. Shareholders have no direct say on the remuneration of individual corporate officers. Shareholders in listed companies nevertheless have to pass an advisory vote on the general principles for executive compensation (so-called 'say on pay').

184 The board of supervisors must determine that total compensation is commensurate with the tasks and performance of each individual director, the situation of the company and the typical level of remuneration. Additionally, compensation should incentivise directors to support the long-term development of the company. These tenets quite clearly focus on **executive compensation as a tool for aligning managerial interests with the interests of the shareholders** and, at least to some extent, the interests of other stakeholders in the company. This is especially important for large companies with dispersed ownership, since direct monitoring of directors by the shareholders does not work well in these circumstances.

185 Meanwhile, executive compensation in large companies usually contains both fixed and variable components. The **variable components** are typically **tied to the company's performance**. This can be either done by making monetary payment contingent upon the fulfilment of aims as to some management ratios (*e.g.* ROI or EBITDA) or by giving managers the right to buy the company's shares at below market value at a certain moment of time if certain criteria are met (so-called stock option plans). The latter is typical for companies listed on the stock exchange. Such stock options can be exercised if shareholder value (usually measured by the market price of the shares) has gone up. Since the exercise price is below the market price, the director makes a profit (although, under many programmes, she/he will not be allowed to sell the shares immediately). In theory, this helps align the interests of managers and shareholders. In practice, however, it is very difficult to implement a stock option plan that achieves this aim properly. Stock option programmes, in particular, are sometimes made responsible for 'short-termism,' where directors excessively focus on short-term results (which are reflected in the share price and will make the options exercisable) at the expense of long-term interests. Of course, this depends on the exact design of the plan. That is why the Austrian Code of Corporate Governance expects companies to include measurable, long-term and sustainable criteria in stock option programmes.

Finally, one brief remark is due concerning the remuneration for members of the **186** **board of supervisors**. They usually receive fixed compensation. Variable elements are not unheard of but not common either. This is due to the fact that it would be extremely dangerous to align the interests of the supervisor completely with those of the supervised managers. Rather, they should have no direct stake in the management decisions they are supposed to control.

E. Running the Company

I. Shareholder Influence

Ultimately, the company is run in the interest of its shareholders, albeit taking into **187** account the interest of other stakeholder groups (see Unit 1 at m.n. 2 *et seq.*). This begs the question of whether and **to what extent shareholders can influence actions** by management. The answers vary considerably – both internationally, where we can find more shareholder-centric systems (such as the UK) and more management-centric jurisdictions (such as the US) – and between corporate forms, which is the subject we will explore for Austria.

For both the public (*AG*) and the private limited company (*GmbH*), the directors **188** cannot **change the basis for the company's existence** on their own, but instead require ratification by a shareholder resolution. First, this encompasses changes of the company's statutes and changes to the company's capital. If the directors *e.g.* want to increase equity by raising more capital, they need shareholder approval. Second, some fundamental corporate changes are not valid without a corresponding resolution, such as mergers (by which two separate companies are amalgamated into one entity), divisions (by which one company is separated into two) or the sale of the company's entire assets. The rules for both types of corporate forms are similar in this respect and aim at providing the shareholders with a say on certain core decisions for their investment.

Very often, though not always, the shareholders need to take the resolution with a supermajority of three-quarters. Such measures are usually invalid without appropriate involvement on the part of shareholders.

189 Austrian law provides the members of a **private limited company** with numerous additional decision rights. We have already seen that members of a *GmbH* directly appoint directors, while shareholders of an *AG* only appoint the members of the board of supervisors (see above at m.n. 167 *et seq.*). Another example is the annual accounts, which, in the case of an *AG*, are prepared by the directors and ratified by the board of supervisors without any shareholder involvement, while, in the case of a *GmbH,* ratification is done by the members. This is important as preparing the accounts is not a mechanical exercise, but includes many important decisions, such as the creation of reserves which directly influences profit margins which can, in turn, be distributed to the shareholders. Finally, and most importantly, the directors of a private limited company cannot take extraordinary decisions on their own, but have to obtain the members' approval. Hence, members must decide on all issues of crucial importance. Typically, the statutes of a private limited company contain further specifications as to which issues have to be addressed in a meeting. However, if directors fail to get the required resolution in this case, any contract they have entered into will remain valid. That is, a third party will not have to determine whether the issue is extraordinary for that particular company – a difficult guess for an outsider –, but can instead rely on the validity if she/he is in good faith. Of course, directors may face other consequences if they consult with shareholders in these situations, such as damages or loss of their directorship.

190 We have dealt with the situation that directors want to take a certain course of action and may have to put the issue to the members; in other words, management takes the initiative. Members of a private limited company can also opt to proactively give **instructions to the directors**, which the latter have to comply with. By simple majority thus, members can instruct managers to buy a certain piece of real estate or to close down a factory. Again, if the director fails to comply with such an instruction, the transaction remains valid as against a third party in good faith. It is important to note that the majority member her/himself cannot give instructions, but instead, only the shareholders via a resolution. Although the majority at the end of the day will carry the vote, the minority will at least have a voice and can bring forward their reasons.

191 Summing up, the **position of members in a *GmbH* is strong**. This is due to the fact that, typically, the (handful of) members of a *GmbH* are closely involved in running the business and there are less coordination problems between them accordingly. As long as the members are also directors, the entire question of directions will thus be moot. This can of course change over time if *e.g.* a founding member of the company dies and her/his numerous offspring are uninterested or unable to carry on the business by themselves, and prefer to rely on third-party managers. Yet even in such situations, the smaller number of members still makes direct intervention by members feasible. Of course, this brings another principal-agent conflict to the fore, namely the one between majority and minority shareholders, which we address in Unit 4 at m.n. 243 *et seq*.

Meanwhile, the situation is completely different for **public limited companies** (*AG*), wherein the directors manage the company 'on their own responsibility'. This is generally understood to mean that they cannot be given instructions on how to manage the company, either by the shareholders or by the board of supervisors. In particular, this does not only refer to ordinary business transactions but (with one exception we will deal with forthwith) also to extraordinary measures as long as there is no explicit need for a shareholder resolution such as with mergers (see above at m.n. 188). **192**

This **managerial independence** can be justified by the fact that small shareholders may find it hard to reach an informed decision on difficult business issues. This is not a judgment on their capacity but due to the fact that a small investment does not justify expending the time necessary for fully appreciating the business issue at stake. Noteworthy, however, are other jurisdictions, such as the UK, which take a different stance and empower shareholders even in companies with dispersed ownership, to take business decisions. Additionally, managerial independence can provide a certain cushion against wishes by the majority shareholder which could be detrimental to the company as a whole even if beneficial to the majority (*e.g.* inflated transfer prices for a subsidiary's purchases from its parent company). From that point of view, it helps in protecting the interest of the minority shareholders. That may sound more important than it actually is because directors may still be willing to follow the (majority) shareholder's wishes despite shareholder instructions lacking binding effect. Otherwise, the directors may risk their directorship, at least in the long run, but in the worst case, also by a resolution of 'no confidence' in the next shareholder meeting. **193**

One important issue of shareholder involvement remains unresolved in practice. Is the statutory enumeration of issues require shareholders' consultation conclusive or are **transactions of comparable importance** for the shareholders covered by analogy? If, for example, a deal does not amount to a merger in the legal sense but is structured differently, albeit with a comparable result, do the directors have to call a meeting on the issue? Although this remains unsettled by court decisions, careful directors tend to place such issues on the shareholders' shoulders. **194**

Finally, directors need **approval by the board of supervisors** if they want to take material decisions, such as a change in corporate strategy or the closure of a plant. This means that the supervisors participate in core business decisions, which also ensures that they will have to be informed properly. This is nevertheless different to a right to instruct directors, as, management still has to take the initiative. In other words, the board of supervisors can prohibit certain measures, but cannot actively order the directors to take a certain course of action. Once again, in practice, the right of the board to remove directors with cause may make the managers more compliant with the supervisor's wishes. As with the approval by the members of a *GmbH,* the lack of approval will nevertheless not affect the validity of a transaction entered into with a third party which is in good faith. **195**

II. Internal Decision-Making Process

196 Most companies, especially public ones, feature boards of more than one director. How do these boards reach a decision? As a default rule, decisions on the part of the directors of a **public limited company** are taken by **majority vote**. If the vote is tied, the CEO's vote decides. For a **private limited company**, the default rule is more cumbersome: **all directors must agree** on a measure.

197 This may not be in the best interests of a functioning business, especially if consent of all directors is required. To that extent, the statutes or resolutions by the board of supervisors often deviate from this default rule, typically via an **assignment of different responsibilities to individual directors**, such as the responsibility for financial issues to the Chief Financial Officer (CFO) or for the running of the production plant to the Chief Operating Officer (COO). Within the allocated field, each director may take the decisions on her/his own. This does not, however, result in a complete separation of responsibilities, for two reasons. First, each director has to supervise the others' areas of responsibility. Each director may object to a management decision by another director, which results in the issue being treated by the entire board. Although such an objection will potentially disrupt the smooth collaboration process between directors, directors may have to take this step in order to avoid personal liability for harmful decisions by other directors. Second, a number of crucial issues, such as introducing and maintaining adequate accounting and internal control systems (in order to detect potential hazards to the company) or deciding to file for insolvency, cannot be delegated to single directors but instead fall within the responsibility of the entire board.

198 The **board of supervisors** is not involved in the running of the company. Its members dedicate only part of their time to the company, although with large companies, such as banks, the Chairman of the board of supervisors may in fact work (almost) full time. The Chairman is elected by the board members themselves (not by the shareholders), again by a double majority of both the board in its entirety and of the representatives of the shareholders. The board decides via resolutions taken in board meetings or via (written) circular resolution. The latter involves the disadvantage that no discussion of the issue is possible. For that reason, each member can demand a meeting. Resolutions are taken by a simple majority of all members (circular resolution) or of the members present (resolution in meeting). The statutes may give the Chairman the casting vote. In order to inform the board of supervisors properly, the directors have to provide a comprehensive report at least once annually. In practice, in order to ensure good information flow, directors are regularly present at meetings of the board of supervisors, with the exceptions of meetings affecting their personal position.

199 Most boards of supervisors install **committees** either to prepare decisions by the full board or to take the decision directly. In order to safeguard employee influence in the board, a third of the members of each committee have to be employee representatives, with the exception of the committee dealing with the details of director remuneration.

Core decisions, *e.g.* on the annual accounts, have to be taken by the full board, but can be prepared by a committee. Listed and very large companies have to appoint an audit committee responsible for supervising accounting and control systems and preparing the decision on the annual accounts. Such committees have been introduced in most jurisdictions over the last 20 years in the wake of various scandals in order to help avoid corporate insolvencies due to inadequate accounting and control instruments.

F. Liability

Liability for damage in our legal order fulfils (at least) two different functions. First, the damaged party may get **compensation** from the party liable for the damage (compensation function). Second, the (potential) injurer is **incentivised to avoid inflicting damage** if she/he is likely to have to pay damages (incentive function). One major tenet of tort law – namely that the injurer will only incur liability if she/he is at fault – is also applicable in the context of company law. Hence, managers do not become liable due to a simple lack of success. Instead, shareholders have to bear this risk. Managers will only be liable if they do not fulfil a specific legal duty and, additionally, if they are to blame, *i.e.* if they have acted negligently or have wilfully inflicted damage. **200**

As far as the damaged party is concerned, we have to distinguish between **damage incurred by the company** – which will be the main topic here – and damage incurred by a third party, especially creditors or investors. Directors are normally not held to be liable against third parties that have been damaged by the company. The third party will have to look for recourse against the company itself. Of course, this rule has numerous exceptions. These exceptions are not, however, within the purview of company law but in other areas of law. We have already seen one example in Unit 2 (at m.n. 135 *et seq.*), namely the liability of directors under insolvency law, but cannot explore this issue in further detail at this time. **201**

From a business perspective, **damage to the company results in damage to its shareholders** as their shares will lose in value. Let us imagine that a managerial mistake costs the company € 200 million. That loss in company value will have an immediate effect on the market price of the shares on the stock exchange (at least if the capital market is reasonably efficient). In principle, the damage could be compensated via the company or directly to the shareholder via a monetary payment. In both cases, shareholders would be compensated for their losses. From a legal point of view, however, the company has incurred the damage and the loss of share value is only a reflex of this primary damage. Any compensation must thus be made at company level and not directly to the shareholder. This helps in avoiding many small payments to individual shareholders and concentrates the proceedings at the level of the company. Only if the damage incurred by a shareholder involves no corresponding loss at company level, may shareholders subsequently bring a claim themselves. Take the case of a director making **202** misleading statements about the value of the shares to be acquired by a potential investor, *e.g.* by overstating the company's business prospects. There is no concomitant loss at company level, but only by the shareholder if she/he acquires the shares.

203 The risk of the business activity as such remains with the company's shareholders. Directors and members of the board of supervisors only become liable if they **violate specific duties**. We cannot explore all of these duties in the present context, but give some general orientation. We will focus on directors, but the following is applicable to members of the board of supervisors as well, always taking into account their different function and the fact that they are only active part-time and thus cannot be held to the same level of familiarity with the company's affairs as directors.

204 First, directors are subject to **duties of loyalty** (*Treuepflicht, Loyalitätspflicht*), which are designed to align the manager's interests with the interests of the company. A good example is the prohibition on competing with the company in its line of business. Another is the obligation of confidentiality, especially salient if managers conspire to use the company's business secrets for their own purposes. Negligent or wilful violations of these duties will usually result in personal liability in case of the company incurring damage.

205 Second, directors are under a **duty of care** (*Sorgfaltspflicht*). They have to act with the 'due care of a proper manager'. This means that there is an objective standard of care which does not depend on the skills of the individual manager, but is determined by the objective requirements of the business.

206 With the duty of care, there is a real **danger that judges will second-guess business decisions** on their merits. This is generally considered to be undesirable for at least two reasons. First, judges generally lack intimate knowledge of the business issues involved in the decision and thus may not be the best arbiters on such topics. Second, if a liability suit is brought against a director, the negative outcome of the decision is a fact known to the judge. In such a situation, judges (like all of us) are likely to overestimate the probability of such a negative outcome at the moment the business decision was made (*i.e. ex ante*) and may therefore see managerial negligence ex post, taking into account the actual developments (so-called 'hindsight bias'). This can lead to over-deterrence and to managers unwilling to take risky business decisions. This is not in the best interest of the shareholders as risky business ventures are usually those with the highest expected returns. This is not to be understood to mean that higher risk as such is positive (especially not if it is potentially threatening the company's existence), but that a certain amount of risk-taking may be beneficial to the company. Summing up, managers should not become risk averse on account of the danger of judicial review of their business decisions in liability suits. Additionally, as the sums involved may be huge, liability suits can potentially threaten the manager's future livelihood.

207 To avoid this, company law privileges business decisions to some extent. A manager is deemed to act with due care (and, therefore, will not become liable) if she/he takes a business decision without a conflict of interest, on the basis of adequate information and if that decision is not manifestly inappropriate (so-called **business judgment rule**). In substance, this means that courts will show deference to business decisions if these conditions are met. However, managers will still have to act carefully and, especially important, obtain adequate information to serve as a basis from which to judge, with crucial decisions generally requiring more careful preparation. Even if liability materialises, most directors, especially of larger companies, are protected by D&O insurance (director's and officer's liability), at least up to the maximum amount covered.

At least as important as these material rules is procedure, especially **who can bring such a lawsuit against directors** on behalf of the company. With a public limited company (*AG*), this lies with the board of supervisors, and in case of a private limited company (*GmbH*), with its members. Hence, as long as the directors are supported by the shareholders or at least the major shareholder, they are not exposed to liability in practice. This is especially important if the directors have acted to the benefit of a large shareholder but to the company's detriment. In order to overcome this, minority shareholders holding 10 percent can raise a liability claim. These shareholders, however, often lack the requisite information about the company's affairs or are unwilling to take the cost risks involved with bringing a lawsuit – they may be rationally apathetic. In reality, liability lawsuits pose threats in two distinct circumstances: first, if the former dominant shareholder sells her/his shares and the new incumbent discovers what has happened and, second, if the company becomes insolvent as such claims will then be brought by the insolvency administrator on behalf of the creditors. **208**

Relevant Literature and Further Reading

Armour/Enriques et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd edn., 2017) 49–77.

Davies, Introduction to Company Law (2nd edn., 2010) 103–217.

Questions

1. Recap central issues of the principal agent conflict between managers and shareholders.
2. What are the differences between the one tier and the two tier board structure? Are there similarities?
3. What is the purpose of board level employee representation? How does it work?
4. Are independent directors a good idea? What does independence mean?
5. What does it mean that directors 'represent' the company? How does representation work?
6. Who appoints and removes members of the board of supervisors?
7. Explain the rules for appointing directors in an AG or a GmbH. What about their removal?
8. Can minority members of a GmbH ensure that they can appoint (some) directors? Is this possible for shareholders in an AG?
9. Explain the effects of removal of a director on the director's employment or service contract.
10. How are managers remunerated?
11. Can shareholders of an AG or directors of a GmbH give directions to managers?

12. What is the role of the board of supervisors in an AG? Can it give instructions to managers?
13. Should directors' liability be strict or lenient? Analyse the effects of liability rules.
14. What is the business judgment rule?
15. Who gets compensation for damage under which circumstances: the company or the shareholders directly?

Unit 4: Membership in Companies

A. Purpose of this Unit

This unit will start by elaborating on the **rights and duties of the company's members**. To this end, we will put a special focus on the right to vote as it is crucial for corporate governance. Next, we will briefly describe **how general meetings work** and highlight some of the most important **differences between public and private companies**. We will then look at the dominant **principal-agent conflict** in companies with a dominant shareholder, namely the one between the majority shareholder on the one hand, and the minority shareholder(s) on the other. In this context, we will also briefly revisit some topics we have already touched upon in earlier units. We will conclude by exploring another issue of high practical importance: how can shareholders **acquire or dispose of their shares**? At the end of the unit, you should have a good overview of a member's position in the company and be able to identify the core issues in conflicts between the majority and the minority. **209**

B. Rights and Duties

I. Financial Duties

The main duty of each member is to **pay her/his contribution**, either initially, upon foundation of the company, or at a later stage, when capital is increased. Shares of members who do not make their contribution in time can be forfeited, albeit only after going through lengthy proceedings. Forfeiture means that the shareholder will be dispossessed of her/his shares and any former owners of the shares will have to make the corresponding payment. Ultimately, the share will be sold on the market. With the private limited company, any shortfall which has not been recovered by a market sale will have to be made up by the other members. Shareholders in a public limited company are not exposed to this liability risk. Otherwise, buying shares on the stock exchange would be a risky venture as the eventual downside would depend on the financial position of the co-shareholders. **210**

Apart from their initial contribution, shareholders in a public limited company are **not obliged to make additional payments**. Such a duty cannot be introduced in the company's statute. Shareholders can, however, generally enter into separate agreements, *i.e.* not in the statutes but in a subcontract between the shareholders. Such an agreement can contain an obligation to provide additional finance which will then be enforced by the courts. With private limited companies, such obligations can be included in the statutes. In practice, this means that the duty to contribute can be enforced not only against the initial members, but likewise against members who have not cofounded the company, but have acquired their membership at a later stage. **211**

II. Duty of Loyalty

212 Generally, shareholders are subject to a **duty of loyalty**, both against the company and against the other shareholders. As shareholders come together to achieve a common purpose, they may not frustrate that purpose by acting to the detriment of the company. However, the **precise nature** of this duty of loyalty is **hard to define** and depends very much on the specific circumstances. For example, such duties will be more significant in a company with few members active in the pursuit of the business purpose than in a company listed on the stock exchange with thousands of small investors as shareholders. Additionally, the answers will also depend on the nature of the right which the shareholder exercises. That is, the duty of loyalty will not kick in easily if members decide on the distribution of profits, but will be more important if the topic is whether to instruct directors on entering into a contract on behalf of the company. Two examples may suffice:

– **May a shareholder compete with the company in its line of business?** Obviously, this would be extremely inequitable if two members have come together to run a business enterprise and one of the members then acts on her/his own account. This member will most probably have violated her/his duty of loyalty if competition was not expressly allowed in the corporate statutes. By contrast, the situation is very different if the company is listed on the stock exchange and a competitor buys some shares. It will not have to close down its own line of business after the acquisition of the stake. Quite obviously, the duty of loyalty will be less prominent. Of course, these cases are extremes. The hard cases lie somewhere in between.
– **Do members have to take the company's interest into account when they decide on the distribution of profits?** The general answer is, *no*, as members have a right to receive a dividend and may exercise that right even if the company could reinvest the money successfully and even if the shareholder requests payment in order to misspend the money. The scenario may be quite different if the company needs liquidity urgently in order to meet due liabilities or else face insolvency. Under such circumstances, shareholders will have to forego their right to a dividend on the basis of the duty of loyalty. Again, there may be other situations in which the issue is less clear.

213 We have seen that the duty of loyalty is not a precise rule ('If X happens, then Y has to be done.'), but rather a **general principle** which has to be specified according to the precise circumstances of the case. In the parlance of law and economics, this is a '**standard**' which leaves the precise determination of compliance up to the judge. Company law makes use of such standards since it is impossible to determine the appropriate handling of each and every one of the myriad different situations that may arise during a company's lifetime by precise legal rules. If the law uses a standard, the **courts will have to determine its correct application *ex post***. By this means it is obviously easier to achieve justice, since standards cannot be circumvented easily due to their open-ended nature (other than rules where it is possible to comply with the word-

ing of the rule but not with its spirit). Hence, the duty of loyalty —as any standard – provides judges with considerable power and requires well-intentioned and capable adjudicators. Over time, the evolving body of decisions will give further guidance as to the standard's correct application – in this case, the duty of loyalty. This also alleviates to some extent one considerable disadvantage inherent with standards, namely, that the results of their application are hard to predict for the parties involved *ex ante* as they can only be adjudicated upon *ex post*.

III. Financial Rights

Shareholders are usually invested in order to make a profit although other motives may play a role, such as the ecologically motivated wish to develop a more environmentally-friendly combustion engine via a business venture. The **core rights of the shareholders are thus of a financial nature**. All other rights, such as the right to vote, serve the protection of these central entitlements. 214

The most important right is the **entitlement to receive a dividend**. A dividend can only be paid, however, if the company makes a distributable profit. We have already discussed that substantive accounting rules determine the amount of profit that can be distributed (Unit 2 at m.n. 114 *et seq.*). We have also discussed the preparation and ratification of the annual accounts (Unit 3 at m.n. 189). With an *AG,* they are prepared by the directors and ratified by the board of supervisors without any shareholder involvement, while with a *GmbH,* ratification is done by the members. Additionally, the accounts of larger companies have to be audited externally (see Unit 2 at m.n. 79). Those who prepare and ratify the accounts also decide on the creation of reserves. These are the parts of the annual surplus that are not distributed to the shareholders as dividends, but withheld in order to provide a cushion for future losses or to improve the company's capital ratios. This is especially true for the *AG*, where that power lies with the directors and the board of supervisors, while for a *GmbH,* the statutes have to foresee the creation of reserves. Otherwise, in principle, the entire profit of a private limited company would have to be distributed to the members. 215

Once the profits are determined, they are typically distributed to the shareholders **in proportion to their financial investment**. The statutes may provide for other types of distribution of dividends, *e.g.* asymmetrical distributions in which only some shareholders receive dividends. In Austria, the dividend is usually expressed as a percentage of the nominal value of the shares. A dividend of six percent for a share with a nominal value of €100 will be €6, for example. However, the return on the money invested is more interesting from the business point of view. That is, if the shareholder has paid € 200 for the aforementioned share on the stock exchange, the return (or yield) will only be three percent. 216

Additionally, shareholders enjoy a number of **secondary financial rights**, such as the **entitlement to receive a proportional part of the proceeds of liquidation** if the company 217 is dissolved. Of these, the so-called preemptive right is of special importance. If a company decides to increase its capital, each shareholder has the **right to receive new shares in proportion to her/his holding**. There are two reasons for this. First, without such a preemptive right, the member's holding – expressed as a percentage of total shares – would get diluted after the capital increase as, for example, her/his 1,000 shares would not represent ten percent of the company's capital any longer, but only five percent; this would result in a proportional loss in voting power. Second, new shares are typically issued at a discount when compared to their market value in order to encourage subscription. Since the new shares have the same rights as the old ones, but are issued at a discount, this results in a loss of value for the old shares. The holders of old shares can protect themselves either by exercising their preemptive rights and buying new shares cheaply (thereby offsetting the loss in value) or by selling the preemptive rights to potential subscribers. The company can exclude this preemptive right. In this case, however, the company has to present a good reason which can be reviewed by the courts upon shareholder application. Additionally, in such a situation, the shares usually have to be issued at the market price.

IV. Voting Right

218 Shareholders have a number of **rights intended to protect their main interest in receiving a dividend**. Among these are the right to attend the general meeting, the right to table motions at the meeting, and the right to speak in the meeting. The most important of these rights is the **right to vote**. As a default rule, each Euro invested in the company conveys an equal number of voting rights (proportional voting rights or, in common parlance, the principle of 'one share one vote'). It follows then, that economic exposure to the risks connected to the company and control are aligned. However, such a rule obviously makes minority shareholders vulnerable to opportunistic behaviour by the majority. We will discuss various protective measures and instruments below (at m.n. 246 *et seq.*).

219 The '**one share one vote**' principle is only a default rule; the company's statute may well provide otherwise. This is especially salient with the private limited company (*GmbH*), where the members' discretion upon setting up the company is virtually unfettered. Each member must nevertheless have at least one vote. For example, each member may have the same number of votes, irrespective of her/his financial engagement. More generally, each member may receive voting rights in a different proportion to the contribution of capital. That is, a minority shareholder – in terms of contributions to capital – may hold a majority of voting rights and have the power to decide on corporate affairs. Additionally, the founders may introduce higher majority requirements than the simple majority prescribed by law. Hence, they can achieve a different but somewhat similar effect to non-proportionate voting powers, namely, by giving a blocking position to single members with a comparatively low capital contribution.

220 Austrian law is less permissive for the public limited company (*AG*). Generally, the 'one share one vote' principle is mandatory, at least for fully paid shares. Multiple voting rights empowering single shareholders disproportionally are, however, prohibited. There are nevertheless **two exceptions** to the 'one share one vote' rule.

221 First, the company may issue so-called **preferential shares** without voting rights. Such shares entitle shareholders to a preferential dividend of, *e.g.* six percent before any further distributions to other shareholders can be made. In return, these holders of preferential shares cannot vote on almost any corporate resolutions. If the preferential divided is not paid for two consecutive years (which will happen if the company does not make any distributable profits), the shares' voting power is reinstituted until all arrears are settled. Such preferential shares are an attractive way for controlling shareholders to raise new equity without losing control. However, the company can only issue preferential shares without voting rights in the amount of up to a third of the company's total capital in order to limit this imbalance between financial exposure and control.

222 Second, the company's statute can introduce so-called **voting caps**, which put an upper limit to the number of votes a single shareholder can exercise. A voting cap of ten percent means, for example, that a shareholder holding 40 percent of the shares will still have only ten percent of the votes. Hence, voting caps do not empower single shareholders, but dilute the voting power of large investors. Obviously, the aim is to deter the creation of large blocks of shares. Thus, a person holding 25 percent of the shares may be interested in introducing a voting cap of 25 percent to make sure that she/he cannot be outvoted in the general meeting.

223 Apart from such general limitations of voting power, **shareholders can be barred from voting in particular cases**. The law enumerates various instances, such as resolutions releasing a shareholder from a duty or allocating a benefit to the shareholder, resolutions on pursuing a claim against the shareholder or, for the *GmbH*, resolutions on a contract between the company and its member. The prohibition on voting is based on the strong conflict of interest in these cases and the consequent danger that the shareholder is likely to pursue her/his own interest to the detriment of the company. There is nevertheless no general rule that shareholders may not vote on resolutions if there is a conflict of interest outside of the instances mentioned in the law. Members of a *GmbH* may, for example, exercise their voting right on resolutions concerning their own directorship (for example, appointment or dismissal).

224 Shareholders are **generally free to decide how to exercise their voting rights**. Limitations may nevertheless arise from the duties of loyalty (above at m.n. 212 *et seq.*) and the equal treatment principle (below at m.n. 251). This is especially important for the protection of shareholder minorities.

V. Right to Information

225 In order to exercise her/his voting right, the shareholder above all **needs information** about the issue on which she/he is to vote. This topic is crucial, as there is strong information asymmetry between the directors – who typically prepare the general meeting – and the shareholders. Directors can try to steer the vote into the direction they favour by providing shareholders with partial or distorted information. For some issues, such as the exclusion of the preemptive rights mentioned above, the law contains special obligations in terms of providing the information. That is, directors have to provide shareholders with a report on the reasons for the measure. For most issues, such specific rules are missing. Again, we will have to distinguish between public and private limited companies:

226 In an ***AG***, shareholders **can request management in the general meeting to pursue any specifics necessary for addressing an item on the meeting's agenda**. As at the annual general meeting, typically the accounts for the last business year are discussed, and shareholders may ask for information on that year's affairs. The directors can only refuse disclosure if it is likely to cause the company (or other companies in the same group) considerable detriment. **Outside of the general meeting, shareholders cannot force management to provide information on certain issues**. Directors may do so, especially with important investors or, even more pertinently, with any parent company. Providing information to some but not to all shareholders usually, however, needs some specific justification. In sum, the position of shareholders is, at least outside of the general meeting, rather weak.

227 Not surprisingly, the position of members of a ***GmbH*** is much stronger. First, for the purpose of deciding on the annual accounts, each member has the **right to inspect the company's books**. This means that members have unfettered access to the company's affairs. Second, the courts have provided members with a **general right to information** about the corporate affairs without a duty to provide reasons. This results from the fact that, ultimately, members decide on the company's affairs (see Unit 3 at m.n. 187 *et seq.*). However, such a right may be dangerous for the company. Just imagine that a competitor buys a share in the company and then makes use of its information right in order to gain access to the company's business secrets. In such cases, the right to information may be adequately limited. Unsurprisingly, such situations easily become very contentious and are often brought before the courts.

C. Shareholder Resolutions

I. Public Limited Company

228 Shareholders of an *AG* **decide on core issues** that are of special relevance for the company, *e.g.* the appointment of members of the board of supervisors or certain core

transactions (see Unit 3 at m.n. 167 *et seq.* and m.n. 188). They have to take their decisions in a **general meeting**. In Austria, this is still required to be a physical meeting; purely electronic meetings are not permitted with a public limited company. There are **two types of shareholder meetings**: the **annual general meeting**, which decides within the first eight months of the following business year on the distribution of last year's profits and the approval of the actions of the board members, and **any extraordinary general meeting**, which may be called for adopting resolutions on issues that cannot be postponed until the next annual general meeting, such as an urgent increase of capital or a merger.

The meeting is **usually convened by the directors**. This has to be done at least 229
28 days before the meeting for larger companies with an anonymous membership, by means of publication in newspapers, among them the so-called *Amtsblatt zur Wiener Zeitung*, a central repository for company-related information. This minimum time limit gives shareholders the opportunity to prepare properly, but on the other hand, makes convening a meeting a cumbersome and slow procedure.

The **chairman of the board of supervisors** (sometimes the gender neutral 'chair- 230
person' is used) chairs the meeting. He or she **decides on the order of business within the agenda**. The agenda is nevertheless binding; any issues that were not included in the initial agenda or added in due time cannot be dealt with in the meeting unless all shareholders agree. The meeting **can take resolutions irrespective of the number of shareholders present or represented**. All resolutions are notarised (*i.e.* attested by a notary public, who is a qualified lawyer empowered by the state to certify certain transactions or facts). Again, the formalities connected with a general meeting in a public limited company guarantee an orderly meeting to the largest extent possible, but are time-consuming and costly.

Besides the directors and the members of the board of supervisors, every share- 231
holder has the **right to participate** in the general meeting regardless of whether she/he has the right to vote. Other interested parties, such as the press, may be invited, but have no right to participate. For unlisted companies, this means that shareholders have a right to attend if they are registered at the moment the meeting commences (see below at m.n. 264 *et seq.*). Companies listed on a stock exchange usually issue bearer shares without a share register. In this case, a 'custody receipt' issued by the bank with which the shares are deposited typically furnishes proof of ownership (see at m.n. 266). With these listed companies, proof of ownership refers to ownership ten days before the day of the meeting. This helps in avoiding technical problems, as, ownership at the moment of the meeting would be nearly impossible to establish.

One major issue in practice is the fact that **attendance at general meetings can** 232
be very low. This is not an issue for companies with few shareholders, who typically attend but for *AGs* with dispersed ownership or a large free float, *i.e.* large listed companies. With such companies, major shareholders (if any) usually attend while smaller owners do not take advantage of their voting rights. In law and economics terms, this

is called 'rational apathy'. That is, it is rational not to engage with the company as, first, it is unlikely that the votes connected to a small stake will tip the balance and as, secondly, the returns expected from a small stake do not justify the effort involved, i.e. familiarizing oneself with the issues and attending the meeting.

233 This **issue of rational apathy** can be potentially overcome by institutional investors (such as pension funds, investment vehicles, or insurance companies) who aggregate many smaller stakes and can thus more easily bear the cost of negotiating with the company at a substantial level. Increased participation by these investors is thought to improve corporate governance, especially in companies without a dominant shareholder. Hence, legislators across the globe intend to motivate institutional investors to make use of their voting power. However, many institutional investors have been reluctant to engage with the companies they are invested in for the purpose of diversifying the risks involved, as they tend to have stakes in hundreds if not thousands of companies. Involvement in every single case would substantially increase the cost of administration, which would obviously have a negative effect on the institutional investor's returns. That is, if an investment fund spends € 100,000 on investigating corporate affairs in order to properly cast its votes, that means € 100,000 less will be available for distribution to its investors – unless, as a result of the institutional investor's actions, the company's returns improve. As a general rule, institutional investors who are dissatisfied with a company's returns do not try to change the company's policies or corporate governance, but follow the so-called 'Wall Street rule' by selling their shares. Let us look at some of the instruments which supposedly lower the barriers to engagement by institutional investors.

234 First, Austrian public limited companies may choose to allow different **forms of distance participation** in their statutes: satellite meetings with real-time transmission, real-time two-way communication enabling shareholders to address the general meeting from a remote location, or a mechanism for casting votes without one's physical presence. Although this may seem like a modern way of participation and could indeed certainly lower barriers for participation – especially for investors from abroad – in practice, however, hardly any companies have ever made use of such a system due to the consequences of potential errors, which could, in turn, easily invalidate the decisions taken in the meeting.

235 Second, this does not mean that shareholders, among them institutional investors, have to attend the meeting in person. They may **authorise third parties** to attend the meeting on their behalf and to cast the votes vested in their shares, either according to explicit instructions for the different resolutions on the agenda or by instructing the representative to cast the vote in the best interest of the principal. In international parlance, both the representative and the underlying authorisation are generally referred to as 'proxy'. Typically, banks are provided with proxies for their custodial shares. Unless combined with specific instructions, this will give banks considerable voting power in the meeting. In companies without a controlling shareholder, contentious issues often

lead to proxy solicitations, where either management or a shareholder (or both) requests other shareholders to provide them with proxies to vote for or against certain proposals. Such proxy fights are very unusual in Austria, as most listed companies have a dominant shareholder. However, for crucial issues which require a supermajority (see below at m.n. 246 *et seq.*), votes cast by proxy may be decisive.

Third, institutional investors are coming under **increasing pressure to cast their votes**. To some extent, it can be argued that exercising the votes is part of the due management of their investor's money and, therefore, a failure to vote may constitute a violation of the institutional investor's duty of care. This point is, however, less than clear as investors may prefer the cost advantages resulting from not engaging with the companies. This can be demonstrated by index-tracking funds which invest in shares in the proportion of their representation in a specific index. This is cost-saving, as, such a fund does not have to make any investment decisions based on an analysis of a certain company's potential. These cost advantages would be (at least partly) consumed by the costs of a duty to engage; thus, in these cases, engaging with the company will not be in the best interest of investors. Internationally, there is a tendency to employ soft law instead, in the form of so-called 'stewardship codes,' which operate on principles similar to corporate governance codes. That is, investors are supposed to engage and have to provide justification for not doing so. **236**

Fourth, this increased pressure on institutional investors to engage has elicited a market response. With so-called '**proxy advisors**,' a new profession has emerged in recent decades. Their business model is analysing the proposals for upcoming general meetings and advising their clients – typically institutional investors – on how to cast their votes on these proposals. Institutional investors following these recommendations will have complied with the expectation to vote without a significant increase in expenditure on company-specific research. Recently, concerns have been voiced that proxy advisors amass considerable power without being themselves subject to the consequences of their recommendations, as they generally do not hold shares in the companies they provide advice about. Additionally, this is a very concentrated market with dominant players from abroad. These advisors tend to have little insights into the workings of smaller markets with corporate governance systems different to the Anglo-Saxon model. **237**

As a result, the issue of **activating shareholders remains on the agenda** for listed companies. Before turning to the very different situation for private companies, let us briefly mention that some shareholders in listed companies actively try to influence managers even though their holding is comparatively small. These so-called 'activist shareholders' use public pressure and informal coalitions with other shareholders in order to further their aims, which may be improvements in corporate governance or a change in business strategy. **238**

II. Private Limited Company

239 Incentivising members to vote is not usually an issue with a *GmbH* as the number of members is typically much smaller than in a listed *AG*. As we have already seen, the members of such a private limited company under Austrian law **can influence corporate affairs to a larger extent** than shareholders in a public limited company, *e.g.* by appointing directors, by determining the annual accounts, or, more generally, by instructing directors to pursue a certain course of action (for details see Unit 3 at m.n. 177 *et seq.* and m.n. 187 *et seq.*). The members have to take resolutions at least once a year in order to pass the terms of the annual accounts.

240 Convening and holding the general meeting of a *GmbH* requires **fewer formalities** than with a public limited company. The directors usually convene the meeting; the statutes very often determine in great detail, under which circumstances the directors are under a duty to do so, *e.g.* if they want to enter into certain substantial transactions on behalf of the company. The meeting has to be convened at least seven days before the date of the meeting by registered letter to the members entered into the business register (for the register see below at m.n. 269). The articles may empower others, *e.g.* members, to convene a meeting and may define other methods for convening, *e.g.* by email. Again, the general meeting can only make decisions on issues that have been included in the agenda on time, as each member must have been afforded the opportunity to prepare properly well in advance. Of course, a core issue is the granularity with which the issues have to be announced. Does an agenda referring to 'personal matter' cover the removal of a director? According to Austrian jurisprudence, it does not (unless all members are represented at the meeting and agree to treating the issue); the company would have to announce 'removal and appointment of directors'.

241 The general meeting will have a quorum of **at least ten percent of the members present or represented by proxy**. If this quorum is not achieved, the company will have to convene another meeting, which can take resolutions irrespective of attendance. The statute may set a higher quorum, which can be used to ensure that minority shareholders can block decisions by not appearing at the meeting. The law does not specify who chairs the meeting and who therefore, *inter alia*, has the power to declare the results of a vote by members. This is indeed a crucial issue, as, any resolution recorded by the chairman is normally valid until invalidated by a court, which in effect means that the chairman decides on who has to bring a claim. This issue has to be settled either in the statutes or by vote at the beginning of the meeting – which, in practice, may very well be the first contentious issue if the members disagree in substance about the issues to be resolved in the meeting.

242 Importantly, members do not have to convene in order to take a resolution. Rather, on almost all issues, they can take **written resolutions outside of a meeting**. Each member can, however, demand a physical meeting. This is important as a discussion of the issue may bring forward convincing arguments which may influence the outcome of

the vote. As a result, a proper written resolution always has to seek approval on two topics: the method of taking a resolution and the substantial issue. In practice, written resolutions can substantially ease and accelerate decision-making in private limited companies, even on crucial issues such as passing the resolution on the annual accounts. Additionally, members can unanimously forego the formalities required for a physical meeting, such as a proper invitation and agenda. Ultimately, as long as all members agree in substance, few formal requirements have to be adhered to under normal circumstances.

D. Minority Shareholder Protection

I. Introduction

We have already seen in Unit 1 (at m.n. 62) that, due to the typical shareholder **243**
structure, the dominant **principal-agent conflict** in Austria is the one **between the majority and the minority shareholders**. This does not only refer to closely-held companies (either public or private), but even to public limited companies listed on the stock exchange, which typically have a controlling shareholder or a controlling group of shareholders. Hence, unsurprisingly, the issue of protection of minority shareholders against the majority (and not against management) is of core importance in Austria (and in other countries with controlling block holders).

The central problem in this context is the extent to which controlling shareholders **244**
can obtain so-called '**private benefits of control**,' *i.e.* disproportionate returns on their investment, often to the detriment of minority shareholders. The easier it is to obtain these benefits, the more likely it is that controlling blocks will arise, as, an acquirer of such a controlling block (not of the entirety of the share capital!) will be able to pay more than the aggregated market value of the shares she takes up. The difference between the aggregated market value of the shares and the (higher) value of the entire controlling block is called the '**control premium**'. Obviously, block holders want to protect their position once they have made an investment in a block of shares. That is the reason why – at least in some jurisdictions with controlling block holders – it can be difficult to pass legislation favouring minority shareholders.

We will now briefly look at some various **mechanisms and instruments** which Aus- **245**
trian law provides for the purpose of **protecting minority shareholders**. We will also return to the topic of private ordering, which covers all measures minority shareholders can take on a contractual basis to protect themselves. In most cases, this obviously has to be done when making the investment in the first place. Some other measures can be taken *ex post*, that is, at the moment the majority shareholder has abused her/his position.

II. Shareholder Resolutions

246 If we look at shareholder resolutions, it is obvious that the majority will normally carry the day as typically a resolution can be passed by a **simple majority of the votes cast at the meeting** (in the case of written resolutions of a GmbH, the majority is calculated on the basis of all issued shares with voting rights). However, for a number of decisions, the law requires a super-majority of three-quarters of the capital represented in the meeting, either as a default rule, which can be deviated from in the corporate statutes, or as mandatory law.

An example is a resolution amending the company's statute, for which a majority of three-quarters of the capital represented is required. The original statute may nevertheless deviate from this, especially by requiring a simple majority only for the *AG*, while for the *GmbH,* the requisite majority can only be increased.

247 The fact that a majority resolution is sufficient constitutes a deviation from a core tenet of contract law since, **generally**, a change of a contract (such as the statute of the company) requires the **consent of all parties**. In the context of company law, this would give every shareholder a blocking position. Since the company's statute may need amendments from time to time due to its long-term nature and the fact that changing circumstances may require changes to the statute, company law permits amendments of the company's contractual basis by majority decision.

248 **Individual consent** is generally only required if an amendment were to divest shareholders of specific rights connected to their shares, such as the free transferability of the shares (see below at m.n. 272) or the right to receive a preferential premium (see above at m.n. 221). Similarly, every shareholder has to give her/his consent if she/he is to make additional contributions.

As always, there are some exceptions to this general rule, such as a change of a *GmbH*'s line of business, which requires a unanimous decision in the meeting, unless the statute stipulates a lower majority of at least three quarters.

249 As a general rule, the mandatory **super-majority of three quarters** covers especially important issues, such as increases in capital without preemptive rights (above at m.n. 217) or mergers. This is why a minority position with at least 25 percent of the voting capital gives the shareholder a so-called 'blocking minority' for many relevant decisions. In practice, the majority shareholder has to strike a bargain with the blockholder in order to get the required majority for these issues. For a very few issues, such as the squeeze-out of a minority (see below at m.n. 278 *et seq.*), the law even requires a supermajority of 90 percent.

250 Additionally, minority shareholders can protect themselves by bargaining for including the requirement of a **supermajority in the company's statute for additional issues**. This is possible for most topics, both in an *AG* and a *GmbH*. Similarly, minority shareholders can request that voting caps be included in the statute or – in the case of a *GmbH* – that they be allocated a disproportionate number of voting rights.

Apart from these formal issues, at least some resolutions must also meet **substantive requirements**. There are different approaches under company law, which, however, lead to similar results. First, the company has an obligation to treat all its shareholders equally if they are 'in the same circumstances'. Of course, one has to determine in which situations circumstances actually are the same. In practice, this will often mean that unequal treatment has to be justified according to the best interests of the company. Second, shareholders are under a judicially developed duty of loyalty not just toward the company, but also toward other shareholders (see above at m.n. 212 *et seq.*). The majority shareholder may thus have to take certain interests of the minority shareholders into account when voting on a resolution. This nevertheless does not put the majority under an obligation to always put the minority's interest to the forefront, but can provide an effective break in situations in which the minority is in special need of protection. Third, for some decisions with special relevance for minority shareholders, such as the exclusion of their preemptive right in capital increases, the courts have developed the requirement that such resolutions must be objectively justified by the company's interest. All three approaches result in a duty to justify at least some types of resolutions in substance. The precise contours of this duty are very much debated both by legal scholars and in practice. 251

Of course, such substantial requirements and, more generally, the legality of shareholder resolutions have to be **controlled by an independent third party**. For that purpose, every shareholder is entitled to challenge a shareholder resolution irrespective of the amount of her/his holding. Grounds for such a challenge can be either procedural errors (such as a deficient procedure for convening the meeting or a faulty counting of the votes) or the substantial illegality of the resolution (such as plain illegality or the matters explained immediately above at m.n. 251). Because of the need to clarify the issue as soon as possible, shareholders have to take action immediately. As a general rule, they will have to lodge their dissent in the meeting itself (otherwise, they are barred from bringing the claim at all) and then bring the claim to court within a month. Except for the gravest violations of the law, the resolution will remain valid if no shareholder sues in court; indeed, there is no public authority charged with supervising the legality of resolutions. For minority shareholders, bringing a claim is a risky action as they will have to bear the full sum of the proceedings, including the costs incurred by the other party if they ultimately lose the lawsuit. Hence, claims of invalidating shareholder resolutions are typically brought only after careful consideration, and are sometimes not lodged at all for cost reasons even in the event that violations of the law have likely occurred. 252

We will close this topic by providing an illuminating **example**: members of a *GmbH* may decide to **retain profits** if the company's statutes empower the company to do so (see above at m.n. 215). That is, the company can create reserves in its books. Profits are retained by resolution of the members, which, by default, is taken by a simple majority of the votes cast. This of course means that the minority is at the mercy of the majority as far as their returns are concerned. As a result, the majority may decide 253 to withhold profits in order to let the other members languish. There would be some motivation behind that move if the majority members themselves had sufficient cash reserves. At some stage, the minority members may simply throw in the towel and try to sell their shares – however, the only taker will probably be the majority member(s) who may subsequently pick up the shares at a bargain. Of course, minority members may protect themselves *ex ante*, *e.g.* by stipulating certain minimum distributions or a super-majority for adopting such a resolution. In the absence of such a provision in the statutes, a resolution designed to starve the minority may be in violation of the majority member's duty of loyalty, which is an instrument for control *ex post*. If the minority members were to sue, the court would have to investigate at least to some extent whether there were some business reasons for not distributing profits (such as expansion plans for which the company needs liquid funds) or whether the sole motivation for the resolution was to damage the minority members, in which case the resolution should be declared invalid.

III. Minority Rights

254 Apart from the right to vote, minority shareholders are also given a number of **specific minority rights**, which they can **exercise outside of the general meeting**. Such rights are typically tied to a certain minimum percentage of shares, which the shareholder must either hold individually or together with others, with whom she/he exercises the right jointly. Examples are the right to call a meeting or to include topics on the meeting's agenda. We cannot go into details here and especially not the varying percentages necessary and the procedural steps, but we'll give one example, which is of some practical importance.

255 One major problem for minority shareholders in both company forms, but especially in the *AG,* is the fact that they often suspect that something is going wrong and may have a general idea as to the nature of the problem, but **do not have sufficient information to bring a claim in court**, either against the company or against its directors. As claimants, they have to bear the burden of proof in court proceedings. To overcome this textbook information asymmetry, shareholders with at least ten percent may request to have a court-appointed special investigator (after the issue has been put to the general meeting unsuccessfully) if there are substantial grounds to suspect that grave violations of the law or the company's statute have occurred. This special investigator can then inspect all records of the company. Meanwhile, directors and members of the board of supervisors have to provide her/him with the requisite information. Importantly, the company will have to bear the cost of such a special investigation. Shareholders may thus obtain information necessary to decide on further steps. They will, however, need a pretty precise idea about what has happened in order to convince the court to appoint an investigator.

IV. Board Representation

Minority members may also protect themselves by **appointing part of the members of the board of supervisors or directors directly**; such members may be charged with monitoring the company's activities for the benefit of minority shareholders. Of course, minority members may bargain for such rights contractually. We have already seen the instrument for achieving this. 256

For public limited companies (***AG***), the statutes may provide that up to half (in unlisted companies) or up to a third (in listed ones) of the members of the board of supervisors be directly appointed by certain minority shareholders (see Unit 3 at m.n. 167). Even in the absence of such a provision in the statute, majority shareholders may conclude a separate shareholder agreement wherein a certain number of representatives of the minority shareholder(s) are to be assigned to the board of supervisors. As far as the directorship itself is concerned, the issue is more difficult as directors are not elected directly by the shareholders but by the board of supervisors. In practice, shareholders make a promise in shareholder agreements to induce 'their' members on the board of supervisors via informal influence to appoint the candidate for directorship put forward by a party to the agreement, in our example, the minority shareholder. 257

This last issue can be easily resolved with a ***GmbH,*** as certain members can be given the right to appoint directors directly (for details see Unit 3 at m.n. 177 *et seq.*). If the minority member wants to become director her/himself, the statutes can confer the directorship upon the member as a personal privilege, which means that she/he cannot be removed by resolution at all but only by a court decision based on important grounds, such as grave violation of directors' duties. 258

In the **absence of a contractual solution**, however, the law offers minority members almost no way of appointing at least some board members. Instead, the shareholder meeting decides on appointment issues by simple majority. For public limited companies, there are provisions designed to provide shareholders holding one third of the votes with at least one representative on the board. Application of these rules can nonetheless be easily avoided (see Unit 3 at m.n. 167). 259

Additionally, minority shareholders' interests can be protected by **appointing independent members to the board of supervisors**. In this context, 'independence' refers to independence from the majority shareholder. Such independent members make self-serving behaviour of controlling shareholders more difficult in theory, as, they can either block suspicious transactions or at least challenge them. Whether this works in practice is another issue. It depends to a large extent on the real degree of independence which is notoriously difficult to ascertain *ex ante*. The Austrian Code of Corporate Governance recommends independent members of the board of supervisors for public limited companies listed on the stock exchange (see Unit 3 at m.n. 151), namely one independent member for companies with a free-float of more than 20 percent of the share capital and two such members if the free-float surpasses 50 percent. However, even such members can be removed by a shareholder vote with a qualified majority. 260

V. 'Tunnelling'

261 Finally, diverting assets from the company to the majority shareholder diminishes the asset base available to all shareholders and, is therefore highly detrimental to minority shareholders. In international parlance, such measures are called '**tunnelling**'. This can be achieved by numerous measures, such as transfer prices favouring the parent company to the detriment of a subsidiary (and its minority shareholders) or excessive salaries paid to director-shareholders.

262 There are of course various ways that a legislator can deal with such issues. Many countries rely on disinterested shareholder approval for such '**related party transactions**', which means that such issues have to be put to the general meeting if they surpass certain thresholds. The shareholder benefitting from the transaction cannot vote. Austria does not adhere to this model, but relies on a statutory prohibition for such transactions if they are not entered into at-arm's-length, *i.e.* as with a third party. We have already explored this issue of illegal distributions under the heading of creditor protection (see Unit 2 at m.n. 120 *et seq.*), but it is also an important instrument for the protection of minority shareholders. However, in practice, minority shareholders tend to have no or – at best – little knowledge of such transactions and will often shy away from bringing an action on behalf of the company due to the considerable cost risk involved. This brings us back to the importance of special investigations explored above (at m.n. 255).

E. Transfer of Membership

263 Companies **cannot be dissolved easily**. Shareholders, in particular, cannot just return their shares to the company in exchange for adequate compensation. Due to the rules on creditor protection, this is only possible if the company has distributable assets, which could be used as a dividend. Even if the company has such assets, however, on account the principle of equal treatment, the company cannot simply help one shareholder alone with disinvesting, apart from in special circumstances. For these reasons, shareholders need to be able to sell their shares on the market in order to exit the company. In Unit 1 (at m.n. 29), we identified the free transferability of membership as one of the core pillars of the definition of the company. As a result of free transferability, the shareholders – as owners of the company – can transfer ownership in the legal person and with it, the position as residual claimant for all her/his assets, liabilities and contractual relations. Importantly, free transferability also means that shares can be used as collateral for other transactions, such as a loan agreement with a bank. We will now examine the rules for the transfer of shares, which vary considerably between public and private limited companies.

I. Public Limited Company

264 As a general rule, an Austrian ***AG*** has to issue **registered shares**. In practice, this means that the company has to keep a shareholder register in which the identities of the owners of the shares are registered. The company will exclusively treat the person entered into that register as a shareholder. To that extent, the new shareholder will have to register the transaction with the company before being able to vote, in order to receive a dividend, *etc*. The shareholder register is not publicly accessible. Registered shares help the company to keep track of its shareholder structure, but can also be used by public authorities for the purposes of tracing shareholders in connection with tax evasion, money laundering, and so on.

265 Traditionally, Austrian public limited companies **used to issue bearer shares**. In this case, the company does not keep a shareholder register, but issues share certificates which represent the bearer share; this is called 'securitisation'. Any person presenting the share certificate must be treated as a shareholder. Obviously, this enables shareholders to remain anonymous and, in principle, such shares are transferred by means of a simple transfer of the share certificate.

266 Today, however, bearer shares are **only permitted for companies listed on the stock exchange**. The *AG* has to lodge a so-called 'global certificate,' representing all shares, with a bank, the 'central depository'. All changes of ownership are effected via account transfers, *i.e.* the change of a book entry in the depository's ledger. Shareholders do not receive individual certificates, but can prove ownership of the shares via a 'custody receipt' issued by the bank with which they keep their securities account. This serves as sufficient proof of the shareholding for all purposes, such as the rights to attend a general meeting or to receive dividends.

267 We can thus conclude that, although, in theory, a bearer share is **anonymous**, it is **possible to trace shareholdings via the depository's ledger** and the **banking system**. This can help public authorities to some extent, but has its limits. If the registered shareholder is a foreign legal entity from outside the European Union (EU), it may be very hard or even impossible to determine the ultimate owner. The company itself will usually not have access to the depository's ledger. Meanwhile, its management will only know their shareholders if they come forward, for example, in order to make use of their voting rights, and can only communicate with the shareholders via the banking system. Due to recent EU legislation, this is different today for companies listed on the stock exchange. That is, the directors are entitled to receive information about the identity of their shareholders with more than one percent of the votes from the banks.

268 Finally, all this does not result in shareholdings being transparent for the general public, such as potential investors or the press. Even the shareholders themselves generally have but poor means of ascertaining the identity of their co-shareholders. There is nevertheless one important exception. That is, shareholders of listed companies **acquiring or selling shares**, have to **notify the public** (via the company) if the acquisition

or disposal results in an amount of voting rights that exceeds, falls below or reaches certain **thresholds** starting at four percent of the total voting rights. Major holdings in listed companies are thus public knowledge.

II. Private Limited Company

269 To some extent, the situation with a ***GmbH*** is similar to an *AG* with registered shares. In order to be able to claim membership with respect to the company, the member has to be **entered into the business register** kept by the courts. The main difference is that other than the register kept by the company, the business register is public (see Unit 1 at m.n. 15 *et seq.*). Indeed any interested person can ascertain the identity of a *GmbH*'s members. One word of warning is warranted on this note. An entry into the business register does not mean that the person registered is a member for all purposes; the entry only means that the company does not have to treat any other person as a member. As a result, a potential buyer of the share cannot rely on the person entered into the business register actually being a member. In other words, if the business register is wrong, the acquirer cannot become a member by good faith. This means that a careful buyer of a share in a *GmbH* should investigate whether the seller actually is the member. This is typically part of the 'due diligence' in a M&A process and will be done by examining membership upon foundation of the company and any further transactions concerning the shares in detail.

270 There is a second important difference in comparison to the *AG*. While with an *AG,* it is comparatively easy to become an owner of shares, the legislator has decided to make the **transfer of membership** in a *GmbH* **more cumbersome**. Hence, the lawmaker wants to avoid membership in a private limited company with its lower level of standardisation in order to become an investment vehicle traded on markets. Access to capital markets is, moreover, restricted to the *AG*. This immobilisation is achieved by requiring a transfer to be authenticated by a notarial deed in order to be valid; this makes the transfer somewhat more time-consuming and costly. It is important to recognize that a notarial deed is not only required for the validity of the transfer itself, but likewise for the validity of a promise to transfer the membership at some later stage. Thus, if A and B agree to transfer A's membership in a *GmbH* to B in 6-months' time, or if some conditions are met, this promise will not be binding unless notarised. Similarly, an option (by which A promises to transfer the membership to B if B so requests) will have to be made as a notarial deed. Unsurprisingly, it is not infrequent that these requirements are overlooked in practice, especially with smaller transactions.

III. Control of Membership

271 Of course, transfer of membership may be problematic for the company, especially if it is a closely-held company with a small circle of members and even more so if

these members cooperate closely in business operations. Under such circumstances, the members will have a genuine interest in controlling the transfer of shares, especially to outsiders. Additionally, the free transferability of the shares may result in a competitor becoming a member and, especially in a *GmbH*, obtaining access to sensitive information and probably even business secrets. In many closely-held companies, members try for that reason to gain **control over the circle of members**. There are a number of methods for dealing with these issues.

The most straightforward way is to **restrict the transferability of the shares in the company's statute**, either upon foundation or at a later stage by amendment. Such an amendment, however, requires the consent of each member affected by the provision, as the free transferability of the shares is a core individual right of each shareholder. Such statutory restrictions are possible both for an *AG*, if it has issued registered shares, and for a *GmbH*; company law determines their consequences. The basic features are similar for both company types. **272**

If a shareholder wants to dispose of her/his shares, she/he will need the company's consent, as, a **transfer without this approval is invalid**. By default, consent is given by the directors in a public limited company and by the members via resolution with a simple majority in a private one. In a *GmbH*, the member aiming to sell her/his shares may vote on the issue, which means that the default rule erects barriers to the sale by minority members but not by the majority. To achieve protection of the minority, the quorum necessary for the resolution has to be raised or else other measures have to be taken, such as an individual right of each member to veto a transfer. If the company refuses to approve the transaction without good cause, the shareholder willing to sell may petition the court. If the court approves, the shareholder can sell, but the company may present a different acquirer, who must be willing to take up the shares on the same terms as in the original contract. As a result, the shareholder may sell, but the company can determine who will become the new member. **273**

This rather cumbersome procedure can be simplified considerably by introducing different provisions in the statute of a *GmbH*. As it stands, it is not completely clear to what extent this is possible for an *AG* not listed on the stock exchange while for a listed *AG,* no deviating provisions can be introduced in the statute. The statute can, for example, introduce options for other members to pick up the shares if certain conditions are fulfilled, *e.g.* the death of a member (as otherwise the shares would pass to the heirs) or if a member becomes insolvent. The thorniest issue is determining the terms at which such an acquisition is to take place and especially the option's strike price. The latter is often set below the real market value of the shares in order to facilitate the acquisition by the company, by using, for example, the book value of the shares. Unsurprisingly, in practice, this sometimes leads to prolonged legal conflicts if upon exercise, the difference between market value and strike price is considerable. **274**

Of course, such provisions do not have to be included in the company's statute, but can form part of a **subcontract between all or some of the shareholders**. Such clauses **275** in shareholder agreement operate similarly with one important difference: if the shares are sold in violation of the agreement, the acquisition by a *bona fide* third party will be valid and the selling shareholder only will become liable for damages. The variations of such clauses are myriad. To name just two more examples, you may encounter so-called tag-along rights, which, in the case of a sale by one shareholder, empower others to sell their shares to the same acquirer as well, or drag-along rights, which conversely oblige a shareholder to sell her/his shares if another shareholder has found an acquirer.

276 Achieving balance between the different interests in connection with the sale of shares right is one of the most important issues when setting up a company. However, founders often give low priority to such provisions, as initially, they are thought to be mere formalities unlikely to ever be put to the test. Time and changing circumstances often prove that assumption to be wrong.

IV. Involuntary Transfers

277 To finalise, we would briefly like to mention that in some cases, shareholders can be **required to transfer their shares even against their will**. For example, shareholders can be expelled from the company if they do not make their contribution even after repeated requests for payment (see above at m.n. 210).

278 In practice, the most important case of involuntary share transfers is the so-called '**squeeze-out**' right – a shareholder holding at least 90 percent of capital may acquire the remaining shares at her/his will in exchange for adequate compensation. After such a transfer, the dominant shareholder can run the company without having to take into account the interests of the minority shareholders, which can simplify management considerably. This would obviously constitute a far-reaching encroachment of the minority shareholders' position, which is nevertheless not unconstitutional. Shareholders can protect themselves by private ordering upon the company's foundation as the right to squeeze-out is a default rule only, which can be abrogated or modified in the statutes.

279 Unsurprisingly, the hardest question in squeeze-outs (and similar situations) is usually the adequacy of the **compensation** packages which shareholders receive in exchange for the release of their shares. Compensation has to be set on the basis of the value of the enterprise. This value is far from easy to determine. According to the current valuation dogma, the value is estimated by finding the company's future returns on the basis of the business plan and then discounting these returns to present value. This approach entails numerous uncertainties, the biggest one being the uncertainty about future developments, and some debatable choices, such as the appropriate discount rate. Hence, 'the' value of the company is usually not pinpointed but expressed as a value range which may have considerable deviation and is typically quite sensitive to changes based on certain key assumptions. This regularly causes shareholders who are dissatisfied with the compensation package offered to them instigate court proceedings, which are, in turn, typically prolonged and costly.

Apart from that, shareholders cannot be expelled from the company even if they have provided good cause. It is nevertheless possible in a *GmbH* to include a provision to that effect in the company's statutes, *e.g.* if a member has violated a prohibition against competing with the company. **280**

Relevant Literature and Further Reading

Armour, Enriques et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd edn., 2017) 57–58, 79–88.

Davies, Introduction to Company Law (2nd edn., 2010) 218–264.

Questions

1. Explain the differences between rules and standards. What is the duty of loyalty?
2. How does one determine the profits of a company? Who is responsible in an AG and in a GmbH?
3. What is a pre-emptive right in company law?
4. What is the principle of 'one share – one vote'? Can you deviate from it?
5. How can a shareholder attend an AG's general meeting? Does he/she have to appear in person?
6. Why is shareholder presence at general meetings low? How does the law try to increase this presence?
7. How can members in a GmbH take resolutions?
8. Can shareholders or members challenge resolutions? Can they do so because the resolution is 'unfair' in substance?
9. What is a special investigation in company law?
10. What is a related party transaction?
11. Explain the different types of shares in an AG and the way to transfer these shares.
12. How do you transfer membership in a GmbH?
13. Are shareholders anonymous? What about members in a GmbH?
14. Describe different methods for restricting the transfer of shares/a membership.
15. What is a squeeze-out?

Unit 5: Mergers and Acquisitions

A. Purpose of this Unit

281 Mergers and acquisitions (or 'M&A') is a broad topic encompassing **many different types of business transfers** which we can only explore to a small extent here. We will examine some typical deal structures so that you will obtain insight on the basic issues of interest. We start by examining **asset deals** and focus here on the issue of the transfer of assets, liabilities, and contracts. Next, this unit turns to **share deals** and related problems. We then explore some basic issues of mergers and divisions so that you will get a general idea of these M&A techniques. The unit concludes by **examining some selected issues common to all types of transfers**, such as the transferring of risk, representation and warranties, and authorisations by public authorities.

B. Overview of M&A Structures

282 Acquisitions of businesses are undertaken with **various motives** which can only be briefly mapped out here. The former **entrepreneur may, for example, want to retire** and to sell her/his business to a successor. The acquirer may have some capital and, instead of starting from scratch, may want to take over an existing business. On a larger scale, a company may decide not to grow internally by expanding its existing business, but may favour external growth via the acquisition of other entities. A merger (in the wider sense of the word) between two different business entities may yield **economies of scale**, which (in an industry setting) means that the production costs per unit decrease as a function of the number of units produced. Among the reasons for such economies of scale may be **synergies** which the merged entities can explore, such as reducing the number of legal departments from two (one for each company before the merger) to one, which will permit at least some cost cutting. Similarly, a well-established company may want to acquire a budding enterprise engaged in developing some cutting-edge technology. However, not all mergers may be in the best interest of the acquiring company's shareholders. Rather, management may engage in empire-building and want to enjoy the perks that come with running a larger business.

One issue of terminology: the word 'merger' in English may refer to different concepts. On the one hand, in the wider business sense, a merger is any combination of two formerly independent businesses irrespective of the technique used. On the other hand, merger in a narrower sense, may be used as a synonym for 'amalgamation,' whereby two formerly separate entities are merged into a new entity; in this context, merger refers to a specific technique for bringing businesses together.

Typically, in M&A transactions, as a first step, the **contract** is negotiated and then it is concluded; in M&A terms, we speak of '**signing**'. However, this does not mean that ownership of the corporate assets passes directly onto the acquirer. Typically, this is the second step, referred to as '**closing**'. Before closing the deal, some **condition precedent** will normally have to be fulfilled, for instance, that all necessary authorisations have been obtained (see below at m.n. 346 *et seq.*). The acquirer can run the business only once the deal is closed. **283**

If a business is run by a company, there are **three basic deal structures** which can be used in order to take over the business: an asset deal, a share deal or a merger (in the narrower sense of the word explained above at m.n. 282)/a division. **284**

If the parties decide to structure the transaction as an **asset deal**, the deal works as follows (for details see m.n. 289 *et seq.*): parties to the contract are the acquirer and the person running the business as a vendor, who can be a natural person ('sole trader') or a legal entity. The acquirer buys the enterprise from the former entrepreneur (that is either the company or the sole trader). The object of the sale is the assets themselves, and among them, the receivables with respect to third parties. Typically, the acquirer will be interested in assuming the vendor's contractual positions as far as they are business related, such as, employment contracts and lease contracts for the business facilities. To some extent, the acquirer will also have to assume some of the vendor liabilities (so-called 'successor liability'). **285**

Example: If Lisa wants to buy Tony's ice cream parlour, they will have to agree to an asset deal, whereby Lisa will acquire property on the premises and the other assets connected to Tony's business. Additionally, Lisa probably wants to continue employing Tony's sales personnel and to keep Tony's contracts with his suppliers. Finally, Lisa will have to deal with the issue of whether she will be liable for Tony's business debts after the transfer.

If the entrepreneur running the business is a company, the transaction can be structured as a **share deal** (for details see m.n. 308 *et seq.*). Parties to the contract are the acquirer and the person holding the shares in the company running the business. The contract does not affect the assets of the company at all. Rather, the shares in the company are sold. Hence, after the transaction, the same company as before will run the business; only ownership in that company's shares will have changed. **286**

Example: If Tony does not run the ice cream parlour himself but through a company for which he is the sole shareholder, Lisa can still acquire the business assets from the company. However, they also can structure the deal differently. Lisa can buy the shares in the ice cream company from Tony. The company will continue running the business; the only change from a legal point of view is in the identity of the shareholder.

If companies run both businesses, the shareholders can also decide to **merge** these two legal entities (for details see m.n. 323 *et seq.*). After the merger, one of the two legal entities will cease to exist and all its assets, liabilities, and contracts will be transferred to the other company at the moment the merger is entered into the business register. The merger also affects the companies' shareholders, who will become shareholders of **287** the surviving entity. That is, a merger will have consequences at both the asset and the shareholder level.

Example: If not only Tony, but also Lisa run their separate businesses via companies to which they are shareholders, they can also structure the deal as a merger. As a result, the assets, contracts, and liabilities of both businesses will be concentrated in one company, either in Lisa's or in Tony's. Additionally, both Lisa and Tony will become shareholders of this surviving company. The other company will be struck off the register and therein cease to exist.

288 Finally, a company can be **divided** as well (for details see m.n. 332 *et seq.*); this is also called a de-merger. In a division, the assets, contracts, and liabilities are transferred to separate companies as a result of a shareholder resolution. The shareholders become either shareholders in all new companies in the same proportion or are allocated shares in only one of these new entities. In this manner, businesses can be separated and, if need be, former business partners as well.

Example: A couple of years after the merger, Lisa and Tony realise that the combination of their businesses has not brought the expected advantages. Furthermore, they continually disagree on business decisions. They therefore decide to divide their company. As a result, Tony gets his ice cream parlour back, which is then transferred into a new company with Tony as a sole shareholder. In return, Tony relinquishes his shares in the formerly common company, which will then have Lisa as a sole shareholder; Lisa will be the residual claimant of all the assets in that company.

C. Asset Deal

I. Introduction

289 An asset deal at its core is not an issue of company law. Rather, **general contract law** and the **law of property** regulate the acquisition of the company's assets etc., albeit taking into consideration some **special business law aspects**. At its heart, the vendor – either a sole trader or a company – transfers all or at least specified corporate assets to the acquirer. Yet, in order to transfer the entire business, the acquirer will also want to become party to the vendor's contracts, which is not as easy to achieve as the mere transfer of assets. We will see that this is one of the core issues of an asset deal.

II. Assets

290 Let us first turn to the **acquisition of assets**, both tangible and intangible. The **law of property** governs the acquisition of tangible, *i.e.* physical assets. According to property law rules, the acquirer will not become proprietor of the entire business assets in an asset sale by any single act. Rather, under the principle of '**singular succession**,' every single asset has to be transferred from the vendor to the acquirer by means of a separate act. Of course, this does not mean that you have to hand over each pencil separately.

You do, however, have to assess in case of each and every asset, whether property has actually been transferred. In other words, although the contract for an asset deal will typically refer to the sale of the business in its entirety (probably enumerating some core assets additionally), as far as the law of property is concerned, there is no 'business' that can be transferred in its entirety, but only as a **mass of single assets**.

Under Austrian property law, a **transfer of tangible assets** needs to meet **three conditions**: the vendor has to be the **proprietor of the goods**, the **contract has to be valid** and the parties have to **set a *modus***, *i.e.* an action by which the parties actually want to transfer property. The purpose of the *modus* is to allow the public to observe that property has been passed on to a new owner. After all, all members of the public will have to respect the acquirer's property in the future. Only if the *modus* is fulfilled can the M&A contract be closed. What conditions precisely need to be met all depends on the type of asset involved. For real estate, an entry of the change of ownership in the land register is necessary. This, in turn, requires a notarised deed by which the seller expressly agrees to passing her piece of real estate on to the acquirer. Property in movable assets – also called 'chattel' – will usually pass upon surrender of the assets to the acquirer, that is, at the moment the acquirer receives control over the assets. For other types of assets, additional rules apply. **291**

Details on the topic of singular succession for tangible assets are an issue for law students. An important matter for legal practice is to ensure that the vendor actually is proprietor of the business assets she/he is selling. This will be easy to determine in the case of real estate due to the public land register, but can be difficult for chattel. Suffice it to say that under certain circumstances, a ***bona fide*** acquirer can obtain property in the assets even if the vendor was not the proprietor. Summing up, the acquisition of tangible property in an asset deal is a complex issue. Of course, the amount of complexity depends on the structure of the business – the smaller the asset base, the fewer problems will arise. **292**

Besides tangible assets, there are also **intangible** ones, especially receivables or claims connected to the business. Typically, these can be transferred by informal agreement between the vendor and the acquirer; this is called '**assignment**' of the debt. The debtor typically has no say in the matter, as from her/his point of view, it is not important to whom she/he makes the payment as long as she/he is discharged of her/his debt. This can be different if the creditor (in an M&A deal the vendor) and the debtor have agreed that the creditor may not assign the debt to a third party. Such agreements are, however, subject to judicial scrutiny, as they can be voided if they are unreasonably detrimental to the creditor. The acquirer nevertheless has to beware of at least two pitfalls. First, the assignment will be void if the receivables have already been assigned to another party; unlike with tangible assets, ***bona fide* acquirers will not be protected**. Second, the debtor should be notified of the assignment as otherwise she/he will be discharged if she/he settles her debt in good faith with the vendor. **293**

III. Contracts

294 Under contract law, a contract can be transferred only with the **consent of all three parties involved**: transferor, transferee and especially the other party to the contract. In this way, the other party is protected, on the one hand, against a change of her/his contractual partner. Otherwise, the transferor could easily transfer the contract to another person who may be less creditworthy. On the other hand, the fact that the other party's consent is required complicates the transfer of a business considerably, as in many instances, one main precondition for running the business successfully is that there is continuity in the business's contracts.

295 The law of business transfers does not deviate completely from the principles of contract law, but modifies them to some extent. As a general rule, the seller and the acquirer of the business can decide whether to transfer contracts or other legal relationships. They may transfer all of them, decide not to transfer anything at all, or else transfer only selected contracts. If no special provisions are made, all legal relationship pertaining to the business are transferred. To this extent, the seller's private contractual positions, such as the lease on her/his flat, remain unaffected by the business transfer. Though this may seem at first glance to be a complete reversal of contract law's tenets reproduced above, this is not the case for two reasons.

296 First, so-called '**personal legal relationships**' are **not transferred**. On the one hand, these are relationships that, by law, cannot be transferred. Examples are contractual rights of first refusal or author's rights. On the other hand, the parties to a contract can stipulate that the contract be 'personal' and, therefore, cannot be transferred. Contractual parties can thus protect themselves *ex ante* by including provisions to that effect in the contract.

297 Second, contractual parties have to be **informed** about the transfer of the contract. Once informed, they can object to the transfer without giving specific reasons. This will result in the legal relationship not being transferred to the acquirer but remaining with the seller of the business. This obviously gives these parties a strong position and will probably result in the acquirer of the business having to negotiate with them in the first place, so as not to encounter an unpleasant surprise after the acquisition. This may also mean that the contractual party may bargain for some type of advantage, such as raising the interest rate of a loan agreement, which, in turn, will probably lower the consideration which the seller of the business can expect to receive. The right of objection is nevertheless likewise a default rule; this means that contractual parties can forego their right to object *ex ante* when entering into a contractual arrangement. This shows that in business life, it is crucial to anticipate future eventualities, such as a sale of the enterprise, even if, at the moment of contract formation, no such sale is envisaged.

298 If the contract is indeed transferred, it features **two important legal consequences**. On the one hand, all liabilities that have already arisen are passed on to the acquirer. On the other hand, for the future, the acquirer will be entitled to demand fulfilment

(and will have to perform her/his side of the contract). As an example, take the lease contract for the business premises: first, the acquirer will have to settle any outstanding lease payments; second, she/he will be able to demand future performance in her/his own name.

However, even if the contract is transferred, the **vendor** of the business will **remain liable at least to some extent**. She/he will remain liable for any arrears and for any future payments due within five years after the transfer of the business. If a loan agreement foresees the repayment of the principal over the next ten years, after the transfer, the vendor remains liable for any unpaid instalments and for the future instalments due within the next five years, but not for any later payments. If the bank does not consider this appropriate, it still can object to the transfer – with the result that the vendor of the business will remain liable for the entire amount irrespective of the date of repayment. 299

Quite clearly, the **position of contractual partners is strong**: they can object to the transfer *ex ante* or *ex post* and, even if they choose not to exercise this right, the transferor remains liable for a significant time period. However, this general rule is **abrogated for certain types of contracts**, such as lease agreements for business premises (*i.e.* rent, not property), labour contracts with the employees, or certain types of insurance. In these cases, the partner does not have a right to object to the transfer. 300

As an example, let us look at lease contracts for business premises covered by rent control legislation. Although the application of that legislation may be difficult to determine in detail, as a rule of thumb, one can say that this legislation applies to buildings erected on the basis of a building permit issued before 1 July 1953 or issued thereafter if the building was erected with public subsidies. For such business premises, lease agreements are transferred automatically to the acquirer; the landlord cannot object. However, if the rent is below an 'adequate' rent, the landlord may raise the rent to that level.

The interplay of these rules is of considerable complexity, a topic which we can only sketch out here briefly. However, it is important to note that **one important issue is not covered by these rules** – any authorisations or business licenses granted by public authorities are not automatically transferred to the acquirer. Whether and to what extent they are depends on the applicable rules of administrative law and has to be determined on a case-by-case basis. Generally, authorisations connected to the person of the entrepreneur, such as licenses under trade law (in German *Gewerberecht*), cannot be transferred together with the business. 301

IV. Liabilities

If legal relationships are passed from the vendor to the acquirer of the business, the latter will **automatically** be **liable for all business debts** (see at m.n. 298). However, as we have seen, this transfer to the acquirer is not mandatory. It will not happen, namely, if either the vendor or the acquirer stipulates otherwise or if the other party to the con- 302 tract objects to the transfer. Yet, this does not mean that the acquirer will not become liable for such debts.

303 Rather, business law foresees such liability to a certain extent. The causes for this are disputed, but most probably boil down to the following reasoning, which is most easily explained with the example of a loan agreement. Imagine the bank has extended (unsecured) credit to an entrepreneur. It has probably done so because the enterprise promises success on the basis of its business plan, but maybe also because of the assets connected to the business. If the business is sold, but the loan agreement remains with the vendor, the reasoning behind the bank's approval of the loan will have changed accordingly, as the business will no longer be able to serve as a basis for the repayment of the loan. Although the vendor will usually have received some sort of consideration, which is also ideally adequate, this is not the same as a business, especially as money is notoriously mobile and may either be squandered or made to disappear with fraudulent intent. Creditors, including the bank in our example, are to some extent protected by a concept of business law called '**successor liability**'.

304 First, even if the acquirer does not assume – as a **default rule** – the business contracts of the vendor, she/he will be fully liable for any debts arising from these contracts. However, this is a default rule and the parties to the transfer of business can stipulate otherwise. In order for this exclusion of successor liability to become effective, it has to be communicated to the business's creditors, typically via a respective entry into the business register.

305 Second, even though full liability is a default rule, the acquirer has to assume another type of liability which is **mandatory**. She/he will be liable for any debts she/he knew of or, had she/he acted carefully, should have known about. That is, the acquirer will be liable for any debts that are in the enterprise's books but not *e.g.* for a liability from a tort (that is for non-contractual damages), which could not be foreseen at the moment of the transfer of the business. Additionally, this liability is limited: the acquirer will only be liable up to the total amount of the assets received. Hence, in the worst case, these assets will be wiped out economically by this liability – which may mean that the consideration for the acquisition will have been paid without receipt of anything in return.

306 As you can imagine, this potential liability constitutes a **major risk** in any asset deal. Parties to a transaction and their lawyers will have to find ways to mitigate this risk as much as possible, *e.g.* by stipulating that parts of the acquisition price not be paid to the vendor, but used to satisfy the creditors. It is of course also possible to enter into negotiations with the vendor's creditors and ask them to forego the acquirer's liability. In practice, however, such an agreement will in most cases require some type of consideration.

V. Summary

We have now examined asset deals and have seen that they are rather **complicated** and that considerable **risks** exist, especially as far as the transfer of contracts and potential liabilities are concerned. However, this does not mean that this type of deal structure is not used. First, when buying assets from a sole trader, an asset deal is the only deal structure available. Second, with an asset deal, it is easy to specify which assets will be transferred and which will remain with the vendor. Third, deal structures in M&A are driven, at least to some extent, by tax purposes. If an asset deal is advantageous for tax reasons, this will be the deal structure of choice. However, in many cases, a share deal is much simpler, safer, and faster. 307

D. Share Deal

I. Deal Structure in Detail

The basic structure of a **share deal** has already been outlined above (at m.n. 286). The parties to the contract are the acquirer and the person holding the shares in the company running the business (usually called the '**target company**'). The shares in that company are the object of the sales agreement. The agreement is thus usually called a '**share purchase agreement**' or '**SPA**'. The company actually running the business does not change at all. We have explored the formalities needed to acquire shares in either a public limited company or a private one in Unit 4 (at m.n. 263 *et seq.*), and will not repeat this here. 308

In principle, the acquirer in a share deal will gain **control over all the target's assets, contracts, and liabilities**. However, this is not necessarily the case as in such a deal, **some assets etc. can be excluded** by, for example, transferring them from the target company to its shareholder (of course, within the limits permitted by company law and especially the rules on forbidden distributions; see Unit 2 at m.n. 120 *et seq.*). Conversely, when buying a company, the acquirer has also to be careful whether she/he really acquires all the assets necessary for running the target's business. This is especially salient with the acquisition of subsidiaries in a group of companies as in such cases, core assets are very often allocated to other companies in the group. It is therefore necessary – as part of the acquirer's due diligence – to determine which assets are actually needed for running the business and to structure the deal accordingly. As a result, even with a share deal, the acquirer has to take careful consideration of the assets. 309

Example: Imagine that in a given group, one subsidiary runs the group's clothing division, while other subsidiaries run other lines of business. The business premises consist of the property of the group's parent company, which also provides group companies with ancillary services, such as legal advice, personnel and accounting. A potential acquirer of the subsidiary running the clothing business will have to bear in mind that the target on its own, lacks many functions necessary for viable business operations, *e.g.*, the acquirer will have to negotiate a lease contract or sales agreement with the transferring parent company for the business premises, etc.

310 Let us consider the **deal structure** a bit more in detail, taking as a starting point that one company takes over the shares of another. Obviously, even after the transaction, the two companies will **retain their separate legal entities**. The acquiring company will continue to run its former business. Meanwhile, the shares in the target company will become part of the acquirer's assets. Crucially, however, the acquiring company as shareholder in the target **will not become directly liable for the target's debts** as the latter retains its separate legal entity and as shareholders, under normal circumstances, is shielded from the company's debts by limited liability. In the worst case, the former target company and new subsidiary may become insolvent at a later stage, which will result in the acquirer's investment losing its value – but at least its other assets remain unaffected. Of course, if the acquirer has taken up credit with a bank in order to finance the acquisition, it will probably not be able to honour this debt after the target's insolvency, which, in turn, may lead to corporate insolvency on the part of the acquirer itself. If we compare this situation with an asset deal, the differences are striking. In an asset deal, the assets of the target's business are passed directly on to the acquirer and, within the limits explored above (at m.n. 302 *et seq.*), the acquirer will become liable for the target business's debts.

311 There is of course a **downside** to this as well: the parent company as new shareholder will **receive returns only if the target company makes profits**, which then must be distributed to the shareholders (see Unit 2 at m.n. 114 *et seq.*). If the parent has taken up a loan to finance the acquisition, it will probably need such dividends for repayment. There thus is a strong incentive to transfer the debt to the subsidiary itself, so that the financing bank will get direct repayment from the subsidiary irrespective of whether the subsidiary makes any profits; these so-called '**debt push-downs**' are a major issue in practice and will very often constitute illegal distribution. We cannot go into these complicated issues in detail, but would like to emphasise that such debt push-downs are quite disadvantageous to the subsidiary's creditors, since, after such a measure, they have to compete with a creditor that has not financed the subsidiary's business but its acquisition.

312 You may have noticed that in a share deal a **group of companies** is formed if the acquirer is a company as well. In the future, the new subsidiary will be managed as part of the group and will, for practical purposes, be subordinated to the parent company's business aims. We will look at the situation of minority shareholders in such transactions below (at m.n. 319 *et seq.*).

313 We have implicitly assumed that the **consideration offered by the acquirer** is cash. Naturally, this is not always the case as the acquirer may also offer any other type of consideration. A typical situation is that the acquirer proposes a share exchange: if the transferor is willing to transfer her/his target shares to the acquirer, she/he will receive shares in the acquirer itself. Under such an arrangement, the transferor does not disin-

vest, but rather changes the nature of her/his investment: she/he will also have invested in the acquirer's business.

II. Assets, Contracts, and Liabilities

At first glance, there is no issue as far as the transfer of assets, contracts, and liabilities is concerned, as there simply is no such transfer. That is, the target company will **remain owner of the business assets**, **party to its contracts** and **debtor of its liabilities**. As far as statutory law is concerned, a share deal does not affect the target company's business. 314

However, one has to bear in mind the possibility of **private ordering**. The other party to a contract of the target company may have made that contract contingent on continuity of the target's ownership (so-called '**change of control clause**'). This can be achieved *e.g.* by giving the party who is not subject to a change in ownership the right to terminate the agreement in the event of a change of control of the other party. There may be many legitimate business reasons for such a clause. For example, a car manufacturer may share secret car specifications of a new model with a supplier of parts. If this supplier is taken over by a competitor of the car manufacturer, it may have a genuine interest in terminating this supply contract. 315

If such a contract is crucial for the target company's success or even its economic survival, a change of control clause will be a **core issue for any acquirer**. Just imagine that a substantial loan agreement entered into by the company contains such a change of control clause, empowering the bank to accelerate the loan, *i.e.* to demand immediate and full repayment. If the target cannot refinance the loan, it will probably become insolvent. If it can refinance but at less favourable conditions, the acquirer may have overpaid, as the increased future interest payments will negatively impact distributable profits. In this situation, a change of control clause serves as a potential deal breaker; the acquirer will probably try to negotiate with the bank for a waiver or otherwise abstain from signing the deal altogether. 316

For this reason, it is eminently important for the acquirer to know about such change of control clauses affecting the target company's business prospects. Of course, this may not be a big issue for smaller businesses, which typically have relatively few long-term commitments that may be affected by a change in control. With bigger companies that have hundreds or thousands of long-term contracts, however, identifying change of control clauses that are potential deal breakers can be an onerous task. Typically, potential acquirers (or rather their legal advisers) are given access to the company's contracts in a (virtual) data room in order to painstakingly examine the agreements for any hidden risks, including change of control clauses; this is part of the usual '**due diligence**' process in bigger transactions. 317

Finally, we would like to mention one **change of control clause based in the law itself**, which affects many smaller enterprises. That is, if the business premises are 318 leased and subject to rent control (see above at m.n. 300), after the change in control, the landlord may not terminate the lease agreement, but is entitled to raise the rent to an adequate level.

III. Minority Protection in Control Transactions

319 We have implicitly assumed so far that the acquirer buys or otherwise acquires all the shares in the target company. Of course, that is not necessarily the case. If the vendor is owner of a **majority of the shares with voting rights**, the acquirer may be content with obtaining this part of the shares. From the **point of view of the minority shareholders**, a change in control is both an **opportunity and a threat**. On the one hand, the new controlling shareholder may be more adept at steering the target company's business, *e.g.* via better control of management or by providing the company with needed financial reserves out of its free cash flow. On the other hand, the new controlling shareholder may be less deferential to the rights of minority shareholders and more inclined to exploit 'private benefits of control,' either by outright looting or by more inconspicuous measures (see Unit 4 at m.n. 244). This is especially important if the target company becomes the subsidiary in a new group of companies as it will probably be subject to new group policies primarily designed to favour the parent company and not the subsidiary's minority shareholders. Similarly, the new shareholder may simply not be equally adept at running the target company. It is very hard to determine the motives that serve as the driver for the acquisition *ex ante*.

320 Generally, this danger for minority shareholders is the **result of a free transferability of shares**, one of the basic tenets of company law. We have already seen that shareholders can protect themselves against unwanted share transfers via private ordering, either in the statutes or in separate shareholder agreements (Unit 4 at m.n. 271 *et seq.*). However, absent such contractual protection, minority shareholders will have to accept the share transfer and try to engage with the new controlling shareholder. In particular, the law puts **no duty on the exiting controlling shareholder to provide her/his fellow shareholders with a comparative opportunity to sell their shares**. If shareholders wish to avail themselves of such a right, they will have to negotiate for a '**tag along clause**' in a shareholder agreement (see Unit 4 at m.n. 275) or some provision with similar effects.

321 There is nevertheless an **important exception for companies listed on the stock exchange under takeover law**. If control over such a company changes because of an acquisition of a controlling block of at least 30 percent, the new controlling shareholder will have to offer to take up the shares of the other shareholders as well (the '**mandatory offer**'). Additionally, this offer will have to be at the highest price paid by the acquirer within the last 12 months prior to him/her acquiring control. In case of the acquisition of control through the sale of a controlling block of shares, this highest price is typically the acquisition price for that block. As a result, the former controlling shareholder will have to share the control premium with all other shareholders. Note that this requirement cannot be deduced from company law's principle of equal treatment (see Unit 4 at m.n. 251), as this applies only to relations between the company and its shareholders and does not affect the acquirer of the shares, who, in principle, can pay different acquisition prices for different shares. Hence, takeover law substantially improves the situation of minority shareholders in case of a change of control as they can decide to either exit the company by taking up the offer or to throw in their lot with the new controlling shareholder. The mandatory bid is thus some sort of **preemptive strike against the potential oppression of minority shareholders**.

E. Mergers and Divisions

Company law provides companies with numerous **additional transaction techniques** apart from asset and share deals. All of these have in common that the **corporate assets do not need to be transferred individually** as is the case in an asset deal. We can only deal with the two most important transaction techniques here, namely with **mergers** and **divisions**, and even this will only be a brief overview. **322**

I. Merger

If both the acquirer and the target are **companies**, they can use a different deal structure altogether: a **merger** (see already above at m.n. 287). This is a transaction technique by which two separate legal entities are amalgamated into one, either by an asset transfer from one company to another already existing company ('**merger by acquisition**') or, less common in practice, by an asset transfer from two companies into a newly founded one ('**merger by formation of a new company**'). After the merger, at least one of two legal entities will cease to exist. Such mergers are possible between two public limited companies (*AG*), two private ones (*GmbH*) and also between an *AG* and a *GmbH*. **323**

According to company law, the merger of two independent businesses into a new one serves as a default model. In this situation, the directors of the two companies will, hopefully, try to negotiate a fair deal for both sides in pursuit of their respective companies' interests. However, in reality, **most mergers take place within corporate groups**, *i.e.*, a subsidiary is merged into the parent as the acquiring company ('**up-stream merger**'), the parent into a subsidiary ('**down-stream merger**'), or one subsidiary into the other ('**side-stream merger**'). In these situations, little negotiating takes place, as the merger is not a merger of equals but one between formally separate albeit economically interdependent companies. For that reason, there can be no assumption that a fair deal has been struck; on the contrary, the danger of abuse is heightened. **324**

At the asset level, a merger **leads to a transfer of all assets, contracts, and liabilities into the acquiring company** (or the newly-founded one). In this respect, a merger is **325**

comparable to an asset deal, wherein the acquirer also becomes owner of the vendor's assets, *etc*. There are, however, **at least two important differences**. First, these transfers take place via '**universal succession**'. This means that the assets do not need to be transferred individually as in an asset deal (see above at m.n. 290 *et seq.*), but pass on to the acquirer at the moment the merger is entered into the business register. Second, and connected to universal succession, the transferring company's **contractual partners and creditors cannot object to the transfer of their positions to the acquirer** since the transferring company ceases to exist after the merger. At that level, a merger offers considerable advantages to the acquirer in comparison to an asset deal.

326 However, from the **point of view of the creditors**, a merger is **essentially dangerous**. First, as a result of the merger, the **asset base changes**. In extreme cases, this may lead to a smaller asset base after the merger if an over-indebted company is merged with a sound entity. Yet, apart from such exceptional circumstances, the asset base will be enlarged as a result of the merger. Second, this would undoubtedly be favourable to the creditors if it were not for the fact that the number of creditors increases as well. While before the merger, two separate groups of creditors (those of the transferring and those of the acquiring company) enjoyed access to separate sets of assets, after the merger, these groups share a single asset base. It is easy to demonstrate that this will normally be to the benefit of one creditor group and to the detriment of the other. Let us just imagine the merger of a highly-leveraged company with a conservatively financed one. For the creditors of the highly-leveraged company, the merger will be a windfall profit as the likelihood increases that their claims will be honoured, while the claim quality of the sounder company's creditors will be impaired.

327 Again, creditors can protect themselves by **private ordering**. That is, a loan agreement could contain a clause empowering the bank to accelerate the credit if a merger adversely affects the ratio of debt to assets. Whether creditors will be able to successfully negotiate such a clause, all depends on whether they are bargaining from a position of strength. The **law** nevertheless **offers some protection** to creditors as well. First, if the merger affects the other party to the contract adversely, under very restricted circumstances, courts may provide the party with an extra-contractual right to terminate the agreement; this will only cover extreme cases. Second, the courts keeping the business register will examine mergers for any potential detrimental effects on creditors, in particular, in case of mergers within a group of companies. Such mergers are not entered into the register and thus do not become effective. To some extent, this helps in weeding out abusive merger plans, such as merging a solvent company into an insolvent one or vice versa. Third, after the merger is registered, creditors may petition the court for adequate safeguards (*e.g.* a bank guarantee) if they plausibly claim that their position is endangered due to the merger. This provision is infrequently invoked in part due to the fact that merging companies tend to reach agreement with major creditors before the merger in order to avoid the application of the rule in the first place.

328 Turning to the **shareholders**, their position is also affected by a merger as the shareholders of the transferring company will exchange their membership in that company for shares in the acquiring company. Similarly, the shareholders of the acquiring company get new fellow shareholders vying for a share in the acquiring company's profits. For this reason, shareholders have to **vote on the deal**. A resolution can only be passed with a majority of three quarters of the votes cast.

We would like to draw your attention to an **important difference between a share deal and a merger**. A **share deal** may be structured as a **public offer**: the acquirer publicly offers to take up all shares in the target at a price of €100 per share. Shareholders who accept will take the money and relinquish their shares. Yet those who refuse the offer are not affected by it, apart from the fact that they have to deal with a new controlling shareholder if the offer is successful; they simply keep their shares. The situation is completely different in a merger, *i.e.*, once the resolution is passed, all shareholders have to relinquish their shares in the transferring company and receive shares in the acquiring one – even if they have voted against the merger. After all, the transferring company will cease to exist. Put differently, with mergers, a collective decision-making mechanism replaces the individual decision of whether to accept an offer. Of course, this is not an issue if there is only one shareholder in the company or if all shareholders have voted for the merger. **329**

Apart from the question of whether the merger makes sense at the business level, the main issue for the shareholders of both companies is the **share exchange ratio** – how many shares in the acquiring company does a shareholder get per share in the transferring company that she/he will have to relinquish? Obviously, the value of the shareholding after the merger must be (at least) equal to the value of the shares in the transferring company before the merger. Otherwise, the merger would result in an expropriation, at least in the business sense of the word. That brings us back to the issue of **valuation** (see already Unit 4 at m.n. 279). The issue is especially salient for mergers within a group as the management of the subsidiary cannot be relied on to negotiate an adequate share exchange ratio for any minority shareholders in the subsidiary. Hence, there are **special proceedings designed to check the adequacy of the share exchange ratio** after the merger has been effected. Importantly, if shareholders make use of this *ex post* remedy, this does not block the merger, but can only lead to an adjustment of the share exchange ratio (to the benefit of shareholders of one of the merging companies and to the detriment of the other's shareholders) or to an additional cash payment. As with the adequate compensation in squeeze-out proceedings (see Unit 4 at m.n. 279), due to the complexity of valuation issues, such proceedings can be extremely lengthy, taking up to ten (!) years. **330**

Finally, we would like to mention briefly that **mergers cannot only happen within Austria**, but may also executed **cross-border**, at least within the European Union (EU). To that extent, companies from other Member States may be merged into Austrian ones ('**incoming merger**') and *vice versa* ('**outgoing merger**'). While incoming mergers do not present special issues, after an outgoing merger, shareholders will find themselves in a company governed not by Austrian, but by foreign company law and subject to **331** the jurisdiction of a different Member State. As company law continues to be national law to a large extent. Moreover, company laws in the EU still differ considerably (see Unit 1 at m.n. 49), which can be a real issue for shareholders and a reason for objecting to the deal. Dissenting shareholders in outgoing cross-border mergers are therefore granted an **exit right**: they can choose to relinquish their shares in the company in return for adequate compensation.

II. Division

332 In a **division**, one legal entity is split into two separate ones; the company's assets, contracts, and liabilities are allocated to the successor companies according to **de-merger plan**. This division may be full or partial: in a **full division**, the company being divided ceases to exist and its assets are allocated to at least two successor companies. In a **partial division** (also called 'spin-off'), the company being divided transfers part of its assets and liabilities to one or more newly formed companies without losing its existence and retaining part of its assets. In both cases, the successor companies may be newly-formed companies or companies already trading. In the latter instance, the division at the same time is a merger as a bunch of assets is first separated from the company being divided and then joined with the assets of another entity. We cannot go into the considerable practical problems of applying merger and division regulation to the same transaction in parallel.

333 Technically, a division is more complicated than a merger as it is only a **partial universal succession**. That is, the de-merger plan has to specify in detail which assets, contracts, and liabilities will belong to which company in the future. Typically, the merger plan will contain default provision for any assets etc. that are not specifically allocated (*e.g.* 'Any assets not allocated specifically by the following provisions shall be allocated to company A.'). There are **no special rules as to how assets and liabilities must be allocated**. Rather, the company being divided is, in principle, free in this allocation.

334 Of course, this makes a division **even more dangerous to creditors than a merger**. One successor company could in theory be allocated almost no assets but virtually all the liabilities of the company being divided. Nevertheless, creditors have **no legal right to veto a division**, but have to **content themselves with various protection devices**, two of which we will name here. First, apart from the company to which a liability is allocated, all the other companies will be liable for the debt towards the creditor as well. However, this liability is limited by the net assets allocated to that company (allocated assets minus allocated liabilities). Hence, the creditors of the other successor companies gain access to the surplus of assets in that company. In order to avoid this liability, the company being divided will have to reach an agreement with its (most important) creditors since they can forego the liability contractually before the division takes effect. Second, creditors may petition the court to order the companies to provide adequate safeguards if they plausibly claim that their position is endangered due to the division. This is similar to merger regulation.

As far as **shareholders** are concerned, they will become shareholders of the successor companies (or remain shareholder in the company being divided and receive shares in the successor company in a partial division) once the division is entered into the register. As with a merger, the transaction needs a **shareholder resolution with a supermajority** of either 75 percent or 90 percent of the votes cast. The 75 percent majority is applicable to proportionate divisions, in which the shareholders receive shares in all successor companies in the same proportion of their shareholding in the company being divided. For example, if shareholder A holds 5 percent in the company being divided, in a proportionate division, she will receive 5 percent of the shares in the successor company as well. 335

However, there is another type of division which is much more dangerous to shareholders: the **disproportionate division**, in which the proportion of the holding in each of the successor companies does not remain the same as before the transaction. Let us imagine, for example, that the company being divided has two shareholders. Shareholder A will receive all the shares in successor company A, and shareholder B, all the shares in successor company B. In such divisions, there is a heightened danger that shareholders will actually lose value as a result of the transaction, namely if B's holding in company B is less valuable than her/his shares in company A before the transaction. The requisite quorum in such cases is thus 90 percent of votes cast. Additionally, all dissenting shareholders have the **right to exit** the company in return for adequate compensation. Other, even more dangerous types of division even require a unanimous shareholder resolution. 336

F. Common Issues

Irrespective of the transaction technique chosen, M&A deals typically have some **common problems,** such as the following. When does risk pass on to the acquirer? What types of warranties should the seller make? Does the acquirer need authorisations by public authorities? Of course, this is not an exhaustive list of issues to be borne in mind, but covers some of the more important topics. We will briefly examine each of these three issues in turn. 337

To be sure, the central issue in any M&A transaction is the **consideration** given in exchange for the assets or shares. However, this is determined by business reasons and is not primarily a legal issue. There are exceptions, such as in mergers, where we have seen that, due to the fact that even dissenting shareholders will be affected by the transaction, they have the right to challenge the share exchange ratio (see above at m.n. 330). Apart from that, price cannot be determined without looking at some legal issues, such as the risks acquirer and vendor assume respectively. The price is therefore not something extra-legal, but will depend at least to some extent *e.g.* on the amount of warranties the vendor assumes. The better the acquirer is protected against unpleasant surprises, the higher the price she/he will likely be willing to pay. 338

I. Risks & Opportunities

339 Ideally, the **risk associated with business** operations passes from the vendor on to the acquirer when the deal is closed, since, at this moment in time, the latter will assume responsibility for the business and will have the rights of an owner (in an asset deal) or a shareholder (in a share deal). Under this concept, any negative or positive developments before the deal is closed will have to be borne by the vendor. Conversely, any adverse developments taking place thereafter will affect the acquirer only. In practice, however, considerable time may pass between the signing and closing of the deal, especially if the transaction is subject to authorisations (see below at m.n. 346 *et seq.*). This makes setting the acquisition price difficult at the moment of entering into the agreement as uncertainty remains concerning the future development until closing. There are various approaches for dealing with this problem.

340 First, the parties may enter into a so-called '**locked-box agreement**', whereby the acquirer pays a price fixed **at the moment of signing the deal**, irrespective of any development before closing. She/he thereby assumes the risk that the company's business prospects take a turn for the worse between signing and closing. On the other hand, any positive developments will provide the acquirer with a windfall profit. However, the acquirer will have to protect her/himself against the possibility of the vendor taking cash out of the company after the deal has been signed ('leakages') since the vendor can still control the business. This is typically achieved by including clauses into the contract specifying actions prohibited to the vendor, such as distributions in cash or in kind. Unsurprisingly, this is a difficult task.

341 Second, the parties may specify a certain mechanism by which the final purchase price is determined **at the moment of closing the deal**. Typically, the M&A contract sets an 'initial' acquisition price when the deal is signed. At closing, the 'final' acquisition price is derived from the initial price using certain algorithms specified in the share purchase agreement, usually based on a balance sheet prepared at the moment when the transaction is completed (this is therefore called '**completion account mechanism**'). Obviously, determining the principles or ratios according to which the purchase price is adjusted is extremely important. It is likewise easy to misjudge this issue, especially without intimate knowledge of the target company. It is not unusual for a deal not to close on account of the disputes about the calculation of the final purchase price.

342 Whether one or the other method is chosen ultimately depends on the situation the parties are in. This was especially the case during and directly after the financial crisis at the end of the 2000s, since locked-box agreements had very much fallen out of favour with acquirers. This seems to have changed again over the last couple of years.

343 Of course, these are just **two examples** for a possible distribution of risks be-tween the seller and the buyer. The parties can also stipulate that the seller receives an initial down payment and the remaining fixed purchase price is to be paid in instal-ments. This means that the vendor to some extent assumes the risks of the acquirer's future

business activities, especially if the remaining instalments are not guaranteed by a bank or otherwise secured. Conversely, the vendor can also be allowed to par-ticipate in any future upsides of the business by a so-called 'earn-out clause'. In this case, the vendor receives a certain fixed sum at the moment the deal is closed and additional variable payments at later stages, which are conditional upon the busi-ness's future success. When entering into such an agreement, the buyer may be will-ing to pay a larger purchase price as the additional payments will only fall due if her/his investment proves to be as profitable as the vendor has made it out to be. Of course, determining business success is the key factor. Under earn-out clauses, the seller will have to assume some risk that the buyer mismanages the business or that she/he understates the business's success by creatively applying accounting principles.

As we have seen, setting the correct price depends, on the one hand, on the parties' **344** expectations as to the **future cash-flows** they can generate from the business, but at least to some extent also on the contractual **allotment of risks**. In the last paragraphs, we dealt with risks on the future success of the company. Risks may also however arise from doubts about the state the company is in at the moment the agreement is entered into.

Of course, this is a main task of the so-called '**due diligence**' we mentioned above **345** (at m.n. 317). The acquirer will want to get to know the target company before the transaction in order to avoid unpleasant surprises after the deal is closed. Additionally, she/he will ask for so-called '**representations and warranties**'. That is, inquiries have to be made into the contractual promises by the vendor on the state of the business for which the vendor will be liable. Such 'reps' and warranties may include – without being limited to – the following:

– The vendor will have to warrant that she/he is the owner of the shares and that they are free of the rights of third parties.
– Frequently, the vendor will warrant that the accounts have been prepared according to the applicable standards of care or even that the accounts give a true and fair view of the company's affairs.

II. Authorisations

It is not unusual for an M&A transaction to need **approval by public authorities**. **346** Typically, the share purchase agreement is made conditional upon such approval. Very often, the law prohibits the closing of the transaction before the requisite approval has been obtained. Of course, there are numerous authorisations which may be required, especially for larger transactions or for transactions in regulated industries, such as banking or insurance. Some of the most important examples are the following.

According to **competition law**, the parties need to notify the competition authorities **347** with regard to certain transactions, that is either the European Commission (if the concentration has a community dimension, which is determined by applying certain thresholds, especially as to turnover) or the Austrian competition authority, called *Bundeswettbewerbsbehörde* (if other, lower thresholds regarding turnover are met). The purpose of these competition proceedings is to determine whether the merger or acquisition is likely to restrict open competition due to a concentration of market power. Until the competition authority unblocks the transaction or until the deadline for issuing a decision expires, the transaction may not be closed, as any premature transfer of the business to the acquirer will be void, on the one hand, and will be subject to an administrative fine of up to ten percent of annual turnover, on the other.

348 Ownership in **banks and other financial industries**, such as insurance, is critical for the stability of the financial system – an issue which has come to the fore in the wake of the financial crisis of the 2000s. Hence, banking, insurance, and other areas of financial law (together often referred to as '**prudential regulation**') make the transfer of controlling blocks of shares contingent upon approval by financial regulators. In recent years, receiving such authorisations has become increasingly cumbersome as regulators painstakingly screen potential acquirers as to their soundness.

349 Finally, there are **additional approval requirements** designed to prevent takeovers by foreign, *i.e.* non-EU, acquirers for industries that are deemed to be especially sensitive, such as core infrastructure businesses (telecommunications, energy supply, *etc.*) or armaments industry. The government can block the transaction if it jeopardises public order and security.

Relevant Literature and Further Reading

Armour, Enriques et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (3rd edn., 2017) 183–195, 205–242.

Questions

1. Explain some reasons for M&A.
2. What is an asset deal?
3. How does a share deal work?
4. How do you transfer property in the assets in an asset deal? Is the passing of property an issue in a share deal?
5. Do contracts pass automatically to the acquirer in an asset deal? Do you have to worry about the company's contracts in a share deal?
6. Explain the concept of 'successor liability'.
7. Compare the liability situation of the acquiror in an asset deal and in a share deal.
8. What is takeover law?
9. Please explain the concept of a merger.
10. What are the core issues of creditor protection in a merger?
11. What are the core issues of shareholder protection in a merger?
12. Can you merge a company across the border?
13. What are the core issues in a division?
14. Describe different pricing mechanisms in an M&A-deal.
15. What is a due diligence?

Unit 6: Constitutional Law and Business Law

A. Introduction

Constitutional law is a body of rules which include the basic rules governing the competition of state organs, rules on elections, fundamental rights, and the judiciary. Some of the core guarantees and their relevance for business law will be discussed in the following chapter. **350**

In Austria, unlike in other states, there is no single document called 'the Constitution.' Instead, the Constitution is composed of various legal documents which collectively serve as the highest laws of the land. The main constitutional document is the Federal Constitutional Act (*Bundes-Verfassungsgesetz*, in short: B-VG) of 1920. The **Federal Constitutional Act** lays down the basic principles of the Constitution; it regulates the organisational structure of the Austrian State, the Constitution and the powers of its various institutions and bodies, and contains several fundamental rights. Apart from the Federal Constitutional Act, many other constitutional acts and constitutional provisions in various legal acts enter into the equation. Both must be expressly specified as constitutional law. Austria consists of nine Federal Provinces, the so-called ***Laender***. There is one Federal Constitution and there are nine *Land* constitutions; the latter play a less important role. **351**

As to the structure of a legal system, the theory of law proceeds from a '**hierarchy of norms**'; the concept was developed by *Adolf Julius Merkl*, a famous Austrian legal scholar of the 20th century. The hierarchy of norms is based on the idea that the law regulates its own creation. Both as regards the content and the formal aspects, every legal act must generally be enacted in accordance with another legal act of superior rank. The law regulating the creation of another law is considered to be of a superior rank in relation to the one whose creation it is regulating. Furthermore, when enacting a legal act, the legislator must comply with the respective rules. In applying this concept to the Austrian legal system, the hierarchy of norms is as follows: the Constitution authorises the legislator to enact ordinary laws. Constitutions and laws authorise administrative authorities to enact ordinances. Laws allow authorities to issue rulings or judgments. No legal act of subordinate rank may contravene a legal act of superior rank. In addition, the hierarchy of norms depends on the rules of enactment and the amendment is interrelated with the hierarchy according to the superseding power of norms. According to the latter, the rank of a legal act in the hierarchy of norms depends on the question of whether it can supersede or whether it is superseded by another legal act. This concept does not say anything about the legal consequences in case a subordinate legal act contravenes a superior one. However, the legal order may provide for the possibility that legal acts of subordinate rank contravene superior norms which can subsequently be quashed in specific proceedings. **352**

B. The Basic Principles of the Austrian Federal Constitution

353 The **basic principles** of the Austrian Federal Constitution enjoy a special position in constitutional law. They are not expressly laid down in the Constitution but they can be derived from its overall context. The basic principles inherent in the Constitution are the democratic, the republican, the federal and the liberal principle, the principle of the separation of powers and the principle of the rule of law (*Rechtsstaatsprinzip*).

354 The basic principles are subject to special rules of enactment and amendment. Their abolition or a fundamental amendment of one or more of these principles is considered to be a '**total revision of the Federal Constitution**' (***Gesamtänderung***) within the meaning of Art. 44 para. 3 Federal Constitutional Act. On such changes, the legislator can vote only in the presence of at least half of the members of the National Council (*Nationalrat*) and by a two-thirds majority of the votes cast. Furthermore, a referendum among the Austrian people must be held.

355 If an amendment of ordinary constitutional law or a provision conflicts with one of the basic principles, it is in violation of the Constitution ('**unconstitutional constitutional law**').

I. Democracy

356 All European constitutions are governed by core elements of democracy. At a European level, we find a legal basis for a binding principle in Art. 2 of the Treaty on the European Union (TEU). According to Art. 2 of the TEU, the EU is founded, among other values, on the core value of democracy. For the wider Europe of non-EU member states (such as Russia, Turkey, and others), a legally binding basis for democracy in constitutions is anchored in Art. 1 of the Statute of the Council of Europe.

357 In Austria, Art. 1 of the Federal Constitutional Act forms the legal basis for the principle of democracy. It reads: 'Austria is a democratic republic. Its law emanates from the people.' According to this rule, the people and its will are the starting point for the drafting of any legal provision.

358 Austria is a **parliamentary** (so-called **indirect**) **democracy**. Unlike in a direct democracy, in an indirect democracy, the law is enacted solely by representatives who are elected by the people. There must be elections to Parliament, i.e. the National Council, at regular intervals.

359 The **right to vote** in the elections to Parliament is granted to every citizen of a certain minimum age (in Austrian, 16 years) on the day of the election. Each citizen has one vote (**universal and equal suffrage**) and elects the candidate running for election directly (**direct suffrage** as opposed to indirect suffrage which exists in the US, where there is an election of an electoral college which elects the President). The voters have to cast their vote in person (no representation by another person – **personal suffrage**).

The election must be secret (**secret ballot** in order to protect the electoral freedom). Canvassing must not be restricted or be supported by the state in a discriminating manner (**free suffrage**). The National Council is elected based on the principle of proportional representation (as opposed to majority representation); thus, all political forces that enjoy the support of a not insignificant number of citizens are represented in Parliament according to their political strength.

Every act of the executive branch (jurisdiction and administration) must be based on law (**principle of legality**; see Art. 18 Federal Constitutional Act); the highest administrative authorities are responsible to the legislator in matters pertaining to the administration. There are certain instruments for making this responsibility effective (Parliament committee of inquiry, vote of no confidence, proceedings against members of the government before the Constitutional Court). **360**

A number of other constitutions in Europe (including the TEU), contain certain **elements of a direct democracy.** They modify the principle of an indirect democracy. In Austria, the following elements can be found **361**

- In case of a 'total revision of the Federal Constitution' or if the National Council so decides, a referendum must be held as an act of parliament.
- If the National Council so decides, a so-called 'consultation of the people' must be held on matters of fundamental and overall national importance for whose competence, the legislature is required to settle. The result of the consultation of the people is not legally binding (but of great political significance).
- 100,000 voters may take a so-called 'popular initiative.' With this motion, they may initiate the passing of a law that concerns a matter to be settled by federal law. The National Council is, however, not obliged to comply with it.

II. Republic

The **Federal President** is one of the highest executive organs of the Austrian State. He/she is elected by all Austrian citizens who are entitled to vote. The term of office is six years, re-election being possible once. Before the expiry of the term of office, the Federal President may be impeached by referendum; there has not been a single impeachment procedure in the history of Austria. The Federal President carries the title of the 'head of state'; this is owing to his/her typical functions, such as Commander-in-Chief of the Army, acts of grace, and overall representation of the republic. Further competences of the Federal President are, for instance, that he/she can dissolve the National Council or that he/she appoints and dismisses the Federal Chancellor, the other members of the Federal Government and State Secretaries. Due to the legal position of the Federal President, his/her political responsibility and the limited term of office, **Austria is a republic**. **362**

III. Federal State

363 A few European states are federal states. The most important example is Germany, others are Belgium and Austria as member states from within the EU, and Switzerland and Bosnia and Herzegovina from outside the EU. The main features of a federal state are explained in the model of the Austrian constitution. Art. 2 para. 1 Federal Constitutional Act stipulates that '**Austria is a federal state**'. Compared to other federal states, the degree of decentralisation of legislation and judicial powers is relatively low. Apart from the federal legislation and administration, the ***Laender*** **enjoy relative autonomy** both in legislation and in the administration.

364 All **competences** which are not expressly allocated to the Federation fall within the competences of the *Laender*. In fact, most competences lie with the Federation (*e.g.* external affairs, civil law affairs, matters pertaining to trade and military affairs). Matters remaining within the competence of the *Laender* (legislation and administration) are, for instance, building and regional planning law, law on environmental protection, hunting and fishing law (Art. 15 Federal Constitutional Act).

365 Compared to other federal states mentioned above, the **federal element** of the Austrian State is rather **weak** since most competences lie with the Federation, whilst the influence of the Federal Council (in which the *Laender* are represented) is very limited.

IV. Principle of the Separation of Powers

366 The **principle of the separation of powers** is reflected in the separation of the state powers in a **legislative body** (National Council and Federal Council, Diets), **administration and jurisdiction**. This principle is supplemented by numerous rules on incompatibility according to which – as a rule – one person cannot, at the same time, exercise another function within two branches of the government (it may be permitted, however, to exercise a function within the same branch of the government at the same time). An exception to this principle is, for instance, the possibility that a member of the government is simultaneously a member of Parliament. Moreover, between the branches, there exist powers of appointment and of dismissal, rights of participation and rights of control.

V. Fundamental Rights

367 A core element of every constitution is fundamental rights. Many constitutions, like the German constitution, start with articles on human and fundamental rights. According to Art. 2 of the TEU, the EU is founded on the values of human dignity, freedom, equality, the rule of law and respect for human rights, among other values. In 2009, a catalogue of binding fundamental rights was integrated into the Treaties of the EU.

According to Art. 6 of the TEU, the rights, freedoms and principles of the Charter of Fundamental Rights (CFR) shall have the same legal value as the treaties.

In Austria, **fundamental rights and freedoms** reflect the self-restraint of the state in the sense of a separation of the state and society. Fundamental rights shall provide 'freedom from the state' (*e.g.* freedom to exercise every kind of gainful activity, protection of property (for details see Unit 10 at m.n. 625 *et seq*.), freedom of opinion), and the principle of equality. 368

VI. Rule of Law

According to Art. 2 TEU, the EU is founded on the values of the rule of law. States under the rule of law are characterised by **legal certainty and foreseeability of the legal order**, and by institutions which guarantee the implementation of these two principles. The difference between a state under the rule of law and a police state lies precisely in the certainty and foreseeability of existing rights and obligations. A state under the rule of law is thus a constitutional state in which constitutional law governs the legislation and laws govern the administration. 369

A main element of the principle of the rule of law (*Rechtsstaatsprinzip*) is the **principle of legality**, which requires that every administrative act must be based on law. In the Austrian Constitution, the principle of legality is laid down in Art. 18 of the Federal Constitutional Act. Another central element of the principle of the rule of law is the existence of institutions which guarantee compliance with the constitution and the law; the individuals concerned may thus seek remedies against acts of the state. The principle of the rule of law is particularly reflected in the opportunity of subjecting decisions of administrative courts to a review by the Constitutional Court (Art. 144 Federal Constitutional Act, *Entscheidungsbeschwerde*) and the Supreme Administrative Court (Art. 133 Federal Constitutional Act; *Revision*); they examine compatibility of these acts with the constitution and the law. The principle of the rule of law is further reflected in the option of having legal acts, regulations and international treaties examined for their compliance with the constitution and legal acts respectively (Art. 139-140a Federal Constitutional Act). 370

C. The Legislature

In a democracy, the legislative power is exercised by a **parliament. In Austria**, the Parliament at federal level consists of the National Council which exercises its power jointly with the Federal Council (the Federal Parliament thus consists of two chambers). Members of Parliament are directly elected by the people. 371

372 In Austria, the **legislative procedure** is initiated by way of a legislative proposal, thus by way of a 'request' directed at the National Council for passing a law. A legislative proposal can be made by members of the National Council, by the Federal Government (Government Bills), by the Federal Council itself or by way of popular initiatives.

373 In general, ordinary laws can only be adopted in the presence of at least one-third of the members of the National Council and an absolute majority of the votes cast. Constitutional laws require the presence of at least half of the members of the National Council and a two-thirds majority of the votes cast; furthermore, they must be expressly labelled as constitutional laws.

374 After a law has been adopted by the National Council, the president of the National Council has to transfer it to the Federal Council, which generally has a right of veto. The Federal Council can reject the enactment by means of a reasoned objection within eight weeks. If it does not object to the enactment, the law is authenticated by the Federal President as having been passed in compliance with the Constitution; this act is then countersigned by the Federal Chancellor. Finally, the law is published in the Federal Law Gazette (*Bundesgesetzblatt*, in short: *BGBl*). If the Federal Council does, however, raise a reasonable objection within eight weeks, the National Council then has to deliberate on the enactment again. The National Council may (in the presence of at least half of its members) insist on the enactment being adopted as a law. In this case, the Federal Council cannot raise an objection again but the enactment is instead authenticated and published as described above.

375 In federal state, there is also legislation at the level of the entities (states, provinces, cantons or *Laender*). The Austrian Federal Constitution provides that for a ***Land* law** to enter into effect, the Diet must first pass a law which is then authenticated and countersigned in accordance with the provisions of the *Land* concerned, and published by the Governor in the *Land* Law Gazette.

376 In a federal state, there are rules governing the resolution of conflicts between the federal Constitution and the constitutions of the federal entities. According to Art. 99 para. 1 of the Federal Constitutional Act, the *Land* Constitution must not contravene the Federal Constitution; ordinary federal laws do not, however, enjoy precedence over ordinary *Land* laws.

D. The Executive

377 The **highest executive bodies** of the Austrian State are the Federal President, the Federal Government (Federal Chancellor, Vice-Chancellor and Federal Ministers) and the Federal Ministers.

378 The **executive power** of the Federation is exercised by federal authorities (*e.g.* police, financial administration) and by the Governor and the *Land* authorities subordinate to him/her (indirect federal administration; *mittelbare Bundesverwaltung*).

I. Federal Government

The Federal **Chancellor**, the **Vice-Chancellor** and the other **Federal Ministers** are entrusted with the highest administrative business of the Federation. In Austria, neither the Chancellor nor the Government as a whole are elected by Parliament. The Federal Chancellor and, on his/her recommendation, the other members of the Federal Government, are appointed by the Federal President. No recommendation is required for the dismissal of the Federal Chancellor or the whole Federal Government by the Federal President. An individual member of the federal government can only be dismissed upon recommendation of the Federal Chancellor. The Federal Government or the Federal Minsters can also be removed from office by an explicit vote of no confidence taken in the National Council or, alternatively, they can of course resign. **379**

Then there are the distinctions between the individual Federal Ministries and the Federal Government. The Federal Ministries and the authorities subordinate to them perform the daily business of the federal administration. A Federal Minister is entrusted with the direction of a certain Federal Ministry. Certain issues are entrusted with the Federal Government as a collegiate body (*e.g.* adoption of governmental bills which are submitted to the National Council as legislative proposals) under the chairmanship of the Federal Chancellor. **380**

II. Federal President

The legal status and functions of the Austrian Federal President are discussed at m.n. 362 above. From a comparative perspective, the Austrian Federal President has only **limited powers**, as compared to the French or US Presidents. The Austrian presidency has a more important role than the German Federal President, particularly when it comes to the formation of government. **381**

E. Judiciary

Art. 82-94 of the Federal Constitutional Act provide for the organisation, authorities and the constitutional principles of the ordinary jurisdiction as well as the administration of justice. In principle, there is a system with three levels of jurisdiction in criminal or civil cases. **382**

I. Organisation of Ordinary Courts

According to Art. 82 para. 1 Federal Constitutional Act, all judicial activities fall within the **competence of the Federation**. Administrative courts, the Supreme Administrative Court and the Constitutional Court are courts, too; however, special rules apply **383** to them (Chapter VII Federal Constitutional Act), which in certain respects refer to the rules governing ordinary courts (*e.g.* Art. 135 para. 4 Federal Constitutional Act).

384 The **constitution and competence of ordinary courts** is laid down by federal law (Art. 83 para. 1 Federal Constitutional Act). The competences of the courts are further determined by the 'allocation of cases' within a certain court. The principle of the 'allocation of cases' is laid down in Art. 87 para. 3 Federal Constitutional Act. It requires that caseload be allocated in advance among the judges of a court. This principle is a special form of the principle of legality and is complemented by the right to a lawful judge pursuant to Art. 83 para. 2 Federal Constitutional Act. This subjective right grants everyone the right to compliance in terms of the allocation of competences.

385 According to Art. 92 para. 1 Federal Constitutional Act, the **Supreme Court** (*Oberster Gerichtshof*, in short: *OGH*) is the court of final instance in civil and criminal matters; it does not, however, require that the parties of each civil or criminal case be provided with a remedy through the Supreme Court.

386 Art. 94 para. 1 Federal Constitutional Act contains an essential principle typical for the principle of the separation of powers: **judicial and administrative powers must be separated** at all levels of proceedings. This principle prohibits an authority from being both a judicial and an administrative authority; it prohibits remedies between ordinary courts and administrative authorities and instructions between administrative authorities and ordinary courts.

II. Administrative Jurisdiction

387 The principle of the rule of law requires not only that the public administration be based on law (Art. 18 para. 1 Federal Constitutional Act), but also that an entity examines whether the laws have in fact been complied with. The latter function is exercised by **administrative courts** and the **Supreme Administrative Court**. The parties to the proceedings before these courts are a person subject to the legal order, on the one hand, and an administrative authority on the other. Administrative courts, moreover, examine whether administrative acts comply with the law; then there is the Supreme Administrative Court which is the court of final instance in administrative matters. Furthermore, it may be appealed to by way of an application for setting a time limit in case an administrative court defaults on passing a decision. The Supreme Administrative Court is also competent to resolve a conflict of jurisdiction between administrative courts or between an administrative court and the Supreme Administrative Court (Art. 133 para. 1 Federal Constitutional Act).

388 In Austria, there are **nine administrative courts of the *Laender*** and **two of the Federation** (the Federal Administrative Court and the Federal Finance Court), with whom the legal protection against acts of administrative authorities lies (with few exceptions).

Administrative courts are not charged with the task of dealing with matters of the ordinary jurisdiction or with matters falling within the competence of the Constitutional Court. **389**

In matters pertaining to the **municipality's own sphere of competence**, municipalities generally conduct business without legal redress to administrative authorities outside the municipality, unless this is specifically barred by law (Art. 118 para. 4 Federal Constitutional Act). **390**

III. The Constitutional Court

The Constitutional Court is the central institution for guaranteeing the precedence of the Constitution, for guaranteeing that all state acts comply with the Constitution and for safeguarding fundamental and human rights ('**guardian of the Constitution**'). It is the oldest institution of its kind in Europe as well as worldwide. The most important competence of the Constitutional Court is the competence to review the constitutionality (or lawfulness) of general norms, in particular the constitutionality of laws. It may do so in the course of pending proceedings (concrete norm control proceedings) and in abstract norm control proceedings. In norm control proceedings, the Constitutional Court examines both federal and *Land* laws. Federal laws are examined for their compliance with the Federal Constitution, *Land* laws for their compliance with the *Land* Constitution and Federal Constitution. The Federal Constitution is examined for its compliance with its basic principles. From the other level of governance, European Union (EU) law – with the exception of the Charter of Fundamental Rights of the European Union (CFR) – is not a standard of review in norm control proceedings. **391**

Another function of the Constitutional Court is, for instance, its role in resolving conflicts of competence between the Federation and a *Land* or between the *Laender* themselves, and that it makes a pronouncement call in case of challenges to elections. **392**

F. Neutrality

Austria's peaceful relations with other states are determined by its status as a 'permanently neutral' state. Neutrality was declared unilaterally by Austria under international law in 1955 and officially divulged to a number of states which explicitly recognised the declaration. Unlike the Scandinavian 'neutral' states (Sweden and Finland), Austria is legally bound to remain permanently neutral. At a national constitutional level, this is laid down in a special constitutional law entitled 'Federal Constitutional Act on the Neutrality of Austria' (*Bundesverfassungsgesetz über die Neutralität Österreichs*; in short: *BVG Neutralität*) of 1955. **393**

394 The **content of the legal status of neutrality** is determined by international law. The classical legal rules of neutrality under international law are laid down in the Fifth and Thirteenth Hague Convention and are, however, determined by customary international law. In times of war, these rules must be observed by any state not taking part in a particular conflict; they apply to states both temporarily and permanently neutral. A neutral state is not allowed to supply belligerents with any war material, to grant loans or financial aid directly for the purposes of warfare or to permit belligerents either to transport war material across its territory or the installation and use of telephone and telegraph devices upon its territory for purely military purposes. If a neutral state maintains economic and financial relations with belligerents, it must observe strict impartiality to both sides.

395 In **times of peace,** the obligations of neutrality apply only to states committed to permanent neutrality under international law. A state bound to **permanent neutrality** must observe indirect or 'secondary' legal obligations. It must not act in such a manner or accept obligations under international law which might undermine the trust of other states in its neutrality in case of war. The respective duties emerge from those applicable in times of war. Accordingly, a permanently neutral state has to shape its foreign relations with a view to preventing possible violations of its neutrality and protecting itself against involvement in future wars. In short, the conduct of foreign relations must enable the permanently neutral state to fulfil its duties in times of war. The concrete conduct of foreign relations, however, is to some extent left to the discretion of the state.

396 In a **common declaration with the EU of April 1994** annexed to the Treaty of Accession, Austria confirmed acceptance of the rights and obligations under EU law and its institutional framework ('*acquis*'), in particular, the principles and the political goals of the EU. As a consequence of this declaration, a special provision confirming Austria's participation in the Common Foreign and Security Policy (CFSP) of the EU was introduced into the Constitution. This provision covers participation in actions by which economic relations with one or more third parties are suspended, restricted or discontinued entirely.

397 At the **international level**, the Austrian government has not taken any further steps in this respect. The government obviously concurred in the opinion that changed expectations towards neutral states and has also modified the status of permanent neutrality, which was, in their view, no longer in conflict with participation in the CFSP.

G. The Federal Constitution and International Law

398 The Austrian Constitution contains **explicit rules** on generally recognised rules of international law and on the incorporation of international treaties. For a general introduction to international law, see Unit 11.

The generally recognised rules of international law form an **integral part of federal law**. That means that customary international law is *ipso iure* transformed into federal law. However, its rank in the national legal system is disputed. 399

International treaties have to be incorporated into domestic law in order to become legally binding. However, their identity as internationally binding legal instruments is not altered by their incorporation into national law. The Austrian Constitution does not contain a rule granting international treaties a superior rank over domestic laws in general. The legal quality of treaties varies depending on their content and the procedure followed in the process of ratification. 400

In so far as they **modify or complement existing laws**, and **treaties** by which the **Treaty on European Union** (TEU) and the **Treaty on the Functioning of the European Union** (TFEU) are modified, **all political treaties and other treaties** may only be ratified with the approval of the National Council (Art. 50 Federal Constitutional Act). International treaties concluded by the Federal Government which concern a matter falling within the autonomous sphere of competence of the *Laender,* on the other hand, have to be approved by the Federal Council. 401

Treaties not falling within the scope of Art. 50 Federal Constitutional Act do not need to be approved by Parliament; they enter into force with an expiration date of the day of their publication in the Federal Law Gazette (general transformation as opposed to special transformation). Whether a treaty is directly applicable depends on whether its content is sufficiently precise. 402

In the current practice, many treaties are multilateral treaties. In this case, the content and the specific rules of a treaty are negotiated by government officials until consensus can be reached on a final text in a conference etc. Parliament has no direct influence on the content of a treaty; it can only vote against a treaty or adopt it. 403

The legislator has the power to prevent an international treaty from being directly applicable in domestic law even if it could – given its content – be directly applicable. On giving its approval to a treaty, the National Council may vote that the treaty in question be implemented by means of a law or several laws (**reservation of implementation**). Such a vote has the effect that the treaty is not directly applicable in national law regardless of whether it is self-executing or not. 404

H. Austria and International or Supranational Organisations

Until 1982, the Federal Constitution did not contain explicit provisions on the **participation of Austria in international organisations** (IOs). In 1981, a provision allowing the transfer of jurisdiction to international institutions, and in 1994, a new chapter on the participation in the decision-making process in the EU were introduced into the 405

Constitution. For a general overview of the principal legal issues concerning IOs, see Unit 11 at m.n. 762 *et seq*.

406 The Austrian Constitution contains a special provision for the **transfer of sovereign powers** to IOs. According to Art. 9 para. 2 Federal Constitutional Act, single competences may be transferred to other states or intergovernmental institutions by federal law or state treaties that have been approved by the National Council. However, the authorisation applies only to the competences of the Federation. Moreover, a general transfer of large areas of sovereign powers cannot be based on this provision as a transfer under Art. 9 Federal Constitutional Act is limited to 'specific' ('single') competences. Decisions by intergovernmental institutions have to respect the limits set by human rights. In addition, the obligation of permanent neutrality must be likewise observed in decisions on the transfer of competences.

407 The most important **transfer of sovereign powers** in the history of the Federal Constitution took place **when Austria acceded to the EU**. However, the transfer was not based on Art. 9 para. 2 Federal Constitutional Act, as, the scope of that provision was too narrow for being the basis of a transfer of sovereign powers to that extent. The government therefore introduced a special constitutional law authorising the competent authorities to ratify the Treaty of Accession. This law (and not the Treaty itself) was subject to a referendum before the ratification of the treaty. The amendment constituted a total revision of the Constitution within the meaning of Art. 44 para. 3 Federal Constitutional Act.

408 Various provisions of the Federal Constitutional Act concern the **participation of Austrian organs in the EU**. Art. 23a Federal Constitutional Act deals with the election of Austrian members to the European Parliament (EP).

409 Another Article provides for the procedure of **participation of the *Laender* and *Land* Governments in the decision-making process of the EU** (Art. 23d Federal Constitutional Act). The Federation is obliged to inform the *Laender* without delay regarding all projects within the framework of the EU which affect their autonomous sphere of competence or could otherwise be of interest to them. The same applies to municipalities insofar as their own sphere of competence or other important interests of the municipalities are affected. *Laender* and municipalities have the right to present their views on these projects. In case the *Laender* make a 'uniform comment' on a project which falls under their purview of legislation, the comment is binding upon the Federation. The Federal Government may deviate from such an opinion only for compelling integration and for foreign policy reasons. These reasons have to be communicated to the *Laender* immediately.

410 The **federal legislative bodies** (National Council and Federal Council) are likewise accorded the **right to participate in the decision-making process of the EU** (Art. 23e Federal Constitutional Act). The respective competent Federal Minister is required to inform these two bodies without delay, of all projects within the framework of the EU and provide them with the opportunity to express their opinion. The opinion of the

National Council is binding upon the Federal Minister if the project is aimed at passing a binding legal act which would affect the issuance of a federal law within the ambit of that EU legal act. The Federal Minister may deviate from such an opinion only for imperative integration and foreign policy reasons. In case the Federal Minister intends to deviate from the opinion of the National Council, the latter must address the issue again. If the project is aimed at passing a binding legal act which either needs to be implemented by a federal constitutional law or which contains rules that can only be adopted following the adoption of constitutional provisions, a deviation is permissible only if the National Council does not object to the deviation within a reasonable amount of time. The Federal Council may adopt binding opinions on projects which encroach on the competences of the *Laender* and have to be implemented by a constitutional act, or which contain rules that can only be adopted following the adoption of constitutional provisions.

In practice, these rules cannot effectively guarantee steady participation on the part **411**
of Parliament. The way documents are negotiated in EU organs often leaves insufficient room for manoeuvre and time in order to have Parliament involved in a way which is comparable to the national legislative procedures.

As mentioned above, there is also a **special provision confirming Austria's partici- 412**
pation in the Common Foreign and Security Policy (CFSP) of the EU. This includes participation in tasks by which economic and financial relations with one or more third countries are suspended, restricted or discontinued entirely (Art. 23j Federal Constitutional Act).

Relevant Literature and Further Reading

Stelzer, An Introduction to Austrian Constitutional Law (3rd edn., 2014).

Stelzer, The Constitution of the Republic of Austria – A Contextual Analysis (2011).

Wiederin, Evolution and Gestalt of the Austrian State, in: Bogdandy/Huber/Cassese (eds.), The Administrative State (The Max Planck Handbooks of European Public Law Vol. 1, 2017), 125–164.

Questions

1. How is the Austrian Federal Constitution composed?
2. What is meant by the concept of the ‘hierarchy of norms’? Describe the hierarchy of norms in the Austrian legal system.
3. The basic principles of the Austrian Federal Constitution enjoy a special position compared to other norms of constitutional law. Explain.
4. Although Austria is an indirect democracy, there are also elements of a direct democracy in the Austrian legal system. Explain.
5. What are the electoral principles of Austrian law?
6. What is understood by the term ‘principle of legality‘? What is the relationship between the principle of legality and the basic democratic principle?

7. What are the competences of the Federal President?
8. May a Member of Government at the same time be a Member of Parliament? State reasons for your answer.
9. Explain the legislative procedure in Austria.
10. Can the Federal Government as a collegial body, or a Federal Minister be dismissed?
11. How is the administrative court system organised?
12. Why is the Constitutional Court described as the 'guardian of the Constitution'?
13. How did EU membership affect Austria's status of permanent neutrality?
14. Assuming that the EU decides to modify the EU Treaties, what has to happen from the perspective of Austrian constitutional law?
15. Is every international treaty directly applicable in Austria? State reasons for your answer.
16. How do the Laender participate in the decision-making process of the EU?

Unit 7: Developments, Legal Foundations and Dynamics of European Integration

A. The Process of European Integration

I. The Aim of European Integration

Why do we have European integration? Why do we have European integration specifically within the framework of the European Union (EU)? The answer to these fundamental questions is that integration within the EU is meant to guarantee lasting **peace in Europe**. This aim must be seen against the background that Europe was a continent afflicted by wars for centuries. Within the EU, peace was to be secured primarily through **economic integration** based on **supranational law**, characteristics of EU integration and EU law that will be explained in this chapter. **413**

II. Historic Developments of European Integration

1. Background

Against the backdrop of the aftermath of World Wars I and II, the realisation sunk in that closer and better **organised cooperation in Europe** was a necessary step for stabilising the continent. An important impetus was provided by the United States (US) which required the creation of the Organisation for European Economic Cooperation in 1948 (OEEC; renamed Organisation for Economic Co-operation and Development, **OECD**, in 1960) in order to administer the Marshall Plan for Europe. Furthermore, the North Atlantic Treaty was opened for signature in 1949, establishing the organisation of the same name (NATO). Moreover, the Statute on the **Council of Europe** was signed in 1949 in the framework of which the European Convention on Human Rights (ECHR; signed in 1950) was adopted and the European Court of Human Rights (ECtHR) was created. **414**

2. The Foundation of the European Communities

The aforementioned organisations are 'traditional' international organisations where decision-making requires unanimity among its Member States and separate transposition in domestic law in order to become effective (see also unit 10 at m.n. 762 *et seq.*). European integration in the specific framework of the EU as we know it today, however, has its origins in a rather different concept. This new approach was designed essentially by *Jean Monnet* and presented by *Robert Schuman*, – then French minister of foreign affairs, – on the 9th of May 1950, in the so-called **Schuman Plan**, which proposed **415** specifically 'that action be taken immediately on one limited but decisive point. [The French Government] proposes that Franco-German production of coal and steel as a whole be placed under a common High Authority, within the framework of an organisation open to the participation of the other countries of Europe. The pooling of coal and steel production should immediately provide for the setting up of common foundations for economic development as a first step in the federation of Europe […] In this way, there will be realised simply and speedily that fusion of interest which is indispensable to the establishment of a common economic system; it may be the leaven from which may grow a wider and deeper community […]'.

416 This plan led to the creation of the **European Coal and Steel Community** (ECSC) which entered into force in 1952. The six founding members were Belgium, France, Germany, Italy, Luxembourg and the Netherlands. As envisaged in the Schuman Plan, the ECSC Member States' production of coal and steel – two of the materials most needed in warfare which were produced in particular in the *Ruhr* and *Saar* regions – was placed under the competence of an independent 'supranational' High Authority (later-on renamed European Commission; on the concept of supranationality see below at m.n. 482). The approach taken was **incremental** in nature, meaning, on the one hand, that participation of other European states was possible, and indeed expected by the ECSC's founders. On the other hand, it meant that further steps of economic, social and political integration were already anticipated in the Schuman Plan, for the time after the successful creation of the ECSC. These steps were to be based, in particular, on a common market; and it was the common market (with its free movement of workers *etc.*) that was expected to invariably lead to social and political integration (the so-called 'spill-over' effect of economic integration).

417 Attempts to instantly harness the momentum created by the ECSC ratification to also found a **European Defence Community** and a **European Political Community** failed, however, when the French National Assembly refused to ratify these projects in 1954. This prompted a return to the considerably more successful route of economic integration, resulting in the signature of the Treaty Establishing the **European Economic Community** (EEC) and the Treaty Establishing the **European Atomic Energy Community** (EAC or Euratom) in Rome in 1957. The original core task of the EEC was the establishment of a customs union, which had been completed already in the 1960s, and a common market comprising all factors of production. For political and legal reasons, Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK did not accede to the European Communities, but founded the politically and economically far less ambitious **European Free Trade Area** (EFTA) in 1960.

418 The integration progress within the EEC was considerably impeded in the 1960s and 1970s by tensions between politicians favouring a more classic **intergovernmental approach** (based on traditional international law and mechanisms such as unanimity voting) and politicians favouring **supranational methods** (based on independent institutions and instruments such as majority voting). That is, during the first years of its existence, the EEC had been perceived as a 'pragmatic economic community under construction' (*Rasmussen*) that appeared acceptable for all political currents. Tensions soon arose, when, according to the EEC Treaty, the EEC Council was to move to majority voting in 1966.

As French President *de Gaulle* regarded the possibility of being outvoted as a threat to the Member States' role as the 'Masters of the Treaty', France resorted to an 'empty chair policy' of failing to participate in Council meetings for six months, thereby triggering a constitutional crisis that could only be resolved by the 1966 **Luxembourg Accords**. Pursuant to the compromise embodied in these Accords, the Member States decided that **419**

> 'where, in the case of decisions which may be taken by a majority vote on a proposal from the Commission, very important interests of one or more partners are at stake, the Members of the Council will endeavour, within a reasonable time, to reach solutions which can be adopted by all the Members […]'.

The Accords also noted 'that there is a divergence of views on what should be done in the event of a failure to reach complete agreement' and therefore in essence constituted an 'agreement to disagree'. However, as the Accords went on to conclude that 'this divergence does not prevent the Community's work [from] being resumed in accordance with the normal procedure', the immediate crisis was overcome. Nonetheless, the Community's **decision-making capacity** continued to be severely hampered well into the 1980s, since the Council would consistently strive for unanimity in light of the looming threat of the veto of a Member State pleading 'vital' national interests. **420**

3. Further Developments

A turn-around was achieved in 1985, when a strategy paper, the so-called **White Paper** on the internal market, was presented by the Commission, enumerating 279 legislative measures to be adopted in order to complete the common market (now officially also referred to as the 'Internal Market') by 1992. This paper took a technocratic approach to the internal market goal that appeared acceptable to all Member States, making it possible for them to agree on majority voting in the 1986 **Single European Act** (SEA), a treaty revising the original EEC Treaty. Importantly, majority voting also applied under a new clause giving the Community the power to harmonise Member State laws, where such measures had 'as their object the establishment and functioning of the internal market' (Art. 100a EEC Treaty, now Art. 114 Treaty on the Functioning of the European Union (TFEU)). This central provision had the effect that relevant decision-making then functioned under the majority principle, effectively reviving the Community and allowing it to regain a **legislative dynamic** that had been stifled with the Luxembourg Accords. **421**

In 1993, another significant step was taken with the **Maastricht Treaty** (signed in 1992) entering into force, by which the **EU** was founded. The EU then functioned as **422** a ‘common institutional roof’ for **three ‘pillars’**, the first pillar consisting of the three original European Communities (ECSC, EEC, and Euratom; the EEC then being renamed **European Community** (EC)), and the second and third pillars comprising the Common Foreign and Security Policy (CFSP) and Cooperation in Justice and Home Affairs (JHA), respectively. Whereas the first pillar continued to be supranational in nature, the second and third pillars were less ambitious in terms of integration, as they were characterised by intergovernmental features that remained grounded more firmly in traditional international law. Furthermore, the Maastricht Treaty laid the groundwork for the establishment of the EU Economic and Monetary Union (EMU).

423 As early as 1999, the EU was reformed again by the **Treaty of Amsterdam** (signed in 1998), which *inter alia* provided the legal basis for ‘flexible’ or ‘enhanced integration’, meaning that the Council was empowered to authorise a group of EU Member States to enter into closer cooperation among themselves in specific policy areas within the EU framework. Furthermore, the Amsterdam Treaty amended the JHA pillar of the EU by transferring important JHA areas into the first pillar (thereby ‘communitising’ them). The remaining third pillar was renamed Police and Judicial Co-operation in Criminal Matters (PJCC).

424 Just one month after the ratification of the Amsterdam Treaty, work on the next EU reform treaty, the **Treaty of Nice** (signed in 2001), commenced. This treaty, which entered into force in 2003, brought about the institutional changes that were necessary to make the EU fit for further enlargement. In 2002, the ECSC Treaty, which had been concluded for a period of 50 years, ceased to be in force; its tasks and competences were taken over by the EC.

425 In June 2003, work was completed on another key reform project, the Treaty Establishing a Constitution for Europe (**Constitutional Treaty**), which had started in 2001. This treaty, which was drafted by a ‘Convention’ consisting of representatives of the governments of the EU Member States, national parliaments, the European Parliament and the European Commission, was meant to substantially simplify the EU’s structure and to underline its ‘constitutional’ significance for EU citizens and Member States alike. The treaty did not enter into force, however, as it had not been ratified by France and the Netherlands due to negative referenda primarily motivated *inter alia* by domestic policy concerns.

426 Despite this setback, work on a new reform treaty commenced on the 50th anniversary of the signature of the EEC and EAC Treaties on 25 March 2007. In this treaty (also referred to as the ‘Lisbon Treaty’), all references to the ‘constitutional character’ of EU law were to be avoided, as the denomination of the 2003 ‘Treaty Establishing a Constitution for Europe’ had contributed to the resistance against the preceding treaty project. However, the main contents of the failed Constitutional Treaty were to be transposed into the new reform treaty, which was signed in Lisbon in 2007 and entered into force in December 2009.

427 Under the Lisbon Treaty, the EU became the successor of the EC. Meanwhile, the EAC continues to exist alongside it, being closely legally entwined. While the EU Treaty and the EC Treaty have been amended, the EC Treaty has also been renamed TFEU. Among the many amendments brought about by the Lisbon Treaty, mention should be made of the following: first, the **EU Charter of Fundamental Rights (CFR)**, which had already been proclaimed in Nice in 2000, has become legally binding. Furthermore, the policy areas in which qualified majority voting is possible in the Council (see below at m.n. 434), have been extended considerably; and the rights of the EU Parliament (EP) and national parliaments have both been strengthened. Additionally, the instrument of the European Citizens' Initiative has been introduced; and the right of Member States to withdraw from the EU has been explicitly recognised (but not circumscribed in detail) in the Treaty on European Union (TEU).

4. EU Enlargements

428 As indicated, the ECSC, EEC and EAC were founded by Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Meanwhile, 22 further **accessions** have taken place:

- 1973: Denmark, Ireland, United Kingdom
- 1981: Greece
- 1986: Portugal, Spain
- 1995: Finland, Austria, Sweden
- 2004: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia
- 2007: Bulgaria, Romania
- 2013: Croatia

429 Any European state which respects the values referred to in the TEU (human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities; pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men) may apply to become a member of the Union (Art. 49 TEU). The **conditions for acceding** to the EU were further defined in the 1993 Copenhagen criteria. These comprise three groups:

- **political criteria**: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities
- **economic criteria**: a functioning market economy and the capacity to cope with competition and market forces
- **administrative and institutional capacity** to effectively implement the so-called *acquis* (*i.e.* the constantly evolving body of common rights and obligations that is binding on all the EU Member States) and the ability to take on the obligations of membership.

B. The EU Institutions

430 The EU has an **elaborate institutional framework** which is meant to advance its objectives. Within their competences, these institutions can enact legally binding acts. The EU's principal institutions are the EP, the European Council, the Council, the European Commission, the Court of Justice of the European Union (CJEU), the European Central Bank (ECB), and the Court of Auditors. The EP, the Council and the Commission are assisted by an Economic and Social Committee and a Committee of the Regions acting in an advisory capacity. There is also a large number of other bodies, such as EU agencies.

I. The European Council

431 The European Council provides the EU with the necessary **impetus** for its development and defines the **general political directions** and priorities thereof. It cannot exercise legislative functions, however. The European Council consists of the Heads of State or Government of the Member States, together with its president and the president of the Commission. The High Representative of the Union for Foreign Affairs and Security Policy takes part in its work. The European Council meets at least twice every six months, convened by its president. Decisions of the European Council are taken by consensus, unless the Treaties stipulate majority voting.

432 The European Council elects its president by qualified majority (on qualified majority see below at m.n. 434) for a term of two and a half years, renewable once. The president chairs the European Council, forges matters forward, and ensures the continuity of its work. The president of the European Council also has the task of ensuring the external representation of the Union on issues concerning CFSP (without prejudice to the powers of the High Representative of the Union for Foreign Affairs and Security Policy (see Art. 15 TEU)).

II. The Council

433 The Council, also called '**Council of Ministers**', exercises legislative and budgetary functions jointly with the EP. It also carries out policymaking and coordinating functions as specified by the treaties. It consists of a representative of each Member State at ministerial level and meets in ten different configurations, depending on the subject being discussed (*e.g.* Council General Affairs, Foreign Affairs Council, Economic and Financial Affairs Council (Ecofin)). Meetings are chaired by the minister of the Member State holding the six-month Council presidency (with the exception of the Foreign Affairs Council, which is chaired by the High Representative of the Union for Foreign Affairs and Security Policy).

The Council acts by a **qualified majority** as a rule unless the treaties stipulate otherwise. Today, a qualified majority is in principle defined as at least 55 percent of the members of the Council, consisting of at least 15 of them and representing Member States comprising at least 65 percent of the population of the Union; a blocking minority must include at least four Council members, short of which, the qualified majority shall be deemed attained. If the Council does not act on a proposal from the Commission or from the High Representative of the Union for Foreign Affairs and Security Policy, the qualified majority is defined differently, namely as at least 72 percent of the members of the Council, representing Member States comprising at least 65 percent of the population of the Union (see Art. 16 TEU and 238 TFEU). **434**

A Committee of Permanent Representatives of the Governments of the Member States (*Comité des représentants permanents* (**Coreper**)) is responsible for preparing the work of the Council. Established at the very first Council meeting in 1958, this body consists of national diplomats. It had originally been created by the Member States as an intergovernmental counterweight against the supranational features of European integration and is highly influential in the preparation of Council meetings and decisions. **435**

III. The European Parliament

The competences of the EP have been **strengthened continuously** during the process of European integration. The EP exercises legislative and budgetary functions jointly with the Council. It also exercises functions of political control and consultation as laid down in the treaties. It elects the President of the Commission. Additionally, the members of the Commission are subject as a body to a vote of consent by the EP. **436**

The EP is composed of **representatives of the Unions' citizens**, not exceeding 751 in number. Representation of citizens is regressively proportional, with a minimum threshold of six members per Member State. No Member State shall be allocated more than 96 seats (with Austria now holding 18 seats). The members of the EP were first elected directly in 1979. According to the TEU, they shall be elected for a term of five years by direct universal suffrage in a free and secret ballot (see Art. 14 TEU). **437**

Since the Lisbon treaty entered into force, the so-called **ordinary legislative procedure** has been applicable in most policy areas. Within this procedure, the EP and Council are on an equal footing (see below at m.n. 460). Only in the specific cases provided for by the Treaties does a special legislative procedure apply, in which legal acts are adopted by the EP with the participation of the Council or by the latter with the participation of the EP (see Art. 289 and 294 TFEU). **438**

IV. The European Commission

439 The Commission is a fully independent institution. Its functions can be characterised by three keywords in particular: its role as the motor of integration; its monopoly of initiative; and its role as guardian of EU law. The Commission thus has the task of promoting the general interest of the Union (**motor of integration**). EU legislative acts may in principle only be adopted on the basis of a Commission proposal (**monopoly of initiative**). The Commission also ensures the application of EU law (**guardian of EU law**). To this end, it can, for instance, bring complaints before the Court of Justice. Moreover, it can enact sanctions against private persons and enterprises in the field of competition law. The Commission also executes the EU budget and – with the exception of the CFSP and other cases provided for in the treaties – it ensures the Union's external representation in international affairs, *e.g.* in international trade and development cooperation. The Commission can also be empowered to adopt delegated and implementing legal acts (see below at m.n. 462).

440 The Commission consists of **one national of each Member State**, including its president and the High Representative of the Union for Foreign Affairs and Security Policy, who serves as one of its vice presidents. The body's term of office is five years.

441 The role of the **President of the Commission** has been considerably strengthened by the Lisbon Treaty. The President thus lays down guidelines within which the Commission is to work, decides on its internal organisation, and appoints its vice presidents from among the members of the Commission, with the exception of the High Representative of the Union for Foreign Affairs and Security Policy. Furthermore, a member of the Commission must resign if the President so requests.

442 The **candidate for President** of the Commission is proposed to the EP by the European Council, which must take into account the elections of the EP. This candidate needs to be elected by the EP by a majority of its component members. The other members of the Commission are appointed as follows: the Council, by common accord with the president-elect, adopts the list of the other persons proposed for appointment as members of the Commission. They shall be selected on the basis of the suggestions made by Member States. As indicated above, all members of the Commission are then subject as a body to a vote of consent by the EP. On the basis of this consent, the Commission is to be appointed by the European Council, acting by a qualified majority.

443 The Commission, as a body, is also **answerable to the EP**. If a motion of censure is carried by the EP, the members of the Commission must resign as a body (see Art. 17 TEU).

444 The 28 members of the Commission act as a **college**. Decisions are usually taken by consensus; if consensus cannot be reached, decisions are taken by a vote requiring the absolute majority of its members.

V. The Court of Justice of the European Union

The CJEU, which has its seat in Luxembourg, includes the **Court of Justice** (traditionally referred to as the 'European Court of Justice' (ECJ)) and the **General Court** (according to Art. 19 TEU, the Court of Justice of the European Union can also comprise specialised courts; at the moment, no specialised courts are established, however). The ECJ consists of one judge from each Member State. It is assisted by 11 advocates-general who present so-called 'reasoned opinions' (non-binding proposals for rulings) to the ECJ; these submissions are usually followed by the ECJ. **445**

The General Court is currently composed of one judge per Member State (as of 2019, there will be two per Member State). The judges and the advocates-general of the Court of Justice and the judges of the General Court are appointed by common accord of the governments of the Member States for six years. Retiring judges and advocates-general may be reappointed. **446**

The ECJ ensures that in the interpretation and application of the treaties, the law is observed. In order to guarantee the uniform interpretation and application of EU law – which is a prerequisite for the functioning of the internal market in particular – the ECJ is **exclusively authorized** to review the legality of the acts of the EU's institutions and to interpret EU law (see Art. 19 TEU). **447**

The ECJ is sometimes regarded as a **motor of integration**, not least given that the ECJ – based on a teleological reading of the Treaties – has developed fundamental principles of EU law, such as direct effect and supremacy of EU law, which have considerably shaped the EC/EU and driven EU integration forward (see below at m.n. 468 *et seq.*). **448**

C. The Sources of EU Law

I. Primary Law

1. The Sources of Primary Law

The sources of EU law are usually classified into primary law and legal acts based upon primary law (secondary law, tertiary law, international agreements concluded by the EU; see below at m.n. 458). **449**

EU primary law is law that has been created directly by the EU Member States. It comprises the TEU and the TFEU (including annexes and protocols), the treaties amending and supplementing primary law (such as the Lisbon Treaty), Treaties of Accession, and the EU CFR. Furthermore, there are unwritten sources such as general principles of EU law (in particular human rights). These instruments have the same legal rank. Collectively, they constitute the '**constitution**' of the EU. **450**

451 The **TEU** contains general provisions such as those on accession to, and withdrawal from, the EU, and deals with EU external relations and CFSP. The **TFEU** deals with the 'functioning' of the EU in more detail, specifying rules on the internal market and other policies of the EU, such as EU competition, trade, environmental and consumer policies.

452 Primary law also defines the **competences** of the EU and the **legal acts** that may be adopted on their basis (see the next two sections).

2. EU Competences

453 It is crucial that the EU's capacity to act – through the creation of secondary and tertiary law and the conclusion of international agreements (see below) – is limited by the **principle of conferral**. Under this principle,

> '[…] the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States' (see Art. 5 para. 2 TEU).

454 Furthermore, the EU's competences are further restricted by the principle of subsidiarity and the principle of proportionality. Under the principle of **subsidiarity**, in areas which do not fall within its exclusive competence (see below),

> '[…] the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level' (see Art. 5 para. 3 TEU).

455 Under the principle of **proportionality**,

> '[…] the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties' (see Art. 5 para. 3 TEU)

456 The categories of EU competence are laid down in the TFEU (see Art. 2 *et seq.*). Accordingly, the EU has the following **main types of competence**: exclusive competences, shared competences, and competences to carry out actions to support, coordinate or supplement the actions of the Member States (the CFSP constituting a special case not further examined here). These categories of competence are defined as follows:

– In areas, where primary law confers an **exclusive competence** on the EU, only the latter may adopt legally binding acts (the Member States may only do so themselves as an exception if the EU empowers them to do so or for the implementation of EU legal acts). The Union has exclusive competence in the following **areas** which are enumerated in the TFEU: customs union, the establishing of the competition rules necessary for the functioning of the internal market, monetary policy for the Member States whose currency is the Euro, the conservation of marine biological resources under the common fisheries policy, and the common commercial policy (*i.e.* trade relations with third countries).

- By contrast, in areas where primary law confers on the Union a **competence shared** with the Member States in a specific area, the Union and the Member States may adopt legally binding acts. However, the Member States may exercise their competence only to the extent that the Union has not exercised its competence. The type of shared competence is the general type of competence. The TFEU explicitly mentions *inter alia* the following principal **areas**: internal market, agriculture and fisheries, the environment, consumer protection, transport, and energy.
- Moreover, the EU has the competence to carry out actions to **support, coordinate or supplement** the actions of the Member States in the following **areas**: protection and improvement of human health; industry; culture; tourism; education, vocational training, youth and sport; civil protection; and administrative cooperation.

Despite the principle of conferral, the EU has some competences that confer very broad powers on it. Mention should be made to this extent, of its **implied powers** (non-written competences of the EU deemed necessary for the attainment of its goals), Art. 114 and Art. 352 TFEU. Pursuant to **Art. 114**, the EP and the Council may adopt measures which have as their objective, the establishment and functioning of the internal market. According to **Art. 352**, if action by the EU is deemed necessary for attaining one of the objectives set out in the treaties, and the treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, may adopt the appropriate measures accordingly. Both Art. 114 and 352 have been used extensively by the EU throughout the integration process. 457

II. EU Legal Acts: Secondary and Tertiary Law

On the basis of EU primary law, the EU institutions can enact further legal acts. 458
Legal acts that are directly based on primary law are usually referred to as '**secondary law**'. Legal acts based upon secondary law are called '**tertiary law**'. International agreements concluded by the EU with third states or international organisations are based upon primary law. Due to space restraints, they cannot be dealt with here in detail.

1. Form of Legal Acts

One needs to distinguish between **binding** and **non-binding legal acts**. Binding legal 459
acts can be adopted in the form of **regulations, directives, and decisions**. Non-binding legal acts can be adopted in the form of **recommendations and opinions** (see Art. 288 TFEU). Besides these main forms of legal acts, there are other types of acts which are adopted by the institutions, but are not systematically defined in the Treaties.

- **Regulations** are functionally similar to acts of parliament at the national level (*e.g.* Regulation 2016/2286 on the regulation of roaming charges). They are used when there is a need for rules applying in a uniform manner throughout the Member States. Firstly, regulations have general application. This means that they do not apply to an individual set of circumstances, but produce legal effects with regard to categories of situations and persons described in a generalised and abstract manner. Secondly, regulations are binding in their entirety (which distinguishes them from directives, recommendations and opinions). Thirdly, regulations are directly applicable in all Member States. This means that they need not be transposed by the Member States into national law; regulations automatically form part of the national legal order and are to be complied with by the Member States, their tribunals and administrative authorities, and all private persons falling into the scope of the regulation. Furthermore, regulations must not be transposed by the Member States into national legal acts, as this could obscure their supranational legal character.
- **Directives** are binding as to the result to be achieved, but leave to the national authorities the choice of form and methods of implementation in their domestic legal orders (*e.g.* Directive 2009/28/EC on renewable energy). Directives set a deadline (usually one and a half or two years) by which the Member States must transpose their obligations into national law. Directives are typically used in areas where there is no need for complete uniformity in the Member States and for the pursuit of EU objectives in areas where there are existing developed national legal frameworks. In case of a Member State failing to implement a directive correctly or in a timely manner, an individual may invoke those provisions that are unconditional and sufficiently precise against that Member State in order to defeat the application of the conflicting national laws ('direct effect' of unimplemented directives). By contrast, Member States that have not implemented a given directive (as well as individuals) may not rely on the directive's provisions as against (other) individuals. Furthermore, a Member State which has not (correctly) implemented a directive can be held accountable in the infringement procedure, which may lead to penalties (see below at m.n. 466 *et seq.*). Individuals who suffer harm due to the non-implementation or incorrect implementation of a directive may eventually claim damages from the Member State concerned ('state liability').
- **Decisions** are binding in their entirety (*e.g.* Commission Decision of 18 July 2018 on *Google Android*). There are two types of decisions: whereas so-called rule-making decisions are addressed to no one in particular (and are similar to regulations, therefore), a decision which specifies those to whom it is addressed is only binding for its addressees.
- **Recommendations** and **opinions** are non-binding legal acts. Whereas recommendations can be adopted by the Council, the Commission, and the ECB, opinions can be adopted by all EU institutions. Despite their non-binding character, they can *e.g.* be relevant for the interpretation of other legal acts.

Note that binding legal acts fall into the categories of legislative acts and non-legislative acts. **Legislative acts** are always secondary law. They are adopted within the so-called 'ordinary legislative procedure' or a special legislative procedure. In the ordinary legislative procedure, the Council – upon a proposal of the Commission – decides by qualified majority and the EP – depending on the phase of the procedure – decides by the majority of the votes cast, or else by the majority of its members (which also means that it has an effective right of veto). Within special legislative procedures, legal acts are adopted by the EP with the participation of the Council or by the latter with the participation of the EP (see Art. 289 and 294 TFEU). **460**

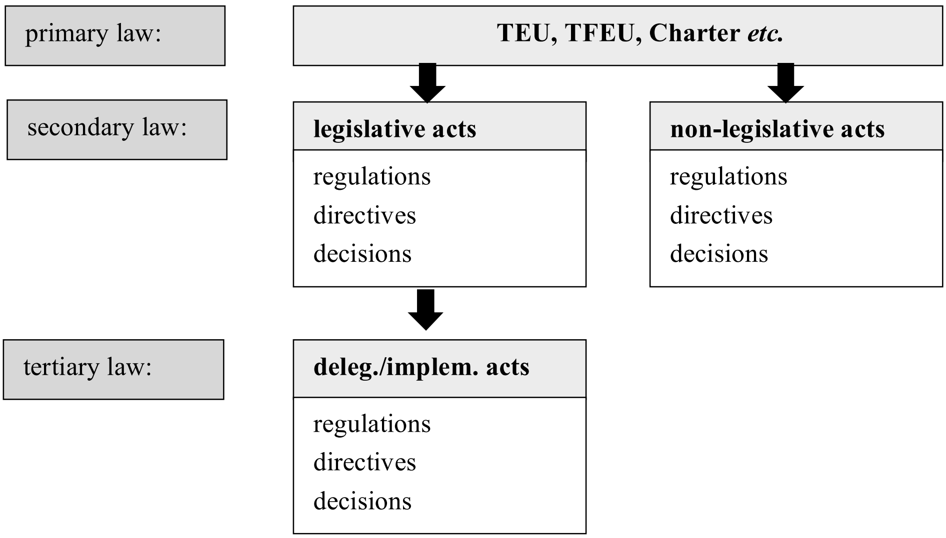
Non-legislative acts are not adopted within such a legislative procedure. They can be enacted by the Council or the Commission (and by the ECB in certain cases) based either directly on primary law (in which case they constitute secondary law) or on legislative acts in the form of delegated legal acts or implementing legal acts (in which case they constitute tertiary law; see next section). **461**

2. Hierarchy of Legal Acts

Legal acts on the level of secondary law must comply with primary law. Otherwise, they can be **challenged before the CJEU**. The same holds true for tertiary law, which must be in conformity with secondary law. There is no clear hierarchy between legislative acts and non-legislative acts belonging to secondary law, however. Tertiary law is always based on legislative secondary law and comes in two forms: **462**

- **Delegated legal acts**: Legislative acts can delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power must be explicitly defined in the legislative acts. The essential elements of an area must be reserved for the legislative act and, accordingly, must not be the subject of a delegation of power. Such acts of tertiary law are explicitly designated 'delegated' legal acts in their title.
- **Implementing legal acts**: Where uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission (or, exceptionally, on the Council). Such legal acts of tertiary law are explicitly referred to as 'implementing' acts in their title.

463 The relationships between primary law and the binding legal acts derived from primary law can be outlined as follows:



III. Implementation of EU Law

464 Primary law and EU legal acts require further steps of implementation. EU law is not normally directly implemented by the EU itself; the EU does so only as an exception, *e.g.* in the fields of competition and external trade ('**direct implementation**' of EU law).

465 Normally, EU law is implemented by the Member States ('**indirect implementation**' of EU law), namely by the national legislator through the enactment of acts of parliament, by national administrative authorities, and by domestic courts and tribunals issuing rulings in concrete cases.

D. Judicial Protection in the EU

466 EU law provides several avenues for judicial protection before the CJEU, which, as mentioned above, consists of the ECJ and the General Court. In the interest of space, this section restricts itself to outlining the **three procedures** most important in practical terms, namely infringement proceedings and actions for annulment ('direct actions', as they are directly brought before the CJEU), and preliminary references (cases that are referred to Luxembourg by national courts and tribunals). In this context, the General Court has jurisdiction principally to hear, in the first instance, direct actions taken by private applicants.

- **Infringement Proceedings**: If the Commission (or, in exceptional cases, another Member State) considers that a Member State has failed to fulfil an obligation under EU law, it can bring the case before the CJEU. If the CJEU finds that the Member State has indeed violated EU law, the state is required to take the necessary measures to comply with the judgment of the Court. Should the Member State concerned not take these measures, then the Commission can bring the case before the CJEU again, which may impose a lump sum or penalty payment on it. In cases where a Member State has failed to notify measures transposing directives, an accelerated infringement procedure applies (see Art. 258 and 260 TFEU).
- **Annulment Actions**: The CJEU also reviews the legality of legislative acts, of acts of the Council, of the Commission and of the ECB, other than recommendations and opinions, and of acts of the EP and of the European Council intended to produce legal effects vis-à-vis third parties. It also reviews whether acts of other EU bodies intended to produce legal effects vis-à-vis third parties indeed comply with EU law. Such actions can be brought on the grounds of a lack of competence, infringement of an essential procedural requirement, infringement of the treaties or of any rule of law relating to their application, or misuse of powers by
  - a Member State, the EP, the Council or the Commission;
  - the Court of Auditors, the ECB and the Committee of the Regions for the purpose of protecting their prerogatives; and
  - any natural or legal person against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures (see Art. 263 TFEU).
- **Preliminary Reference Procedure**: When judicial proceedings before national courts or tribunals raise questions of EU law, these questions can be referred to the CJEU for a preliminary ruling. According to the TFEU, the CJEU has jurisdiction to give preliminary rulings concerning the interpretation and the validity of EU law. If such questions arise in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal must refer the matter to the CJEU (Art. 267 TFEU). The CJEU's answers are to be taken into account by the national courts, which also render the final judgments in such proceedings.

The preliminary reference procedure has been of **particular importance** for EU integration. On the one hand, it has enabled the CJEU to ensure a uniform interpretation and application of EU law, which is indispensable for the functioning of the internal market in particular. On the other hand, this procedure is used by private citizens and companies to obtain rulings by the CJEU as to whether national law is in conformity with EU law. Although the CJEU is not explicitly empowered to answer such questions (as it is expressly authorised by Art. 267 TFEU merely to interpret and annul EU, not national law), the CJEU in fact gives an answer to such questions by declaring how EU law has to be interpreted in cases of the type referred to it, thereby in effect clarifying **467** whether there is a conflict between EU law and national law (which does amount to an implicit answer to the question of whether national law is in conformity with EU law). It has therefore been correctly observed that the preliminary reference system has developed into the '**infringement procedure of the European citizen**' (*Pescatore*), which is **highly effective** both in view of the number of potential claimants – individuals and businesses throughout the EU – and the direct effect and supremacy of EU law, characteristics that we will turn to in the concluding section.

E. The Dynamics of EU Integration – EU Law as Supranational Law

I. Background

468 European integration within the EEC, EC and EU is a process of economic and political regional transformation of **unprecedented dynamism**. From a **legal viewpoint**, there are many features that can be cited as an explanation for this dynamic economic integration, and the political transformation of Europe that ensued from it, ranging from factors such as the specific institutional structures of the former Community and the EU, the rules establishing the internal market, the EU's far-reaching competences and many more.

469 Usually, however, lawyers refer to the **fundamental principles** underlying the formal and substantive constitution of the EU as reasons for this quasi-automatic economic and political integration and transformation process. As regards relevant formal principles of EU law (leaving aside the special case of the CFSP), these comprise the **direct effect** of EU law, its **supremacy**, and the aforementioned **preliminary reference procedure**. Furthermore, regarding the formal-institutional aspects that have accelerated the integration project, lawyers commonly refer to the **far-reaching powers** of the former Community's and today's Union's institutions that have categorically distinguished them from any existing international organisation. On the other hand, there are the **substantive principles**, such as that of mutual recognition, which serve as fundaments of the internal market and, just as the formal principles, have been defined and further developed by the CJEU in its case law (on the substantive principles see below, Unit 8). By having been ingeniously coupled with the aforementioned formal principles and the specific powers of the Community's and Union's institutions, these substantive principles have made EU integration a **self-sustaining transformation process** that is spurred by overlapping political, economic and individual interests.

II. The *van Gend* Ruling: The Introduction of Direct Effect

470 From the very first case that was brought before the CJEU when the ECSC had entered into force, the legal service of the High Authority (the predecessor of the Com-

mission) tried to convince the CJEU to develop a teleological interpretation of the EEC Treaty taking full account of its aforementioned quasi-constitutional, federal potential. As early as 1963, the Commission was able to convince the CJEU of its understanding of the treaty in the groundbreaking *van Gend* case. Dealing with the EEC prohibition on Member States to increase tariffs, this case raised the fundamental question of a **direct effect** of EEC law, namely whether this provision could be invoked by individuals against a Member State before national courts.

The momentousness of the first question becomes clear when one considers how **international law** ordinarily deals with the issue of direct effect. International law leaves it to the national constitutional law of any given state to decide whether or not it attributes direct effect to norms of international law, thereby empowering its national courts and/or authorities to apply norms of international law in concrete cases and, possibly, its individuals to invoke such norms of international law within a state. Hence, pursuant to the interplay between traditional international law and national constitutional law, individuals hold those rights which accrue to them under national law and those (very few) rights, stemming from international law, which have been declared by a state to exert a direct effect on the domestic legal order (or which have explicitly been transformed by a state into national law, the exact techniques of transformation depending on the constitutional law of any individual state). **471**

In the *van Gend* ruling, the CJEU reversed these principles of international and national constitutional law, thereby **revolutionising** international relations and the **interplay between international law and national law** in the Community (and the EU today): according to the CJEU, the EEC Treaty (and by implication the TFEU today), 'is more than an agreement which merely creates mutual obligations between the contracting states'. Relying on interpretative arguments such as the treaty's preamble, the sovereign rights that had been transferred on the Community institutions, their effects on citizens, the existence of the European Parliament and the preliminary reference procedure, the CJEU concluded that the Community constitutes 'a new legal order of international law […] the subjects of which comprise not only Member States but also their nationals. Independently of the legislation of Member States, Community law [today EU law] therefore not only imposes obligations on individuals, but is also intended to confer upon them supranational rights,' which they can invoke before national courts as against the Member States. **472**

In the concrete case, the CJEU held that the relevant norm of the treaty contained a clear and unconditional prohibition which did not depend on any further implementing measures by the Community or its Member States. **473**

Practically and economically speaking, the impact of the doctrine of direct effect is tremendous, as any individual in the EU has become a potential plaintiff who can invoke Community (today: Union) law against every Member State. In other words, the *van Gend* judgment has created a virtually infinite number of 'private attorney generals' who can take action against any EU Member State that violates its EU obligations by **474**

invoking the rights they derive from EU law. This vast 'enforcement pull' has been regarded as the **most effective enforcement model** not only due to the sheer number of potential legal actions, but also since very real economic, political and social interests of the individual and private enterprises, which are protected by EU law, are subsequently ultimately utilised to promote the public interest of ensuring Member State compliance with their obligations under EU law.

475 In its **subsequent jurisprudence**, the CJEU extended the concept of direct effect from primary law to other legal instruments, namely decisions, general principles, most international agreements, and directives which have not been implemented into national law in due time or which have been implemented incorrectly. The CJEU also requires national administrative authorities to take account of the direct effect of EU law (even though administrative authorities appear to rarely comply with this duty) and obligates all national courts and authorities to interpret national law in line with EU law, which incurs a practically important 'indirect effect' of EU law.

III. The Supremacy of EU Law

476 The direct effect of Community and Union law has always been meant to make relevant norms decisively more effective, in particular those dealing with the internal market. It is obvious that a true common market requires a legal '**level playing-field**', which necessitates that EU law applies equally in all Member States. This of course requires that the Member States be prohibited from invoking national law against EU law. In other words: EU law must generally take precedence over national law, in principle. Although this issue was not openly addressed in the *van Gend* judgment, establishing the primacy of Community law vis-à-vis national law was the 'logical next step' that was to be expected of the CJEU.

477 The occasion for addressing this question presented itself almost immediately after *van Gend* in the 1964 *Costa/ENEL* case. This case involved a conflict between an EEC Treaty provision and an Italian act of parliament. By adopting a teleological interpretation focusing on the uniformity and effectiveness of Community law, the CJEU concluded that Community (today EU) norms enjoy **supremacy** vis-à-vis national law.

478 As has become clear in later cases, the CJEU's doctrine of supremacy is particularly **far-reaching**, with the Court claiming that any piece of EU law (even secondary and tertiary law such as 'minor' Commission regulations) takes precedence over any conflicting rules of national law, be they rules of constitutional rank or human rights. It does not come as a surprise that Member State courts have not fully accepted this claim of supremacy, in particular as regards (fundamental principles of) national constitutional law. This resistance, expressed in several landmark rulings by national supreme courts, has prompted the CJEU to develop a comprehensive EU human rights jurisprudence, which is meant to mitigate the consequences of the far-reaching doctrine of supremacy. What's more, it has also acted as a catalyst in the debates leading to the

EU Charter of Fundamental Rights and the (failed) attempt at bringing the Treaty Establishing a Constitution for Europe into force.

IV. Direct Effect, Supremacy, and Preliminary References

The extensive consequences of the principles of direct effect and supremacy cannot fully be understood unless one also takes into account their interlinkages with the preliminary reference procedure. As indicated, according to this procedural device, domestic courts may – and courts of last instance must in principle – refer questions on the interpretation of EU law to the CJEU whose answers are to be taken into account by the national courts. **479**

As mentioned above, the preliminary reference system has developed into the 'infringement procedure of the European citizen'. Its ties with the doctrines of direct effect and supremacy have been particularly well described by *Weiler*: direct effect makes EU law the '**law of the land**' in every Member State; supremacy makes it the '**higher law of the land**'. The fact that this higher law can be invoked as a shield against national law before all national courts makes it so effective in concrete proceedings, but also, more generally, in furthering integration. Nonetheless, national judges will often perceive EU law as 'foreign law' and may also hesitate to convict their own state. These are two further aspects where the preliminary reference procedure comes in as a 'remedy'. That is, as regards the first problem, preliminary rulings of the CJEU help national courts become familiarised with this type of 'foreign law'. As for the second problem, the CJEU's interpretation is *de facto* binding for the domestic courts of all Member States, so a single domestic court 'is not alone' when it enforces EU law against its own government. **480**

In sum, due to the doctrine of direct effect, EU institutions can reach the individual directly, without the intermediary of the Member State. Moreover, supreme EU law is directly infused into national proceedings through the preliminary reference procedure. Due to the judicial coupling of direct effect and supremacy, individuals can force EU Member States to change national law, therein promoting the progress of legal, economic and political transformation. **481**

V. Supranationality

EU law (with the exception of the CFSP, which still relies on traditional international law mechanisms to a considerable extent) is also said to constitute **supranational law** as opposed to **traditional international law**. The characteristics that are usually associated with supranational law are independent organs, one's own financial resources, direct effect, supremacy, and the fact that decisions at the supranational level can be taken against the will of individual Member States (*e.g.* in majority votes or court rulings). As we have seen, all of these criteria are fulfilled by, and characterise, EU law. **482**

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Questions

1. Does the EU have a constitution?
2. Why is it important to distinguish the 'Council of Europe' from the 'European Council' and the 'Council'?
3. How did the Single European Act influence the trajectory of European integration?

4. While the name suggests continuity, the post-Lisbon 'EU' is, for the most part, hardly comparable to the 'EU' after Maastricht. Explain.
5. Against what criteria would an accession to the EU of Turkey (or any other third country) have to be assessed?
6. Why did the 'empty chair policy' arise and how was it overcome?
7. Given the rules on how a qualified majority vote is taken within the Council, is it necessary to have a specific rule on how to establish a blocking minority?
8. How are Commission decisions taken?
9. Are Advocates-General a useful institution?
10. Does Article 352 TFEU make the principle of conferral obsolete?
11. Given the principle of proportionality, are directives always preferable to regulations?
12. Why does the Council in some cases prefer TFEU provisions allowing it to adopt 'non-legislative' regulations or directives over TFEU provisions allowing it to adopt 'legislative' regulations or directives?
13. As for delegated regulations or directives, why must the essential elements of a policy area be reserved for the empowering legislative act?
14. The *van Gend* ruling may be perceived as a revolutionary act. How did the CJEU justify its interpretation of the law?
15. Why would an EU tertiary law decision adopted by the Commission enjoy supremacy over Austrian constitutional law?
16. The preliminary reference procedure has been described as the 'infringement procedure of the European citizen'. Why would you agree or disagree?

Unit 8: The EU Internal Market

A. The Internal Market as the Centre of Gravity of EU Integration

483 The internal market has always been at the centre of European Union (EU) integration. After the failure of the European Political Community (EPC), the founding members of the European Coal and Steel Community (ECSC) established the European Economic Community (EEC) (see above Unit 7), whose main task was the creation of a common market. The common market project was meant to serve, and has indeed continuously functioned as a kind of 'vehicle' for moving integration forward also in relation to other fields such as social policy, an effect also referred to as the '**spillover**' of economic integration.

484 The **dynamics** of this integration process can be explained not only by relevant EU internal market legislation, but also – as outlined in the preceding unit – in particular by the fact that pertinent rights can be invoked by individuals on the basis of the doctrine of direct effect, and are particularly effective due to their supremacy and the preliminary reference procedure. These formal characteristics of EU law must be seen in view of their interaction with the 'logic' of a relatively small number of landmark rulings of the Court of Justice of the European Union (CJEU) concerning substantive EU law, which have unleashed the vast integrative potential of the internal market. These seminal judgments on substantive internal market law – in particular *Dassonville*, *Cassis*, *Keck,* and some more recent rulings – have all concerned the free movement of goods. As will be seen in this chapter, the CJEU has at least partially extended the underlying ideas to the internal market as a whole.

B. Forms of Economic Integration

- **Free trade area**: The Member States of a free trade area (FTA) eliminate customs duties (tariffs) and other restrictive (non-tariff) regulations of commerce on substantially all trade in goods within the FTA. They nevertheless maintain various national tariffs and import policies for goods imported from third countries. Hence, the risk arises that products will be imported into the FTA through the Member State with the lowest external tariff. Consequently, there is a need to determine the origin of products and to impose compensatory tariffs within FTAs.
- **Customs Union**: This problem is overcome in customs unions. In a customs union, the contracting parties do not only abolish all internal tariffs and internal restrictive non-tariff regulations on substantially all trade in goods, but likewise apply a common customs tariff and common trade policies vis-à-vis third countries.

- **Internal Market**: Within an internal market, not only products enjoy free movement (as in a customs union), but all factors of production may basically move freely across the internal borders.

In line with this concept, the EU internal market (formerly also referred to as 'common market' or 'single market') is defined in Art. 26 of the Treaty on the Functioning of the European Union (TFEU) as **485**

> 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties.'

The free movement of these factors is ensured by the so-called **fundamental freedoms** (free movement of goods, workers, establishment, services, capital and payments) at the level of primary law and EU legal acts adopted by the EU institutions. The underlying economic idea is that the free movement of all factors of production will lead to their optimal allocation, resulting in an international division of labour, economies of scale and an increase in wealth. More fundamentally, as mentioned above, the envisaged economic integration was designed to **stabilise Europe** through highly increased political and social integration, therein rendering military conflict among closely interwoven states an impossibility. **486**

C. The Creation of the Internal Market: Positive and Negative Integration

I. Positive and Negative Integration Defined

The EU internal market has been established by two main instruments, namely positive and negative integration. **Positive integration** means that the EU institutions enact secondary or tertiary law laying down general rules harmonising divergent national measures in order to facilitate free movement in the internal market. **Negative integration** means that the judiciary (the CJEU and national courts) – upon application by individuals and enterprises and on the basis of direct effect and supremacy – strikes down national rules that are in conflict with the fundamental freedoms enshrined in primary law. In other words, negative integration is driven forward by individuals interested in their internal market rights and by courts. Negative integration has therefore functioned as a very powerful tool of integration, in particular in times and areas where the legislator has not yet enacted relevant rules (see Unit 7 at m.n. 479 *et seq.*). **487**

II. Harmonisation

Positive integration harmonising divergent national measures requires a legal basis in the Treaties. A series of such provisions are enshrined in primary law, therein empowering the EU institutions to enact relevant measures, the most important being **488**

Art. 114 TFEU. This provision allows the European Parliament (EP) and the Council – acting in accordance with the ordinary legislative procedure – to adopt the measures for the harmonisation (also referred to as 'approximation') of national law in the Member States which have as their objective the establishment and functioning of the internal market.

489 One central problem of Art. 114 TFEU is the fact that the scope of the EU's power is defined by the wording 'measures […] having as their object […] the internal market', as this power can thus be read in a very broad manner. In the leading case dealing with an EU directive prohibiting tobacco advertising in the media (*Tobacco I*), the CJEU clarified the **scope of Art. 114** holding that EU measures based on it must contribute to removing appreciable obstacles to trade or disruptions of competition. Such measures may also address problems that are anticipated from future divergent national measures, provided such problems are indeed likely to arise. Furthermore, non-economic concerns such as health issues can be addressed on the basis of Art. 114 as well, provided such considerations are integrated in rules having as their goal the promotion of the internal market.

490 The fact that Art. 114 TFEU can, and has indeed been, interpreted in a very **broad fashion** by the CJEU, is underlined by a second leading case, *Swedish Match*, concerning an EU directive banning chewing tobacco. The Court found in this case that the directive could be based on Art. 114, since it was likely that otherwise the Member States would adopt divergent policies undermining the internal market. It has rightly been pointed out by commentators that it is counter-intuitive that prohibiting a product should be regarded as a measure 'promoting the internal market'. This quite permissive stance taken by the CJEU as regards the scope of Art. 114 appears to be somewhat in conflict with the principle of conferral (see above Unit 7 at m.n. 453).

491 Another problem arising under Art. 114 TFEU is the fact that individual Member States can be outvoted under Art. 114, as it permits majority voting (with the exception of sensitive areas – fiscal provisions, the free movement of persons, rights of employed persons – calling for unanimity), possibly requiring such Member States to lower their national standards of protection. In order to prevent this problem from arising, Art.114, on the one hand, obliges the Commission, the Council and the EP to take a **high level of protection** as a basis in legal acts concerning environmental and consumer protection.

492 On the other hand, it provides for the following two **exceptions**:

– If, after the adoption of an EU harmonisation measure, a Member State deems it necessary to maintain national provisions on legitimate grounds (such as public morality, public policy or public security; the protection of health and life of humans, animals or plants; the environment or the working environment), it shall notify the Commission of these provisions (Art. 114 para. 4 TFEU);
– if, after the adoption of an EU harmonisation measure, a Member State deems it necessary to introduce national provisions based on new scientific evidence relating to the protection of the environment or the working environment on the grounds of

a problem specific to that Member State arising after the adoption of the harmonisation measure, it shall notify the Commission of the envisaged provisions (Art. 114 para. 5 TFEU).

When receiving such a notification, the Commission must **approve or reject** the national provisions when they constitute a means of arbitrary discrimination or a disguised restriction on trade or when they constitute an obstacle to the functioning of the internal market. In the absence of a decision by the Commission, the national provisions are deemed to have been approved. When the Commission authorises a Member State to maintain or introduce national provisions deviating from an EU harmonisation measure, the Commission must immediately examine whether to propose an adaptation to that measure. **493**

While these exceptions provide some leeway for non-economic concerns of the Member States, critics have argued that the Commission tends to overly rely on experts and science in relevant decisions. It has also been submitted by some commentators that this type of (ostensible) depoliticization of decision-making could in fact aggravate the legitimacy problems of the EU. **494**

D. Fundamental Freedoms

I. Common Structures

There are several features that are common to all fundamental freedoms. Firstly, the fundamental freedoms only apply to **cross-border economic activity** (such as the import or export of a product, or border crossing by a worker or service). The fundamental freedoms cannot be invoked in purely domestic circumstances. **495**

Secondly, the fundamental freedoms prohibit discriminatory measures and non-discriminatory restrictions. As regards the first type of measure, a distinction must be drawn between directly (*de iure*) discriminatory measures and indirectly (*de facto* or disguised) discriminatory measures. **496**

- **Direct discrimination**: directly discriminatory measures disadvantage persons, products, services, capital or payments from other EU Member States explicitly on the basis of their foreign origin (*e.g.* nationality requirements for professional players in sports in a given Member State).
- **Indirect discrimination**: indirectly discriminatory measures do not explicitly rely on the foreign origin of a person, product, service *etc.*, but use a distinguishing criterion that disproportionately affects foreign persons, products, services *etc.* (*e.g.* language skills as recruiting requirements or residence requirements that can more easily be fulfilled by nationals).

On the other hand, **non-discriminatory measures** that restrict cross-border activities are also caught by the fundamental freedoms when their utilisation is impeded or rendered unattractive (*e.g.* packaging requirements for products). **497**

498 However, and this brings us to the third common characteristic, discriminatory measures and non-discriminatory obstacles to trade can be **justified** under all fundamental freedoms. Directly discriminatory measures can be justified on the basis of grounds that are explicitly mentioned in the TFEU provisions regulating a given fundamental freedom. Other restrictions can be justified by invoking non-written 'mandatory requirements' (overriding reasons relating to the general interest, such as consumer protection) that were recognised by the CJEU as a non-exhaustive category of grounds of justification in its case law. Meanwhile, however, the CJEU tends to permit the justification of directly discriminatory measures on the basis of mandatory requirements and, *vice versa*, the justification of other restrictions on the grounds explicitly mentioned in the TFEU as well.

499 In any case, a restrictive Member State measure must, – in order to be justified – , pass the following test, also referred to as the '**test of proportionality**':

– the measure must pursue a legitimate objective (*i.e.* grounds explicitly mentioned in the TFEU or mandatory requirements);
– it must be suitable to attain this objective (*i.e.* it must be capable of making a contribution to promoting the objective);
– it must be necessary (*i.e.* there must not be an alternative measure that is equally suitable but less restrictive of trade); and
– it must be proportionate in the strict sense (meaning that the measure's contribution to promoting the legitimate objective is not out of proportion with its trade-restrictive effects).

500 It is obvious that the CJEU can be **more or less stringent in its review** of these requirements. For example, in its recent jurisprudence, the CJEU has tended to lower its standard of review under the necessity test when a trade-restrictive measure was enacted by a Member State in the interest of important health concerns. By contrast, it has reinforced the test of suitability by introducing a test of consistency: this test requires Member States employing trade restrictions on legitimate grounds to apply such measures in a consistent and systematic manner. Consequently, the CJEU has *e.g.* objected to national measures that, on the one hand, purport to reduce the risks associated with gambling by reserving the provision of gambling services to a state monopoly, when such measures, on the other hand, however, permit extensive advertising for such services (see *e.g.* CJEU, case C-316/07, *Stoß*).

501 Fourthly, as mentioned above, the fundamental freedoms have a **direct effect** on and, in principle, supersede conflicting national law due to the **supremacy** of EU law. Individuals suffering harm from Member State measures violating the fundamental freedoms may claim damages from the Member State concerned ('**state liability**').

502 Finally, while the fundamental freedoms originally were understood as merely obliging the Member States, the CJEU has in exceptional cases found that they can be invoked by private persons vis-à-vis other private persons as well. It has thereby

attributed so-called '**horizontal effects**' to the fundamental freedoms (for details, see below at m.n. 537).

II. Free Movement of Goods

The free movement of goods in the EU is established by prohibitions on internal 503
customs duties, discriminatory internal taxation and quantitative restrictions on trade between Member States (on these see below), a prohibition on quantitative restrictions on exports and all measures having an equivalent effect (Art. 35 TFEU), as well as the requirement that the Member States adjust state monopolies of a commercial character so as to prevent discrimination against imported products (Art. 37 TFEU).

Goods are defined as 'products which can be valued in money and which are ca- 504
pable, as such, of forming the subject of a commercial transaction' (CJEU, case 7/68, *Works of Art*). This definition is very broad, covering for instance, works of art, electricity, gas, and even waste. The free movement of goods encompasses products produced in the EU just as products coming from a third country, which are considered to be 'products in free circulation' as soon as the relevant import requirements (formalities, payment of tariffs *etc.*) have been met (Art. 29 TFEU).

1. Customs Duties and Measures Having an Equivalent Effect

EU law prohibits customs duties on imports from and exports to other Member 505
States and any charges having the equivalent effect (**Art. 28, 30 TFEU**). In line with the abovementioned concept of a customs union, EU law also requires the adoption of a common external customs tariff that applies to imports from third countries. For space restraints, this unit deals with the internal dimension of the customs union only.

A **customs duty** is a tax charged by a state on importation or exportation. As customs 506
duties are obvious trade restrictions that are clearly ruled out by Art. 30 TFEU, they have had little practical relevance in CJEU jurisprudence. As the drafters of the Treaties had foreseen the possibility that Member States might be tempted to circumvent the prohibition on customs duties by adopting disguised protectionist measures, they also included a prohibition on '**charges having an equivalent effect**' in this provision.

Due to the vital importance of this provision for the internal market, the CJEU has 507
adopted a very strict interpretation of the term 'charges having an equivalent effect'. Accordingly,

> 'any pecuniary charge, however small and whatever its designation and mode of application, which is imposed unilaterally on domestic or foreign goods by reason of the fact that they cross a frontier, and which is not a customs duty in the strict sense, constitutes a charge having an equivalent effect […] even if it is not imposed for the benefit of the state, is not discriminatory or protective in effect and if the product

on which the charge is imposed is not in competition with any domestic product' (CJEU, case 24/68, *Commission/Italy*, para. 9).

508 The CJEU permits only two **exceptions** from this strict reading. First, a charge is not regarded as having an effect equivalent on a customs duty if it amounts to a proportionate consideration for a service rendered specifically to the importer or exporter concerned. Secondly, proportionate charges levied by a Member State upon importation or exportation for inspections required by EU law do not constitute charges having an equivalent effect.

2. Internal Taxation

509 The prohibition on customs duties and measures having an equivalent effect (*i.e.* pecuniary border measures between Member States) is complemented by a prohibition on **internal discriminatory taxation** (Art. 110 TFEU).

510 According to this provision,

> '[no] Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.'

511 As follows from the explicit wording of para. 1, this provision prohibits both direct and indirect tax discrimination between imports and domestic products. In order for para. 1 to be applicable, it must be shown that the differentially taxed products are indeed 'similar'. In this regard, the CJEU relies in particular on the characteristics – analysed from the viewpoint of consumers – of the products compared and other proxies such as their fiscal, customs or statistical classification (*e.g.* two types of red wine regarded as close substitutes by consumers). The thrust of para. 1 is however extended in para. 2 to directly competitive or substitutable products. Such products are not 'similar' in the sense just described, but are nonetheless in a somewhat looser competitive relationship to the domestic product (*e.g.* beer and wine). Regarding such products, para. 2 prohibits measures having a protective effect for domestic products. The borderline between paras. 1 and 2 is blurred, but practically important, given that para. 1 calls for equalisation of the tax differential, whereas para. 2 merely requires the removal of the protective effect.

512 Importantly, only indirectly discriminatory measures may be justified, namely where a Member State can invoke legitimate grounds (thus, for example, a Member State can in principle impose different taxes on similar products that were produced in a different manner, *e.g.* consuming more or less energy; this is of evident importance for policies such as environmental and climate protection).

3. Quantitative Restrictions and Measures Having an Equivalent Effect

a) Articles 34, 36 TFEU, and *Dassonville*

The **central rule** for the free movement of goods and the internal market more generally is Art. 34 TFEU. Whereas Art. 30, 110 and 37 TFEU are regarded as *leges speciales*, Art. 34 TFEU constitutes the *lex generalis*. 513

According to Art. 34 TFEU, 514

> '[q]uantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.'

Quantitative restrictions and measures having an equivalent effect (MEEs) are not defined in the Treaties. The CJEU has made it clear that **quantitative restrictions** are total or partial restraints (quotas) of imports of a given product. Like tariffs, quantitative restrictions are measures rarely used in today's trade regulation. The real problems are caused by MEEs, *i.e.* other Member State measures – often inadvertently – affecting trade. 515

The CJEU has had a lot more trouble providing an adequate **definition of MEEs** and thereby in clarifying the scope of Art. 34 TFEU. Three cases stand out in its case law, all of which are still highly relevant today. First, the CJEU famously found in the 1974 *Dassonville* case that 516

> '[a]ll trading rules enacted by Member States, which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions' (CJEU, case 8/74, *Dassonville*, para. 5).

In later cases, the Court has made it plain that the prohibition applies not only to 'trading rules', as indicated in *Dassonville*, but to **any** state measures that are **capable of affecting, indirectly or potentially, trade in goods** between Member States. This is arguably the broadest reading that one can give to this prohibition. 517

Art. 34 TFEU must be read in conjunction with **Art. 36** TFEU, which permits the justification of measures violating Art. 34. Pursuant to Art. 36, as an exception, 518

> '[t]he provisions of [Art. 34] shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.'

Two crucial issues need to be pointed out as regards Art. 36 TFEU. First, it contains an **exhaustive list** of grounds of justification. Secondly, the CJEU has consistently conducted the aforementioned **proportionality analysis** under Art. 36, requiring that 519 national measures adopted to promote these legitimate aims be suitable and necessary, meaning that Member States must, among alternative measures with legitimate non-economic aims, adopt the one which is least restrictive of trade.

520 Hence, the CJEU's approach in *Dassonville* creates a **dilemma**: on the one hand, it gives a very broad reading to the scope of the prohibition enshrined in Art. 34 TFEU. On the other hand, the corresponding provision in Art. 36 TFEU contains a limited number of grounds of justification and tends to be interpreted strictly by the CJEU as regards the necessity requirement just mentioned.

b) The *Cassis* Ruling

521 In the next prominent case, *Cassis de Dijon*, decided in 1979, the CJEU confirmed, furthermore, that this prohibition covers not only discriminatory measures, but also '**indistinctly applicable**' measures. This case dealt with a German measure prohibiting the importation of Cassis de Dijon, a French liqueur, from France into Germany. This measure was motivated by the fact that Cassis had an alcohol content of less than 20 percent, whereas under German law, liqueurs could only be marketed if they had an alcohol content of at least 25 percent. The CJEU found that the measure, although indistinctly applicable, constituted an MEE requiring justification.

522 Furthermore, this ruling has also set the course in several other important respects. To that extent, the CJEU reasoned further:

> 'In the absence of [EU] rules relating to the production and marketing of alcohol […] it is for the Member States to regulate all matters relating to the production and marketing of alcohol and alcoholic beverages on their own territory. Obstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognised as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer' (CJEU, case 120/78, *Cassis de Dijon*, para. 8).

523 In other words, the CJEU first confirmed the competence of the Member States, as 'masters of the treaty', to regulate issues regarding such products, meaning that obstacles resulting from divergent Member State policies had to be accepted. Secondly, however, this **competence** is **quite closely confined**, as it can be exercised only to the extent that such measures are 'necessary', which means, as we have seen, that they must constitute the least trade-restrictive alternative that is available.

524 Equally crucially, the CJEU, thirdly, recognised in this passage that the Member States may invoke additional non-economic policy goals ('**mandatory requirements**') that are not mentioned in Art. 36, such as consumer protection, as grounds for justifying measures restricting trade. The recognition of a non-exhaustive number of such unwrit-

ten grounds for justification extends the regulatory autonomy of the Member States, thereby to some extent correcting the imbalance between the broad *Dassonville* reading of Art. 34 and the narrow wording of Art. 36.

The CJEU held, furthermore, that the import prohibition was not necessary for consumer protection in the concrete case, given that 525

> '[…] it is a simple matter to ensure that suitable information is conveyed to the purchaser by requiring the display of an indication of origin and of the alcohol content on the packaging of products' (para. 13).

This reasoning clearly shows the Court's role as a **motor of EU integration**: it rules out a highly effective national measure (an import ban to protect consumers), favouring instead a suitable less trade-restrictive alternative (labelling of products). 526

Finally, the CJEU famously held that 527

> '[t]here is […] no valid reason why, provided that they have been lawfully produced and marketed in one of the Member States, alcoholic beverages should not be introduced into any other Member State' (para. 14).

The Court therefore introduced the **principle of origin**: products that have been lawfully produced and marketed according to the regulations of one Member State – the country of origin – basically must be admitted to all other Member States and can move freely across the EU (unless a Member State can invoke legitimate grounds for justification and restricts trade through suitable and necessary measures). 528

It is obvious that this principle of origin incurs a series of **consequences**. On the one hand, there is a certain shift of sovereignty from importing to exporting countries. On the other hand, the need for the EU legislator to implement rules on mutual recognition of products, decreases, since the principle of origin – introduced by the CJEU in *Cassis* – has the same effect. The *Cassis* ruling therefore shifts power from the EU legislator to judges and private companies willing to invoke the principle of origin before courts (a shift from 'positive integration' to 'negative integration'). Moreover, there is a risk of a legislative 'race to the bottom', since Member States may be tempted to decrease their standards so as to give products a competitive advantage in the Internal Market. The Commission reacted quickly to this judgment. It changed its approach to the free movement of products, henceforth on the one hand challenging state measures violating the principle of origin before the CJEU, and, on the other hand, trying to harmonise state regulations that survived the *Cassis* test. 529

c) The Turnaround in *Keck* and post-*Keck* Jurisprudence

The **core problem** resulting from *Dassonville* and *Cassis* was that any state measures that directly or indirectly, actually or potentially affected trade could be held to be *prima facie* unlawful under Art. 34 TFEU, thus requiring judicial scrutiny as to their necessity 530 under Art. 36 or the 'mandatory requirements' introduced in *Cassis*. This problem was illustrated in a series of cases, for example in *Torfaen*. In this case, the CJEU held that national laws which prohibited retail shops from selling on Sundays constituted MEEs falling under Art. 34, thus requiring justification. Critics argued that national measures of this type should not be regarded as coming under Art. 34 at all, since they would not hinder cross-border trade and affected imported and domestic products in the same manner.

531 As the *Dassonville* formula was in fact applied by private businesses – in conjunction with direct effect and the supremacy of EU law – ever more frequently to challenge even non-discriminatory state regulations, the CJEU declared in its 1993 *Keck* ruling which concerned a French law that prohibited the resale of goods at a loss, that 'the Court considers it necessary to re-examine and clarify its case-law on this matter'. Explicitly overruling its constant jurisprudence, the CJEU found that

> 'contrary to what has previously been decided, the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements is not such as to hinder directly or indirectly, actually or potentially, trade between Member States within the meaning of the Dassonville judgment […], so long as those provisions apply to all relevant traders operating within the national territory and so long as they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States' (CJEU, case C-267/91 and case C-268/91, *Keck*, paras. 14-15).

532 This **judicial turnaround** has provoked a sustained intense academic discussion which cannot fully be restated here. One principal reason for this controversy has been the debatable adequacy of the concept of 'certain selling arrangements', which was central to *Keck*. Following *Keck*, the concept had been applied, *e.g.* to a German rule prohibiting pharmacists from advertising certain products (CJEU, case C-292/92, *Hünermund*) or to an Italian law restricting the number of outlets for a given product (CJEU, case C-387/93, *Banchero*). In contrast, any domestic rules relating to the goods themselves, such as laws concerning the required composition, production or labelling of goods, may well constitute MEEs.

533 It is noteworthy, however, that the CJEU has also held in *Keck* that provided that the aforementioned conditions are fulfilled (*i.e.* equal treatment of all traders and of products imported from other Member States),

> 'the application of such rules to the sale of products from another Member State meeting the requirements laid down by that State is not by nature such as to prevent their access to the market or to impede access any more than it impedes the access of domestic products. Such rules therefore fall outside the scope of [Art. 34 TFEU].'

534 In subsequent cases such as *Gourmet* and *Mickelsson*, the CJEU has arguably clarified and reconfirmed that its new approach to determining the ambit of Art. 34 TFEU hinges on the concept of **market access**.

Even though the concept of market access may not have acquired an unambiguous meaning so far, the CJEU's judicial **tendency** seems to have become clearer: accordingly, rules that are non-discriminatory, that do not impose product requirements (*e.g.* regarding the production or composition of goods) and do not significantly impair market access, may arguably not fall under Art. 34 TFEU. Hence, national measures of this type would not need to be justified by the Member States, which are not, therefore, required to design such measures to be least restrictive of trade. Consequently, although several details are still uncertain, the Member States have regained considerable regulatory freedom through the *Keck* and post-*Keck* case law. **535**

In sum, while the CJEU's jurisprudence following *Dassonville* had represented a distinctly liberalist approach, that – in conjunction with direct effect, supremacy and preliminary rulings – has incited many individuals to challenge even Member State rules whose specific impact on trade may have been doubtful, the Court's reorientation in *Keck* and post-*Keck* has arguably been attempting to steer this dynamic into more appropriate channels that are genuinely conducive to transborder market integration. **536**

d) Horizontal Effect of the Free Movement of Goods?

In the past, the CJEU had refused to recognise a **horizontal effect** of Art. 34 TFEU. In 2012, it surprisingly found, however, that this provision can be invoked by individuals not only against states, but possibly also against private citizens. Pursuant to the CJEU, Art. 34 must be interpreted as meaning that it applies to certification activities of a private-law body (the German *TÜV*), where the national legislation considers the products certified by that body to be compliant with national law and that has the resultant effect of restricting the marketing of products which are not certified by that body (CJEU, case C-171/11, *Fra.bo*). **537**

III. Free Movement of Workers

The free movement of persons encompasses the free movement of workers and the freedom of establishment (dealt with in this and the next sections, respectively). Though non-economic in nature, the rights flowing from EU citizenship are also relevant in this context (see below at m.n. 575 *et seq.*). **538**

The freedom for movement of workers entails **539**

> 'the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment' (Art. 45 para. 2).

More precisely, it encompasses the right **540**

> '(a) to accept offers of employment actually made;
>
> (b) to move freely within the territory of Member States for this purpose;

(c) to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action;

(d) to remain in the territory of a Member State after having been employed in that State, subject to conditions which shall be embodied in regulations to be drawn up by the Commission' (para. 3).

541 This freedom has been elaborated in secondary law, especially by Regulation 492/2011 and the Citizens' Rights Directive 2004/38.

542 The scope of this freedom depends, in particular, on the **notion of workers.** According to the CJEU, a 'worker' is any person who

'for a certain period of time performs services for and under the direction of another person in return for which he receives remuneration.' Such activities must be 'effective and genuine, to the exclusion of activities on such a small scale as to be regarded as purely marginal and ancillary' (CJEU, case C-337/97, *Meeusen*, para. 13).

543 For reasons of effectiveness, this fundamental freedom cannot only be invoked by workers, but also by employers (against a restrictive Member State measure). Furthermore, ancillary rights can be derived by family members of workers as well, even if they are third-country nationals (*e.g.* the right to residence).

544 Employment in **public service** is not covered by this fundamental freedom. Hence, Member States are free to enact rules differentiating between nationals and foreigners in this field. The Court has narrowly defined this exception, finding that it only covers

'posts which involve direct or indirect participation in the exercise of powers conferred by public law and duties designed to safeguard the general interests of the State or of other public authorities' (CJEU, case 149/79, *Commission/Belgium*, para. 10).

545 Later, the public-service exception was (mostly) unsuccessfully invoked, *e.g.* by Italy concerning laws protecting researchers at the National Research Council (CJEU, case 225/85, *Commission/Italy*) or by Spain concerning posts as master and chief mate of merchant ships flying the Spanish flag (CJEU, case C-405/01, *Colegio de Oficiales de la Marina Mercante Espanola*).

546 In line with the other fundamental freedoms, the rules on free movement of workers firstly prohibit **directly discriminatory measures**. Such measures can be justified only on the grounds explicitly mentioned in Art. 45 TFEU, namely public policy, public security or public health. Secondly, the CJEU has made clear that this freedom also applies to **indirectly discriminatory measures** (such as regulations based on language or residence requirements excessively disadvantaging foreigners), which can however be justified on the basis of non-written legitimate policy goals ('mandatory requirements' analogous to those recognised in *Cassis*). In this case as well, in order to be justified, measures must be proportionate to the aim pursued.

In the 1990s, the CJEU began to extend the ambit of this freedom to **non-discriminatory obstacles** by adopting a 'market access approach'. A leading precedent is *Bosman*, a case involving rules according to which the transfer of a football player to another club would only be possible if the new club paid a compensatory fee to the player's former club (even after the expiry of the employment contract). This transfer fee system functioned on a non-discriminatory basis, applying to transfers within a Member State and cross-border transfers alike. Nonetheless, the Court held that these rules came under the prohibition of Art. 45 TFEU, as they 'directly affect[ed] access to the employment market in other Member States', thereby possibly impeding the free movement of workers. **547**

Like discriminatory measures, such obstacles can be justified by invoking mandatory requirements if they constitute the least trade-restrictive measure available, a requirement which considerably restricts **national sovereignty**. As a result, the CJEU's 'market access' approach has been criticised as being overly deregulatory, but also conceptually vague. The CJEU seems to have reacted to this critique by returning to a discrimination-based approach in at least some of its more recent rulings and by introducing a threshold requirement in other cases, holding that measures whose effect on the free movement of workers is 'too uncertain and indirect' cannot be challenged on the basis of Art. 45 (CJEU, case C-190/98, *Graf*, para. 25). **548**

The freedom of movement for workers also has a 'horizontal direct effect', which means that it can be invoked by workers not only against a Member State, but also against private persons. The Court first recognised such a horizontal effect in *Bosman*, where the obstacles at issue were created by private associations (the UEFA and the Belgian football association). While the extension of the reach of the prohibition in Art. 45 to private associations like national and international football associations can be explained by their collective powers (which make it possible for them, similarly to a legislator, to lay down rules of a general nature), the CJEU has gone even further in the *Angonese* case. In this ruling, it held that Art. 45 TFEU can even be invoked by an individual against a single private employer accused of (indirectly) discriminating against job applicants (CJEU, case C-281/98, *Angonese*). **549**

IV. Freedom of Establishment

EU law furthermore guarantees the freedom of establishment. According to the TFEU, **550**

> 'restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State' (Art. 49 para. 1 TFEU).

551 This freedom includes

> 'the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Art. 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected' (Art. 49 para. 1 TFEU).

552 Art. 54 TFEU makes it clear that

> '[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.'

553 As with the free movement of workers, the freedom of establishment does not apply to activities which are connected with the exercise of **official authority** (Art. 51 TFEU). This exception has been interpreted quite strictly by the CJEU. That is, there must be a 'direct and specific connexion with the exercise of official authority' of a given activity accordingly. Only individual activities, and not professions as a whole (such as that of lawyers), can be regarded as being exempt from this freedom (CJEU, case 2/74, *Reyners*, para. 45).

554 '**Establishment**' means 'the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period' (CJEU, case C-213/89, *Factortame*, para. 20). Whereas the free movement of workers applies to persons performing services under the direction of another person in return for remuneration (see above), the freedom of establishment covers self-employed persons and companies in the aforementioned sense.

555 The freedom of establishment can be invoked by nationals (natural as well as legal persons) of a Member State against **host** Member States. Contrary to the wording of Art. 49, but in line with its purpose, it can theoretically also be invoked against the **home** Member State in such cases when it restricts the freedom to move to and establish oneself in another Member State. However, regarding the latter constellation, a distinction must be made between natural persons and companies, as the freedom of companies to leave their home country can be restricted by national law.

556 As with the other fundamental freedoms, the freedom of establishment prohibits directly and indirectly discriminatory measures. Likewise, its scope has been extended to cover non-discriminatory obstacles 'liable to hinder or make less attractive the exercise' of this fundamental freedom (CJEU, case C-55/94, *Gebhard*, para. 37). Examples of non-discriminatory obstacles include a Catalonian retail law involving stringent regulation of larger retail establishments (CJEU, case C-400/08, *Commission/Spain*) as well as Belgian rules curtailing the freedom to set rates for private health insurance (CJEU, case C-577/11, *DKV Belgium*). The CJEU has also made clear that Art. 49 and 54 TFEU may prohibit non-discriminatory (host or home Member State) obstacles to

primary or secondary establishment of legal persons (companies) within the internal market.

Discriminatory measures can be justified on grounds of public policy, public security or public health (Art. 52 TFEU). For other measures, this is possible on the basis of the non-written 'mandatory requirements' first recognised in *Cassis*. In its recent jurisprudence, the CJEU does not seem to have drawn a clear dividing line between discriminatory and non-discriminatory measures in this regard and permits both invoking unwritten 'mandatory requirements' when discriminatory measures are at issue and invoking Art. 52 in cases involving non-discriminatory measures. Measures to be justified must in any case be proportionate to the aim pursued. **557**

In the CJEU's case law, the freedom of establishment has acquired a **horizontal direct effect**. Transferring its *Bosman* reasoning (see above) to the freedom of establishment, the Court has held that rules issued by associations having collective regulatory powers must comply with Art. 49 (CJEU, case C-309/99, *Wouters*, para. 120). Furthermore, going beyond *Bosman*, the CJEU has found that associations such as trade unions that have collective powers (as opposed to collective regulatory powers), like the ability to organise strikes, are bound by the freedom of establishment (CJEU, case C-438/05, *Viking*, para. 90). **558**

Mention must briefly be made of **secondary law** that further develops this freedom (restrictions of which may or may not be justified). On the one hand, the EU has created three types of legal entities in order to mitigate the problems encountered by companies when doing business in or moving within the internal market. In particular, it has established the so-called *Societas Europaea (SE)*, a supranational type of company which can transfer its registered office to another Member State without the need for dissolving or creating a new legal person. The other types are the European Economic Interest Grouping (EEIG) and the *Societas Cooperativa Europaea* (*SCE*). On the other hand, it has adopted the so-called Services Directive (Directive 2006/123), which, despite its name, covers both the freedom of establishment and the freedom to provide services. This directive *inter alia* provides for administrative simplification in the Member States. **559**

Furthermore, the EU has enacted a directive which deals quite comprehensively with the recognition of professional qualifications of natural persons obtained in other Member States (Directive 2005/36/EC). Persons not falling under this directive and other relevant secondary law can invoke the principles developed by the CJEU on the basis of Art. 49 TFEU. Accordingly, a Member State must examine the qualifications acquired by a person in other Member States. In the case of non-recognition of such qualifications, the Member State must issue a reasoned decision and provide for access to tribunals (which are to refer cases involving questions of EU law to the CJEU; see CJEU, case C-340/89, *Vlassopoulou*). **560**

V. Free Movement of Services

561 (Cross-border) trade in services has become an important part of modern economies. Pursuant to the TFEU,

> 'restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended' (Art. 56 TFEU).

562 **Services** in the sense of this fundamental freedom are services that are normally provided in exchange for remuneration. The notion specifically includes activities of an industrial or commercial character, as well as activities of craftsmen or of the professions (Art. 57 TFEU). The freedom to provide services is subsidiary to the other fundamental freedoms. Hence, with respect to the activities covered *e.g.* by the free movement of goods, the free movement of services cannot normally be invoked (Art. 57).

563 Furthermore, according to this provision,

> '[…] the person providing a service may, in order to do so, temporarily pursue his activity in the Member State where the service is provided, under the same conditions as are imposed by that State on its own nationals.'

564 Cross-border services can be provided through several **modes of supply** (all of which are protected by this freedom), namely the supply of a service

(i) by a provider temporarily present in another Member State;

(ii) by a provider to recipients coming from another Member State (*e.g.* medical services);

(iii) by a provider to recipients in another Member State without movement of persons (*e.g.* services provided via telephone or internet);

(iv) by a provider to recipients temporarily moving to another Member State together (*e.g.* tourist guides and their clients).

565 Like the freedom of establishment, the free movement of services does not apply to activities which are connected with the exercise of **official authority** (Art. 51 and 62 TFEU). The dividing line between the freedom of establishment and the freedom to provide services is drawn in particular by the permanent or **temporary nature** of the economic activity in question. This dividing line is important due to differences in relevant secondary law and due to the divergent degrees to which national restrictions can be imposed on persons entitled by the freedom of establishment, on the one hand, and those merely temporarily supplying services, on the other. To that extent, the mere existence of an office in another Member State cannot in and of itself mean that economic activity is being carried out in a permanent manner.

566 Despite the explicit wording of Art. 57 TFEU, this fundamental freedom, too, has been interpreted by the CJEU as prohibiting not only **directly or indirectly discriminatory** measures, but also non-discriminatory obstacles to trade in services. Important case-law concerns national requirements for prior authorisation before travelling to

receive medical care in another Member State (CJEU, case C-372/04, *Watts*) as well as restrictions on the provision of lotteries and gambling (CJEU, case C-64/08, *Engelmann*). Discriminatory measures can be justified on the grounds mentioned in the Treaty (public policy, public security and public health; see Art. 52 and 62 TFEU). Other restrictions can be justified by invoking 'mandatory requirements'.

As regards relevant **secondary law**, reference is to be made once more in particular to the aforementioned Services Directive 2006/123 and Directive 2005/36 on the recognition of foreign qualifications, since both cover the freedom of establishment as well as the free movement of services in terms of substance. **567**

VI. Free Movement of Capital and Payments

The free movement of capital and payments is regulated in Art. 63-66 TFEU. In contrast, with the other fundamental freedoms, it can be invoked by individuals and legal persons from third countries as well ('*erga omnes* effect'). This effect was introduced by the Maastricht Treaty, *inter alia,* in order to attract foreign direct investment (FDI) from third countries and to make the Euro attractive as a global reserve currency. **568**

According to the Treaty, **569**

'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited' (Art. 63 para. 1 TFEU).

The same holds true for payments (Art. 63 para. 2). **570**

There is no explicit definition of the **notions of 'capital' and 'payments'** in the treaty. The CJEU has consistently referred to the Third Capital Directive (Directive 88/361), which contains a relevant nomenclature indicating a very broad understanding of these terms. 'Capital' thus covers *e.g.* FDI, shares, dividends, financial loans and credits. 'Payment' encompasses *e.g.* money, electronic money, bills of exchange and cheques. By 'free movement of capital', the understanding is of the unilateral transfer of values from one Member State to another, usually for investment purposes. 'Free movement of payments' covers transfers in return for goods bought or services rendered and thus constitutes an auxiliary freedom. **571**

In interpreting the wording of Art. 63, the CJEU has transposed its extensive ***Dassonville*-formula** to this fundamental freedom. In that vein, the prohibition covers any measures affecting the free movement of capital and payments, such as exchange controls, authorisation procedures for capital transfers *etc.*; it also covers special rights in companies (*e.g.* companies of strategic importance) that Member States reserve for themselves. **572**

Restrictions can be justified, however. There are three explicit **exceptions** laid down in the TFEU, which underline the particular sensitivity of the movement of capital and payments. Art. 64 TFEU rules out the introduction by the Member States, of pertinent **573** new restrictions vis-à-vis third countries (standstill clause). Art. 65 TFEU concerns tax-related restrictions adopted by Member States in their relations with other Member States. Art. 66 TFEU finally deals with the protection of the Economic and Monetary Union (EMU) against sudden inflows and outflows of capital. Moreover, the CJEU has recognised mandatory requirements as unwritten grounds of justification under this freedom as well.

574 In the last decade, the ***erga omnes*** effect of the free movement of capital has given rise to apprehensions that private and public companies and so-called sovereign wealth funds from third countries, could, alternatively, use this fundamental freedom so as to gain control over companies and infrastructure in the EU that are of strategic importance. The CJEU has reacted to these fears by finding that investments leading to effective control over enterprises are not covered by the free movement of capital, but instead fall under the freedom of establishment (which cannot be invoked by third-country nationals; see CJEU, case C-326/07, *Commission/Italy*). Furthermore, several Member States have enacted rules dealing with this problem; once again, the EU is currently preparing relevant legislation accordingly.

VII. Union Citizenship and Free Movement

575 The Maastricht Treaty has established the 'Citizenship of the Union', which was originally meant to emphasise the move from an Economic Community (EEC) to a more comprehensive political Union (EU). The concept of EU citizenship, and the rights associated with it have, however, dynamically evolved since Maastricht, especially due to the CJEU's quite activist jurisprudence, whose exact confines, by the way, currently elude prediction.

576 According to Art. 20 TFEU,

> '[e]very person holding the nationality of a Member State shall be a citizen of the Union. Citizenship of the Union shall be additional to and not replace national citizenship.'

577 EU citizens enjoy **political rights** such as the right to vote and to stand as candidates in elections to the European Parliament and in municipal elections in their Member State of residence, under the same conditions as nationals of that state.

578 Importantly for our context, EU citizens also have the **right to move and reside freely** within the territory of the Member States (Art. 21 TFEU). In contrast to the fundamental freedoms discussed above, this provision applies irrespective of any economic activity by the citizen invoking it. The CJEU has read this provision particularly in conjunction with the general provision of Art. 18 TFEU, which prohibits any discrimination on grounds of nationality.

579 On this basis, the CJEU has developed a **general prohibition** addressed to the Member States, against (i) discrimination on the basis of nationality within the scope of application of EU law and against (ii) the restriction of free movement of EU citizens. This prohibition on discrimination and restriction applies, subject, however, to the option of the Member States justifying proportionate measures taken for legitimate purposes. It is subsidiary to the fundamental freedoms discussed above, but comes close, functionally and structurally, to constituting a fundamental freedom of its own besides the traditional fundamental freedoms discussed above, on the basis of which the internal market has been established.

Art. 21 is partly concretised in the EU's Citizens' Rights Directive (Directive 580
2004/38/EC). Pursuant to it, EU citizens in particular have the right

– of residence on the territory of another Member State for a period of up to three months without any conditions or any formalities other than the requirement to hold a valid identity card or passport (Art. 6 of Directive 2004/38);
– of residence on the territory of another Member State for a period of longer than three months if they are workers or self-employed persons in the host Member State; or have sufficient resources for themselves and their family members not to become a burden on the social assistance system of the host Member State during their period of residence and have comprehensive health insurance coverage in the host Member State (Art. 7 of Directive 2004/38) and
– of permanent residence in the host state if they have resided legally for a continuous period of five years there (Art. 16 of Directive 2004/38).

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Questions

1. How does an internal market differ from a free trade area and a customs union?
2. Who is empowered by the fundamental freedoms?
3. Who is limited by the fundamental freedoms?
4. Who ensures compliance with the fundamental freedoms?
5. Why would indirectly discriminatory measures impair the operation of the internal market?
6. How can non-discriminatory measures impede the operations of the internal market?
7. As for the free movement of goods, explain the relevance of customs duties, internal taxation, and quantitative restrictions.
8. How has the trouble with the concept of 'measures having an equivalent effect' resulting from the Dassonville and Cassis de Dijon rulings been resolved in Keck and later, in case-law?
9. According to the CJEU, under what conditions may the rules on the free movement of goods, free movement of workers and the freedom of establishment have a 'horizontal direct effect'?
10. Under what conditions may other societal goals (to be pursued at Member State level) trump negative market integration processes (and hence market efficiency and economic welfare)?
11. On what grounds can non-discriminatory restrictions on the free movement of services or the free movement of capital be justified?
12. What is the relationship between the freedom of establishment and free movement of workers on the one hand, and the free movement of EU citizens (Article 21 TFEU) on the other hand?
13. Why is there a need for positive market integration when there is negative market integration?
14. As a matter of principle, when will a harmonising measure have as its 'object … the internal market' (Article 114 TFEU)?
15. How can a directive prohibiting tobacco advertising in the Member States have as its 'object … the internal market' (Article 114 TFEU)?
16. Article 114 TFEU allows Member States derogations from harmonising measures on the grounds of, *inter alia*, the protection of health and life of animals and plants. Why is this problematic?

Unit 9: Fundamental Rights – General Issues

A. Introduction

Fundamental rights are subjective rights of individuals that are granted to them at a constitutional, European or international level. They may be enforced in constitutional and international procedures and shall grant '**freedom from the state**'. The essential objective of fundamental rights is to protect the individual against arbitrary action by the public authorities. However, some fundamental rights impose additional positive obligations on states. Usually, fundamental rights do not state in what ways a state has to fulfil its negative and positive obligations. In both contexts, the state enjoys a certain margin of appreciation. **581**

B. Categories of Fundamental Rights

I. Citizen's Rights and Human Rights

Citizens' rights differ from human rights in that **human rights** are granted to everyone, while **citizens' rights** are granted only to citizens. However, different rules apply with respect to European Union (EU) citizens. EU law stipulates that any discrimination of EU citizens on the basis of their nationality is prohibited. Hence, to a certain extent, EU citizens may rely on constitutional fundamental rights as well. **582**

Persons entitled to fundamental rights are both natural persons (humans) and legal persons (*e.g.* stock companies, limited companies). **583**

II. Content Categories of Fundamental Rights

Fundamental and human rights can be divided into the following groups: **584**

- **Civil liberties**: They grant certain freedoms to individuals (*e.g.* right to life, freedom of religion, artistic freedom, freedom to engage in any kind of gainful activity).
- **Rights of equality**: They shall prevent discrimination (*e.g.* general principle of equal treatment,).
- **Procedural guarantees**: They guarantee the enforcement of rights (*e.g.* right of access to a court, right to a fair trial, right to a judge).
- **Political rights** (*e.g.* right to vote, right to petition).
- **Social fundamental rights**: In general, the Austrian Constitution does not enshrine social fundamental rights (*e.g.* right to work, right to housing). Such claims may possibly be derived from existing fundamental and human rights. The application of the Charter of Fundamental Rights of the European Union (CFR) may lead to the implementation of further social rights into the Austrian Constitution.

C. Sources of Fundamental Rights

585 The legal situation in Europe comprises **three levels of protection**: the level of national constitutional law, the level of EU law, and the level of (regional) international law, *i.e.* basically the European Convention on Human Rights (ECHR). In the majority of cases, all three or at least two levels apply at the same time. 90 percent of the claims may be based on either catalogue of rights, the national one, the CFR and the ECHR.

I. Fundamental Rights in the Federal Constitution

586 Like the Federal Constitution itself, fundamental and human rights in Austria are spread throughout various legal documents. They are laid down, in particular, in the Basic Law on the General Rights of Nationals of 1867, the Federal Constitution and the ECHR and the Protocols thereto; they all have constitutional rank.

1. Implementation of Human Rights Treaties into the Austrian Legal System

587 In the field of **approving human rights treaties,** the **practices** by the Austrian Parliament are **varied**. The **ECHR**, for instance, was originally considered to be a non-self-executing treaty, which ranked only as an ordinary federal law. In 1964, however, it was raised to the rank of constitutional law. Since then, it has been an indisputable fact that the Convention is directly applicable in domestic law. All Protocols to the ECHR also have the rank of constitutional law. Today, the guarantees of the ECHR constitute the most important source of human rights in Austrian constitutional law.

588 Other international human rights treaties like the **Convention on the Elimination of All Forms of Racial Discrimination (CERD)** were ratified with a reservation of implementation and are thus not directly applicable in domestic law. In 1973, a specific Constitutional Law on the Implementation of the CERD was adopted. Its Art. 1 prohibits any form of racial discrimination and puts the legislative and executive powers under an obligation to refrain from discriminatory measures. The same applies to the **Convention on the Rights of the Child (CRC)**. It was ratified by Austria with a reservation of implementation. In 2011, a special constitutional law, the Federal Constitutional Law on the Rights of the Child, was adopted in order to implement the most important rights contained in the CRC.

589 The **International Covenant on Civil and Political Rights (ICCPR)** was also ratified with a reservation of implementation and still ranks only as an ordinary federal law. No law on the implementation of the Treaty has been adopted so far. However, the guarantees of the ICCPR are to a large extent covered by the ECHR.

2. Enforcement of Human Rights by the Austrian Constitutional Court

In the first place, fundamental rights may be enforced in proceedings before the Constitutional Court. Following the accession of Austria to the ECHR in 1958, the approach in **interpreting the Constitution**, in particular, when it comes to fundamental rights, has gradually changed over the last decades. In the 1970s, the Constitutional Court started to incorporate the proportionality test established by the European Court of Human Rights (ECtHR) in a number of cases concerning different fundamental rights, amongst them, the right to property and the freedom of expression. In a landmark decision in 2012, the Constitutional Court incorporated the rights under the CFR as a standard of review in the proceedings before it and found that they were functionally equivalent to fundamental rights of the Federal Constitution. **590**

II. The European Convention on Human Rights

1. Introduction

The **ECHR** was the first international treaty which made certain rights specified in the Universal Declaration of Human Rights of 1948 binding. It was opened for signature in Rome on 4 November 1950 and came into force in 1953. All Member States of the EU as well as 20 other countries such as Russia, Turkey and Switzerland are members of the ECHR. The Convention in its Art. 19 established the **European Court of Human Rights (ECtHR)** which is based in Strasbourg. Any person, non-governmental organisation (NGO) or group of individuals claiming to be a victim of a violation of the fundamental rights enshrined in the ECHR, may take a case to the Court. Hence, alongside the constitutional courts in the Member States, the ECtHR provides for the enforcement of Convention rights. Austria has been a Member State of the ECHR since 1958. **591**

2. Personal Scope of the ECHR

According to Art. 1 ECHR, the 'Contracting Parties' **secure** 'everyone within their jurisdiction' the **rights and freedoms** provided for in the Convention. It follows thus that the Member States are the obligated parties under the ECHR and the persons within their jurisdiction are the beneficiaries. **592**

The wording '**everyone**' shows that the Convention – contrary to other catalogues of fundamental rights in national constitutions – abstained from imposing any restrictions, such as the nationality requirement, on the group of persons entitled to the rights under the Convention. Apart from a few exceptions, being under a state's jurisdiction (Art. 1 ECHR) is the only criterion decisive for the question whether or not an individual is entitled to the fundamental rights of the Convention. **593**

594 In general, protection under the convention begins with birth and ends with death. **Legal persons** may also rely on fundamental rights as long as they are not closely related to the state. Such a close relationship exists where a legal entity exercises public authority. The reference given in Art. 34 ECHR states that the ECtHR may receive applications from 'any person, non-governmental organisation or group of individuals', therein reflecting this restriction. Art. 34 therefore determines who may invoke the rights of the Convention. Whether the party concerned is a private or public citizen is an indication for possible governmental control. That is, a private citizen under 100 percent governmental control may not be entitled to fundamental rights, whereas a company with both private and public shareholders might be entitled to the rights under the Convention. On the other hand, if an organisation qualifies as a public entity, trust, fund or any other public institution under national law, it may rely on the Convention if it is sufficiently independent from the government – as in the case of universities or churches and religious communities, as well as broadcasting corporations.

595 Where, due to its nature, a Convention right may not be applied to legal entities such as companies, fundamental rights protection is not granted. This is the case for the right to life, the prohibition of torture and inhuman or degrading treatment (Art. 2 and 3 ECHR), as well as the right to liberty and security (Art. 5 ECHR), the prohibition of the death penalty (Art. 1 of Protocol No 6 to the ECHR), the right to respect for family life (Art. 8 ECHR) or the right to marry (Art. 12 ECHR). Here, only natural persons can meet the criteria for the application. The most important rights companies may invoke are the protection of property and the right to a fair hearing before court.

596 The Member States have the **obligation to respect the human rights** provided by the Convention. The principles are the following: according to the nature of the ECHR as an international law treaty, the contracting states are obliged to safeguard and comply with the guarantees under the Convention. An infringement by a state may be determined in cases where the state either takes action or fails to act.

597 Under the Convention, it is immaterial whether the state acts are governed by public or private law. Whether the state itself carries out tasks of public authority or delegates the tasks to private individuals is also irrelevant. At any rate, the ultimate responsibility under international law remains with the state as the contracting party to the Convention.

3. Rights and Freedoms Guaranteed by the ECHR

598 The ECHR consists of **three sections** and features **several protocols**. The first Section of the ECHR contains the main rights and freedoms protected therein. The Court is established by Section II of the ECHR. This Section also determines the composition and procedure of the Court and is supplemented by the Court's rules of procedure. Section III of the Convention includes miscellaneous general provisions.

The rights and freedoms guaranteed by the ECHR include fundamental guarantees such as the right to life, the prohibition of torture and the prohibition of slavery and forced labour. Those guarantees are followed by the right to liberty and security according to Art. 5 of the Convention. The procedural safeguards protected by the ECHR are laid down in Art. 6, 7, 13 as well as Art. 1-4 of Protocol No. 7 to the ECHR (see Unit 10 at m.n. 666 *et seq*.). The fundamental rights of the individual include the right to respect for private and family life in Art. 8, the right to marry in Art. 12, the right to education in Art. 2 of Protocol No. 1 to the ECHR as well as the freedom of thought, conscience and religion. The ECHR also grants political and community-related human rights such as the freedom of expression (Art. 10), the freedom of assembly and association (Art. 11) and the right to free elections according to Art. 3 of Protocol No. 1 to the ECHR. As an economic fundamental right, the ECHR guarantees the protection of property in Art. 1 of Protocol No. 1 to the ECHR (see Unit 10 at m.n. 625 *et seq*.). Lastly, Art. 14 ECHR contains a general prohibition of discrimination which is accessory to the rights and freedoms as set forth in the Convention. **599**

III. The Charter of Fundamental Rights of the European Union

1. Personal Scope of the CFR

Since the entering into force of the Charter of Fundamental Rights (CFR) with the Lisbon Treaty in 2009, the fundamental rights guaranteed by the Charter have become **increasingly important**. They have the same legal value as the EU Treaties. In principle, only the EU, its institutions and bodies are bound by the provisions of the Charter. Moreover, according to Art. 51 CFR, Charter rights are also addressed to the Member States of the EU, but only where they implement Union law. '**Implementation of Union law**' pursuant to Art. 51 CFR certainly includes direct implementation of EU legislation such as regulations as well as the implementation of directives into domestic law. Beyond that, an obligation of the EU Member States to respect Charter rights is subject to comprehensive debate. In addition, the Court of Justice of the European Union (CJEU) has dealt with the issue of the field of application of the CFR in a number of cases. As an exception in Europe, in cases of a corresponding guarantee in the Austrian Constitution, the rights protected by the CFR constitute a standard of review in proceedings before the Austrian Constitutional Court. **600**

2. Rights and Freedoms Guaranteed by the CFR

The content of the rights and freedoms enshrined in the Charter is **inspired by the fundamental rights of the ECHR and the constitutional traditions common to the Member States of the EU**, but there are also differences in some areas. The CFR does not only include rights that can be enforced by private individuals but also so-called '**principles**' which are not self-standing rights but rather instructions for the Union leg- **601** islature and the Member States. They may be implemented by legislative and executive acts taken by institutions, bodies, offices and agencies of the EU, and by acts of the Member States when they implement EU law in the exercising of their respective powers. An example of a 'principle' in the CFR is its Art. 22 which states that 'the Union shall respect cultural, religious and linguistic diversity'.

602 The CFR consists of **54 Articles grouped into seven titles**. The first six titles include the substantive provisions of the Charter whereas the last title contains general provisions governing the interpretation and application of the Charter. The first title of 'dignity' entails the protection of human dignity, the right to life, the right to the integrity of the person, the prohibition of torture and inhuman or degrading treatment or punishment as well as the prohibition of slavery and forced labour. In title II, 'freedoms', the CFR guarantees the right to liberty and security, the right to respect for private and family life, the protection of personal data (for details see Unit 10 at m.n. 624), the right to marry and to start a family, the freedom of thought, conscience and religion, the freedom of expression and information, the freedom of assembly and of association, the freedom of the arts and sciences, the right to education, the freedom to choose an occupation or to engage in work, the freedom to conduct business, the right to property (for details see Unit 10 at m.n. 665), the right to asylum and protection in the event of removal, expulsion or extradition.

603 The CFR also grants comprehensive equality rights as well as the rights of children and elderly people in Title III. The fourth title of the Charter, 'solidarity', contains social rights and 'principles' such as, for example, environmental and consumer protection, access to health care, social security and social assistance, the right to fair and just working conditions as well as the right of collective bargaining and action and the right to protection in the event of unjustified dismissal. Title V mainly applies to EU citizens and contains, on the one hand, 'administrative rights' such as the right to smooth administration and the right of access to documents as well as political rights including the right to vote and to run as a candidate at elections to the European Parliament (EP) and at municipal elections.

604 Title VI is the last title containing substantive Charter rights and it pertains to procedural safeguards such as the right to an effective remedy and to a fair trial, the presumption of innocence and the right of defence, the principles of legality and proportionality of criminal offences and penalties and the right not to be tried or punished twice in criminal proceedings for the same criminal offence. For details concerning the procedural guarantees under the CFR, see Unit 10 at m.n. 716 *et seq*.

605 The general provisions of Title VII of the CFR include provisions on its field of application, on the scope and interpretation of the rights and principles of the CFR, an abuse clause as well as the rule that no Charter right is to be interpreted as restricting or adversely affecting human rights and fundamental freedoms as recognised by Union law and international law and by international agreements to which the Union or all the

Member States are party, including the ECHR, and by the Member States' constitutions (Art. 53 CFR).

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Questions

1. What are fundamental rights?
2. What are the objectives of fundamental rights?
3. What are the differences between human rights and citizen's rights?
4. What groups of fundamental and human rights are there?
5. What are the levels of protection from a European perspective?
6. What are the legal documents providing for fundamental rights protection in Austria, apart from the Federal Constitutional Act itself?
7. Name the Human Rights Treaties that are considered part of the Austrian legal system.
8. Who monitors compliance with fundamental rights in Austria?
9. What is the European Convention on Human Rights (ECHR)?
10. Who are the obligated parties under the ECHR?
11. Who are the beneficiaries under the ECHR?
12. Under what conditions may legal persons rely on fundamental rights protected under the ECHR?
13. Who are the obligated parties under the Charter of Fundamental Rights of the European Union (CFR)?
14. Name the conditions under which the CFR may also be addressed to the Member States of the EU?
15. What is the role of the so-called 'principles' in the CFR?
16. Do the rights protected under the CFR constitute a standard of review in proceedings before the Austrian Constitutional Court? State reasons for your answer.

Unit 10: Selected Fundamental Rights of Businesses

A. Introduction

606 Over the last decades, fundamental rights have become a **crucial element for activities of businesses** not only in constitutional law but also at an international and European level. They include guidelines for the legislature and individuals may base their claims directly on fundamental rights.

607 The following text presents crucial guarantees for economic activities of companies, *i.e.* the right to privacy including data protection, protection of property and procedural guarantees of fair trial.

608 When examining a potential violation of a human right like the protection of data and the protection of property, lawyers proceed in **three steps**. First, they ask for the (personal and material) **scope** of the right. Second, an investigation has to take place to determine whether there was an **interference** with the right, and third, whether this interference was **justified**. If a right is applicable and if the interference with the right is not justified, a violation of the right has taken place.

B. Right to Privacy and Data Protection under the ECHR

609 Art. 8 of the European Convention on Human Rights (ECHR) contains a particular guarantee for the protection of privacy. It names **four different spheres of protection**: private life, family life, a person's home, and correspondence. These four spheres cannot be clearly distinguished from one another; they may overlap in various aspects. Collectively, they form a broad guarantee for an individual's freedom, which is indispensable for the free development of a person's personality. Due to the possibilities of computer-based collection and analysis of data, the protection of personal information became an important part of the guarantees under Art. 8.

I. Personal Scope of Article 8 ECHR

610 All **natural persons** are subject to the rights under Art. 8. In view of the guarantees provided by the Convention and the right to an individual application according to Art. 34 ECHR, it becomes clear that **legal entities** may invoke the rights under Art. 8 of the Convention as well. Art. 8 not only applies to the interests of 'home' and 'correspondence' – such as in cases of seizures of offices and other premises or the monitoring of correspondence of a legal entity – but also to their interest of 'private life' in cases of data or environmental protection.

II. Material Scope of Data Protection under Article 8 ECHR

An issue under Art. 8 ECHR is raised in situations where **data** of a person is **collected, recorded or analysed** and his or her private life is thereby affected. If a state has access to information relating to a person's private life, it is generally not allowed to make use of it or to store the information. Moreover, public information can fall within the scope of private life where it is systematically collected and stored in files held by the authorities. It follows then, that the data protected may not only include information about one's private life, but also about business matters and the public life of a person, such as information about political activities and the publication and distribution of leaflets. **611**

Art. 8 ECHR also protects the right to determine the disclosure and use of one's own personal data ('**informational self-determination**'; *informationelle Selbstbestimmung*) which means that the individual's autonomy is protected in view of the development of one's personality in different social contexts in an information society. The right to 'informational self-determination' establishes a connection between the general protection of privacy and the right to data protection. **612**

III. Interferences

Interferences with the right to data protection may occur by acquiring or storing information, or by saving or using data. It constitutes a restriction of the fundamental right when certain tools are used for the acquisition of information, in particular, instruments used in the course of police investigations. In addition, secret surveillance measures, interception of communications, and wiretapping constitute interference with the rights under Art. 8 ECHR. **613**

IV. Justification

An interference with the rights under Art. 8 para. 1 ECHR is justified according to Art. 8 para. 2 if it is **in accordance with the law (1.)** and is **necessary (3.) in a democratic society** in the interest of **legitimate aims (2.)** mentioned in its para. 2. In essence, examining the necessity in view of a legitimate aim is equivalent to the **proportionality test** which applies to most fundamental rights. **614**

1. Prescribed by Law

The collection, storage and transfer of data are often conducted secretly, *i.e.* without the knowledge of the person concerned. In these cases, the **legal basis** has to meet specific requirements as to its precision and must likewise provide safeguards from arbitrary use by an authority. **615**

2. Legitimate Aim

616 Art. 8 para. 2 ECHR lists the **legitimate aims** for the justification of an interference with Art. 8 para. 1. The list covers a wide range of possible legitimate aims behind an interference: national security, public safety or the economic well-being of the country, the prevention of disorder or crime, the protection of health or morals and the protection of the rights and freedoms of others. However, this does not mean that the rights guaranteed under Art. 8 para. 1 are subject to broad reservation. In each individual case, the European Court of Human Rights examines whether one or more of the aims listed in Art. 8 para. 2 have been pursued. The Court occasionally rejects the respondent's submission that a certain legitimate aim was pursued, even though that aim may have been relevant.

617 Legislation granting powers to collect and release personal information without the individual being able to foresee the measure or having access to the data may, under exceptional circumstances, be necessary in a democratic society in the interests of national security and/or for the prevention of disorder or crime.

3. Necessary in a Democratic Society

618 When the European Court of Human Rights examines the **proportionality** of an interference – which essentially means that a fair balance has to be struck between the interests of the individual and the community as a whole – it is obvious that the case law established groups of cases within the wide scope of Art. 8 ECHR. No general statement can be made, however, on the weighing of the interests involved and the degree of scrutiny applied.

619 In evaluating whether or not an interference with the right to protection of personal data is necessary in a democratic society, the **public interest** in collecting certain data for the organisation of societal processes has to be **balanced** against the **individual's interests** in protecting the confidentiality of the information in question. Hence, the character of the data and its importance to a person's enjoyment of his or her right to respect for private and family life as guaranteed by Art. 8 ECHR have to be considered.

620 The public interests in the collection and use of the data also have to be weighed against the interests of the persons concerned. Thus, even though investigating and punishing crime may, in principle, be a legitimate aim, **the margin of appreciation** left to the Member States depends on such factors as the nature and seriousness of the interests at stake and the gravity of the interference.

621 Although there may be a need for a comprehensive record of all fines, convictions, warnings, reprimands, acquittals and even other information of the nature, an indiscriminate and open-ended collection of criminal record data is unlikely to comply with the requirements of Art. 8 in the absence of clear and detailed statutory regulations

clarifying the safeguards applicable and setting out the rules governing, *inter alia*, the circumstances in which data can be collected, the duration of their storage, the use to which they can be put and the circumstances in which they may be destroyed.

V. Positive Obligations

A number of **positive obligations** for the state have been derived from Art. 8 ECHR by the Court. It repeatedly held that, although the essential object of Art. 8 is to protect the individual against arbitrary interference by the public authorities, there may also be positive obligations inherent in an effective respect for private life. In determining whether or not a positive obligation exists, a **fair balance** has to be struck between the general interest of the community and the interests of the individual. Having regard for the wide range of practices applied and the situations in the Contracting States, the notion's requirements will vary considerably from case to case and Member States enjoy a **margin of appreciation**, accordingly. **622**

The protection of sensitive personal data, in particular medical data, is of fundamental importance to the enjoyment of a person's right to respect for private and family life as guaranteed by Art. 8 of the Convention. Hence, as a positive obligation arising from Art. 8 ECHR, the domestic law must therefore afford appropriate **safeguards** to prevent any communication or disclosure of personal health data that is possibly inconsistent with the guarantees in Art. 8 of the Convention. **623**

VI. Right to Privacy and Data Protection under the CFR

A **special right to the protection of personal data** – which, by the way, does not exist in the ECHR as a separate guarantee – was added in the form of Art. 8 Charter of Fundamental Rights of the European Union (CFR). According to Art. 8 para. 1 CFR, everyone has the right to the protection of his or her personal data. Para. 2 of this provision states that personal data must be processed fairly for specified purposes. Legitimate data processing under the CFR requires the consent of the person concerned or some other legitimate basis laid down by law. Art. 8 CFR also guarantees the right of access to data which has been collected concerning him or her, and the right to have it rectified. Due to the existence of a separate fundamental right to data protection in Art. 8 CFR which is distinct from the right to respect for private life as protected by Art. 7 CFR, data protection under the CFR is more elaborate than under the ECHR. For this reason, abundant European Union legislation exists in the field of data protection, which in turn led to a high amount of jurisprudence of the Court of Justice of the European Union in this area. **624**

C. Protection of Property

I. Introduction

625 Art. 1 of Protocol No. 1 to the ECHR comprises **three distinct rules**: the first rule enunciates the general principle of peaceful enjoyment of property (para. 1, first sentence), whilst the second rule covers protection against deprivation of possessions (para. 1, second sentence) and the third rule entitles the states to control the use of property in accordance with the general interest (para. 2). These rules are closely related to each other. The second and third rules constitute special cases of interference with the right to peaceful enjoyment of property. These special cases must thus be interpreted in the light of the general principle enunciated in the first rule. Before considering an interference with the first rule, the ECtHR examines whether a deprivation of possessions or a control of their use has taken place.

II. Scope of Protection

626 Art. 1 of Protocol No. 1 explicitly clarifies the personal scope of the guarantee. It not only protects **natural persons**, but also mentions **legal persons** as its beneficiaries. The provision therein takes into account the fact that legal persons are often subject to infringements of (at least) their right to property.

627 According to the authentic language versions of the Protocol, the object of protection is the 'right to peaceful enjoyment of [one's] possessions' *or 'droit au respect de ses biens*'. The wording shows a **broad concept of property** which is derived from public international law comprising not only the 'ownership of physical goods' but also all 'acquired' rights that constitute assets or other interests.

628 In any case, **assets under civil law** are protected. These encompass, on the one hand, property rights under domestic law ('existing possessions') and, on the other – often going beyond the national legal concept of property – claims which are 'sufficiently established to be enforceable'. At any rate, the scope of protection includes claims awarded to an individual by a 'final and binding' judgment or arbitration award.

629 Furthermore, Art. 1 of Protocol No. 1 covers claims wherein a person has 'legitimate expectations of obtaining effective enjoyment of a property right'. For the purpose of determining whether such '**legitimate expectations**' exist, the ECtHR does not consider a 'genuine dispute' or an 'arguable claim' as criteria; it requires the claim to be based on domestic law. This might, for example, apply in case of settled case law by domestic courts confirming the claim's validity. Conversely, no legitimate expectation arises in the case of a dispute as to the correct interpretation and application of domestic law. The mere hope that a claim might be acknowledged in a pending case does not give rise to 'legitimate expectations'. Claims subject to conditions do not suffice either. The 'legitimate expectations' must, in any case, be certain and of a fixed amount. The loss

of future income, however, is not protected by the right to property unless the income has already been earned or an enforceable claim exists, since it is based on personal economic contributions.

630 If a state enacts a law awarding compensation to a specific group, the state is obligated to secure the practical and legal requirements for its implementation. The legal beneficiaries may 'legitimately expect' the implementation of the law.

631 Until proof is provided otherwise, a person in possession of an item must be presumed to have the property in relation to that item. This presumption of ownership applies even if certain conditions enshrined by national law (such as a valid contract proving the ownership or a licence to possess weapons) are not fulfilled.

632 The terms '**possessions**' or '**property**' extend beyond moveable and immovable property and cover several other rights, such as the co-ownership of corporations (in particular shares) or a credit vis-à-vis a state (state bonds). Intellectual property (copyright, patents and trademark rights, right to the business name of a company engaging in e-commerce, use of certain internet domains) is protected too. As to the concept of 'possession', the ECtHR stressed that it has 'an autonomous meaning which is independent from the formal classification in domestic law'. In any event, the ambit of Art. 1 of Protocol No. 1 is limited by the economic and pecuniary scope of the provision.

633 The ambit further extends to **economic interests** that are a principal condition for carrying out business activities. This was expressly held by the ECtHR with respect to the (partial) withdrawal of licences (such as a licence to operate a cinema or to sell tobacco or alcoholic beverages in restaurants) which have an effect on the goodwill and the value of the business. A company's goodwill or clientele (for example an advocate's clients or the visitors of an open-air cinema) falls within the ambit of Art. 1 of Protocol No. 1; what is not covered is the future income from those clients.

634 The guarantee of property may encompass **claims under public law** (claims on taxes or other contributions as well as penalties). This already follows from Art. 1 para. 2 of Protocol No. 1.

III. Interferences

635 In taking the ECtHR's case law and the structure of Art. 1 of Protocol No. 1 into account, **three different types of interference** with the right to property may be distinguished: a) deprivation of possessions (para. 1, second sentence), b) control of the use of property (para. 2) and c) other interferences with the right to property (para. 1, first sentence).

1. Deprivation of Possessions

636 Among the cases of deprivation of possessions, we distinguish between formal and de facto expropriation. Nationalisation as a special case of expropriation is discussed separately. An **expropriation** constitutes an instantaneous act and does not produce a continuing situation. In this context, a distinction should be made between formal and *de facto* expropriations. Formal expropriations include interferences with the right to property on the grounds of a formal transfer of property; this (as a general rule) entails the loss of property for the benefit of the state or in the public interest, and holds true irrespective of whether the expropriation was based on laws, administrative acts or civil law contracts. However, it is not necessary for the state concerned to have already acquired full ownership of the property asset. For example, the expropriation for an individual's benefit – as long as the cause for it is set out in law or is based on an act attributable to the state – represents another case of formal expropriation.

637 **Nationalisation** also constitutes a case of formal expropriation. In this case, private property of a certain kind is transferred in its entirety to the state (enterprises, private housing, etc.). However, confiscations without compensation geared toward achieving a specific aim are qualified as regulations for controlling the use of property (see 3.).

638 ***De facto* expropriations** do not require a formal seizure of property. They encompass measures which have an adverse effect comparable to effects of a formal expropriation. In such instances, the ECtHR assesses whether the remaining legal position of a proprietor still allows meaningful use of the property in question. In order to distinguish expropriation from the control of the use of property, the severity of the measure as well as the question of whether a party was able to legitimately expect to continue exercising property rights without any state interference, are decisive.

2. Control of Use of Property

639 **Regulations to control the use of property** (Art. 1 para. 2 of Protocol No. 1) constitute measures by the state that command or forbid certain usage of property: construction bans, restrictions under planning law, sovereign authorisation to engage in economic activity, restrictions on occupancy and tenancy law, the imposition of compulsory administration in insolvency proceedings, measures affecting the possibility of engaging in the activity corresponding to a licence, the denial of a vehicle's registration or the denial of the right to use the internet domain registered. The provision also covers the loss of control and the option of use of the property amounting to constant prevention of access to the property. Control of the use of property under the second paragraph further entails interferences with the right to property which are necessary 'to secure payment of taxes or other contributions or penalties'. This includes procedural and substantive rules in the fields of law mentioned above.

3. Other Interferences with the Right to Property

The so-called 'other interferences' as laid down in the first sentence of Protocol No. 1 in Art. 1 para. 1, are the third category of interference with the right to property. This **catch-all provision** encompasses all those interferences that may not be classified into any of the aforementioned categories – in particular if it is for a complex factual and legal situation. 'Other interferences' include violations of the right to property by way of forestalling the attainment of the right to property over a period of decades, the failure of enforcement of court or administrative decisions in the applicant's favour, the intervention of the legislator in pending proceedings, certain planning policies exceeding the scope of the control of the use of property, the declaration that including land in nature conservancy projects constitutes public interest, the refusal of national authorities to pay interest to compensate for the delay in refunding taxes unduly paid, the privileged status of public hospitals in calculating the default interest payable for any outstanding salary to the detriment of their employees compared to non-public hospitals, or an employer's action for redundancy payments rejected by domestic courts. Furthermore, the failure to have a final judgment enforced in order to recover money owed to the individual by a municipal authority which had become insolvent as well as a cap on pensions and reductions in the remuneration of public servants, constitute interferences of this category. **640**

IV. Justification of Interferences

1. Deprivation of Possessions

Pursuant to Art. 1 of Protocol No. 1, a deprivation of possessions is permissible only 'if provided for by law and by the general principles of international law', 'in the public interest' and by means which are appropriate and proportionate to achieving the aim sought. **641**

As regards the requirement of the **legal basis** for the interference, any interference must be based on an instrument of general application, which means that justification does not always rely on a law adopted in the legislative procedure and that executive orders may also serve as a legal basis as long as they are based on an authorisation by the parliament. The legal basis needs to be of a certain quality, namely, it has to be compatible with the rule of law and must provide guarantees against arbitrariness. Hence, it must be sufficiently accessible, precise and foreseeable in its application. **642**

States enjoy a wide margin of appreciation in determining what is in the **public interest**, especially when implementing social and economic policies. Only the manifest deprivation of possessions without reasonable foundation, does not satisfy the requirements of the public interest. This is equally true for the protection of the environment or of a country's historical or cultural heritage. The mere interest of the state's cash flow cannot in itself be treated as a public or general interest justifying interferences with **643** individual rights. The implementation of an EU Directive or compliance with other EU obligations is, however, irrespective of the substantive content, to be considered a legitimate objective.

644 Finally, the **principle of proportionality** between the means employed and the aim sought to be achieved, must be applied. This requires that the measures of deprivation of possessions are reasonable for the purpose of achieving the aim pursued. Proportionality in a narrow sense requires a fair balance between the demands of the public interest and the requirements of the protection of the individual's fundamental rights. It is primarily for the states to ensure a requisite balance between the opposing interests. That is, national authorities have to strike a fair balance in each individual case, taking into account all relevant circumstances of the case, considering, in particular, the severity of the burden imposed on the expropriated individual and the extent of the benefit to the public. It follows then, that a manifestly unreasonable balance between the interests concerned, gives rise to a violation of Art. 1 of Protocol No. 1. A fair balance will not be struck where the person concerned has to bear 'an individual and excessive burden'. However, the deprivation of possessions must not be a necessary measure, meaning that national authorities do not have to use the least severe measures to achieve an objective.

645 **Compensation terms** are considered material to the assessment of whether the deprivation of possessions has been proportionate. Compensation generally reaches a fair balance. With regard to the standard in the states, the seizing of property in the public interest without payment of an amount reasonably related to its value, normally constitutes a disproportionate interference with the right to property. The seizure of property in the public interest without compensation is justifiable only in exceptional circumstances. No violation of Art. 1 of Protocol No. 1 occurs when an expropriated person fails to take advantage of the opportunity to obtain compensation offered by the state.

646 The **amount of compensation** is determined by an autonomous standard. However, Member States have a wide margin of appreciation. In any event, there might be a tendency in the case law of the ECtHR to award compensation amounting to the full market value of the property, whereas compensation for global expropriations may be appropriately limited. The ECtHR, however, has determined that there is a violation only in cases where a breach of the prohibition of arbitrariness has occurred.

647 A compensation system must be **flexible** enough to take into account the specific situation or the disadvantages of the person expropriated. When determining the amount of compensation, benefits for property owners derived from infrastructural measures may be taken into account, though individual circumstances, such as a loss in the value of a property due to road projects, always have to be taken into consideration. In general, having compensation payments which are considerably lower than the market value, violates Art. 1 of Protocol No. 1.

648 Moreover, Art. 1 of Protocol No. 1 stipulates **procedural requirements** with regard to the determination and payment of the compensation. As a general rule, it conforms

to the procedural requirements when domestic law provides for 'full' compensation, except when there is an excessive length of expropriation proceedings and/or when authorities refuse to pay compensation over a long period of time after the proceedings have ended.

A **duty to retransfer property** may arise when it appears that the purpose for which the expropriation was aiming, will not be realised. Such an obligation only arises in case of an earlier expropriation. It does not arise, however, if the former proprietor has transferred his/her property to the state by means of a sales contract. 649

2. Control of Use of Property

Justification criteria for the control of the use of property are similar to those applied in cases of deprivation of possessions. That is, the interference must be **prescribed by law**. In so far as the tax sphere is concerned, the ECtHR accepts some additional deference and latitude in the exercise of the fiscal functions of states in relation to the requirements of the legal basis. 650

The criterion '**in accordance with the general interest**' is parallel to the criterion of 'in the public interest' of para. 1 second sentence. A general modification of the control density cannot be deduced from this. The criterion of public interest does not, however, apply to laws necessary 'to secure the payment of taxes or other contributions or penalties'. Hence, in this respect, states enjoy a wider margin of discretion. As decisions in these areas, as a rule, involve the consideration of political, economic and social questions, it is primarily for the legislator to leverage its value decisions unless such an approach were unreasonable. 651

The **principle of proportionality**, which was derived from para. 1, must also be satisfied under para. 2. Where possessions are confiscated, a fair balance is influenced by many factors, one of them being the owner's behaviour, including the degree of fault or care on his/her side or, in cases of sanctions, the relationship between his/her conduct and the offences which were committed. 652

Proportionality is also required in proceedings on the enforcement of tax debts. In order to strike a fair balance, the authorities have an obligation to take careful and explicit account of the character and the amount of the existing debt as well as of the pending and probable claims against the company, the nature of the company's business and the relative weight of the company in the domestic economy, the company's current and probable economic situation and the assessment of its capacity to survive the enforcement proceedings. Other factors to be considered are the various categories of stakeholders, the attitude of the company's management and owners as well as the economic and social implications of various enforcement options. 653

3. Other Interferences with the Right to Property

654 Although other interferences are not subject to written limitations, the practice of the ECtHR is to consider whether there has been a **sufficient legal basis** and whether the interference has been **proportionate**. According to its case law, a **fair balance** needs to be struck between the demands of the community's general interest, on the one hand, and the requirements of the protection of fundamental rights of the individual, on the other. The essential criteria are that a state may review whether an interference with the right to property was lawful, and also make a determination on the flexibility of the applicable system, on the time span of uncertainty as to the ultimate fate of a property, as well as on the option of receiving compensation and on the certainty of the respective entitlement. There is nevertheless no outright obligation to provide compensation.

655 In the context of property rights, particular importance must be attached to the **principle of good governance**, or, as the ECtHR puts it: 'it is desirable that public authorities act with the utmost scrupulousness, in particular when dealing with matters of vital importance to individuals, such as welfare benefits and other property rights'. When correcting mistakes, it is nonetheless important not to disproportionately interfere with the exercise of rights acquired by an individual in good faith.

4. Peaceful Enjoyment of Possessions

656 As the three types of interference are connected and the applicable principles are similar, the ECtHR, in certain cases, does not find it necessary to decide whether an interference should be examined under the heading of 'deprivation of possessions', 'control of the use of property' or 'other interferences'. In such cases, it examines the complaint in the light of the **general principle of peaceful enjoyment of property**. This is particularly true in cases that do not easily fall into the rubric of one of the three rules.

V. Positive Obligations

657 In order to ensure the effective exercise of the right to property, states are required not only to refrain from unjustified interferences but may also be called to take positive steps to avoid the loss of property. The nature and extent of those **positive obligations** vary depending on the circumstances of the case.

658 The question of whether the state has an obligation to adopt positive measures of protection in a particular case is determined by striking a **fair balance between the demands of the public interest and the requirements of the protection of the individual's fundamental rights**. States are under an obligation to adopt positive measures of protection particularly where there is a direct link between the measures an individual may legitimately expect from the authorities and the effective enjoyment of its possessions. Even in the case of horizontal relations between private persons or entities, public-

interest considerations may enter into the equation which may, in turn, impose some obligations on the state. Art. 1 of Protocol No. 1 does not require the states to take preventive measures to protect private possessions in all situations and areas prone to natural disasters. Since states have to make operational choices in terms of priorities and resources, the obligations arising from Art. 1 of Protocol No. 1 cannot be interpreted so as to impose an impossible or disproportionate burden on the authorities.

States enjoy a **wide margin of appreciation** when adopting positive measures to protect property. The ECtHR thus exercises a low degree of scrutiny as regards the striking of a fair balance between the competing interests in the context of justifying an interference with the right to property. States have an even wider margin of discretion where they are required to take positive actions. The ECtHR acknowledged that its task is not to substitute the views of the local authorities with its own view of what might be the best policy to adopt in dealing with the social, economic and urban problems of an area. This wide margin of appreciation particularly applies in difficult social and technical spheres. **659**

Positive obligations with respect to the **protection of financial assets** have to be considered as well. However, Art. 1 of Protocol No. 1 does not require the state to maintain the purchasing power of sums deposited with financial institutions or to compensate for losses caused by inflation. As a general rule, the state is not directly liable for debts on the part of private individuals or the wrongdoing committed by their managers. Whether a state can be held directly responsible for the wrongful acts of a private bank's liquidator depends on whether his/her actions can be considered as those by a state agent. A decisive factor in the assessment of this question is the degree of the liquidator's operational and institutional independence in relation to the state. **660**

In its case law, the ECtHR has recognised the existence of **procedural positive obligations** under Art. 1 of Protocol No. 1, both in cases involving state authorities and in cases between private parties only. An individual must be afforded a sufficient opportunity to effectively challenge the measure imposed on it by the state, limiting its right to property, such as the imposition of a fine. In assessing these measures, the Court must take into account the justifying conditions developed in its case law. This right to legal protection derived from the right to property complements the corresponding guarantee of Art. 13 in conjunction with Art. 1 of Protocol No. 1. **661**

In cases between private parties only, the states must provide judicial procedures that offer the necessary procedural guarantees and therefore enable the domestic courts and tribunals to adjudicate any disputes between private persons effectively and fairly. **662**

Not every procedural violation covered by Art. 6 of the Convention will automatically lead to a violation of positive obligations under Art. 1 of Protocol No. 1. However, a state may be held responsible for losses under Art. 1 of Protocol No. 1 caused by court decisions that contradict domestic law or that are flawed by arbitrariness. Furthermore, the ECtHR identifies such responsibility in situations where the act of a state creates a situation in which third parties are able to interfere with an individual's possessions **663** and where the national law does not **provide effective measures of legal protection** for the individual.

664 Under Art. 1 of Protocol No. 1, states are under an obligation to ensure the **effective enforceability** of court decisions, even if it involves a property dispute between private parties. All relevant domestic procedures must be complied with in enforcement proceedings. In cases of judicial determination of the debts of a state-controlled entity, the state is directly liable. This applies regardless of whether the state has sold large parts of its shares at a later date. It is thus the state's responsibility to make use of all available legal means at its disposal to enforce a final court decision, such as an eviction order.

VI. Protection of Property under the CFR

665 Even before the entry into force of the Lisbon Treaty, the CJEU held that the right to property constituted an **independent fundamental right of the EU** based on the constitutional traditions common to the Member States of the EU. In its Art. 17, the CFR also lays down a guarantee of the protection of property, which generally corresponds to Art. 1 of Protocol No. 1 to the ECHR. In the second paragraph of Art. 17 CFR, the protection of intellectual property is especially highlighted.

D. Procedural Safeguards

I. Right to a Fair Trial

1. Introduction

666 The so-called **judicial and procedural rights** under Art. 6 ECHR encompass various legal positions. Their common denominator is the principle of effective legal protection – a principle reflecting the European constitutional principle of the **rule of law** ('*Rechtsstaatsprinzip*').

2. Scope of Protection

667 Art. 6 ECHR applies to proceedings concerning '**civil rights and obligations**' as well as concerning '**criminal charge[s]**'. The guarantees of Art. 6 para. 1 apply to both types of proceedings while Art. 6 para. 2, which provides for the principle of the presumption of innocence, and the various guarantees of Art. 6 para. 3, apply only to criminal proceedings. Art. 6 does not apply to proceedings that can neither be classified as civil nor criminal.

668 The **application of Art. 6 ECHR** in civil proceedings in the broadest sense requires a 'determination of […] rights' in the proceedings or a decision on a 'legal dispute' over

civil rights and obligations. The ambit, however, not only includes 'private law disputes in the traditional sense', but extends to certain other proceedings where the outcome is decisive for civil rights and obligations.

Based on the wording in both authentic languages of the ECHR ('civil rights and obligations' and '*droits et obligations de caractère civil*'), Art. 6 allows it to be construed as including certain rights under public law in addition to civil rights in the narrow sense. The English term, in particular, is **not limited to the 'classical' civil law** in continental law systems. **669**

There is one important **exception** from the scope of Art. 6 ECHR, namely as regards proceedings relating to **matters at the very heart of public law**. Such matters are criminal law and proceedings on the deprivation of liberty. **670**

The concept of '**determination of a criminal charge**' is also to a large extent influenced by the terminology used in domestic legal orders. In order not to leave the scope of the guarantee to the discretion of domestic legislators, the ECtHR adopted an autonomous interpretation of the term in its case law. When deciding whether there is a 'criminal charge' for the purposes of Art. 6, the Court refers to three criteria set out in the Engel judgment of 1976 (so called '**Engel criteria**'). These are, first, the classification of a norm under domestic law, secondly, the nature of an offence, and, thirdly, the nature and severity of a penalty. These criteria are alternative, *i.e.* it suffices if only one criterion is fulfilled. In some cases, however, in particular, as regards the second and third criterion, a cumulative approach is adopted. **671**

3. Guarantees of Article 6 ECHR in Detail

The **scope** of the Art. 6 ECHR guarantees can be divided into **several areas**, namely (a) the right of access to a tribunal, (b) procedural guarantees in the narrow sense (the right to a fair hearing), (c) length of proceedings, (d) public hearing and (e) special procedural guarantees in criminal proceedings. **672**

a) Access to an Independent and Impartial Tribunal

Access to an independent and impartial court established by law is one of the main points of the procedural guarantees of Art. 6 ECHR. Within its scope of application Art. 6 para. 1, ECHR guarantees the right to obtain a decision by an independent court. **673**

According to Art. 6 ECHR, all proceedings falling within its scope of application have to be decided by independent and impartial tribunals established by law. The notion of '**tribunal**' is to be interpreted autonomously. It follows from this that the classification of a domestic institution as a 'tribunal' depends neither on the concept used for it in domestic law nor on its domestic legal classification. Domestic decision-making organs are 'tribunals' if they satisfy the requirements set out in Art. 6, even if they are **674** not formally courts under domestic law. The requirements are relatively strictly defined in the Convention and interpreted autonomously by the ECtHR; hence, Member States practically have no margin of appreciation in this respect.

675 First, courts of ordinary jurisdiction are considered 'tribunals' within the meaning of Art. 6 ECHR. Furthermore, and irrespective of the domestic terminology tribunals under Art. 6, courts, in the substantive sense encompass all decision-making organs which have the competence to determine matters on the basis of legal rules, and after proceedings conducted in a prescribed manner, and governed by corresponding safeguards. The organ must be competent to exercise judicial functions, to take a decision binding to the parties, to establish the facts of a case and to apply the legal provisions to the facts.

676 A tribunal within the meaning of Art. 6 ECHR must be '**established by law**'. The purpose of this criterion is to prevent special courts, i.e. chambers established *ad hoc* by law or administrative act. In particular, this legal reservation covers the composition of the bench of a tribunal, its organisation in other respects as well as its competence. It constitutes one of the main prerequisites of a democratic state under the rule of law and secures, among others things, the independence of tribunals.

677 A tribunal has to be **independent.** The independence of a tribunal is, *inter alia*, assessed on the basis of the manner of appointment of its members and their term of office as well as of the existence of guarantees against outside pressure and the question of whether the body appears to be independent. This means that the independence of a court requires their occupational freedom, a certain minimal term of office, as well as the impossibility of discharging or transferring its members. It first has to be examined whether a tribunal is independent of the executive and of the parties. This requirement refers primarily to the tribunal as a whole. Independence has also to be granted in the relationships among the individual members of a tribunal.

678 The third criterion for a tribunal is **impartiality**. The purpose of this requirement is to ensure that the person concerned may trust in the impartiality of a tribunal, which determines the question of right or wrong. The concepts of independence and impartiality are closely interrelated and often used in connection with one other. There is a functional connection between the two since independence is a prerequisite for impartiality. A court is impartial only if the judge of the court in question is prejudiced neither in objective nor in subjective respects. A subjective test is geared to the personal relationship between the particular judge in question and the parties of the proceedings. An objective test extracts key information from individuals and asks the abstract question if – according to the organisational and procedural rights and especially the extent and nature of measures taken by the judge before the proceedings – prejudice has to be presumed. Finally, the court must have full jurisdiction both on questions of facts and on questions of law.

679 In the light of the special significance of the right to a fair trial in a democratic society, the ECtHR stresses that the right of **access to court** has to be 'practical and effective' and not 'theoretical or illusory'. Member States are therefore required to set up an appeal system which grants each individual with effective access to court. In certain cases, it might be necessary to provide free legal assistance, though the Member States enjoy wide discretion in that respect.

The **guarantee** of an independent and impartial tribunal prescribed by law is, however, – even within the scope of protection of Art. 6 ECHR – **not absolute**. Limitations are formulated within the scope of the right of access to court, which is granted with the provision of proportionate restriction only. Such limitations are permissible as long as they pursue a legitimate aim and as long as there is a reasonable relationship between the means employed and the aim sought to be achieved. **680**

b) Fair Hearing

The **right to a fair hearing** is at the core of the procedural guarantees and expresses the principle of fair trial. It contains a multitude of guarantees aimed at proceedings in which the parties may represent their procedural position under essentially the same conditions. This right particularly demands that the individual affected can represent his/her legal position effectively. However, it is not the function of the ECtHR to assess the reasons behind national courts taking one certain decision over another. Art. 6 para. 1 ECHR thus does not guarantee the 'right result' in decisions by domestic courts. **681**

Part of the principle of fairness are, first, **partial guarantees** as the principle of the equality of arms, the right to inspection of files, the right to be heard, and to reasoning behind decisions. Apart from that, also the rights of the accused, enshrined in Art. 6 para. 2 and para. 3, form part of the requirement of fairness, as do the rights developed in case law, such as the principle of *nemo tenetur*. In some cases, the ECtHR limits itself to the finding that the proceedings in question generally did not meet the requirements of a fair trial without considering a certain partial guarantee to have been violated. This holds particularly true in cases where the decision of a national instance in its conclusion appears to be arbitrary and incomprehensible so that in the overall context, the trial seems to be unfair. In other cases, the standard of review applied by the ECtHR was the principle of fair trial in conjunction with one of the guarantees explicitly laid down in Art. 6 para. 1. **682**

The **principle of equality of arms** stands at the core of the requirement of fairness under Art. 6 para. 1 ECHR and is simultaneously an important aspect of the principle of equal treatment of the parties. Accordingly, all parties must be afforded with a reasonable opportunity to present their case – including evidence – under conditions that do not place them at a substantial disadvantage vis-à-vis their opponent. The legal position of opposing parties must be essentially the same. This means that the opposing parties basically have to be treated equally with regard to the procedural law. It is not important whether the opponent has actually exploited the advantage, but only whether such an advantage exists in the abstract and the party was able to exploit it. Art. 6 does not lay down any rules on the admissibility of evidence or the way it should be assessed. How- **683** ever, from the viewpoint of ensuring a fair hearing, the ECtHR has, in individual cases, established certain requirements for the obtaining and handling of evidence.

684 Art. 6 ECHR also encompasses the **right to be heard**. The person concerned must be able to present his/her standpoint either in person or by means of appropriate representation in the form of legal counsel. Each party must be afforded a reasonable opportunity to present his or her case. Tribunals are obligated to properly examine all submissions, arguments and evidence adduced by the parties. It is a precondition for the effective exercise of the right to be heard that both parties are given the opportunity to have knowledge of the content of files and the submissions and evidence adduced by the other party. In this context, it is relevant – in the light of the principle of equality of arms – what opportunities a party has to comment on submissions of the opponent. If one of the parties has greater knowledge in this respect, he or she has better opportunities to respond to submissions of the other party; this regularly amounts to a violation of Art. 6.

685 The principle of a fair trial may also be violated if the legislator aims at influencing the imminent outcome of proceedings by way of **enacting new laws**. There is a link between the right to a fair trial and the requirement of legal certainty flowing from the rule of law. Against this background, the right to a fair trial also affords protection against unreasonable contradictory interpretation and arbitrary changes in jurisdiction.

c) Length of Proceedings

686 According to Art. 6 para. 1 of the ECHR, the tribunal shall make its decision '**within a reasonable time**'. This guarantee is, on the one hand, part of the principle of effective legal protection, but on the other hand, its relationship to the individual guarantees of fair trial is strained, as an increase of procedural rights regularly results in a prolongation of proceedings. Especially with regard to criminal proceedings, and in particular in cases where the accused is in detention, the time of uncertainty about the outcome of the proceedings is supposed to be kept to a minimum.

d) Public Hearing

687 Art. 6 ECHR provides for a **public trial** in two different respects: on the one hand, it demands a hearing open to the public, and on the other hand, the final decision of the court, which ends the proceedings, has to be announced publicly. The right to a public hearing is not only a right of the parties to proceedings. As a consequence, 'everyone' has the right to access court hearings. While the provision that holds that decisions are to be made in public is guaranteed without reservation, the public conduct of proceedings is governed by a directly applicable limitation clause. That is, the entire process or parts of it can be closed to the public in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the

private life of the parties so require, or in special circumstances where publicity would prejudice the interests of justice (in the latter case to the extent strictly necessary in the opinion of the ECtHR).

The wording of Art. 6 para.1 second sentence of the ECHR provides for **grounds for the exclusion of the public** but not for the dispensation of the obligation to hold a hearing. However, the jurisdiction considers that exceptional circumstances might justify dispensing with a hearing. In particular, a dispensation of oral hearings may be justified if the person entitled to the fundamental right waives his or her respective right of his/her own free volition. **688**

e) Special Procedural Guarantees in Criminal Proceedings

Art. 6 para. 3 ECHR contains a non-exhaustive enumeration of the **rights of the accused**. It is made clear in the jurisprudence of the ECtHR that these rights are part of the concept of a fair hearing pursuant to Art. 6 para. 1 of the ECHR. All these guarantees are characterised by the idea of the effectiveness of the defence, regardless of whether: a certain element of time is prescribed, disadvantages resulting from language difficulties of the defendant are outweighed, contact with the defender is guaranteed, economic disadvantages for the legal assistance are reimbursed, or effectiveness and equality of arms are protected within the trial process. **689**

According to **Art. 6 para. 3 (a) ECHR**, everyone who is charged with a criminal offence has the right to be informed promptly in a language which he/she understands and in detail, of the nature and cause of the accusation against him/her. The accused has the right to be notified of the charges brought against him/her (and of a detention order) in a language, which he/she understands. Apart from that, the right to translation is limited. **690**

According to **Art. 6 para. 3 (b) ECHR**, a person charged with a criminal offence is granted the right to have adequate time and facilities for the preparation of his/her defence. The time element largely depends on the individual circumstances of each single case. Art. 6 para. 3 (b) not only guarantees adequate time for preparing the defence but also adequate facilities for doing so. This encompasses, *inter alia*, the right to effective and confidential communication with legal counsel. Adequate facilities for the preparation of defence also require a certain degree of access to evidence. However, the question of a violation of the fundamental right in this context largely depends on the circumstances of each individual case. **691**

Art. 6 para. 3 (c) ECHR contains three different guarantees aiming at the effectiveness of the defence: the right to defend oneself in person or through legal assistance, the right to choose one's legal assistance, and the right to free legal assistance. **692**

The right to defend oneself in person includes the **right to be present at the hearing** in criminal proceedings, and in particular, during the main trial. In proceedings of appeal, the absence of the accused does not necessarily imply a breach of Art. 6 para. 3 (c) **693**

ECHR. The accused may also waive his/her right to be present at the trial. Domestic law providing for mandatory legal assistance at certain stages of the proceedings complies with Art. 6 para. 3 (c). Such rules do not infringe on the right of the accused to defend him/herself in person. In this context, particular consideration has to be given to the procedural law standard in the various Member States.

694 Art. 6 para. 3 (c) ECHR also provides for the **right to choose one's legal assistance**. This encompasses the whole range of services specifically associated with legal assistance, such as the discussion of the case, the organisation of the defence, the collection of evidence favourable to the accused, the preparation for questioning, the support of an accused in distress and inspection of the conditions of detention as well as the right to presence of the legal counsel at the hearing and the pre-trial hearing.

695 The third guarantee under Art. 6 para. 3 (c) ECHR is the **right to free legal assistance**. In contrast to the right to choose one's legal assistance, the right to free legal assistance is restricted in two respects: first, the defendant must lack sufficient means for paying for legal assistance. Second, legal assistance is only granted if the interests of justice so require.

696 **Art. 6 para. 3 (d) ECHR** provides for **equality of arms** in a particular conflict. It vests the accused with the right to examine or have witnesses against him/her examined, and to obtain the attendance and examination of witnesses on his/her behalf under the same conditions as witnesses against him/her. A distinction thus has to be made between the right to adversarial proceedings including the right of the accused to examine or have examined witnesses, and the right to summon witnesses. The ECtHR has developed comprehensive case law, in particular, on witness and expert evidence. According to Art. 6 para. 3 (d), the accused has the right to ask or let his/her legal representative ask the witnesses for the prosecution questions and to obtain the attendance and examination of witnesses for the defence under the same conditions that are valid for witnesses for the prosecution. When determining the court's obligations to attend witnesses and experts, one must ask – according to the jurisprudence of the ECtHR – if the denial of a summons or a non-admission of the rights to question can be justified by legitimate reasons. In this respect, it is necessary to balance the importance of these reasons with the disadvantages incurred by the defendant.

697 **Art. 6 para. 3 (e) ECHR** vests the accused with the **right to free assistance of an interpreter** if he/she cannot understand or speak the language used in court. The interpretation assistance provided must enable the defendant to have knowledge of the case against him/her and to defend himself, notably by being able to put before the court his/her version of the events.

698 The right to remain silent and not to incriminate oneself ('***nemo tenetur***') is included in the rights of the defendant. The principle of '*nemo tenetur*' is not explicitly mentioned in Art. 6 ECHR, but it is considered as being part of the main aspects of a fair hearing by the ECtHR. In this context, the Court always refers to the close connections between this main aspect and the presumption of innocence pursuant to Art. 6 para. 2 ECHR.

Finally, the rights of the accused also include the principle of the **presumption of innocence**, even though it is autonomously settled in Art. 6 para. 2 ECHR and therein falls outside of the scope of guarantee of a fair trial. The presumption of innocence must be respected by the members of a court. Judges must not start proceedings with the preconceived idea that the accused has committed the offence charged. Art. 6 para. 2 ECHR prohibits statements of courts and other public authorities at the pre-trial stage as well as during criminal proceedings concerning an accused person, which reflect the opinion that he or she was guilty, even before it has been proven so according to law. This shows that the presumption of innocence has a twofold impact: first, the public must be discouraged from believing that the accused is guilty prior to his/her conviction; second, an assessment of the facts by the competent judicial authority must not be ventured. **699**

II. No Punishment without Law

1. Introduction

The principle of '***nulla poena sine lege***' (**no punishment without law**) in Art. 7 ECHR states that 'no one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed'. The provision contains a prohibition against retroactive criminal legislation and an obligation to define an offence clearly. Hence, it constitutes one of the main fundamental rights in states subject to the rule of law. The scope of application of Art. 7 ECHR corresponds with that of Art. 6 ECHR, which means that it includes not only criminal law but also administrative and regulatory offence law and parts of disciplinary law. **700**

2. Scope of Protection

Art. 7 ECHR applies to **criminal proceedings and offences** within the meaning of Art. 6 ECHR. The scope of Art. 7 ECHR thus includes classical 'criminal offences' as well as administrative offences (disorderly conduct) and certain disciplinary offences. As regards the substance of Art. 7, its application is limited to convictions and sentences (no 'punishment' without law). The notion of 'penalty' ('nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed') has, however, the autonomous meaning as established by the ECtHR and does not depend on the classification in domestic law. **701**

3. No Punishment without Law

702 The guarantees under Art. 7 ECHR are based on the principle that criminal convictions must have a basis in criminal laws, a requirement which is best expressed in the Latin phrase '***nulla poena sine lege***'. This particular principle of legality, which applies only to criminal law, is directed at the judicial power and restricts domestic courts in the interpretation of criminal provisions. The ECtHR accepts that many laws are inevitably couched in terms, which – to a greater or lesser extent – are vague and that an inevitable element of judicial interpretation thus exists. National courts must, however, lay down the criteria for the application of a law. What is decisive is that individuals may reasonably foresee what consequences a given action may entail. As with other provisions of the Convention referring to national 'law', criminal offences within the meaning of Art. 7 ECHR may constitute part of the unwritten law (in particular in common law systems) as long as certain minimum requirements of clarity and foreseeability are satisfied.

4. Prohibition of Retrospective Application of Criminal Law

703 Art. 7 ECHR expressly **prohibits the retrospective application of criminal law**. When assessing whether an act or omission constituted a criminal offence under national law at the time when it was committed, the Member States' courts enjoy a margin of appreciation. It is primarily up to them to interpret and apply domestic law.

5. The Requirement of a Sufficiently Clear Legal Basis

704 Art. 7 ECHR further provides for the requirement that an offence and the corresponding penalty must be **clearly defined by the law**. This requirement complements the principle of legality. The requirement is met if one can gather from the respective provision's wording – with the help of judicial interpretation if necessary – which acts and omissions an individual can be held responsible for according to criminal law. Whether a criminal conviction was sufficiently foreseeable is assessed by the ECtHR in an *ex ante* approach from the perspective of the accused. Art. 7 ECHR cannot be read as outlawing the gradual clarification of the rules of criminal liability through judicial interpretation on a case-by-case basis, provided that the resultant development is consistent with the essence of the offence and can be reasonably foreseen. The requirement of a sufficiently clear legal basis is not absolute, but varies in accordance with various criteria. The scope of the concepts of foreseeability and accessibility depends to a considerable extent on the content of the text at issue, the field it is designed to cover, and the number and status of those parties to whom it is addressed.

6. Prohibition of Retrospective Imposition of Heavier Penalties

Art. 7 para. 1 second sentence ECHR stipulates that a heavier penalty than the one that was applicable at the time of commitment shall not be imposed, which means that a heavier penalty may not be imposed retrospectively. The **principle of non-retroactivity** thus applies to both criminal provisions and the imposition of a penalty. In this context, the same questions arise as do with regards to the retrospective establishment of criminal liability. **705**

Unlike Art. 49 para. 1 third sentence CFR (for details see below at m.n. 719), Art. 7 ECHR does not expressly provide for the right of the offender to get the more lenient penalty if the maximum penalty is reduced by law after he/she has committed the crime. In clear deviation from its former position, however, the ECtHR now holds that **Art. 7 ECHR also requires the more lenient law to apply retrospectively**. The reasons given in the Court's judgment refer particularly to EU law, which contains a corresponding right in the EU Charter. Moreover, according to the CJEU, such a right also forms part of the common constitutional traditions of the EU Member States. The wording of Art. 7 ECHR does not exclude this broader understanding, which is also in line with other developments at an international level. **706**

III. Right not to be Tried or Punished Twice

Art. 4 of Protocol No. 7 to the ECHR contains the **prohibition of double jeopardy** (‘***ne bis in idem***’). According to Art. 4 of Protocol No. 7, ‘no one shall be liable to be tried or punished again in criminal proceedings’. Hence, Art. 4 of Protocol No. 7 is not confined to the right not to be punished twice, but extended to the right not to be prosecuted or tried twice for an offence for which the accused has already been acquitted or convicted. Hence, even if criminal proceedings are concluded by an acquittal, a new trial or punishment is barred by the *ne bis in idem* principle. **707**

IV. Right to an Effective Remedy

1. Scope of Protection

According to Art. 13 ECHR, each person who claims a violation of his/her rights and freedoms under the Convention has the **right to an ‘effective remedy**’ before a national authority. The right to an effective remedy is an ancillary right. This means that Art. 13 ECHR can be invoked only in conjunction with other provisions of the ECHR or the additional protocols applicable thereto. Due to its ancillary character, the scope of the obligation under Art. 13 ECHR varies depending on the substantive right which is claimed to have been violated. **708**

709 The guarantee aims at protecting the rights under the Convention in the Member States and demonstrates the **subsidiary character** of the Convention machinery to the national systems of protection of fundamental rights. Furthermore, it requires that all domestic remedies be exhausted. The right to an effective remedy against violations of Convention rights before national authorities may make it necessary for the states to introduce new procedures in order to comply with the guarantees under Art. 13 ECHR.

710 The rights guaranteed under domestic law whose violation may be claimed before national courts, do not, moreover, have to be identical to those under the Convention. Rather, it is required that the **rights** invoked must be **substantially the same** as those whose violation is alleged before the ECtHR. Member States are not required to incorporate the guarantees of the Convention into domestic law, nor to implement them directly. Member States are therefore afforded some discretion as to the manner in which they provide the relief required and the manner in which they conform to their obligation under Art. 13 ECHR, as long as the substance of the Convention rights and freedoms is secured under the domestic legal order.

711 Art. 13 ECHR applies to cases of alleged violations of Convention rights and freedoms through **acts attributable to a state** – independent of whether they were committed by legislative, executive or judicial authorities. However, Art. 13 ECHR does not go so far as to guarantee a remedy allowing domestic laws as such to be challenged before a national authority on the grounds of being contrary to the Convention or to equivalent domestic legal norms.

712 According to the ECtHR's established case law, a **violation** of the Convention is not **a prerequisite for the applicability** of Art. 13 ECHR. The aforementioned article must rather be interpreted as guaranteeing an 'effective remedy before a national authority' to everyone who claims that his/her rights and freedoms under the Convention have been violated. Provided that this condition is met, the ECtHR examines a possible breach of Art. 13 ECHR notwithstanding its findings that no right invoked has been infringed, provided that a violation of another right under the Convention is arguable. Each individual claim of a violation of a fundamental right does not, however, amount to the basis for a complaint under Art. 13 ECHR. In order to enjoy the right under Art. 13 ECHR, an individual must have an tenable claim to be the victim of a violation of the rights set forth in the Convention.

2. The Guarantee of Article 13 ECHR

713 Art. 13 ECHR provides for the **right to an efficient remedy**. As other concepts under the Convention, the notion '**remedy**' is interpreted autonomously by the ECtHR. Art. 13 ECHR requires the availability at the national level of a remedy for enforcing the substance of the Convention rights and freedoms and the granting of commensurate relief. The authority referred to in Art. 13 ECHR must not necessarily be a judicial authority in all instances, in the strict sense. The '**national authority**' may be a court, in particular, a constitutional court as well as an administrative authority, a governmental authority or a parliamentary body. Minimum requirements for a remedy before a non-judicial authority to be effective are its independence and impartiality. A remedy cannot be considered effective if the authority deciding on the claim of violation is the one who was involved in the alleged violation.

714 It is left to the Member States' discretion on how to secure the substance of the Convention rights and freedoms. What is required is that the remedy must be '**effective**' **in practice as well as in law**, in the sense either of preventing the alleged violation or its continuation, or of providing adequate redress for any violation that has already occurred and, in particular, in the sense that its exercise must not be unjustifiably hindered by the acts or omissions of the authorities of the respective state.

715 Whether a remedy is '**effective**' within the meaning of Art. 13 ECHR depends on the competences an authority possesses and the procedural guarantees that apply to proceedings before it, though it must be assessed on a **case-by-case basis**. At any rate, the principle of fairness – including the equality of arms – is a constituent element of an effective remedy. The effectiveness of a remedy does not depend on the certainty of a favourable outcome. Rather, effectiveness requires that a remedy be adequate and accessible. In this context, particular attention should be paid to the speediness of the remedial action itself. If proceedings are excessively lengthy, the remedy is considered to be inadequate.

V. Procedural Guarantees under the CFR

716 Guarantees comparable to the **fundamental judicial and procedural rights** of the ECHR can also be found in EU law, and especially in **Art. 47-50 CFR**.

717 Art. 47 and 48 CFR contain corresponding guarantees to Art. 6 ECHR, however, **without the limitation of the scope of application** of that provision. Art. 47 CFR provides for a guarantee comparable to that under Art. 13 ECHR. Its application is, however, not limited to the fundamental rights set forth in the CFR but extends to 'all rights and freedoms guaranteed by the law of the Union'. Apart from that, according to Art. 47 CFR, everyone is entitled to a fair and public hearing within a reasonable amount of time by an independent and impartial tribunal previously established by law. Art. 47 CFR also guarantees the right to advice, legal defence, and representation in court. Apart from that, according to the same provision, legal aid shall be made available to those who lack sufficient resources in so far as such aid is necessary for ensuring effective access to justice. According to the case law of the CJEU, the principle of a **fair trial**, such as the requirement of effective judicial control as laid down in Art. 6 and 13 ECHR, reflects **general principles of law**.

718 Comparable to Art. 6 para. 2 ECHR, Art. 48 CFR provides for the **presumption of innocence**. Furthermore, this provision guarantees the respect for the rights of defence of anyone who has been charged.

719 The CFR includes the principle of '***nulla poena sine lege***' too and adopts in its Art. 49 almost all safeguards of Art. 7 ECHR. According to the CJEU, a comparable fundamental right exists as a general principle of EU law. Going beyond the guarantees of Art. 7 ECHR, Art. 49 para. 1, the third sentence of the CFR expressly demands that if, subsequent to the commission of a criminal offence, the law is changed and the new law provides for a lighter penalty, then the more lenient penalty shall be imposed. A penalty is more lenient if either the maximum possible penalty is reduced or if the type of penalty is changed, for example, from imprisonment to fine. Moreover, Art. 49 para. 3 CFR expressly contains the provision that the severity of penalties must not be disproportionate to the criminal offence. Similar to Art. 7 para. 2 ECHR, Art. 49 para. 2 CFR states that 'this article shall not prejudice the trial and punishment of any person for any act or omission which, at the time when it was committed, was criminal according to the general principles recognised by the community of nations'.

720 The **right not to be tried or punished twice** (Art. 4 of Protocol No. 7 to the ECHR '***ne bis in idem***') is also provided for in international criminal law and EU law. Art. 50 CFR stipulates that no one shall be liable to be tried or punished again in criminal proceedings for an offence for which he/she has already been acquitted or convicted within the EU in accordance with the law. The principle is also recognised as a general principle of EU law – at least in the relationship between the EU and its Member States.

E. Enforcement of Fundamental and Human Rights before Courts

721 Fundamental and human rights may be **enforced before courts** specialised in certain areas of law.

722 Fundamental rights under the **Austrian Constitution** may be invoked in proceedings before the **Constitutional Court**. In particular, applications may be submitted against decisions of administrative courts or directly against laws if the alleged violation follows directly from the law and not from an administrative decision or a judgment of a court.

723 Human rights under the **ECHR** may be invoked in **individual applications** according to Art. 34 ECHR. A condition of admissibility is the exhaustion of domestic remedies. As the ECHR forms an integral part of the Austrian Federal Constitution, the rights under the Convention must, as a rule, be invoked before the Constitutional Court before an application based on the alleged violation of this right may be introduced before the ECtHR in Strasbourg.

724 The rights under the **CFR** may be invoked **before all Austrian courts,** as, they constitute part of primary EU law which is directly applicable and enjoys precedence over any national law in case of contradiction. In particular, most of the rights of the CFR may be invoked as constitutionally guaranteed rights before the Constitutional Court

(see Unit 9 at m.n. 590). However, there is no direct access on the part of the individual to the CJEU in Luxemburg. The CJEU may only decide on questions of the CFR after a national court has submitted questions in a preliminary reference procedure under Art. 267 TFEU.

Relevant Literature and Further Reading

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Stelzer, An Introduction to Austrian Constitutional Law (3rd ed., 2014).

Stelzer, The Constitution of the Republic of Austria – A Contextual Analysis (2011).

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Questions

1. What are the three steps that must be observed when examining a potential violation of a fundamental right?
2. Does the ECHR provide for a special right to the protection of personal?
3. What does ‘informational self-determination’ in the context of the right to privacy and data protection under Art. 8 ECHR mean?
4. How can an interference with the rights under Art. 8 para. 1 ECHR be justified? Name and explain the conditions.
5. Describe the proportionality test employed by the European Court of Human Rights (ECtHR).
6. What does the term ‘margin of appreciation’ mean?
7. What is the material scope of the protection of property under Art. 1 of Protocol No. 1 to the ECHR?
8. Name the three types of interference with the right to property.
9. What is the personal scope of the right to property?
10. What are the defining characteristics of a ‘criminal charge’ for the purposes of Art. 6 ECHR?
11. What are the guarantees of Art. 6 ECHR?
12. What is a ‘tribunal’ within the meaning of Art. 6 ECHR?
13. What does the principle of ‘nulla poena sine lege’ in Art. 7 ECHR guarantee?
14. The right to an effective remedy is an ancillary right. Was does the term ‘ancillary right’ mean?
15. Is there a possibility for an individual to get direct access to the ECtHR in Strasbourg? State reasons for your answer.
16. Is there a possibility for an individual to get direct access to the CJEU in Luxemburg? State reasons for your answer.

Unit 11: International Law and Globalisation

A. The Concept of International Law

725 International law can be **defined** as the sum of rules that regulate the conduct of the subjects of international law and do not form part of the internal legal order of states. Originally, the primary subjects of international law were states. Meanwhile, other entities, in particular international organisations (IOs) and individuals, have become partial subjects of international law as well (see below at m.n. 756 *et seq.*).

726 International law deals with issues as diverse as the creation of states, war and peace, international diplomacy, borders, nationality, international trade and monetary affairs, human rights, and the protection of the environment. There is hardly any **international activity** that is not affected, and hardly any **internal matter** that could not be regulated by international law. International law today is thus not only concerned with the peaceful coexistence of states ('**international law of coexistence**'), but also with facilitating cooperation between states themselves and other subjects of international law ('**international law of cooperation**'), and even the control of states in their internal relations with private persons and enterprises.

727 Moreover, due to the process of globalisation, international law may be transforming, in terms of its structures and its objects, into an '**international law of the globalised world**' (*Hobe*). We will return to this issue at the end of this unit.

B. The Development of International Law

728 Whereas some basic concepts of international law can be traced back thousands of years, *e.g.* to the relationship between ancient city-states in Mesopotamia, international law came to be recognised as a **self-standing legal system** in the 16th and 17th centuries, when modern nation-states came into existence. Of particular importance were early contributions by scholars like *Hugo Grotius* (*Hugo de Groot*, 1583–1645), who systematically described international law as it stood in his time, *Alberico Gentili* (1552–1608), *Francisco de Vitoria* (1483–1546), *Samuel von Pufendorf* (1632–1694) and *Emer de Vattel* (1714–1767).

729 The treaties constituting the Westphalian Peace, which ended the Thirty-Years' War in 1648, are generally regarded as the starting-point of **modern international relations** and the so-called 'European International Law' (*ius publicum europaeum*), which is characterised above all by state sovereignty and the equality of states. This 'European' system gradually became recognised as universal international law.

730 Another milestone in the development of international law was the overall contribution made by the Final Act of the **Congress of Vienna** (1815). This multilateral treaty

which ended the Napoleonic Wars, established the 'European Concert', a system of political cooperation that was meant to stabilise Europe. Furthermore, in the context of the Vienna Congress, rules of diplomatic relations were codified, slavery was condemned, and freedom of navigation on rivers was recognised. Due to the considerable advances in technology in the period between the Vienna Congress and World War I, industry, communication, trade, among other key developments, the first IOs were founded; at the same time, other fields of international law such as humanitarian law were advanced.

In the aftermath of World War I, the international community realised that a profound transformation of the system of international relations and a more reliable institutionalised framework were necessary to guarantee peace. This led to the creation **731** of the **League of Nations** in 1920. Within the League, a system of collective security was established, according to which collective interventions against states breaching the peace or violating minority rights were permissible. The League system, however, suffered from a series of shortcomings, such as the non-accession of the United States (US) and the expulsion of the Soviet Union in 1939, and was ultimately unable to prevent the outbreak of wars and the use of 'force short of war'. Nonetheless, the experiences in the League helped create the United Nations (UN) after World War II, which was also meant to specifically overcome major defects of the League system.

The time since World War II can be referred to as the 'era of the UN', which was **732** founded in 1945 (see below at m.n. 767 *et seq.*). Due to its universal character, the UN has been able to move many fields of international law forward, such as international human rights protection and international environmental law.

C. Effectiveness of International Law

It is a fundamental characteristic of international law that there is **no global legislature, executive or judiciary** involved. This creates problems regarding the creation and **733** enforcement of international law. Nonetheless, it is generally accepted that 'almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time' (*Louis Henkin*).

How can this **effectiveness** of international law be explained? On the one hand, a **734** series of instruments are available for enforcing international law at the international level. Although there is no global court with comprehensive compulsory jurisdiction, there is an ever-increasing number of specialised courts and tribunals that are well rehearsed in the specific rules of international law. Furthermore, there are international mechanisms such as negotiations, mediation, good offices and arbitration that enhance the effectiveness of international law. Furthermore, IOs help promote compliance with international rules. Not least, obligations under international law are often transformed into corresponding obligations under national law, which can eventually be enforced before national courts.

735 Furthermore, international relations theorists and international lawyers have identified a series of **factors** that contribute to the effectiveness of international law. In this regard, reference has *e.g.* been made to:
- the fact that international agreements are negotiated on a voluntary basis, so that there is a **propensity to comply** with them
- the perceived **legitimacy and fairness** of international obligations
- **positive sanctions** or incentives such as increases in trade, development aid and cooperation
- **negative incentives** such as military and economic sanctions
- **linkage mechanisms** (*e.g.* trade preferences in treaties explicitly linked to compliance with human rights, labour or environmental standards)
- **reciprocity** (meaning *e.g.* that states can suspend treaty obligations vis-à-vis states failing to comply with a given treaty)
- **reputation concerns** (meaning that states not complying with international law risk losing credibility, which may incur material and immaterial costs in the future)
- **factors internal to states** (such as pressure by voters in democratic states to comply with international obligations)

736 In recent years, there have also been efforts to effectuate international law through **market forces** and **private action**. Examples are schemes developed by international organisations, non-governmental organisations (NGOs) and private initiatives in which labels or certificates are attributed to producers and sellers of products only if they comply with international standards. Such schemes are meant to influence the purchasing decisions of consumers in order to compel states and economic operators to comply with pertinent international obligations. There have also recently been attempts to incorporate such international standards into private contracts governing the supply chains of products so as to make it possible to enforce international standards before national courts.

737 It is obvious that the effectiveness of, and degree of compliance with international law tends to differ in accordance with specific **state interests** and from one field of international law to another. Particularly effective regimes have been established in the fields of regional human rights protection and international economic law (see Units 9 and 10).

D. The Sources of International Law

The **main sources** of international law are enumerated in Art. 38 of the Statute of the International Court of Justice (ICJ): 738

> 'a. international conventions, whether general or particular, establishing rules expressly recognised by the contesting states;
> b. international custom, as evidence of a general practice accepted as law;
> c. the general principles of law recognised by civilized nations;
> d. subject to the provisions of Art. 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law' (Art. 38 para. 1 ICJ Statute).

A few comments are in order. First, it is often proffered that this list is not complete, 739 as it does not refer to **unilateral legal acts** and **decisions of international organisations**. Secondly, the judicial decisions and teachings referred to in lit. d. do not constitute sources of law, but merely function as sources for determining law. Thirdly, despite the sequence in the list in Art. 38 ICJ Statute, there is no abstract **hierarchy** between the sources in international law (usually, however, rules laid down in treaties will be more specific than customary law and general principles of law and may then be found to have priority on the basis of the *lex specialis* principle (*lex specialis derogat legi generali*). In concrete cases, however, this hierarchy can be inversed, *e.g.* if a norm of customary law adopted later is found to override an older treaty norm due to the *lex posterior* principle (*lex posterior derogat legi priori*)).

By contrast, there is only a rudimentary abstract hierarchy in international law: 740 norms belonging to the category of *ius cogens* cannot be superseded by norms in treaties. Such *ius cogens*-norms are norms 'accepted and recognised by the international community of states as a whole from which no derogation is permitted' (see Art. 53 of the Vienna Convention on the Law of Treaties (VCLT); on the VCLT, see below). Only very few norms – such as the prohibitions on slavery and torture – have been met with general agreement as falling within this category.

I. Customary International Law

An important source of international law is customary international law. Rules of 741 customary law deal, for example, with statehood, state borders, environmental protection, international criminal responsibility and many other issues.

As follows from Art. 38 ICJ Statute, customary international law comprises two ele- 742 ments: **state practice** and the belief that this practice is required by law (***opinio iuris***). As regards the first element, relevant practice includes virtually any acts or omissions by state legislatures, governments or courts, such as relevant national legislation, statements made by governments, court rulings, and the practice in or of international organisations and arguably also other subjects of international law. This practice must be general and should include states particularly affected, but need not be universal; it must also be reasonably consistent, although the duration of practice may vary depending on the subject. A state which proceeds from the outset and in a clear and sustained manner, with objecting to a given practice, will not ultimately become bound by relevant customary law ('persistent objector').

743 As regards the second element, ***opinio iuris***, states must be convinced that their conduct is required by law, not merely by political or other considerations. There has to be an overall – not necessarily universally shared – attitude in the community of states. Meanwhile, the subjective element of *opinio iuris* can often only be inferred indirectly from state practice.

744 Despite the growing number of treaties, customary law continues to serve important **functions** in international relations: as opposed to treaty norms, customary law can bind states that have not explicitly consented to relevant rules; moreover, customary law fills the void when there is no relevant treaty law.

II. Treaties

745 Treaties (international agreements) are the **most important source** of international law today. Treaties can cover any issue of concern in international relations. They can be employed to establish individual legal positions ('contract treaties'), but also to establish general rules for future conduct ('law-making treaties') in bilateral and multilateral constellations.

746 A treaty can be **defined** as (i) a legally binding agreement (ii) that is governed by international law and is (iii) deliberately concluded (iv) by two or more subjects of international law (v) that have treaty-making capacity.

747 A few comments are in order again. In particular, it **follows** from (i) that non-binding political declarations of intent (such as 'gentlemen's agreements' like the Luxembourg Accords; see Unit 7) do not constitute binding treaties under international law. It follows from (ii) that contracts concluded by states under national law (*e.g.* rental contracts concluded between states under the domestic law of one state) do not constitute international agreements. States normally enter into treaty obligations on a voluntary basis (iii), although there may be unforeseen obligations (see below). Treaties can only be concluded by subjects of international law, namely states and IOs (iv). However, IOs only have treaty-making capacity (v) to the extent that such competence has been explicitly or implicitly transferred to them by their Member States and to the extent that this capacity is also recognised by the other contracting parties (a striking example is the EU, which has acquired a broad range of explicit and implicit treaty-making powers that have also been recognised by third countries and other IOs).

International law relating to treaties is governed by the principles of **freedom of conclusion, content and form**. This means that states are free to decide in principle whether, when and with whom to conclude treaties; states are likewise free to decide in what manner they wish to express their consensus. However, the freedom of content is restricted by *ius cogens* norms and Art. 103 of the UN Charter; pursuant to the latter, the obligations of UN Member States under the Charter prevail over conflicting obligations under any other international agreement. **748**

The specific rules dealing with treaties – such as the conclusion and entry-into-force of treaties, their interpretation and termination – are laid down in particular in the **Vienna Convention on the Law of Treaties** (VCLT) of 1969, which codified customary international law and has been ratified by 116 states as of 2018. **749**

Treaties in force must be performed in **good faith** (*pacta sunt servanda*, Art. 26 VCLT). A party may not invoke its **domestic law** as justification for its failure to perform a treaty (Art. 27 VCLT). States have the capacity to conclude treaties, but need **organs that act** on their behalf. It is up to the national law of every state to determine which organs have such power; these requirements thus vary from one state to another. Reasons of legal security in particular also contribute to the fact that rules governing the **conclusion of treaties** are therefore also needed at the level of international law. In particular, according to the VCLT, heads of state and government and foreign ministers are deemed to have full powers for the purpose of performing all acts relating to the conclusion of a treaty (Art. 7 VCLT). If the national constitutional law of a contracting party requires that assent be given by the national parliament, the treaty must be referred to it for ratification ('ratification' in terms of national law) before the consent to be bound by the treaty may be declared on the international plane ('**ratification**' in the sense of international law; see Art. 2 and Art. 24 VCLT). **750**

Treaties must be **interpreted** in (i) good faith (ii) in accordance with the standard meaning to be assigned to the terms of the treaty (iii) in their context and (iv) in the light of its object and purpose (Art. 31 VCLT). Hence, interpretation starts with the ordinary meaning of words in their context, which also comprises the preamble and annexes of a treaty and, in particular, agreements relating to the treaty made in connexion with its conclusion and relevant subsequent practices and agreements. Recourse to other ('supplementary') means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, may only be obtained in order to confirm the meaning resulting from the application of Art. 31, or to determine the meaning when the interpretation according to Art. 31 leaves the meaning ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable (Art. 32 VCLT). **751**

When a treaty has been authenticated in **two or more languages**, the text is in principle equally authoritative in each language and the terms of the treaty are presumed to have the same meaning in each authentic text. However, when there is a difference in meaning between the authentic texts which cannot be removed through the application of Art. 31 VCLT and Art. 32 VCLT, then the meaning which best reconciles the texts, **752** which pays regard to the object and purpose of the treaty, is the one which has to be adopted (Art. 33 VCLT).

753 As these principles exclude assigning preponderant weight to the subjective intentions of (one or more of) the contracting parties, states may face unexpected interpretative results and, thus, unforeseen obligations: an illustrative **example** in international economic law is provided by the *US-Gambling* case. Under the WTO General Agreement on Trade in Services (GATS), the *US-Gambling* case involved the US undertaking commitments to offer market access to foreign online providers of 'recreational services', but wherein the US had excluded the sub-category of 'sporting services'. Whereas the US understood 'sporting services' as covering 'gambling and betting services', the WTO found that 'sporting services' could not be interpreted in line with the subjective US understanding, but had to be read instead on the basis of the more 'objective' principles of the VCLT, as not covering 'gambling and betting services'. The US therefore lost the case and had to open its market for foreign online gambling services.

III. General Principles of Law

754 General principles of law are mentioned in Art. 38 ICJ Statute as a third source of international law. These are principles that are common to the **national legal systems** and need to be ascertained through a comparison of law (in this regard, the reference to 'civilised nations' in this provision is obsolete today and should be understood as referring to the principal legal systems of the world). As opposed to customary law, there is no need to identify state practice and *opinio iuris* before such general principles can be applied.

755 While the role of general principles of law has been decreasing with the rise of international agreements, they nevertheless remain relevant for filling gaps and for providing guidance on the interpretation of other rules. **Examples** of general principles of law are the duty to make reparation for breaches of treaty obligations and the permissibility of using circumstantial evidence.

E. The Subjects of International Law

756 The subjects of international law are those **entities whose conduct is regulated directly by international law**. In other words, they enjoy '**international legal personality**', *i.e.* the capacity of being direct addressees of rights and obligations of international law. States are the 'traditional' subjects of international law. They enjoy '**original personality**' under international law, as this personality is not derived from other subjects of international law. Their international legal personality is also comprehensive. Beside states, there are other subjects of international law whose international personality follows from its recognition by states ('**derived personality**'), namely, IOs, individuals,

and atypical subjects of international law (such as the International Committee of the Red Cross).

I. States

A state is **defined** in international law 'as a person of international law [which possesses] the following qualifications: a) a permanent population; b) a defined territory; c) a government and d) capacity to enter into relations with other states' (Art. 1 of the 1933 Montevideo Convention). The fourth criterion is not regarded as a self-standing one, but as merely qualifying the third one. **757**

The '**permanent population**' is defined by citizenship. States are free to decide whom to award their citizenship within the confines of international law. International law requires a genuine link between a citizen and its home country (which prohibits arbitrary decisions on the awarding of citizenship) and in particular, recognises the award of citizenship on the basis of the *ius sanguinis* and the *ius soli* principles (or combinations thereof). According to the *ius sanguinis* principle, citizenship may be granted by a state to persons descending from its citizens. Pursuant to the *ius soli* principle, a state may award citizenship to persons born in its territory. Since the application of these principles can lead to an individual having multiple nationalities, or, conversely, statelessness, international agreements have been concluded to avoid such problems. Citizenship is important given that individuals enjoy a limited international legal personality only and normally depend on the protection by his/her home country on the international plane ('diplomatic protection' (see below at m.n. 774 *et seq.*). It is also relevant for other rights and duties such as compulsory military service. **758**

For statehood to exist, there must, secondly, be a '**defined territory**', which means that there must be an undisputed natural core territory, but not necessarily complete certainty over its exact limits. The state territory comprises the mainland, the subterranean area, the territorial sea, and the airspace above the state territory. **759**

Thirdly, statehood requires an **effective government** that is capable of creating and enforcing the law internally and of guaranteeing compliance with international law externally. For reasons of legal security and the functioning of international law, it is the effectiveness of government which is relevant under international law, not its legitimacy. If a state transfers sovereign rights to an IO such as the UN or the EU, this does not affect its statehood, since these rights can be regained by unilaterally leaving the organisation in question. By the same token, states can confer sovereign rights to other states without losing statehood (examples are protectorates such as Liechtenstein and Monaco). For reasons of legal security, an established state does not lose statehood when its government loses substantial control over its state territory (so-called failed or failing states, *e.g.* Somalia after 1991). **760**

761 The **recognition** of a state by other subjects of international law is not relevant for statehood, in principle. If a state declines to recognise another state, this 'merely' implies that it is not ready to enter into diplomatic relations. However, (collective) recognition or non-recognition by many states can have an indicative effect as to whether the three criteria for statehood are to be regarded as fulfilled.

II. International Organisations

1. General Aspects

762 IOs make it possible for states to pursue common interests – ranging *e.g.* from security issues to environmental and economic affairs to human rights protection – through **institutionalised cooperation**. Whereas the first IOs were founded in the 19th century, most were established after World War II. Today, there are more than 200 IOs.

763 An IO can be **defined** as an entity that has been established on a (i) permanent basis and (ii) based on international law (iii) by at least two subjects of international law (iv) in order to autonomously pursue specific tasks entrusted to it (v) through its own organs. As organisations created by states (and possibly other IOs), IOs must be distinguished from non-governmental organisations (NGOs) which are established by private persons, such as, associations, for instance, under domestic law.

764 IOs can be **universal** (*e.g.* UN) or **regional** organisations (*e.g.* NATO, EU). Depending on the degree of integration achieved, they can be regarded as '**classic**' international organisations (such as the UN again) or **supranational** organisations (the EU in particular). As mentioned above, the legal personality under international law of an IO is **derived** from its Member States. Furthermore, it is **partial**, as the extent of the personality depends on the degree to which competences have been transferred to a given IO by its Member States. Thirdly, the personality of an IO is **relative**, given that in an IO's relations with third countries, the existence or non-existence of international legal personality depends on its (non-) recognition by third countries. An exception is the UN, which has been regarded by the International Court of Justice (ICJ) as possessing an *objective personality*, *i.e.* personality existing vis-à-vis third countries irrespective of recognition by them.

765 States (and in some cases, other IOs) can become **members** of an IO as founding Members (*e.g.* the EU as a founding Member of the WTO) or, later on, through accession (*e.g.* accession of Switzerland to the UN in 2002). In many IOs, there is the option for participation not amounting to full membership, in particular the possibility of acquiring association status (*e.g.* association of Turkey with the EU) or observer status (*e.g.* EU in the UN General Assembly).

766 The **competences** of IOs vary considerably. While some IOs only have observer or advisory functions, others are empowered to adopt non-binding resolutions (*e.g.* resolutions of the UN General Assembly), to issue binding decisions (*e.g.* decisions by the

UN Security Council), or even to enact rules of a general nature (*e.g.* EU secondary law). Likewise, the concrete **institutional structures** of IOs differ widely. Generally speaking, however, in most IOs, there is a plenary organ consisting of representatives of all Member States and a secretariat that is responsible for administrative tasks. In some IOs, an executive body is in place consisting of the representatives of some of the IOs' Member States only. The **decision-making requirements** in IOs vary as well. As opposed to former times, when unanimity played a greater role, IOs nowadays often function on the basis of majority voting. Some take their decisions by consensus, which means that a body is deemed to have made a decision without a formal vote if no formal objections are raised (*e.g.* WTO).

2. The United Nations

The UN was founded in 1945 by 51 Member States; with 193 members today, it has **767**
acquired virtually universal membership. Its **purposes** are, in particular, to
– maintain international peace and security,
– develop friendly relations among nations,
– achieve international cooperation and to
– promote respect for human rights (see Art. 1 UN Charter)

In pursuit of these purposes, the UN and its members must act in accordance with **768**
the legally binding **principles** laid down in Art. 2 of the UN Charter, which specifically stress the **sovereign equality** of its members that is protected by the **prohibition on intervention**. Furthermore, Art. 2 para. 3 requires all members to settle their international **disputes by peaceful means**; as this provision's counterpart, Art. 2 para. 4 lays down the **prohibition on the use force**, which is central to the UN system.

The **principal organs** of the UN are the General Assembly, the Security Council, the **769**
Economic and Social Council, the Trusteeship Council, the ICJ and the Secretariat. A large series of subsidiary organs have been established within the UN system.

The **General Assembly** consists of all UN members. All members have one vote, **770**
irrespective of their size or political power. Decisions on important questions, such as recommendations with respect to the maintenance of international peace and security, are to be made by a two-thirds majority of the members present and voting. Decisions on other questions require a majority of the members present and voting. In practice, however, most decisions are taken by consensus. The General Assembly has comprehensive competence in principle, as it may discuss any matters within the scope of the Charter and (with the exception of situations being dealt with by the Security Council) may make recommendations to the UN members or to the Security Council on any such matters. Whereas the General Assembly can adopt binding resolutions regarding internal affairs (such as budgetary issues), all other resolutions are legally non-binding. The latter can nonetheless carry considerable political weight; also, such resolutions

can have legal effects of a lesser degree ('soft law') and can contribute to the formation of customary international law.

771 The **Security Council** serves as the UN's executive body. It has the primary responsibility for the maintenance of international peace and security. It has the power to adopt decisions that are binding for all UN members. The Security Council consists of 15 members, five of which are permanent members (China, France, Russia, the UK and the US). Ten non-permanent members are elected by the General Assembly for a term of two years, due regard being specially paid to equitable geographical distribution. Each member of the Security Council has one vote. Decisions on procedural matters require an affirmative vote of nine members. Decisions 'on all other matters' are to be made by an affirmative vote of nine members including the concurring votes of the permanent members. Hence, the permanent members have the power to veto all such 'decisions on all other matters'. What is more, if a dispute arises as to whether a decision merely concerns a 'procedural matter', a permanent member can first veto the classification of the decision as a 'decision on procedural matters'. When the decision is then treated as one concerning 'other matters', the permanent member can use its veto a second time (a so-called 'double veto' of permanent members).

772 The **Secretariat** comprises the UN Secretary-General and its staff. The **Secretary-General** is appointed by the General Assembly upon recommendation of the Security Council. The Secretary-General is the chief administrative officer of the UN and acts in that capacity in all meetings of the General Assembly, of the Security Council, of the Economic and Social Council, and of the Trusteeship Council. Importantly, the Secretary General may bring any such matters to the attention of the Security Council, which, in her/his opinion, may threaten the maintenance of international peace and security. Furthermore, the Secretary-General may offer to serve as a neutral mediator between UN members and can also be given such mandates by the General Assembly and the Security Council. Moreover, the Secretaries General of the UN have thus far taken political initiatives of their own that have gone beyond the tasks explicitly specified in the Charter.

773 The **ICJ** is the principal judicial organ of the UN. All UN members are *ipso facto* parties to the Statute of the ICJ. The ICJ consists of 15 judges, no two of whom may be nationals of the same state. The judges are elected by the General Assembly and by the Security Council. Only states may be parties in cases before the ICJ. Disputing parties, however, need to recognise the jurisdiction of the ICJ. This can be effected by means of an *ad hoc* agreement (*compromis*) or implicitly by participating in a dispute before the ICJ, by means of treaties providing for the jurisdiction of the ICJ for the resolution of disputes arising under such treaties, or by unilaterally recognising as compulsory *ipso facto* and without special agreement – in relation to any other state accepting the same obligation – the jurisdiction of the Court in all legal disputes under international law (Art. 36 ICJ Statute). Decisions of the ICJ are binding on the parties. In addition to disputes between states, the ICJ is also charged with giving advisory opinions which

are non-binding, but carry considerable weight. Advisory opinions may be requested by the Security Council and the General Assembly (and other UN organs and agencies so authorised by the Assembly).

III. Individuals and other Entities

Traditionally, international law was seen as applying to states only. Individuals were regarded as citizens of a given state, but did not hold rights or obligations directly under international law. In other words, they were conceived of as '**objects**', not subjects of international law. From the viewpoint of international law, states were free to treat their citizens as they chose. Individuals were only protected indirectly by international law when they stayed in other states. That is, if alien persons were injured in another state, then their home state was regarded as injured and could decide whether to bring claims of its own under international law (which is referred to as exercising '**diplomatic protection**'). **774**

This situation has gradually changed after World War II, when individuals have increasingly come to be recognised by states as possessing **international legal personality**, *i.e.* as having the capacity to be addressees of rights and obligations under international law. This personality under international law is thus derived from states and is partial, as it exists only to the – quite limited – extent it is recognised by states. In terms of substance, individuals, in particular, enjoy the protection of **international human rights**, which they themselves can enforce in certain settings (such as the ECHR); in others, individuals still depend on a state willing to enforce relevant human rights obligations against another state violating their human rights. On the other hand, individuals today are also directly subjected to duties under international law, namely in the field of **international criminal law** (see below at m.n. 797 *et seq.*). **775**

Other entities have also come to be considered as subjects of international law in the course of the 20th century: especially **peoples** (as regards their right to self-determination), Non-Governmental Organisations (**NGOs**) (*e.g.* as regards certain fundamental rights and rights of participation in some IOs), and **transnational corporations** (*e.g.* as regards their investments). The international legal personality of these entities is also derived from states, and only partial. **776**

F. Peaceful Settlement of Disputes

All states are required by international law to **settle their international disputes peacefully**. This fundamental principle has found expression in Art. 2 para. 3 UN Charter. The UN Charter deals with this obligation in **Chapter VI**, enumerating the typical means of pacific dispute settlement, namely, negotiation (the method traditionally employed in international relations), enquiry, mediation, conciliation, arbitration, **777** judicial settlement (before the ICJ or other courts and tribunals), and resort to regional agencies or arrangements. States are free, moreover, to resort to any other peaceful means of their own choice.

778 Under Chapter VI, the **Security Council** can, when it deems necessary, call upon the parties to settle their dispute by such peaceful means. Furthermore, the Security Council may investigate any dispute likely to endanger international peace. Any UN Member State may bring any international dispute to the attention of the Security Council or of the General Assembly. The Security Council may recommend appropriate procedures or methods of adjustment.

779 Should the parties to an international dispute fail to settle it by peaceful means, they must refer it to the Security Council, which can then recommend terms of settlement. Set forth in Chapter VI of the UN Charter, these powers of the Security Council are **non-binding** (as opposed to those under Chapter VII, see below).

780 As a matter of course, several other specialised UN agencies (such as the International Labour Organisation and the International Atomic Energy Agency) and numerous **other international (regional) organisations** can be resorted to for the peaceful settlement of disputes as well.

G. Use of Force and Collective Security

I. Unilateral Use of Force

781 As mentioned above, one of the central principles of the UN is the **prohibition on the use force** (Art. 2 para. 4 UN Charter). According to it, all members must refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the purposes of the UN.

782 This prohibition constitutes *ius cogens*. It is concerned with military force, and not economic pressure (as the latter constitutes an important means of enforcing international law). Crucially, there are only **three exceptions** to this prohibition that are recognised by the UN Charter, namely

– lawful self-defence,
– use of force under Chapter VII of the UN Charter (see next section) and
– use of force by regional organisations under Chapter VIII of the UN Charter (see next section, too).

783 Pursuant to Art. 51 UN Charter, nothing in the Charter impairs the 'inherent right of individual or collective **self-defence** if an armed attack occurs against a Member of the United Nations until the Security Council has taken measures 'necessary to maintain international peace and security'. Exercising the right of self-defence requires a massive military attack which is either occurring or imminent; the use of force in self-defence must be proportionate to the attack.

It does not come as a surprise that the interpretation of the criteria laid down in Art. 2 para. 4 and Art. 51 UN Charter has given rise to numerous **controversies**, many of which have remained unresolved. One core problem is that the far-reaching prohibition on the unilateral use of force in Art. 2 para. 4 would require an effective exercise by the Security Council of its monopoly on the use of force within the system of collective security (see below at m.n. 785 *et seq.*). As the Security Council has not been functioning satisfactorily, in particular, due to the veto power of its permanent members during the Cold War and on several occasions since then, the unilateral use of force and resort to self-defence have remained a fact whilst their controversial limits continue to cause legal and political problems. **784**

II. Collective Use of Force

1. Collective Security within the UN

The UN Member States have established a system of collective security which is meant to resolve military conflicts within the system: on the one hand, by agreeing to the **prohibition on the use of force** just outlined, the UN members have foregone the use force in international disputes which cannot be settled peacefully. On the other hand, they have vested the **monopoly to use force** in the Security Council (Chapter VII of the UN Charter). **785**

The Security Council is competent to determine, with binding effect, the existence of any threat to the peace, breach of the peace, or act of aggression. It may then prescribe necessary provisional measures and may decide what measures not involving the use of armed force are to be employed by UN members (*e.g.* **economic embargoes**). If necessary, the Security Council may decide to take military action, which constitutes the **core of the UN system of collective security**. Since the requisite armed forces have, however, not been made available by the UN members to the Security Council, the Security Council has had to resort to authorising 'willing Member States to use force on its behalf'. **786**

2. Regional Organisations

Chapter VIII of the UN Charter encourages the development of **pacific** settlement of local disputes through regional arrangements and organisations (such as the Organisation for Security and Cooperation in Europe (OSCE) and the EU). As regards the **use of force**, however, the **monopoly** lies with the Security Council: no such enforcement action may be taken under regional schemes without the authorisation of the Security Council. **787**

H. Selected Issues and Areas of International Law

I. Extraterritorial Jurisdiction and Foreign Business Activities

788 A state's competence ('jurisdiction') to enact law, to have it applied by its domestic courts and to enforce these rules is in principle confined to its own territory ('**territorial jurisdiction**'). However, as an exception, a state may enact rules regulating the conduct of individuals abroad and have these rules applied by its domestic courts to such behaviour occurring abroad ('**extraterritorial jurisdiction**'). It is obvious that in times of **globalisation** and increasing cross-border activities, states tend to increasingly exercise such extraterritorial jurisdiction.

789 The **relevant limits** of such exercises of extraterritorial jurisdiction are defined by international law. First of all, states must not enforce these rules abroad *e.g.* through police forces, unless affected states give their consent (in other words '**enforcement jurisdiction**' is strictly territorial in principle).

790 Secondly, there must be a so-called **genuine link** between a state's legitimate interests and behaviour occurring abroad which justifies both the enactment of laws dealing with such extraterritorial conduct and the application of such laws by domestic courts. In the field of criminal law, a series of **principles** have been recognised that constitute a genuine link. According to the 'objective territorial principle', for example, a state may proscribe foreign criminal behaviour having negative effects in its territory (the most obvious case being a shot across the border that injures somebody). Alternatively, pursuant to the 'active personal principle', a state may regulate the conduct of its own citizens abroad on the condition that there is an identical norm abroad.

791 Apart from attempts to prohibit criminal behaviour occurring abroad, there is a growing tendency in some states to exercise extraterritorial jurisdiction in order to also regulate – and prohibit unwelcome – **economic activities abroad**. Such regulatory attempts have firstly concerned foreign **anticompetitive behaviour**, like cartels formed abroad that have negative effects on a state's economy. Meanwhile, however, states are increasingly trying to regulate other economic activities abroad as well. The US has given rise to a series of prominent cases since World War II, in particular, such as a 'pipeline embargo' prohibiting subsidiaries of US companies established in Europe from fulfilling contracts on the delivery of pipeline equipment to the former Soviet Union. Likewise, since the 1990s, there has been a US economic embargo against Cuba that has been extended to third countries and requires foreign companies not to entertain economic relations with Cubans (these US rules are to be enforced indirectly through law suits in the US against US assets of foreign companies and through prohibitions on entry into the US for foreign managers not complying with US rules).

792 One core problem is that the international law principles mentioned above have been developed with a view to criminal behaviour. It is therefore questionable whether and to what extent they can be applied to the regulation of extraterritorial economic

activities. Regarding such cases, there is a growing tendency to apply a **balancing approach** in which it is ascertained whether the state exercising extraterritorial jurisdiction is pursuing a legitimate objective through proportionate means.

II. International Human Rights Law

While instances of the recognition of, and instruments for, the protection of human rights can be found in international and national law already in earlier centuries, a principal step in the international protection of human rights was the **Universal Declaration of Human Rights**, which was adopted by the UN General Assembly in 1948. It contains a catalogue of civil and political rights, such as the rights to life, liberty and security of the person, and the prohibition of slavery, torture and arbitrary arrest and detention. The Universal Declaration of Human Rights was originally proclaimed as a non-binding instrument. However, some of its rights, like the prohibition of torture, have acquired the status of customary international law. **793**

In 1966, the UN General Assembly adopted the **International Covenant on Civil and Political Rights** (ICCPR) and the **International Covenant on Economic, Social and Cultural Rights** (ICESR), which constitute multilateral treaties that entered into force in 1976. The ICCPR recognises a series of civil and political rights, such as the right to life, the prohibition of torture and forced labour, and the right to liberty and security of the person. According to the ICESR, the state parties to the Covenant are required to take steps 'to the maximum of [their] available resources, with a view to achieving progressively the full realisation of the rights recognised' in the ICESR. The ICCPR and the ICESR are to be enforced on the basis of periodic reports that must be submitted by the state parties to the Human Rights Committee established under the ICCPR. Furthermore, the ICCPR makes it possible for a state party to recognise the right of other parties to bring complaints against it before the Committee. Additionally, on the basis of the First Optional Protocol to the ICCPR, a state party may recognise the competence of the Committee to receive and consider communication from individuals subject to its jurisdiction who claim to be victims of a violation by that state party of any of the rights set forth in the Covenant. **794**

A series of **further international agreements** protecting human rights have entered into force. Mention should *e.g.* be made of the UN Convention on the Prevention and Punishment of the Crime of Genocide (in force since 1951), the UN Convention against Torture (in force since 1987) and the UN Convention on the Rights of the Child (in force since 1990). **795**

In the European context, the **European Convention of Human Rights** (ECHR) was inspired by the Universal Declaration of Human Rights and constituted the first binding regional codification of human rights (on the ECHR see Unit 9 at m.n. 591 *et seq.*). **796**

III. International Criminal Law

797 International criminal law is concerned with so-called **core crimes**, namely genocide, war crimes, crimes against humanity, and the crime of aggression. Relevant norms have a **direct effect**, which means that individuals can be held responsible directly on the basis of international law. In other words, these rules do not need to be transposed into national law in order to become binding for individuals.

798 A principal step in the **development** of this rather recent field of international law was the establishment of the Nuremberg Tribunal after World War II. The rules applied by the Tribunal were recognised as customary law in subsequent practice. Relevant principles have also been laid down in treaty law.

799 However, it was not until the 1990s that **international criminal tribunals** were established again. This was achieved on the basis of resolutions of the UN Security Council, issued under Chapter VII of the UN Charter, which created the International Criminal Tribunal for the Former Yugoslavia (**ICTY**) and the International Criminal Tribunal for Ruanda (**ICTR**).

800 In 2002, the Rome Statute of the **International Criminal Court** (**ICC**) entered into force, which has jurisdiction for the aforementioned core crimes. Its jurisdiction is complementary to that of national tribunals, which means that the ICC may only deal with a case when the state which is primarily competent, is, however, 'unwilling or unable' to genuinely carry out the investigation or prosecution. Moreover, the ICC may exercise its jurisdiction only with respect to crimes having occurred on the territory of, or committed by a national of, a state party.

801 Cases can be referred to the ICC Prosecutor by a state party. The ICC Prosecutor can also initiate proceedings. Importantly, the **Security Council** can refer cases involving states which are not even parties to the ICC Statute to the Prosecutor under Chapter VII of the UN Charter.

IV. International Environmental Law

802 International environmental law as we know it today is a fairly recent field of international law and has **developed mainly since the 1970s**, starting with the UN Conference on the Human Environment held at Stockholm in 1972, which was followed in particular by the 1992 UN Conference on Environment and Development in Rio and the 2002 World Summit on Sustainable Development in Johannesburg. Since the Stockholm Conference, a large series of **sectoral agreements** has been concluded, dealing *e.g.* with the protection of the marine environment, inland waters, the atmosphere and air pollution, the ozone layer, world climate, endangered species and waste. Typically, relevant treaties consist of a framework convention that lays down general principles and protocols that are agreed upon later. They also set forth more specific obligations so as to take into account new developments in science and technology in particular.

Beside these sectoral agreements, a series of **principles** of international environmental law has become recognised, although their exact legal status (*e.g.* customary international law or non-binding principles) and content are often disputed. These principles encompass especially procedural obligations, such as the duty to inform neighbouring states about accidents, the obligation to consult them about projects likely to have transboundary environmental effects, and the precautionary and the polluter-pays principles. **803**

Despite the considerable number of sectoral treaties concluded during the last decades, **progress** in this field of environmental law remains **difficult to achieve** not least due to the considerable divergence of interests among states and the fact that the behaviour to be regulated in this area of international law is that of (an often vast number of) individuals and companies rather than that of states themselves. **804**

I. Globalisation and International Law

There is no universal consensus on the **definition** of globalisation. Yet it is usually understood as a process of an increasing international economic, political, cultural, social and legal **integration**. The term is also used in connection with other **global concerns**, such as international environmental and security problems, *i.e.* problems that typically surpass the legislative, executive and judicial capacities of single states. **805**

The process of globalisation has been spurred not only by technological and economic advancements, but – to a considerable degree – also by **international, supranational** and **national law**. At the international level, international regimes as the GATT 1947 and the World Trade Organisation (WTO), for instance, have contributed to the liberalisation of trade and investment flows (see next unit for details). At the regional level, integration regimes such as that of supranational EU law have accelerated these developments. Furthermore, within many states, a strong trend of **deregulation** has given rise to a durable increase in cross-border economic activities. **806**

However, international law has not only contributed to the process of globalisation. Rather, globalisation has also retroacted on the **structures** and the **functioning of international law**. On the one hand, the **sovereignty** of the state – the key element of traditional international law – has decreased, with states losing or willingly reducing control over their population and the economic and other activities occurring within their territories and across their borders. On the other hand, **non-state actors** have gained in importance as subjects of international law, in particular NGOs, individuals and transnational corporations. These actors, together with IOs, in turn, also greatly influence the **creation of international law** today, *e.g.* as participants in international conferences and international judicial proceedings or as observers with special status in IOs. **807**

Due to the dynamism of this process and perceived problems resulting from it, there are increasingly more calls for **re-regulation**, which frequently require the creation of **808** new international rules due to the international nature of many (*e.g.* economic, environmental or security) of the conflicts.

809 This is where several overarching problems of international law and globalisation enter into play. On the one hand, the process of creating law at the international level is often cumbersome and **time-consuming** due to the usually great number of actors and the **divergent interests** involved. On the other hand, international law-making is usually effected by government representatives, with national parliaments being involved to a considerably lesser extent than in domestic democratic processes. In other words, while effective solutions to global problems require international rules, the process of their creation increasingly raises concerns in terms of **democratic legitimacy**.

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Questions

1. Are you a subject of international law?
2. Why could one be surprised by the effectiveness of international law?
3. Why is international law effective?
4. How can states consciously create new rules of international law?
5. Which principles limit states' freedom to award their citizenship to individuals?
6. What are the consequences of an established state government losing substantial control over the state's territory?
7. What are the consequences of one state declining to recognise another state?

8. International Organisations enjoy an international legal personality status which is partially derived and relative. Explain.
9. What are the tasks of the UN Security Council, and what hinders it from discharging them?
10. Compared to the CJEU, in what sense is the International Court of Justice's jurisdiction weaker?
11. Within the UN system of collective security, does the Security Council have the power to compel Member States to resort to certain non-military or military action?
12. A State's enforcement jurisdiction is territorial in principle. Explain.
13. Under what conditions may the EU be entitled, under international law, to adopt legislation so as to regulate economic activity taking place, for example, in China?
14. Are the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights legally binding?
15. What limits the jurisdictional powers of the International Criminal Court?
16. Globalisation may raise concerns of democratic legitimacy. Explain.

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Glossary

above par	gegen Aufgeld
abrogate	außer Kraft setzen
accelerate a debt	einen Kredit fällig stellen
access to court	Zugang zu einem Gericht
accession	Beitritt
account transfer	Umbuchung
accounting	Bilanzierung
accrual	Rückstellung
acquis	Besitzstand
act attributable to a state	dem Staat zurechenbare Handlung
activist shareholder	aktivistischer Anleger
ad-hoc agreement	Ad-hoc-Vereinbarung
adjudicate	urteilen, entscheiden
administration	Verwaltung
administrative authority	Verwaltungsbehörde
administrative court	Verwaltungsgericht (VwG)
administrative fine	Verwaltungsstrafe
administrative offence	Verwaltungsübertretung
advisory resolution	nicht bindender Beschluss
Advocate-General (AG)	Generalanwalt/Generalanwältin (GA)
agency cost	Agenturkosten
agency law	Vollmachtsrecht
agency theory	Prinzipal-Agenten Theorie
agenda	Tagesordnung
agent	Vertreter
agreement	Übereinkunft, Vertrag
allocate	zuweisen
amalgamate	verschmelzen
ambit	Anwendungsbereich
amendment (of the statutes)	Änderung (der Satzung)
annual accounts	Jahresabschluss
annual general meeting	ordentliche Hauptversammlung
annulment action	Nichtigkeitsklage
anticompetitive behaviour	wettbewerbswidriges Verhalten
applicable law	anwendbare Rechtsordnung
appointment	Bestellung
appreciation (of assets)	Zuschreibung
approximation	Angleichung
arbiter	Schiedsrichter
arbitrary use	Willkür
arrears	Rückstände
asset	Aktivum
asset base	Vermögensbestand

asset deal	Unternehmenskauf ieS
assign	zedieren, abtreten; zuweisen
assignment	Zession
association	Verein(igung)
at arm’s length	dem Fremdvergleich entsprechen
attach	beschlagnahmen, pfänden
attribution	Zurechnung
auditing committee	Bilanzausschuss
auditor	Abschlussprüfer
author’s right	Urheberrecht
authorisation	Genehmigung
authority	Behörde
award	Zuerkennung, Urteil
balance sheet	Bilanz
balance-sheet insolvent	überschuldet
balancing approach	ausgleichender Ansatz
ballot	Wahl
bank certificate	Bankbestätigung
bank guarantee	Bankgarantie
bankruptcy law	Insolvenzrecht
base rate	Basiszinssatz
Basic Law on the General Rights of Nationals 1867	Staatsgrundgesetz 1867 (StGG)
basic principle of the Constitution	Grundprinzip der Bundesverfassung
bearer shares	Inhaberaktien
beneficiary	Begünstige(r)
blocking majority	Sperrminorität
board (of directors)	Vorstand
board level employee	Arbeitnehmermitbestimmung im Aufsichtsrat
representation board of supervisors	Aufsichtsrat
bona fide	gutgläubig
bond	Schuldverschreibung
bondholder	Inhaber einer Schuldverschreibung
book entry	Buchung
book value	Buchwert
branch	Zweigniederlassung
bring a claim	klagen
building society	Wohnbaugenossenschaft
burden of proof	Beweislast
business judgment rule	Business Judgment Rule (auch in Deutsch)
business license	Konzession
business premises	Betriebsstätte
business purpose	Unternehmensgegenstand
business register	Handelsregister (D), Firmenbuch (Ö)
capital	(Eigen)Kapital

capital markets law	Kapitalmarktrecht
case law	Fallrecht (typisch im common law)
cash-flow test	Liquiditätstest
cast a vote	Stimme abgeben
catch-all provision	Auffangregelung
central administration	Hauptverwaltung
central depository	Zentralverwahrer
chairman/chairperson	Vorsitzende(r)
challenge a resolution	einen Beschluss anfechten
change of control clause	Kontrollwechselklausel
charges having equivalent effect	Abgaben gleicher Wirkung
charitable	gemeinnützig
Charter of Fundamental Rights (CFR)	Grundrechtecharta (GRC)
chattel	bewegliche Sache
Chief Executive Officer (CEO)	Vorstandsvorsitzender
circular resolution	Umlaufbeschluss
circumvent	umgehen
citizen's rights	Staatsbürgerrecht
civil liability	zivilrechtliche Haftung
civil liberties	Freiheitsrecht
civil proceedings	Zivilverfahren
civil rights and obligations	zivilrechtliche Ansprüche und Pflichten
claim	Anspruch
claimant	Kläger
claw back	sich zurückholen
closely held company	Gesellschaft mit geschlossenem Gesellschafterkreis
closing	Vollzug (des Vertrags zum Unternehmenserwerb)
codermination	Mitbestimmung (der Arbeitnehmer im Aufsichtsrat)
codified law	Gesetzesrecht
codify	kodifizieren, im Gesetz niederschreiben
collateral	Kreditsicherheit
collective investment	kollektive Veranlagung
collective powers	kollektive Befugnisse
collusion	Kollusion
commercial court	Handelsgericht
commercial register	Handelsregister (D), Firmenbuch (Ö)
committee	Ausschuss
Committee of Permanent Representatives of the Member States (Coreper)	Ausschuss der Ständigen Vertreter der Mitgliedstaaten (Coreper)
Committee of the Regions	Ausschuss der Regionen
Common Commercial Policy (CCP)	Gemeinsame Handelspolitik (GHP)
Common Foreign and Security Policy (CFSP)	Gemeinsame Außen- und Sicherheitspolitik (GASP)
common law	common law = angelsächsisches Richterrechtssystem

Common Market	gemeinsamer Markt
Community	Gemeinschaft
company	(Kapital)Gesellschaft
company/corporate law	(Kapital)Gesellschaftsrecht
compensating tariff	Ausgleichszoll
compensation	Vergütung, Entlohnung; Ersatz
compensation committee	Vergütungsausschuss
compensation terms	Entschädigungsmodalitäten
compensatory fee	Ausgleichsabgabe
competence	Kompetenz
competence to carry out actions to support, coordinate or supplement	Unterstützungs-, Koordinierungs- bzw Ergänzungskompetenz
competition authority	Wettbewerbsbehörde
competition law	Wettbewerbs-/Kartellrecht
competition law	Wettbewerbsrecht
completion account	Abschlusskonto
comply	befolgen
compulsory administration	Zwangsverwaltung
condition precedent	aufschiebende Bedingung
confiscation	Konfiszierung
connecting factor	Anknüpfungspunkt
consent	Zustimmung
consideration	Gegenleistung
consolidated accounts	Konzernbilanz
constitution	Verfassung
Constitutional Court	Verfassungsgerichtshof (VfGH)
constitutionally guaranteed rights	verfassungsgesetzlich gewährleistete Rechte
consultation of the people	Volksbefragung
contest	anfechten (in Insolvenz)
contract law	Vertragsrecht
contract of exchange	Austauschvertrag
contractual relationship	Vertragsbeziehung
contribution	Einlage
contribution in cash	Bareinlage
contribution in kind	Sacheinlage
control of use	Eigentumsbeschränkung
control premium	Kontrollprämie
controlling holding	kontrollierende Beteiligung
convene	einberufen
convention	Konvent
Convention on the Elimination of All Forms of Racial Discrimination (CERD)	Internationales Übereinkommen zur Beseitigung jeder Form von Rassendiskriminierung
conviction and sentence	Verurteilung und Strafe
cooperative	Genossenschaft

core crimes (international law)	Kernverbrechen (Völkerrecht)
corporate governance	Unternehmensführung, -verfassung
corporate group	Konzern
corporation	(Kapital)Gesellschaft (US)
Council (of the European Union)/ Council of Ministers	Rat der Europäischen Union/Ministerrat
Council of Europe	Europarat
counterparty	die andere Vertragspartei
court	Gericht
court fees	Gerichtsgebühren
Court of Auditors	Rechnungshof
Court of Justice	Gerichtshof
court-appointed	gerichtlich bestellt
covenant	Verpflichtung, Zusicherung (in Vertrag)
credit purchase	Kreditkauf
credit rating agency	Kreditratingagentur
creditor	Gläubiger
creditworthiness	Kreditwürdigkeit
criminal charge	Strafanzeige
criminal sanctions	strafrechtliche Sanktionen
cross-border merger	grenzüberschreitende Verschmelzung
custodial shares	depotverwahrte Aktien
custody receipt	Depotbescheinigung
customs	Zoll
customs union	Zollunion
D&O insurance	Managerhaftpflichtversicherung
damage	Schaden
damages	Schadenersatz
damages	Schadenersatz
de facto expropriation	faktische Enteignung
de-merger	Spaltung
debt	Fremdkapital
debt push-down	Debt-Push-Down (Verschieben von Schulden in die Tochtergesellschaft)
debtor	Schuldner
debtor in possession	Eigenverwaltung (in Insolvenz)
decision	Entscheidung (eines Organs)
decisions	Gerichtsentscheidungen
deed	Urkunde
default (verb)	in Zahlungsrückstand geraten
default rules	dispositives Recht
defendant	Beklagter
degree of scrutiny	Kontrolldichte
delegated legal act	delegierter Rechtsakt
democratic legitimacy	demokratische Legitimation

Democratic Principle	demokratisches Grundprinzip
deposit	hinterlegen
depreciate	abwerten, abschreiben
deprivation of liberty	Freiheitsentzug
deprivation of possessions	Enteignung
deregulation	Deregulierung (Liberalisierung)
derived personality	derivative/abgeleitete (Rechts-) Persönlichkeit
development cooperation	Entwicklungszusammenarbeit
Diet	Landtag
diplomatic protection	diplomatischer Schutz
direct democracy	direkte Demokratie
direct discrimination	unmittelbare Diskriminierung
direct effect	unmittelbare Geltung/Anwendbarkeit
direct suffrage	direktes Wahlrecht
direction	Weisung
directive (EU)	Richtlinie (der EU)
directly applicable	unmittelbar anwendbar
director	Vorstandsmitglied
discharge	(eine Schuld) erlassen
discharge of the residual debt	von der Restschuld befreien
disciplinary offence	Disziplinarvergehen
discount	Disagio, Abschlag; abzinsen
discount rate	Diskontierungssatz
disguised distribution (of profits)	verdeckte Gewinnausschüttung
disguised restriction on trade	verschleierte Beschränkung des Handels
dismiss	entlassen
disorderly conduct	ordnungswidriges Verhalten
dispensation of oral hearings	Befreiung von einer mündlichen Verhandlung
dispersed membership	Streubesitz
disproportionate division	nichtverhältniswahrende Spaltung
dissolution	Auflösung einer Gesellschaft
dissolve a contract	einen Vertrag auflösen
distance participation	Fernteilnahme
distressed company	Gesellschaft in der Krise
distributable	ausschüttungsfähig
distribution	Ausschüttung
diversification	Diversifizierung (bei einem Investment)
divest	veräußern
divest somebody of something	jemandem etwas entziehen
dividend	Dividende
division	Spaltung
domestic law	innerstaatliches Recht
down paymnet	Anzahlung
down-stream merger	Verschmelzung auf die Tochtergesellschaft
drag along right	Drag-along Recht (Mitverkauspflicht)
due	fällig

due diligence	Due Diligence (Überprüfung des Kaufobjekts)
duty	Pflicht, Verpflichtung
duty of care	Sorgfaltspflicht
duty of loyalty	Treuepflicht
duty to retransfer property	Verpflichtung zur Rückübereignung
earn-out clause	Earn-Out-Klausel
Economic and Monetary Union (EMU)	Wirtschafts- und Währungsunion (WWU)
Economic and Social Committee	Wirtschafts- und Sozialausschuss
economic embargo	Wirtschaftsembargo
economic fundamental rights	wirtschaftliche Grundrechte
economic integration	wirtschaftliche Integration
economic wellbeing	wirtschaftliches Wohl
economies of scale	Skalen-/Größeneffekte
EEC Council (Council of the European Communities)	Rat der Europäischen Wirtschaftsgemeinschaft (EWG)
EEC Treaty (Treaty Establishing the European Economic Community	EGV (Vertrag zur Gründung der Europäischen Wirtschaftsgemeinschaft
effective enforceability of court	wirksame Durchsetzung von
effectiveness	Wirksamkeit
employee	Arbeitnehmer
employment contract	Arbeitsvertrag
empower	ermächtigen
enforce	vollstrecken
enforcement	Durchsetzung
enforcement-jurisdiction	Vollstreckungshoheit
Engel criteria	Engel-Kriterien
entrepreneur	Unternehmer
environmental law	Umweltrecht
equal suffrage	gleiches Wahlrecht
equal treatment	Gleichbehandlung
equality of arms	Waffengleichheit
equality of states	Gleichheit der Staaten
equality rights	Gleichheitsrechte
equity	Eigenkapital
erga omnes effect	*erga omnes*-Wirkung
established by law	gesetzlich verankert
EU institutions	EU-Institutionen/EU-Organe
European Atomic Energy Community	Europäische Atomgemeinschaft (Euratom)
European Charter of Fundamental Rights (CFR)	Europäische Grundrechtecharta (GRC)
European Citizens' Initiative	Europäische Bürgerinitiative

European Coal and Steel Community (ECSC)	Europäische Gemeinschaft für Kohle und Stahl (EGKS)
European Commission	Europäische Kommission
European Community (EC)	Europäische Gemeinschaft (EG)
European Company	Europäische Gesellschaft, SE
European Convention on Human Rights (ECHR)	Europäische Menschenrechtskonvention (EMRK)
European Council	Europäischer Rat
European Court of Human Rights (ECtHR)	Europäischer Gerichtshof für Menschenrechte (EGMR)
European Court of Justice (ECJ)	Europäischer Gerichtshof (EuGH)
European Defence Community	Europäische Verteidigungsgemeinschaft
European Economic Interest Grouping (EEIG)	Europäische wirtschaftliche Interessenvereinigung (EWIV)
European Free Trade Area (EFTA)	Europäische Freihandelsgemeinschaft (EFTA)
European Parliament	Europäisches Parlament
European Political Community	Europäische Politische Gemeinschaft
exclusive competence	ausschließliche Kompetenz
executive	Exekutive (vollziehende Gewalt)
exit right	Austrittrecht
expell	ausschließen
expenditure	Aufwand
expert opinion	Sachverständigenbericht
expropriation	Enteignung
extension	Verlängerung (hier: Laufzeit eines Kredits)
extraordinary general meeting	außerordentliche Hauptversammlung
extraterritorial jurisdiction	extraterritoriale Jurisdiktion
fair hearing	rechtliches Gehör
fair trial	faires Verfahren
fault	Verschulden
federal	Bundes-
Federal Chancellor	Bundeskanzler
Federal Constitutional Act	Bundesverfassungsgesetz (B-VG)
Federal Constitutional Act on the Neutrality of Austria	Bundesverfassungsgesetz über die Neutralität Österreichs
Federal Council	Bundesrat
Federal Law Gazette	Bundesgesetzblatt (BGBl)
Federal President	Bundespräsident
Federal Principle	bundesstaatliches Grundprinzip
Federal Province	Bundesland
fiduciary duty	Treuepflicht
field of application	Anwendungsbereich
file for insolvency	Insolvenz anmelden
fiscal provision	Steuervorschrift
fixed assets	Anlagevermögen

fixed reserves	gebundene Rücklagen
floating rate	variabler Zinssatz
for cause	aus wichtigem Grund
foreseeability of the legal order	Rechtssicherheit
forfeit	verfallen
formal expropriation	formelle Enteignung
foundation	Stiftung
founder	Gründer
fraudulent conveyance	betrügerische Übertragung von Vermögenswerten
free movement of capital	Kapitalverkehrsfreiheit
free movement of goods	Warenverkehrsfreiheit
free service contract	freier Dienstvertrag
free suffrage	freies Wahlrecht
free trade area	Freihandelszone
free-float	Streubesitz
free-riding	Trittbefahrerphänomen
freedom of assembly and association	Versammlungs- und Vereinigungsfreiheit
freedom of conclusion, content and form	Abschluss-, Inhalts- und Formfreiheit
freedom of establishment	Niederlassungsfreiheit
freedom of opinion	Meinungsfreiheit
freedom of thought, conscience and religion	Gedanken-, Gewissens- und Religionsfreiheit
full division	Aufspaltung
fully paid shares	volleingezahlte Aktien
fundamental freedoms	Grundfreiheiten
fundamental judicial and procedural rights	Justizielle und Verfahrensgrundrechte
fundamental rights and freedoms	Grund und Freiheitsrechte
fundamental rights of the individual	Grundrechte des Einzlnen
gender quota	Geschlechterquote
General Assembly	Generalversammlung
General Court	Gericht der Europäischen Union
general interest	Allgemeininteresse
general meeting	Haupt/Generalversammlung
general partner	Komplementär
general partnership	Offene Handelsgesellschaft (D), Offene Gesellschaft (Ö)
general principle	Grundprinzip, Grundsatz
general principles of law	allgemeine Rechtsgrundsätze
genuine link	hinreichender Anknüpfungspunkt
global certificate	Globalurkunde
going private	Rückzug von der Börse
going public	Börsegang
golden share	Goldene Aktie (mit besonderen Rechten verbunden)

good faith	guter Glaube
goodwill	Goodwill, Firmenwert
government bill	Regierungsvorlage
gross negligence	grobe Fahrlässigkeit
grounds for the exclusion of the	Gründe für den Ausschluss
group of companies	Konzern
harmonisation	Harmonisierung
hidden contribution in kind	verdeckte Sacheinlage
hidden distribution	versteckte (Gewinn)Ausschüttung
hierarchy of norms	Normenhierarchie/Stufenbau der Rechtsordnung
High Authority of the ECSC	Hohe Behörde der EGKS
High Representative of the Union for Foreign Affairs and Security	Hoher Vertreter der Europäischen Union für auswärtige Angelegenheiten und Sicherheitspolitik
highly-leveraged	stark fremdfinanziert
hindsight bias	Rückschaufehler
holding	Beteiligung
honour a debt	eine Schuld begleichen
horizontal effect	horizontale Wirkung (unter Privaten)
hostile takeover	feindliche Übernahme
housing cooperative	Wohnbaugenossenschaft
human rights	Menschenrechte
humanitarian law	humanitäres Völkerrecht
illiquid	zahlungsunfähig
immovable property	unbewegliches Vermögen
impair	beeinträchtigen
impartial	unparteiisch
implementation	Umsetzung
implementation of EU law	Umsetzung des Unionsrechts
implementing legal act	Durchführungsrechtsakt
incentive	Anreiz
income	Einkommen
income statement	Gewinn- und Verlustrechnung (GuV)
incoming merger	Hereinverschmelzung
incomplete contract	unvollständiger Vertrag
incorporate	gründen
increase of capital	Kapitalerhöhung
incur damage	Schaden erleiden
incur liability	haftbar werden
independence	Unabhängigkeit
independent director	unabhängiges Board-Mitglied
index-tracking funds	Indexfonds
indirect discrimination	mittelbare Diskriminierung
indirect federal administration	mittelbare Bundesverwaltung

indirect parliamentary democracy	indirekte parlamentarische Demokratie
indistinctly applicable	unterschiedslos anwendbar
informational self-determination	informationelle Selbstbestimmung
infringement	(Rechts-)Verletzung
infringement procedure	Vertragsverletzungsverfahren
inherit	erben
inheritance	Erbschaft
insolvency administrator	Insolvenzverwalter
insolvency dividend	Insolvenzdividende (an Gläubiger)
insolvency law	Insolvenzrecht
insolvency proceedings	Insolvenzverfahren
insolvent	zahlungsunfähig
instalment	Rate
institutional investor	Institutioneller Anleger
instruction	Weisung
intangible asset	immaterielle Güter
intellectual property	geistiges Eigentum
intellectual property right	Immaterialgüterrecht
intentionally	vorsätzlich
inter alia	unter anderem
interest	Zinsen
interest rate	Zinssatz
interference	Eingriff
intermingle	vermischen
internal control system	Internes Kontrollsystem (IKS)
Internal Market	Binnenmarkt
international conventions	internationale Übereinkommen
International Court of Justice (ICJ)	Internationaler Gerichtshof (IGH)
International Covenant on Civil and Political Rights (ICCPR)	Internationaler Pakt über bürgerliche und politische Rechte (IPBPR)
International Covenant on Economic, Social and Cultural Rights (ICESR)	Internationale Pakt über wirtschaftliche, soziale und kulturelle Rechte (IPWZKR)
International Criminal Court (ICC)	Internationaler Strafgerichtshof (IStGH)
international criminal law	internationales Strafrecht/Völkerstrafrecht
International Criminal Tribunal for Ruanda	Internationaler Strafgerichtshof für Ruanda (ICTR)
International Criminal Tribunal for Yugoslavia (ICTY)	Intenationaler Strafgerichtshof für das ehemalige Jugoslawien
international criminal tribunals	Internationale Strafgerichte
international custom	internationale Gepflogenheiten
international division of labour	internationale Arbeitsteilung
international human rights	internationale Menschenrechte
international law	internationales Recht/Völkerrecht
international law of co-existence	internationales Recht der Koexistenz
international law of cooperation	internationales Recht der internationalen Kooperation

international legal personality	Völkerrechtspersönlichkeit
international organisations (IOs)	internationale Organisationen (IO)
international relations	internationale Beziehungen
involuntary creditor	Gläubiger aus gesetzlichem Schuldverhältnis (zB Schadenersatz)
issue price	Ausgabepreis
issue shares	Aktien ausgeben
ius cogens	zwingendes Recht (*ius cogens*)
joint and several liability	solidarische Haftung
joint representation	Gesamtvertretung
judgement	Urteil
judicial and procedural rights	Verfahrensrechte
judicial oversight	gerichtliche Überwachung
judicial protection	Rechtsschutz
judicial review/scrutiny	gerichtliche Überprüfung
judiciary	Judikative (rechtsprechende Gewalt)
junior creditor	ungesicherter Gläubiger
jurisdiction	Rechtssystem, Gerichtsbarkeit, Zuständigkeit
jurisprudence	Rechtsprechung
Justice and Home Affairs (JHA)	Justiz und Inneres (JI)
justification	Rechtfertigung
justified	gerechtfertigt
labour contract	Arbeitsvertrag
Land law	Landesrecht
land register	Grundbuch
law	(geschriebenes oder richterliches) Recht
law of property	Sachenrecht
leackage	hier: Schwund
League of Nations	Völkerbund
leas payment	Zinszahlung
lease contract	Mietvertrag
ledger	Konto, Verzeichnis
legal act	Rechtsakt
legal basis	gesetzliche Grundlage
legal capital	Grund/Stammkapital
legal certainty	Rechtssicherheit
legal entity	Rechtsperson
legal order	Rechtsordnung
legal person	juristische Person
legal personality	Rechtsfähigkeit
legal relationship	Rechtsbeziehung
legal reserve	gesetzliche Rücklage
legislative act	Rechtsetzungsakt
legislative body	Gesetzgebungsorgan

legislative measure	gesetzgeberische Maßnahme
legislator	Gesetzgeber
legislature	Legislative (gesetzgebende Gewalt)
legitimate aim	legitimes Ziel
legitimate expectation	berechtigte Erwartung
legitimate grounds	rechtmäßige Gründe
lender	Kreditgeber
liabilities	Passiva
liability	Haftung
liable (to be liable)	haftbar (haften)
Liberal Principle	liberales Grundprinzip
lien	Pfand
limited liability	beschränkte Haftung
limited partner	Kommanditist
limited partnership	Kommanditgesellschaft
linkage mechanisms	Verknüpfungsmechanismen
liquid funds	liquide Mittel
liquidation	Liquidation
liquidation proceeds	Liquidationserlös
listed company	an der Börse notierte Gesellschaft
loan	Darlehen
locked-box agreement	Festkaufpreisvereinbarung
lodge dissent	Widerspruch zu Protokoll geben
losses	Verluste
ltd	siehe private company limited by shares
lump sum	Pauschale
Luxembourg Accords	Luxemburger Kompromiss
maintenance of capital	Kapitalerhaltung
majority shareholder	Mehrheitsgesellschafter
majority voting	Mehrheitsvotum
mandatory offer	Pflichtangebot
mandatory requirements	zwingende Erfordernisse
mandatory rules	zwingendes Recht
margin	Marge
margin of appreciation	Ermessensspielraum
mark-to-market	Bewertung mit Marktwerten
market access	Marktzugang
market access approach	Marktzugangsansatz
market forces	Marktkräfte
market value	Marktwert
material scope	sachlicher Anwendungsbereich
means of arbitrary discrimination	Mittel der willkürlichen Diskriminierung
measures having an equivalent effect (MEEs)	Maßnahmen gleicher Wirkung
member	Gesellschafter

Member State	Mitgliedsstaat (der EU)
merge	zusammenführen, auch: verschmelzen ieS
merger	hier: Verschmelzung
merger by acquisition	Verschmelzung zur Aufnahme
merger by formation of a new c'y	Verschmelzung zur Neugründung
minimum legal capital	Mindeststammkapital
minority rights	Minderheitenrechte
minority shareholder	Minderheitsgesellschafter
misrepresentation	falsche Darstellung
mode of supply	Erbringungsweise
monetary policy	Geldpolitik
money laundering	Geldwäsche
monitor	überwachen
more lenient law	günstigeres Recht
mortgage	Hypothek (= Pfandrecht auf Liegenschaft)
movable assets/property	bewegliche(s) Güter/Vermögen
multilateral treaty	multilaterales (mehrseitiges) Übereinkommen
mutual recognition	gegenseitige Anerkennung
national authority	nationale Behörde
National Council	Nationalrat
national security	nationale Sicherheit
national sovereignty	nationale Souveränität
nationalisation	Verstaatlichung
natural person	natürliche Person
ne bis in idem	Verbot der Doppelbestrafung
negative incentives	negative Anreize
negative integration	negative Integration
negligence	Fahrlässigkeit
negligent	fahrlässig
nemo tenetur	Recht, zu schweigen und sich nicht selbst beschuldigen zu müssen
net assets	Nettoaktivvermögen
no punishment without law	keine Strafe ohne Gesetz
nominal value	Nominalwert
nominate	entsenden, nominieren
nomination committee	Nominierungsausschuss
non-distributable reserves	gebundene Rücklagen
non-economic policy goal	nicht wirtschaftliches Politikziel
non-executive director	nebenberuflich tätiges Mitglied des board
non-exhaustive	nicht taxativ
Non-Governmental Organisation (NGO)	Nichtregierungsorganisation (NGO)
non-legislative act	Rechtsakt ohne Gesetzescharakter
non-statutory body	privatrechtliche Körperschaft
notarial deed	notarielle Urkunde

notarise	notariell beglaubigen
notary public	Notar
notify	verständigen
nulla poena sine lege	keine Strafe ohne Gesetz
object	widersprechen
objective personality	objektive (Rechts-)Persönlichkeit
objects of international law	Objekte des Völkerrechts
officer	leitender Angestellter
official authority	öffentliche Gewalt
on one's own account	auf eigene Rechnung
one-tier board	einstufiges Boardsystem (UK)
operational and institutional independence	operationelle und institutionelle Unabhängigkeit
opinio iuris	rechtliche Überzeugung/Überzeugung von der rechtlichen Verbindlichkeit (*opino iuris*)
opinion	Stellungnahme
option	Option
ordinance	Verordnung
ordinary constitutional law	einfaches Bundesverfassungsgesetz
ordinary courts	ordentliche Gerichte
ordinary law	einfaches Gesetz
ordinary legislative procedure	ordentliches Gesetzgebungsverfahren
Organisation for Economic Development and Cooperation (OECD)	Organisation für Wirtschaftliche Entwicklung und Zusammenarbeit (OECD)
origin of products	Warenursprung
original personality	originäre (Rechts-)Persönlichkeit
outgoing merger	Hinausverschmelzung
outside director	nebenberuflich tätiges Mitglied des board
outside finance	Außenfinanzierung
outsource	extern vergeben
outstanding claims	offene Forderungen
over-indebted	überschuldet
overriding reasons relating to general interest	zwingende Gründe des Allgemeininteresses
overvaluation	Überbewertung
own shares	eigene Aktien
par value	Nennwert, anteiliger Betrag
parent company	Muttergesellschaft
partial division	Abspaltung
partial universal succession	Teilrechtsnachfolge
partnership	Personengesellschaft
partnership under civil law	Gesellschaft bürgerlichen Rechts
patrimony	Vermögen
peaceful means	friedliche Mittel

pecuniary charge	finanzielle Abgabe
penalty	Sanktion, Strafe
penalty payment	Strafzahlung
pending proceedings	anhängiges Verfahren
pension funds	Pensionsfonds
perform	erfüllen
permanently neutral	immerwährend neutral
persistent objector	persistent objector
personal guarantee	Personalsicherheit
personal liability	persönliche Haftung
personal privilege	Sonderrecht
personal scope	persönlicher Anwendungsbereich
personal suffrage	persönliches Wahlrecht
petition	beantragen
piercing the corporate veil	Durchgriffshaftung (auf Gesellschafter)
plant	Betriebsstätte
plc	siehe public limited company
Police and Judicial Co-operation in Criminal Matters	Polizeiliche und justizielle Zusammenarbeit (PJZS)
political and community-related human rights	politische und gesellschaftsbezogene Menschenrechte
political rights	politische Grundrechte
popular initiative	Volksbegehren
positive integration	positive Integration
positive obligations	positive Verpflichtungen
positive sanction	positiver Anreiz
possession	Eigentum
power of representation	Vertretungsmacht, Vollmacht
pre-emptive right	Bezugsrecht
preamble	Präambel
precedent	Präzendenzfall
preferential dividend	Vorzugsdividende
preferential shares (w/o voting rights)	(stimrechtslose) Vorzugsaktien
preliminary reference procedure	Vorabentscheidungsverfahren
preliminary ruling	Vorabentscheidung
prescribed by law	gesetzlich vorgeschrieben
presumption of innocence	Unschuldsvermutung
prevention of disorder or crime	Prävention von Chaos/Kriminaltität
preventive measure	Präventivmaßnahme
primary law	Primärrecht (der EU)
principal	Geschäftsherr, Prinzipal
principle of conferral	Prinzip der begrenzten Einzelermächtigung
principle of equality	Gleichheitssatz
principle of good governance	Prinzip der guten Regierungsführung
principle of legality	Rechtsstaatsprinzip

principle of non-retroactivity	Rückwirkungsverbot
principle of origin	Herkunftslandprinzip
principle of peaceful enjoyment of property	Eigentumsfreiheit
principle of proportionality	Verhältnismäßigkeitsgrundsatz
principle of the rule of law	Legalitätsprinzip
principle place of business	Hauptgeschäftssitz
private action	private Maßnahmen
private autonomy	Privatautonomie
private benefits of control	Sondervorteile aus der Kontrolle einer Gesellschaft
private company limited by shares	englisches Äqivalent unserer GmbH
private limited company	GmbH
private ordering	privatrechtliche Vereinbarung
procedural error	Verfahrensfehler
procedural guarantees	Verfahrensgarantien
procedural requirement	Verfahrensvorschrift
proceedings of appeal	Berufungsverfahren, Revision
profit and loss account	Gewinn- und Verlustrechnung (GuV)
profits	Gewinne
prohibition of discrimination	Diskriminierungsverbot
prohibition of double jeopardy	Verbot der Doppelbestrafung
prohibition of slavery and forced labour	Verbot der Sklaverei und Zwangsarbeit
prohibition of the death penalty	Verbot der Todesstrafe
prohibition of torture and inhuman or degrading treatment	Folterverbot und Verbot der unmenschlichen oder erniedrigenden Behandlung
prohibition on intervention	Interventionsverbot
prohibition on the use of force	Gewaltverbot
prohibition to compete	Wettbewerbsverbot
propensity to comply	Bereitschaft, etwas zu befolgen
property	Eigentum
proportionality	Verhältnismäßigkeit
proportionality test	Verhältnismäßigkeitsprüfung
proportionate division	verhältniswahrende Spaltung
proprietor	Eigentümer
prospectus	Wertpapierprospekt
protection of legitimate expectations	Vertrauensschutz
protection of property	Eigentumsgarantie
provision	(1) Bestimmung, Regel; (2) Rückstellung (Bilanz)
proxy	Vertreter; Vollmacht
proxy advisor	Stimmrechtsberater
proxy solicitation	Bewerbung um Ausstellung einer Vollmacht
prudential authority	Aufsichtsbehörde
prudential regulation	rechtliche Regulierung einer Branche (v.a. am Finanzmarkt)
pseudo-foreign corporation	Scheinauslandsgesellschaft, Briefkastengesellschaft

public	der Öffentlichkeit
public hearing	öffentliche Verhandlung
public limited company	ungefähr unsere Aktiengesellschaft
public morality	öffentliche Sittlichkeit
public policy	öffentliche Ordnung
public security	öffentliche Sicherheit
public service	öffentlicher Dienst
qualification	Befähigung
qualified majority	qualifizierte Mehrheit
quantitative restriction	mengenmäßige Beschränkung
question of fact	Tatsachenfrage
question of law	Rechtsfrage
raising of capital	Kapitalaufbringung
ratification	Ratifizierung
ratify (a decision)	genehmigen
re-incorporation	Sitzverlegung, Neugründung
re-regulation	(erneute) Regulierung
real estate	Liegenschaften
reappointment	Wiederbestellung
reasoned opinion	begründete Stellungnahme
receivable	Forderung
reciprocity	Gegenseitigkeit
recommendation	Empfehlung
recommendation	Empfehlung
recourse	Regress
reduction of capital	Kapitalherabsetzung
redundancy payment	Entlassungsentschädigung
referendum	Volksabstimmung
registered letter	eingeschriebener Brief
registered office	eingetragener Sitz
registered shares	Namensaktien
registrar	Registerführer
registration	Eintragung
registration fee	Eintragungsgebühr
regulated market	geregelter Markt (Börse)
regulation (EU)	Verordnung (EU)
related party transaction	Geschäft mit nahestehenden Personen
relative autonomy	relative Autonomie
release from	entbinden von
remedy	Rechtsmittel
removal	Abberufung
removal for cause	Abberufung aus wichtigem Grund
remuneration	Entlohnung
reorganisation	Umstrukturierung, Reorganisation

repository	Hinterlegungsstelle, Archiv
represent	vertreten
representations	Erklärungen
representative	Vertreter
Republican Principle	republikanisches Grundprinzip
reputation concerns	Bedenken hinsichtlich des Rufs/ der Reputation
reservation	Vorbehalt
reservation of implementation	Gesetzesvorbehalt
reserve	Rücklage
residual claimant	Residualanspruchsberechtigter
residual debt	Restschuld
resolution	Beschluss
restructure	reorganisieren, umschulden (in Insolvenznähe)
retail investor	Kleinanleger
retain profits	Gewinne thesaurieren
retain title to the goods	sich das Eigentum vorbehalten (bis zur Zahlung)
retirement	Pensionierung
return	Ertrag
return (verb)	ausschütten
revenue	Einnahmen
revoke	widerrufen (insb Vollmacht)
right not to be tried or punished	Doppelbetrafungsverbot
right of defence	Verteidigungsrecht
right of first refusal	Vorkaufsrecht
right of lien	Pfandrecht
right of the accused	Rechte des Beschuldigten
right to a fair trial	Recht auf ein faires Verfahren
right to an effective remedy	Recht auf einen wirksamen Rechtsbehelf
right to be heard	rechtliches Gehör
right to education	Recht auf Bildung
right to free assistance of an interpreter	Recht auf die unentgeltliche Beiziehung eines Dolmetschers
right to free elections	Recht auf freie Wahlen
right to free legal assistance	Recht auf Verfahrenshilfe
right to inspection of files	Recht auf Akteneinsicht
right to liberty and security	Recht auf Freiheit und Sicherheit
right to life	Recht auf Leben
right to marry	Recht, eine Ehe einzugehen
right to respect for family life	Recht auf Privat- und Familienleben
rights of equality	Gleichheitsrechte
risk aversion	geringe Risikoneigung
rule of law	Rechtsstaatlichkeit
rules on incompatibility	Inkompatibilitätsbestimmungen
safeguard	Sicherung
sales contract	Kaufvertrag

seat (of a company)	Gesellschaftssitz
secondary law	Sekundärrecht
secret ballot	geheime Wahlen
Secretariat	Sekretariat
Secretary-General	Generalsekretär
sectoral agreements	sektorspezifische Abkommen
secured creditor	besicherter Gläubiger
securities	umlauffähige Wertpapiere
securities account	Wertpapierkonto
securities law	Kapitalmarktrecht
securitisation	Verbriefung
Security Council	Sicherheitsrat
separation of powers	Gewaltenteilung
services	Dienstleistungen
settlement	Vergleich, Ausgleich
share	Aktie, Anteil
share certificate	Aktienurkunde
share deal	Anteilskauf (=Unternehmenskauf iwS, s asset deal)
share exchange	Aktientausch
share exchange ratio	Umtauschverhältnis
share premium	Agio, Aufgeld
share purchase agreement	Aktienkaufvertrag
share(holder) register	Aktienbuch
shared competence	geteilte Zuständigkeit
shareholder	Aktionär, Gesellschafter
shareholder agreement	Syndikatsvertrag (Nebenvereinbarung zwischen Gesellschaftern)
shareholding	Beteiligung
shares without voting rights	stimmrechtslose Aktien
side-stream merger	Verschmelzung auf die Schwestergesellschaft
signing	Unterzeichnung (des Vertrags zum Unternehmenserwerb)
silent partner	stiller Gesellschafter
silent partnership	stille Gesellschaft
Single European Act (SEA)	Einheitliche Europäische Akte (EEA)
singular succession	Einzelrechtsnachfolge
small and medium-sized enterprises	Klein- und Mittelunternehmen (KMU)
social fundamental rights	soziale Grundrechte
social security	Sozialversicherung
Societas Cooperativa Europaea/	Europäische Genossenschaft (SCE)/
Societas Europaea (SE)	Europäische Gesellschaft (SE)
society	Verein
soft law	Soft Law (nicht bindende Normen mit bloß faktischer Wirkung)
sole proprietor/trader	Einzelunternehmer(in)
sources of fundamental rights	Grundrechtsquellen
sovereign equality	souveräne Gleichheit

sovereign power	Hoheitsgewalt
special investigation	Sonderprüfer
special legislative procedure	besonderes Gesetzgebungsverfahren
spill-over	spill-over-Effekt
spin-off	hier: Abspaltung
squeeze-out	Gesellschafterausschluss
staggered board	board mit gestaffelter Bestellung (zB jedes Jahr ein Drittel)
stakeholder	auch im Deutschen: Stakeholder = Gesellschafter, Gläubiger, Arbeitnehmer, etc.
standard	Standard, auch: Richtlinie
standard form contract	Formularvertrag
state interests	Staatsinteressen
state liability	Staatshaftung
state objective	Staatszielbestimmung
state practice	Staatenpraxis
State Secretary	Staatssekretär
state sovereignty	staatliche Souveränität
statutes	Gesetze; aber auch Satzung/Gesellschaftsvertrag
Stewardship Code	Verhaltenskodex für Vermögensverwalter
stipulate	bestimmen, festlegen
stock exchange	Börse
stock option	Aktienoption
strike of the register	aus dem Handelsregister löschen
strike price	Ausübungspreis
subjective rights	subjektive Rechte
submission	Vorbringen
subordinated creditor	nachrangiger Gläubiger
subscription	Zeichnung
subsidiarity	Subsidiarität
subsidiary	Tochtergesellschaft
subsidiary character	subsidiärer Charakter
substantive EU law	materielles EU-Recht
successor company	Nachfolgegesellschaft
successor liability	Nachfolgehaftung
sue	klagen
suffrage	Wahl
suit	Klage
supermajority	qualifizierte (d.h. erhöhte) Mehrheit, zB ¾
superseding power of norms	derogatorische Kraft von Normen
supervisory board	Aufsichtsrat
supranational	supranational
supranational law	supranationales Recht
supremacy	Vorrang
Supreme Administrative Court	Verwaltungsgerichtshof (VwGH)
Supreme Court	Oberster Gerichtshof (OGH)

surplus	Überschuss
surrender	übergeben
sustainability	Nachhaltigkeit
synergies	Synergien, Verbundvorteile
system of collective security	System der kollektiven Sicherheit
table a motion	Beschlussvorschlag/Antrag machen
tag along-right	Tag along-Recht (Mitverkaufsrecht)
takeover bid	Übernahmeangebot
takeover law	Übernahmerecht
tangible asset	körperliche Sache
target company	Zielgesellschaft
tariff	Zoll
tax burden	Steuerlast
tax declaration	Steuererklärung
tax law	Steuerrecht
teleological	teleologisch
tenancy law	Mietrecht
term of office	Amtsperiode
terminate	kündigen, auflösen
territorial jurisdiction	territoriale Jurisdiktion
tertiary law	Tertiärrecht
test of proportionality	Verhältnismäßigkeitsprüfung
third party	Dritte(r)
title to the goods	Eigentum an Sachen
to claim damages	Schadenersatz geltend machen
to enact laws	Gesetze erlassen
to incriminate oneself	sich selbst bezichtigen
to state reasons	begründen
to weigh interests	Interessen abwägen
tort	Schadenersatz
tortfeasor	Schädiger
total revision of the Federal Constitution	Gesamtänderung der Bundesverfassung
trade creditor	Lieferantengläubiger
trade law	Gewerberecht
trade policies	Handelspolitiken
trade terms	Handelsbedingungen
trade union	Gewerkschaft
transfer	übertragen
transfer price	Verrechnungspreise im Konzern
transferee	Empfänger
transferor	Übertragender
transformation	Umsetzung
transnational corporations	transnationale Unternehmen
transposition	Umsetzung

Treaty Establishing a Constitution for Europe (Constitutional Treaty)	Vertrag für eine Verfassung für Europa/ Verfassungsvertrag
Treaty Establishing the European Atomic Energy Community (EAC/Euraton)	Vertrag zur Gründung der Europäischen Atomgemeinschaft (Euratom)
Treaty of Accession	Beitrittsvertrag
Treaty on European Union (TEU)	Vertrag über die Europäische Union (EUV)
Treaty on the Functioning of the European Union (TFEU)	Vertrag über die Arbeitsweise der Europäischen Union (AEUV)
tribunal	Tribunal
trust	Trust, eine spezielle stiftungsähnliche Konstruktion des englischen Rechts
trustee	Treuhänder
tunneling	aushöhlen (das Vermögen einer Gesellschaft zum Nutzen eines Gesellschafters)
turnover	Umsatz
two-tier board	zweistufiges Boardsystem (D, Ö)
UN Convention on the Rights of the Child (CRC)	UN-Kinderrechtskonvention
unanimity	Einstimmigkeit
undercapitalised	unterkapitalisiert
unduly paid	(rechts)grundlos bezahlt
unilateral legal act	einseitiger Rechtsakt
Universal Declaration of Human Rights (UDHR)	Allgemeine Erklärung der Menschenrechte (AEMR)
universal succession	Gesamtrechtsnachfolge
universal suffrage	allgemeines Wahlrecht
unlimited liability	unbeschränkte Haftung
unsecured credit	ungesicherter Kredit
unsecured creditor	ungesicherter Gläubiger
up-stream merger	Verschmelzung auf die Muttergesellschaft
use of force	Gewaltanwendung
validity	Gültigkeit
valuation	Bewertung
vendor	Verkäufer
venture	Unternehmung
void	nichtig
void (verb)	für nichtig erklären
voting cap	Höchststimmrecht
voting right	Stimmrecht
waive	verzichten
warranty	Gewährleistung

welfare	Wohlfahrt
White Paper	Weißbuch
widely held company	Gesellschaft im Streubesitz
wilfully	absichtlich
windfall profit	unerwarteter/-verdienter Gewinn
withdrawal	Austritt
works council	Betriebsrat
written resolution	Umlaufbeschluss
yield	Ertrag