

Chapter 17

Family Constitutions and the Complexity of Family Businesses from a Counsel's Point of View¹

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Abstract

Family constitutions are relatively new to the law of family companies, although there might have been forerunners in the history of entrepreneur families. The practical importance and the proliferation of family constitutions in German family companies are increasing, along with the discussion of family constitutions in legal literature. This new instrument of family governance is not law driven but business driven, it has been designed by business advisors. Its analysis and classification are still at the very beginning in academic research and practice. Even though family constitutions are generally deemed to be without any legal effect and not legally binding, from a legal point of view, this assumption is at least highly questionable.

Keywords: Family constitution; family governance; legal analysis of the family constitution; family business counsel; conflicts; Germany

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17.1. Introduction – Managing Complexity and Managing Conflicts

Family businesses are often faced with various conflicts: conflicts between shareholders, between members of the family or between family branches. Conflicts in family businesses are part of the daily business. Of course, these sorts of conflicts are very delicate. But families are very discrete, being aware of the public perception and negative effects on both the family and the family business. The public in general never hears of such conflicts (Holler, 2020, § 75 para. 4). Therefore, advising family businesses often means not only giving legal advice; in addition, it demands managing complexity and managing conflicts – in each case in a very diverse and individual structure of both the family and the family business.

17.2. The Law of Family Businesses

Complexity starts with the absence of any legal codification in respect of family businesses (Holler, 2018, p. 557). Every family business is different. This explains why there are hardly any systematic presentations in corporate law literature.² The law of family companies has not been codified. It is a law of individual contracts and regulations (Holler, 2020, § 75 paras. 5 and 84 et seq.).

17.2.1. Law of Individual Contracts and Regulations

The special and characteristic aims of a family business and its owners must therefore be individually regulated on the basis of tailor-made drafting, especially in the areas of corporate law, succession law, and family law.³ Interface problems are typical and a challenge, especially in the design of contracts.

17.2.2. Typical Characteristics and Regulation Requirements

Although each family company has its individual design, there are typical characteristics and regulation requirements, such as (i) the typical limitation on the group of possible shareholders and the restriction of share transfer only to descendants of the founder (closed shop), (ii) the increasing number of shareholders from generation to generation, (iii) the corporate structure being divided into management, advisory council and the shareholder meeting with the shareholders being organized and divided into groups of families and family branches, (iv) the special importance of internal shareholder financing for the existence and growth of the family business, (v) restrictions on the right to terminate the company and

²Holler (2018); Holler (2020), Hennerkes and Kirchdörfer (1998); Scherer et al. (2012); Ulmer (2010a); Ulmer (2010b); Bochmann and Scheller and Prütting (2021); Vogt et al. (2017); for Austrian law Kalss and Probst (2013).

³Holler (2018, p. 557); Holler (2020, § 75 para. 5 and 84 et seq.); focusing on succession law and planning in family businesses Holler (2021a, 2021b).

reduction of shareholder compensation claims in order to avoid liquidity outflow relating to crucial exit occasions.⁴

These various regulations on different legal levels must be well coordinated. They must fit together and mesh. Inadequate regulation and a lack of interlocking of such regulation can endanger the family business and is one of the typical reasons for conflicts (Holler, 2018, p. 558; Sigle 1994, p. 459).

There are various legal limitations in German corporate law, making an adequate and legally certain design with regard to these typical family businesses characteristics such a challenge that there has been a call for a “special law” (*Sonderrecht*) for family businesses comparable to the “special law for public partnership companies.”⁵

17.2.3. Tradition of the Family Business, Values, and Goals

These typical characteristics are the mission to preserve the company and its character as a family business in the long run. They can be summarized as the tradition of the family business, including its values and goals (Holler, 2019a, p. 883). They are an expression and consequence of the tradition of the family business as determined by the founder and the values and goals that this individual has designated to be the “program” for the following generations (Holler, 2018, p. 558 et seq.).

17.2.3.1. The Founder's Will and Tradition

The founder's will and tradition are the origin and basis of the family business and its legal statutes as provided by the founder, which is relevant and at least in partnership law can even be decisive for both the content and the interpretation of a partnership agreement (Holler, 2018, p. 558 et seq.).

17.2.3.2. Legal Significance for Interpretation and Content of Family Business Statutes

The founder's will is the very beginning of every family business. In jurisprudence, the visions of the founders have been summarized as the “tradition of the family business” based on the founder's will.⁶ Courts have determined such tradition of the founder to be responsible for the content and interpretation of the partnership agreement. It is therefore the founder's will and tradition as incorporated in the corporate membership that is to be passed from one generation to the next (Fig. 17.1).

⁴Ulmer (2010, p. 552); Holler (2018, p. 558); pointing out the specific effect of corporate law on family businesses Habersack (2020, p. 2093).

⁵See Holler (2019a, p. 882); Holler (2018, p. 558); Ulmer (2010, p. 549); Ulmer (2010, p. 805); Binz and Sorg (2018, § 6 para. 178); see for discussion and ample references Holler (2020, § 75 paras. 25 and 79 et seq.); critical Lieder (2017, p. 59); Holler (2012, p. 719ff.); Lieder (2021, § 3 paras. 115ff.); Fleischer (2017, p.1201); explicitly against any special law (*Sonderrecht*) Bochmann and Scheller and Prütting (2021, Einf. Vor § 1 paras. 6 et seq.) (“Kein Sonderrecht der Familienunternehmen”).

⁶Cf. Higher Regional Court of Hamm (OLG Hamm), decision of 3 November 1999 in case 8 U 220/98, NJOZ 2001, 170 and decision of January 17, 1991 in case 15 W 428/90, NJW-RR 1991, 837, 840; Holler (2018, p. 559).

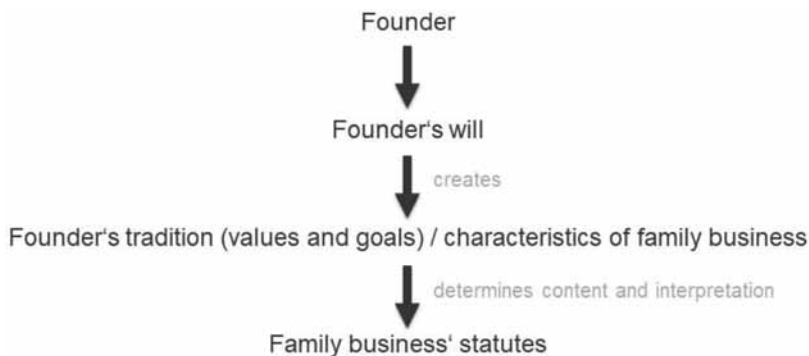


Fig. 17.1. The Link Between the Founder's Will and the Family Business Statutes.

17.2.4. Great Diversity of Legal Forms of Companies

There is a great diversity of company legal forms that the family can choose for their family business (Holler, 2020, § 75 paras. 56 et seq. and 64). And there is not solely one suitable legal form. The selection in the individual case depends not only on the business demands of the company, but especially on the succession situation within the family (Holler, 2020, § 75 paras. 72 et seq.; Lieder, 2017, p. 62).

17.2.5. Architecture of Family Business Providing for Different Corporate Levels and Statutes

17.2.5.1. Not Only Articles of Association, But Different Corporate Levels

Quite often, the internal corporate organization is not limited to the articles of association of the family business itself, although such articles are in general the fundamental place where this organization is stipulated (Holler, 2020, § 75 para. 87 et seq.). The architecture can be rather complex and eclectic. It has been compared with the structure of an onion, thus having different layers ("Zwiebelschalenmodell") (Fleischer, 2016). Such an image, as accurately defined by Fleischer, is attractive also because the corporate structure of a family business in the individual case is a "grown structure" – with the family business usually providing for a closed shop of family shareholders only (Holler, 2020, § 75 paras. 20 and 38 et seq.); it has grown with the family from generation to generation and therefore is multilayered and complex in many respects.

The corporate structure of a family business frequently provides for different corporate levels and statutes for different purposes.

17.2.5.2. Shareholder Agreements

Family shareholders often agree upon a shareholder agreement for different reasons (Holler, 2018, p. 559, 2020, § 75 paras. 86 et seq. and 132 et seq.; Kalss & Probst, 2013: paras. 4/2 et seq.). One important motive is that these agreements, in contrast to the content of the company's articles of association, do not have to be disclosed to the public or filed with the commercial register

(Holler (2020, § 75 para. 87). Additionally, shareholder agreements are more flexible than the articles, as their content, changes or amendments do not have to comply with form requirements or the formal strictness of the articles in stock corporation law.⁷

Individual and versatile content. The content of shareholder agreements of family businesses is individualized and versatile.⁸ Shareholder agreements often contain pooling agreements in which a group of shareholders (for example, a family branch⁹) concentrate their votes to maintain a certain influence on the family business either in general or regarding specific matters and affairs. Families often provide regulations with regard to the composition of the management and advisory boards as well as profile requirements for their members. The definition is one of the crucial issues, and regulation requirements in family businesses are vulnerable to internal conflicts since the family must determine (i) whether or not family members are to be members of the management or supervisory board and (ii) the social and professional qualities required. Other clauses typically provided in shareholder agreements are regulations governing the transfer of shares (for example, transfer restrictions, exit regulation and – in large companies – regulations for an internal share transfer market).

Legal qualification – company under civil law. As far as the legal qualification is concerned, such shareholder agreements themselves usually serve under German law to constitute companies under civil law pursuant to section 705 German Civil Code.¹⁰ Therefore, there often exist other company statutes and other corporate levels beyond the corporate entity of the actual family business, each with its own corporate life and decision-making processes that need to be well coordinated in practice.

Consequences for corporate design practice. The parallel coexistence of various corporate levels requires careful design and drafting so as to achieve an interlocking regulation that meshes and fits together smoothly. Various designs for these companies within the family business structure are possible.

The relatively easiest variation is where the participants and shareholders of both companies – family company and civil law company – are identical. We call this an omnilateral shareholder agreement.¹¹ If the family shareholders only partly become parties, we speak of a fractional shareholder agreement.¹²

⁷Sec. 23 para. 5 German Stock Corporation Act (AktG).

⁸Wicke (2021, § 18 para. 4) ; Wicke (2022, para. 132); in detail Hoffmann-Becking (1994, p. 444); Holler (2018, 559 et seq.).

⁹For more detail on the organization of family branches and their legal implications, Holler (2020, § 75 paras. 91 et seq.); Fleischer (2019); on the criticism of the family branch principle, Kormann (2012, chapter 6 paras. 4 et seq.).

¹⁰Ulmer and Löbbecke (2013, § 3 paras. 119 and 123); Holler (2020, § 75 para. 137 and in more detail paras. 132 et seq.); Holler (2018, p. 560); Wicke (2021, § 18 para. 6).

¹¹See in detail, Noack (1994, p. 33); for the Limited Liability Company (GmbH) Ulmer and Löbbecke (2013, § 3 para. 120); Holler (2018, p. 560).

¹²Noack (1994, p. 33); for the Limited Liability Company (GmbH) Ulmer and Löbbecke (2013, § 3 para. 120) Holler (2018, p. 560).

Rather often, not all of the family shareholders are parties to the shareholder agreement for different reasons. If the family is divided into family branches and the internal relationship between the members of such family branches is not regulated within the partnership agreement or articles of associations, each branch will conclude its own shareholder agreement (family branch statute).¹³ If there are third-party shareholders who are not members of the family, the family often will conclude a shareholder agreement in order to bundle family influence on the family business, thereby providing restrictions on voting rights in the shareholder meeting, which is called a pooling agreement or protective association agreement (*Schutzgemeinschaftsvertrag*).¹⁴ Sometimes there are two or more families who do the same. Together they conclude a multi-family shareholder agreement.

17.2.5.3. Shareholder Resolutions

Another level of regulation is established by shareholder resolutions (Holler, 2018, p. 560). Typical subjects of shareholder resolutions – as in usual, non-family businesses – are rules of procedure for the board of directors, the advisory council, and/or the shareholders' committee. But families can also decide to agree upon sensitive issues not being regulated in the articles of associations but in a shareholder resolution, especially with regard to family issues in relation to the company (Holler, 2018, p. 560).

Example: There was a member of the family who was a shareholder who wanted to buy a product manufactured by the family company. As a legal transaction with a shareholder, the transaction required a shareholder resolution with a majority of 75% of the voting capital as provided by the articles of association. The shareholder concerned by the transaction had no voting right.¹⁵ Since there was a severe conflict in the family as well as a shareholder dispute, the respective shareholder of the other family branch – in protest and on principle – did not agree. The legal transaction had to remain uncompleted. Some months later, this purchase-seeking member of the family discovered a long-forgotten shareholder resolution buried in oblivion that had been passed 20 years earlier and that provided detailed regulations stipulating specific conditions for product sales to family members and family shareholders. The management was entitled to execute the transaction on the basis of such shareholder resolution.

As this practical example illustrates, families can regulate their tradition and interests in relation to the company by means of shareholder resolutions, which are insofar an appropriate instrument.

¹³For more details, see Holler (2020, § 75 paras. 91 et seq.).

¹⁴For further details, see Hoffmann-Becking (1994, p. 442ff.); for a sample pool agreement among shareholders of a listed stock corporation, see Löbbe (2012, chapter 5.01 paras. 1 et seq., pp. 463 et seq. and chapter 5.02, pp. 494 et seq.); Holler (2018, p. 559f.).

¹⁵Sec. 47 para. 4 s. 2 German Limited Liability Company Act (GmbHG).

17.2.6. Other Levels of Regulations – Inheritance and Family Law

There are other levels of regulation for family businesses and their members, such as inheritance and family law. Each family shareholder must ensure that his testament or contract of inheritance complies with requirements for the succession of shares to members of the family as provided by the family business statutes.¹⁶ Since the situation of succession within the family varies over the course of time and therefore constitutes a dynamic process, such compliance can be a challenge and requires continuous and careful monitoring in fact and law.¹⁷

Additionally, claims on the reserved portion of an estate (*Pflichtteil*), in the event of the death of a family shareholder, as well as claims on equal distribution of surplus (*Zugewinnausgleich*), in cases of divorce, can force the family shareholder to exercise the right to terminate the company and to claim compensation. Liquidity outflow caused by a claim of compensation can overstrain the financial means of the company and must be avoided (Holler, 2020, § 75 para. 312). Therefore, claims on the reserved portion of an estate as well as claims on equal distribution of surplus must be excluded by contract in each individual case by every single family shareholder.

Since such claims can endanger the existence of a family business,¹⁸ corporate statutes often provide clauses authorizing the shareholder meeting to decide on the exclusion of a shareholder that has neglected to exclude such claims by contract with his marriage partner and to provide evidence of having done so within a fixed time limit.¹⁹

Last but not least, precautionary powers of attorney are part of the law of family businesses.²⁰ These are important precautionary measures for cases of mental illness or emotional, mental, or physical disability in which a family shareholder is no longer able to manage his or her affairs, especially the exercise of shareholder rights. Precautionary powers of attorney avoid legal guardianship, which is especially important to family businesses because any influence of third parties is often excluded by all means. Apart from that, guardianship can cause severe problems for the functioning of the family company, for the decision-making procedure in the shareholder meeting of the family business and for the exercise of shareholder rights.²¹

¹⁶Holler (2020, § 75 paras. 70 and 220 et seq.) ; see for the design of succession clause (Nachfolgeklausel) in corporate statutes of family businesses, Holler (2021a).

¹⁷Holler (2020, § 75 para. 70); regarding succession clauses (Nachfolgeklauseln) in corporate statutes of family businesses in detail, Holler (2021a).

¹⁸On the problem of the strain on liquidity in the context of corporate succession, see Mayer (2013, p. 75).

¹⁹Explaining such matrimonial property clauses in articles of association, Wenckstern (2014, pp. 1, 12f et seq.); for further detail, see Sanders and Rolfes and Hawickenbrauck (2021: 1797ff.).

²⁰On guardianship and particular challenges, Langenfeld (2005, p. 52).

²¹Generally and for ample references, see Schäfer (2020, § 705 paras. 126 et seq.).

17.3. Complexity in Law and Fact

Complexity often is underestimated. Dealing with family businesses demands an awareness of complexity as regards each person involved. The complexity in terms of legal advice is multilayered and eclectic in law and fact (Holler, 2020, § 75 paras. 1 et seq. and 5 et seq.).

17.3.1. Juxtaposition of Family and Family Business

Family and the family business stand side by side in business reality. You cannot deal with the one without the other. In order to understand the business and its structure, you must know the family as well as the family tradition, including the family history, family conflicts, and family moral values.

17.3.2. Emotions

There often are emotions – and family members sometimes let them run free in the exchange of letters, shareholder meetings or negotiations. Emotions place high demands on each person involved, especially third parties, these including management who are not part of the family and professional advisors (Holler, 2020, § 75 para. 69).

In normal companies, such emotional and not exclusively rational behavior would be regarded as inappropriate or out of place. It may occur that family shareholders will start to cry or shout at each other during a shareholder meeting. However, if a sister shareholder insults her brother shareholder and acts in an offensive manner, this behavior will not necessarily have the same quality as the equivalent behavior among usual shareholders in normal and non-family business. Imagine the addressee of such behavior being the representative of a third party, e.g., a financial investor. In a family business, there are different standards, but no schematic solutions as far as the legal consequences where such behavior is concerned. Rightly, in the case law of the German Federal Court of Justice, fiduciary duties (*gesellschaftsrechtliche Treuepflichten*) of the family shareholder can be either more or less intensive, something which must be determined on a case-by-case basis.²² Specific characteristics of family businesses lead to specific standards for fiduciary duties of the family shareholder as well as the legal consequences in the event of their violation (Holler, 2012, p. 719ff., 2020, § 75 paras. 355 et seq. and 384 et seq.; Holler & Mann, 2021, p. 404 et seq.).

17.4. Conflicts Are Typical and Dangerous for Family Businesses

Conflicts are both typical and dangerous for family business (Holler, 2020, § 75 paras. 67 et seq.).

²²German Federal Court of Justice (BGH), decision of 9 December 1968 in case II ZR 42/67, NJW 1969, 793, 794, and the decision of December 12, 1994 in case II ZR 206/93, NJW 1995, 597; Schmidt (2016, § 140 para. 35).

17.4.1. *Special and Individual Characteristics*

Family thinking and family feelings, including emotional behavior, can prevail so much over family members that they are not able to make rational decisions in the affairs of the family business (Holler, 2020, § 75 para. 69). Such conflicts between family members or family branches are dangerous (Holler, 2020, § 75 para. 93). It is common sense that experience in corporate litigation outside family businesses suggests that shareholder disputes can even endanger the existence of a company. This is true for family businesses, too. Nevertheless, there are different rules for conflict resolution and (corporate) litigation at least in most of the entrepreneur families. This is a question of (dispute) culture and tradition and therefore – once again – very individual.²³

Shareholders are not just business partners, but family. Whereas shareholders in normal, non-family businesses only see each other in shareholder meetings – and after their exit from the company they go their separate ways – this does not hold true for a family business. The family comes together outside of shareholder meetings and is connected by family ties (*Familienband*).²⁴ The family ties will survive any business partnership or shareholder exit in the long term.

17.4.2. *Typical Reasons for Conflicts*

17.4.2.1. *Unanimous Votes and Individual Consent Requirements*

Unanimous votes and the individual consent of shareholders are often required in the structures of family businesses. Although a corporate adviser may try to avoid requirements of unanimous voting and individual consent because they can result in standstills and the blockage of necessary decisions, these crucial and challenging situations are typical in family businesses for different legal reasons:

Section 709 German Civil Code. As pointed out above, we often have to deal with civil law companies in a different regulatory context and on different corporate levels. Even if the family business does not itself have the legal form of a civil law company, often typical shareholder agreements as described above themselves might constitute each in their own right a civil law company pursuant to sections 705 ff. German Civil Code (BGB). Therefore, the law governing civil law companies plays a decisive role within the law of family businesses (Holler, 2020, § 75 paras. 316 et seq.). Unless otherwise stipulated, shareholder resolutions require a unanimous vote pursuant to section 709 German Civil Code.

Special Rights (Section 35 German Civil Code). Special rights (*Sonderrechte*) pursuant to section 35 German Civil Code as well as preference rights (*Vorzugsrechte*) are typical for family businesses and are frequently provided in favor of an individual family shareholder, a group of family shareholders or family branches (Holler, 2020, § 75 paras. 292 et seq.). These special rights, such as a multiple voting right or a presentation right for a member of the management or supervisory board, cannot be restricted or withdrawn without the

²³For ample references, see Holler (2018, p. 559).

²⁴In detail with regard to family connectedness constituting family businesses' DNA, Holler (2019b, p. 931); Holler (2020, § 75 para. 27).

individual consent of the shareholder or the group of shareholders concerned pursuant to [section 35](#) German Civil Code. This statutory rule provides for a general principle valid for all kinds of legal forms, although there are of course particularities to be considered.²⁵ Once such a special right has been granted, it can make a change of the partnership agreement, articles of association or shareholder agreement very difficult or even impossible in fact ([Holler, 2020](#), § 75 para. 308). Furthermore, conflicts arise with regard to the continuity of special and preference rights in cases of succession ([Holler, 2020](#), § 75 para. 309).

The Core of the Membership (*Kernbereich der Mitgliedschaft*). The core of the membership (*Kernbereich der Mitgliedschaft*)²⁶ constitutes another crucial limitation for the design of agreements or decisions in family businesses ([Holler, 2018](#), p. 558; [Holler, 2020](#), § 75 paras. 249 et seq.). There are certain fundamental shareholder rights that cannot be restricted or withdrawn without the individual consent of the shareholder concerned. It is a dilemma for family businesses that elementary regulation encompasses interference with the core of membership of the shareholders (*Eingriff in den Kernbereich der Mitgliedschaft*) and therefore requires the individual consent of each family shareholder concerned. For example, in order to avoid liquidity outflow, the right to terminate the partnership must be excluded ([Holler, 2019b](#), p. 941f., 2020, § 75 paras. 312 et seq.) and compensation claims must be reduced.²⁷ Both of these shareholder rights are part of the core of the membership at least in general and on the basis of the statutory structure of the company. There can be great uncertainty whether a particular shareholder right or position belongs to the core of membership or not in the individual case, depending on the individual design of the family company and its actual or effective shape (*Realstatut*) ([Holler, 2020](#), § 75 paras. 252 et seq.).

17.4.2.2. *Obligation to Consent Due to Shareholder's Fiduciary Duty*

Since unanimous voting and individual consent often cannot be achieved, a frequent shareholder dispute relates to the question of whether the dissenting shareholder has an obligation to consent as a result of the fiduciary duty owed by a shareholder ([Holler, 2020](#), § 75 paras. 371 et seq.; [Holler & Mann, 2021](#): 407 et seq.). But here as well, the German Federal High Court places strict demands in evaluating the individual case.²⁸ That is why blockades of essential corporate measures are often a challenge in family businesses.

²⁵On the particularities of the law governing German Limited Liability Companies (GmbH), partnerships and German Stock Corporations (AG), [Holler \(2020, § 75 paras. 300 et seq.\)](#).

²⁶About this in general and about the term, [Roth \(2021, § 119 para. 36 et seq.\)](#).

²⁷In detail recently, [Holler \(2019b, p. 940f.\)](#) and [Fleischer and Bong \(2017, p. 1957\)](#); [Hamburger Kreis Recht der Familienunternehmen \(2020\)](#).

²⁸Cf. the recent German Federal Court of Justice (BGH) decision of August 14, 2014 in case 23 U 4744/13, NZG 2015, 66 – Media-Saturn.

17.4.2.3. Intergenerational Conflict

Another typical reason for dispute in family businesses is intergenerational conflict. If the founder, for example, appoints one of his children as his successor and after a couple of years regrets this decision and removes the child from the position of director, a severe intergenerational conflict can be the consequence, affecting both the family and the business. Such generational conflict can be momentous not only because the child may have chosen a particular education, career or profession specifically because of having been designated as successor; wounds that children suffer often cannot be healed with financial compensation, and they burden family and shareholder relationships in the long run (Holler, 2021b, § 33 para.33).

17.4.2.4. Juxtaposition of Corporate and Succession Law

The juxtaposition of corporate law and succession law in a particular case is complex and a source of conflict. Quite often, we have to deal with interface problems, for example in the law of executorship (*Recht der Testamentsvollstreckung*),²⁹ which is an indispensable instrument of succession and succession planning from a legal point of view.³⁰ In general, under German succession law the executor of a will is exclusively entitled to exercise the shareholder rights of shares being part of the estate, and the heirs are insofar excluded – but details and exceptions are highly disputed.³¹ Whether there are exceptions to be made with regard to a particular situation – for example in cases of a conflict of interest or an interference with the core of the membership (Holler, 2020, § 75 para. 273a, 2021b, § 33 para. 187 et seq.) – can be hard to determine in the individual case; equally challenging is determining the consequences for the shareholder decision-making process.³² The interplay between corporate law and succession law in particular is complex.

17.5. Family Constitutions

How does a family constitution fit in the law of family businesses, especially with regard to the complex challenges routinely faced by practitioners in designing contracts as well as in resolving or managing conflicts between members of the family, family shareholders, and family branches?

17.5.1. A Novelty in Corporate Law

Family constitutions are relatively new to the law of family companies, although there might have been forerunner in the history of entrepreneur families.³³

²⁹Sec. 2197 et seq. German Civil Code (BGB).

³⁰In detail, Holler (2021b).

³¹For an overview, see Zimmermann (2017, § 2205 paras. 14 et seq.); in detail with regard to family businesses, see Holler (2021b, § 33 para.185 et seq.).

³²Cf. German Federal Court of Justice (BGH), decision of March 13, 2014 in case II ZR 250/12, NZG 2014, 945; Wicke (2015); Holler (2021b, § 33 para. 185 et seq.).

³³For detailed historical and comparative legal classification of family constitutions, see Fleischer (2017); Holler (2020, § 75 para. 164 et seq.).

The practical importance and the proliferation of family constitutions in German family companies are increasing, along with the discussion of family constitutions in legal literature.³⁴ This new instrument of family governance is not law driven but business driven, it has been designed by business advisors. Its analysis and classification are still at the very beginning in academic research and practice. (Fleischer, 2017; Holler, 2020, § 75 para. 167; Hueck, 2017; Uffmann, 2015).

17.5.2. Family Governance Instrument

One main reason for the rising emergence of family constitutions is probably that family companies have become increasingly aware that for the long-term success of the family company, not only good corporate governance but also good family governance is essential.³⁵ Following the example of the German Corporate Governance Kodex, in 2004 a commission of leading professionals and family entrepreneurs was established and subsequently developed a Governance Code for Family Businesses (*Governance Kodex für Familienunternehmen* [GKFU]), which proposes guidelines for the responsible management of family companies.³⁶ An essential part of the Code is the recommendation to create a family constitution (May & Koeberle-Schmid, 2011, p. 488f.).

17.5.3. Name, Definition, Purpose, and Content of the Family Constitution

Just as there is hardly a uniform name or definition of a family constitution, there is no uniform standard for the content and aim of family constitutions (Fleischer, 2019, p. 2823; Holler, 2018, p. 554, 2020, § 75 para. 168; Hueck, 2021, § 50 para. 1). A family constitution is supposed to define the goals and values of the family and the family shareholders in relation to the company. The aim of a family constitution is to secure the success of the company in the long run, to keep the company in the hands of the family, and to strengthen the coherence of the family (Fleischer, 2019, p. 2823; Holler, 2018, p. 555; Kalss, 2014, p. 350; Lange, 2009, p. 147).

Possible topics and the material content of a family constitution are as diverse as the different forms and designs of family constitutions which can be found in practice (Holler, 2018, p. 555; 2020, § 75 para. 173; Hueck, 2017, p. 9f.). Considering that essential aspects like corporate governance and the financing of the company are typically regulated by either the corporate statutes of the family business or by

³⁴Holler (2018); Fleischer (2017); Fleischer (2016); Holler (2020, § 75 paras. 164 et seq.); Uffmann (2015); Reich and Bode (2018); Hueck (2017); Bong (2022); Kalss (2022); for Austrian law, Kalss and Probst (2013, chapter 3).

³⁵Holler (2020, § 75 para. 165); cf. on the development of family governance, Kirchdörfer and Breyer (2014).

³⁶INTES, FBN Deutschland, ASU Die Familienunternehmer: Governance Kodex für Familienunternehmen. „Kodex.“ www.kodex-fuer-familienunternehmen.de/kodex.

means of shareholder agreements or shareholder resolutions, as outlined above, the family constitution must not compete with these corporate documents, which would pose a risk for conflicts between the different provisions.³⁷ Furthermore, the *process* of developing and formulating a family constitution is deemed to be as important as – and for some experts even more important than – the actual content of the family constitution with regard to its conflict-avoiding effect.³⁸

17.5.4. Parties, Language, and Versions of a Family Constitution

It is recommended that a family constitution be commonly developed by all family members, not only family shareholders, in understandable language and that it be signed by all family members, so that all family members, including those who might not be legally or economically educated, accept and understand the instrument.³⁹ Furthermore, different versions are recommended – one for the family (family version) and another one for the management company (company version).⁴⁰

17.5.5. Legal Quality and Relevance of Family Constitutions

The legal basis for family constitutions is still not clear and for the most part has never been discussed, especially with respect to the legal effect of family constitutions.⁴¹ Therefore, the family constitution has properly been qualified as a mystery (*Rätsel*).⁴² It is a common opinion that a family constitution is merely a memorandum of understanding, being only morally binding and legally non-existent and thus unenforceable.⁴³ These views are, however, in their generality at least questionable and need to be examined carefully on the basis of the relevant legal and especially corporate law standards.⁴⁴ With regard to the purpose and qualification of the document as a “constitution”, it is rather questionable that the family constitution is only a morally binding document without any legal effects. The term “constitution” already implies a certain commitment with legal effect.⁴⁵

³⁷Holler (2018, p. 557); Holler (2020, § 75 para. 173); critical as well Lange (2013, pp. 33, 40); Kirchdörfer and Lorz (2011, p. 105); Graf and Bisle (2010, p. 2409ff.).

³⁸For a detailed description of this process and the procedural regulatory tasks for conflict avoidance and resolution, see Holler (2018, p. 555f.); Holler (2020, § 75 para. 174 et seq.); Hueck (2021, § 50 para. 5); Kalss (2022: 37ff.).

³⁹May and Koeberle-Schmid (2011: 489f.); Baus (2016: 108); Lange (2009: 148); Kirchdörfer and Lorz (2011: 101); Holler (2020: § 75 para. 193); Oertzen and Reich (2017: 1123).

⁴⁰Baus (2016: 110); Holler (2018: 561).

⁴¹Holler (2020: § 75 para. 167); Hueck (2017: 335).

⁴²Fleischer (2016).

⁴³Kirchdörfer and Lorz (2011: 101); Koeberle-Schmid, Schween and May (2011: 2500).

⁴⁴Holler (2018: 557, 560ff.); Holler (2020: § 75 paras. 196 et seq.).

⁴⁵Holler (2020: § 75 para. 195).

17.6. Classification of Family Constitutions in the Law of Family Businesses

17.6.1. General Approach to Legal Effects and Legal Characterization

Let us have a closer look at the moment of adoption of a family constitution and its effect: What actually happens, and what exactly is the family doing (Fig. 17.2)?



Fig. 17.2. The Link Between the Founder's and the Family's Will, resp., and the Family Business Statutes.

The owner family draws up the values and goals for the family and the family business (Holler, 2018, p. 559). In fact, the family is setting up a new tradition and thereby a new design of the characteristics of the family business.

How does this relate to the founder's will, the founder's tradition, and the founder's design of the family business?

The family touches upon the founder's will, which is – as outlined above⁴⁶ – relevant and decisive for the determination of content and the interpretation of the family business statutes (Holler, 2018, pp. 559, 562). Ultimately, the family either amends, modifies, or even replaces the founder's will and tradition, which – until this moment – had been the DNA of the family business and had determined the content and interpretation of the family business statutes; it is to some extent an *emancipation process* of the family and the following generation(s) in relation to the founder generation (Holler, 2018, pp. 559, 562). This event illustrates that the family constitution, with its adoption, is not without legal effect in relation to the law of family business (Holler, 2018, p. 562). Therefore, it cannot be generally stated that a family constitution is legally non-binding.⁴⁷ As pointed out, this assumption represents a contradiction in relation to family business law principles.

As an interim result, it can be stated that family constitutions may have legal effects on determining the content and interpretation of the corporate statutes of

⁴⁶See above under point 10.2.3.2.

⁴⁷However in this sense, Hueck (2021, § 50 paras. 22ff.).

the family business, which – of course – in each individual case must be examined carefully. These principles apply at least to partnerships. The question of whether they are valid also for corporations cannot be answered at this point – for corporations these principles are at least valid for typical shareholder agreements such as pooling agreements or protective association agreements (*Schutzgemeinschaftsverträge*) (Holler, 2018, p. 561). If the family business is a closed shop and therefore a pure family business with the shares having been transferred only to family members since its foundation, they should also be applicable to private limited companies.⁴⁸

17.6.2. The Family Constitution Can Constitute Another Corporate Level

17.6.2.1. Partnership Under Civil Law

Furthermore, a family constitution can constitute – depending on the particular design and formulation in the individual case – a partnership under civil law among the family members.⁴⁹ As a consequence, sections 705 ff. German Civil Code are applicable for the internal relationship of the family members that are part of the family constitution.

I have outlined the typical internal corporate structure of family businesses, often divided by shareholder groups and family branches each having their own statutes and shareholder agreements. Similar and corresponding to this, different levels of civil law companies within the owner family are possible, since – in general – there will be two groups within the family: the shareholding family members and the non-shareholding family members (e.g., marriage partners or future shareholders) who directly support the coherence of the family and who indirectly support the family business.

The purpose of a family constitution will regularly be supporting the family business company purpose (*Gesellschaftszweck*)⁵⁰ required for the existence of a civil law company. Such purpose includes the common will of all members of the family to secure the success of the family business in the long run, keeping the company in the hands of the family and strengthening the coherence of the family (Holler, 2018, p. 561).

In practice, a large number of families will have followed and implemented the rules recommended by the Governance Code for Family Companies (*Governance Kodex für Familienunternehmen* (GKFU)). This includes the recommendation to agree on a fixed term for the validity of the family constitution and to allow

⁴⁸On the subjective and objective interpretation of articles of association, Holler (2020, § 75 paras. 225 et seq.); Prütting and Schirmacher (2017, 839 et seq.).

⁴⁹Holler (2016, § 75 para. 111); Holler (2018, p. 561); Holler (2020, § 75 para. 198); In this sense, Fleischer (2016, p. 1515); Prütting and Schirmacher (2017, p. 837); Reich and Bode (2018, p. 307); Kindler (2019, § 105 para. 2); for Austrian Law Kalss (2022, 46). critical of this classification Hamburger Kreis Recht der Familienunternehmen (2018, M26).

⁵⁰On the special company purpose of family businesses and its momentous legal consequences, Holler (2019b, p. 936ff.).

amendment of the family constitution by a qualified majority decision of the family.⁵¹ The recommendation of the Code is, therefore, based on the idea of a company relationship between the family members, which meets all the requirements for a partnership under civil law.⁵²

As a consequence, the family constitution must comply with the law of civil law partnership, meaning regulation and design requirements with regard to issues such as the right of termination (sec. 723 para. 1) or the death of a family member (sec. 727 para. 1), since a civil law partnership – if not otherwise agreed – ends automatically with the death of one of its members.⁵³

17.6.2.2. Shareholder Resolutions

Finally, a family constitution can include a valid shareholder resolution possessing potential regulatory content in relation to the family business (Holler, 2018, p. 561). Pursuant to general corporate principles, this is conceivable if within the family constitution all family shareholders agree upon a particular earnings retention rate in order to strengthen the internal financing of the company; also required is that such agreement is disclosed to the management of the family business, for example, where a “company version” of the family constitution is provided to management.

17.6.2.3. Impact on a Shareholder's Fiduciary Duties

Last but not least, a family constitution can have an impact on shareholders' fiduciary duties (Fleischer, 2016, p. 1518f.; Hamburger Kreis Recht der Familienunternehmen, 2018: M 27; Holler, 2018, p. 561; Holler, 2020, § 75 paras. 206 et seq., 232 et seq. and 241; Holler & Mann, 2021, p. 409; Reich & Bode, 2018, p. 307), especially if it provides include terms regarding shareholder issues of the family business, for example, the requirement that a family member be a member of the board of directors. In such a case there might even arise an approval obligation depending on the design and substance of the family constitution.

17.7. Conclusions

1. Family constitutions are generally deemed to be without any legal effect and not legally binding. From a legal point of view, this assumption is at least highly questionable.
2. The founder's will and his values and goals (tradition) are legally relevant and can be decisive for the content and interpretation of a family business' corporate statutes. The family's will – as unanimously incorporated and manifested

⁵¹Cf. Sec. 8.3 Governance Kodex für Familienunternehmen (GKFU); Kirchdörfer and Lorz (2011, p. 101); Hueck (2017, p. 123f.).

⁵²Holler (2018, p. 562); Holler (2020, § 75 paras. 205 and 202 et seq.); approving Fleischer (2016, p. 1515); Prütting and Schirrmacher (2017, p. 837).

⁵³Holler (2018, p. 562); Holler (2020, § 75 para. 217); in this sense, Reich and Bode (2018, p. 308f.).

in the family constitution – touches upon such “corporate DNA” of the family business if it provides for a material regulation of values and goals (tradition).⁵⁴

3. Therefore, even if otherwise stipulated, family constitutions – in the individual case – can have material legal effects on the content and interpretation of corporate statutes as well as on shareholders’ fiduciary duties. Especially where it is disclosed to the management of the family business (business version), the family constitution might also have the quality of a shareholder resolution providing for management instructions. But each potential legal effect of a family constitution must be examined carefully on a case-by-case basis.
4. The interpretation of corporate statutes is a common basis for shareholder conflicts and corporate litigation. In order to avoid family disputes on this corporate level – which can disturb or even endanger operational business and the family business itself – the material regulation of tradition (aims and goals) should rather *not* be stipulated in a family constitution, being covered instead in the traditional legal documentation for family businesses (such as corporate statutes, shareholder agreements and resolutions, inheritance and marriage contracts, etc.). By all means, a family constitution must avoid any regulation that is (potentially) contrary to the regulation set forth in the corporate statutes, including shareholder agreements, articles of association, shareholder agreements, and shareholder resolutions.
5. Since the procedure of family governance is placed center stage within the family governance discussion, a family constitution – as an acknowledged instrument of family governance – should be reduced to procedural rules only, providing for clear, well-balanced, and fair procedure regulation with regard to the decision-making processes within (i) the family as a whole, (ii) particular groups of the family (for example, family branches) and (iii) individual family members (Holler, 2018, p. 563 et seq.). Corporate statutes of family businesses should provide for regulation to harmonize corporate governance and family governance in order to avoid conflicting rules and shareholder conflict (family business clause⁵⁵).
6. A family constitution may have the effect of forming civil law companies between family members on different levels such that it will need to be carefully examined on a case-by-case basis with regard to its regulatory content as well as the potential legal effects within the family, groups or individual members of the family. The applicability of sections 705 ff. German Civil Code (BGB) lead to particular regulation requirements, for example with regard to the death (sec. 727) of a family member and termination rights (sec. 723).
7. The (potential) legal effects of a family constitution can result in severe family conflicts and family shareholder disputes. Since one of the main purposes of the family constitution is to avoid conflicts, its proper legal design is of capital importance.

⁵⁴On the corporate DNA of family businesses characterized by their special company purpose, Holler (2019b, p. 937ff.).

⁵⁵See for terminus Holler (2018, p. 563); in detail with regard to legal design and typical family governance elements in corporate statutes of family businesses Holler (2020, § 75 para. 185 et seq.); Fleischer (2019).

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