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Intergenerational Transfer of Family-Run Enterprises in Slovenia in Comparison with German Law

- **ABSTRACT:** *After the Republic of Slovenia declared its independence in 1991 and adopted a new constitution, business in the country began to increasingly develop. Now, 30 years since declaring independence and the start of business development, we are witnessing the retirement of the first generation of business owners, and it is reasonable to expect the rise of such examples in the following years. With the change in generation and retirement of the first generation of business owners, the question arises as to how to legally regulate the transition of family companies to younger generations, with the objective of keeping the company within the family circle and avoiding fragmentation of the company because of a higher number of potential heirs. This article presents information on the transfer of a family company to the next generation with sole traders, personal companies, and companies with share capital in comparison to German law.*
- **KEYWORDS:** Slovenia, family company, sole trader, personal companies, companies with share capital, inheritance.

1. Introduction

After the Republic of Slovenia declared its independence in 1991 and adopted a new constitution, business in the country began to increasingly develop. Now, 30 years since declaring independence and the start of business development, we are witnessing the retirement of the first generation of business owners, and it is reasonable to expect the rise of such examples in the following years. Many of these businesses are family companies in which other family members participate or are employed in. With the change in generation and retirement of the first generation of business owners, the question arises as to how to legally regulate the transition of family companies to younger generations, with the objective of keeping the company within the family circle and avoid

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fragmentation thereof because of a higher number of potential heirs. The transition of a family business to the next generation requires appropriate advance planning long before it is transferred to the next generation. Planning the transition of the company to the next generation is not only needed when planning retirement, but also in the event of possible unexpected death (crisis scenario).² Advance agreement regarding the transition of a family business to the next generation is especially recommended in the event of unexpected death, as otherwise, the transition would take place based on the rules of inheritance law, which could lead to fragmentation of the company and cause a step back or failure of the family business. Therefore, we need to distinguish between cases when the business owner wished to transfer the company to the younger generation during his life and those when this was done in the event of death.

With the transition of a family business to the next generation, the rules of inheritance law and corporate law are both considered. The basic rules of inheritance law in Slovenia are regulated by the Inheritance Act (*Slovenian: Zakon o dedovanju, hereinafter ZD*).³ The basic legal source for Slovenian corporate law is the Companies Act (*Slovenian Zakon o gospodarskih družbah, hereinafter ZGD-1*).⁴ It defines the basic rules of incorporation and operation of companies, sole traders, affiliated entities, commercial associations, and foreign subsidiaries, as well as changes to their status.⁵ When composing ZGD-1, the Slovenian legislator referred to German corporate legislation as a framework.⁶

Slovenian legislation companies are divided into companies with shared capital (Slovenian. *kapitalske družbe*) and personal companies (Slovenian. *osebne družbe*). According to ZGD-1, limited companies can be a public limited company (PLC; Sln. *delniška družba, d.d.*), European public limited company (Societas Europea; Sln. *evropska delniška družba*), limited partnerships with share capital (Sln. *komanditna delniška družba, k.d.d.*), and a limited liability company (LLC; Sln. *družba z omejeno odgovornostjo, d.o.o.*) Unlimited companies are unlimited liability companies (Sln. *družba z neomejeno odgovornostjo, d.n.o.*) and limited partnerships (Sln. *komanditna družba k.d.*)⁷ Possible solutions for the transition of family businesses to younger generations depend on the legal form of the company, as the corporate rules of transition differ depending on the legal form in which the company is organised. This article addresses the transition of the company business to the next generation with sole traders, personal companies, and companies with share capital.

2 Lorz, Kirchdörfer, 2011, p. 5.

3 Uradni list Socialistične Republike Slovenija (Official Journal of the Socialist Republic of Slovenia), no. 15/76, 23/78, Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 13/94, 40/94, 117/00, 67/01, 83/01, 73/04, 31/13, 63/16.

4 Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 65/09, 33/11, 91/11, 32/12, 57/12, 44/13, 82/13, 55/15, 15/17, 22/19.

5 Art. 1 of the ZGD-1.

6 Ivanjko, Kocbek, Prelič, 2009, p. 869.

7 Para. 3 Art. 3 of the ZGD-1.

2. Intergenerational transfer of family-run enterprises in the case of sole traders

A sole trader is a natural person who performs profitable activities independently on the market within an organised business.⁸ The basic features of sole traders' businesses are the same as those of companies. Sole traders perform activities on the market for their own benefits and risks to make a profit. Compared to companies, they do not have the status of a legal entity and neither does their business. Thus, they participate in legal transactions as natural persons who are liable for their business with all their assets including personal assets.⁹ A sole trader business does not require start-up capital.¹⁰ Only a physical person can be a sole trader and act as a physical person in a legal transaction. A sole trader can only be an individual and not multiple individuals, and multiple individuals can act together only in the form of a company. Slovenian sole traders can be compared with merchants in German law (German: Kaufmann; § 1 HGB).¹¹

Slovenian ZGD-1 has a special provision that enables a sole trader to transfer the company to another person during his/her life. Based on Para. 1 Art. 72.a of the ZGD-1, a sole trader during his life can transfer his/her business to another natural person (hereinafter: transferee sole trader), meaning that the sole trader can transfer the business to another family member as a successor of the family company.¹² The transfer of such business can be done only to a physical person, as Slovenian company law does not allow more individuals to have sole trader status. For the transfer of the company business, this means that the sole trader needs to choose one family member he wishes to pass the family business to. Upon the transfer, the sole trader's business and all rights and obligations associated with that business are transferred to the transferee sole trader. The transferee sole trader will enter into all legal relations of the sole traders' business as a universal legal successor (Para. 1 Art. 72.a of the ZGD-1).

If a sole trader does not decide to transfer its business during his/her lifetime, the transfer in the event of death is considered. In this event, the rules of inheritance laws need to be considered, together with the rules of corporate law under ZGD-1. Slovenian inheritance law recognises two legal bases for inheritance, namely legal succession and succession according to will. In the event of a sole trader's death and

8 Para. 6 Art. 3 of the ZGD-1.

9 Zabel, 2014a, p. 497.

10 Ivanjko, Kocbek, Prelič, 2009, p. 324.

11 Zabel, 2014a, p. 499.

12 It is interesting that until the acceptance of amendment of ZGD-II in 2015 (Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 55/15), ZGD-1 allowed the transfer of the sole trader's business based on the first paragraph of Article 72.a only to the sole traders' spouse; unmarried partner with a duly attested long-term relationship, which has the same consequences as a marriage according to the law regulating marriage and family relations; or to a person living in a registered partnership with the sole trader, his children, adopted children, parents, adoptive parents, grandchildren, brothers, and sisters.

transfer of his/her family business to the heirs based on legal succession or on the sole trader's will, we must distinguish between situations in which there is only one heir or when there are more heirs.

If one heir inherits the sole trader's business, there is no collision with the provision of corporate law. ZGD-1 enables the sole trader to determine that in the case of his/her death, the heir who continues the business of the deceased may continue to use the deceased's full name in the business name of their business (first paragraph of 72. Article ZGD-1). The heir of the sole trader shall enter into all legal relations in connection with the transferred business as a universal legal successor at the moment of the death of the deceased/sole trader.¹³ German law has the same provision and determines that the heir who becomes the legal successor and owner of the business at the time of the death of the sole trader, can continue to use the business of the deceased (first paragraph § 22 HGB).¹⁴ If the heir does not fulfil the legally specified conditions needed for the business of the deceased (e.g. he does not have a license), the heir cannot conduct this business.¹⁵

When the person chosen to continue the family business is determined through will, the question arises whether the deceased can determine a condition in which the heir needs to continue carrying out the sole trader's business. In this case, a collision occurs between the constitutional right to inheritance (Art. 33 and Para. 2 Art. 67 of Constitution RS) and the constitutional right to Free Enterprise (Art. 74 of the Constitution), which determines that no one can be forced to carry out an enterprise. Considering these two rights, the literature on inheritance law provides an advantage to the right to inheritance and considers that the appointment of the heir under such conditions is valid. The argument presented in the inheritance law literature is that the freedom of inheritance is a specific form of private anatomy in civil law, which grants an individual the right to form its property regime in the event of his/her death as well. Therefore, this is an expression of the right to free enterprise with a sole trader that should be in force following his/her death.¹⁶ The literature on corporate law, however, believes that the right to free enterprise has an advantage over the right to inheritance, and therefore claims that the condition given in the will opposes the constitution right of free enterprise and thus, threatens this condition as not existing in the will (Para. 3 Art. 82 ZD).¹⁷ A similar view is presented in the German literature, which determines that the long-term limitation of free enterprise, determined by the deceased in his will, is not admissible.¹⁸

When rules of inheritance law determine that the business of the sole trader should be inherited by multiple heirs, this presents a problem, as based on corporate law, multiple individuals cannot jointly have the status of the sole trader. If the

13 Zupančič, Žnidaršič Skubic, 2009, p. 346.

14 Lorz, Kirchdörfer, 2011, p. 111.

15 Zupančič, Žnidaršič Skubic, 2009, p. 347.

16 Zupančič, Žnidaršič Skubic, 2009, p. 347.

17 Zabel, 2014b, p. 507, 508.

18 Otte, 2002, cited in Zupančič, Žnidaršič Skubic, 2009, p. 347.

deceased did not determine the transferee of his business, and if the heirs did not reach agreement on the continuance of the business, the rules of inheritance law and corporate law do not prevent the fragmentation of the business. In this event, a community of heirs is formed between coheirs at the moment of the death of the deceased, which lasts until the division of the inheritance.¹⁹ All heirs together are holders of the rights and obligations of the inheritance, meaning that all heirs together are holders of the rights and obligations of the inherited company.²⁰ Slovenian ZD has shaped the so-called union of heirs based on German regulation (*Gesamthandsgemeinschaft*, § 2032 and next BGB). Based on the prevailing belief of German theory and court practice, the union of heirs can be the holder of an inherited company; however, such rights can only be inherited and cannot be obtained based on a legal transaction between the living. The argument in favour of this position that the union of heirs can be the holder of an inherited company is that the company cannot exist without a holder.²¹ However, both the Slovenian and German literature believe that the union of heirs is not appropriate for the governance of the company.²² The Slovenian literature holds the position that the union of heirs can exist for a limited period—a maximum of three months—following the finality of the procedural decision on inheritance (applicable use of third paragraph of 75 Article ZGD-1). However, the prevailing contention in the German literature is that the union of heirs can manage inherited companies for an unlimited period, although it recommends that coheirs should reshape the union of heirs so that they would enter into the agreement and form a company.²³ Based on the prevailing opinion of the German literature, the union of heirs is not an *ipso facto* restructured in a personal company.²⁴ The same view prevails in the Slovenian literature, namely that the union of heirs is not an *ipso facto* restructured into the company.²⁵

Note, however, that the Slovenian corporate law rules know a special institute of representative for the event of death (Para. 8 Art. 72 ZGD-1). Sole traders can appoint representatives for the event of death, and such representatives are authorised to carry out all legal transactions within the scope of the sole trader's regular operations as of the moment of the sole trader's death. In so doing, the sole trader assures that his/her company shall not remain without governance and representation following his/her death.²⁶ Such authorisation may be revoked at any time by the sole trader's heir or heirs.

19 Decision of the Higher Court in Ljubljana, no. II Cp 1497/2016, 22 August 2016.

20 Para. 1 Art. 145. člena ZD; Zupančič, Žnidaršič Skubic, 2009, p. 348.

21 Schmidt, 1985, p. 2785, 2786.

22 Zupančič, Žnidaršič Skubic, 2009, p. 349; Ebenroth, 1992, p. 563.

23 Lorz, Kirchdörfer, 2011, p. 112.

24 Schmidt, 1985, p. 2786.

25 Zupančič, Žnidaršič Skubic, 2009, p. 353.

26 Zupančič, Žnidaršič Skubic, 2009, p. 350.

3. Intergenerational transfer of family-run enterprises in personal companies

Personal companies are those in which several people come together for ongoing gain in the form of a joint company, and mutual trust and cooperation between them is essential.²⁷ Under Slovenian law, personal companies include unlimited liability companies and limited partnerships.²⁸ For limited partnerships, the provisions of ZGD-1 that apply to unlimited companies shall apply *mutatis mutandis*, unless the law determines otherwise (Para. 2 Art. 135 ZGD-1). From the ZGD-1G novel, Slovenian corporate law no longer regulates silent partnerships (ger. stille Gesellschaft).²⁹

Even though the Slovenian regulation of personal companies follows the German ones, multiple differences exist between both. For example, Slovenian unlimited companies differ from similar German ones (offene Handelsgesellschaft, OHG) in that a legal person, and therefore its shareholders, are responsible for solidarity for the obligation of the company. The company is the primary bearer of liability, in which it is liable for its debts with all its assets. If it fails to meet its obligations, its partners carry a subsidiary liability for the debts.³⁰ The same applies for a Slovenian limited partnership, which in the German legal system corresponds to Kommanditgesellschaft (KG).

As personal companies have the status of a legal entity in Slovenian law, shareholders have company shares in such companies. ZGD-1 considers that the company members are tightly connected in this type of personal company; therefore, ZGD-1 determines for such a personal company that a company member may not dispose of their company share without the consent of the other company members (Art. 97 ZGD-1). The same applies for general partners in limited partnerships, which are liable for the obligations of the limited partnership with all their assets (135. člen ZGD-1). A company member who wishes to retire and during his lifetime, transfers his share in a personal company to his successor, must obtain consent from other company members.

In contrast to German law, Slovenian corporate law determines as a rule that personal companies end with the death of their company members.³¹ Unlimited companies are dissolved with the death of a company member, unless otherwise provided in the Articles of Associations (Para 4 Art. 104 of the ZGD-1). The same applies to limited partnerships in the event of the death of a general partner. However, a limited partnership shall not be dissolved as a result of the death of a limited partner (Art. 151 ZGD-1). Therefore, the death of a company member in a personal company means that the company is dissolved, unless the company members agree otherwise in the partnership contract. The reasoning behind such a regulatory framework is the personal nature

27 Pretnar, 1990, p. 12.

28 Line 1 Para. 3 Art. 3 of the ZGD-1.

29 Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia), no. 57/12.

30 If the company fails to fulfil the creditor's written request to pay his debts, all partners are jointly liable for the debts; para. 1 Art. 100 of the ZGD-1.

31 Brox, Walker, 2010, str. 435.

of personal companies. Compared with companies limited by shares, it is typical for company members in personal companies to be more personally connected, and a higher level of trust exists between company members. Although the deceased has the intention that his/her heirs enter into his/her position in the company, the personal nature and connection between the family members of personal companies means their interest is that this does not happen. This means there is a conflict between corporate and inheritance law, as the rules of corporate law determine that the company share generally does not pass to the heir or heirs of the deceased, while the rule of inheritance law establishes such a transition.³²

If the company members specify in the articles of association that following the death of one of its members, the company shall continue to exist with the remaining company members, this agreement is called a continuation clause, reasonably the same as Fortsetzungsklausel in the German literature. However, such an agreement between company members leads to a collision between inheritance and corporate law. This means that the deceased has a company member managing and transacting with the property he will have following his death. Contrary to German law (§§ 1941, 2347 and following BGB), such transactions are not valid according to Slovenian law, in which succession agreements are not valid (Art. 103 ZD). The Slovenian literature resolves the stated collision between inheritance and corporate law in favour of the continued existence of unlimited partnerships, with the explanation that the regulation under the corporate law is *lex specialis* in relation to inheritance law. Therefore, in this case, the inheritance law prohibition of contractual transactions of company share does not apply.³³ The consequence of the other family members continuing with the company is that the settlement of assets is carried out with the heir or heirs of the deceased (112. Article ZGD-1). The heirs are entitled to receive payment in the amount equal to the amount the company member would receive with the settlements if the company would be dissolved at the time of his/her death.³⁴

Company members of a personal company can prevent the dissolution of the company due to the deaths of a company member if this is agreed upon in the Articles of Association (Line 4 Para 1. Art. 105 ZGD-1). When considering various legal positions that may occur in such events, the same clauses regarding the continuance of the company with heirs shaped in German theory and practice are to be considered in Slovenian regulation.³⁵

The continuance clause (ger. Nachfolgeklausel) is a provision in the Articles of Association, which determines that in the event of the death of the deceased, his/her heirs automatically enter the position of the deceased in the company.³⁶ The German literature delineates between simple and qualified clauses depending on whether the

32 Zupančič, Žnidaršič Skubic, 2009, p. 362.

33 Zupančič, Žnidaršič Skubic, 2009, p. 364.

34 Zupančič, Žnidaršič Skubic, 2009, p. 366.

35 Zupančič, Žnidaršič Skubic, 2009, p. 377.

36 Brox, Walker, p. 440.

company is to continue with all heirs, one heir, or some heirs. The company continues with all heirs based on the simple clause of succession. If only one heir inherits after the death of a company member, the company share passes onto the heir, and the heir enters the position of the deceased company member.³⁷ If multiple heirs inherit the company share of the deceased, a conflict arises between the rules of inheritance and corporate law. The majority opinion in this example is that the union of heirs cannot be a company member in an unlimited company, as this would oppose the core principle of the personal work connection of company members in personal companies. Therefore, succession clauses mean that every coheir becomes indirectly and automatically heir in the company share of the deceased, which equals the size of his inherited share.³⁸ With qualified clauses about succession, company members determine that the share of the deceased does not pass to all, but only to one or a few heirs. The intention of this clause is to prevent fragmentation of the company share of the deceased. The heir to whom the clause applies enters directly and automatically in the legal position of the deceased within the company. If the heir gains more than his heritage share, he is required to pay the difference to an equal value of the share to his coheirs.³⁹

The entrance clause (Eintrittsklausel) is an agreement between the company members based on which, following the death of the company member, his/her heir or appointed third person obtains the right to enter the company. The position of the deceased in the company does not automatically pass to his/her heir or appointed third person, as in the event of the succession clause. The successor does not become heir based on inheritance, but on the basis of new membership according to the legal transaction between the living. With the entrance clause, company members agree to enter into an agreement with the heir or appointed person of the deceased company member. This type of heir obtained a claim towards other company members to enter into the agreement with him/her regarding his/her entrance into the company; however, such heirs are not obligated to enter into such an agreement.⁴⁰ The difference between the clause of entrance and of succession is that the clause of entrance means that the person entering the company can also be a person who is not the heir of the deceased family member.⁴¹

4. Intergenerational transfer of family-run enterprises in companies limited by shares

According to ZGD-1, companies limited by shares can be a public limited company (PLC; Sln. *delniška družba*, d.d.), European public limited company (Societas Europea; Sln. *evropska delniška družba*), limited partnerships with share capital (Sln. *komanditna*

37 Zupančič, Žnidaršič Skubic, 2009, p. 373.

38 Ebenroth, 1992, p. 577; Zupančič, Žnidaršič Skubic, 2009, p. 377.

39 Lorz, Kirchdörfer, 2011, p. 122.

40 Lorz, Kirchdörfer, 2011, p. 129.

41 Ebenroth, 1992, p. 591.

delniška družba, k.d.d.), and a limited liability company (LLC; Sln. *družba z omejeno odgovornostjo*, d.o.o.) All companies limited by shares are legal persons (Art. 4 of ZGD-1).

Participation in companies limited by shares is generally transferable in all societies between the living and in the event of death. As in Slovenia, family companies are in most cases, organised in the form of limited liability companies. I will address the transition of the company share of limited liability companies in the continuance of this article.

Slovenian corporate law enables the transfer of company shares in limited liability companies among the living and in the event of death (Para. 1 Art. 481 of the ZGD-1). However, it considers that the company members decide to cooperate in such a form of the company based on mutual trust among specific company members. This is why ZGD-1 addresses the transfer of the company share in the special provision and protects the interests of company members and the company itself, as it protects company members from the entrance of other persons into the company.⁴²

With the transfer of the company share in limited liability companies among the living, note that ZGD-1 determines that the existing company member has priority over other persons regarding the purchase of a business share, unless articles of association exclude such rights in the Articles of Association (Para 4 Art. 481 of the ZGD-1). If company members want to transfer their company share to a successor with the Purchase Agreement and there are other company members within the company, they need to consider the pre-emption rights of other company members. The drastic limitation of legal transactions of the business share among the living is included in Para. 7 Art. 481 of the ZGD-1. Based on this, the Articles of Association may determine that the disposal of the company share to persons other than the company members shall require the consent of the majority or all company members and determine the conditions for the issue of such consent. If such limitations are included in the Articles of Association, the company member in the family company, where other members have company shares as well, must obtain consent from other family members for the disposal of his/her company share to the successor.

An applicable view in the event of disposal of the company share in the event of death is that the Articles of Association can neither prohibit nor exclude the inheritance of the company share. The German literature has the predominant view that the inheritance of the company share cannot be excluded with the Articles of Association in a manner that the death of a company member would cause automatic withdrawal of the business share.⁴³ Determining the position of the heirs in the queue is not possible, and neither is excluding a person from inheritance. However, the article of association can determine the further destiny of inheritance share, for example, that the heir is required to transfer the inheritance share to the company or specific company member of another person. The transfer can be done only with the consent of the acquirer;

42 Zabel, 2014c, p. 850.

43 Ebenroth, 1992, p. 600.

otherwise, agreement on the burden of the third party would be prohibited.⁴⁴ The Slovenian literature accepts this solution in the German law for Slovenian law as well.⁴⁵ In the event of multiple heirs, company share is passed to the union of heirs. Similar to the German regulations, company share in such events is passed to the union of heirs. Coheirs manage and dispose of the company share in a consensual and joint way until the inheritance is divided (Para 1. Art. 145 of the ZD).

5. Conclusion

Transfer of the family company or share therein to the next generation can be done during the lifetime or in the event of death. A possible solution to the transition of the family company to the younger generation first depends on the corporate form of the family company, as the corporate rules regarding the transition of the company vary depending on its corporate structure. If the family company is passed to the next generation with the death of the previous business owner, the rules of inheritance law must be considered together with the rules of corporate law. The transition of the family company to the next generation in the event of death can be problematic if the deceased does not arrange the transition thereof or its share in his/her will prior to his/her death. In the event of multiple heirs, this would lead to fragmentation of the family business or family share, which can jeopardise the existence of the family company. Therefore, it is recommended that the company owner organise the transition of the family company to the next generation in time, either in a way that this is done during his lifetime or that the transition is addressed in his will and aligned with corporate laws rules.

⁴⁴ Ebenroth, 1992, p. 606.

⁴⁵ Zupančič, Žnidaršič Skubic, 2009, p. 386.

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