

# US-American Company Law – An Overview

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*Fremdsprachenkenntnisse gehören mittlerweile zum Pflichtkatalog der juristischen Ausbildung. Der folgende Beitrag wendet sich an Studierende, Referendare und junge Praktiker, die sich mit der englischen Rechtssprache im Bereich des Unternehmens- bzw. Gesellschaftsrechts vertraut machen wollen. Wichtige Vokabeln sind daher in den Fußnoten erläutert. Zugleich vermittelt der Beitrag einen ersten Überblick über die in den USA verbreiteten Rechtsformen. Dabei wird deutlich, dass – wie auch im deutschen Gesellschaftsrecht – zwischen Personen- und Kapitalgesellschaften differenziert wird und für die Auswahl der Rechtsform vor allem haftungsrechtliche und steuerliche Aspekte maßgebend sind.*

## A. Introduction

Company law comprises the creation, organization, and regulation of business associations. In the US, this area of law is commonly known as “corporate law”. However, as shown below, a corporation is merely one legal form among others. The term “company law”, therefore, might be more precise.

Since the US is a federal system, most company law issues retain by the states. Consequently, “the” US-American company law does not exist, but 50 more or less different types have to be taken into account. Company law can vary substantially from state to state. Players on the market are free to choose where to settle down in business and, thus, which state’s law system will govern their affairs. The dominant state in attracting the incorporation of companies<sup>1</sup> is the small state of Delaware, which charges no tax<sup>2</sup> on activities outside the state and has courts experienced in commercial law as well as a computerized registration system. Today, more than 50% of all US companies have their legal home in Delaware (a fact that is known as “Delaware Effect”).

In the face of regulatory competition between the states, efforts have been made to establish common standards of business law. In terms of company law, several model acts<sup>3</sup> were created by the NCCUSL (National Conference of Commissioners on Uniform State Laws) and adopted by most of the states. The following text is based upon these model acts. But bear in mind that considerable distinctions between the states may remain as they are not bound to implement the uniform law literally. A few states, such as Louisiana, even decline to adopt the model acts at all.

## B. Sole Proprietorship

The most simple way of running a business is the sole proprietorship<sup>4</sup>. A large part of the US-American economy is organized that way. A sole proprietorship is a business which

has no separate legal existence from its owner. All debts<sup>5</sup> of the business are personal debts of the proprietor<sup>6</sup> since the business is just an “extension” of him/her and not a different legal entity<sup>7</sup>. Consequently, only the person who organized the business is subject to taxation and not the business as such. The sole proprietor may register a business name<sup>8</sup> that allows him to do business with a name different from his individual name.

Given the fact that a sole proprietorship only consists of one owner, this legal structure is, strictly speaking, not part of “company” law.

## C. General Partnership

A general partnership (GP) is a business organization established by at least two partners, which may be private individuals or entities such as other partnerships or corporations. Each partner is personally, jointly and severally<sup>9</sup> liable for all of the partnership’s debts and obligations. In turn, each partner is entitled to manage the business as a co-owner together with the other partners.

As a general rule, the partners share equally in profits and losses. However, the partners often agree upon other distribution procedures based on the amount of contribution<sup>10</sup> made by the respective partner. Such contribution may be provided in capital (money, property) or by means of rendering services or expertise (know-how) to the partnership.

Since the general partnership is characterized by the “spirit of cooperation” among the partners, it is dissolved<sup>11</sup> in case a partner leaves the partnership, for instance due to termination<sup>12</sup>, withdrawal<sup>13</sup> or death. For the same reason the transfer of a partner’s interest<sup>14</sup> to a third party is not permitted. The structure of membership may only change by way of admission of the new and withdrawal of the old partner.

Except for the unlimited liability of each partner, the partners are free to modify the aforementioned principles by the partnership agreement. Such agreement is not subject to any form requirements. A handshake or a nod of the head may make people partners.

## D. Limited Partnership

The limited partnership (LP) constitutes a variation of the general partnership and is, to a certain extent, comparable to

<sup>5</sup> Debts = Schulden, Verbindlichkeiten.

<sup>6</sup> Proprietor = Geschäftsinhaber, Eigentümer.

<sup>7</sup> Legal entity = Rechtsträger, Rechtssubjekt, juristische Person.

<sup>8</sup> Business name = Firmenname (Firma).

<sup>9</sup> Jointly and severally = gesamtschuldnerisch.

<sup>10</sup> Contribution = Einlage.

<sup>11</sup> To dissolve = (eine Gesellschaft) auflösen.

<sup>12</sup> Termination = Kündigung.

<sup>13</sup> Withdrawal = Austritt.

<sup>14</sup> Interest in a partnership = Beteiligung.

<sup>1</sup> Incorporation of a company = Gründung einer Gesellschaft.

<sup>2</sup> To charge tax = Eine Steuer erheben.

<sup>3</sup> Model Act = Unverbindliches Mustergesetz (vergleichbar z.B. mit dem Musterentwurf für ein Polizeigesetz in Deutschland).

<sup>4</sup> Sole proprietorship = Einzelfirma, Einzelunternehmen.

the German KG. It consists of one or more general partners plus one or more limited partners. As in a German GmbH & Co. KG the general partner may also be an LLC or a corporation which avoids the unlimited liability of a private individual. The rules relating to the general partners are basically the same as those relating to the partners of a general partnership (see above, C).

In contrast, the liability of limited partners is limited to their investment in the partnership. Limited partners do not participate in the management and are not entitled to act on behalf of the company<sup>15</sup>. Only in the event they, nevertheless, exercise control in the partnership, they face the risk of being personally liable without any limit.

Tax considerations have made limited partnerships very popular as vehicles for investments, particularly in real estate or "venture capital"<sup>16</sup> companies. Many big investment funds are organized as limited partnerships.

### E. Corporation

A corporation is a legal entity comparable to the German AG. It can easily be formed by filing the articles of incorporation<sup>17</sup> with the respective state authority, which then issues the certificate of incorporation, a document evidencing the existence of the corporation. The articles of association<sup>18</sup> usually contain provisions regarding the name of the corporation, the registered office, and the jurisdiction of incorporation, its purpose, the classes of stock<sup>19</sup> and the rights related to such classes (e.g., common stock<sup>20</sup> and preferred stock<sup>21</sup>). The business name has to include an addendum that discloses the limitation in liability, such as "Corp." (Corporation), "Inc." (Incorporated) or "Ltd." (Limited).

The stocks in a corporation are held by its stockholders. If the stocks of the corporation are traded on a stock exchange<sup>22</sup>, the corporation is a public corporation<sup>23</sup>. Otherwise, the corporation is also referenced as a closely held corporation ("close corporation"<sup>24</sup>). A stockholder can transfer its stocks to a third party based on a transfer agreement. As a principle, the consent of the remaining stockholders is not required for such transfer. However, the articles of association can provide for restrictions on the transfer of stocks such as the consent of the other stockholders.

<sup>15</sup> On behalf of the company = im Namen der Gesellschaft.

<sup>16</sup> Venture capital investments = Investitionen in Risikokapital.

<sup>17</sup> Articles of incorporation = Gründungsurkunde.

<sup>18</sup> Articles of association = Satzung, Gesellschaftsvertrag.

<sup>19</sup> Stocks = Aktien.

<sup>20</sup> Common stock = Stammaktie.

<sup>21</sup> Preferred stock = Vorzugsaktie, die bei Gewinnausschüttungen und Liquidation Vorrechte genießt, häufig aber keine Stimmrechte besitzt.

<sup>22</sup> Stock exchange = Börse.

<sup>23</sup> Public corporation = Börsennotierte Aktiengesellschaft.

<sup>24</sup> Close corporation = Nicht börsennotierte Aktiengesellschaft.

The corporation is managed and represented<sup>25</sup> by its officers such as the chief executive officer (CEO)<sup>26</sup>. The board of directors appoints the officers and monitors their management of the corporation. Both directors and officers owe a duty of care<sup>27</sup> and a duty of loyalty<sup>28</sup> to the corporation. However, business decisions of the directors and officers are protected by the business judgment rule<sup>29</sup> pursuant to which courts do not examine business decisions unless there is a conflict of interest.

As a general rule, stockholders cannot be held liable for the debts of the corporation. However, in rare circumstances the corporate veil may be pierced<sup>30</sup> and the stockholders may be held liable if they disregard that the corporation is a separate entity (e.g., by mingling<sup>31</sup> corporate and personal assets) or if they use the corporation for fraudulent<sup>32</sup> purposes.

The advantages of a corporation include the perpetual lifetime, i.e. the existence of the corporation does not depend on the life of its stockholders. Furthermore, as a principle, stockholders of a corporation do not face liability with respect to the corporation's debts. Finally, the corporation and its directors and officers are obliged to do business in the best interest of the stockholders; in particular, they are legally obliged to maximize the profit. A disadvantage of the corporation is taxation: A corporation has to pay taxes on its income and when the profits are distributed<sup>33</sup> to its stockholders, they have to pay taxes on the dividends, as well. This tax disadvantage led to the creation of the limited liability company.

### F. Limited Liability Company

The limited liability company (LLC) is a relatively new type of legal entity, which was recently established by statutory law to provide the legal market with a flexible type of legal entity. It combines both the advantage of limited liability of a corporation and the tax status of a partnership, i.e. the avoidance of double corporate income tax.

The formation procedure is very similar to such of a corporation. It requires a written LLC agreement and a certificate of formation duly filed with the respective state authorities. However, in contrast to the corporation, an LLC can only have a limited term. Furthermore, a member of an LLC may transfer its interest in an LLC to a third party without the prior consent of the other members but may not transfer its voting rights<sup>34</sup> without their consent. As in a general partnership, the management of an LLC consists of its members who represent the company vis-à-vis third parties.

<sup>25</sup> To represent = vertreten.

<sup>26</sup> Chief executive officer = Vorstandsvorsitzender.

<sup>27</sup> Duty of care = Sorgfaltspflicht.

<sup>28</sup> Duty of loyalty = Treuepflicht.

<sup>29</sup> Business judgement rule = Grundsatz vom Managementermessen.

<sup>30</sup> Piercing (lifting) the corporate veil = Durchgriffshaftung.

<sup>31</sup> To mingle = vermischen.

<sup>32</sup> Fraudulent = arglistig, betrügerisch.

<sup>33</sup> To distribute = ausschütten.

<sup>34</sup> Voting rights = Stimmrechte.

### G. Limited Liability Partnership

A limited liability partnership (LLP) is a general partnership in which the partners enjoy certain types of liability protection. The scope of such liability protection varies from state to state. The model act provides for a limited liability comparable to a corporation. Many states, however, limit the partners' liability protection to professional negligence or malpractice<sup>35</sup> committed by the other partners. In this case, each partner is solely responsible for his or her own professional acting. The LLP, therefore, is a popular legal form for professionals such as lawyers or tax advisors. Many big law firms are organized that way.

In contrast to the LLC, the LLP may have an unlimited term and a change of membership requires the consent of the other partners (by way of admission of the new and withdrawal of the old partner). As to formation and structure, please refer to C above.

### H. Conclusion

The aforementioned provided you with a brief overview of the most popular legal forms for business organizations in the US. Similar to German law, the US company law distinguishes between two fundamental types of legal organizations: partnerships and corporations. However, in order to comply with the needs of market, further "hybrid" legal forms were introduced by US case and statutory law<sup>36</sup>.

At the end of the day, choosing the appropriate legal form highly depends on liability risks and tax driven considerations, in both the US and Germany.

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<sup>35</sup> Malpractice = Fehlverhalten, Kunstfehler.

<sup>36</sup> Case law = Fallrecht; statutory law = kodifiziertes Recht.