Memo to clients

First

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New location from 1 October 2014

As of 1 October 2014, First Advisory Group will be moving to new premises, bringing all Group companies and employees in Vaduz under one roof.

Please note that with effect of 1 October 2014 our new address will be: Wuhrstrasse 6, 9490 Vaduz.
The telephone number +423 236 30 00 and all other contact details remain unchanged.

Founder's rights of control – options and limitations

Rights of control represent a major area of difficulty in the law on foundations. While Austrian law, for example, does not generally countenance the exercise of control by the founder or beneficiary, Liechtenstein law provides some room for manoeuvre. Although this flexibility is generally in line with the founder's wishes (especially if the founder is also the intended beneficiary), in many cases it leads to conflicts between the personal interests of the beneficiary, the implementation and interests of the foundation and the foundation's purpose. This is illustrated by the case below, which concerns a distribution of the entire foundation's assets.

The foundation as "an ownerless structure for special-purpose assets"

Foundations are often described as ownerless structures for special-purpose assets, which become a separate entity from the person of the founder in order to solely further the purpose defined by the founder. Despite the greater scope afforded by Liechtenstein foundation law, it is still consistent with the basic concept that *the founder may only continue to exert control* over these ownerless special-purpose assets *post-formation subject to certain restrictions*. Certain restrictions were introduced when the law on foundations was overhauled in 2008. These and other issues are discussed below.

Founder's rights by operation of law

The most far-reaching right accruing to the founder is unquestionably the *right of revocation* set out in Article 552 § 30(1) of the Liechtenstein Persons and Companies Act *(Personen- und Gesellschaftsrecht – PGR)*. This is because the revocation of the foundation constitutes one of the grounds for dissolution and ultimately results in termination of foundations that have

been lawfully established (cf. Article. 552 § 39 et seq. PGR). If the foundation deed contains such a revocation clause and the founder has designated himself or herself as the ultimate beneficiary (Article 552 § 8[3] PGR creates such a presumption in case of doubt), this also means that the beneficiaries are deprived of their right to information and disclosure within the intendment of Article 552 § 9 PGR and that such rights are conferred solely on the founder. The far-reaching effects of exercising such a right of revocation are a major reason why the founder should not have such a right unless this is expressly reserved in the foundation deed. In addition, the founder can only reserve the right to revoke the foundation himself or herself, but cannot confer such a right upon the foundation management, for example.
Alongside the right of revocation, it is also possible for founders of Liechtenstein foundations to ensure that they can control the foundation on an ongoing basis by reserving the *right to amend the foundation documents* (cf. also Article 552 § 30[1] PGR).

Article 552 § 30(1) sentence 2 PGR provides that the aforementioned rights of control may not be assigned or inherited. As already mentioned, such rights may only be conferred on the founder himself or herself, but not on third parties (for example the foundation council, although the foundation council may be given the right to amend the foundation purpose and other matters in accordance with Article 552 § 31 and § 32 PGR). The new foundation law therefore clearly defines the rights of the founder as *strictly personal*.

Note: exercise of founder's rights upon formation of a foundation in a fiduciary capacity

The founder's rights are deemed to be strictly personal to the founder is also linked to one of the key concerns of the reform of foundation law, which was to establish a legal basis for *foundations set up in a fiduciary capacity*, previously not covered by the law, and, accordingly, for the rights of the economic founder. The old foundation law made a distinction between legal and economic founders in relation to foundations established in a fiduciary capacity. The legal founder was generally a licensed fiduciary company, which appointed the members of the foundation council and usually had close ties with them. The economic founder was the client of the fiduciary agent, who instructed the agent to establish and administer the foundation. Over many years, the case law of the Liechtenstein Supreme Court took the view that the founder of a fiduciary foundation was the legal founder (i.e. the fiduciary agent) rather than the economic founder (the client instructing the fiduciary agent). This meant that any rights accruing to the founder (right of amendment, right of revocation, etc.) were solely conferred on the fiduciary agent, provided that such rights were reserved in the Articles of Association. According to the case law, it was immaterial for the purposes of establishing the foundation and the validity thereof whether it was the legal or economic founder who was responsible for making the endowment or transferring assets to the foundation.
None of this apparently poses a problem provided that the fiduciary founder and economic founder are in complete agreement. However, in the event of a dispute, this would result de facto in the disempowerment of the economic (and actual) founder. The reform of the law on foundations was intended to alleviate this problem.

This objective has subsequently been realised with Article 552 § 4(3) PGR: it now provides that if the foundation is formed by an indirect representative, the settlor (principal, authorising party) is always deemed to be the founder, which represents a significant departure from the previous legal position. This means that the legal and economic founders are identical, with the principle restated as follows: if the foundation is formed by an indirect representative, the *principal (authorising party)* is deemed to be the founder, who is therefore also entitled to *exercise the founder's rights* (such as the right to amend the foundation documents or revoke the foundation).

In this context, it should be noted, in particular, that the Liechtenstein Supreme Court is applying the new provisions of Article 552 § 4 PGR to foundations established under the old law – even though the transitional provisions of the Act provide otherwise (Article 1[4] sentence 1 PGR).

Extended founder's rights

However, we now return to the founder's rights, which are not confined to the right of revocation and right of amendment referred to above. The rights of control that may be exercised by the founder, i.e. the right of revocation and right of amendment laid down in Article 552 § 30 PGR, are not meant to be exhaustive. On the contrary, in practice there are a number of non-standard rights that can be secured by the founder, such as the right to issue instructions and/or powers of veto in relation to the foundation bodies.

As a general rule, neither the founder nor the beneficiary has any right to participate in, let alone veto, any management decisions made by the foundation council. However, the founder and/or beneficiary have the option to become direct members of the foundation council and thus attain a level of control. It follows a fortiori that if the founder and/or beneficiary are permitted to *sit on the foundation council*, it must also be possible for them to *reserve the right to issue instructions and/or exercise powers of veto* in relation to the foundation council.

The founder may also acquire the *status of a private controlling or governing body* or protector, which would give him or her limited authority over the foundation council.
Lastly, it should be added that even where the foundation documents give the beneficiary the right to exercise a right of revocation by issuing instructions to the foundation council, this only allows the beneficiary to exert *limited control*, for example in relation to distributions. If the foundation documents do not stipulate that the beneficiaries are legally entitled to (certain) benefits, for instance, then the beneficiaries will not have any beneficial interest, even if they have a right to issue instructions to the foundation council. As a result, they would not have any enforceable claim against the foundation.

This aspect will be discussed in more detail below. But firstly, we should briefly consider founder's rights in connection with a vehicle that is also widely used in practice: the mandate agreement *(Mandatsvertrag)*.

It is important to distinguish the limited legal powers of control in relation to foundations from rights that stem merely from a *legal obligation* between the economic founder and the foundation council. Rights to issue instructions and/or revoke the foundation may be secured under a mandate agreement, while the right to alter legal relationships or rights of intervention may be secured under the Articles of Association. However, the *interaction* between the provisions and obligations set out in the Articles of Association and the legal obligations of the foundation council under a mandate agreement can *potentially give rise to tension and conflict*. The foundation council is therefore only required to comply with instructions issued by the economic founder in respect of its legal obligations insofar as it is able to do so within the scope of the discretionary powers conferred on it under the Articles of Association, having due regard to the *purpose of the foundation*. Otherwise, the foundation council might well find itself liable to the foundation without being able to rely on the defence that a mandate agreement is in effect or the fact that it was complying with the founder's instructions.

Distribution of the entire foundation's assets?

Finally, it is necessary to consider another specific issue, which invariably coincides with rights of control on the part of the founder and/or beneficiary: the distribution of the entire foundation's assets. In 2010, the Liechtenstein Supreme Court held that there could be *no entitlement to distribution of the entire foundation's assets unless the right of revocation had been reserved* (Supreme Court, 5 March 2010, 6 CG.2005.232). The facts on which this decision was based are as follows:
The plaintiff invested in a number of unregistered family foundations which had been established on a fiduciary basis. The fiduciary founder and the initial members of the foundation council promised the plaintiff that he could dispose of the assets of the foundations and also dissolve the foundations at any time. However, these (verbal) promises and the resulting expectations of the plaintiff did not have any basis in the Articles of Association and by-laws of the foundations against which the claim had been brought. The plaintiff had a sole beneficial interest in respect of the first defendant foundation, and a joint beneficial interest with his wife in respect of the second defendant. In both cases, the plaintiff had an "unconditional, lifetime beneficial interest in the assets and any income generated thereon".

In accordance with the Articles of Association and by-laws, the foundation council was entitled, at its discretion, to determine the timing, size and recipients of any distributions. The foundations refused to make distributions to the plaintiff. The plaintiff claimed that both foundations were obliged to distribute the entire (remaining) foundation's assets. The plaintiff's request for payment relied on the following facts and legal arguments:

The plaintiff accused the members of the foundation councils of making several unauthorised withdrawals from the assets; he claimed that they had acted contrary to the purpose of the foundation and abused their powers with regard to the assets entrusted to them, and in so doing had caused substantial loss. The plaintiff argued that he was the primary beneficiary of both foundations. The members of the foundation councils in this case were concerned with beneficial interests in relation to foundations under Liechtenstein law, in whom rights in respect of the distribution of beneficial interests were clearly vested. In view of this, the plaintiff argued that the members were obliged, pursuant to the law, the Articles of Association and the by-laws, to pay out any freely disposable income and the assets of the foundations unconditionally to the plaintiff. He submitted that on no account were the distributions and beneficial interests to be determined at the foundation council's sole discretion. Neither did the foundation council have discretionary power to determine whether and to what extent it would pay out distributions to the primary beneficiary (the plaintiff).

The defendant foundations requested that the action be dismissed, arguing that the plaintiff was merely a discretionary beneficiary under the Articles of Association and did not have any enforceable claim to payment of the entire foundation's assets or any income thereon. The requested transfer of all the assets would result in the dissolution of the foundations, which the plaintiff had no right to initiate given that the Articles of Association did not permit him to exercise any right of revocation. Moreover, the plaintiff's request conflicted with the rights of creditors and prospective beneficiaries and with the fact that only the foundations were actively authorised to pursue claims

against the members of the foundation councils.
The Liechtenstein Supreme Court held that the plaintiff was merely a "Begünstigungsempfänger" (recipient of benefits) and had no legal entitlement to any distribution from the assets of either of the defendant foundations. The Court also disallowed the claim for distribution of the entire (remaining) foundation's assets, which, by implication, would give rise to the dissolution of the defendant foundations, on the grounds that the Articles of Association did not confer any right of revocation on the plaintiff.

In a later decision, the Liechtenstein Supreme Court also held that a discretionary beneficiary who had not been granted any right to issue instructions to the foundation council under a mandate agreement was not entitled to request the dissolution of the foundation (or its de facto dissolution as a consequence of distributing the entire assets contrary to the purpose of the foundation). There was no such entitlement even if the foundation council had a right of dissolution under the Articles of Association, but failed to exercise this right, as this would circumvent the right of the foundation council to dissolve the foundation (Supreme Court,10 June 2011, 01 CG.2008.210).

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