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Foundation beneficiaries in arbitration proceedings

Advantages and disadvantages of arbitration in the context of foundations

The statutes of Liechtenstein foundations often provide that disputes must be settled by arbitration. One significant advantage of resolving a dispute through arbitration is that hearings are generally held in camera. In the event of a dispute with a foundation regarding the amount of a distribution, it is not usually desirable for beneficiaries to have any interests which they may have to be disclosed to third parties. In contrast, in-camera hearings in national courts are only permitted, if at all, in exceptional circumstances. The reasons for conducting hearings in camera are not generally suited to addressing the beneficiaries' wish for confidentiality, as these are designed to protect individual privacy rather than the financial interests of the parties. Arbitration proceedings are better suited to addressing this wish for secrecy, because as well as being conducted in camera, the rules of most arbitration institutions require both the parties and the arbitrators to treat all information disclosed to them in connection with the proceedings as confidential. Moreover, the Rules of Arbitration of Liechtenstein provide that certain documents may be disclosed to a third party, who will report on the contents to a limited extent and on an anonymous basis, but that these documents must be kept confidential and not disclosed to the other party or the arbitrators during arbitration. Another advantage of arbitration over proceedings in national courts is that it is not generally confined to a specific territory. For example, the arbitrators could potentially take evidence from a witness in that person's place of residence, which could be beneficial in the case of older people with restricted mobility. In contrast to the process of obtaining evidence through mutual legal assistance, this also allows the arbitrator to gain a first-hand impression of the witness.

However, there are potential problems in that arbitration is basically used as a mechanism for settling commercial disputes, with the parties deemed to be substantially at arm's length, which is not always the case with foundations. However, the beneficiary of a foundation does not fit the typical consumer model either, which means that consumer proceedings only have limited relevance to arbitration. However, the overall flexibility of arbitration means that specific arbitration rules can be used to close any gaps, although this may give rise to conflicts with mandatory provisions of national law.

Extent to which arbitration agreements bind beneficiaries

a) *In general*
Assessing whether an arbitration agreement has binding effect, or more precisely, whether a beneficiary is actually bound to comply with an arbitration clause in the statutes, is far from straightforward. Article 598 of the Liechtenstein Code of Civil Procedure (Zivilprozessordnung – ZPO) essentially provides that arbitration clauses must be in writing. This would also require the beneficiary to acknowledge the clause in writing. In order to avoid potential problems, paragraph 2 provides that it is sufficient for arbitration to be stipulated under a testamentary disposition, under other legal transactions that are not based on agreements between the parties or under the statutes. This means that arbitration clauses will be binding upon beneficiaries by operation of law even if the beneficiary has not approved such a clause in writing.

b) *In an international context*
Liechtenstein foundations usually have strong links to other countries, given that many beneficiaries of such foundations are not resident in Liechtenstein. This poses the question of which law would be used to determine whether an arbitration clause applied to individuals. In addition to the fact that the beneficiaries reside outside Liechtenstein, a link with a country other than Liechtenstein may be established where a beneficiary brings an action against the foundation or another beneficiary before a foreign court notwithstanding the existence of an arbitration clause. In these circumstances, the question would then arise as to whether the foreign court would be obliged to dismiss the action on the grounds that an arbitration clause applied. In 2011, Liechtenstein acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention" or "NYC") of 1958. Since then, it has been possible to recognise and enforce arbitral awards across national borders. The issue of whether an existing arbitration clause would preclude a foreign court from determining a dispute between a foundation and its beneficiaries, or between beneficiaries, would be governed both by applicable national arbitration law and the NYC. For example, the NYC requires Contracting States to determine whether arbitration agreements are null and void, inoperative or incapable of being performed in addition to recognising arbitral awards (Article II [3] NYC).

c) *In enforcement situations*
Under the NYC, a valid arbitration agreement must be in effect to enable the cross-border recognition and enforcement of an arbitral award. This means that there must be a document setting out the arbitration agreement which has been signed by all the parties.

This requirement could cause serious problems when attempting to enforce a Liechtenstein arbitral award abroad in connection with an action brought by a foundation against a foreign beneficiary, as it would be rare for such a document to exist between the beneficiaries and the foundation. As indicated above, an arbitration clause in the statutes would be valid under Liechtenstein rules (but not under the NYC) as these do not require a document signed by both parties. This requirement means that if a foundation's statutes are only signed by the founder, any arbitration agreement will remain inoperative until the beneficiary has also signed the agreement.

If the arbitration tribunal is based in Liechtenstein, the requirement for the written form will be superseded by the provisions of the Liechtenstein Code of Civil Procedure, which means that an arbitral award against a beneficiary under the NYC will be enforceable even if the beneficiary has not signed the arbitration clause. The same would apply if the arbitration tribunal were based in Austria because the Austrian Code of Civil Procedure contains equivalent provisions. For arbitration tribunals based in Switzerland, Swiss private international law would apply, which merely provides that the arbitration agreement will be effective under the law chosen by the parties, the law applying to the main agreement or Swiss law. In contrast, the emphasis in Germany is on the legal relationship between the parties to the arbitration agreement, rather than on the arbitration clause itself and thus on the law governing the agreement. In many cases this will mean that the arbitration law in effect in the location in which the tribunal is based will apply. This law will then determine whether an arbitration clause will still be effective even if the formal requirements under the NYC are not met.

As indicated above, if an action is brought in a court of law rather than submitted to arbitration, despite the existence of an arbitration clause, this will result in the action being dismissed. In circumstances of this type, it will also be necessary to determine in advance whether the parties are actually bound by an arbitration clause in the statutes. In making such a determination, it will again be necessary to establish the governing law first. In the case of Germany, the law governing the main agreement would apply, which means that the statutes of the foundation, rather than the arbitration rules, will apply.

Arbitration and consumer protection: the beneficiary as a consumer

In terms of consumers, arbitration agreements are a "risky business" given the economic disparity that exists in many cases. For example, no legal aid is available for arbitration proceedings. In addition, a party may be obliged to pay the other party's costs in advance. The new Liechtenstein arbitration law therefore sets tougher standards for arbitration agreements in consumer contracts to be valid. It is important to note that this does not apply to statutes or by-laws containing arbitration clauses which were drafted prior to 1 November 2010.

Under Liechtenstein arbitration law, consumers and companies may conclude arbitration agreements in respect of disputes that have already arisen but not future disputes. Arbitration clauses are therefore only valid in relation to consumers if they are set out in a separate, signed document which may not include any other terms relating to arbitration proceedings per se. It is therefore necessary to provide specific information to consumers in writing on the differences between arbitration and litigation in a court of law.

The term "consumer" includes any person who is carrying out the transaction concerned other than as part of their business. In most cases, beneficiaries of foundations, especially family foundations, will be regarded as consumers rather than businesses. However, the law confers merchant status on foundations, which means that they are categorised as businesses. As a result, arbitration clauses in statutes would normally be ineffective as they do not meet the specific requirements applying in a consumer protection context or, to be more precise, cannot be agreed in respect of future disputes. An arbitration clause in the statutes would therefore only apply if the foundation was in dispute with a beneficiary who also qualifies as a business and could not therefore be categorised as a consumer.
If this were not the case, it would again be necessary to enter into a separate arbitration agreement which satisfied the requirements for the agreement to be effective.

However, in the process of updating arbitration procedure, the Liechtenstein legislator evidently took the view that consumer protection did not apply in relation to foundations. According to the legislator, this only applies to bilateral legal transactions between businesses and consumers, whereas foundations involve contractual relationships that fall outside the scope of consumer protection legislation. Accordingly, applying the interpretive principle of teleological reduction, this means that, notwithstanding any contrary wording, consumer protection rules will not apply to disputes between foundations and beneficiaries. However, it will probably not be necessary in future to use a roundabout, teleological approach to interpreting the law,

as the Liechtenstein legislator has specifically opted to preclude the application of consumer protection law in relation to foundations. The consultation period on amendments to the law ended on 29 August 2014.

The new Liechtenstein arbitration rules should be welcomed. In the context of foundations in particular, these provide a valuable alternative to ordinary court proceedings where there is likely to be a specific need for flexibility and discretion in contentious matters. The favourable new legal rules should be put to greater use in practice.

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