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The Business Judgment Rule in Liechtenstein with special emphasis on foundations

Introduction

During the reform of the Liechtenstein foundation law in 2009, the opportunity was taken to introduce new rules concerning the due diligence obligations of the governing bodies of legal entities. The new provision of Art. 182 (2) 2nd sentence of the Personen- und Gesellschaftsrecht (PGR, Persons and Companies Act) codifies the Business Judgment Rule («BJR»), which comes from American company law. As this new regulation has been placed in the General Chapter of the PGR, it applies not only to foundation board members of Liechtenstein foundations but quite generally to the governing bodies of legal entities, such as to members of the board of directors of corporations and establishments (Anstalt). However, the Liechtenstein Supreme Court has applied it to the trustees of Liechtenstein trusts before and after the codification of the BJR, so that a trustee of a Liechtenstein trust may invoke it, too.

Scope of application of the Business Judgment Rule

In the codification in Art. 182 (2) 2nd sentence PGR, the Liechtenstein legislator has deliberately subscribed to the BJR. The new Liechtenstein provision is oriented towards both the American model for the BJR and the German corporation law model. A member of the administration acts in accordance with the principles of diligent management and representation if such member lets himself not be guided by extraneous interests in an entrepreneurial decision and could reasonably assume to have acted on the basis of adequate information in the best interests of the legal entity (cf. Art. 182 (2) 2nd sentence PGR).

1. Entrepreneurial decision («business judgment»)

The BJR only applies in legally relevant entrepreneurial decisions. In the specific case, the foundation board member must have a power of discretion. A decision is not a «business judgment» if it is determined by the law, articles, by-laws, or regulations that a decision must or must not be taken in a certain way. For example, the decision to pay all assets of a foundation to the capital beneficiaries is not covered by the BJR if this will impair claims of creditors of the foundation. For this premature payment of assets would violate the duty of the foundation board to preserve the capital, a duty recently laid down in the law (cf. Art. 552 § 37 (2) PGR). There is no safe harbor, either, if a foundation board member invests a foundation›s assets contrary to the foundation›s purpose, i.e. contrary to its articles of association; if the articles explicitly prohibit high-risk investments, no foundation board member may invoke the BJR if compensation for losses resulting from this is later demanded from him.

Furthermore, there is no «safe harbor» for unlawful conduct in terms of freedom from liability rules. Inactivity - at least if it is not untenable - may also be subject to the BJR; governing bodies may be granted exemption from liability if they have taken no decision at all, for due to limited time resources it is unacceptable for persons taking decisions to devote themselves to all questions and to handle them in terms of an agenda or business schedule.

The term «entrepreneurial» must be interpreted widely and includes all decisions of the foundation board or board of directors relating to or affecting the management or use (sic!) of assets. Without doubt, this includes decisions on the investment of assets. The appointing of beneficiaries or the determining of the type and amount of their benefit by the foundation board member in the exercise of the discretionary power granted to him by the articles must also be considered an entrepreneurial decision in terms of the BJR. An indication for this is that it is one of the fundamental and non-delegable duties and tasks of the foundation board to determine beneficiaries continuously and in accordance with the founder›s wishes, which are alone relevant for this. Leaving this area out of the protected area of the BJR would be inappropriate.

2. No conflict of interests

In his entrepreneurial decisions, the foundation board member must not let himself be guided by extraneous interests,

i.e. he must be free of any conflicts of interest. This is not just about individual interests of the foundation board member but also about extraneous special interests in the widest possible sense. A conflict of interests can be assumed to exist wherever contracts are entered into between the foundation and the foundation board member or persons close to him. Furthermore, a foundation board member who through an entrepreneurial decision wants to benefit not himself but a third party who is not a beneficiary is prejudiced and guided by extraneous interests. This may for example happen with so-called retrocessions or kickbacks without an objectively justified or proportionate counter-performance, even if such «incentives» are not kept by the foundation board member but have been promised or granted to a third party that is close to the foundation board member (such as a bank or an asset manager). The question of whether or not it will suffice that the foundation board member concerned abstains from the decision must be decided on a case-by-case basis. The basic idea behind this provision is respect of the freedom of decision, which must not be limited or endangered in any way by extraneous circumstances.

The Supreme Court always assesses the question of a conflict of interests on a case-by-case basis. Although strict criteria are applied, a purely potential or apparent conflict of interests seems to be insufficient in cases concerning the BJR.

3. Taking of decisions in good faith

A foundation board member is in the «safe harbor» if he also «could reasonably assume» to be acting in the best interests of the company. The term «reasonably» is indeterminate and absolutely alien to Liechtenstein law. According to the German material on legislative intent, one cannot assume reasonability in taking a decision if „the director›s assessment of the risk connected with the entrepreneurial decision is incorrect in an absolutely untenable way». This explanation is not exactly enlightening.

It is more rewarding to refer to the documentation of US law for interpretation. According to this, «reasonable judgment» is equivalent to acting in good faith: the directors must conduct the company›s business in the honest belief that the actions taken are in the best interests of the company. This criterion is of practical importance in particular where the error that the directors are accused of cannot be assigned to any of the other BJR criteria. In standard references, it is said that «bad faith may be inferred where the decision is so beyond the grounds of reasonable judgment that it seems essentially inexplicable on any [other] ground.»

Therefore, the term «reasonably» can and should be put on par with the important principle of Treu und Glauben (good faith), which is firmly laid down and plays a pivotal role in Liechtenstein law in Art. 2 PGR. Pursuant to Art. 2 PGR, everybody has to act in good faith when exercising his rights and carrying out his duties. The obvious misuse of rights will not be protected.

4. Taking of decisions on the basis of adequate information

How diligently must a foundation board member plan his decisions? First of all, it is clear that a decision that is based on no information at all does not pass the BJR test. The same applies to a foundation board member who does not substantively take part in the decision process although he is responsible, be it that he does not attend the meeting in the first place, be it that he remains passive or uninterested in a matter. The foundation board member must therefore inform himself in advance on the basis for his decision and in the best case document that basis, obtain information, if necessary obtain advice (from experts, lawyers etc.), and come to a decision after weighing and thoroughly discussing all objectives and legal questions.

When is it that the amount of information gathered is adequate? The necessary intensity of information gathering must be decided by the foundation board member on the basis of lead time, the weight and type of the decision, and in consideration of recognized rules of proportionality of business economics, if applicable depending on the department in question. The fact that entrepreneurial decisions are frequently based on instinct, experience, a feeling for future developments, or flatly on common sense must be taken into account just like the fact that decisions are normally taken under high time pressure.

In this context, there is an informative decision by the Liechtenstein Supreme Court (Supreme Court 06 Dec 2001, 1 CG.378/99-50, LES 2002, 41), according to which the following rules of procedure apply to meetings of a foundation board that consists of more than one person: the subject of the resolution must be announced as a matter of principle (agenda). Resolutions by the foundation board that are not listed on the agenda cannot be passed in a legally effective way. Calling a meeting without an agenda therefore generally prevents a foundation board with more than one member from passing any resolutions at all. And resolutions passed without all foundation board members being present or with some not even having been invited are void.

At the end of the day, the BJR has the consequence that when checking the lawfulness of decisions by the foundation board, the procedural aspect of how such decisions came about takes precedence: he who proceeds as demanded by the BJR shall be able to rely on immunity from liability.

5. Acting in the best interests of the legal entity

The foundation›s welfare is determined by its purpose. The foundation›s purpose can be common-benefit or private-benefit, and it determines the fundamental element of the foundation and at the same time justifies its existence. The central idea is always the (presumed) wishes of the founder, which the foundation board is responsible for carrying out, in accordance with the provisions of the foundation documents. In this regard, asset management is of special importance. The foundation board must manage the foundation›s assets in compliance with its purpose and in accordance with the principles of good management. (Art. 552 § 25 PGR).

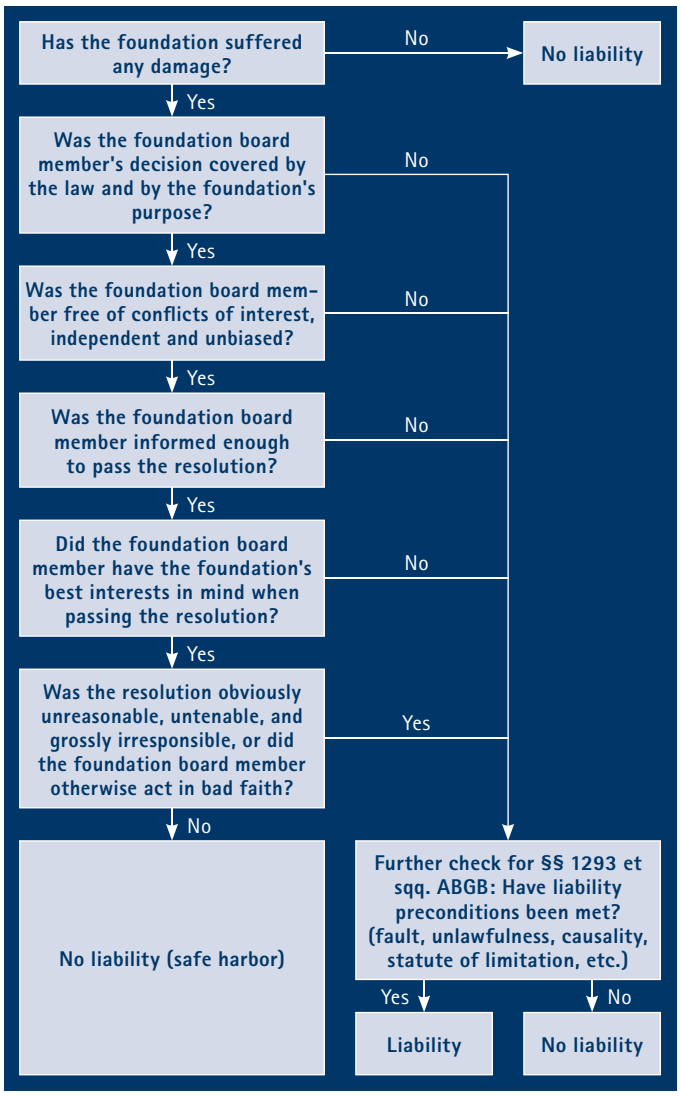
Anyone who invests a foundation›s assets in structured financial products with an increased risk of loss even though this is prohibited pursuant to the articles or e.g. supplementary investment regulations cannot from the outset invoke the BJR, because the investment decision was contrary to the articles. However, if the foundation documents do not specify a certain way of asset management for the foundation board, and if the latter invests all assets of the foundation in high risk financial products without having examined alternatives, without having obtained opinions from financial experts, or without being able to state other good reasons and present documents that suggest this way of investment, the judge must examine under the BJR whether the foundation board has in fact weighed the chances and risks ex ante in a comprehensible decision making process and acted in the foundation›s best interests.

Summary

The BJR creates a non-liability zone in which the foundation board member may move and unfold freely and exercise his rights and carry out his duties without disturbance, without any concern for personal liability. This zone is also called the «safe harbor». If he moves within that zone, he need not worry about bad decisions and the resulting losses of the foundation assets that he has been entrusted with for management. A judge will only check if the foundation board member›s assumptions before the decision were well-prepared, plausibly justified, and - in terms of the general principle of good faith - were tenable, responsible, reasonable, and in the best interests of the foundation.

Even if the provision comes from a foreign jurisdiction, and difficulties in interpretation are bound to happen due to the use of uncommon verba legalia alone, the delimitation and creation of such a harbor «where one can nicely sail around without meeting the ugly face of liability at every corner» is basically welcome for reasons of legal certainty and to deter fraudulent liability lawsuits.

The following flowchart shows the BJR checklist under Liechtenstein law:



Authors: Dr. iur. Johannes Gasser, LL.M.
Mag. iur. Silvana Dorner

First Advisory Group
Vaduz | Zurich | Geneva | Singapore | Hong Kong
www.firstadvisorygroup.com