Nr. 1 May 2011

FIRST establishes presence in Asia

In line with the growth strategy of First Advisory Group, we are pleased to report that FIRST has expanded into Asia with the acquisition of two offices in Singapore and Hong Kong which took place towards the end of last year. This development is seen as an important milestone for the Group in its attempt to establish itself as a truly international financial services company and opens up new perspectives in a major market segment.

This step into the fast growing and exciting Asian market is in line with our slogan «FIRST – closer to you» and will allow FIRST to offer an even better standard of service to both existing and new Asian clients by being nearer to them and having a greater understanding of their needs. The move will also allow FIRST to offer and develop additional products and services to meet the needs of its existing client base worldwide. Philipp Schmid, a Member of the Management Board of FIRST, has relocated to Singapore to oversee operations in Asia, to ensure a smooth transition and to help develop new business opportunities. Philipp is an experienced trust professional holding a masters degree in Business Administration and Law. He is a member of the Society of Trust and Estate Practitioners and of the Liechtenstein Trustees Association and has been with FIRST since 2001. Philipp will be heading both operations in Singapore and Hong Kong. In Singapore, Philipp will be supported by Mark Forsythe, an experienced trust officer who has also relocated to Singapore. Mark holds an honours degree in Business Administration, is a member of the Society of Trust and Estate Practitioners and has been with FIRST since 2003. In Hong Kong, Philipp will be assisted by Shirley Sin. Shirley holds both a degree and postgraduate certificate in laws from the University of Hong Kong, is a member of the Trust and Estate Practitioners and has been involved in the trust industry for over fifteen years.

Singapore lies off the Southern tip of the Malay Peninsula, approximately 85 miles north of the equator. Its strategic location, sound legal system and attractive fiscal policies have ensured that in recent times it has become one of the worlds most important financial centres, and most international banks and financial institutions now have a presence in Singapore. FIRST is one of a limited number of regulated trust companies who are authorised to carry out trust business in Singapore. Our Singapore office offers the setting up and administration of trusts and companies from a number of various jurisdictions. Of particular interest may be the settlor reserved powers trust, which permits the settlor to retain powers over the investment of the trust fund. This allows the client to discuss and decide the investment and management of the trusts assets directly with the bank, without the risk of the trust being classified as a sham. We are also able to administer Panama foundations out of Singapore and of course our Singapore office is also able to offer the incorporation and administration of Singapore companies, which benefit from a wide range of double tax treaties around the globe. Our Singapore staff consists of a multi-cultural and multi-lingual team who can count English, German, Mandarin and Hindi amongst their mother tongues. As a result of expansion plans, the team in Singapore has recently relocated to new, larger premises.

Hong Kong is situated on China's south coast. In 1997 it became a Special Administrative Region of China. The Chinese government, under the principle of «one country, two systems» allows Hong Kong considerable autonomy in running its own affairs, particularly in economic and political matters. It is also one of the worlds leading financial centres with a major capitalist service economy characterised by low taxation, free trade, a sound legal system and minimum government intervention. As well as setting up and administration of trusts and companies in a number of jurisdictions, our Hong Kong office specialises in the setting up and provision of British Virgin Islands Trusts. By having our own trust licence in the British Virgin Islands, we are also able to offer VISTA trusts in-house. VISTA trusts are particularly attractive in cases where the client would like to bring the shares of his business under the trust without relinquishing control over the management and running of the business. Furthermore, we are also able to provide company secretary and director services for companies incorporated in various jurisdictions, including BVI and Hong Kong.

We firmly believe that this step into Asia compliments the existing range of services which are offered to our clients and bring FIRST closer to achieving our goal of becoming a global wealth management company.

Piercing the corporate veil

A) Introduction – Executive Summary

1. In principal, the separate legal personality of a legal entity is also respected in Liechtenstein, so that claims against a legal entity cannot normally be asserted against that legal entity's bodies, and neither against their backers / de facto bodies. It is therefore an acknowledged fact that a legal entity's assets must be regarded to be strictly separate from those of the founder or owner.[1] Nevertheless, the Liechtenstein courts offer the possibility of access to a legal entity's backers, for example by way of a procedure that is called «piercing the corporate veil». Liechtenstein law and Liechtenstein court practice offer various options to do so, which are subject to different requirements.

2. This Memo to Clients discusses the question of what options Liechtenstein law offers to creditors to access the de facto bodies of a company. In this, the term faktisches Organ (de facto body) as defined in Liechtenstein court practice is explained, and four different bases for claims are discussed that can lead to liability of a de facto body.

B) Option 1: piercing the corporate veil due to misuse of the legal entity

3. Piercing the corporate veil due to misuse of the legal entity is not regulated in Liechtenstein law. This option is only offered through the practice of the Liechtenstein courts.[2] However, the Liechtenstein Supreme Court has ruled that such piercing may only happen where this is indispensable on the basis of the strict definition of good faith in order to prevent a misuse of rights.[3]

4. According to the Liechtenstein Supreme Court, piercing the corporate veil due to misuse of the legal entity is generally subject to an objective and a subjective requirement. If it is creditors who want to pierce the corporate veil, two additional requirements must be met.[4]

(i) Objective requirement: de facto body

5. The beneficial founder[5], i.e. the person who initiated the establishment of the foundation, must have formed the foundation with the intention of remaining in a position to dispose of the foundation's assets to his advantage and in his own interests, regardless of the foundation's purpose.[6] This happens for example by keeping control of the foundation's assets through sole signature authority for the foundation's accounts.[7] However, it also suffices if the beneficial founder is able on a continuous basis to give instructions through a mandate agreement or by having been granted rights of intervention and control for his benefit[8], so that the founder is a «de facto body» of the foundation.[9] For it is not only the governing bodies laid down in a legal entity's articles that are considered to be a body of that entity but also any persons who exercise control functions in a de facto way (de facto body).[10] Therefore, this person essentially becomes a governing body of the foundation. Court practice thus considers the economic backer of the foundation who in fact exercises dominant control of the foundation's administration to be a de facto body.[11]

[1] Among others: Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 116 et seq.; Supreme Court in 3 C.388/96-25 of 3 May 2000, LES 2000, 192, 196; Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159 et seq.

[2] Supreme Court in 7 C.247/87-27, 47 et sqq., 50 of 11 Dec 1989; Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159 et seq.; Supreme Court in E 2413/95-15 of 27 Nov 1995, LES 1996, 163; Supreme Court in 6 C.416/94-72, 22 of 1 Oct 1998, LES 1999, 122, 124.

[3] Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159 et seq.

[4] Subjective and objective requirement alone only suffice in the event of a so-called «reverse piercing of the corporate veil», where the objective is not access through the legal entity to the underlying owner or de facto body but through the owner or de facto body to the legal entity.

[5] Often, a foundation is ordered to be formed fiduciarily. What is therefore crucial is not the rights and intentions of the trustee instructed to form the foundation, who appears as the rechtlicher Stifter (legal founder). Rather, it is the rights and intentions of the underlying principal that are crucial, who is called the wirtschaftlicher Stifter (beneficial founder).

[6] Supreme Court in 4 C.376/96 of 07 May 1998, LES 1998, 332, 337.

[7] Supreme Court in 4 C.376/96 of 07 May 1998, LES 1998, 332, 337.

[8] Supreme Court in 8 C.285/88 of 4 Oct 2001, LES 2002, 162, 167.

[9] Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159.

[10] Supreme Court in 1 CG.2000.293-39 of 25 Jul 2002, LES 2003, 128.

[11] Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159.

However, the existence of such a de facto body is only the objective requirement for piercing the corporate veil due to misuse of the legal entity. In addition, the following subjective requirement must be met:

(ii) Subjective requirement: misuse of rights

6. When forming the foundation, the beneficial founder must from the outset have had the intention of misusing the legal form of the legal entity to act dishonestly or in a way damaging to another person's assets.[12] An intent to this effect by the beneficial founder is expressly required (such as where a foundation was intended from the outset to circumvent provisions of the succession laws).[13] Objective misuse alone is insufficient to prevail over the principle of separation.[14] However, it is not necessary to prove that the beneficial owner acted with qualified fault such as intention. If there is blatant or particularly gross misconduct, «particularly gross negligence» is sufficient for piercing the corporate veil.[15]

7. At any rate, the mere fact that rights of intervention have been granted is not on its own sufficient for piercing the corporate veil; as the mentioned intention of misuse is also required. Without this subjective component, a foundation structured with a «de facto body» – which is basically admissible under applicable Liechtenstein law – would simply be considered legally inexistent from the outset and without any indications for concrete misuse. But in view of the principle of proportionality, piercing the corporate veil and therefore negating the legal existence of the foundation must certainly be used as an ultima ratio and with the utmost restraint.[16]

8. In addition, it has been ruled by court practice that the two following requirements must be met if creditors intend to pierce the corporate veil:

(iii) Further requirement if claim asserted by creditors: danger of deficiency

9. Without piercing the corporate veil to access the foundation's backer, the creditor must be in acute danger of suffering a deficiency in the amount of his claims against the foundation. It must therefore be probable that without piercing the corporate veil, his claims against the foundation will come to nothing (e.g. because the foundation does not have any assets). The Liechtenstein Supreme Court has ruled that an additional requirement must be demanded for a creditor of a legal entity to be able to assert a claim against a body of the legal entity, where the claim is in fact a claim of the legal entity. This requirement is that the suing creditor – an injured party only in indirect terms – must be in acute danger of losing the coverage basis for realising his own claims directed against the legal entity. As long as and as far as that danger does not exist, the principles of good faith would prevent him from asserting his claims not with the contractual partner but with a third party, i.e. the contractual partner's body.[17]

(iv) Further requirement if claim asserted by creditors: good faith

10. Finally, creditors must meet the requirement that the creditor himself must have acted in good faith too (e.g. he must not have known of the de facto body's intention to misuse the legal entity). The creditor must not have violated the principle of mutual considerateness, which is based on the principle of good faith.[18] The Supreme Court has ruled in this context that the rule of acting in good faith is directed equally at both parties, who at a certain point in time meet with mutually opposite interests. Both the person exercising a right and the person having to meet an obligation must act as is required by the mutual trust of honest people on the basis of public morals. Therefore, the rule of acting in good faith includes in particular the demand for mutual considerateness in both parties.[19]

11. All four requirements must be met where a creditor asserts the piercing of the corporate veil to justify this measure. If a foundation has been formed with a mandate agreement, the first requirement – a de facto body – is normally not a problem. Good faith and the danger of a claim deficiency are in most cases quite easy to prove, too. What is normally difficult is proving the beneficial owner's intention of misuse. Sound evidence for this is rare, so that piercing the corporate veil on the basis of misuse of the legal entity normally fails as a result of not meeting the requirement.

---

[12] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 117; State Court in StGH 2002/17 of 16 Sep 2002, LES 2005, 128; Supreme Court in 3 C.388/96-25 of 03 May 2000, LES 2000, 192, 196.

[13] State Court in StGH 2002/17 of 16 Sep 2002, LES 2005, 128.

[14] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 117 et seq.; Supreme Court in 3 C.388/96-25 of 03 May 2000, LES 2000, 192, 196; State Court in StGH 2002/17 of 16 Sep 2002, LES 2005, 128.

[15] State Court in StGH 1997/26 of 02 Apr 1998, LES 1999, 7, 11.

[16] State Court in StGH 2002/17 of 16 Sep 2002, LES 2005, 128.

[17] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 119, 123.

[18] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 121; Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159 et seq.

[19] Supreme Court in 1 C.36/86-71 of 15 Oct 1990, LES 1991, 143, 159.

C) Option 2: piercing the corporate veil pursuant to Art 223 (1) PGR

12. Another option to access the de facto body of a legal entity is offered by Art 223 (1) PGR (PGR = Personen- und Gesellschaftsrecht, Persons and Companies Act). This translates as follows: «Where the company's creditors suffer damage, they may demand, if the company does not have a claim, that they be compensated directly for the damage inflicted upon them.» (emphasis by author). Art 223 (1) PGR is one of the provisions regulating claims against the bodies of companies and of legal entities treated as equivalent to them, such as foundations. The purpose of this claim pursuant to Art 223 (1) PGR is to protect creditors against the bodies of the company.[20]

13. Once again, governing bodies are not just those listed in the company's articles but also other persons who have a dominant economic position (so-called backers or de facto bodies).[21] This makes it clear that it is the functional rather than the formal definition of a company's bodies that must be used. Not only those persons and bodies of a legal entity who are listed in the articles, but also those who in fact (de facto) exercise management functions for the legal entity.[22]

14. For Art. 223 (1) PGR to be applicable, the wording «... if the company does not have a claim...» requires that the company is itself unable to assert any claims against its (de facto) body. However, the question whether there is a claim at all is primarily decided on the basis of Art 218 (1) PGR:

15. Pursuant to Art 218 (1) PGR, the bodies of a company with legal personality and the legal entities treated as equivalent to them (such as foundations) are liable to the company for the damage caused by them if they have caused such damage with intent or gross negligence. It is therefore necessary pursuant to Art. 218 (1) PGR for successfully asserting a claim of the company against its bodies that firstly, the company has suffered damage, and secondly, that the bodies have acted at least with negligence.

16. However, another requirement of the law on damages must be met in addition to damage and fault: an adequate causal relation between damage and breach of duty by the bodies.[23] Only then does the company have an enforceable claim in terms of Art 218 PGR against its bodies. If these requirements are not met, the company therefore does not have a claim against its bodies in terms of Art 218 PGR, and it is only in this case that Art 223 (1) PGR will apply. An example would be a delay by the bodies in filing a petition of insolvency. This will normally not cause damage to the company itself, so that it will not have a claim against its bodies. However, damage will certainly be suffered by the company's creditors.[24]

17. If the company or legal entity itself does not have a claim against its (de facto) bodies, but its creditors have nevertheless suffered damage through the bodies' actions (such as in a delay in filing a petition for bankruptcy), the creditors may take recourse to Art 223 PGR and approach a body directly for liability. Art 223 (1) PGR grants a direct claim for damages to the creditors of a legal entity against the latter's bodies. The advantage of this option compared with piercing the corporate veil due to misuse of the legal entity is that neither a subjective nor an objective intention of misuse must exist, let alone be proven. Also, the danger of claim deficiency is not a prerequisite in this case for liability by the legal entity's bodies. However, the creditors must have suffered damage caused by the bodies.

D) Option 3: piercing the corporate veil due to an extensive interpretation of Art 223 (1) PGR

18. This option is also based on Art 223 (1) PGR, which however – as has been explained above – basically grants piercing of the corporate veil only where the bodies have directly caused damage to the creditors without having caused damage to the legal entity. However, Liechtenstein court practice also acknowledges the necessity of granting creditors a claim in the event that the company (or legal entity treated as equivalent) does have a claim in principle against its (de facto) bodies but does not assert that claim. For in this case, creditors do not have a direct claim for damages against the (de facto) body because the creditor has suffered damage by the (de facto) body only indirectly. To protect the creditors, Liechtenstein court practice grants creditors a claim against the (de facto) body in extensive application of Art 223 (1) PGR:[25]

[20] Supreme Court in 7 C.333/87-29 of 12 Mar 1990, LES 1990, 147; Supreme Court in 1 C.7/75-127 of 27 May 1986, LES 1988, 60, 64; Supreme Court in 2 C.45/85-40 of 30 Sep 1986, 116, LES 1988, 108, 116 et seq.

[21] Supreme Court in 2 C.355/83-68 of 16 Feb 1987, LES 1988, 147.

[22] Supreme Court in 1 CG.2000.293-39 of 25 Jul 2002, LES 2003, 128.

[23] Supreme Court in 2 C.355/83-68 of 16 Feb 1987, LES 1988, 147.

[24] Supreme Court in 10 CG.2001.406-48 of 06 May 2004, LES 2005, 310; Supreme Court in 4C.240/76-27 of 10 Jan 1979, LES 1981, 129.

[25] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, LES 1988, 108, 116; Supreme Court in 1C.7/75-127 of 27 May 1986, LES 1988, 60; Supreme Court in 7 C.333/87-29 of 12 Mar 1990, LES 1990, 147; Supreme Court in 3 C.69-96-88 of 10 Jan 2001, LES 2001, 41.

19. It is required that the legal entity itself has a direct claim for damages in terms of Art 218 PGR against the (de facto) body. In addition, it is crucial whether the injured legal entity exercises the claim for damages that is due to it directly. In those cases in which a legal entity that has suffered damage through a negligent breach of duty persistently fails to assert its claim for damages against the (de facto) body, waives the claim expressly or implicitly with intent, or forfeits the right to assert its claim, Liechtenstein court practice grants the creditors the right to take legal action for their claims in extensive interpretation and application mutatis mutandis of Art 223 (1) PGR.[26] The unused right to take action therefore passes to the creditors in subsidiary succession.

20. This right to take action is not limited to cases of deliberate damage but, as is laid down in Art 218 PGR, also applies in the event of negligence.[27] Of course, it is also necessary that the other requirements to a claim for damages must be met for successful assertion of the claim (damage, causality, unlawfulness, and fault).

21. Dogmatically speaking, this transfer of the right to take legal action is a case of assignment by operation of law: according to the principles of assignment, the debtor – here the (de facto) body – keeps all defences vis-à-vis the new creditor (here: the legal entity's creditor as the assignee) that he had against the old creditor (the legal entity).[28]

22. Another requirement for this extensive application of Art 223 (1) PGR is good faith on the part of the creditor. For if the creditor can be accused of having acted contrary to good faith himself, he loses the special protection gained by court practice through analogous conclusion and extensive interpretation.[29]

23. Furthermore, there is another objective requirement that must be met for a creditor to be able to take action against a legal entity's body for a claim that is directly due to the legal entity: the suing creditor, who has suffered damage only indirectly, must be in acute danger that because of the delays by legal entity (the party directly entitled to take legal action), he will lose the coverage basis for realising his own claims against the legal entity. As long as and to the extent that there is no such danger, the principle of good faith prohibits to search redress not from his contract partner but from a third party, i.e. the governing body of his contractual partner.[30]

24. In summary, this extended interpretation of Art. 223 (1) PGR serves as a basis for creditors who act in good faith and are in acute danger of losing their claim to assert their claim directly against the (de facto) bodies – even though they are indirectly injured parties – if the legal entity fails to assert its claim against its bodies.

25. Probably the most important difference as compared to piercing the corporate veil due to misuse of the legal entity is that there is no need to prove a subjective or objective intent of misuse. In turn, the above option of liability on the basis of an extended interpretation of Art 223 (1) PGR is limited to claims for damages, in contrast to piercing the corporate veil due to misuse.[31]

E) Option 4: creditors obtain a judgement against the company and then levy execution against the company's claims against its body

26. As an alternative to the above option of assignment by operation of law by applying Art 223 (1) PGR mutatis mutandis, there is also the following variant: if a creditor has successfully asserted claims for damages against the legal entity in court, he is able to execute them against the legal entity's assets. If the legal entity is largely without assets but has pecuniary claims against its (de facto) body, the creditor may access these claims as assets by way of execution. This is another way for a creditor to himself assert the attached claims against the (de facto) body. The creditor may then satisfy his claim from the proceeds. There is no requirement of a subjective intention of misuse, and neither acute danger of debt deficiency nor good faith are required.

[26] op.cit.
[27] Supreme Court in 4 C.240/76-27 of 10 Jan 1979, LES 1981, 129.
[28] Supreme Court in 7 C.333/87-29 of 12 Mar 1990, LES 1990, 147.
[29] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, LES 1988, 108.
[30] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, LES 1988, 108.
[31] Supreme Court in 2 C.45/85-40 of 30 Sep 1986, LES 1988, 108, 116 et seq.

First Advisory Group
Aeulestrasse 74
Postfach 86
LI-9490 Vaduz
Fürstentum Liechtenstein

T +423 236 30 00
F +423 236 30 01
www.firstadvisorygroup.com