

## General articles

# How a trust lawyer ended up drafting a law on foundations: *the experience of an English lawyer with a funny accent*

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### Abstract

What has led a Swiss lawyer turned English trust lawyer to go back to his roots and deal with foundations? First and foremost the realization that the two instruments bear significant similarities, followed by a desire to explain this fact to trust lawyers who think nothing of foundations (and the other way round). Thanks to the increasing number of foundations laws and the success of the Hague Trust Convention, the functional similarities are there for everyone to see. The next step consists in picking the right vehicle and using foundations along trusts to solve complex structural issues for their clients.

infamous white, grey, and black lists and the crumbling of banking secrecy at the height of the credit-crunch<sup>1</sup>—was published in 1998.

### The big earthquake

Then something happened:

- In 1998 (yes, that's right, same year—hardly a coincidence), the courts in Liechtenstein confirmed what everyone knew or suspected, ie that:

if the founder retains a right of intervention with the intention of continuing to use the assets of the foundation for his own benefit and not for the purpose of the foundation, there is a simulated transaction (pretence) which is invalid.<sup>2</sup>

### Once upon a time

When I moved to London 14 years ago, I was fascinated with the idea of trusts. Foundations, I thought, belonged to the past, or at the very least I thought that they had been consigned to the past by the then prevailing professional practices which were at odd with the winds of change that were starting to blow across the globe. It seems like a million years ago, but the OECD's Report on Harmful Tax Competition—which led to the publication of the

- The LGT and UBS affairs did the rest. Today, Liechtenstein has a new foundation law and a fresh strategy as regards its place in the wider financial world.
- While this was unfolding, a number of common law jurisdictions—some of which were unaware of the earth shattering changes in Liechtenstein—decided to get on the foundation's bandwagon.

1. Most readers will remember that on 3 April 2009, Gordon Brown announced the creation of a 'new world order' after the conclusion of the G20 summit of world leaders in London. Two months earlier, Singapore and Hong Kong announced that they would amend their tax transparency rules and relax their bank secrecy laws for tax purposes. Switzerland followed hot on their heels with a similar announcement on 13 March 2009.

2. Liechtenstein's Supreme Court (OGH), 8 January 1998, 2 C 133/95-70 (author's translation).

In 1998, the Supreme Court in Liechtenstein confirmed what everyone already knew or suspected. In the same year, the OECD published its Report on Harmful Tax Practices. Not a coincidence, but the sign of a new dawn for foundations in the new world order.

When all this was happening, I had already decided to leave Switzerland for the UK in order to pursue a new career as a trust lawyer. Therefore, I could have been forgiven for not taking notice of what was happening on the other side of the common law—civil law divide.

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## Two different worlds

However, in 2004 I came across a statement contained in a consultation paper for a new law on foundations which left me utterly puzzled, as it suggested that:

a foundation can legitimately meet the needs of clients who want to retain more directional power over their assets than trustees of discretionary trusts can normally permit a settlor.<sup>3</sup>

This was not only in contrast with the case law that was coming out of Liechtenstein, but also with the reality under the local Jersey trust law, which contained strong settlor-reserved power legislation.<sup>4</sup>

Back in England, when discussing foundations with other solicitors, I was often faced with those who continued to think that foundations were an inferior

animal that could not ever compete with that great invention of common law which is the trust.

I therefore decided that I should write an article to explain why, as a civil law lawyer turned common law lawyer, I thought that (i) the new law was odd with what I knew about foundations; and (ii) take the defences of the foundations concept. In order to make a point, I chose a strong title ‘The Foundations (Jersey) Law 2009: A Civilian Perspective – Not so plain vanilla and possibly a tad wacky’.<sup>5</sup>

When the article was published, I thought that that was that and that I would go back to my daily life as a trust lawyer. However, I was soon approached by the authorities of another government who were considering introducing a new law on foundations and wanted to obtain advice from someone who was conversant with the foundation’s concept, but who could also explain it using a language that common lawyers could understand, as terms such as ‘founder’s rights’, ‘simulation’, ‘dedication/ endowment of assets’ ‘statutes and by-laws’ do not mean much to a common lawyer.

## Two sides of the same coin

What became increasingly apparent as I set out to explain basic foundation law concepts using a trust law jargon that my clients could understand were the commonalities between trusts and foundations, if not from a legal perspective because we all know that a foundation has legal personality whereas a trust does not,<sup>6</sup> at least from a functional perspective.

In both cases, a person divests himself of property for the benefit of a purpose which may include objects, ie beneficiaries. In both cases, it is important that the person who administers the assets—whether as legal owner (trustee) or as an officer of the asset-holding structure (foundation’s council)—should be accountable, as otherwise there is created

3. Consultation paper issued by the Economic Development Committee of the States of Jersey on 25 November 2004.

4. Art 9A of the Trusts (Jersey) Law, 1984 (as amended) effectively provides that the reservation of a power to revoke or vary a trust, make distributions, hire and fire a trustee, an investment manager or adviser or even a director of an underlying company, etc shall not affect the validity of the trust.

5. Jersey & Guernsey Law Review—February 2010.

6. With the notable exception of the ‘Treuunternehmen’ (aka ‘registriertes Treuunternehmen’ or “Trust reg.”) under Liechtenstein law.

a black-hole where assets can disappear without the beneficiaries having a valid recourse.

It is interesting to see how judges on either end of the civil law—common law divide came to the conclusion that the right of beneficiaries to information represents the essence of both trusts and foundations. Indeed, the words spoken by the Liechtenstein judges (*'the main rationale of this information right is to ensure the proper supervision of the foundation council'*)<sup>7</sup> are almost identical to what one sees in trust law judgements.<sup>8</sup> In addition, the Liechtenstein Supreme Court's decision in relation to 'simulation' (see above) is reminiscent of the common law jurisprudence in relation to the trust law concept of 'sham'.<sup>9</sup>

As far as Liechtenstein is concerned, this similarity of approach should not come as a surprise, as the old foundations law contained a cross-reference to Liechtenstein's domestic trust law.<sup>10</sup>

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## But also notable differences

When I got down to drafting a new law on foundations, I also started appreciating the differences that exist between trusts and foundations. Most lawyers will be able to tell you that the main difference between trusts and foundations is that one has legal personality and the other one has not.

However, when one has to draft a law from scratch that one becomes acutely aware of what this really means—not just in terms of property rights (the distinction there is easy)—but what it means for the *beneficiaries*, who are at the heart of any private foundation (unless we are dealing with pure purpose foundations).

Article 25 of the foundations law in Jersey provides that 'a beneficiary under a foundation –

- a. has no interest in the foundation's assets; and
- b. is not owed by the foundation or by a person appointed under the regulations of the foundation a duty that is or is analogous to a fiduciary duty'.

This is a logical consequence of the foundation's separate legal personality, ie the fact that the assets are owned by the foundation itself and that the foundation's council owes its duty to the foundation, rather than the beneficiaries.

In the eyes of a trust lawyer, this looks extremely peculiar and even a tad dangerous. What happens if a member of the foundation's council violates his/her duties and the other members do nothing? In these circumstances, should the beneficiary of a foundation be allowed to bring a direct claim *qua* beneficiary (or perhaps a derivative on behalf of the foundation)? In the case of a trust, of course, a beneficiary can sue any trustee who commits a breach of trust.

And what happens if a foundation gets struck off the register or is wound up? I once had a case where a beneficiary only found out about the family foundation years after her father had died and that millions had gone missing. Unfortunately, the bank would not give her any information (as the bank's client was the foundation)—and as the foundation was no more, the service providers were unable to convince the bank to release information to the

7. Liechtenstein Supreme Court decision (OGH) 10 Ob 46/08 z dated 23 September 2008.

8. See eg for trusts the Privy Council decision in the Isle of Man case of *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26 and the English case of *Breakspear v Ackland* [2008] EWHC 220 (Ch).

9. See eg the English case of *Midland Bank plc v Wyatt* [1995] 1 FLR 696 and the Jersey case of *Abacus (CI) Ltd and Grupo Torras SA v Sheikh Fahad Mohammed Al-Sabah* 2003 6 ITELR 368 (the 'Esteem' case), in which my firm advised the beneficiaries.

10. Old Art 552(4) of Liechtenstein's Persons and Companies Act provided that the rules that apply to trust enterprises with legal personality (a special type of trust modelled on early 20th century Massachusetts business trusts) applied *mutatis mutandis* to foundations, in particular in relation to the position of the founder, council and beneficiaries, unless the foundation documents or the foundations law did not provide otherwise.

beneficiary. How does a beneficiary enforce his/her rights in these circumstances? Under a trust, the position is more straightforward, as a trust liability sticks with the trustee even after he steps down. This is the direct consequence of the lack of legal personality. Of course, a trustee may achieve limited liability by acting through the filter of a company (but what happens here if the company gets struck off?) but at least the basic position of a beneficiary under a trust seems stronger than that of a beneficiary under a foundation.

### Same time next year?

These are some of the issues that anyone drafting a foundation's law needs to grapple. As Johanna Niegel points out in her editorial article, the

various foundations laws out there are not all based on the same model, ie there is not a *common law* of foundations. Does this mean that the people tasked with drafting a new law should seek increased harmonization? Or should a common law jurisdiction draw inspiration from its trust law to deal with perceived shortcomings of the foundation's concept, eg by introducing a statutory fiduciary duty that would make the foundation's council directly accountable to the beneficiaries?

These are all fascinating questions that need answering. Hopefully, by the time next year's Private Foundations: A World Review hits the newsstand, the law I have been working on will have entered into force and I will be able to share my thoughts with you.

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