

Discretionary powers in the Austrian Private Foundation Law

Daniela Olbrich*

Abstract

The fact that only an objective qualification of the foundation board is decisive with regard to its liability is sufficiently ruled by the Austrian Supreme Court. However, in the end the board member is left alone with the question of what is required in concrete terms. A recent decision of the Austrian Supreme Court granting the foundation's executive board an extremely wide scope for decision-making where the foundation statute does not provide detailed guidelines came as a surprise. This article deals with the issues faced by foundation board members in avoiding liability when exercising their powers and the need to limit the wide discretionary powers of such board members by creating an adequate statutory framework.

some cases confront founders with the need to adapt their foundation statutes to the extent that the respective founder has reserved a corresponding right of amendment. The Supreme Court decision OGH 30.1.2017, 6 Ob 251/16d, serves as an example of this. This decision concerned the exclusion of beneficiaries by the foundation's executive board, where the court confirmed the foundation's executive board had an extremely wide scope for decision-making - even in cases where the founder is to be excluded as a beneficiary. Where the foundation statutes do not provide detailed guidelines the Supreme Court considered the decision-making of the foundation's executive board to be limited only by the will of the advisory board (if provided for at all) and by the principle of equality under constitutional law, taking into consideration in particular "... the requirement of objectivity and the prohibition of arbitrariness".¹

Introduction

In comparison to similar trust structures in other jurisdictions, the Austrian Private Foundation is a relatively young legal entity, introduced by the Austrian legislation only in 1995. Repeated changes in the legal framework and a number of Supreme Court rulings on foundation law have necessitated discussion amongst founders, beneficiaries and foundation bodies and in

Founders perspective

In this specific case, the competence of the executive board of the foundation board to remove beneficiaries in combination with a clause enabling the executive board to remove a person as a beneficiary was highly disadvantageous to the beneficiary founder. It shows once again, how important it is to ensure the

*Mag. Daniela Olbrich, M.B.L., Lawyer, PHH Prochaska Havranek Rechtsanwälte GmbH & Co KG, Julius-Raab-Platz 4, A – 1010 Vienna, Austria. Tel: +43 (0) 676 404 13 31; Fax: +43 1 714 24 40 – 6; Email: olbrich@phh.at; Website: www.phh.at

1. OGH 30 January 2017, 6 Ob 251/16d "Dem Vorstand einer Privatstiftung ist beim Ausschluss eines Begünstigten aus dem Begünstigtenkreis ein nur durch das Gebot der Sachlichkeit und das Verbot der Willkür begrenzter äußerst weiter Ermessensspielraum eingeräumt." [When excluding a beneficiary from the group of beneficiaries, the board of directors of a private foundation is granted an extremely wide scope of discretion limited only by the requirement of objectivity and the prohibition of arbitrariness.] Original quotation translated by the author.

foundation statutes are appropriately drafted to include, either a final beneficiary concept or by restricting the discretionary scope of the decision-making body (foundation board, advisory board or a third party) by means of a controlling body or corresponding statutory regulations.

Final beneficiary concept

The final beneficiary concept is usually embedded in the foundation statutes in the form of a regulation of succession. An exhaustive list of beneficiaries could limit the duration of the foundation, except for legal entities as beneficiaries. At a minimum, there should be included framework requirements and powers to decide on the type, circumstances, amount and intervals of the contributions. Depending on the flexibility of the beneficiary concept, the entitled body will have to be granted more or less scope of decision-making.

Controlling body

If the foundation organization is limited to the statutory bodies (foundation executive board and foundation auditor), control mechanisms provided by law tend to be inconvenient, time-consuming and in many cases ineffective. In order to overcome such deficit of control, the majority of Austrian foundations have one or more additional bodies installed in addition to the obligatory foundation bodies. These are to be established by corresponding provisions in the foundation statutes and may—like the beneficiaries of the private foundation itself—be granted various rights and competences to achieve an effective supervision of the management.

In addition to external monitoring by the foundation auditor, a system of mutual monitoring is recommended, which is suitable for identifying undesirable developments in the ongoing management of the foundation as early as possible as well as for taking

countermeasures. In this context, regular reporting is one of the essential requirements for an effective control system. At the same time, however, a set of instruments is needed to sanction breaches of obligations and enforce claims for compensation.

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In principle, certain management agendas cannot be placed under the control of another body, but to a certain extent, they can even be transferred directly to other bodies.² However, there are limits to the founder's freedom to design the organization of the foundation. Such transfer of management responsibilities is excluded with regard to the core competences of the foundation's executive board. In such cases, other foundation bodies can only be assigned an advisory or supervisory role. Along with the controlling function, they may be granted approval or hearing rights, the right to review and/or information rights.

When a foundation board is granted appointment or dismissal competences, it must be considered that supervisory bodies composed of a majority of beneficiaries are denied the power to dismiss the foundation's executive board.³ In this event, a respective amount of third persons have to be brought in. Finally, attention should also be drawn to subsidiary competences in the event of inaction by the primary competent body should be considered to be implemented.

At all events, when allocating responsibilities and granting rights, it has to be safeguarded to avoid blocking decision makers in order to support efficient processes.⁴

2. cf. P Csoklich, "Die Haftung des Stiftungsvorstandes", in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000).

3. OGH 5 August 2009, 6 Ob 42/09 h.

4. C Nowotny in P Csoklich/K Müller/B Gröhs/F Helbich, *Handbuch zum Privatstiftungsgesetz* (ORAC, 1994) 146.

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Foundation's board perspective

Coming back to the decision of the Supreme Court presented in the introduction, the question arises—from the perspective of the foundation's executive board—on how to deal with the granted discretionary power and what it means with respect to liability.

Liability of the foundation's executive board in general

Like every managing board in Austria, the foundation's executive board is subject to the specific statutory liability provisions of the Austrian Federal Fiscal Code (BAO),⁵ the Austrian Labour and Social Security Act (ASVG),⁶ the provisions of insolvency law and the related criminal offences.⁷ In addition, the responsibility of the foundation's executive board is based on the general liability regulation of § 29 Private Foundation

Act (PSG),⁸ which stipulates the personal liability of each member of a foundation's body.

The Private Foundation Act defines the standards of diligence the foundation's executive board must ensure when performing the tasks imposed on it by law or the foundation's statutes.⁹ Guided by the provisions for management bodies of corporations, the Austrian legislator has introduced the diligence of a prudent and conscientious manager as an objective standard likewise for the foundation's executive body. The allegation of negligent conduct, therefore, cannot be invalidated by the argument of personally lacking subjective abilities.¹⁰ In such a case the foundation's executive board would face negligence of admission.

Violation of due diligence

A failure to comply with the required due diligence may arise by violation of special legal liability provisions, orders under foundation law or foundation statutes or generally in the failure to exercise due diligence in discretionary decisions.¹¹

The foundation's executive board is bound by the provisions stipulated in the foundation statutes. If these or legal provisions give rise to specific duties to act or if the foundation's executive board is bound by instructions—where legally permissible—these must be

5. § 9 (1) BAO: "Die in den §§ 80 ff. bezeichneten Vertreter haften neben den durch sie vertretenen Abgabepflichtigen für die diese treffenden Abgaben insoweit, als die Abgaben infolge schuldhafter Verletzung der den Vertretern auferlegten Pflichten nicht eingebracht werden können." [Section 9 para 1 Austrian Federal Fiscal Code: The representatives referred to in sections 80 et seq. shall be liable, apart from the taxable persons they represent, for the taxes they are liable to pay to the extent that the taxes cannot be collected due to negligent breach of obligations imposed on the representatives.] Original quotation translated by the author.

6. § 67 (10) ASVG: "Die zur Vertretung juristischer Personen oder Personenhandelsgesellschaften (offene Gesellschaft, Kommanditgesellschaft) berufenen Personen und die gesetzlichen Vertreter natürlicher Personen haften im Rahmen ihrer Vertretungsmacht neben den durch sie vertretenen Beitragsschuldern für die von diesen zu entrichtenden Beiträge insoweit, als die Beiträge infolge schuldhafter Verletzung der den Vertretern auferlegten Pflichten nicht eingebracht werden können." [Section 67 para 10 Labour and Social Security Act: Persons appointed to represent legal entities or partnerships (general partnership, limited partnership) and the legal representatives of natural persons shall be liable, within the scope of their power of representation, apart from the contribution debtors represented by them, for the contributions payable by them to the extent that the contributions cannot be collected due to negligent breach of obligations imposed on the representatives.] Original quotation translated by the author.

7. cf. P Csoklich, "Die Haftung des Stiftungsvorstandes", in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97.

8. § 29 PSG: "Unbeschadet des § 21 Abs. 2 letzter Satz über die Haftung des Stiftungsprüfers haftet der Privatstiftung jedes Mitglied eines Stiftungsorgans für den aus seiner schuldhaften Pflichtverletzung entstandenen Schaden." [Article 29 Private Foundation Act: Notwithstanding the last sentence of section 21, para. 2 concerning the liability of the foundation auditor, each member of a foundation body shall be liable to the foundation for the damage resulting from his negligent breach of duty.] Original quotation translated by the author.

9. § 17 (2) PSG: "Jedes Mitglied des Stiftungsvorstandes hat seine Aufgaben sparsam und mit der Sorgfalt eines gewissenhaften Geschäftsleiters zu erfüllen. Der Stiftungsvorstand darf Leistungen an Begünstigte zur Erfüllung des Stiftungszwecks nur dann und soweit vornehmen, wenn dadurch Ansprüche von Gläubigern der Privatstiftung nicht geschmälert werden." [Section 17 para 2 Private Foundation Act: Each member of the foundation's executive board has to economically perform its duties with the diligence of a diligent manager. The foundation's executive board may only execute payments to beneficiaries in order to fulfil the foundation's purpose if and to the extent this does not impair claims of creditors of the foundation.] Original quotation translated by the author.

10. cf. P Csoklich, "Die Haftung des Stiftungsvorstandes", in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97; A Hofmann, "Überlegungen zur Verantwortung des Stiftungsvorstandes bei Investitionsentscheidungen", PSR 2010/46.

11. G Schima, "Business Judgment Rule und Verankerung im österreichischen Recht", GesRZ 2007, 93.

complied with. There is no scope for action or discretion. In these cases, compliance with due diligence lies in the non-infringement of this duty to act. The question is how due diligence is defined for discretionary decisions?

Discretionary decisions

The intensity and content of the concrete duty to act can be deduced from the concrete task on the one hand, and from the assigned functional responsibility as a competent or supervising body on the other, thus specifying the diligent behavior of the so-called “measure figure”.

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Functional responsibility

The legally mandatory three-person composition of the foundation’s executive board and the right of each individual member to request a special audit in the event of irregularities implies that the legislator does not regard the foundation’s executive board as a purely executive body, but that it has also assigned the members a mutual duty of supervision.¹² The dual duty of management and supervision can be divided by allocation of responsibilities or sole decision-making powers. In this

case, the responsible member has the duty to carry out the task, while the other members are functionally reduced to a mere supervisory role. Although this does not exempt the members of the foundation’s executive board from its overall responsibility (i.e. each member remains liable),¹³ the diligence of a competent member is defined differently from that of a supervising member.

The measure figure as the comparative standard for a competent member is expected to take all actions that require an efficient but well-prepared implementation, such as the comprehensive examination and preparation of the basis for decision-making, in particular, the evaluation of the risks associated with the decision and the careful selection of the persons involved, for example, by means of invitations to tenders. If necessary the competent member has to obtain expert opinions.

A diligently monitoring board member, on the other hand, will only be responsible to review the decision itself and the decision-making process is comparable to that of a Supervisory Board. It will have to review the basis of the decision prepared by the competent member in order to check whether the decision taken by the competent member was comprehensible and carefully prepared as regards content.¹⁴

However, such a relief of liability can only be effected by an allocation of responsibilities permitted by the foundation statutes, whichever body (including the foundation’s executive board) is assigned and entitled to establish such delegation. Furthermore, it is argued that for the area of core competences an allocation of responsibilities is irrelevant and therefore a functional transfer of the standard of due diligence is not possible.¹⁵

12. cf. P Csoklich, “Die Haftung des Stiftungsvorstandes”, in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97.

13. N Arnold, *Kommentar zum Privatstiftungsgesetz*, 2. Auflage, § 17 Rz 82 and § 28 Rz 22; P Csoklich, “Die Haftung des Stiftungsvorstandes” in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97.

14. OGH 22 May 2003, 8 Ob 262/02s, according to which the Advisory Council, while applying due care, is not obliged to independently review the annual accounts anew but may rely on the audit report. An obligation to check and to request information only exists with a view to apparently incomplete, and contradicting information or reports. Obviousness leading to an obligation to double check is given, if a member of the Advisory Council should have noticed the contradictions when applying the required diligence.

15. N Arnold, *Kommentar zum Privatstiftungsgesetz* (2nd ed., Linde, 2007) § 17 Rz 83; ebenso A Hofmann, “Überlegungen zur Verantwortung des Stiftungsvorstandes bei Investitionsentscheidungen” PSR 2010/46; zur Gesamtverantwortung bei der aktienrechtlichen Leitungspflicht, C Nowotny in P Doralt/C Nowotny/S Kalss, *Aktiengesetz I* (Linde, 2012) § 70 Rz 26.

Responsibility by content

In terms of content, the due diligence requirement is based on the task assumed or the decision to be taken in each case. The core tasks assigned to the foundation's executive board cannot be delegated. It, therefore, bears full responsibility for respective compliance.¹⁶

Core tasks of the foundation's executive board are, in particular, the implementation of the foundation's mission, the asset management and effective control of the same, the use of funds in accordance with the mission and the accounting, as well as the observance of creditor protection and the provisions of the Insolvency Act.

Each member of the foundation's executive board is obliged to apply "... the diligence of a prudent businessman in a responsible management position when exercising an independent fiduciary function safeguarding other parties' financial interests".¹⁷ Even if the foundation itself is not a corporate entity, the foundation's executive board must meet similar requirements with regard to the asset management of the foundation.

The assessment and evaluation of restrictions with a view to contributions require investment-related knowledge as well as a fundamental understanding of business administration and "... the ability to independently analyse the economic situation" of the foundation "... to analyse independently on the basis of the data obtained from the business accounting system"¹⁸ enabling the monitoring and forecast of the asset development, financial position and earnings of the foundation. The foundation's executive board has to ensure that the foundation's organization is adapted to its mission and size.¹⁹

Concept of business judgment rule

The Supreme Court is referring to both the principle of objectivity and the prohibition of arbitrariness as a framework for discretionary decisions of the foundation's executive board, which can be found as fundamental principles in the Business Judgment Rule (BJR).

From the BJR, originally an Anglo-American concept of granting a liability-free entrepreneurial discretion, which has found its way into the German-speaking jurisdictions²⁰ and is established in the Liechtenstein legal order in a similar manner,²¹ principles can be derived for management bodies under which conditions they can assume to have acted objectively and diligently.²²

The BJR distinguishes the substantive assessment of business decisions from the examination of how the decision was reached, namely by observing or disregarding due diligence.²³ Accordingly, compliance or non-compliance with the necessary diligence depends on the legality and procedurally correct execution of a decision, but not on the justifiability of the specific decision itself. The discretionary scope of the management body in entrepreneurial decisions lies in the substantive freedom to decide on one of several "carefully worked out" options. Hence, the decision taken by members of a management board should no longer be subject to further judicial review if the conditions of the BJR are met, namely

- review of an entrepreneurial decision,
- reasonable belief of the competent board that it is acting in the best interests of the person represented,

16. cf. P Csoklich, "Die Haftung des Stiftungsvorstandes", in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97.

17. OGH 9 January 1985, 3 Ob 521/84; Quotation translated by the author (Sorgfalt, die "... ein ordentlicher Geschäftsmann in verantwortlich leitender Position bei selbständiger treuhänderiger Wahrnehmung fremder Vermögensinteressen einzuhalten hat").

18. C Nowotny, *Kommentar zum Aktiengesetz*, § 84 Rz 7; Quotation translated by the author; ("die Fähigkeit, die wirtschaftliche Lage "der Stiftung" an Hand der aus dem betriebswirtschaftlichen Rechnungswesen ermittelbaren Daten eigenständig zu analysieren").

19. cf. P Csoklich, "Die Haftung des Stiftungsvorstandes", in W Gassner/P Göth/B Gröhs/M Lang, *Privatstiftungen – Gestaltungsmöglichkeiten in der Praxis* (Manz, 2000) 97; MC Steiner, "Vermögensveranlagung in Stiftungen – Rechtliche Rahmenbedingungen (Teil II)", ZfS 2007, 68.

20. § 93 para 1 sentence 2 German Stock Corporation Act and since 1 January 2016 now also included in § 84 para 1a Austrian Stock Corporation Act and § 25 para 1a Limited Liability Companies Act.

21. A member of an administrative organ acts with due care, if it takes its business decisions without taking into account extraneous interests and may have reasonably assumed to act on the basis of adequate information in the interests of the legal person.

22. R Briem, "Unternehmerische Entscheidungen in Stiftungen", PSR 2010, 27; A Hofmann, "Überlegungen zur Verantwortung des Stiftungsvorstandes bei Investitionsentscheidungen" PSR 2010/46.

23. J Gasser, "Die Business Judgment Rule in Liechtenstein" PSR 2/2011, 62.

- unbiased decision, free from conflicts of interest,
- decision on the basis of appropriate information and
- avoiding inappropriate risks, which according to the BJR would, in any case, preclude careful action.²⁴

An entrepreneurial decision is understood to be the choice of a managing body from “several actually possible and legally permissible alternatives of conduct”,²⁵ the outcome of which is uncertain and associated with the assessment of risks,²⁶ for example, the decision on investment alternatives or the assumption of liability in favor of a subsidiary.²⁷

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At the time of the decision, the foundation’s executive board may legitimately assume (in the sense of an ex-ante consideration) that the decision will be made in the best interests of the foundation or will contribute to the fulfillment of the foundation’s mission. Unjustified, however, are decisions that accept an almost irresponsible risk—measured against the overall situation. The resulting damage then does not represent a “realisation of the typical entrepreneurial risk”.²⁸

Furthermore, the decision has to be made free of conflicts of interest. If special interests outside the foundation manifest, the legal transaction does not fall under the typical entrepreneurial risk²⁹ and is not covered by the BJR concept.

Finally, a person is acting diligently only if his decision is made on the basis of an intensive examination of opportunities and risks associated with a transaction and their probability of occurrence. This includes discussing the core problems and considering alternatives with the other members of the foundation’s executive board.³⁰ Appropriateness is based on the expertise of the parties involved, available financial and time resources and priority and business significance of the decision in relation to the capacity of the foundation.

Summary

Establishing a foundation under Austrian law requires the drafting of a suitable statutory framework in order to reduce the very wide discretionary powers of the foundation’s executive board to a level suitable for the respective foundation. Only a detailed interpretation of the foundation statutes enables the liable foundation bodies to assess the limits of their discretionary scope. Depending on the specific foundation organization and the task assumed by the foundation board in terms of function and content, the requirements for due diligence differ in connection with the procurement, preparation and evaluation of information as well as reporting.

24. M Lutter, “Die Business Judgment Rule in Deutschland und Österreich” GesRZ 2007, 79.

25. S Schneider, “Unternehmerische Entscheidungen als Anwendungsvoraussetzung für die Business Judgement Rule” DB 2005, 707, 711.

26. R Briem, “Unternehmerische Entscheidungen in Stiftungen” PSR 2010, 27.

27. R Briem, “Unternehmerische Entscheidungen in Stiftungen” PSR 2010, 27.

28. U Torggler, “Business Judgment Rule und unternehmerische Ermessensentscheidungen” ZfRV 2002/9; quotation translated by the author (“Verwirklichung des typischen Unternehmerrisikos”).

29. U Torggler, “Business Judgment Rule und unternehmerische Ermessensentscheidungen” ZfRV 2002/9.

30. J Gasser, “Die Business Judgment Rule in Liechtenstein” PSR 2/2011, 62.

Mag. Daniela Olbrich, M.B.L., joined PHH Rechtsanwälte in 2007 after having worked with other law firms in Vienna and the European Center for E-Commerce and Internet Law. She has since specialized in corporate matters, including private foundations. She lectured at the Vienna University of Economics and at the University of Vienna Law School. Daniela has written several academic papers, inter alia, on asset management in private foundations, taxation and profit determination of private foundations or cross-border loss recovery. She took a post-graduate master's degree in economic law at the University of Salzburg Law School and completed the training as a senior project manager at Roland Gareis Consulting. Daniela speaks German and English fluently. Email: olbrich@pvh.at