Piercing the Corporate Veil in the UAE: Suing and Enforcing against LLC Shareholders, Directors and Managers

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The volatile mass number of persons establishing, liquidating, or not renewing limited liability companies (LLCs) in the United Arab Emirates causes a plethora of claims being met with enforceability issues – particularly due to lack of assets.

Creditors take action against debtor LLCs to find that the latter have expired licenses, transferred assets to a new LLC, or distributed dividends leaving no assets in the creditor LLC.

The frustration that debtors face in these circumstances is agonizing – resulting from years of litigating before the courts or arbitral tribunals, only to find enforcement is to no avail.

However, the court systems are not without resolve in these circumstances.

Here we provide a brief palatable overview of when liability may not be limited, and the evidence and procedure required to trigger the courts into action.

When is liability not limited?

Most of the legislative provisions have been discussed in

various articles issued by firms in the UAE over time, but for clarity's sake, this article is segmented into a palatable breakdown of circumstances where personal liability can arise, and at the end of this article, relevant cases and provisions of the law have been provided.

Shareholders (whom one of, if not all, are usually managers or board members) are protected by the limitation of liability, i.e. the corporate veil of an LLC.

In brief; the shareholders, board members, or managers who operate the LLC, benefit from it, but as a general matter an LLC's creditor is limited to action against the LLC itself, not those operating and benefiting (unless there is a financial instrument triggering criminal liability).

There are, however, certain actions that if taken by the shareholder(s), board member(s), or manager(s) would hold them liable in their personal capacity, either jointly or severally.

Following is a brief summary of when such circumstances could be.

Shareholders can be held personally liable if they had:

- Not contributed the disclosed share capital in cash.
- Overvalued contributions of shares in-kind.
- Increased number of shareholders without notifying the authorities.
- Identified the LLC as another legal form.

Board members and/or managers can be held personally liable if they had:

- Not registered the Articles of Association or any amendments thereto with the authorities.
- Distributed fictitious profits to shareholders.
- Distributed to the shareholders or other profits or

interests in contravention with the law.
- In case the company is in bankruptcy and it was found that the company's assets are not sufficient to meet at least (20%) twenty percent of its debts.

Managers can be held personally liable if they fail to clearly disclose that the company is an LLC by name, i.e. by explicitly stating after the name of the company the expression "Limited Liability Company" or in short "LLC". In the event of a sole proprietorship, the name of the company shall be accompanied by the name of its owner and followed by the expression "sole proprietorship with limited liability".

Evidence

The more important, follow-up question, to the above analysis is to do with evidence.

Most, if not all, of the circumstances mentioned above, are either undisclosed to the public and/or require an uphill battle to prove without tangible evidence.

The UAE courts have powers to issue subpoena orders against defendants or third parties to provide witness statements and/or disclose documents that would assist in the plaintiffs' claims.

A court may issue a subpoena order for the disclosure of the documents such as general assembly minutes of the meeting, bank deposits at the time of establishment (to evidence share capital deposits), official documents (such as trade licenses, articles of association, etc.).

Bearing in mind that the evidential threshold for the court to issue a subpoena order, and such requests are usually to no avail.

Alternatively, plaintiffs may rely on experts to act as mediums in obtaining documentary evidence.

There is no explicit provision in the law that identifies an expert’s permissible actions, but the courts have the authority to state the expert’s duties and the urgent measures he is allowed to take.

In practice, expert duties may include investigation of documents and devices at the plaintiff’s, or any other third party’s location, in addition to valuation, obtaining witness statements, etc.

Moreover, the plaintiff and their counsel may accompany the expert during his investigation of the defendant’s (or any other third party’s) premises, documents, or devices.

Conclusively

The reality is; it is not farfetched that LLCs have issues with miscalculated profit distribution or paid-up capital, or merely not maintaining enough assets to meet at least 20% of their debts.

Any of these missteps could trigger personal liability on the shareholder, board member, or manager, piercing the corporate veil and allowing plaintiffs to find recourse for their claims/judgments/awards.

Sample Cases

Dubai Cassation Court 239/2008: It was decided that the non-availability of the substantive elements of the company would lead to its nullity – and any interested party may claim this nullity and the court would automatically consider it.

Federal Supreme Court 669/2014: Shareholders in an LLC are not personally liable for any of the debts of the company, other than for the amount already invested in the company; creditors cannot seize the shareholders’ personal assets as long as the shareholder(s) was acting on behalf of the company within the limits of their authority.

Federal Supreme Court 811/2004: Creditors have the right to pursue a shareholder's personal assets and hold him personally accountable for an LLC's debts once it was proven that he has exploited the financial independence of the LLC's patrimony, limited from its shareholders' patrimony, as a mean and cover to his apparent fraudulent acts against the LLC's creditors.

Federal Supreme Court 167/2001: Non-publication of the registration documents of a limited liability company has, in terms of the corporate veil and its standing towards the shareholders, the same effect as non-registration.

Commercial Companies Law No. 2 of 2015 ("CCL")

Articles 8 and 9 of the CCL: A company is a contract under which two or more persons are committed to participating in an economic enterprise with the objective of profit realization by contributing a share in capital or work and dividing between themselves the profit or loss resulting from the enterprise. Any company which does not adopt one of the legal forms shall be considered null and void, and the persons concluding contracts in its name shall be individually and jointly liable for the obligations arising from such contracts.

Article 15 of the CCL: The managers, or directors of the company, as the case may be, shall be jointly liable to indemnify the damage suffered by the company, the shareholders or third parties due to the non-registration of the Articles of Association or any amendments thereto with the competent authority.

Article 16 of the CCL: If the invalidity of the company is ruled based on a third-party request, the company shall be deemed void ab initio as against such third party. Persons who have contracted with such third party in the name of the company shall be personally and jointly liable for the obligations arising from such Contract.

Article 30 of the CCL: No fictitious profits may be distributed to the partners or shareholders. The board of directors or any similar body shall be liable towards the partners or shareholders and the creditors of the company for such procedure.

Article 72: A Limited Liability Company shall have a name derived from its objective or from the name (s) of one or more partners, provided that name of the company shall be followed by the expression “Limited Liability Company” or in short “LLC”. In the event of a sole proprietorship, the name of the company shall be accompanied with the name of its owner and followed by the expression “sole proprietorship with limited liability”. If the manager (or managers) contravene the provision of this article, such manager (managers) shall be jointly liable, in their own assets, for the obligations of the company and, as applicable, for the compensations.

Article 75 of the CCL: If at any time upon the incorporation of the company, the number of the partners exceeds the maximum limit of 50, the manager or managers, as the case may be, shall notify the competent authority within thirty (30) days from the date of such increase. Other than in the event of transfer of title to the share of a partner by way of inheritance or court judgment, the company shall adjust its position within three months from the date of the notice, and the competent authority may extend such period to another period of three months, otherwise the company shall be deemed terminated. The partners shall be personally and jointly liable from their assets for the debts and obligations of the company from the date of increase of the number of the partners.

Articles 76 and 78 of the CCL: Shares may be in cash and/ or in-kind and shall be paid in full at the time of incorporation. The shares in cash shall be deposited in a bank operating in the State. The bank may not pay such shares other than to the managers of the company after providing such

evidence that the company has been registered with the competent authority and as provided by the contract appointing such managers. The partners may agree on the value of shares in kind. In such event, such value shall be approved by the competent authority. The partner providing such contribution shall be liable to third parties for the evaluation of its value in the Articles of Association.

Article 363 of the CCL: Any manager or board member who distributes to the shareholders or others profits or interests in contravention of the provisions of the CCL or the Memorandum of Association or Articles of Association of the company and any auditor who approves such distribution while being aware of such contravention shall be punished by imprisonment for a period between six months and three years and/ or a fine between AED 50,000 (fifty thousand) and AED 500,000 (five hundred thousand).

Insolvency Law No. 9 of 2016 ("IL")

Article 144 of the IL: If it was found that the company's assets are not sufficient to meet at least (20%) twenty percent of its debts, the court that adjudicated bankruptcy may compel some or all the members of the board or the managers, jointly or severally, to pay all or some of the company's debts, in the cases where they are proved to be liable for the company's losses according to the provisions of the Commercial Companies Law.

Evidence in Civil and Commercial Transactions Law No. 10 of 1992 ("ECCL")

Article 18 of the ECCL: A party to the litigation may request the court to compel his opponent to submit any useful written document or paper detained by him…

Article 20 of the ECCL: The court may, during the examination of the case, even before the court of appeal, give permission to force the intervention of a third party compelling him to

submit a document in his possession, in the instances and without prejudice to the provisions and the circumstances provided for in the preceding articles. It may also order – even if by itself – to involve any administrative party to give all information and documents necessary for the flow of the case.

Article 54 of the ECCL: Parties to the litigation may not be heard as witnesses in a case but the court may, however, interrogate those present in court, and each one of them may request the interrogation of his attending opponent. The court may also, on its own or upon request of his opponent order summoning a party to the case to interrogate him. The party summoned for interrogation has to attend the hearing fixed in the order.

Article 71 of the ECCL: Should the court decide to delegate an expert or more, its decision must include the following…an accurate statement of the expert's duties and the urgent measures he is allowed to take.

Translations of law and case decisions provided by LexisNexis Middle East.

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