PRECEDENT: UAE Supreme Court pierces the corporate veil and finds foreign company liable for its UAE subsidiary in USD 1.2 billion energy dispute

March 21, 2021

Summary

The UAE Supreme Court ruled that foreign companies engaging in commercial activities in the UAE are liable for the actions of their UAE subsidiaries even where the UAE subsidiary is the party to the contract in dispute and not the foreign company.

The Supreme Court considered the following arguments:

- The ownership percentage of the UAE subsidiary by the foreign parent company.
- The degree of benefit and responsibility of the foreign parent company in the transaction entered into by its UAE subsidiary in dispute.
- The extent to which the foreign parent company engages in pre-contract activities (such as negotiation) and post-contract activities (such as implementation).
- The extent to which the UAE subsidiary is acting on behalf or for the foreign parent company.

Facts

In 2005, two parties entered into a gas supply agreement for the manufacture of ammonia on the basis that the gas supply would commence on 31 December 2006 (the “Agreement”).

One party to the Agreement was to develop the manufacturing capacities (the “Manufacturer”), and the second party to the Agreement was the UAE subsidiary (“UAE Subsidiary”) of the foreign company (the “Foreign Supplier”).

The Manufacturer completed the development of the facilities, but the UAE Subsidiary did not comply with the supply of the gas by 31 December 2006.

Claim

In 2012, the Manufacturer sued the UAE Subsidiary, the Foreign Supplier and six of the Foreign Supplier’s foreign subsidiaries for the following:

- Almost USD 740,000,000 in lost profits.
- Almost USD 100,000,000 in future lost profits.
- Almost USD 280,000,000 in depreciation of assets.
- Almost USD 40,000,000 in financing costs.
- And other heads of claim regarding leasing and insurance costs, and moral damages.

The Foreign Supplier and its six foreign subsidiaries had no corporate registration in the UAE.

The UAE Subsidiary filed a counterclaim requesting the non-entry into force of the Agreement, and in alternate for the rescindment of the Agreement, and almost USD 30,000,000 in compensation on the basis that:

- the Agreement was subject to a condition precedent for the Manufacturer to secure buyers for the manufactured goods by September 2005 – which the Manufacturer had allegedly failed to conclude.

Primary and Appeals Judgments

The Primary Court rejected the counterclaim by the UAE Subsidiary and ordered compensation by the UAE Subsidiary of almost USD 260,000,000 in favor of the Manufacturer.

The Primary Court did not find the Foreign Supplier or its six foreign subsidiaries liable on the basis that they were not signatories to the Agreement and were not licensed to operate in the UAE.

The Appels Court upheld the Primary Court ruling and increased the compensation quantum in favor of the Manufacturer to almost USD 290,000,000.

Supreme Court Appeal

The Manufacturer challenged the Appeals judgment before the Supreme Court in its part in finding the UAE Subsidiary solely liable – and not finding the Foreign Supplier and its six subsidiaries liable.

The Manufacturer argued that the Foreign Supplier should be held liable for the following reasons:

- the Foreign Supplier is the 100% owner of the UAE Subsidiary;
- the Foreign Supplier is the owner of the gas intended for supply;
- notwithstanding that the UAE Subsidiary was signatory to the Agreement, the Foreign Supplier was the party responsible for negotiating the Agreement; and
- the UAE Subsidiary signed the Agreement on instruction of the Foreign Supplier.

The Manufacturer also argued that the six foreign subsidiaries should be found liable on the basis that:

- the six foreign subsidiaries assisted in the negotiation and conclusion of the Agreement, and hence are jointly liable for any liabilities on the UAE Subsidiary.

Supreme Court Judgment

The Supreme Court overturned the Appeals Court judgment (and in turn the Primary Court judgment) and found that the Foreign Company and its six foreign subsidiaries are to be held jointly and personally liable alongside the UAE Subsidiary for the ordered compensation of USD 290,000,000.

In its reasoning, the Supreme Court applied Articles 313, 314, 315, and 316 of the UAE Commercial Companies Law of 1984 as the governing law at the time of the transaction ("Old CCL") – as opposed to the new UAE Commercial Companies Law of 2015.

The Supreme Court ruled that Articles 313 to 316 of the Old CCL:

"…indicate that the foreign company incorporated abroad may not practice its activity inside the United Arab Emirates unless it obtains a license to do so from the Ministry of Economy after the approval of the competent authority in the Emirate in which it carries out this activity, provided that it is proclaimed by being registered in the commercial register.

If the foreign company or the office or branch to which these procedures are affiliated do not fulfill such requirements before carrying out any activity within the UAE, then they shall not be considered as an independent personality separated from the liabilities of the registered subsidiary, and all that is done in terms of actions by, or arrangements for the account of, the foreign company before the completion of the registration procedures results in personal liability on the foreign company, and joint liability with the persons who performed the act or the disposition on the foreign company's behalf."

The Supreme Court found that the Primary and Appeals Courts' judgments were deficient in excluding the Foreign Supplier from the liabilities of a foreign company active in the UAE.

The Primary and Appeals Courts' judgments relied on Article 2(3) of the Old CCL which excludes the provisions of the Old CCL to petroleum companies working in the field of prospection, extraction, marketing, and transport; companies producing electricity, gas, water desalination and related activities such as transport, and distribution, as well as companies that are exempt by a Cabinet of Ministers decision.

The Supreme Court ordered that Article 2(3) of the Old CCL applies and exempts oil and gas, and electricity and water companies that are registered in the UAE. However, it does not apply to foreign energy companies that do not have any form of registration in the UAE.

Significance

The Supreme Court judgment creates a substantially novel landscape for creditors in the UAE by providing precedent to pursue foreign parent companies for the debts of their UAE subsidiaries – even where the party to the contract in dispute is the UAE subsidiary of the foreign parent company, and not the foreign parent company.

For foreign parent companies, this novelty manifests the need to consider the extent to which a foreign parent company will negotiate and engage in a contract prior to the signing of the contract by its UAE subsidiary, the ownership structure that the foreign parent company will have over its UAE subsidiary, and the level of managerial control the foreign parent company will apply to its UAE subsidiary.

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