

# The 10 Elements Required To Prevent Company's Nullification In The UAE

The nullification of a commercial company (the "Company") is one of the main instances which could lead to piercing the Company's corporate veil, rendering the shareholders personally and jointly liable for the Company's obligations. Therefore, it is important to examine the circumstances in which a Company could be considered or declared nullified and the key implications of such nullification.

**Thomson Reuters:** Let us start with the Law's definition of a "Company"

**Al Sebae:** The UAE Federal Law No. 2 of 2015, concerning Commercial Companies in UAE, has defined in Article 8 a company to be "a contract under which two or more persons are committed to participate in an economic enterprise aiming at profit by contributing a share of capital or work and dividing between themselves the profit or loss resulting from the enterprise" (the "Contract" – also known as the Memorandum of Association). Having that said, a Company must adopt one of the five legal forms listed in Article 9 of the Law, otherwise it will be considered void.

This Contract must include certain elements relating to the establishment of the Company, which, once formed and registered in the commercial register, is considered as a separate legal entity. Consequently, the lack of any one of those elements could result in the nullification of the Contract and of the Company established thereby.

**Thomson Reuters:** You mentioned "elements"; are they divided into different types of categories?

**Al Sebae:** Yes they are. These elements are divided into "substantive elements" and "formal requirements". The substantive elements are further divided into "general" and "specific".

**Thomson Reuters:** Would please explain the difference between all these elements?

**Al Sebae:** Absolutely. Let's start with the "general substantive elements".

These are elements which must be present in all contracts, namely:

1. A mutual agreement, which occurs when two or more wills meet together to achieve a particular legal effect, because no contract may exist without the presence of a valid will, free of defects and expressed by a person who has capacity to do so;

2. A subject matter, which constitutes the purpose for which the Company has been established and which the Company seeks to achieve through the use of its capital. The purpose must be legitimate and it must not violate public order and morals, and it must be financially and legally possible; and
3. A lawful cause represented in the shareholder's desire to make profit through the Company's activities, which must be legitimate.

Coming to the "specific substantive elements", the Dubai Court of Cassation has decided - in various judgments - that the Company's Contract is not considered valid unless these elements are fulfilled, which helps in demonstrating the Company's unique characteristics.

These "specific substantive elements" are:

1. Having more than one shareholder, which is considered to be one of the conditions for the Company's formation. However, this condition is subject to specific statutory exceptions, whereby one person alone may establish a Company for special economic considerations;
2. The contribution to the Company's share capital which is required by the Company to exercise its activity. Therefore, if some of the shares are real and others are sham, this could lead to the nullification of the Company due to nonpayment of the Company's capital in full when established;
3. The shareholders' intention to enter into this partnership in the Company and their willingness to share the profits generated or the losses incurred by the Company's activities; and
4. Sharing the profits and losses of the Company, being the aim for which the Company was established.



### Thomson Reuters: What are the "formal requirements" then?

**Al Sebae:** The "formal requirements" must be met to have a valid formation of a Company. They may be summarized as follows:

1. The Contract must be in writing because writing is a formal requirement. Furthermore, the Dubai Court of Cassation has confirmed that the Company's shareholders may not establish something that contradicts the provisions of the Contract unless it is in writing. Therefore, any attempt to establish that the Contract is a sham will not be considered unless the claim can be established by means of a written document;
2. Disclosure of the Company's Contract by registering it (and any amendment thereto) in the commercial register. The Contract or any amendment thereto will only be valid and effective towards third parties from the date of its registration, which represents the Company's date of birth as a corporate person. However, in spite of this, Dubai Court of Cassation has held that the failure to register the Company's Contract does not prevent third parties from proving the Company's existence as a de facto Company (in which the shareholders will be jointly and personally liable, along with the Company itself, for the Company's obligations) by all methods of proof; and
3. Having at least one local shareholder holding not less than 51% of the Company's capital, taking into account the commercial activities limited to Companies fully owned by Emirati shareholders. This is considered as a matter of public order, and the absence thereof at the beginning or at any time would nullify the Company.

### Thomson Reuters: We have looked into the different elements when forming a company. What are the consequences if one or all elements were missing?

**Al Sebae:** The absence of any of the above mentioned elements of the Company could lead to its nullification. However, such nullification differs in nature according to the element which is considered to be absent, taking into account the special nature of the Contract.

### Thomson Reuters: How can the nature of the nullification differ?

**Al Sebae:** We need to differentiate between the "absolute nullification" and the "relative nullification" of a company. This depends on the element missing.

For instance, the absence of any of the general or specific substantive elements could lead to the "absolute nullification" of a company. The

characteristics of such nullification are:

1. Any person with an interest may rely on it, whether a shareholder or third parties;
2. The judge may decide on it on his own motion; and
3. The Contract may not be ratified and the case for nullification may not be heard after the elapse of 15 years from the date of conclusion of the Contract.

On the other hand, the absence of any of the elements relating to the formal requirements could lead to the "relative nullification" of a Company. The characteristics of such nullification are:

1. The Court may not decide on its own motion, rather the shareholders or third parties should raise the point;
2. The nullification may be rectified once its cause has been eliminated by the shareholders before the issuance of the nullifying judgment;
3. Third parties may insist on nullification, as so required by their interest; and
4. The shareholders may not rely on it against third parties, although they may do so against each other.

### Thomson Reuters: What are the consequences to the Company's nullification?

**Al Sebae:** If the Company was declared null based on a judgment at the request of a third party, the Company would be rendered as if it did not exist for that party. Thus, the nullification would apply retrospectively as well as for the future. This may also entail personal and joint responsibility of the shareholders towards such a third party with whom they had contracted in the name of the Company.

Whereas if one of the shareholders relied on this nullification, the Company would be dissolved and liquidated.

Furthermore, the UAE legislator has stepped out of the general rules applicable to null contracts and stipulated in article 16 of the Law that if the nullification of the Company is upheld, the conditions set forth in the Contract shall apply to the liquidation of the Company and the settlement of the rights of the shareholders against each other, on the grounds that it was valid before the judgment of nullification. Hence, the legislator limited the effect of nullity of the Company, as a corporate person, only to the future, without placing any effects to the past, with the objective of protecting the apparent status, stability

of transactions and legal positions acquired by shareholders as well as among themselves. But if the shareholders have not begun any activity through the Company, in this case the expiry and invalidity of the Company's Contract will be retrospective.

**Thomson Reuters:** Finally, what can you tell us about the stance Courts in UAE have taken regarding the nullification of a company?

**Al Sebae:** The Dubai Courts have held in many judgments that if a Company began its activity without registering and publishing its Contract according to the Law, it will still be considered existent in relation to third parties as a de facto Company, for which it will have a corporate personality and financial liability independent of its shareholders. However, those shareholders shall be liable among themselves jointly with the Company for actions carried out by its manager or one of the shareholders in the Company's name.

**Thomson Reuters:** Which Companies are most likely to be subject to nullification and why?

**Al Sebae:** Although all Companies could be subject to nullification, limited liability companies are mostly the Companies that could face the risk of being nullified and this is due to the nature of the agreements which are usually entered into by the foreign investors with their local shareholders in such Companies".

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