

Dubai: Liability of Shareholders in a Limited Liability Company

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A Limited Liability Company as defined by Article 218 of the UAE Commercial Companies Law is a company in which the liability of its partner is limited only to the extent of their shares in the capital.

However, The Dubai Court of Cassation in its rulings established an exception to this general rule laid by law. The court in the following judgment rendered its decision extending the liability of the partners in a limited liability company to reach their personal assets provided the satisfaction of certain extraordinary specific circumstances as we will see.

Summary of Facts:

- The Claimant (a creditor of a limited liability company) obtained a court judgment (First Action) against its debtor (the limited liability company, referred to as “the LLC”) obligating the latter to pay the sum of AED 781,619.07 with interest.
- The Claimant, upon failing execution of the First Action, sought recourse against the shareholders of its debtor ,the LLC, by filing another commercial action against the Respondents (shareholders of the LLC).
- The Claimant requested in its second action engaging the liability of the Respondents in their personal assets to pay the sum of the debt.
- The Claimant also stated that the Respondents as shareholders in the LLC are liable to pay the awarded amount each to the extent of his share in the capital. Furthermore, according to the UAE Commercial Companies Law the “Law” the Second Respondent being the Manager of the LLC is liable to the full extent of his personal assets for the company’s liabilities and for claims for indemnity. Additionally the Respondents are personally liable for their fault to comply with Articles 238 and 255 of the said law.

Procedural History:

- The Court of First Instance dismissed the case.
- The Claimant appealed before the Court of Appeals which overturned the appealed judgment on the grounds of pre-adjudication in the same subject matter.
- The Claimant, therefore, appealed to the Dubai Court of Cassation which in turn overturned the Appeals Court’s decision, and referred the case back to the Appeal Court to adjudicate the case. The Cassation Court held that the lower court erred in its application of the law when it considered the matter pre adjudicated against the Respondents although there is no unity in the parties or the causation of the dispute.
- The referral court after referring the case to the Dispute Resolution and Expertise Department of the Ruler’s Court rendered its judgment obligating the Respondents to pay to the Claimant the sum of AED 781,619.07 jointly and severally each to the extent of his share/shares in the capital.
- The Respondents appealed to the Court of Cassation requesting overturning the judgment.

The Court of Cassation

The Respondents in their challenging the Court of Appeals judgment raised two arguments

1. The Respondents argued that the lower court erred in obligating the Respondents to pay the sum awarded in the first action. On the grounds that the lower court contradicted the principal of res judicata (courts may not re-adjudicate matters which have been previously judicially finalized). In this sense the Appeals Court allowed the Claimant to obtain a court order with the payment of the sum awarded twice from the same transaction.

Responding to this argument the court held that it was groundless. It is an established judicial principle, that if there are several sources of an obligation, meaning if one person's liability is derived from the contract and another person's liability is derived from the harmful act, while both liabilities are tied to the same matter, each of these persons will be held liable against the injured party for full compensation.

In this case, the Claimant did not receive satisfaction of the debt from the LLC as an entity, therefore, the Claimant sought recourse against its shareholders personally (the Respondents). However, the Claimant will not obtain compensation twice. The Claimant's right is limited to receiving satisfaction of the sum just once. If he receives the awarded sum from either the LLC as an entity or from one of the Respondents, then the other is discharged. The Claimant will then have no right of recourse or enforcement against any of the obligors (being the LLC or the Respondents).

Since there was no proof furnished that the Claimant obtained the awarded amount, he has the right for recourse against the Respondents for their harmful act.

2. The Respondents further argued that the Court of Appeals erred in establishing that the Respondents intentionally committed an aggravated harm to the Claimant. The appealed judgment did not demonstrate the harmful act or the Respondents' role in harming their company's creditor (the Claimant).

The Cassation Court held that this argument was groundless. The court established its reasoning on three bases:

1. The effect of the provisions of the UAE Commercial Companies Law in relation to limited liability companies provides:

- The share holders who are not also directors shall have the right to inspect the operations of the company, to examine its books and documents in addition to providing advice and guidance to the manager.
- The company shall have a general assembly consisting of all of the shareholders, which shall meet at least once a year during the four months following the end of the financial year.
- The agenda of such meeting must include hearing the manager's report concerning the activities and the financial status of the company during the year, the auditor's report, and a discussion of the balance sheet and profit and loss account in addition to ratifying them.
- Any of the shareholders, whether in person or by his agent, has the right to examine minutes of the general assembly meeting and resolutions and he shall also have the right to examine the balance sheet , profit and loss account and the annual report.
- The company must have an auditor of accounts elected by the general assembly to audit accounts of the company and to observe whether the law and the constitutive documentation of the company have been observed, he must submit his report stating the result of the examination to the general assembly.
- The company must set aside 10% of its net profits to form the statutory reserve, and the shareholders may decide to stop setting aside such monies if the reserve reaches one-half of the capital.
- The Court construed from the above that shareholders of a limited liability company are required by the law to be aware and informed of its profit and loss accounts.

2. The general rule set forth in Article 218 of the CCL provides that a shareholder in a limited liability company is responsible only to the extent of his share/shares in the capital of the company. The exception to this general rule, as the Court reasoned, is that such shareholder will be held personally liable, if he exploited the principle of the independent liability of the company, as means to conceal his fraudulent acts or misappropriation of the funds of the company in order to cause harm his partners or creditors. In such case, the protection bestowed by law for shareholder in a limited liability company will not apply. He will be held liable in his personal capacity for such dispositions in a way that such liability will extent to his personal assets.

3. It is also construed from provisions of the CCL that the manager of a limited liability company is liable towards the company, the shareholders and third parties for indemnifying loss arising out of his default and neglect in management, all acts of fraud and abuse of power and any breach of the law or the company's constitutive documents.

The court further held that, the appointed expert's report established the LLC's budget exhibited that its most valuable asset was its reserve which value reached AED 6 million. The expert stated that there are no traces of such reserve while the company's debt reached AED 1 million.

The expert report in its conclusion revealed the intentional vast committed by the manager and the shareholders (the Respondents). Their fraudulent acts are exhibited in concealing the company's assets which represented the company's general guarantee to its debts.

The Court therefore established that the Respondents by misappropriating the funds of the LLC by their faults intended to cause damage it its creditors. The Court therefore held the Respondents personally liable for the awarded sum and dismissed the challenge.

Practice Note:

We understand from the above judgment that the exception to the limitation of the liability of limited liability companies' shareholders to the extent of their shares is crucial to safeguard the company's creditors. In some instances, shareholders in limited liability companies opted to abuse the protection bestowed by law to defraud the company's creditors. By engaging their personal liability, this exception imposes a condition upon the shareholders and directors of the limited liability company to maintain its assets as a general guarantee to the creditors of the company. Such court practice helps restore customers and investors credibility in conducting transactions with limited liability companies.

Learn how our [corporate structuring practice](#) offers legal advice to shareholders in a Limited Liability Company.