

Pre-Incorporation Contracts under UAE Law

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In entering into these contracts the description of the parties would, in relation to the company, include the statement “under formation” after the name of the company.

However if the company only exists once it has been registered in the relevant official register, then what is the status of contracts purportedly entered into by a company “under formation”?

The Law

In order to establish what under UAE law the status of a contract signed by (or on behalf of) a company that is yet to exist is, reference must be made to the relevant legislation.

In the case of companies formed under the Commercial Companies Law No.8 of 1984, Article 11 of the 1984 Law provides that ‘with the exception of a joint participation, a company memorandum and any amendment thereto has to be registered in the Commercial Register’. Further, Article 12 of the 1984 Law states that “...a company shall not have a corporate personality and shall not be allowed to perform its business unless it is registered in the commercial register.....” and goes on to state that “All business and transactions performed on behalf of the company by individuals before its registration shall result in their joint liability”.

This concept is further confirmed in the context of public joint stock companies by Article 72 of the 1984 Law, which provides that ‘during the incorporation period, the company will have the corporate personality to the extent necessary for its incorporation. During this period, the Company will be bound by the actions of the founder members, provided that its incorporation is completed in accordance with the Law’, and in the case of limited liability companies by Article 225 of the 1984 Law which provides that ‘the company may not practice any of its activities except after registration in the Commercial Register’.

The above provisions logically suggest that in order for a company to undertake business, and more specifically to incur liabilities and obligations to third parties by entering into contracts and agreements, it must first exist and it is only capable of demonstrating that it does so exist by virtue of appropriate registration. Of course, one of the prime benefits of undertaking business through a limited liability company is the protection offered to the shareholders against exposure to the liabilities of the company itself. However it seems clear from the above provisions that individuals who enter into contracts for and on behalf of a company before its incorporation will be personally liable under that contract.

Extent of Personal Liability

Are there any circumstances where individuals may be protected from such personal liability before the company is established? What is the status of the contract purportedly entered into by a company prior to its registration once that company is established?

The last section of Article 12 of the 1984 Law states ‘However, during the incorporation period, the

company shall have a corporate personality up to the extent required for its incorporation’.

In our view Article 12 means that a company can be said to have a corporate existence for purposes such as opening a bank account or entering into a lease, which is required as part of the incorporation process. The company will be described in any contracts entered into during this stage as “XYZ LLC (under formation)”.

But what does this really mean? Individuals who sign on behalf of a company that has yet to be registered, i.e. on behalf of a company ‘under formation’, will be personally liable. With regard to any such contracts that are entered into as part of the formation process, in our view the courts would interpret the effect (and benefit) of Article 12 to mean that that as soon as the company is incorporated it will be automatically bound to such contracts in place of those individual signatories and it is at this point that the personal liability of the individual signatory falls away.

Of course, if the Company was not subsequently registered then any individual signing for and on behalf of that company ‘under formation’ would remain personally liable. Signatories should be aware of this risk as it is not uncommon for individuals who are to be employed by the company after its incorporation (i.e. prospective managers) to sign such contracts without regard for the potential liability attaching to their signature.

However, with regard to contracts other than those required in connection with a company’s formation that may be signed by individuals for and on behalf of a company “under formation” it is certainly arguable that upon the formation of the company these contracts will not automatically be binding on the company in place of the individual signatories. This is due to there being no reference in the 1984 Law to a “pre-incorporation” company having any form of corporate personality in the context of any such arrangements. Rather, in our view, there is certainly a risk that the individual signatories may be found to remain personally liable under such arrangements even after the company has been incorporated.

If, notwithstanding this risk, individuals do decide to enter into pre-incorporation contracts other than those required in connection with a company’s formation then we would certainly advise that following the company’s formation the company, the individuals who signed for and on behalf of the company and the other party to that contract enter into some form of written acknowledgement that the company itself is bound in place of those individuals who signed for and on behalf of the company prior to its incorporation, i.e. effectively an assignment agreement (or novation agreement in common law terms).

Even if such a written acknowledgement was not entered into it may be arguable from the parties’ subsequent conduct that the individual signatories who signed on the part of the company prior to its formation are no longer personally liable and that the other party has accepted that the company is now the relevant party that is bound by the terms of the contract. An example may be where the other party continues to deal with the company on the terms of the pre-incorporation contract.

Free Zone Companies

In respect of regulations governing corporate entities in Free Zones in the UAE, the 1984 Law will apply unless the relevant regulations implemented in the Free Zone specifically deal with issues otherwise covered by the 1984 Law. Generally though, the regulations in Free Zones take a similar approach to the 1984 Law when providing for pre-incorporation contracts.

By way of example, Article 8 of the Dubai Silicon Oasis Implementing Regulations 1/2006 provides that:

‘a Free Zone Company “Limited Liability” shall be deemed to have been duly formed with effect from the date of registration thereof in the FZCO Register. Each such Free Zone Company shall then be capable of exercising all the functions of a Free Zone Company but with such liability on the part of its shareholder to contribute to its assets ...’.

Again in our view this means that a person purportedly signing a contract for and on behalf of a company prior to its registration with the Dubai Silicon Oasis Authority will be personally liable and there is a risk that such personal liability may be found to continue even following the subsequent registration of that company. However, with regard to contracts that are required to be entered into prior to the company's incorporation as part of its incorporation procedure, in our opinion, the concept set out in the 1984 Law dealing with these types of contracts will not be seen as being an issue that is specifically contemplated by the free zone's regulations and hence the 1984 Law will have application in addition to the free zone's regulations. As such the analysis set out above in the context of onshore companies will be equally applicable to Dubai Silicon Oasis (and indeed many other free zone) companies.

Conclusion

Whilst there is a reference in the 1984 Law to companies having a "limited" corporate existence prior to their incorporation, any individuals signing on behalf of any company prior to its incorporation should be mindful of the personal liability that he or she will be exposed to by doing so, not just up to the point of incorporation of the company but also potentially, depending on the type of contract, after the incorporation of the company.