

Lifting or piercing the corporate veil



By David Salt and Louise Verrinder

The general principle

Limited Liability Companies (LLCs) established pursuant to Law No.(5) of 2002 as amended (the Companies Law) are the most common vehicles used by foreign investors in Qatar. LLCs have traditionally been seen as a safe option by foreign investors who are familiar with the general principle of the 'corporate veil', a legal concept which separates the personality of a limited liability corporate entity from the personalities of its investors by limiting their liability to the amount each invested in the LLC, except in exceptional circumstances, generally involving fraud, referred to as 'lifting' or 'piercing' the corporate veil.

In Qatar the circumstances where the piercing of the corporate veil is possible may not be so exceptional. Under Article 290 of the Companies Law (Article 290) it is possible to expose the shareholders to the LLC's liabilities in circumstances where the LLC loses half or more of its capital regardless of the reason for those losses, effectively resulting in a loss of limited liability.

Article 290

According to Article 290 where an LLC has losses amounting to half or more of its share capital, the following steps should be taken:

- (1) The Manager(s) (or any person whose name appears on the Commercial Register as an LLC authorised signatory) must call a Shareholders' General Assembly.
- (2) The shareholders must resolve (by a majority of shareholders holding 75 percent of the share capital), to either:
 - (a) reinstate the LLC's capital; or
 - (b) dissolve the LLC.

Both of these steps must be complied with and completed within 30 days after the date the losses amounted to half or more of the LLC's share capital, in order to avoid the shareholders and/or the Manager(s), becoming jointly and severally liable for all the LLC's debts, effectively resulting in a shareholder guarantee.

How to avoid a breach of Article 290

It is not unusual for an LLC to incur losses which exceed half of its capital in the early stages following incorporation but this will not necessarily prevent the business becoming profitable once it is more

established. So what can be done to prevent the principle of limited liability being lost?

- (1) The initial capitalisation should be carefully considered as required by Article 232 of the Companies Law which states that the LLC's capital be "...sufficient to realise its objects". By carefully assessing the amount of capital needed to run the business in its pre-profit stages rather than merely complying with the minimum QAR 200,000 capital requirements, the adverse consequences of Article 290 could be avoided.
- (2) The Companies Law does not specify when and how to determine the LLC's losses, although the generally accepted position is that when the net position of the LLC is negative (ie. when the losses appear in the audited accounts) and the losses amount to half or more of the LLC's share capital then Article 290 will apply. Carefully reviewing the annual audited accounts and requesting the appointed auditor to prepare regular interim accounts will allow the auditors and the Manager(s) to foresee when Article 290 losses are likely to occur and take preventative action if necessary.

What does this mean in practice?

The application of Article 290 remains largely untested before the Qatari courts. In practice, the Article 290 issue will usually only crystallise in situations where:

- a) the annual accounts show a loss;
- b) the LLC's third party creditors issue a debt recovery or bankruptcy claim against the company for failure to make payments; or
- c) where a shareholder wishes to sell its shares and the third party buyer questions the valuation of the LLC.

In order to avoid falling foul of Article 290 the preventative measures suggested in this article should be considered as a matter of standard practice.

Note: all Qatari Laws (save for those issued by, eg. the QFC to regulate its own business), are issued in Arabic and there are no official translations, therefore for the purposes of drafting this article Clyde & Co LLP has used its own translation and interpreted the same in the context of Qatari laws, regulation and current market practice.

Clyde & Co LLP

Qatar Financial Centre, West Bay, Doha, Qatar
 PO Box 31453

Tel: (974) 4496 7434

Fax: (974) 4496 7412

Email: david.salt@clydeco.com

louise.verrinder@clydeco.com

www.clydeco.com