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DUBAÏ DESK

Case Study

The Annulment of Arbitral Awards in Case of Contract's Comprisal of Leonine Clause



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The Existence of Clauses Exempting a Shareholder from Sharing the Liabilities Arising Out of the Agreement Leading to Material Contractual Imbalance Generates Annulment of Arbitral Awards

Overview

Directed by the aim to restrain the risk associated with partnership, shareholders tend to limit their liability through their choice entity type. Contingent on the form of the company, shareholders will be entitled to restrain their liability to the loss of their contribution in the company. Nevertheless, legal industry is witnessing a practice whereby shareholders go even further beyond the choice of entity type and safeguard their contribution in the company while contributing as risk-free shareholders in the company. This is so-called the leonine clause. The leonine clause corresponds to agreements which allocate the entire gains and profits to one of the shareholders are deemed null and void. An identical remedy applies for a clause which excludes monies or goods contributed to the company by one or more of the shareholders from any contribution to the loss.

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The legal validity of this construction has been subject of much debate. In the same direction, the use of a leonine clause in an arbitration agreement can have various effects depending on the jurisdiction in which the agreement is being enforced. In view of the fact that the core of Arbitration consists of an alternative dispute resolution that is based on cooperation and mutual agreement between parties involved, Courts are often hesitant to enforce leonine clauses in arbitration agreements. The insertion of an arbitration clause can be deemed as undermining this cooperation tendance and may potentially lead to a breakdown in the arbitration process. On a similar note, the use of a leonine clause in an arbitration agreement can be considered as an attempt to intimidate or coerce the analogue into accepting unfavourable terms and foregoing their legal rights.

Legal Background

First and foremost, public policy is the body of laws, regulations, and guidelines that shape the actions and decisions of governmental bodies and public institutions. It encompasses a wide range of issues, from economic and social welfare to national security and foreign policy. The ultimate intention of public policy tends to promote the social security, common good, and to preserve the interests of the society as a whole, rather than allocating privileges to one individual of group. With the aim to protect the public policy given its crucial role in shaping the society and ensuring the well-being of all citizens, the judicial bodies and policymakers gravitate toward the elimination of any disruption likely to cause concernment to the said order. Legally speaking, a leonine clause refers to a clause inserted in an agreement that is deemed excessively or unreasonably favorable to one party over the other.

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Such clause constitutes a provision granting one party an unfair advantage or places an unreasonable burden or loss on the other party. At present, there is relative consensus in the legal doctrine concerning the ban on exclusion from profit in a company. The underlying rationale for the latter ban is associated to the core objective of the company: for shareholders to pursue profits and gain. Nonetheless, the ban on exclusion from profit does not mean that all shareholders must share equally in the profit. As long as the shareholders are treated equally, disproportionate treatment is permitted.

Judgement Under Study

The case under study is a verdict rendered by the Dubai Court of Appeal in 2022. Pursuant this judgement, the Court of Appeal has decided upon a dispute involving a memorandum of association of a limited liability company comprising an arbitration clause entered into between two parties whereby the opponent has been assigned a fifty-one percent of the total shares of the company against forty-nine percent for the claimant. The facts of the case illustrated the establishment of a limited liability company pursuant a memorandum of association concluded between the litigant parties whereby both signatory parties agreed that only the claimant shall benefit from the company's profits and shall solely endure its losses against a monthly remuneration eligible to the respondent granting that the minimum annual compensation due to the respondent shall in no case be less than one hundred thousand Dirhams. Furthermore, it has been stipulated in the memorandum of association that the respondent shall not be involved in collecting the entity's turnover. Albeit the plaintiff's involvement in all shareholders' duties, the respondent has been illustrated through this clause as a silent shareholder, only eligible to receive a monthly remuneration acting as an

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employee in the company in return of an integral involvement from the plaintiff unsuccessfully declined from meeting the buyer's expectations. The judgement under study referred to Article 53 entitled Challenging Arbitral Awards of the Law No. 6 of 2018 providing that: "The Court shall, on its own initiative, set aside the arbitral award if it finds that: (a) The subject-matter of the dispute is not capable of settlement by Arbitration. (b) The arbitral award is in conflict with the public order and morality of the State". Along the same lines, the verdict has further indicated that the Article 29 entitled Distribution of the profits and losses of the Law No. 32 of 2021 stated that "A Company's Memorandum of Association depriving a partner of the profits or exempting him from sharing the losses, or granting him a fixed percentage of profits, shall be deemed null and void." According to the verdict, it has been decided by the doctrine of Court of Cassation that nullification of a company's memorandum of association due to the reluctance of one of the shareholders to benefit from the company's profits and bear its losses illustrates a leonine clause.

The judgement has provided that the legislator has decided upon the nullification of a memorandum of association containing a clause allocating the entire profits to one of the shareholders or exempting monies or goods contributed to the company by one or more of the shareholders from any contribution to the loss. Upon the Court's analysis, and provided that the respondent has originally filed the request for arbitration claiming his reimbursement with his fixed percentage interest amounted to 1.5% of the total turnover of the company, it has become apparent that the memorandum of association of the company has assigned a fixed monetary compensation to the respondent with a minimal cap of one hundred thousand Dirhams and has exempted the latter from any benefit from the company's profits and from any contribution to its losses.

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In line with the Appellant Court's reasoning, the arbitral award pursuant which the respondent of the present dispute has been granted the monetary compensation related to its contractual fixed interest of the company's turnover is deemed contrary to the public policy and public order. The judgement has based its reasoning on the above-referenced articles of law explicitly providing that any memorandum of association depriving a partner of the profits or exempting him from sharing the losses, or granting him a fixed percentage of profits, shall be directly considered as null and void.

Furthermore, the Court has accentuated the evident fact that the respondent has initially concluded the memorandum of association with the claimant for the purpose of obtaining a fixed percentage of the profits. Hence, the respondent's failure to comply with the commonly applied participation in the company's functions defines a fundamental and material breach of a memorandum of association's balance entitling the plaintiff to challenge the arbitral award albeit having mutually agreed to the said clause.

Based on all the above, the Dubai Court of Appeal has judged upon the setting aside of the arbitral award rendered inn connection with the request for arbitration filed by the respondent and ordered the latter to bear the judicial fees of the filed lawsuit.

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Conclusion

In conclusion, in order for a clause to construe a leonine clause in a company's memorandum of association, it shall comprise an allocation of the entire gains and profits or losses to one of the parties to the agreement in exchange to the mere obtainment by the other party of a fixed interest of the company's turnover. The inclusion of such clause in the memorandum of association generates material imbalance between the parties contradicting the core essence of partnership. In all instances, the setting aside of arbitral award rendered in relation to the claim of the said fixed interest constitutes an equitable remedy aimed to restore the shareholders to their pre-arbitration position, and shall be an available remedy to the other contracting party bearing on their own the whole consequences originated from the company's business. Lastly, it is crucial noting that the Court's remedy in regards to the judgement under study was not limited to the annulment of the leonine clause but extended to the annulment of the entire contract due to public policy's infringement.

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