Claim No: CFI 018/2010

THE DUBAI INTERNATIONAL FINANCIAL CENTRE COURTS

In the name of His Highness Sheikh Mohammad Bin Rashid Al Maktoum, Ruler of Dubai

IN THE COURT OF FIRST INSTANCE

BEFORE CHIEF JUSTICE MICHAEL HWANG

BETWEEN

DIWAN CAPITAL AG

Claimant/Respondent

and

DIWAN CAPITAL LIMITED

Defendant/Appellant

Hearing: 18 April 2011

Counsel: Kaashif Basit, KBH Kaanuun LLP for the ClaimantDr. Urs Rechsteiner, for the Defendant

Judgment: 16 May 2011

JUDGMENT

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1. This is an appeal against the Judgment of H.E. Justice Ali Al Madhani issued on 13 June 2010.

2. The Claimant/Respondent ("Diwan AG") lodged a Claim Form seeking monetary relief of AED 91,800 against the Defendant/Appellant ("Diwan DIFC") for preparing and producing a Regulatory Business Plan ("RBP") for Diwan DIFC, which the latter then submitted to the Dubai Financial Services Authority ("DFSA") to assist Diwan DIFC to be licensed as a company within the DIFC.

3. After conciliation efforts before the Small Claims Tribunal had failed, the parties proceeded to an adjudication hearing before H.E. Justice Ali Al Madhani, who gave Judgment in favour of Diwan AG for the sum claimed. Diwan DIFC now appeals against that Judgment.

FACTS

4.1 The parties in the present proceedings were involved in the development of a business project ("the Project") to establish a foothold in the financial markets of the Gulf Cooperation Council (GCC). The Project required the use of three entities forming part of the Diwan Group:

(a) The Claimant/Respondent, Diwan Capital AG ("Diwan AG");
(b) Diwan (Cayman Islands) Limited ("Diwan Cayman"); and
(c) The Defendant/Appellant, Diwan Capital Limited ("Diwan DIFC")

4.2 The control and ownership of the above entities substantially overlapped. Thus, Diwan Cayman was the sole shareholder of Diwan DIFC. Up until November 2008, Robert Bertschinger was at the same time the Chairman of Diwan AG and Diwan DIFC. Further, Benoit Demeulemeester, Urs Rechsteiner and Ruedi Daellenbach were the founders of both Diwan AG and Diwan Cayman.

4.3 The ultimate objective of the Project, referred to at paragraph 1.1 of the RBP, was for Diwan DIFC (following its incorporation) to apply for a ficense from DFSA, which was a pre-condition for dealing in financial instruments in the DIFC and GCC. However, that was the final stage in the process.

4.4 In essence, it was envisaged that the Project would be implemented over three stages:\

4.4.1 In the first stage, Diwan AG was set up around March 2006. The purpose of incorporating Diwan AG is described in paragraph 3.2.3 of the RBP as follows:"[Diwan AG was incorporated] as a Special Purpose Vehicle for pre-operational purposes relating to the incorporation of [Diwan Cayman] ... [Diwan AG's] sole purpose is to provide consulting within the finance industry and perform financial analysis. Diwan AG will not conduct financial services of any kind ..."

4.4.2 The second stage was the incorporation of Diwan Cayman, whose purpose is described in paragraph 3.2.2 of the RBP as follows:" [Diwan Cayman] was incorporated as a Special Purpose Vehicle for capital raising and shareholder participation... [Diwan Cayman] will not conduct financial services of any kind and will not do any business as a company based in the DIFC or the UAE"

Thus, while Diwan AG was responsible for consultancy, Diwan Cayman was responsible for raising the necessary finance for the Project, while also retaining Diwan AG for this purpose.

4.4.3 The final stage was the creation of Diwan DIFC, whose purpose would be to actually issue, list and trade sophisticated financial instruments in the DIFC and GCC.

The services provided by Diwan AG (the subject-matter of the claim).

4.5 In order to achieve the final stage, various formal requirements had to be satisfied. Diwan AG alleges that it prepared all the necessary documents to obtain a license from the DFSA, which was ultimately granted on 3 March 2008. It is those services which form the basis for the claim.
4.6 It is not in dispute that Diwan DIFC was not in existence at the time of the RBP. Thus, paragraph 1.1 of the RBP states that: *"[Diwan Cayman] is in the process of incorporating a wholly-owned DIFC subsidiary, [Diwan DIFC]."* Moreover, Diwan AG accepted (at paragraph 6 of Diwan AG's statement of case) that: *"in this case the Venture Company - [Diwan DIFC] - didn't existed yet [sic] and that the work had to be performed through another company, Diwan AG."*
4.7 The consideration for the services provided by Diwan AG is not clearly stipulated under the terms of the RBP. However, a diagram at 3.2.1 refers to *"Compensation/Participation through ESOP [Employee Stock Ownership Plan)"*. Further, this appears to be accepted by Diwan AG which states at paragraph 6 of its statement of case: *"It was therefore concluded that the obligation of the [Diwan DIFC] would be set off by shares of the [Diwan DIFC] which would be handed over to the [Diwan DIFC] which then would forward such shares to the private persons in compensation for their work performed,"* The latter statement appears to contemplate an agreement between specific individuals carrying out the work to be remunerated through the provision of shares in Diwan DIFC.
4.8 Further, the nature of the contractual relationship between the parties is not clearly expressed in the RPB. At paragraph 3.2 3 it is stated that: *"There are no formal contractual relations between [DIFC Cayman] and [Diwan AG]. [Diwan AG] is put in charge by [Diwan Cyman] on a "// needed" basis. [Diwan AG] has been retained by [Diwan Cayman] to perform capital raising for [Diwan Cayman]."*
4.9 Notwithstanding that the work was carried out in 2006, no invoice was sent by Diwan AG until 15 August 2009.
4.10 Three leading individuals who carried out the work on behalf of Diwan AG, Benoit Demeulemeester, Urs Rechsteiner and Rudi Dellenbech, each signed compromise agreements (between October 2007 and February 2010) under which they confirmed that they had no claim against Diwan DIFC.
4.11 Notwithstanding that the sum claimed in the invoice was US$759,937, Diwan AG only pursued Diwan DIFC for the sum of AED 91,800 (US$24,980). This was an arbitrary figure chosen merely to bring the claim within the small claim threshold of AED 100,000 (Appeal Bundle, Tab 8 and Skeleton and Authorities Bundle Tab 13). The stated basis (at paragraph 8 of Diwan AG's Statement of Case) for claiming this sum is that it constitutes a portion of the total sum claimed by this invoice, and relates to 10 (out of 282) consultancy days. Diwan AG does not state how long the preparation of the RBP took. It is apparent that Diwan AG's rationale for pursuing this course was to provide itself with an economical means of testing the merits of the claim prior to incurring costs in seeking to recover the full amount.
4.12 Diwan DIFC has since entered into liquidation.

FINDINGS OF THE COURT BELOW

5. Justice Ali Al Madhani's reasons for his decision may be summarised as follows.

(a) Diwan AG provided Diwan DIFC with the RBP, which was received without any comment from Diwan DIFC. He, therefore, considered that an unwritten contract between the parties had been proved.
(b) He rejected the affidavits tendered by Diwan DIFC as they were made by persons without first-hand knowledge of the contractual arrangements and had not been employed at the relevant time when the alleged contract had been made
(c) He rejected Diwan DIFC's argument that the consideration for the preparation of the RBP was the employment of Diwan AG's executives in Diwan DIFC. He could not find anything in the RBF itself to support such an argument (as alleged by Diwan DIFC), and accordingly did not consider that this or any other defence had been provided to avoid liability or to challenge the quantum claimed.

APPELLANT'S ARGUMENTS

6. Before me, Diwan DIFC was represented by Mr Kaashif Basit (who had not appeared in the Small Claims Tribunal below). He argued that there was insufficient evidence to support the learned Judge's findings below that:

(a) a contract had been concluded; and

(b) Diwan DIFC was liable in the sum of AED 91,800.

7. His arguments were divided into the following sections.

The First Defect - contract concluded prior to incorporation

8. Counsel argued that DIFC Company Law clearly provides that a company incorporated in the DIFC (as Diwan DIFC undoubtedly was) is not bound by contracts purporting to be entered into on its behalf by its promoters or other persons before its incorporation, although such persons may be personally liable for such contracts.

9. Diwan AG, in its arguments before me, asserted that the date when the contract was entered into was sometime in late 2006. The relevant law at that time would have been Article 26(1) of DIFC Companies Law no 3 of 2006 (which came into force in April 2006), and provided:

"Where a contract purports to be entered into by a Company, or by a person as agent for a Company, at a time when the company has not been formed, then, subject to Paragraph (2) and unless otherwise agreed by the parties to the contract, the contract has effect as one entered into by the person purporting to act for the Company or as agent for it, and he is personally bound by the contract and entitled to its benefits."

(This provision has now been replaced by Article 26(1) of DIFC Companies Law No 2 of 2009, which is in identical terms.)

10. The only way in which Diwan DIFC could have been bound by a pre-incorporation contract made in its name is under the doctrine of adoption provided by Article 26(2) of DIFC Companies Law No 3 of 2006, which was in the following terms:

> Notwithstanding the provisions set out in other DIFC laws concerning formation of contract, a Company may, within such period as may be specified in the terms of the contract or if no period is specified, within a reasonable time after it is formed, by act or conduct signifying its intention to be bound thereby, adopt any contract of the nature set out in Paragraph {1), and it shall from that time be bound by such contract and entitled to its benefits and the person who purported to entered into the contract for the Company or as agent for the Company shall cease to be so bound and entitled.
>
> (This provision has now been replaced by Article 26(1) of DIFC Companies Law No 2 of 2009, which is in identical terms.)

11. There was no such act of adoption in this case, nor was there a new agreement in similar terms as the alleged pre-incorporation contract; hence Diwan DIFC could not be liable on the pre-incorporation contract (if there was indeed such a contract).

12. Counsel also submitted that the fact Diwan DIFC may have benefited from the work done by Diwan AG on the RBP was insufficient to give rise to any liability on the part of Diwan DIFC, citing Vaughan Williams LJ in *Re English and Colonial Produce Co[1906] 2 Ch. 435 at 442:*

> "In these circumstances I think we were all prepared to hold that there is no binding authority for the proposition that a company, because it has taken the benefit of work done under a contract entered into before the formation of the company, can be made liable in equity under that contract."

The Second Defect - no basis for the sum claimed

13. Counsel submitted that, assuming there to have been a valid contract, there was no evidence of any agreement as to the basis for the sum claimed. There was no prior agreement as to the fee to be paid for the RBP, either on a lump sum or on the basis of a time charge.

14. Furthermore, Diwan AG had argued in paragraph 6 of its statement of case as follows:

> "As the planned operation was never established before in the DIFC, it was required to perform more research and preparation work than the approval of a regular financial institution would require. It was clear from the beginning that any work undertaken could not be financially compensated immediately but would be honored in the future after financing would be secured. The work was performed by private persons that had been shareholders of the Claimant and also worked for the Claimant. Normally it is like Richard described it in his statement: the private persons would directly receive shares from the Venture Company. Problem was that in this the Venture Company - the Defendant - didn't exist yet and that the work had to be performed through another company, the Claimant. It was therefore concluded that the obligation of the Defendant would be set off by shares of the Defendant which would be handed over to the Defendant which then would forward such shares to the private persons in compensation for their work performed. As these private persons never received shares of the defendant - neither directly nor indirectly - their work performed still has not been remunerated. An ESOP plan had been in force for this purpose."

15. This argument of Diwan AG was totally inconsistent with a contractual claim for cash payment for services rendered when its own case was that the agreement was supposed to be that Diwan AG would be allotted shares through its executives who were working in Diwan DIFC by way of an Employee Share Option Plan ("ESOP").

16. While the learned Judge below rejected this last argument of Diwan DIFC, he did not go on to consider on what contractual basis Diwan AG was making its claim for AED 91,600.

The Third Defect - procedural errors

17. Counsel for the Appellant also made several other criticisms of various procedural and evidential errors allegedly made by the Judge below. For reasons which will become apparent later, it is unnecessary to set those criticisms out in detail.

RESPONDENT'S ARGUMENTS

18. At the hearing before me, Diwan AG was represented by its Director, Dr Urs Rechsteiner (a different director having appeared at the Court below). I will set out its arguments under the same headings as the Appellant's arguments for ease of reference.

The First Defect - contract concluded prior to incorporation

19. Diwan AG relied on Article 9 of the DIFC Contract Law No 6 of 2004, which states:

> "Nothing in this Law requires a contract to be concluded in or evidenced by writing. It may be proved by any means, including witnesses"

20. The Respondent further relied on the terms of the RBP, which made it plain that Diwan AG was doing professional work for Diwan Cayman on a contractual basis which was not formalised. Such work was not for free, and it was plain that there would be some form of remuneration. Although there was no written contract, there was clear evidence of work done by Diwan AG (including but not confined to) the preparation of the RBP. This liability on the part of Diwan Cayman would eventually be transferred to Diwan DIFC, since Diwan Cayman was only a holding company, and was not intended to carry on any business; all costs incurred by Diwan Cayman would eventually be "pushed down" to Diwan DIFC, since that was the company which would invite investors and take on employees to carry on business in the DIFC.

21. Diwan AG also argued that, although Diwan Cayman and Dtwan DIFC were two separate legal entities, they were in fact one company. By a Deed of Transfer dated 4 March 2008 Diwan Cayman transferred (among other things) all its obligations in relation to the Project of incorporating a financial services company in the DIFC to Diwan DIFC and, in Clause 3 of the Deed, Diwan DIFC had covenanted to pay Diwan Cayman such amount as might be necessary to enable Diwan Cayman to discharge any liability, claim or payment due to any person.

22. Diwan AG also relied on Article 26 of DIFC Companies Law No 3 of 2006. It argued that Diwan Cayman, investors, shareholders and board members (presumably of Diwan DIFC) had (by act or conduct), on the one hand, accepted the conditions and implied covenants in the business plan and other documents and, on the other hand, benefited from the work performed prior to completion of the first financing round of the

project, Article 26, therefore, applied. It further argued that, since Diwan Cayman was the legal person purporting to act for Diwan DIFC, and the two companies were actually one, "the contracts and commitments were adopted by [Diwan DIFC] immediately after its formation". Also, Diwan DIFC had declared itself liable for work performed prior to incorporation.

23. Diwan DIFC never reacted when Diwan AG sent its invoice for preparing the RBP. Clearly, Diwan AG had done work for which there was a contractual entitlement to be paid.

The Second Defect - no basis for the sum claimed

24. Diwan AG did not directly address the issue of how it justified its claim for exactly AED 91,800. However, it argued as follows:It is commonly known that consultancy work is paid on a daily (or hourly) basis

(a) However, in the venture industry, this is not always the case as companies "regularly" do not have the required cash for an immediate remuneration. Therefore, such companies offer their own shares to those performing work in the initial phase.

(b) Diwan DIFC *"did the same"* (presumably meaning that it offered its shares to Diwan AG), but never provided Diwan AG with such shares and, because of this breach of its contractual obligation to provide Diwan AG with shares in Diwan DIFC, Diwan AG was forced to ask for the "traditional" remuneration or "a commonly accepted form of payment" (meaning the usual method of charging for consultancy work on a time charge basis).

(c) In this connection, the Respondent cited Article 12 of DIFC Contract Law no 6 of 2004 which provides:

Usages and Practices

(1) The Parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.

(2) The parties are bound by a usage that is widely known to and regularly observed in international trade by parties in the particular trade concerned except where the application *of such usage would be unreasonable.*

25. Finally, the Respondent cited the principle of good faith. A company may bind itself to commitments or contracts prior to incorporation prior to incorporation. Refusing to comply with such commitments or contracts after being incorporated is clearly against good faith

DISCUSSION

26. The recurring theme of Diwan AG's submissions is that it did professional work for the benefit of Diwan DIFC, for which it ought to be paid. However, that submission does not address the question: paid by whom? The central issue in this case is the ability of Diwan DIFC to have made a valid contract with Diwan AG for the provision of services in return for some form of remuneration. That issue was (at the material time) clearly governed by Article 26 of DIFC Companies Law No 3 of 2006, which (being in similar terms to section 51 of the English Companies Act 2006) implicitly proceeded on the basis of the English common law rule that a company is incapable of entering into a contract before its incorporation by modifying that rule in the terms set out in Article 26.

27. Accordingly, the starting point of any analysis of the facts in this case must be on the basis that, whatever may have been agreed by way of contract on behalf of Diwan DIFC before its formation, that contract would not have bound Diwan DIFC absent an act of adoption by it of that contract, as provided under Article 26(2).

28. Diwan AG has argued that Diwan DIFC did adopt the contract by: (a) using the RBP; and (b) by not responding to the invoice.

29. As to (a), the fact that Diwan DIFC may have used the RBP does not itself mean it adopted any contract for payment of the services rendered by Diwan AG in preparing that document. Under Article 26(1), assuming that there was a contract at all made between Diwan AG and someone on behalf of Diwan DIFC for the provision of consultancy services in the production of the RBP in return for remuneration by Diwan DIFC (as to which it is unnecessary for me to make a finding), contractual liability for that obligation on the part of Diwan DIFC would have rested with the person making that contract purportedly on its behalf. The fact that Diwan DIFC made use of the RBP does not (in the absence of other evidence) give rise to the inevitable inference that Diwan DIFC had assumed the contractual responsibility for payment to Diwan AG. It is equally likely to suppose that Diwan DIFC was content to leave that responsibility with the person who made the contract in its name, and to make its own arrangements for reimbursement of that person in due course (if at all).

30. As to (b) an invoice is not (in the usual case) a contract. It is merely a demand for payment. It gives rise to no legal obligation to respond, in the sense that such failure would automatically lead to a finding that the invoicee is liable for the sum invoiced. The submission of an invoice may well have evidential significance for both the issuer as well as the recipient of the invoice in terms of inferences to be drawn in the context of contractual liability, but such inferences must be seen in the whole factual matrix.

31. This leads to the next major factor which makes Diwan AG's case untenable. It has openly stated that the contractual arrangement was for Diwan AG to be remunerated by the issuance of shares in Diwan DIFC. Only when Diwan DIFC failed to do so did Diwan AG issue its invoice several years after the completion of its work for payment in cash. On its own case, cash remuneration was not the original agreed method of payment, and Diwan AG has advanced no case that the original method of remuneration was contractually agreed to be amended to a cash payment on the basis of US$2500 per day (which formed the bulk of the amounts claimed in the invoice). Accordingly, no adverse inference can be drawn from Diwan DIFC's failure to respond, as Diwan AG's own invoice was without contractual basis.

32. In the circumstances, it is unnecessary to deal with the other grounds of appeal as the reasons stated above are sufficient to decide this case. The learned Judge's reasons for his decisions were wrong in law which must therefore be set aside.

COSTS

33. While costs are not normally awarded in SCT cases, I propose to make an exception in this case.

34. One of the criticisms that Diwan DIFC has made of Diwan AG's conduct of these proceedings has been that Diwan AG has abused the Small Claims Tribunal procedure by artificially constructing a claim for AED 91,800 when the true value of the claim (as evidenced by the invoice which forms the basis of its claim) is US$759,937. Diwan DIFC argues that Diwan AG is seeking to use the Small Claims Tribunal procedure to run a test case without incurring any liability to pay legal costs, and this has not been denied by Diwan AG.

35. While the principle of instituting a test case is not in itself objectionable, that process can only be used in the Small Claims Tribunal where there is a distinct and complete claim within the jurisdiction of the Small Claims Tribunal, with other similar claims to be filed later based on the same facts and legal principles in case the first case is successful. In this case, there has been an arbitrary carve-out of the sum of AED 91,800 purportedly attributed to Diwan AG's services in preparing the RBP to bring this claim within the jurisdiction of the Small Claims Tribunal when the invoice simply shows a sum of US$705,000 being billed for 282 days of work at US$2500 per day. That is clearly an abuse of process and I, therefore, award the costs of this appeal against Diwan AG.

DECISION

36. The Court, therefore, makes the following Orders:

(a) The Appeal is allowed.
(b) Diwan AG's claim is dismissed with costs of this Appeal to be the subject of a detailed assessment unless otherwise agreed.

Chief Justice Michael Hwang

Date of Issue: 16 May 2011