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A Worldwide Review
Third Edition

Edited by
Alexander Loos



the global voice of
the legal profession®

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International Bar Association

The Global Voice of the Legal Profession



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The International Bar Association (IBA), established in 1947, is the world's leading organisation of international legal practitioners, bar associations and law societies. The IBA influences the development of international law reform and shapes the future of the legal profession throughout the world.

It has a membership of over 55,000 individual lawyers and 206 bar associations and law societies spanning all continents. It has considerable expertise in providing assistance to the global legal community as well as being a source of distinguished legal commentators for international news outlets.

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The IBA GEI will become the leading voice and authority on global HR issues by virtue of having a number of the world's leading labour and employment practitioners in its ranks, and the support and resource of the world's largest association of international lawyers.

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United Arab Emirates

Imtiaz Shah

The challenge historically facing directors of United Arab Emirates (UAE) companies is that the requirements relating to their obligations and liabilities are an unclear area of law and regulation. Directors have had to work within this environment to create self-imposed governance guidelines which bring their actions into compliance with the broad principles set out in the existing legal and regulatory framework.

Many companies in the UAE are in the process of developing their internal processes and providing guidance to their directors and managers to ensure they are equipped to deal with the new regime being put into place.

I UAE LEGAL REGIME

[A] Introduction

The UAE is a federation separated into seven different Emirates (Abu Dhabi, Dubai, Ras Al Khaimah, Sharjah, Ajman, Umm Al Quwain, and Fujairah). Federal laws are applicable to the UAE as a whole and are issued either by the president of the UAE or cabinet ministers by virtue of the powers conferred upon them.

[B] Free Zones

In order to facilitate the conduct of business by foreigners, the UAE has set up a number of 'free zones' within which certain exemptions from federal and local laws are operated. Companies can be established and can operate within these free zones.

The key difference between free zone entities and those incorporated in the UAE outside the free zones is that whilst, pursuant to the Commercial Companies Law (CCL), onshore companies must be majority (minimum 51%) owned by UAE nationals, 'free zone' companies may be 100% owned by foreigners. Vehicles which can be established in free zones include both companies and also branches of a foreign parent.

Of particular note is the Dubai International Financial Centre (DIFC), established in 2004. This is unlike other free zones which have regulations dealing purely with the establishment and operation of entities in the free zone. The DIFC is a separate jurisdiction based within the UAE¹ and is governed by its own laws and regulations, including company laws and employment laws. As such, companies located within the DIFC are exempt from the provisions of the CCL and all other UAE federal laws, save for the Penal Code.

[C] Permitted Corporate Vehicles

The main types of corporate entities utilized in onshore UAE areas are:

- *The Limited Liability Company (LLC)*. Its main characteristics are that it has limited liability, between two and fifty partners, and cannot offer its shares to the public. Under the LLC structure, directors are generally referred to as ‘managers’ and shareholders as ‘partners’.
- *A Public Joint Stock Company (JSC)*. This is either a public or private joint stock company (hereinafter JSC where provisions apply equally to both forms of this entity). The former must have at least five founder members and must offer its shares for public subscription and must have at least AED 30 million in share capital. The latter must have a share capital of AED 5 million and a minimum of two shareholders and, by contrast, cannot offer its shares to the public.

The types of companies which can be established in the DIFC are:

- *A DIFC Company Limited by Shares*. This is a company incorporated by one or more shareholders whose obligation is limited to the payment of the subscription price of its shares.
- *A DIFC LLC*. This is a company incorporated by one or more members whose obligations are limited to pay the amount of their subscribed membership interest, which may not be represented by securities. The capital of the company is divided up into membership interests, each of which may be of a different value and class. The company may not raise capital by offering membership interests by way of a public offer, nor may it issue securities of any kind.

This chapter considers directors’ liability in the context of LLCs, JSCs, and DIFC companies limited by shares.

LLCs and JSCs are governed primarily by the CCL together with relevant federal law, depending on the activity they are carrying out. Public JSCs are also governed by the rules and requirements of the Emirates Securities and Commodities Authority (ESCA). DIFC companies are governed by the DIFC Companies Law No. 2 of 2009 (the

1. As established by Federal Decree No. 35 of 2004.

‘Companies Law’) supplemented by the DIFC Companies Regulations, and if they are listed companies they are governed by the DFSA Market Rules Module of the DFSA Rulebook.

II ‘NATIONAL BASICS’ AND NATIONAL LEGAL THEORIES OF DIRECTORS’ LIABILITIES

[A] Company Structure

The governance of an LLC is assumed primarily by its General Manager and the managers (if any are appointed) who all have day-to-day responsibility of the management and report to the partners. There is no equivalent to a board of directors. Whilst the CCL does contemplate² the formation of a board of managers where more than one manager has been appointed, there is no requirement – beyond the appointment of a General Manager – to implement any formal management structure where the number of partners is below seven. However, it should be noted that the responsibilities of members of the board of managers are the same as for a member of the board of directors of a joint stock company. If an LLC has more than seven partners (it can have up to fifty), it must appoint a supervisory body with the role of inspecting the company books and its financial position, which will be composed of representatives of at least three of the partners.

JSCs must have a board of directors of between three and eleven members. Public JSC directors may delegate their responsibilities to committees of the board (see further section III below).

A DIFC company is managed by a board of directors, which must be more than two in number and who must, if it is a listed company, appoint an audit committee (again, see further below).

[B] Chairman/CEO

There is no concept of a Chairman of an LLC. A Chairman of a meeting of the managers of a company could be appointed, or a Chairman of the partners during a General Assembly, but this is not a statutory position under the CCL.

The board of directors of both a JSC and DIFC company must elect a Chairman. A Chairman of a JSC must be a UAE national and is tasked with executing the decisions of the board and complying with its recommendations. A person cannot be Chairman of more than two companies that have their head offices in the UAE.

The equivalent for a CEO in an LLC is a General Manager. A General Manager has the authority to run and manage the company (pursuant to statutory powers set out in the CCL and constitutional documentation). The General Manager’s actions bind the company, unless there are specific limitations on his or her powers contained in the constitutional documentation and he or she is acting outside of those powers. The

2. Article 83.

General Manager is appointed either in the constitutional documentation of the LLC or by a separate management contract. A General Manager is appointed for an initial finite term, which can be extended indefinitely by the members renewing this term of appointment in a General Assembly. His or her name also appears on the trade licence of the company and he or she is the representative of the company with respect to any governmental or regulatory body or third parties.

The CEO of a JSC or DIFC entity is appointed by the board of directors. A CEO of a JSC or DIFC entity can only hold the position of CEO for one entity.

[C] Board Structures

An LLC has no board of directors, but can have more than one manager. Under the CCL, managers of an LLC have the same responsibilities as the directors of a public JSC. There is no requirement for non-executive and independent managers of an LLC.

A JSC is managed by a board of directors ranging from three to eleven in number. In order to be appointed as a member of the board, an individual must not have been convicted of any crime involving honour or breach of trust. The majority of the board must be UAE nationals.

A director of a JSC cannot be a director of more than five JSCs. At least one-third of a public JSC's board should be independent and a majority should be non-executive directors (NEDs) (pursuant to Ministerial Decision No. 518 of 2009) with the experience and technical skills to best serve the company. A public JSC NED must be able to dedicate enough time to the board (although he or she will not be remunerated for the privilege).

Under the Companies Law, a DIFC company may not have less than two directors. In order to be appointed as a member of the board, an individual must: (a) be over 18 years; (b) not be disqualified from being a director by virtue of: (i) having been convicted of a criminal offence, involving dishonesty or moral turpitude, in any jurisdiction in the past ten years; (ii) having been found guilty of insider trading or the equivalent in any jurisdiction at any time; (iii) having been judged disqualified by the court; (iv) disqualification under the articles; (c) not be an undischarged bankrupt; and (d) be a natural person. A DIFC company is managed by the directors, but can delegate the day-to-day operations to the company's officers. A listed DIFC company board must comprise both independent directors and NEDs. A third of the board must be NEDs and at least two of those NEDs must be independent.

[D] Directors' Elections

Directors of all types of corporate entities onshore and in the DIFC are appointed by the shareholders/partners. The first managers of an LLC are appointed in the LLC's constitution.

[E] Directors' Term of Appointment

In an LLC, managers can be appointed for an unlimited period.

In a JSC, each director is appointed for a term of no more than three years, which can be extended by the shareholders in General Assembly.

In a DIFC company, directors can hold tenure for an unlimited period.

[F] Delegation

In an LLC, the responsibilities of the manager and General Manager are normally set out in the constitutional documents of that entity but can be delegated, in accordance with international governance principles, to others pursuant to a power of attorney, issued by the General Manager.

A JSC's Chairman represents the company before the courts and third parties who are entitled to rely on the Chairman's signature as being that of the board of directors. The Chairman can delegate his or her authority to individual directors through a power of attorney. A public JSC should also implement an audit and remuneration committee to whom those functions are formally delegated by the board.

DIFC directors can delegate their responsibilities to company officers and senior employees as and when required under an appropriate power of delegation. Listed DIFC companies are obliged to 'consider' establishing nominations and remuneration committees alongside the obligatory audit committee.

In all cases, delegation does not restrict or remove the responsibility of the board of directors in respect of decisions taken by delegated individuals or committees.

[G] Removal of Directors

In an LLC, where a manager is appointed for an indefinite period, he or she is entitled to remain in that position unless the constitutional documents stipulate a dismissal process and he or she can only be dismissed following that process, or unless the partners vote unanimously to remove him or her.

In a JSC, a director can be removed by the decision of the General Assembly.

For a DIFC company, directors can be removed by a shareholders' resolution.

III CORPORATE GOVERNANCE

There are no specific corporate governance requirements for LLCs or private JSCs, save for requirements set out in the CCL relating to annual meetings of members and board meetings. It should be noted, however, that representatives of the Ministry of Economy or relevant Federal Economic Departments have the right to attend meetings of the General Assembly of JSCs as observers and may in certain circumstances call a General Assembly – acting as a form of independent governance/check on the governance of that entity. LLCs and private JSCs are not required to set out any internal corporate governance guidelines outside of the constitutional documentation.

Public JSCs are subject to the requirements of Ministerial Decision 518 of 2009 issued by the UAE Ministry of Economy. A summary of this is set out below.

[A] Decision 518

Decision 518, which concerns corporate governance rules and discipline, provides standards applicable to all companies and institutions whose securities are listed.

An important aspect of Decision 518 is the additional accountability that is placed upon the board of directors. The board is required to develop procedural rules for corporate governance and supervise their application. It is also responsible for the education and knowledge of the board members. Furthermore, the Chairman is required to encourage participation by all members of the board in addition to promoting procedures for effective communication and improved relations. The board must also provide a 'Code of Conduct' in order to set down processes and procedures to enable compliance with the laws and regulations.

A company is required to provide a Corporate Governance Report to the ESCA on an annual basis, reporting on the company's governance processes and procedures and any violations that have occurred. The report must also detail the method of formation of the board, including details of remuneration. This report should be made available to shareholders.

Decision 518 also requires the formation of two independent committees, an audit committee and a nomination and remuneration committee. These committees shall be formed pursuant to procedures determined by the board of directors. The audit committee will review, monitor, and report on financial and accounting matters of the company. Decision 518 states that recommendations of the audit committee must be included in the company's Corporate Governance Report to be sent to the ESCA, along with any reasons for non-compliance with such recommendations. We understand that this measure is designed to add accountability to the board for its reasons for departing from the audit committee's recommendations.

Although there are no corporate governance guidelines for private DIFC companies, the OSRs provide corporate governance regulations for those DIFC companies which have listed securities. The requirements are not surprising and cover issues such as the independency of the board, experience of the directors, role of the Chairman, conduct of the board and of directors, financial reporting, disclosure, and the requirement for various committees. Further, it sets out that a director must act on a fully informed basis, in good faith, honestly, with due diligence and care, and in the best interest of the company. The company must provide an annual report to the DFSA including a statement on how it applies the relevant corporate governance principles.

Numerous private companies in the DIFC have established their own corporate governance principles. Further, in the DIFC, certain functions of companies are regulated by the Dubai Financial Services Authority (DFSA), which also imposes certain governance requirements on entities it licenses. As a result, in brief, compliance

manuals must be drafted and anti-money laundering officers appointed. Companies can also be subject to an impromptu inspection by the DFSA to ensure that these requirements are being adhered to.

IV LIABILITY ISSUES

[A] General Concept

Conceptually, the board of directors (or managers) of entities assume all the power and responsibility necessary to run the business of the company as set out in the CCL (where relevant), the Constitution and, with respect to the DIFC entities, the Companies Law. The liability attaching to that role includes both civil and criminal liability. Broadly speaking, any abuse of power (by fraud, mismanagement, breach of federal or local law) by a manager/director will lead to liability of that manager/director. There are also some specific liability issues (particularly with respect to onshore vehicles) set out below.

With respect to LLCs that the partners or members of any board of supervision are specifically absolved from any liability as regards the actions of managers where they are not aware of mistakes or faults committed by such managers. This reinforces the concept of liability for such errors remaining with the managers themselves.

[1] General Liabilities: Onshore Companies

It is generally understood that the duties of a manager/director of an LLC/JSC can include:

- abiding by the company's constitutional documents;
- not disclosing confidential information;
- acting with loyalty towards and in the best interests of the company;
- avoiding any conflict of interest between a director's personal interests and the interests of the company (if a director profits from any act carried out in competition/conflict with the business of the company, he or she can be forced to account (and indemnify) to the company as a result); and
- using his or her discretion in good faith.

In addition, in exercising his or her discretion, a manager/director can accrue additional liability unless he or she abides by the following general guidelines:

- not to delegate without express authority;
- not to act under dictation (e.g., a director/officer must be free to exercise his or her own judgment and must not act on the instructions of another person);
- not to bind him- or herself as to how he or she will exercise his or her discretion in future (e.g., a director should not contract as to how he or she will vote at future board meetings, unless approved by the company);

- to consider whether to exercise his or her discretion properly (e.g., a director/officer must be prepared to act when his or her action would be advantageous to the company);
- not to exercise his or her powers in his or her own or a third party's interests; and
- not to act unreasonably.

The CCL provides³ that a manager of an LLC must preserve the rights of the company and must extend such care as a diligent person would.

[2] Criminal/Other Liabilities: Onshore

In addition to sanctions which can be imposed in the event a manager/director abuses his or her power or does not adhere to the guidelines set out here or breaches the CCL or the constitution of the company, a manager/director can also be criminally liable in the event that he or she carries out any of the following acts:

- fraud or embezzlement in respect of property or a legal right;
- disclosure of confidential information to obtain a personal benefit;
- writing a cheque on behalf of the company when the company has insufficient funds to honour the cheque;⁴
- insider trading; and
- attempting to make a public offer of shares in an LLC (whose shares must, by definition, be privately held).

In the event that the company is sued for having created any environmental liabilities, the managers/directors themselves are punishable by imprisonment or fine depending on the offence committed.

Any 'harm' (a civil law concept) carried out by a manager/director during his or her term of directorship which can be proved by a third party to have caused that party loss can also bring personal liabilities under the Civil Code.

[3] General Liabilities: DIFC Companies

The general duty imposed on directors in exercising their powers and discharging their duties is that directors shall:

- act honestly, in good faith, and lawfully, with a view to the best interests of the company; and
- exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.⁵

3. Article 22.

4. Article 401 UAE Federal Law No. 3 of 1987, the Penal Code.

5. Article 53 Companies Law.

If he or she does not, and harm is caused either to the company or a third party, the director will be personally liable.

Furthermore, a director of a company who has, directly or indirectly, an interest in a transaction entered into, or proposed to be entered into, by the company which may present a conflict with the interests of the company has a duty to disclose the potential conflict to the company, in addition to an explanation as to the nature and extent of his or her interest.⁶

Under DIFC Law No. 5 of 2005, the Law of Obligations, a director, in his or her position as a fiduciary, owes certain fiduciary duties to the company, including duties of loyalty, avoiding conflicts of interest, confidentiality, no secret profits and exercising care, skill and diligence.

For a public DIFC company, under the Market Rules, a director must act on a fully informed basis, in good faith, with honesty and due diligence and care, and in the best interests of the company.

If an action is brought against a company and/or a director and it can be shown that the director did not follow the principles set out above, personal liability will accrue. The director will be liable to pay damages to the company in respect of any loss suffered by the company and also account for any benefit he or she has acquired in consequence of the breach. In addition, if the director has entered into an agreement with the company, or deals with any property, in breach of his or her duties, the company may apply to the court to set aside the agreement or deal.

V WHO CAN SUE?

Directors of all types of companies onshore and offshore are liable towards their company, its shareholders/partners, and third parties (where relevant) for all acts of fraud, abuse of authority, violations of the CCL (where appropriate), DIFC laws (where appropriate), or constitutional documents of the company and any losses as a result of any mismanagement.

Managers/directors may also have additional responsibilities to their employees for health and safety concerns.

VI 'DE FACTO' DIRECTOR

Although there is no concept of a de facto or shadow director in the UAE, some of the penalty provisions in the Companies Law, Commercial Code, Civil Code and Penal Code can apply to people holding themselves out to be directors. For example, an employee who enters into a contract on behalf of the company with a third party, conducting him- or herself as a director, for his or her own personal gain would be subject to the same sanctions as that of a director not acting in the best interests of the company and criminal sanctions would apply.

There is no similar concept of de facto directors in the DIFC.

6. Article 54(1) Companies Law.

VII THRESHOLD AND LIMITATIONS/CAPS OF LIABILITIES

For onshore vehicles, aside from liability thresholds under relevant laws which may be breached by a manager/director whilst carrying out his or her role, to the extent that the director (or the company) tries to contractually limit any liability, the Civil Code sets out that such limitations on liability may not be taken into consideration by a Dubai court, which can decide upon the damages to be imposed independently of any contractually agreed limitations.

Conversely, with DIFC companies the director is able exclude or restrict his or her obligation of loyalty by contract with the company, subject to the Implied Terms in Contract and Unfair Terms Law.

VIII RELEVANCE OF BANKRUPTCY OF CORPORATION

Directors of a bankrupt company may be criminally liable for: (i) concealing, destroying, or altering the company books; (ii) misappropriating company assets; (iii) knowingly declaring debts not owned by the company or failing to submit the papers in their possession; (iv) fraudulently obtaining an arrangement with the company's creditors; (v) making untrue statements about the capital of the company; (vi) distributing fictitious profits; and (vii) receiving remuneration or bonuses in excess of the amounts stipulated by law or by the company's constitutional documents.

However, unlike in a number of jurisdictions, a director of a bankrupt company may be a director of another entity in the future (although directorship of the bankrupt entity will need to be declared if requested).

IX INDEMNIFICATION

The standard memorandum of association of an LLC includes a restrictive indemnity in favour of the General Manager with respect to acts carried out by the General Manager in connection with his or her role (unless such act was fraudulent or negligent).

As DIFC law is based on common law and the Companies Law regime is based on English law, there is a general indemnity in the articles of DIFC companies in favour of the directors (see further section VII above).

X D&O INSURANCE

This is available with respect to both onshore, free zone, and DIFC entities. Insurance of this kind is becoming increasingly common in the UAE, particularly as a result of recent legislation, such as the DIFC Companies Law 2009 and Decision 518, imposing a higher standard of duty on directors.

XI FORECAST ON FUTURE LEGISLATION DEVELOPMENT

The aim of Decision 518 is to bring corporate governance more in line with internationally accepted standards and further to give the force of law to the previous ESCA decision. Although Decision 518 is only applicable to companies with listed securities, it provides a benchmark for private JSCs to follow.

Decision 518 seeks to create an internal control system in a company and encourage companies to adopt the principles of good corporate governance and establish an effective framework for the protection of shareholder rights, fair treatment of shareholders, and ensuring transparency within the governing scheme, which has been needed for some time and generally is eagerly anticipated.

This is a time of significant change to the way in which corporate governance and directors' duties and liabilities are viewed in the UAE.