

Company & Commercial - United Arab Emirates

Directors' duties under UAE law

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Author

[Sarah Standish](#)



Introduction

The issue of directors' responsibilities and obligations under UAE law has gained increasing importance for companies incorporated in the United Arab Emirates.

This update focuses on the duties of directors under the relevant UAE laws and regulations, and primarily on directors of limited liability companies established in the United Arab Emirates. The duties of directors of public companies are not covered in this update.

Source of directors' duties

The duties owed by directors of limited liability companies established in the United Arab Emirates are mainly contained in:

- the Commercial Companies Law (8/1984);
- the Civil Transactions Law (5/1985) (the Civil Code); and
- the Commercial Transactions Law (18/1993) (the Commercial Code).

General directors' duties

The general duties which directors owe to a company and its shareholders are contained in the laws listed above. These duties are generally prohibitive or negative in nature and tend to require a director to refrain from engaging in certain activities or conduct.

Duty to exercise reasonable care

The business and affairs of a company are managed on its behalf by its directors acting as a board. The directors are therefore akin to agents of the company and, pursuant to the Civil Code, an agent must carry out his or her responsibilities under the agency arrangement according to the standard of a reasonable person.

In this regard, directors should therefore always ask themselves, when carrying out their duties, how a reasonable person would act under the same or similar circumstances.

In replying to this question, consideration should be given to the functions of the director, his or her specific responsibilities and the circumstances of the company. For example, the amount of time which a director should dedicate to the company's affairs is likely to depend on whether the director is an executive or a non-executive director. While the Companies Law does not distinguish between executive and non-executive directors, it is reasonable to argue that an executive director with particular responsibilities will be expected to devote more time and attention to the company's affairs than a non-executive director with no express role to play. Nevertheless, a non-executive director should at least regularly attend board meetings and generally take an active interest in the company's affairs in order to discharge his or her duties.

Duty to act within their powers

The Companies Law and the Civil Code grant directors wide powers to manage a company's affairs and to act on its behalf in accordance with its objectives. However,

the powers of directors are subject to limitations contained in the company's constitutional documents, such as its memorandum of association and any resolutions of the shareholders adopted at a general meeting. As a company is required to conduct its business within the parameters of its licence, directors are also required to ensure that their conduct does not extend beyond the activities that the company is licensed to undertake.

A company will be bound by any act taken by its board of directors, so long as the board of directors has not exceeded its powers.

Duty not to compete with the company's business

A director may not carry out a commercial activity which competes with an activity carried out by the company (whether for his or her own account or for the account of others), unless that activity has previously been disclosed to, and approved by, the company at a properly constituted general meeting. The approval of the shareholders must be renewed annually if a director continues to be involved in the same commercial activity on an ongoing basis.

If a director makes a profit as a result of carrying out an unapproved commercial activity, he or she will either have to account for it to the company or pay compensation to the company for any damages resulting from that activity.

Duty to declare interest in proposed transaction or arrangement with the company

A director must declare to the other directors the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company.

An interested director should record his or her declaration in the minutes of the board meeting and will not be entitled to vote on the transaction or arrangement in which he or she is interested.

Duty not to distribute fictitious dividends

The Companies Law provides that the directors will be liable to the shareholders and the company's creditors for the distribution of any 'fictitious profits'.

Duty not to enter into any loan arrangements with the company

The Companies Law prohibits a company from making a loan of any kind to a director of the company and from guaranteeing the payment to a director of a loan made by any person to that director. The exception to this prohibition relates to loans made to directors by companies whose ordinary business is lending money. Such exemption will apply only if a loan is given in the ordinary course of the company's business and is not on more favourable terms than would be offered to an unconnected customer of the company.

Duty not to misrepresent the company's financial position

In each financial year directors are responsible for preparing the company's balance sheet, profit and loss account and an annual report on the company's activities and financial position.

Directors should ensure that the financial statements reflect the company's true and accurate financial position, and will be held liable if they intentionally insert false particulars in the financial statements or intentionally omit to mention substantial facts with the intent to conceal the company's real financial position.

Duty to keep confidential, and not to benefit from, the company's secrets

A director must keep confidential all information regarding the company which comes to his or her knowledge through his or her position as a director and must not use such information to obtain a benefit, whether for himself or herself or for another person.

Consequences of breaching directors' duties

Directors are responsible to the company, the shareholders and third parties for deception, misuse of authority, violation of law or the memorandum of association and mismanagement of the company. Any provisions restricting such liability are void.

The general rule is that directors are responsible jointly to the company, the shareholders and third parties for any wrongful acts resulting from a unanimous decision of the board.

If, however, a director records his or her objection to a wrongful decision taken by his or her fellow directors in the minutes of the meeting, he or she will not share responsibility for that decision.

The absence of a director from a meeting in which a wrongful decision was taken does not relieve him or her from liability, unless:

- he or she was unaware of the decision;
- he or she was aware of the decision, but was unable to object to it; or
- he or she objected to the decision once he or she was made aware of it.

Right to bring an action

Company

The company has the initial right to bring an action against its directors for mistakes that they commit in the management of the company which result in damage to the shareholders. The resolution to initiate proceedings and to appoint a person to bring an action against a director on the company's behalf must be adopted by the shareholders in a general meeting.

Shareholders

A shareholder can bring an action against the directors if:

- the company fails to bring an action;
- the wrongful act carried out by the directors has caused personal harm to the shareholder; and
- the shareholder informs the company of its intention to bring an action against the directors.

The rights of shareholders in this regard cannot be excluded by the company's memorandum of association.

A liquidator

If the company is in liquidation, the liquidator will have a right to bring an action against the directors.

If the directors are proven to be liable under the Companies Law and the assets of the company are insufficient to settle at least 20% of its debts, the court may order the directors (jointly or severally) to cover all or part of the indebtedness of the company.

Penalties for breaching directors' duties

The Companies Law contains a number of penalties for breach of a director's duty.

A director who participates in the distribution of fictitious profits, misrepresents the company's financial position or divulges company secrets or benefits from those secrets may be liable to a penalty of up to two years' imprisonment and/or a fine of up to Dh100,000.

Other contraventions of the Companies Law can trigger fines of up to Dh100,000.

Breach of a director's duty could also constitute grounds for disqualification. In general, a director will be automatically disqualified if he or she:

- is declared bankrupt;
- is convicted of a crime of honour or honesty; or
- fails to attend three consecutive board meetings without valid excuse (as determined by the board).

Comment

The duties of directors of UAE companies are fairly broad and the potential penalties for breach are serious. Therefore, directors need to be aware of their responsibilities and duties and ensure that they act in an appropriate manner so as not to give rise to any claims or actions.

In the United Arab Emirates, increased attention is being given to issues of corporate governance, management practices, disclosure and transparency, particularly in light of the discovery of fraud in a number of local organisations. In turn, this has raised awareness in directors of their duties and highlighted the importance of understanding these duties and the potential liability and risks involved in carrying out their role.

For further information on this topic please contact [Sarah Standish](#) at Taylor Wessing (Middle East) LLP by telephone (+97 14 332 3324), fax (+97 14 332 3325) or email (s.standish@taylorwessing.com).

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