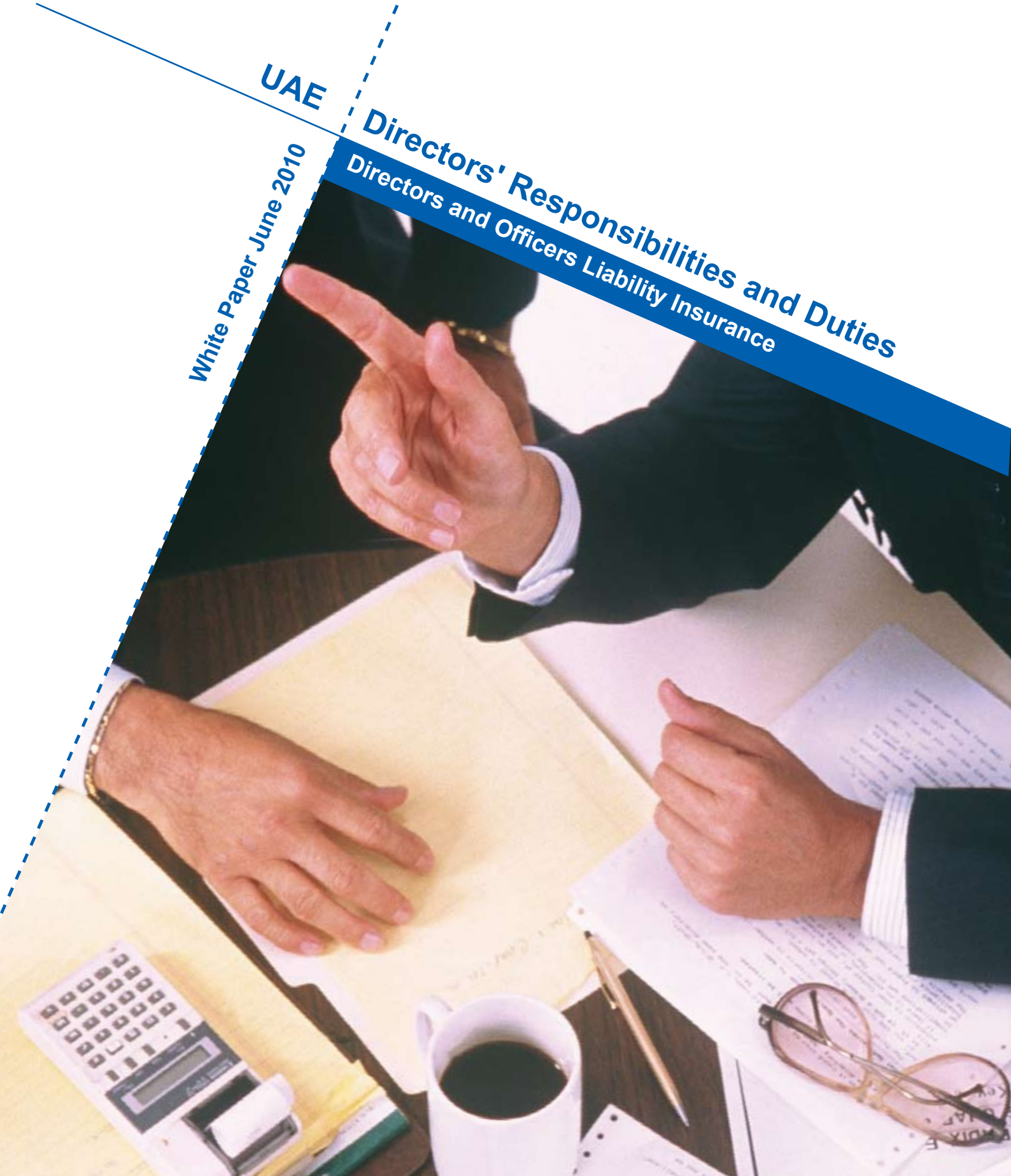


UAE

**Directors' Responsibilities and Duties**  
Directors and Officers Liability Insurance

White Paper June 2010



# The responsibilities and duties of directors of onshore companies in the United Arab Emirates:

## The emergence of Directors and Officers Liability Insurance

### Introduction

Corporate governance, and in particular the duties (and potential liabilities) of directors, officers and senior management, has become an issue of the foremost importance for companies incorporated in the United Arab Emirates (UAE).

Directors and officers of companies in the region are increasingly at risk from exposure to personal financial liability arising from claims brought against them in connection with the discharge of their duties as directors and officers. As the leading Directors and Officers Liability Insurer in the Middle East, we have commissioned Clyde & Co LLP, a leading international law firm, to summarise and outline the responsibilities and duties of directors and officers of onshore companies in the UAE.

Increasingly stringent legislative requirements, together with the enforcement of existing standards and a growing number of corporate governance related regulatory investigations, are of course an immediate response to the significant financial failures experienced in the UAE as a result of the global financial crisis. Yet, as the markets look towards future growth, there are clear signs that the move to embrace and institutionalise good corporate governance principles may also reflect an underlying shift towards an economic model that favours sustainable growth through transparency, responsibility and accountability.

Directors and officers of UAE companies must therefore adapt to this increasingly regulated environment, and ensure that corporate governance is given due consideration and priority. Failure to do so may give rise to an increased risk of exposure to corporate (and potentially personal) litigation, and regulatory and/or criminal investigation.

### An introduction to the duties of directors and officers in the UAE

A number of different forms of companies may be established in the UAE, either 'onshore' (ie within the UAE, but outside one of the free zones), or offshore within one of the UAE's free zones. Each type of corporate entity is subject to different types of corporate governance requirements, as set out in the respective civil laws applicable to each type of company.

This paper focuses on the duties (and potential liabilities) of directors and officers of companies incorporated onshore in the UAE. If you would like to find out more about the duties of directors of offshore companies, please refer to our paper on the duties (and potential liabilities) of offshore companies.

The principal entities used onshore in the UAE are the limited liability company (the LLC), and the joint stock company (the JSC), which may be either a private or public entity. This paper firstly examines the general duties (and potential liabilities) applicable to directors of all onshore companies, before examining the additional responsibilities of directors specific to each type of company.

### The general duties of directors and officers of 'onshore' companies

A number of general duties and responsibilities attach to the directors and officers of both LLCs and JSCs (both public and private). These are generally negative and prohibitory in nature, and may be contrasted to 'principle' based duties adopted in other legal systems, for example the duties of directors under the Companies Act 2006 in the United Kingdom. Instead, there is a body of law that is prescriptive and in certain instances potentially more punitive, which requires directors to refrain from engaging in certain types of behaviour, penalising those directors and officers who breach the requirements with a fine and/or prison sentence.

These general obligations arise from a number of sources, such as the constitutional documents of the company (usually the memorandum or articles of association), the Commercial Companies Law (Federal Law No. 8 of 1984) (the Companies Law),

Directors of onshore companies who fail to comply with the applicable laws and regulations may be liable to a significant fine of up to AED 1,000,000 and/or imprisonment for a maximum term of five years. Directors may also be banned from acting as directors in the future.

the Code of Commercial Practice (Federal Law No. 18 of 1993) (the Commercial Code), the Civil Code (UAE Law No. 5 of 1985) (the Civil Code), and the Penal Code (UAE Law No. 3 of 1987) (the Penal Code). The activities of the company may also be restricted by the terms of its commercial licence, and directors must ensure that their actions on behalf of the company do not extend beyond the company's permitted activities.

## The Companies Law

The Companies Law provides that directors are liable to the company, its shareholders and third parties for all acts of fraud, abuses of power, and for violations of the Companies Law or the constitutional documents of the company. The company may also have the right to initiate proceedings against the board of directors to claim damages for losses suffered by shareholders 'caused by faults of the board'. Directors may also be liable for the mismanagement of the company, an offence that has the potential to be remarkably wide-ranging and extend beyond, by way of comparison, the duties and potential liabilities of directors under English law. Indeed, from reviewing this particular provision of the Companies Law in its original Arabic, it would appear that the potential liability of directors or officers is not necessarily limited to deliberate or serious acts of wrongdoing. In fact, there is potential for relatively innocuous breaches of the law (eg, enticing the employees of another trader in competition with the company to take up employment with the company), or even failings in the performance of the company attributable to management decisions, to be considered tantamount to 'mismanagement', and may lead to sanctions against directors.

Directors must take care as to how they use and distribute information about the company, and administer the company's everyday affairs. For example, the Companies Law provides that directors who arrange the distribution of a dividend in breach of the Companies Law or the company's constitutional documents, or sign documents which contain false information on behalf of a company, or knowingly insert false information into company documents and then sign or circulate them, or disclose or use the company's confidential information in any way for their own (or a third party's) benefit, may be subject to a prison sentence or fine. Particular care must also be taken when preparing formal financial documents such as accounts, as a director who intentionally omits material facts or inserts false details in a company's balance sheet or profit or loss statement with intent to conceal the real financial position may, under the Companies Law, be subject to a prison term of up to two years and/or a maximum fine of AED 100,000.

A director may also be liable to pay a fine of not less than AED 10,000 and not more than AED 100,000 if he or she issues shares, or obtains a loan or guarantee in breach of the Companies Law, or intentionally prevents auditors or persons appointed by the UAE Ministry of Economy (or any other competent authority) from inspecting or enquiring in relation to the company's books or documents, or if they refuse to give such persons the information that is required.

*The Companies Law: what you need to know*

*Directors may be liable to the company, its shareholders, and third parties for:*

- Acts of fraud
- Abuses of power
- Violations of the Companies Law or the company's constitutional documents
- Mismanagement of the company

*Directors may also be liable to fine and/or prison sentence where they:*

- Sign documents containing false information on behalf of the company
- Knowingly insert false information into company documents and then sign or circulate them
- Disclose or use the company's confidential information in any way for their own or a third party's benefit
- Intentionally omit material facts or insert false details in a company's balance sheet or profit or loss statement with the intent to conceal the true financial position of the company

*Directors must inform the board as soon as a conflict of interest arises, and may not vote on board resolutions concerning such matters*

*Directors must not conduct business in competition with that of the company, unless the shareholders approve otherwise*

*A director may also be liable to pay a fine if he or she issues shares, or obtains a loan or guarantee in breach of the Companies Law, or intentionally prevents auditors or any other competent persons from inspecting the company's books, or by refusing to provide information*

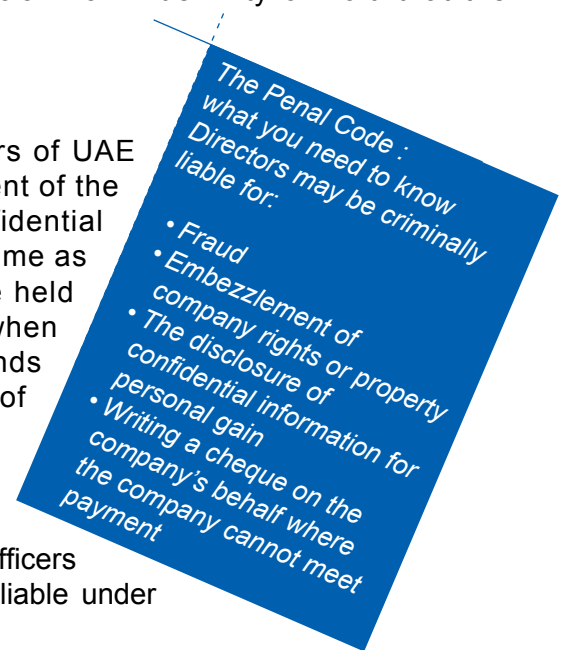
Directors of both JSCs and LLCs must also take special care when becoming personally interested in the company's affairs, as directors who have an interest that conflicts with those of the company are under an obligation to present that conflict to the board of the company for deliberation and approval. In such circumstances, a conflicted director may not participate in voting in board resolutions relating to that matter. Similarly, a director may not conduct their own business in a way that competes with the company's business unless the shareholders' of the company have given prior approval by resolution, failing which the company may claim an indemnity or hold that the business was conducted on its behalf.

## The Penal Code

Separately, the Penal Code provides that directors and officers of UAE entities may be found criminally liable for fraud or embezzlement of the company's property or legal rights or for the disclosure of confidential information in order to obtain a personal benefit. It may also come as a particular surprise to directors and officers that they may be held criminally liable for writing a cheque on the company's behalf when the company cannot meet payment, a position that again extends the potential liabilities of directors and officers far beyond that of many other jurisdictions.

## The Commercial Code

In the event of the insolvency of the company, the directors and officers of the company may, in certain circumstances, be held criminally liable under Commercial Code for fraudulent and/or intentional acts.



### The Commercial Code: what you need to know

*Directors of an insolvent company may be criminally liable for :*

- *Concealing, destroying or altering company books*
- *Misappropriating or concealing company assets*
- *Knowingly declaring debts not owed by the company or failing to submit papers in their possession*
- *Fraudulently obtaining arrangements with company creditors*
- *Making untrue statements about the company's capital*
- *Distributing fictitious profits*
- *Receiving remuneration or bonuses in excess of the sums specified by law or the company's constitutional documents*

*Directors of an insolvent company may face imprisonment and/or a fine if it is proved that they committed one of the following acts :*

- *failing to keep commercial books of the company that are sufficient to arrive at a true picture of the company's financial position;*
- *failing to submit the information required of them by the judge supervising the winding-up of the company or the trustee in bankruptcy or wilfully submitting false information;*
- *disposing of assets of the company with the intention of removing them from the reach of creditors after the company has ceased to be able to pay its debts;*
- *paying the debt of one creditor to the detriment of others or resolving to give sureties or advantages to one creditor in preference to the company, even with the intention of obtaining an arrangement, after the company has ceased to be able to pay its debts;*
- *disposing of the company's goods at an undervalue with the intention of delaying the time at which the company would be unable to pay its debts, delaying the declaration of bankruptcy or the cancellation of an arrangement with creditors or resorting to illegal means to obtain money;*
- *spending large sums on reckless ventures or speculation not required for the business of the company; or*
- *participating in or consenting to actions contrary to law or to the memorandum of association of the company.*

## The Civil Code

It is also possible for a claim to be made against a director relying on the provisions of the Civil Code, where for example, a director carries out, in the course of his duties, an act which causes harm to another person (such as the company itself, or a shareholder). This is a general liability and is in many respects similar to the English law concept of tort.

## **Additional duties specific to directors of Limited Liability Companies or 'LLCs'**

In addition to general responsibilities outlined above, certain specific duties and obligations apply to the directors of LLCs only. By way of background, an LLC may have between one and five directors, which are referred to as 'managers'. LLCs must also have a general manager, who need not be a director, and who is responsible for the everyday affairs of the company. Although general managers are not directors of the company, due to the language used in the Companies Law, a number of directors' duties may also extend to the general manager.

The Companies Law requires that directors who make a public offer of shares in an LLC, or who value an LLC's shares in bad faith for more than their real worth, may be liable for a fine of up to AED 100,000. It is also important for a directors of LLC's to examine the company's constitutional documents, which frequently supplement the basic duties owed by the directors to the company (and its shareholders), for example in respect of the operation and nature of decision making by the board.

## **Additional duties specific to directors of all Joint Stock Companies or 'JSCs'**

A JSC may have between three and twelve directors, who have collective responsibility for the everyday management of the company. The responsibilities of such directors include all the duties outlined in the general section above, together with a number of further requirements.

A JSC company must provide a list specifying the name, capacity and nationality of each director to the Ministry of Economy every year, and the company is required to notify the Ministry of amendments to this list. The directors must also ensure that the company provides to its shareholders a directors' report on the company's activities and financial status, all financial statements, and a copy of the auditors' report.

## **Further duties specific to the directors of public Joint Stock Companies or 'PUJSCs'**

As might be expected, a number of additional obligations exist in respect of publicly listed JSCs (PUJSCs) listed on the Dubai Financial Market or Abu Dhabi Securities Exchange, to the requirements outlined above. Such PUJSCs are regulated by the Securities and Commodities Authority (ESCA), Federal Law No. 4 of 2000 concerning the Emirates Securities and Commodities Authority and Market (ESCA Law), and the Chairperson Decision No. (R/32) of 2007 on Governance of Joint Stock Companies (ESCA Decision).

A PUJSC director who deals in the securities of his own company in breach of the ESCA Law, or on the basis of insider information, may be liable to a maximum of three years imprisonment and a fine of up to AED 1 million. Transactions made in contravention of the ESCA Law may also be invalid.

Whilst it is possible for directors of PUJSCs to deal in securities issued by their company, all proposed dealings must first be disclosed to the relevant stock exchange, and are subject to the prior approval of the board of directors. Failure to comply with these requirements will render the transaction void.

In many ways, the ESCA Decision may be contrasted to the more traditional laws governing the actions of directors of onshore companies, and arising under the Companies Law and Commercial Code. Arguably, the ESCA Decision marks a departure from the prohibitory, negative regulations of the past, placing a positive obligation on the board of PUJSCs to establish internal control systems to evaluate procedures for risk management and to oversee the implementation of corporate governance controls, reviewing and then reporting on such matters to shareholders on an annual basis. Such requirements are intended to encourage good management practice, whilst increasing management accountability and transparency to shareholders.

In 2008, ESCA imposed penalties and/or took action against more than 260 persons or entities in breach of ESCA laws and regulations.

## **Is it possible for the company to indemnify a director against liabilities?**

A company may indemnify a director or officer against liabilities arising in the course of the performance of their professional duties. There are also no laws or regulations preventing directors of LLCs or JSCs from obtaining liability insurance coverage.

The Companies Law provides that the directors of LLCs and JSCs are collectively liable for all actions prohibited by law where they were carried out as a result of a unanimously adopted resolution. However, if

the majority of the board adopted the resolution causing the liability, any dissenting directors (who had their objections properly recorded in the minutes of the meeting) are not liable.

In respect of those directors that are held liable, the shareholders of an LLC or JSC may however ratify by resolution any acts of directors causing such liability, although there is a time bar after one year from the date of the shareholder meeting on proceedings for civil liability. Typically, where the shareholders agree to ratify such acts, the company will also agree to indemnify the directors against any associated liabilities.

### Protection through D&O Insurance

Directors and Officers liability insurance (D&O) provides coverage for directors and officers in respect of wrongful acts undertaken in the course of the performance of their duties. D&O cover therefore protects the personal assets of directors and officers. Chartis offers its Corporate Guard policy to cover such liabilities.

D&O insurance may be purchased by a company for a number of reasons. Typically it is acquired for the benefit of the directors and officers as individual insureds, to protect them from personal financial liabilities. However, D&O insurance can also provide balance sheet protection for the company. In particular, a D&O insurance policy may provide for the reimbursement of the company where the company has indemnified a director in respect of a claim made against them. However, it is also important that, in the event that the company is unable to reimburse the director, the policy will pay the individual directly. This is especially relevant in the event of the insolvency of the company, and the policy should allow directors and officers to claim under the policy directly, even where the company is insolvent.

D&O insurance therefore protects directors and officers and the company from the financial consequences of their actions. Importantly, it will typically provide an advance to cover defence costs in civil proceedings against the director or officer. Chartis Corporate Guard D&O policy also provides coverage for legal expenses incurred in responding to investigations by regulators. The policy also provides coverage in respect of criminal proceedings up until the point of final adjudication (although criminal offences are excluded).

There are no specific laws or regulations governing D&O insurance, although this is a position that may change as the UAE Insurance Authority is expected to issue a number of new regulations in 2010 and 2011. General UAE insurance legislation requires insurance to be placed locally with a licensed insurance company. As any insurance placed in respect of onshore risks with an unlicensed insurer is null and void, multinational groups with a single, group-wide D&O policy must therefore introduce a local insurer to front coverage in the UAE.

Chartis Corporate Guard offers protection to executives from the financial consequences of their past, present and future actions. Coverage can include the following circumstances:

- **Regulatory protection.** An increasingly controlled regulatory environment and reporting requirements inevitably mean that investigation by the authorities is an ever increasing concern. Chartis Corporate Guard will respond to Investigation costs and the legal fees and expenses for attendance at an investigation of an Insured.
- **Bankruptcy/Insolvency protection.** In the event that an Insured company becomes insolvent and a Director or Officer is subsequently named in a claim, the policy will be able to respond directly to the individual. This coverage will not be subject to a deductible.
- **International exposures, including the United States.** As businesses become more international due to globalization, directors and officers should be aware that claims in some international courts, such as in the UK and the US are increasingly common and even where such courts can be persuaded to decline the jurisdiction, legal costs will be necessarily incurred in preliminary hearings to challenge this jurisdiction. The Chartis Corporate Guard policy will cover legal costs in relation to (alleged) mismanagement.
- **Shareholder claims and claims from Insured Persons.** Business losses can be the result of internal disputes. The Chartis Corporate Guard policy can provide coverage for claims made by shareholders and insured persons alleging mismanagement.
- **Exposures arising from directorships of subsidiary and non-subsidiary companies.** With ever more complex group structures, directors are often appointed to the boards of several entities within a group. Automatic coverage is provided for new subsidiaries acquired during the policy period. Coverage is also available for directors representing the company at other entities, in which the company has a minority shareholding.

- **Emergency costs.** Emergencies may require the company to enlist legal counsel immediately, without having time to contact Chartis for permission. In this event we give retrospective cover for costs up to a pre-agreed amount.
- **Employment practices violations.** Claims made by employees alleging violations of their legal rights as employees. Possible lawsuits against directors and officers include claims for sexual harassment, breach of employment contract, wrongful termination, discrimination and failure to hire or promote.

## The future

For many directors and officers, the global financial crisis has raised awareness of their respective duties, bringing with it a realisation that the litigation risk and potential liabilities attaching to directors of onshore companies in the UAE are just as real as in other developed jurisdictions, and in specific circumstances, perhaps more rigorous.

Shareholders creditors and counterparties of affected companies are increasingly seeking to obtain compensation for alleged mismanagement or wrongful acts by bringing actions against companies and/or directors and officers personally. Anecdotally, it would appear that the number of such claims is rising, not only as a consequence of increased regulatory scrutiny (itself attributable to the global economic crisis), but also because such parties are more aware of, and willing to enforce, their legal rights. This is a trend that is expected to continue.

D&O insurance, which is common in developed marketplaces, is a principle means by which a company can protect its directors and officers, and also its own balance sheet. A D&O policy may also assist companies to attract and retain talented directors and officers.

As the UAE economy looks beyond the economic slowdown, and becomes an increasingly sophisticated marketplace, it is inevitable that the future will bring more regulation, particularly as far as corporate governance and the duties of directors and officers are concerned. Yet there are also strong indications that the desire to entrench directors' duties and the principles of good corporate governance, herald recognition of the fact that having a strong business model that promotes transparency, responsibility and accountability ultimately positions businesses for more profitable and sustainable growth, by minimising trading risks and potential exposure to liability, for example.

It is therefore of paramount importance that directors not only ensure compliance with corporate governance principles, but also give appropriate consideration to how any action against the company (and themselves personally) might be properly defended.

## About Chartis Insurance

Chartis is a world leading property-casualty and general insurance organization serving more than 40 million clients in over 160 countries and jurisdictions. With a 90-year history, one of the industry's most extensive ranges of products and services, deep claims expertise and excellent financial strength, Chartis enables its commercial and personal insurance clients alike to manage virtually any risk with confidence. Chartis is the marketing name for the worldwide property-casualty and general insurance operations of Chartis Inc.

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