

Liability of Directors in an LLC

Hassan Arab - Partner, Regional Head of Dispute Resolution - Litigation / Arbitration
h.arab@tamimi.com - Dubai International Financial Centre

May 2011

As a general principle, a limited liability company will be held liable for the actions of its manager when those actions are carried out in its name and within the scope of the manager's authority as set out in the company's Memorandum of Association. The exception to this general principle is where the manager's activities are fraudulent.

In a recent decision, the Court of Cassation held that a manager of a limited liability company shall be held liable with his personal assets at risk, for any fraudulent or criminal act committed while dealing with the company's creditors. The Court of Cassation held that the manager will be held personally liable along with the company when issuing a cheque. The exception to this is unless the manager proves that at the time of the issuance of the cheque the company had sufficient funds. A failure to prove this shall warrant payment of the cheques from his personal assets. In reaching its decision the Court of Cassation had regard to Articles 218, 219, 237-3 & 111 of the Commercial Companies Law ("CCL").

Claim

A commercial action was filed by a buyer (the "Claimant") against a Limited Liability Company ("the First Defendant") and its Manager ("the Second Defendant") (together "the Defendants"). The Claimant submitted that the First Defendant had purchased scaffolding from him amounting to AED 473,750, but that the First Defendant had paid only AED 99,812. The Claimant argued that the First Defendant had issued two posted dated cheques - signed by the Second Defendant - for the remaining amount. The first cheque was dated 2 September 2008 and amounted to AED 75,938, and the second cheque was dated 14 September 2008 and amounted to AED 298,000.

The Claimant alleged that the two cheques had bounced upon their presentation, due to insufficient funds. The Claimant subsequently initiated legal proceedings against the Defendants and requested the Court to direct them to pay the outstanding amount plus interest and legal fees.

The Court of First Instance

The Court of First Instance accepted the claim against the First Defendant only. The First Defendant was directed to pay the amount of AED 373,938 plus interest. The case against the Second Defendant was dismissed. On that basis the Claimant appealed the judgment to the Court of Appeal.

The Court of Appeal

The Court of Appeal upheld the Court of First Instance's decision. Consequently the Claimant appealed to the Court of Cassation.

The Court of Cassation

The Claimant argued that the Court of Appeal had erred in its decision to uphold the decision of the Court of First Instance. The two main grounds for the Claimant's appeal were as follows:

- the Second Defendant is a partner in a limited liability company;
- the Second Defendant shall be only held liable only to the extent of the capital of the company

The Claimant argued that the Second Defendant was both responsible of the management of the First Defendant and that he had signed the two bounced cheques in the knowledge that the First Defendant

company did not have sufficient funds. The Claimant submitted that this equated to a finding that the Second Defendant should be held personally liable (together with the First Defendant company) to the Claimant as a creditor of the company.

The Court of Cassation overturned the Court of Appeal's decision and held that acts committed by a manager of an LLC Company bind the company when they are carried out in the company's name and within the scope of the manager's authority. The exception, as outlined above, is when the subject acts are fraudulent. With respect to the issue of a cheque, if the manager is aware that the company does not have sufficient funds at the time he signs and issues the cheque, he will be liable in his personal capacity.

In light of the above, the Court of Cassation overturned the Court of Appeal's decision. The Second Defendant was found to have acted in his capacity as a duly authorised manager of the First Defendant. The Second Defendant was also found to have signed the cheques in the knowledge they would bounce. The Second Defendant was therefore held jointly and severally liable with the First Defendant with respect to the payment of the outstanding amount.