Corporate Benefit: An analysis under the UAE Legal Regime

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The principle: In a world where large corporate groups are the norm, corporate benefit issues constantly rear their head in common law legal systems. In this article, we examine to what extent similar and parallel doctrines apply to UAE companies operating under a civil code legal system.

A director or manager of a company in the UAE is obliged, when dealing on the company's behalf, to act in its best interests at all times. In practical terms, this means that the director must, in exercising the powers of his office, attempt to realise the greatest benefit possible to the company. In reality, the best interests of a company set up for commercial purposes are served by profitable dealings.

In the UAE, this quest for profitability is enshrined in law. Under the UAE Companies Law, a company itself is expressed to be a contract under which two or more shareholders agree to participate in an economic concern for the purpose of generating profits. Under UAE Companies Law a company has a distinct juristic personality from the legal personalities of its shareholders, and so this independent juristic personality's sole purpose must be to conduct its business in order to make profit from its dealings, for and on behalf of its shareholders. It is the duty of its directors to see that this is achieved.

A company in the UAE is further constrained however by its 'objects', which the UAE Companies Law provides a company must observe and comply with. The UAE Companies Law states in Article 13 that: "The objectives of the company must be legitimate. Specialization and uniformity of purposes must be maintained in its main objectives".

Therefore the directors of a company are tasked with conducting the business of the company with regard to these two key principles; compliance with both the company's purpose and its objects. In doing so the company can be said to be acting in furtherance of its 'corporate benefit'.

Sometimes the directors of a company make decisions on a day to day basis which have significant and long lasting effects on the company's prospects. For such decision makers it is key that they are mindful of the corporate benefit (if any) flowing from their decisions. However, rather than considering themselves constrained by the rules put in place by the UAE Companies Law and the company's Articles of Association, the directors should view these rules as providing a 'safe habour' where they cannot be attacked with allegations of wrongdoing.

A clear practical example of this principle is the provision of a guarantee by a company of the liabilities of one of its shareholders or directors.

The first paragraph of Article 197 of the UAE Companies Law states that: "The company may not grant cash loans of whatever kind to the chairman of its board of directors or to a member of the board, neither may it guarantee any loan agreement concluded with third parties in their favour".

A further example is provided by Article 103 of the UAE Companies Law which sets out limitations on the powers of directors for certain business activities which directors cannot undertake, including entering into loan agreements for periods in excess of three years, the sale or mortgage of the company's real estate assets and the cancellation of debts owed to the company. Such actions can only be legitimised by the express inclusion in the Articles of Association of the authority to perform such actions, or, less explicitly when the action can be justified as being in complaince with the company's objects.

By inserting such express provisions, the shareholders in a company can give explicit authorisation to the directors to take such corporate actions. In the absence of these provisions Article 103 provides that such significant decisions require a resolution of shareholders to be passed before the directors are able to undertake the corporate actions listed in Article 103.

It is common for a parent company to seek guarantees of its debts from its subsidiaries. Directors of a subsidiary company must ensure that they exercise their powers in the best interests of the company of which they are a director, regardless of whether these interests coincide with the interests of the parent company. When guaranteeing upstream liabilities directors must consider the potential risks to the subsidiary company's balance sheet and balance them against any possible financial benefits to the subsidiary company as a single entity within a wider corporate group. Directors must sometimes be mindful of a clash of their own duties when they are directors of both parent company borrower and subsidiary company guarantor.

Article 110 of the UAE Companies Law provides that a company is bound by the actions of its board of directors and liable in damages for any unlawful actions or those undertaken with out the proper authorisation of the Articles of Association or objects. However, if a proper corporate benefit does not stand behind the resolutions or acts of the directors, the directors themselves may find themselves liable to the company for any loss suffered as a result of failing to show a sufficient duty of care.

Third parties therefore can be confident in their dealings with directors that, by purporting to act on the company's behalf, the directors are binding the company to any contractual arrangement entered into with such third parties. The UAE Companies Law further provides that directors are personally liable towards the company itself, its shareholders and economic third parties for all acts of fraud, abuse of power and mis-management, or for acts for which they were not authorised to do. This Article is important in this context as failure to act properly renders directors personally liable (e.g. by failing to secure any corporate benefit) granting third parties an additional recourse against the directors if the event that they are unable to seek redress from the company (such as a company in liquidation).

Practical considerations

Given that the company's directors are constrained in their actions as described above, it is important that the directors can demonstrate that they had considered the economic benefit to the company in their decision making. It is advisable therefore that regular minutes of meetings and written notes of resolutions are taken whenever the directors enter into contracts on behalf of the company. Not only will such paper work create an audit trail to demonstrate the company's corporate benefit had been considered, the need to record the rationale for decision making itself serves as a timely reminder to the directors to consider their duty to the company at critical times.

DIFC law – a common law perspective

A similar level of accountability of directors for the conduct of the business of a company is taken by common law jurisdictions, including the Dubai International Financial Centre, based as it is on the law of England and Wales, itself a common law jurisdiction. The juristic personality of companies incorporated under the DIFC Companies Law no. 2 of 2009 is also separate from that of the company's shareholders or members. Common law (from which DIFC laws derive) imposes on all directors fiduciary duties and a duty of care and skill. These duties are now codified by the

Companies Act 2006, the primary source of UK company law, and similarly duties of directors of a DIFC company are also codified in the DIFC Companies Law.

Article 53 of the DIFC Companies Law provides that “a director or other director of the company, in exercising his powers and discharging his duties shall a) act honestly, in good faith and lawfully, with a view to the best interests of the company; and b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances”.

The fiduciary duties of directors towards the company would also include an obligation to use the powers granted to them for the purposes for which they were conferred. Under article 33 of the DIFC Companies Law (in relation to a company limited by shares), “a company may be incorporated to conduct any lawful business”, a mirror of the obligation imposed by the UAE Companies Law.

In entering into such lawful business on behalf of the company the directors must have consideration for the benefit to the company and its members as a whole. Whilst ‘benefit’ is not defined, in the case of companies, it is likely to mean the sustained profitability of the company. If such benefit cannot be clearly established then the directors will have breached their duties, which would inhibit their ability to enter into a transaction on the company’s behalf.

Conclusion

In conclusion, although not explicitly identified, the concept of corporate benefit is relevant under the UAE Companies Law, and similar provisions under the DIFC Companies Law mean that directors of companies incorporated onshore or offshore in the UAE are subject to the same basic requirement to act only in the furtherance of the company’s interest. It is important that directors always have regard to their prime duty when dealing on behalf of the company that they represent, both to ensure they are fulfilling their duties and to ensure the long term success of the company.