

Remedies for shareholders in the company law of the UAE and the DIFC

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It is a settled principle under many legal systems that a company is a separate legal person distinct from its shareholders, embodied in the well-known concept of the corporate veil. Accordingly, the company is the proper claimant in an action where a wrong has been done to it. A shareholder is not usually permitted to sue where a wrong is done to the company of which he or she is a member, or to claim damages for that loss (known in English law as the rule against reflective loss).

It is also settled law in many jurisdictions that the company shall run its affairs through meetings of its shareholders and the board of directors, by virtue of the matrix of power provided in the company's memorandum and articles of association ('AOA') and the law under which the company is incorporated.

However, there are certain events where a shareholder can bring an action, for instance if the company is unable or unwilling to. This type of action is described in English law as a derivative claim because the shareholder's right to sue is not personal to him or her but derived from the right to sue which is vested in the company. Furthermore, in exceptional circumstances the court can grant relief where the affairs of a company are threatened to be or have been conducted in a manner that is unfairly prejudicial to the interests of the members generally, or some part of its members.

There is a distinction between a shareholder's personal right to enforce his or her rights under the company's AOA and the shareholder's right to bring a derivative claim or an unfair prejudice claim, which this article considers. It also addresses the events and the prerequisites necessary for a shareholder to file a derivative claim and an unfair prejudice claim under the UAE Commercial Companies Law ('CCL') and the DIFC Companies Law (DIFC Law No.5 of 2018 as amended).

Shareholders' personal rights under a company's AOA in UAE law

In broad terms, in UAE law a shareholder has, amongst others, the right to vote at shareholders' meetings, receive dividends once declared, and share in surplus capital if the company is wound up. When a shareholder sues to enforce his or her rights under the AOA or the shareholders' agreement as the case may be, he or she is effectively bringing an action for breach of contract. Any judgment he or she obtains will be directly enforceable by him or her and binding on the company.

There are two dominant examples for enforcing a shareholder's personal rights under UAE law:

Example one: where the company defaults on the repayment of a loan or payments advanced by the shareholder. In this case, the shareholder can bring a claim against the company by invoking the general rules in the UAE's respective laws. Unless the parties agree to the contrary, the shareholder is freed from any restrictions provided in the CCL or the AOA, as long as, he or she is establishing his or her claim on the breach of contract event.

Example two: where the company refrains from distributing declared profits. In this case, the shareholder can initiate a claim against the company claiming for the undistributed profits. This claim may also be

instituted against the company's director, where they commit an act of gross negligence and/or a serious mistake.

Article 8 of the CCL provides that *"A Company is a contract whereby two or more persons agree to participate in an economic profit making venture by contributing a share of capital or work and splitting among themselves the profit or loss resulting from the venture."*

In this regard, the Dubai Court of Cassation held that *"It is settled in this Court that a company's profit and loss are determined only once a year, at the end of its financial year, according to its balance sheet. If the company has made a profit, each partner's share of the profit is then determined as an amount standing to his credit which the company must pay him. Consequently, each partner has a right to claim, from the company, accumulated profit from previous years based on the company's balance sheets for those years. Accordingly, the fact that no balance sheets had been prepared for previous years would not preclude a partner from claiming his profit if it is proven that the company has made a profit for the years in question. Indeed, entitlement to profit is recognized when profit is actually realized, not when a balance sheet is prepared."* (Dubai Cassation Judgment No 1049 of 2018; 13 October 2019).

Unfair prejudice claims in UAE law

Article 164 of the CCL, headed "Acts Harmful to the Interests of the Company", entitles a shareholder holding at least five per cent of the company's shares, who believes that the affairs of the company are being or have been conducted to the detriment of the interests of all or any of the shareholders, or that the company intends to commit an act or omission that may prejudice their interest, to submit an application to the authority to issue appropriate decisions at its own discretion. If the authority denies the application or the application is not considered within 30 working days, the shareholder shall be entitled to have recourse to the competent court within ten days from the date when the application was declined or that deadline expired, as the case may be. The court may then issue a judgment to either annul the act or omission that forms the subject matter of the application, or to order the company to continue doing an act from which the company has refrained.

Similarly, Article 149 of the DIFC Companies Law, "Orders in Event of Unfair Prejudice", affords a protection to prejudiced shareholders. Moreover, it grants the court wider authority to entertain such applications.

It provides that:

Where a Company's affairs are being or have been conducted in a manner whereby the conduct is unfairly prejudicial to the interests of its Shareholders generally or of one or more Shareholders, or an actual or proposed act or omission of the Company (including an act or omission on its behalf) is or would be so prejudicial, the Court may, on application of one or more Shareholders of the Company, make one or more of the following orders:

1. an order regulating the conduct of the Company's affairs in the future;
2. an order requiring a person to do, or refrain from doing, any act or thing;
3. an order authorising proceedings to be brought in the name of and on behalf of the Company by such person or persons and on such terms as the Court may direct;
4. an order providing for the purchase of the rights of any Shareholders of the Company by other Shareholders or by the Company itself and, in the case of a purchase by the Company itself, the reduction of the Company's capital accounts accordingly; or
5. any other order as the Court sees fit.

It is clear that Article 149 grants the DIFC Courts a very wide discretion to deal with the alleged prejudice,

as the Court may direct any order as it sees fit. In practice, however, the Court would usually order that the minority shareholding is bought out at a fair market value by the respondent shareholders. The position is quite different for claims under Article 164 of the CCL. In such claims, the competent court's discretion is limited to granting declaratory reliefs for determining the merits in question. Article 149 also waives the prerequisites mandated by Article 164 of the CCL. There is no minimum threshold of the number of shares owned by the claimant shareholder and the application may be filed directly with the court without having to wait for the competent authority's directions.

Derivative claims under UAE law

Article 166 of the CCL states that *"Each shareholder may individually pursue a liability claim against the board of directors of the Company if not filed by the Company, provided that the error may cause damage to him personally as a shareholder and that such shareholder shall notify the Company of his intention to pursue the claim. Every provision in the articles of association of the Company to the contrary shall be invalid."*

The Dubai Cassation Court has ruled in this regard that *"the shareholder in a limited liability company is entitled to claim by his own name against the director of the company for the compensation for himself or the company in case a wrongdoing made by the director in the company's management which resulted in damages suffered by the shareholder or the company, in the event that the company failed to initiate this claim"* (Judgment 159 of 2015).

This claim under Article 166 is a liability claim against the company's director(s), where the relief sought shall be limited to damages. Accordingly, it is not permissible for the claimant shareholder to claim for a specific performance or declaratory relief. Moreover, such a claim shall not be instituted against a third party even if such party has a contractual relationship with the company.

Personal damage

There is no precise definition of personal (special) damage referred to in Article 166 of the CCL. There is no case law that deals with this issue. However, more likely, special damage refers to the loss of profit that the claimant shareholder has sustained as a result of the alleged mistake. In any event, assessment of the claimed damages is subject to the court's sole discretion.

Remedies available under UAE and DIFC law for a shareholder where the company fails to take action against a defaulting contracting party

As explained above, pursuant to Article 71 of CCL and Article 9 of the DIFC Companies Law a company shall have a distinct legal personality from that of its shareholders. Moreover, pursuant to Articles 83, 84/2 and 155 of CCL and Articles 20 and 21 of the DIFC Companies Law a director of the company shall have the capacity to represent the company and enter into binding contracts.

Accordingly, a company's shareholder has no capacity to institute a legal action against a defaulting party which has a contractual relationship with the company. Nevertheless, such shareholder may cause the

company to pursue such a legal action by virtue of an application pursuant to the aforementioned Articles 164 of CCL and 149 of DIFC Companies Law, where they will seek a court order enforcing the company to take an action or refrain from doing an action.

As a general rule, courts are reluctant to interfere in companies' affairs, which shall run by the general assembly and the directors. Therefore, a strict burden of proof lies with the claimant shareholder who will have to establish that the directors are acting in bad faith and/or committed a gross negligence, the act or omission in question is detrimental to the company's interest, and that the relief sought is the correct action which a prudent person would seek.

In sum, an aggrieved shareholder may, amongst others, take any of the following actions:

1. a shareholder can file a claim before the competent court seeking to enforce their rights under the respective contract e.g. recovery of the unpaid debts advanced by the claimant shareholder etc.
2. a shareholder can file a liability claim under Article 166 of CCL against the company's director(s) (not third parties), where the relief sought will be limited to damages; and
3. a shareholder holding at least five per cent of the company's shares, can file a claim under Article 164 of CCL (or Article 149 of DIFC Companies Law where the DIFC is the regulatory authority), where the company's affairs are being conducted to the detriment of the shareholder(s).

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