SHAREHOLDERS' DISPUTE IN UAE

GRATA INTERNATIONAL

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Disaccord between the shareholders of a company typically entails differences in opinion, conflicting interests, or disputes over the management, assignment of shares, control, or direction of the company including disagreements over strategic decisions, financial matters, profit distribution, breach of fiduciary duties, or violation of shareholder rights.

At the outset, we must understand that in most jurisdictions globally, a limited liability company is the preferred type of business setup as it distinguishes the identity of the company from its shareholders. In UAE too the most favored form of business is an LLC as protecting personal assets from litigation is paramount for entrepreneurs. The Shareholders in a Limited Liability Company are distinct from the Company and the company is a separate legal person in the eyes of law.

THE SHAREHOLDERS OF AN LLC ARE AFFORDED RIGHTS UNDER A WELL-ESTABLISHED LEGAL FRAMEWORK PRIMARILY GOVERNED BY THE FEDERAL DECREE-LAW NO. (32) OF 2021 ISSUED ON 20/09/2021 ON COMMERCIAL COMPANIES AND THE "FEDERAL LAW NO 1 OF 1987 CONCERNING CIVIL TRANSACTIONS LAW IN THE UAE"

The most striking part of the jurisdiction of UAE in relation to the powers and obligations of the Shareholders is that the Shareholders in a company are different from Shareholders acting as managers in the company. The roles of a shareholder and a manager in a company are distinct and can be held by different individuals or entities. A shareholder is an equity or a stockholder, that owns shares or equity in a company. Shareholders typically invest capital in the company in exchange for ownership. They have certain rights, such as voting rights in general meetings, entitlement to dividends, and the right to receive a portion of the company's assets upon liquidation.

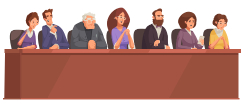
On the other hand, a manager, also referred to as a director or executive, is an individual appointed to manage and oversee the operations of a company. Managers have the responsibility of making strategic decisions, implementing policies, and ensuring the company operates efficiently. They are typically involved in day-to-day management, supervising employees, financial planning, and executing the company's business objectives. Further, there could be Shareholders appointed as Managers in the Company. Managers may or may not be shareholders in the company.

Article 83 of the Federal Decree-Law No. 32 of 2021 mandates that the management of a Limited Liability Company shall be undertaken by one or more managers as determined by the partners in the Memorandum of Association. The Managers may be appointed in the Memorandum of Association of the Company or under an independent contract by the General Assembly of Shareholders. If there is more than one manager, the partners may appoint a board of managers. Such a board shall have the powers and functions set out in the Memorandum of Association.

Shareholders acting as managers are vested with the full powers of a manager. They are authorized under the law to exercise full powers to manage the Company and his acts shall be binding on the Company. This can be read under Article 83(2) of Federal Decree-Law no. (32) of 2021.

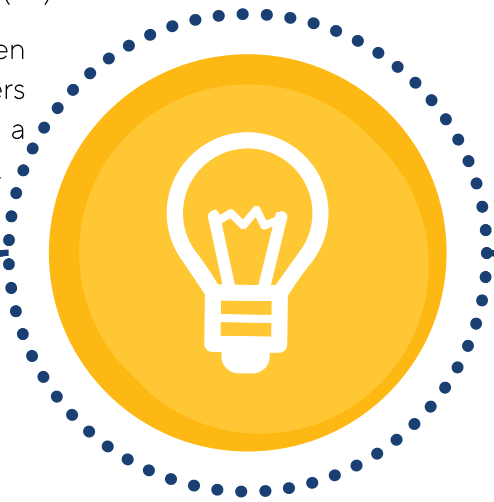
Our article will focus on the disputes between Shareholders and disputes between Shareholders who are uniquely investors and managers with a special focus on pre-emptive measures to be taken.

It is important to understand the roles and responsibilities of shareholders and directors within the company structure.



Some of the main causes for shareholder dispute is the transparency in the allocation of profits and dividends, diverging opinions on the management of the company in relation to investments, operations, and most commonly the removal of managers who are shareholders too in the business.

At GRATA Dubai Office, one of the ongoing cases of shareholders' dispute can be relevant for discussion.



The shareholders formed a mainland LLC with the demarcation of powers under the Memorandum of Association wherein one of the Shareholders was appointed as a manager bestowed with powers of single-handedly operating bank accounts, to represent the company before the official and unofficial authorities, obtaining licenses including other powers along with managing the company day-to-day affairs.

In this case, a person was employed in the company (an LLC) and over the years because of the effectiveness in handling all of the company affairs and manoeuvres was promoted as a Shareholder in the company with a 50% equity and was added as a manager of the company. The Commercial License reflected the two shareholders' names with each having 50% Shares in the company and simultaneously reflecting the employee-turned Manager as a Shareholder cum manager.

The dispute arose between the shareholders when the Shareholder who is not a manager issued a Power of Attorney to a third party. The third party apparently acting as a Shareholder vide the powers granted under the Power of Attorney raised questions on the transparency of the activities undertaken by the manager cum shareholder, alleged negligent handling of a business's affairs, resulting in financial losses, operational inefficiencies. This dispute has many realms out of which the initial concern was the operation of the bank accounts wherein one of the shareholders had imposed debit restrictions on the company's bank accounts. Grata Dubai, at the request of the aggrieved shareholder, intervened in this matter and successfully resolved the issue with the concerned bank.

It is recommended that the shareholders in order to avoid dispute and hassle must delegate or appoint unanimously the authorized person from among the shareholder to operate the bank's accounts in the Memorandum of Association. The Shareholders prior to delegating such powers must be wary of the repercussion of authorizing such individuals. To compress, the advice is to define the powers in the MOA or through Board Resolution passed during the general assembly meetings as the banks are bound to comply with the MOA unless any other written agreement exists. Further to other areas of a dispute under this matter are allegations of breach of fiduciary duties by manager cum shareholders, such as self-dealing, misappropriation of funds, or unfair prejudice.

The main reason for the disputes is often the motive by the shareholder and their POA holder to create for their own benefit a parallel competing business with the mala fide intentions of enticing existing clients/businesses of the companies for their own personal benefits. One more common reason behind the disputes is the failure of a manager to adhere to the rules of law and corporate governance requirements, i.e. failure to call for AGMs, prepare and maintain proper books of accounts signed by the shareholders, prepare and implement internal policies...etc.

Other common disputes we noticed in the market are when the shareholder cum manager acts singly under full absolute powers, creating a conflict of interests situation which can be seen in areas of corrupted procurements, side commissions on the sale, hiring relatives and friends, or disposing of company's assets in a unilateral decision.

In UAE, dispute resolution between the shareholders typically involves negotiation to arrive at an amicable settlement. If there is a deadlock there may be options of business split or share sale.

In case of alleged mismanagement, or discrepancies in the day-to-day activities, the first step to legal proceedings is the appointment of an expert. The aggrieved party may reach out to the court requesting the appointment of an expert. The courts in UAE maintain a list of experts registered with the court who have expertise in various fields. The court analyzes the dispute and accordingly appoints an expert for a fee who has expertise in the subject matter of the dispute. The expert's duties may include but are not limited to, visiting the commercial premises, inspecting books of account, analyzing the dispute, raising queries from both parties and requesting documents based on which the expert prepares an independent report.

The court takes into consideration the expert report and it's the judge's discretion to critically analyze the credibility of the expert report based on the rules.

A preemptive measure to avoid such disputes is to have a shareholders' agreement outlining the duties and powers of the shareholders with a clear dispute resolution process. However, not all 50/50 shareholders have such an agreement.

We recommend reaching out to our Grata Dubai office directly for consulting with a legal professional who can provide you with the most up-to-date and accurate information regarding court procedures, reports, or documents in UAE in relation to resolving the shareholder's dispute.

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