

New Saudi Arabia Companies Law: Effective 2016

Francis Patalong - Senior Counsel - Corporate / Mergers and Acquisitions / Commercial / Mediation / Sustainability focused Corporate Governance / Sustainable Finance / Sustainable Business / Sustainable Sourcing / Climate Change & Energy Transition

f.patalong@tamimi.com - Riyadh

December 2015 – January 2016

The last time (also the first time) a companies law was promulgated in the Kingdom was 1965 – a time when the average global price for a barrel of crude oil was USD 1.80 (USD 13.55 adjusted to 2015 prices), the oil shocks of the 1970s were in the future, the Gulf Cooperation Council had not yet been established and the internet was firmly in the realm of science fiction.

The old law has served Saudi Arabia through a period of transition – being the basis for company regulation during a period which has seen extensive and accelerating inward investment in the country together with the launch (in 1994) and subsequent reinvigoration (in 2007) of Tadawul – the domestic Saudi stock exchange.

However, what worked in 1965 is not necessarily fit-for-purpose in an era of global financial connectivity, volatility and fragility, shareholder activism and burgeoning corporate governance scandals.

Since 2002 a revised law has been under discussion – a process which was intended to take into account such innovations as Saudi accession to the World Trade Organization (achieved in 2005), the establishment of the Saudi Arabian General Investment Authority (SAGIA), the Saudi Industrial Property Authority and the Capital Market Authority. The process of agreeing and then enacting the new companies law has been protracted (but certainly comparable to developments around such keystone blocks of legislation in other jurisdictions), involving a multiplicity of stakeholders and experts.

The new Companies Law (1437H/2015G) was published by the Ministry of Commerce and Industry (MOCI) on 9 November 2015, published in the Saudi Gazette (Um Al-Qura) on 4 December 2015, and will come into effect on 2 May 2016. The new Companies Law completely replaces the old Companies Law. It will provide existing companies with a period of one year from its effective date to make such changes as are necessary to comply with the new Companies Law, subject to any new rules set in respect of such existing companies by the competent regulatory authorities.

Key innovations made by the new Companies Law are:

- Three of the rarely used forms of corporate entity under the old Companies Law are no longer permitted – namely Cooperative Companies, partnerships limited by shares and Variable Capital Companies (article 3). In practice the main forms of corporate entity used will continue to be the Limited Liability Company (LLC) or Joint Stock Company (JSC).
- Specific provisions (articles 182-186) are introduced to govern the establishment of a holding company (either by way of LLC or JSC) for controlling other JSCs or LLCs by holding more than 50% of their capital or through board control. Any such new holding company will have to include the word “holding” in their name and produce annual consolidated financial accounts.
- Perhaps the most significant change in practice is that LLCs (article 154) can now be formed with a single shareholder, replacing the current requirement for a minimum of two shareholders.
- JSCs can now be formed with two shareholders reduced from the current requirement of a minimum of

five shareholders. Also in certain cases (JSCs formed by the Government or Government owned entities or formed by entities with a minimum of SAR 5 million) closed JSCs may be formed with a single shareholder (articles 2 and 55).

- The minimum share capital requirement for JSCs is reduced from SAR 2 million to SAR 500,000 (article 54). There continues to be no minimum capital requirement for LLCs, although in practice if the LLC or JSC is foreign invested SAGIA may impose a higher minimum capital requirement.
- Share contributions in kind for both LLCs and JSCs must now be independently valued (article 61).
- Another major change is the removal of the provision contained in the current Companies Law which makes shareholders in LLCs jointly liable for the debts of an LLC where its losses exceed 50% of its capital and the shareholders make no decision to recapitalize or liquidate the company and the company continues to trade. Instead a new provision provides for termination of the company by operation of law if either the managers of the LLC take no steps to call a shareholder meeting or the shareholders take no action (article 181). There are also analogous revisions around the process for termination where a JSC's losses exceed 50% of its share capital (article 150).
- A duty of confidentiality is imposed on shareholders in relation to information they receive in their capacity as shareholders of an LLC (article 173).
- There continues to be a requirement for LLCs and JSCs to set aside 10% of net profits as a statutory reserve, but this is no longer needed once the reserve attains 30% of the share capital. This is a reduction from the current requirement of 50% of share capital (articles 129 and 130 for JSC and article 176 for LLCs).
- An LLC will be required to undertake a conversion to a JSC if the number of its shareholders increases beyond 50 (article 151).
- JSCs will be permitted to purchase or pledge their own shares (article 112).
- JSCs will be permitted to issue negotiable debt instruments (article 122).
- There is recognition of modern communications methods for the purpose of running shareholder meetings.
- Measures are included to enhance corporate governance (including the requirement for an audit committee and a prohibition on combining the role of Chairman with an executive position) for JSCs (article 81) with an enhanced role for the Capital Market Authority which becomes the "concerned authority" in respect of listed JSCs.

It is not yet clear if in the months ahead there will be any implementing regulations from MOCI, adding further depth to the new law, although this is anticipated. The practical implementation of the new law will doubtless have to cascade through other relevant agencies such as SAGIA and it will take some time for custom and practice to adjust. However, by trimming the length of the primary law and enabling more detail to be addressed through subordinate regulation, it is envisaged that in future the corporate legal framework will be more responsive to wider global trends in regulation.

Although perhaps not a sea change in the law, the revised package does offer some indication of where the Saudi economy might be headed (and will certainly have some impact on foreign investors' deliberations around the nature of any permanent establishment in the country). In particular, the provisions relating to single shareholder LLCs, holding companies and company formation suggest that the process of establishing entities and group structures may be easier.

The provisions relating to debt instruments indicate that structured finance of infrastructure may be another avenue that is eased by the new law. This might be welcome news for those monitoring developments in terms of public private partnerships and privatizations, creating as it does, a corporate platform which is more familiar to the international market.

The ability to compartmentalize the assets of a group is also likely to be of interest - we envisage non-trading subsidiaries for proprietary assets (real and intellectual) might be considered (subject to satisfying applicable investment regulations).

The new law will certainly expand the toolkit available to investors, family businesses, shareholders and

management as they craft their company structures and cultures. It will be subject to much scrutiny in the months ahead as advisers (including tax advisers) seek to understand and optimize the opportunities it affords (and in particular how it sits with the existing Foreign Investment Law). It may prompt some businesses to undertake an audit of their existing portfolios.

Some things however cannot change - it should always be remembered that the fundamental law of the Kingdom is the Sharia'h and that any law will be read and applied in that context. There is a clear preference for transparency of purpose in any company formation (and that applies to holding companies too) - exotic group structures with opaque risk profiles will continue to be critically scrutinized.

Clearly, the new law will bring with it implications and challenges - the ink is hardly dry yet. Al Tamimi & Co's team of dedicated professionals in Riyadh and Jeddah will be pleased to assist you should further input be required.