

# Saudi Arabia – New Companies Law

More than a decade in the making, the new Saudi Companies Law will come into force on 2 May 2016. Its provisions will significantly impact the governance and compliance obligations of Saudi companies, as well as how new companies will be established. It also presents new opportunities for corporate restructuring, such as via the introduction of single shareholder companies, in ways not previously possible

To view our original client alert on the New Companies Law [click here](#).

## Introduction

The new Companies Law was enacted by Royal Decree No M3 dated 28/1/1437H (i.e. 10/11/2015G) (New Law). It was published in the Official Gazette on 22/2/1437H (4/12/2015G) and will come into force on 2 May 2016.

It replaces the current Companies Law enacted by Royal Decree No M6 dated 22/3/1385H (i.e. 22/4/1965) (Current Law). Although several provisions of the Current Law have been updated since its enactment, it was widely considered to be in need of updating, particularly in light of the significant developments that have taken place in Saudi Arabia since 1965: in particular, the establishment of the Saudi Arabian General Investment Authority (SAGIA) in 2000, the establishment of the Saudi Capital Market Authority (CMA) in 2003 and the accession of Saudi Arabia to the World Trade Organization in 2005.

This briefing provides an overview of the key changes introduced by the New Law and then focuses in particular on the provisions applicable to joint stock companies (JSCs) and limited liability companies (LLCs) as these are the most commonly-used

corporate vehicles in the Saudi market for our local and foreign clients.

## Regulatory oversight

The New Law designates the Ministry of Commerce and Industry (MOCI) as the regulator of all companies, other than listed companies for which the Capital Market Authority (CMA) is designated as the regulator.

The CMA under the New Law has wide powers to regulate listed companies (and, in some cases, companies applying to list), including in relation to governance, operations, mergers and inspections. Whilst many of these powers are already exercised in practice by the CMA pursuant to the Capital Market Law, the New Law affirms these powers and also grants new ones to the CMA, such as the regulation of mergers where a listed company is involved.

The Royal Decree enacting the New Law clarifies that its provisions do not apply to investment funds or special purpose entities, which the CMA has the authority to regulate pursuant to the Capital Market Law.

## Key developments

- The CMA has been given broad authority to regulate listed companies from a company law perspective
- New constitutional documents must be adopted by existing companies
- LLCs and JSCs can have a single shareholder in certain circumstances
- Guarantee shares are no longer required for JSC directors
- LLC shareholders are not at risk of having personal liability
- If JSCs or LLCs suffer losses, they can be dissolved by operation of law in certain circumstances
- Companies must comply with sharia principles in relation to debt when issuing or trading debt instruments
- The process to convene shareholder meetings has been streamlined.

## New constitutional documents

The New Law provides that MOCI will issue new model articles of association (AoA) and bylaws by 9 March 2016 which will be published on the MOCI website and will be applicable from 2 May 2016. Companies will be required to amend their affairs to comply with the New Law within a (Hijri) year from the coming into force of the New Law, however MOCI and the CMA will prescribe which provisions of the New Law need to be adopted by companies during this transitional period. We await further guidance from MOCI and the CMA in this respect.

## Legal forms of company

The New Law abolishes certain corporate forms from the Current Law, namely companies with variable capital and partnerships limited by shares. We expect this change to have little practical effect given that these forms have only very rarely been used in the Saudi market.

This leaves the following five forms of company which were legislated for by the Current Law and remain, with limited changes, in the New Law:

1. General partnership
2. Limited partnership
3. Joint venture
4. JSC
5. LLC

The provisions of the New Law related to general partnerships, limited partnerships and joint ventures have undergone limited amendment

from the position under the Current Law. This briefing focuses on the changes in the New Law applicable to JSCs and LLCs.

## Single shareholder companies

Both JSCs and LLCs may now have a single shareholder in certain circumstances.

### JSCs

JSCs with a single shareholder may be owned or incorporated by: the Saudi government; Saudi government establishments (e.g. the Public Investment Fund); companies wholly owned by the government (e.g. National Water Company); and companies whose capital is at least SAR5 million.

### LLCs

LLCs with a single shareholder may be owned or incorporated by natural or legal persons. If a natural person, he/she may not own more than one single shareholder LLC. In addition, any single shareholder LLC (whether owned by a natural or legal person) may not own another single shareholder LLC.

## Holding companies

The concept of a holding company is recognised in the New Law for the first time and is defined as being a JSC or LLC whose objectives are to control other JSCs or LLCs by holding a majority of their share capital or controlling the formation of their boards of directors. The New Law requires holding companies to prepare consolidated financial statements on an annual basis in

accordance with generally accepted accounting standards. A subsidiary may not hold shares in its holding company.

## Publication of constitutional documents

The publication of AoA, bylaws or amendments thereto in the Official Gazette or a local newspaper is no longer required. Instead, such documents must be published on the MOCI website; MOCI may charge fees for such publication. The New Law provides a right for such documents to be made available to the public, although how this public access right will be implemented by MOCI remains to be seen.

## JSCs

### Share capital

The New Law introduces a new requirement that the capital of a JSC must be "sufficient to achieve its objectives". While this remains a responsibility of the shareholders to ensure this sufficiency of capital, it is not clear whether MOCI (or the CMA in relation to listed companies) will intervene to require shareholders to raise a company's capital if, in its view, the capital is insufficient.

The minimum share capital for JSCs has been reduced from SAR2 million to SAR500,000. 25% of a JSC's capital must be paid up at the time of incorporation and the balance must be paid up within five years. The New Law permits undistributed profits to be used to pay amounts due in respect of shares that have not been fully paid up.

The minimum number of shareholders has been reduced from five to two.

The lock-up period for JSC founder shares remains unchanged (i.e. following the publication of financial statements for two financial years), however the CMA has the discretion to lengthen or shorten this period for listed companies or those intending to list.

## Incorporation

Incorporation of a JSC still requires a resolution from MOCI, even if a governmental entity is to be a shareholder. A feasibility study is however no longer required to be submitted to MOCI in order to incorporate a JSC.

## Remuneration of board members

The New Law does not alter the methodology by which board members' remuneration may be calculated (e.g. a fixed amount, fees based on meeting attendance, in kind benefits, a percentage of the company's profits, or a combination of any of them). However, it imposes a new cap of SAR500,000 per year in respect of board members' remuneration, increasing the current, MOCI-imposed, maximum of SAR200,000. The new cap includes any entitlement to the company's profits. The Chairman or the Managing Director may earn more than the SAR500,000 cap.

## Board of directors

Echoing the provisions of the Corporate Governance Regulations

issued by the CMA, the new maximum number of directors is 11; the minimum remains as three.

Should all or a majority of the directors resign, MOCI or the CMA (as applicable) may appoint a temporary committee to supervise the company's business.

### No guarantee shares

A welcome development is the abolition of the requirement for there to be guarantee shares in respect of each JSC director. The Current Law requires that shares worth SAR10,000 be deposited with a Saudi bank as a guarantee in respect of the liability of each director. The arrangements to implement this were often problematic, while the consequences of non-compliance were very serious, namely the board appointment being void. In any event, the value of SAR10,000 worth of shares was not a particularly commensurate reflection of the potential liability that the sum was supposed to guarantee.

Current guarantee shares will therefore be able to be transferred back to the party who originally provided them.

### Board appointments

The New Law prohibits the Chairman from holding an executive position within the company. There is a new requirement that a director be appointed to the position of Deputy Chairman.

An ordinary general meeting of shareholders (OGM) has the power to dismiss a director from office if he/she fails to attend three consecutive board meetings without a justified reason.

## Conflicts of interest

JSC board members who have a direct or indirect interest in a transaction may not vote at board or shareholder meetings in respect of the same. However, ambiguity still remains as to whether conflicted shareholders who are not board members may vote in respect of such matters at shareholder meetings (the New Law does not contain any clear restriction). We hope the implementing regulations to be issued by MOCI/the CMA will clarify this issue.

Where a board member fails to disclose that he/she has an interest in a transaction, the relevant contract could be deemed to be void and the board member may be required to repay any profits received from such contract. This is a welcome clarification of the potential consequences of non-disclosure, which the Current Law did not address.

### Board meetings

A JSC is now required to hold a board meeting at least twice a year and at least half of the board members must attend in order for the meeting to be quorate.

Board minutes must now be signed by all of the board members present at the relevant board meeting, the Chairman and the Secretary, and not just by the latter two as per the Current Law.

## Shareholder meetings

### Convening shareholder meetings

The notice period to convene an OGM has been reduced from 25 days to 10 days, providing companies with a greater degree of flexibility. The OGM notice must be either published in a local newspaper or sent by registered mail to all shareholders.

Provided that (i) a company's bylaws permit it and (ii) the original OGM notice provides for it, if an OGM is not quorate, then a second OGM may be held after one hour following the first OGM. Interestingly, for an extraordinary general meeting (EGM), the New Law only requires limb (ii) and not limb (i) above.

### Attendance

All shareholders of a JSC may now attend shareholder meetings, irrespective of the number of shares

they own. The Current Law permits the restriction of a shareholder holding fewer than 20 shares from attending shareholder meetings. In addition, a shareholder may appoint any other person (who does not have to be a shareholder) to attend a shareholder meeting on its behalf. Electronic means may be used by shareholders to attend and vote at shareholder meetings; we await further clarity from MOCI and the CMA in respect of how this will be implemented.

### Quorum

The relevant quorum for OGMs is as follows:

- **First meeting** – 25% of the capital, unless the bylaws provide for a higher threshold, which may not exceed 50%
- **Second meeting** (which could take place after an hour) – No minimum threshold of shareholders.

For EGMs, the relevant quorum is as follows:

- **First meeting** – 50% of the capital, unless the bylaws provide for a higher threshold, which may not exceed 2/3 of the capital
- **Second meeting** (which could take place after an hour) – 25% of the capital
- **Third meeting** (which must be held after a minimum of 10 days) – No minimum threshold of shareholders, provided the relevant authority (i.e. MOCI or the CMA) approves.

The imposition of a maximum quorum threshold for the first OGM and EGM is a new development. Under the Current Law, and particularly significant for closed JSCs, companies are able to provide that all,

## Auditor appointments

Reflecting global trends to promote fiscal objectivity, the New Law restricts companies from appointing the same audit firm on an ongoing basis. The same auditor may not be appointed for longer than five consecutive years. In such circumstances, that auditor may only be reappointed after an interval of two years.

or a supermajority, of shareholders must attend OGMs or EGMs. This discretion is fettered by the New Law.

### Preference shares

While the Current Law permits JSCs to issue preference shares, this right has not been exercised by companies in the Saudi market. The details of how preference shares will be issued under the New Law will be contained in forthcoming implementing regulations and we expect this further clarity to result in an increased interest among companies to consider the issuance of preference shares.

### JSC purchasing and pledging its own shares

The New Law provides that JSCs may purchase or pledge their own shares in accordance with rules to be laid down by MOCI and/or the CMA. This permission is expected to facilitate various arrangements such as employee share schemes. We await further guidance from the relevant authorities in this regard.

## Accumulative voting

Directors must now be appointed by the OGM using accumulative voting. As defined in the CMA's Corporate Governance Regulations, this is *"a method of voting for electing directors, which gives each shareholder voting rights equivalent to the number of shares he/she holds. He/she has the right to use them all for one nominee or to divide them between his/her selected nominees without any duplication of these votes. This method increases the chances of the minority shareholders to appoint their representatives in the board through the right to accumulate votes for one nominee."*

## Debt instruments and sukuk

### Sharia principles

The New Law obliges JSCs to comply with sharia principles in relation to debt when issuing or trading debt instruments. However, the New Law is silent on how sharia compliance is to be determined. We hope that further clarity will be provided in the implementing regulations to be issued by the CMA.

The New Law has also clarified the position on convertible debt instruments. In particular, an EGM resolution to increase the company's capital is not required at the time of conversion so long as an EGM resolution has approved the issuance of convertible instruments and the conversion details. Upon conversion, the board of the company is authorised to issue the new shares without reverting to the EGM again. However, the New Law confirms that conversion can only occur at the choice of the holder of the instrument, i.e. it is not possible for issuers to have a conversion feature that is exercisable at their discretion.

The New Law removes the requirement for OGM approval to enable a company to issue debt instruments, other than convertible instruments, in which case a resolution of the EGM would be required.

### No publication of financial statements for closed JSCs

A welcome development is that closed JSCs no longer have to publish their financial statements, provided they have been given to the company's shareholders.

## Capital increases

### Issuing shares for the benefit of employees

Where a JSC increases its capital in order to issue shares for the benefit of its employees, the company's shareholders may not exercise any priority rights to subscribe for shares as part of such capital increase.

### Assignment of priority rights

A shareholder in a listed company is currently able, via Tadawul, to sell its right to participate in a capital increase of the listed company to third parties. The New Law explicitly permits this current practice and we expect further rules to be issued by the CMA in this regard. However, how this principle should be applied to closed JSCs we expect to be clarified following the issuance of further rules by MOCI.

### Losses and dissolution of a JSC

There are now strict procedural requirements that must be adhered to by officers, auditors and shareholders of JSCs to ensure that the company is not inadvertently deemed, owing to its losses, to be dissolved by operation of law.

If the losses of a JSC reach 50% of its capital (the threshold is 75% under the Current Law) at any time during the financial year, then the following must occur:

1. The company's officers or auditors must, once they are aware of the situation, inform the Chairman
2. The Chairman must immediately inform the board of the losses
3. The board must call an EGM within 15 days

4. The EGM must take place within 45 days of the occurrence of the losses
5. The EGM should pass a resolution to:
  - (a) increase or decrease the capital to bring the losses below the 50% threshold or
  - (b) dissolve the company.

By operation of law, the company will be deemed to be dissolved if:

- The EGM is not held within the 45 day period;
- The EGM is held but fails to pass an appropriate resolution; or
- The EGM resolved to increase the capital of the company but the increase was not fully subscribed for within 90 days of such resolution.

We expect that the CMA will expedite the relevant processes to assist companies to comply with these capital increase or decrease deadlines prescribed by the New Law. In addition, the CMA rules governing distressed listed companies will need to be amended to reflect, *inter alia*, the new 50% threshold for losses.

## LLCs

### No personal liability for shareholders

The spectre of inadvertent unlimited liability was an issue that caused a great deal of concern for LLC shareholders under the Current Law. This risk of this materialising if a company's losses reached 50% of its capital was potentially high and, on a strict reading of the law, irremediable.

In a most welcome development, the New Law clarifies that a shareholder of an LLC will not be personally liable for the debts of the company except if:

1. It causes, in bad faith, the company to be dissolved or its activities to be suspended prematurely;
2. It fails to separate the company's business from its other private business; or
3. It undertakes business on behalf of the company before the company has legal personality (which occurs upon registration in the Commercial Register).

Particularly for family companies in which it is not uncommon for the assets of the company to be treated in practice as being, interchangeably, the assets of the shareholders, point two above should be considered carefully.

### Share capital

As with the Current Law, the New Law does not mandate any minimum share capital for LLCs. However, as with JSCs, the principle of "capital sufficiency" has been introduced by the New Law and its ramifications remain to be seen.

### Pre-emption rights

The New Law retains pre-emption rights for LLC shareholders. If a shareholder wishes to transfer its shares to a third party, then it must notify the other shareholders and give them the opportunity to purchase the shares at a fair price within 30 days. However, the New Law clarifies that shareholders are permitted to stipulate a different valuation methodology and time period in the AoA.

What remains unclear – as it was in the Current Law – is whether the right of pre-emption applies if one shareholder wishes to sell to another shareholder, rather than a third party. We hope this will be clarified in the

implementing regulations to be issued by MOCI.

### Management

LLCs may still be managed by a single general manager or by a board, as the shareholders may decide.

### Losses and dissolution of an LLC

As with the provisions dealing with JSCs, the New Law sets out a procedure to be followed where an LLC's losses reach an amount equal to 50% of its capital. In such circumstances:

1. The directors must publish this fact in the Commercial Register (we assume MOCI will provide further guidance in respect of how this is to be done) within 90 days of becoming aware of such losses
2. A shareholder meeting must be called and held within such 90 day period and a resolution must be passed to either continue or dissolve the company. The resolution must be published on the MOCI website.

The company shall be deemed to be dissolved if:

- The directors fail to call a shareholder meeting; or
- The shareholders do not pass a resolution to continue or dissolve the company.

In the context of a JSC which has losses that have reached the 50% threshold, the New Law stipulates that the EGM resolution must provide for an increase or decrease of the JSC's capital to bring the losses below the 50% threshold. This detail is missing from the provisions regarding LLCs, which raises an interesting question:

## An opportunity to restructure

The introduction of single shareholder companies (and LLCs in particular) presents an excellent opportunity for many of the thousands of businesses in Saudi Arabia structured as establishments – including some of the largest family businesses in the Kingdom – to consider restructuring their holdings as corporate vehicles and thereby benefiting from, among other things, the limited liability protection that the New Law offers shareholders of LLCs and JSCs.

what would happen if the LLC's shareholders passed a shareholder resolution to continue the company without increasing or decreasing the capital? We hope MOCI will provide further clarity on this matter in the forthcoming implementing regulations.

### Conversion of an LLC into a JSC

The New Law provides that an LLC may be converted into a JSC following a request by shareholders holding more than 50% of the LLC's capital, unless the AoA specify a *lower* threshold. This is a curious result: changing the legal form of an LLC is a serious matter which has hitherto required the amendment of the AoA, something which usually requires a supermajority, or unanimity, of shareholders to approve.

## Penalties

The New Law sets out three main categories of violations, each with differing sanctions attaching to them.

The first two categories, which carry heavy fines and possible imprisonment, fall within the jurisdiction of the Bureau of Investigation and Public Prosecution. The third category, where the maximum sanction is a SAR500,000 fine, falls within the jurisdiction of MOCI and the CMA (as applicable), who have been given the right to impose penalties for appropriate violations, up to this limit.

The categories, and a sample of violations under each, are set out below.

### Category 1 – Violations carrying a fine of up to SAR5 million and/or up to 5 years' imprisonment

These are the most serious violations under the New Law and include:

- Provision of false or misleading data in respect of the financial statements (or the making of material omissions in respect thereof) by any officer, director, board member, auditor or liquidator
- Misuse of authority, votes or company funds contrary to the best interests of the company
- Failure by any manager, officer or director to call a shareholder meeting when he/she knows that the company's losses have reached 50% of its capital (including, in the case of an LLC, a failure to publish this fact in the Commercial Register).

### Category 2 – Violations carrying a fine of up to SAR1 million and/or up to one year's imprisonment

These violations include:

- Failure by auditors to inform the company about violations uncovered during their work (which may include criminal violations)
- Announcement by any person that a company has been registered, when in fact it has not
- Provision of false information in the AoA, bylaws, incorporation application or other company documents by any person and including any person who signs or publishes such documents.

### Category 3 – Violations carrying a fine of up to SAR500,000

It is under this category that MOCI and the CMA have been given broad powers to impose penalties for breaches of the New Law. Any person sanctioned by MOCI or the CMA can lodge an appeal before the competent court.

Violations in this category are numerous and include:

- Distribution (and receipt, in bad faith) of sums in violation of the New Law, including the making of any related decision or distribution and including ratification of such distribution by an auditor (if it was aware of the violation)

- Any deliberate disruption to the call for, or convening of, a general assembly by any director
- Obtaining a guarantee or loan by a director of a JSC in violation of the New Law (and any Chairman who was aware of it)
- Failure to publish the financial statements of the company
- Failure to provide MOCI with the documents required by the New Law
- Failure to prepare or record minutes
- Failure to publish AoA, bylaws and amendments thereto
- Breach of the New Law by any auditor
- Non-compliance with the instructions, circulars or rules issued by MOCI or the CMA.

## Conclusions

The 227 articles of the New Law have been long anticipated. They clarify and codify certain matters which were unclear or not provided for in the Current Law, introduce new concepts (e.g. sufficiency of capital), abolish others (e.g. potential personal liability of LLC shareholders) and, whilst imposing some new obligations on market participants, offer those on the ground in Saudi Arabia – and those abroad looking to invest here – opportunities to organise their businesses in better and more flexible ways than before.

Please feel free to contact us if you have any queries.

## Contacts



**Khalid Al-Abdulkareem**  
Partner  
T: +966 11 4819 740  
E: khalid.alabdulkareem@cliffordchance.com



**Omar Rashid**  
Partner  
T: +966 11 4819 720  
E: omar.rashid@cliffordchance.com



**Sahel Mughal**  
Senior Associate  
T: +966 11 4819 758  
E: sahel.mughal@cliffordchance.com



**Majid Al-Sheikh**  
Senior Associate  
T: +966 11 4819 759  
E: majid.alsheikh@cliffordchance.com



**Mansoor Al-Hagbani**  
Senior Associate  
T: +966 11 4819 760  
E: mansoor.alhagbani@cliffordchance.com

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Clifford Chance Law Firm, Building 15, The Business Gate, King Khaled International Airport Road, Cordoba District, Riyadh, P.O. Box: 90239, Riyadh 11613, Kingdom of Saudi Arabia

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