



THE NEW SAUDI COMPANIES LAW AND ITS IMPLICATIONS FOR KSA COMPANIES

On 9 November 2015, the Kingdom of Saudi Arabia's Council of Ministers approved the long awaited new companies law 1437H/2015G (the New Law) which will come into force in May 2016 and is set to modernise the current framework under the law enacted in 1965 (the Current Law). This follows the accession of Saudi Arabia to the World Trade Organization (the WTO) and the commitment of the Kingdom to modernise its legal and regulatory environment in line with international trends and standards.¹

In essence, the New Law aims to promote small and medium business activity establishing more flexible new entry requirements. It also introduces rules on corporate governance for large enterprises aligned with international best practice. It aims to provide more efficiency and clarity to the regulatory environment in line with the growth of the Saudi Arabian stock market and the influx of foreign investments into the country.

Further, it addresses a number of ambiguities which previously existed, and introduces new concepts and rules to simplify and streamline company processes under the Current Law.

While the Ministry of Commerce and Industry (the MoCI) will remain the primary regulator of Saudi companies under the New Law, the Capital Market Authority, the regulator for listed joint stock companies, has been entrusted with overseeing the operations of listed joint stock companies and to participate with the MoCI in preparing the rules for the implementation. The MoCI and the Capital Market Authority will be responsible for the implementation of the New Law.

Current companies, existing as of the date of the coming into force of the New Law, are required to comply with the new changes within a one year period. The New Law sets out the following key changes in relation to the regulation of companies in KSA.

¹ The New Law also follows the enactment of the new United Arab Emirates Commercial Companies Law (Federal Law No. 2 of 2015) which came into force on 1 July 2015 and as reported in our insurance bulletin (http://www.hfw.com/Insurance-Bulletin-4-June-2015#page_1).



In respect of a Limited Liability Company (LLC):

- LLCs can now be formed with only one shareholder, as opposed to a minimum of two under the Current Law. However, the sole shareholder of an LLC is prohibited from holding a sole shareholder position in another LLC.
- The minimum total statutory reserve is reduced from 50% to 30% of the company's share capital.
- Greater protection of shareholders' personal interest is introduced whereby shareholders can no longer be held personally liable in cases where they fail to convene a meeting and decide whether to dissolve the company or to continue with its operations when the company's losses reach 50% of the capital. Under the New Law, if losses reach 50% of the company's capital and the shareholders fail to take necessary measures within a certain period of time, the company will be deemed dissolved by force of law.
- A new duty of confidentiality applies to all shareholders in respect of information they have about the company.
- The process of transferring shares in an LLC has been simplified by the New Law whereby it is sufficient to record such transfer in a special share register held by the company, for such transfer to be effective (subject to the pre-emption rights of existing shareholders). Under the Current Law, it is necessary to amend the company's articles of association and to sign the relevant amendment resolution at a notary public in order for the transfer of shares to be effective; thus, allowing the non-transferring shareholders to veto such transfer by refusing to sign the resolution amending the company's articles of association.

In respect of a Joint Stock Company (JSC):

- A JSC can now be formed by a minimum of two shareholders as opposed to five under the Current Law. Further, state owned JSCs and JSCs with a capital exceeding SAR 5 million (circa US\$1.3 million) can be formed by only one shareholder.
- The minimum capital requirement is reduced from SAR 2 million (circa US\$500,000) to SAR 500,000 (circa US\$130,000) (subject to additional capital requirements as applied under the Foreign Investment Law for foreign investment companies).
- In view of strengthening the position of minority interests, the New Law introduces the:
 - Requirement to establish an audit committee independent from the board of directors.
 - Right to nominate board members only in accordance with the shareholder's ownership percentage.
 - Requirement to elect the board members through cumulative voting. Additionally, the position of a chairman must now be separate from that of an executive officer.
- There are new provisions for convening ordinary general assembly meetings using "modern technologies".
- The New Law allows JSCs to buy-back and pledge their shares; such shares to be deemed non-voting shares. A JSC is also allowed to issue convertible debts and *Sukuk* as well as shares to be strictly allocated to the JSCs employees.
- The board of directors' "qualification shares" guaranteeing the members' liability during the term of their mandate are no longer required under the New Law.

The New Law now expressly defines a "holding company", whether registered as an LLC or a JSC, as a company which owns more than half of another company's share capital or which controls the formation of its board of directors. Finally, both in the case of LLCs and JSCs, any shares in kind will be subject to independent valuation by a certified expert and thereby ensuring fairness.

In light of the New Law, KSA companies should consider the following action prior to the New Law coming into force (which is not intended to be an exhaustive list):

- Review the KSA company's constitutional documentation commensurate with the New Law including:
 - Making any necessary amendments to the minimum capital requirements given the reduction in minimum capital rules.
 - Making any necessary amendments to quorum voting rights amongst others given the reduction in minimum shareholder requirements.
 - For JSCs, introducing the cumulative voting process for the election of board members.
 - For JSCs, removing the requirement for the board members to hold "qualification shares" guaranteeing their liability.
 - For JSCs, appointing an independent audit committee.
 - For JSCs, ensuring that the Chairman of the Board does not hold any executive position.
 - For LLCs, removing any provision which stipulates that the shareholders will become "personally liable" in the event they fail to take necessary measures if the company's losses reach 50% of its capital.



- For JSCs and LLCs, reducing the total statutory reserve from 50% to 30% of the company's capital.
- Create a special shareholders register for LLCs to include all actions applied on the company's shares, for example transfers and pledges.
- Liaise with the company's finance department and/or accountants and/or financial advisers on financial management following the reduction of the statutory reserve by 20% and to ensure financial safeguards continue to be met.
- Make shareholders aware of the new duty of confidentiality; however, it may be prudent for the KSA company to enter into confidentiality agreements with its shareholders as it is unclear how the law will be enforced at this early stage.

Although the New Law is still untested and remains to be assessed over time, we believe that the introduction of the changes is a fundamental step towards achieving a more friendly, regulated environment. The issue of the implementing regulations by the MoCI and by the Capital Market Authority will help to further this goal.

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