Back to Business: Kingdom of Saudi Arabia issues new Companies Regulations

May 2016
On the 4th of December 2015, the Saudi Arabian Ministry of Commerce and Industry (MOCI) published new and amended companies regulations (the **New Regulations**), which are set to replace the existing Companies Regulations which have been in place for over 40 years (the **Current Regulations**).

Features of the new regulations:

– More transparency
– Impact all companies in Saudi Arabia
– Addresses long standing issues

The New Regulations come into effect on the 2nd of May 2016.

Existing companies on that date have one year to alter themselves to abide by the New Regulations, unless the CMA or MOCI set an earlier date for a particular issue.
## The New Regulations in numbers

### JSCs

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**SAR 500,000**
Minimum capital amount (in SAR) for JSCs.

**SAR 500,000**
Maximum total annual compensation figure (in SAR) for a board director of a JSC.

25%
Minimum amount of paid-up capital for JSCs.

10
Minimum notice period (in days) for calling an OGA or EGA in a JSC.

3
Number of days which constitute the minimum notice period for the constituent general assembly for closed JSCs.

1
Number of hours after which a second general assembly may be called, in the event the first-called assembly was inquorate.

2
Minimum number of annual board of directors’ meetings in a JSC.

30%
Minimum percentage of the capital that must be maintained as a statutory reserve by a JSC.

Simple majority
The threshold required to pass an OGA resolution.

2/3
The threshold required to pass an EGA resolution.

No limit
Claims against a JSC’s board directors relating to deceit and forgery can be heard at any time.

No limit
Claims against an LLC’s managers relating to deceit and forgery can be heard at any time.

30%
Minimum percentage of the capital that must be maintained as a statutory reserve by an LLC.

5 and 3 years
Statute of limitations – a claim for liability of an LLC’s managers is time-barred after the later of (i) 5 years from the end of the financial year on which the harmful act has occurred; and (ii) 3 years from the date of termination of the relevant manager’s employment in the LLC.

50
Maximum number of shareholders an LLC can have. If the number of shareholders in an LLC exceed 50 (other than pursuant to a will or inheritance), the LLC must convert into a JSC within 1 year.

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Number of months following the end of an LLC’s financial year, within which the board of managers must meet to discuss the company’s financial statements, the distribution of dividends, appointment of the LLC’s managers and auditors, and compensation of the LLC’s managers and auditors.

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Limited liability

Piercing the corporate veil

The New Regulations explicitly detail instances where shareholders of a company can lose their limited liability status or be asked to return any funds that they have unlawfully extracted from a company.

For e.g., any value extracted from a company, where the company has not received anything of similar or higher value in return, risks being deemed an unlawful “fictitious” dividend, even if such extraction/distribution was done in good faith.

A shareholder of an LLC must keep its moneys and activities clearly separate from those of the LLC; otherwise, the shareholder risks losing its limited liability status.

The New Regulations expressly prohibit a company from:
– advancing any kind of loan (not just cash loans) to any of its board members or shareholders; and
– guaranteeing a loan between all or any of its board members or shareholder and a third party.

In-kind contributions

Valuation, valuation, valuation

The New Regulations place robust controls on how in-kind assets can be contributed to a company, with an emphasis on the concept of “fair value”.

These controls establish valuation methodologies, certification requirements, and third party affirmations on the valuations. For e.g., an application to establish a JSC or LLC with in-kind contributions must include a valuation report prepared by an expert or a certified valuator, and which includes a “fair value” of the contributions.

An LLC’s shareholder remains liable for the “fairness” of the valuation of its in-kind contributions (jointly, if such contributions were made with other shareholders) for a period of 5 years from the date of registration of the LLC. A JSC’s shareholder is liable for the accuracy of the valuation of its in-kind contributions.
Planning a sukuk or bond issuance?

The sky’s (almost) the limit

Under the New Regulations, any company (e.g., an LLC) will be able to form a wholly-owned JSC (with one shareholder) with minimum capital (SAR 500,000), and use that vehicle to issue bonds or sukuk that exceed that JSC’s capital. This has not been possible under the Current Regulations, and we expect this change to be welcomed by participants in debt capital markets and be particularly useful in Project bonds/sukuk. This change will also address some of the tax and regulatory issues which plague sukuk and bond issuances that use offshore vehicles.

Changes introduced by the New Regulations include:

- no cap on the value of sukuk/bonds that can be issued by a JSC relative to the capital of the JSC; and
- no requirement for the capital of a JSC to be fully paid up, for such JSC to be able to issue sukuk/bonds and debt instruments.

A JSC may authorize the issuance of convertible bonds and sukuk, and delegate the authority to agree terms to the board of directors. Furthermore, the EGA of a JSC may approve a capital increase with the capital of a JSC being partially paid up, provided that the authorized but unissued capital relates to convertible bonds or sukuk whose period for conversion into shares has not lapsed yet.

The New Regulations expressly allow a JSC to issue convertible bonds and debt instruments including sukuk, provided that the issuer considers Shari’ah principles.

One shareholder companies

New structuring opportunities

The New Regulations allow an LLC or a JSC to be wholly-owned by one shareholder. This change presents multiple transaction structuring opportunities.

The Saudi Arabian government, public entities, companies wholly-owned by the Saudi Arabian state, as well as companies with a minimum capital of SAR 5 million may establish JSCs owned by one shareholder.

Any person (including natural persons) may establish a one-shareholder LLC, however, a one-shareholder LLC cannot own another one-shareholder LLC.

We expect the introduction of one-shareholder companies to reduce the need for companies to resort to complex cross-ownership structures or having to nominate natural persons as second shareholders, which should allow for better control, proper segregation, and SPVs to be formed. For example, project companies, fund managers and finance companies would find this change useful.
Shareholder rights
One for the minorities

In relation to JSCs:

- Board directors are to be appointed by cumulative voting, whereby a share may not be voted more than once – a change that will undoubtedly be welcomed by minority shareholders in JSCs.

- All shareholders in a JSC have the right to attend general assemblies (no 20 shares minimum).

- General assemblies may be held using electronic communication means, subject to regulations to be set by the CMA.

- The EGA cannot amend a JSC’s bylaws to amend or deprive a shareholder of his/her ‘basic rights’. These protected rights include the rights to:
  - receive distributable profits;
  - receive a share of assets upon liquidation;
  - attend general assemblies and vote on matters in them;
  - transfer shares, in accordance with the New Regulations;
  - inspect the books and documents of the company, audit the board of directors’ actions, claim liability of board directors, and object to the validity of shareholders’ resolutions; and
  - have a pre-emptive right to subscribe in newly issued cash shares, unless the bylaws provide otherwise.

- MOCI, and the CMA (for publicly listed JSCs), may still appoint one or more representatives to attend shareholder meetings.

- The CMA can call the OGA of public JSCs to meet in specified instances, such as if the board of directors of a JSC fails to call an OGA to meet within 15 days from the date of a meeting request.

Quorum for first-called OGAs in a JSC – shareholders representing a minimum of 25% of the JSC’s capital. A JSC’s bylaws may provide for a higher percentage, but not to exceed a maximum of 50%.

Quorum for first-called EGAs in a JSC – shareholders representing a minimum of 50% of the JSC’s capital. A JSC’s bylaws may provide for a higher number, but not to exceed two-thirds of the capital.

In relation to LLCs:

- If a shareholder in an LLC liquidates the LLC or terminates its activities in bad faith before the end of its term or the achievement of the objectives for which such LLC has been established, such shareholder loses his/her limited liability status and becomes personally liable before the creditors of the LLC.

- Shareholders in LLCs, however, must take note that shareholders of an LLC, and their delegates, are subject to express obligations to keep company information confidential, and are prohibited from using such information in any matter which can be of harm to the company or to its shareholders.

- At the end of a term of an LLC, a shareholder who no longer wishes to continue with the LLC has the option of withdrawing from the company. The LLC’s term may not be renewed until such withdrawing shareholder’s shares have been sold.
In relation to JSCs:

- Shareholders of a JSC have a preemptive right to purchase cash shares issued as part of a capital increase.
- The 2-year lock up on the shares of founding shareholders in a JSC remains. The CMA may change the lock-up period for any JSC wishing to publicly list its shares.
- The bylaws of a JSC may include restrictions on the transfer of shares, as long as such restrictions do not amount to an “absolute prohibition” of the transfer of shares.
- At least 25% of the nominal value of a cash share must be paid at the time of its issuance, provided that the remaining balance is paid within 5 years from the date of issue. In-kind shares, however, are only issued after their value has been fully paid and ownership of the in-kind assets has been fully transferred to the JSC.
- The EGA of a JSC may allocate some or all of the issued shares following a capital increase to its employees, provided that shareholders may not exercise any preemptive right in relation to these shares.
- The bylaws of a JSC may override shareholders’ preemptive rights in a capital increase, and provide that shares be first offered to non-shareholders, subject to what is in the benefit of the JSC.
- If the EGA of a JSC approves a capital increase, shareholders of such JSC may waive or sell their preemptive rights from the date of such EGA resolution and until the end of the subscription period following the capital increase.

In relation to LLCs:

- Shareholders of an LLC will continue to enjoy a statutory pre-emptive right that applies whenever a shareholder of the LLC intends to transfer its shares by way of a gift or in return for compensation. Whether such right applies as a ‘right of first refusal’ or a ‘right of first offer’ remains unclear.
- A shareholder exercising its right of first refusal may do so based on the “fair value” of the shares or as agreed in the LLC’s articles of association (which emphasises the importance of parties including a valuation methodology in the articles of the association of an LLC).
- LLCs are still required to maintain a share register with details of the LLC’s shareholders, shares, and any transfers occurring in relation to the LLC’s shares, and must register the same in the Commercial Register. Otherwise, any such transfer is not binding on third parties.
Treasury shares are a CFO’s best friend!

Banks take notice

JSCs are expressly allowed to purchase and pledge their own shares under the New Regulations. Any such shares purchased by a JSC will **not** have voting rights in the JSC’s general assemblies.

Shares pledged by a JSC allow the security-holder to receive dividends and enjoy the rights associated with such shares, subject to the relevant pledge agreement. The security-holder is **precluded** from attending or voting at the general assemblies of such JSC.

If a shareholder of a JSC pledges his/her/its shares to a lender, such lender may request that the competent judicial authority sells such pledged shares and that the lender be repaid from the proceeds of such sale. However, shareholders in an **unlisted JSC** will have a **preemptive right** to purchase such shares.
Mergers

All about the votes

The affirmative vote of 75% of the shares in attendance at a shareholders’ meeting in each merging company is still a requirement to approve a merger between companies. The New Regulations, however, explicitly limit shareholders owning shares in both merging companies to voting at only one of these companies. This may impact transactions between related parties or companies under common ownership.

Mergers can be either by way of a combination (a ‘merger’ of companies into a new company) or an amalgamation (whereby one company disappears by merging into another company). All assets and liabilities of the merging company(ies) transfer to the new company (in case of a combination) or to the surviving company (in case of an amalgamation).

The objection period during which creditors of a merging company may object to a merger is reduced from 90 days to 30 days.

The New Regulations name the CMA as the authority to regulate mergers that involve at least one publicly listed JSC.

In financial trouble?

No 180, but risk of automatic dissolution

If the losses of an LLC reach 50% of its capital, the shareholders of such LLC will no longer automatically lose their limited liability status, as has been the case under the Current Regulations.

Instead, if the losses of an LLC reach 50% of its capital, the LLC’s shareholders must meet and decide on whether to dissolve or continue the LLC. If the shareholders do not meet within the designated time period, then the LLC shall be deemed to have been dissolved. The shareholders may also decide to increase the capital of the LLC so that the losses are no longer 50% of the capital.

If the losses of a JSC reach 50% of its capital at any time, the JSC’s shareholders must meet, pursuant to an invitation by the JSC’s board, to decide on whether to increase or decrease the JSC’s capital, or to dissolve the JSC. If the shareholders of the JSC fail to issue a resolution to increase or decrease the capital, then the JSC shall be deemed to have been dissolved.
**Attention, board directors and managers!**

*An emphasis on duties of care and loyalty*

### In relation to JSCs:

- **Board directors of a JSC continue to have duties to act in the best interests of the JSC.** Some of these significant duties include:
  - **Duty of care towards the JSC:**
    JSC board directors are jointly liable for compensating the JSC, the JSC’s shareholders, or third parties for any damages caused by their mismanagement of the JSC’s affairs or violation of the JSC’s bylaws or the New Regulations.
  - **Duty to declare conflicts of interest:**
    A board member who has a direct or indirect interest must declare his/her conflict and abstain from voting on matters in relation thereto, in board and shareholders’ meetings, and must obtain an annual approval of shareholders in relation to such contracts. Otherwise, the JSC, as well as any interested party, may claim for the relevant contract to be voided and for such director to repay any profit or benefits accrued from such contract.
  - **Duty of loyalty towards the JSC:**
    Board directors may not compete with the JSC on which they serve, and must use their powers and voting rights in the interest of the JSC only.
  - **Duty of confidentiality:**
    Board directors continue to have a duty to keep a JSC’s secrets confidential and not to disclose to shareholders or third parties outside of the general assemblies.
- **The New Regulations provide for the appointment of a chairman, a deputy chairman, and a secretary to the board of directors of a JSC, however, the chairman is expressly prohibited from holding any other executive position in the JSC.** Casting vote of the chairman remains unless the Bylaws opt out.
- **Board directors of a JSC are no longer required to own treasury shares worth SAR 10,000 in the capital of such JSC.**
- **A board director shall be liable to a JSC for any damages which may arise following his/her resignation.**

### In relation to LLCs:

- **The board managers of an LLC shall be personally and jointly liable for the LLC’s commitments if the words “limited liability company” or the capital figure of the LLC is not shown before its name on all documents and correspondence of the LLC.**
- **Duties of board managers of an LLC to act in the best interests of an LLC are emphasised under the New Regulations.** These include:
  - **Duty of care towards the LLC:**
    Managers of an LLC will remain jointly liable to the LLC’s shareholders, the LLC, and third parties for any damages arising from their breach of the New Regulations or the LLC’s articles of association, or any wrongful acts they commit in the performance of their duties.
  - **Duties of loyalty towards the LLC:**
    Managers of an LLC must use their powers and voting rights in the interest of the LLC only.
Authorities of JSC directors and LLC managers

The importance of setting limits

- JSC directors and LLC managers continue to have a duty to act within the scope of the authorities granted to them by the shareholders.
- Directors will continue to have the widest possible authorities in managing a JSC, however, these authorities are limited to the extent required to achieve the JSC’s objects.
- An expanded list of enumerated board authorities is provided under the New Regulations, including the authority to enter into loan agreements of any term.
- However, the New Regulations provide that the wide authorities of a JSC or LLC board remain subject to any authorities reserved to the general assembly or shareholders. This emphasises the importance of carefully drafting the bylaws of a JSC and articles of association of an LLC in order to place appropriate limits on board powers.
- The chairman in a JSC has the authority to represent the JSC before courts and arbitral tribunals, amongst others, and the power to delegate, in writing, some of his powers to board members or others.
For companies further afield

Regulation of foreign companies

The New Regulations reflect the creation of the SAGIA (post-Current Regulations) as the governmental authority regulating the practice and establishment of foreign (i.e. non-GCC) companies, branches, agencies, and offices.

Licensed foreign companies are expressly prohibited from commencing their activities until after registration in the Commercial Register; otherwise, or if such a licensed foreign company engages in activities beyond its licensed scope, the company and all persons who have conducted such activities shall be jointly liable for these activities and resulting penalties.

Branches, agencies, and offices of foreign companies must prepare financial statements and an auditor’s report (in relation to their in-Kingdom activities), and to file the same with MOCI within 6 months from the end of the financial year of such branch, agency, or office.
Paperwork matters

Registration, publication, and document filings

The New Regulations explicitly define **registration in the Commercial Register** as the event upon which a company is incorporated.

The board of a JSC must register amendments to the JSC’s bylaws with MOCI within **15 days** from the date of the amending EGA resolution.

In addition to its name, corporate form, and head office address, any document issued by a company **must** now also bear the company’s commercial registration number.

The board of an LLC must, within **30 days** from the date of notarization, publish the articles of association of the LLC, and any amendments thereto, on MOCI’s website and reflect the same in MOCI’s Commercial Register.

The New Regulations replace the requirement for physical publication of an LLC’s articles of association and a JSC’s incorporation resolution by MOCI in Umm Al-Qura, with a requirement to publish the same on **MOCI’s website** instead.

The board of an LLC must, within **30 days** from the date of notarization, publish the articles of association of the LLC, and any amendments thereto, on MOCI’s website and reflect the same in MOCI’s Commercial Register.

JSCs and LLCs must submit their annual financial statements, board report, and auditors’ report to MOCI (with public JSCs having to additionally submit such documents to the CMA) within **30 days** from the date of OGA approval (for JSCs) or their preparation (for LLCs).
Hitting hard with the penalties

More offences, fines, and jail time

Penalties double for any re-offender who commits the same act within 3 years from the date of the final judgement convicting such person of that act.

Actions which could be subject to penalties include, amongst others:

- the inclusion of false or fraudulent information in, or the omission of material information with the intent of hiding the financial position of the company from, the financial statements and/or reports of a company by a manager, officer, board member, auditor, or liquidator of a company;
- the use of company monies or authority for personal gain or to third parties against the interests of a company by any one of its managers, officers, or board members;
- the declaration, distribution, or receipt, in bad faith, of fictitious dividends, by any person, and the knowing certification of such declaration, distribution, or receipt by an auditor;
- the use of a company for other than the purpose for which it has been established, by any person;
- the receipt of a loan or a guarantee by a board director in a JSC;
- the receipt or giving of, or the promise to receive or give, any benefits or guarantees to any person in return for voting in a certain way or abstaining from voting;
- failure to publish the financial statements, articles of association, or amendments to the articles of association of a company, by any person;
- failure to make the requisite filings with MOCI, by any person;
- failure to comply with the requirements of the New Regulations (including, for example, the requirement to call shareholder meetings when the losses of a company reach 50% of its capital);
- the submission of false declarations in relation to, or the exaggeration of, valuations of in-kind contributions by any person;
- the intentional disruption or delay of a general assembly or shareholders' meeting by any board member.

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Further issuances by the CMA and MOCI

What to stay on the look out for

The New Regulations makes multiple references to additional rules, templates, and guidelines to be issued by the relevant authorities, to aid in the implementations of the New Regulations.

**TO BE ISSUED BY THE CMA:**

- Rules to govern the use of modern communications means to hold and conduct general assemblies in a public JSC;
- Rules to govern the purchase and mortgage of shares by a public JSC;
- Guidelines to govern the issuance of preferred shares by a public JSC;
- Rules to govern the sale of shares of a public JSC shareholder who has defaulted on paying the value of its shares in public auctions or on the stock exchange;
- The maximum period by which a board of directors of a public JSC must distribute profits approved by the OGA;
- Rules to govern a public JSC shareholder’s right to sell or waive its right of first refusal, following a capital increase in a public JSC;
- Rules to govern mergers that involve at least one public JSC; and
- Rules to govern the compensation of board directors of a public JSC.

**TO BE ISSUED BY MOCI:**

- Template articles of association and bylaws for each type of company. This has now been issued and can be found here;
- Rules to govern the use of modern communications means to hold and conduct general assemblies in a closed JSC;
- Rules to govern the purchase and mortages of shares by a closed JSC;
- Guidelines to govern the issuance of preferred shares by a closed JSC;
- The maximum period by which a board of directors of a closed JSC must distribute profits approved by the OGA;
- Rules to govern a closed JSC shareholder’s right to sell or waive its right of first refusal, following a capital increase in a closed JSC; and
- Rules to govern the compensation of board directors of a closed JSC.
We are a team of veteran Saudi and internationally qualified lawyers who litigate and advise on a wide range of practice areas, including corporate, local and cross-border M&A, debt and equity capital markets, projects, banking, Islamic finance transactions, litigation, and international arbitration.

The Riyadh team is led by three partners: Zeyad Khoshaim, who is a Saudi Arabian and New York qualified lawyer; Julian Johansen, a UK qualified lawyer who is fully fluent in Arabic; and Johannes Bruski, a corporate lawyer with over 20 years of experience.

Together, the team has an unparalleled understanding of the Saudi Arabian commercial landscape, legal framework, and cultural issues. The team routinely handles all aspects of sophisticated transactions and works seamlessly with Allen & Overy’s offices around the world, providing first class, efficient, and integrated legal services.
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- Capital Markets

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- Capital Markets
- M&A
- Project Finance

*Legal 500 Saudi Arabia 2015 Band 1:*
- Corporate / M&A
- Banking & Finance
- Capital Markets
- Projects & Energy
Glossary

CMA | The Saudi Arabian Capital Market Authority.
Commercial Register | The commercial register at MOCI.
Current Regulations | The Companies Regulations issued pursuant to Royal Decree No. M/6 on the 22nd of Rabi Al-Awwal 1385H (corresponding to the 21st of July 1965G), and which are currently in force in the Kingdom.
EGA | Extra-ordinary general assembly.
JSC | Joint-stock company.
Kingdom | Kingdom of Saudi Arabia.
LLC | Limited liability company.
MOCI | The Saudi Arabian Ministry of Commerce and Industry.
New Regulations | The new Companies Regulations announced by MOCI on the 27th of Muharram 1437H (corresponding to the 9th of November 2015G).
OGA | Ordinary general assembly.
SAGIA | The Saudi Arabian General Investment Authority.
SAR | Saudi Arabian Riyal.
Umm Al Qura | The Official Gazette of the Kingdom.

Disclaimer

This bulletin is for information purposes only, and does not include, or purport to include, all changes made in the New Regulations. This is not legal advice and it should not be relied upon in any way. The information contained in this bulletin is based on our understanding of the New Regulations as of the date of this bulletin. This bulletin is not intended to be construed as reflecting the views and motives of the Saudi government in relation to the subject matter thereof.
Interested in learning more?

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