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AMENDMENTS TO SAUDI ARABIA COMPANIES LAW

A COMPARATIVE ANALYSIS



The Council of Ministers (Resolution number 403 dated 24/7/1439H corresponding to 10/4/2018G) (the “**Resolution**”) and Royal Decree No 79 (dated 25/7/1439 corresponding to 11/4/2018G (“**Decree**”), set out amendments to the KSA Companies Law (M/3 dated 28/1/1437H) (“**Companies Law**”). The Resolution and the Decree came into effect on 17 April 2018 (i.e. the publication date of the Official Gazette).

Whilst the above referenced amendments address a variety of articles in the Companies Law, the focus is on the enhancement of protection of minority shareholders (such as ability to be reimbursed for claims as well as further developing corporate governance matters (such as adding to the conflict of interest provisions relating to joint stock companies)). Please refer to table one for commentary.

Additionally, another resolution, issued by the Ministry of Commerce and Investment (“**MOCI**”), followed the above Resolution and Decree. Resolution of the Minister of MOCI – Resolution number 42240 was issued on 2/8/1439 H (corresponding to 18 April 2018) and came into effect on 24 April 2018 (i.e. the publication date of the Official Gazette) (“**MOCI Resolution**”).

The MOCI Resolution may be relied upon to clarify certain practical aspects of various articles of the Companies Law. Whilst the MOCI Resolution does not clearly identify which section applies to what article, it generally mentions the following articles of the Companies Law: Articles 161, 169, 174 and 225, replacing a previously issued resolution by MOCI number 32565 dated 27/6/1438 H (corresponding to 26 March 2017).

The MOCI Resolution, overall, primarily outlines a timeline for distribution of dividends in a limited liability company (“**LLC**”), requires shareholders’ approval for sale of 50% or more assets of an LLC, and mandates a deadlock provision in the LLC’s articles of association. Please refer to table two for commentary.

Overall, the Resolution, the Decree, and the MOCI Resolution are consistent with an increasing compliance and corporate governance culture that we are observing in Saudi Arabia and are consistent with some of the key messages under the Kingdom’s Vision 2030 such as “*embracing transparency*”, “*being responsible in business*” and “*enhancing ease of doing business*”.

In the tables set out in the following pages we provide a comparative analysis of the Companies Law prior to and following the issuance of the Resolution, the Decree and the MOCI Resolution.

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TABLE ONE
COMPANIES LAW – BEFORE AND AFTER THE RESOLUTION AND THE DECREE

Article No. of Companies Law	Amendment to Companies Law ¹	Companies Law (prior to Amendment) ¹	Commentary
12	<p><i>“Except for the partnerships (un-registered)/Mahasa Company, the Articles of Association of the Company and all amendments thereto shall be executed in writing; otherwise, the Articles of Association or the amendment shall be null and void. The establishment of the Company and the amendment of its Articles of Association shall be effected after the completion of the necessary requirements as provided for in this Law or as determined by the Ministry.”</i></p>	<ol style="list-style-type: none"> 1. Save the partnerships (un-registered)/Mahasa Company, a company’s Articles of Association as amended must be in writing and attested before the relevant competent authority; otherwise such Articles of Association shall not be valid vis-à-vis third parties. 2. The company’s managers or directors, as the case may be, shall be held jointly responsible for damages sustained by the company, by the shareholders or by third parties as a result of the failure to record the Articles of Association in accordance with paragraph (1) hereinabove. 	<p>Amending Article 12(1).</p> <p>Clarifying the requirement for companies to have articles of association in written form at incorporation, and not only at the time of making amendments (as was described in the previous version of article 12(1)).</p> <p>We also believe that removing reference to validity vis-à-vis third parties as per the original text may suggest that any amendment that is not documented may face enforceability issues even as between the shareholders themselves.</p> <p>Further, the amendment confirms that the incorporation of the company and/or amendment to its articles shall be effectuated once all formalities required by the MOCI are completed.</p>

¹ The KSA Companies Law (M/3 dated 28/1/1437H) and the amendments set out by the Council of Ministers (Resolution number 403 dated 24/7/1439H corresponding to 10/4/2018G) and Royal Decree No 79 (dated 25/7/1439 corresponding to 11/4/2018G) are issued in Arabic with no official English translation. We have therefore relied on our own translation and interpretation of the same in the context of Saudi regulations and current market practice.



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Paragraph (1):

“A member of the Board of Directors may not have a direct or indirect interest in transactions or contracts completed in the benefit of the company (1) without permission from the Ordinary General Assembly, and (2) in accordance with the controls set by the competent authority. The Board Member shall report to the Board its direct or indirect interest in the transactions and contracts executed for the benefit of the Company. This reporting shall be recorded in the minutes of the meeting. Such member shall not participate in the voting on the resolution issued in this regard in the Board and the shareholders’ meetings. The Chairman of the Board shall notify the Ordinary General Assembly upon commencement of the transactions and contracts in which any Board Member has a direct or indirect interest therein. The notification shall be accompanied by a special report from the External Auditor of the Company.”

New to add – Paragraphs (3):

“Liability for damages resulting from the transactions and contracts referred to in paragraph (1) of this article shall be borne by the Board Member, with interest in the transaction or contract, as well as by remaining board members, if such transactions or contracts are executed in violation of the provisions of that paragraph, if they are proven unfair or involve a conflict of interests and harm shareholders.

Paragraph (1):

A director may not have any interest, whether directly or indirectly, in the transactions or contracts concluded for the company, unless through prior authorization from the regular/ordinary general assembly, to be renewed annually. A director must declare to the board (of directors) any direct or indirect interest that he may have in the transactions or contracts concluded for the company. Such declaration must be recorded in the minutes of the (board) meeting, and this member shall not participate in voting for the resolution to be adopted in this respect in the board of directors and the shareholders’ meetings. The chairman of the board of directors shall inform the regular/ordinary general assembly upon convening, of the transactions and contracts in which any director has a direct or indirect interest. Such notification shall be accompanied by a special report from the company’s external auditor.

71 (1):

This is a key development.

The Companies Law was very clear that permission from the Ordinary General Assembly was required prior to entering into certain transactions/contracts where a direct/indirect conflict of interest existed.

This is not as clear anymore and it may be that such transactions/contracts may simply be ratified by the Ordinary General Assembly in due course. The amended version also refers to “regulations determined by the competent authority [i.e. the Ministry of Commerce and Investment in respect of non-listed joint stock companies and the CMA in respect of listed joint stock companies]”. Unfortunately, the relevant regulations have not been published yet so it will remain interesting to observe the future development of this provision. The scope of the term “indirect interest” remains unclear and could, potentially, be very wide thus potentially requiring the Ordinary General Assembly to convene frequently to provide the required permission. The obligations to renew the permission “annually” has been removed, but it may be that the “regulations determined by the competent authority” will shed more light on this.



	<p>New to add – Paragraphs (4):</p> <p><i>The members of the Board of Directors who dissent such resolution shall be released from liability if they prove that their objection was expressly noted in the minutes of the meeting. Absence from attending the meeting at which the resolution is passed shall not be regarded as a reason for releasing from liability unless it is proven that the absent member has not been informed of the resolution or was unable to object to it after being aware thereof.”</i></p>		<p>71 (3) and 71 (4): These are new articles and address the liability of the board members in respect of conflicts of interest. The effect is that board members are exposed to liability in relation to both improper form and undesirable effects, which should encourage proper reporting under 71(1). As proper treatment of conflicts of interest is a cornerstone of good corporate governance and transparency, the amendments to article 71 is consistent with the development of corporate governance and developing compliance culture that we observe in KSA.</p>
72	<p><i>“A member of the Board of Directors may not, without permission from the Ordinary General Assembly to allow him to do so in accordance with the controls set by the competent authority,, participate in any business that would compete with the company, or compete with the company in one of the branches of activity that it operates, otherwise the company would have to claim appropriate compensation before the competent judicial authority.”</i></p>	<p>A director may not, without prior authorization from the regular/ordinary general assembly – to be renewed annually – participate in any business competitive with that of the company, or compete with the company in any of the branch activities that it carries out; otherwise, the company shall have the right to claim damages from him before the competent judicial entity.</p>	<p>Similar to the development in Article 71(1), the amendment removes the explicit term, “prior”, from the text of the law, which may be interpreted to mean that the any act to compete may be ratified by the Ordinary General Assembly in due course.</p> <p>Therefore, the key amendment here is that it refers to the “regulations determined by the competent authority [i.e. the Ministry of Commerce and Investment]”. Again, it will be very interesting to observe the further development of this article once the regulations have been issued.</p> <p>It may also be interpreted that under the amendment, the company would be mandated to bring a claim against the board manager. Whilst, previously, the company had a right to do so at its discretion.</p>



80	<p>New article to be added:</p> <p><i>“The Company may be charged the expenses incurred by the shareholder to file a claim against the company, whatever the result thereof provided it was done under the following conditions:</i></p> <ul style="list-style-type: none"> ■ <i>If the shareholder files the claim in good faith.</i> ■ <i>If he submits to the company the reason for which he files the claim and did not receive a reply within thirty days.</i> ■ <i>If filing such claim serves the interest of the company pursuant to the provisions of Article (79) of the Law.</i> <p><i>If the claim is properly founded.”</i></p>	<p>Every shareholder shall have the right to institute a Liability Action, entitled to the company, against directors if the wrongful act committed by them is of a nature to cause him personal prejudice. However, the shareholder may institute such action only if the company’s right to institute it is still valid. The shareholder shall notify the company of his intention to do so, and his right shall be limited to claiming compensation for personal damages caused to him.</p>	<p>Easier for shareholders to bring claim, hence drives claim culture, but in turn also drives compliance culture.</p> <p>Addition to Article 80, nonetheless, allows partners² to recover expenses incurred for claims filed against the company without mentioning claims against directors (as outlined in the currently drafted Article 80).</p> <p>It will be interesting to see how, in practice, the text of the law will be applied to reconcile the differences in claiming expenses when claims are filed against the company vs. the directors, noting that the amendment does not limit compensation to personal damages as previously set out.</p>
91	<p><i>“The invitation to convene the Ordinary General Assembly and the agenda shall be published in a daily newspaper distributed in the whereabouts where the Company’s main office is located at least (twenty-one) days prior to the meeting date. However, serving the invitation within the specified date to all partners by registered letters may be sufficient. A copy of the invitation and the agenda shall be sent to the Ministry and to the Authority if the company is listed in the exchange market, within the period specified for publication.”</i></p>	<p>The call for general assembly meeting shall be published in a daily newspaper distributed in the locality of the head office of the company, at least ten days prior to the date set for the meeting. Nevertheless, a notice sent by registered mail to all shareholders on the mentioned date shall suffice. A copy of both the invitation and the agenda shall be sent to the Ministry as well as to the Authority in companies listed in the financial market, within the period specified for publication.</p>	<p>Providing for a longer notice period to call the Ordinary General Assembly along with mandating the requirement to publish its agenda in the daily newspaper distributed in the whereabouts where the Company’s main office is located is more protective of shareholder’s rights.</p>

² Partners and shareholders are used interchangeably throughout this briefing note.



104	<p><i>“The Audit Committee shall review the financial statements of the Company, the reports and notes submitted by the Auditor, provide feedbacks on them, if any, and prepare a report on its opinion on the adequacy of the Company’s internal control system on its other activities that fall within its jurisdiction. The Board of Directors shall deposit sufficient copies of the report at the Company’s main office at least (twenty-one) days before the date of the Ordinary General Assembly, to provide each desiring partner with a copy of the report. The report shall be read out during the convention of the assembly.”</i></p>	<p>The Audit Committee shall check the company’s financial statements, and the reports and notes to be provided by the auditor. It shall express its opinion on the same, if any. It shall also prepare a report on its opinion with respect to the sufficiency of the internal control in the company, along with other activities within its competence. The board of director shall deposit enough copies of this report in the company’s head office at least ten days prior to the date of the regular general meeting convention, in order to provide it to any shareholder wishing to have the same. The report shall be read out at the meeting.</p>	<p>Allowing a longer timeframe to the board of directors to submit copies of the report prepared by the Audit Committee to the Company to synchronize the Shareholder’s rights to the extended timeline for notice for the Ordinary General Assembly as set out in Article 91 above.</p>
126 (3)	<p>Paragraph (3): <i>“The Chairman, the Chief Executive Officer and the Chief Financial Officer shall sign the documents referred to in paragraph (2) of this Article. Copies of such documents shall be deposited in the Company’s head office at the disposal of partners at least twenty-one days before the date set for the General Assembly Meeting.”</i></p>	<p>Paragraph (3): The company’s chairman, chief executive officer and financial manager shall sign the documents referred to in paragraph (2) of this Article. Copies of these documents shall be deposited in the company’s head office at the disposal of the shareholders (10) ten days at least prior to the date set for holding the general meeting.</p>	<p>Increased time line.</p>



<p>157 (I)</p>	<p>Deleted – Paragraph (I):</p> <p><i>“Subject to the provisions of Article (14) of the Law, the Limited Liability Company shall not be established unless all cash and in-kind shares are distributed to all the partners and have been fully paid. Cash shares shall be deposited with a licensed bank. The bank may dispose of shares value only after the completion of the announcement procedures of the company and its registration in the commercial register.”</i></p>	<p>Paragraph (I):</p> <p>Subject to Article (14) of the Regulations, a limited liability company shall not be incorporated unless all contributions in cash and in kind are distributed among all shareholders and are entirely fulfilled. The contributions in cash shall be deposited in a licensed bank, which shall not be entitled to release them prior to the finalization of the procedures of the company’s publication and registration in the commercial register.</p>	<p>The deletion of this article suggest that LLCs may now be incorporated without fully paid up capital. Unlike the provisions relating to joint stock companies, where there are minimum thresholds for partly paid up capital and time periods in which all of the capital must be paid up, by simply deleting Article 157 no alternative obligations were set out.</p> <p>It is interesting to note that in practice, the competent KSA authority responsible for issuing the commercial registration certificates (i.e. MOCI) to complete the incorporation process for LLCs had already started issuing commercial registration certificates for LLCs without requiring local bank deposit certificates as reflected in the amendment to Article 157(I).</p> <p>It will be interesting to observe how the competent authorities in KSA will continue to address this amendment in practice.</p>
<p>161</p>	<p><i>“1. The Shareholder may assign its share to one of the Shareholders in accordance with the terms and conditions of the Company’s Articles of Association.</i></p>	<p>1. A shareholder may assign his share to a co-shareholder or to a third party in accordance with the terms of the Company’s Articles of Association. Nevertheless, if a shareholder wishes to assign his share to a third party for valuable consideration, he must notify his co-shareholders through the manager of</p>	<p>Amendments are requiring shareholders who wish to assign shares to a third party, with or without compensation, to provide a notice to co-shareholders and follow the procedures outlined in the Law, or in the company’s articles of association.</p> <p>This increases the scope of the Shareholders’ right to cover transactions that would take place without consideration.</p>



	<p>2. <i>The Shareholder must, if it wishes to assign its share to non-partners of the company – with or without compensation – notify the other partners through the manager of the company of the name of the assignee or the buyer and with the terms of the assignment or sale. The manager shall inform the rest of partners upon being notified. Each partner may request recovery of the share within thirty (30) days from the notifying the Manager at the price agreed upon, unless the Company’s Articles of Association provide for another valuation method or a longer period. If recovery is requested by more than one partner, such share(s) shall be divided among them pro-rata to their respective shares in the capital. If the period referred to in this paragraph has elapsed without any of the partners requesting to recover such shares, the owner of such share shall have the right to assign it to the assignee or buyer.</i></p> <p>3. <i>The right of request for recovery provided for in this article shall not apply to the title transfer of shares by inheritance, bequest or by a decision of the competent judicial authority.”</i></p>	<p>the Company, of the terms of such assignment in which case every shareholder shall have the right to recover the share at its fair value, within thirty days of the date of being notified of the same, unless the company’s Articles of Association shall stipulate for another evaluation method or period of time. If the right of recovery is exercised by more than one shareholder and the assignment involves a number of shares, these shall be divided among the applicants for recovery in proportion to the interest of each of them in the capital. The right of recovery provided for in this Article shall not apply to the transmission of shares by inheritance or bequest, or by virtue of a judgement of a competent judicial body.</p> <p>In case the prescribed time for the exercise of the right of recovery is expired without being used by any shareholder, the holder of the share shall have the right to waive it for a third party.</p>	
<p>167 (3)</p>	<p>Paragraph (3):</p> <p><i>“The General Assembly may be invited at any time at the request of the Directors, the Supervisory Board, the Auditor or any or more partners representing at least ten per cent of the capital.”</i></p>	<p>Paragraph (3):</p> <p>A general meeting may, however, be called at any time at the request of the managers, the board of controllers, the auditor, or a number of shareholders representing at least one half of the capital (of the Company).</p>	<p>Increasing ease for minority shareholders to participate in company affairs.</p> <p>By reducing the minimum ownership/% threshold creates more flexibility for minority shareholders to convene General Assembly meeting of an LLC.</p>



TABLE TWO
CLARIFICATIONS SET-OUT IN THE MOCI RESOLUTION

MOCI Resolution Text ³	Commentary
<p><i>“A partner in a limited liability company is entitled to his share in profits as per the partners’ resolution issued in this regard. A limited liability company must distribute profits which were decided to be disbursed within thirty days as of the date of the partners’ resolution.”</i></p>	<p>MOCI Resolution is imposing a timeline to distribute dividends in an LLC once the shareholders have resolved to do so (i.e. within thirty days of the date of the shareholders’ resolution). In doing so, the MOCI Resolution is laying out practical guidelines for distribution of dividends in LLCs, and possibly reducing fictitious dividend being recorded on an LLC’s accounts.</p>
<p><i>“The approval of all partners is mandatory to introduce a new partner with new shares in a limited liability company.”</i></p>	<p>Previously, in practice, it seemed sufficient for all shareholders to demonstrate consent to add a new partner/shareholder to an LLC by appearing before the notary public to effect the amendment of the LLC’s articles of association before a notary public.</p> <p>However, the MOCI Resolution explicitly outlines a requirement for all shareholders to provide approval. In practical terms, it may be read to require a “prior” written approval from all shareholders since the word, “mandatory” is used, which means that without approval, the new shareholder cannot be added, and seeking approval after the fact, if withheld, would require undoing of the transaction by the shareholder.</p> <p>This clarification may be read as further enhancing minority shareholder rights.</p>

³ Resolution of the Minister of MOCI – Resolution number 42240 dated 2/8/1439 H (corresponding to 18 April 2018) was issued in Arabic with no official English translation. We have, therefore, relied on our own translation and interpretation of the same in the context of Saudi regulations and current market practice.



“A limited liability company’s manager or managers or board of directors – as the case may be – is obliged to get the partners’ approval before issuing a resolution to sell more than (50%) of the company’s assets, whether the sale is done via one transaction or several transactions. If the sale is done via several transactions, the transaction that lead to exceeding the 50% in sale of assets is the transaction that requires getting the approval of partners. Such percentage is calculated as of the date of the first transaction that was concluded during the past twelve months.”

Although this section of the MOCI Resolution has not been explicitly linked to Article 174, it appears that it is adding to it in order to clarify that requirement for partner’s approval in relation to sale of assets in an LLC.

Article 174 lists various thresholds required to obtain shareholder approval/consent in different scenarios (such as increase of share capital, amendment to the articles, etc.). Along the same lines, the MOCI Resolution may be seen as enhancing Article 174 by stating that shareholders’ approval is required in the event the LLC intends to sell up to 50% of its assets either in a single transaction or if there are multiple transactions, for the transaction that takes the total sale of assets to 50% assets of the LLC being sold.

However, since there is no mention of the threshold (i.e. 100%, 75% or 50%, nor does the MOCI Resolution mention that the threshold may be determined by the LLCs articles of association), it will be interesting to see how the local KSA authorities will apply the MOCI Resolution in practice.

Further, it will also be interesting to see how the MOCI Resolution will be applied in practice to the Holding LLCs as holding and selling assets forms a key part of their business, and requiring unanimous shareholder consent may add a burdensome layer onto such entities.

“Shareholders in a limited liability company shall stipulate in the Articles of Association the means to settle the disputes that may arise between them and lead to halting the company’s business, provided that the scope and framework of this means are specified, as well as the cases in which such means shall be resorted to.”

It appears that LLCs are now required to include a deadlock provision in their articles of associations. Hence, it may be inferred that MOCI may issue a new set of templates for LLCs that include a deadlock provision.

We should wait and see when and how these new templates, if at all, will be introduced by MOCI and whether there will be a grace period issued by MOCI to comply with the stated requirement to include the deadlock provision in LLCs articles of associations.

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