The New Saudi Companies Law:

What Is New?

24 August 2022

On 28 June 2022, the Saudi Council of Ministers approved the new KSA Companies Law (Companies Law) and the final approved version of the law was published in the official gazette on 4 July 2022. The Companies Law comes into effect 180 days from publication, on 31 December 2022, and its implementing regulations are expected to be published on or before such time.

Companies law in the Kingdom has not been amended or updated since 2015, and, with the accelerated development of the corporate and business environment over recent years, the new Companies Law introduces a number of developments critical to ensure alignment with the Kingdom's Vision 2030.

We provide below an overview of the key changes introduced in the Companies Law.

General Changes Applicable to All Companies

The Companies Law adds new provisions addressing key issues arising under any corporate form, as well as new provisions on managers and directors of companies.

I. Directors' Duties and Entitlements

It has often been debated whether directors of Saudi companies, particularly limited liability companies (LLCs), owe fiduciary duties to the company and its members. Article 26 addresses this clearly by imposing an express duty of care and loyalty on all managers and directors of companies.

Standards of Care

The Companies Law also provides express obligations on directors in order for them to meet their standard of care, which includes acting in the best interests of the company; acting independently when adopting or voting on resolutions; discharging their duties with the reasonable and expected care, attention and diligence; and avoiding conflicts of interest. This reflects a number of concepts similar to those included in the Capital Market Authority's Corporate Governance Regulations (which is applicable only to listed companies), which through this new provision now extends to all companies.

Under Article 31, managers and directors are considered to have fulfilled their duties of care and loyalty (required under Article 26) if they:

- have no interest in the subject matter of a resolution
- are informed and familiar with the relevant subject matter to the extent it is appropriate in the circumstances to their reasonable belief
- reasonably believe that the decision is in the company's best interest

Such principles are referred to under the Companies Law as the "Rules for Evaluating Decisions."

Conflicts

Relatedly, Article 27 expressly prohibits a director or a manager from:

- having any direct or indirect interest in activities or contracts undertaken on behalf of the company, except pursuant to an authorization from the shareholders (acting through written resolution or by decision of the general assembly)
- engaging in any activity that competes with the company, except pursuant to an authorization from the shareholders (as indicated above)
- using or usurping (directly or indirectly) the company's assets, information or corporate opportunities for his or her own benefit

Should managers or directors commit any of the above, they may be liable to the company for any profits or benefit gained from their action and further compensation.

Article 28(3) expressly allows companies to procure insurance for their managers and directors against any claim or liability arising out of performing their duties.

II. Distribution of Dividends

Under Article 22, joint stock companies (JSCs) and LLCs may distribute annual or interim dividends, the conditions for which are to be set out in the implementing regulations.

III. Shareholder Disputes

Under Article 29, aggrieved shareholders have several avenues for recourse against the company or its directors as follows:

- shareholders may sue in their own capacity to enforce their rights as shareholders
- shareholders representing 5% of the company's capital may sue on behalf of the company to enforce a corporate right that affects the company (so-called "derivative actions")
- shareholders may also elect to sue managers or directors individually for any damages they incur as shareholders as a result of the managers' or directors' actions

Notably, an action against a director or a manager can still be brought even if the shareholders or the general assembly resolve to discharge the director or manager from liability. This should be noted by directors who seek to limit their liability retrospectively through shareholder approval/whitewashing, and may give such persons pause for thought when taking decisions. The importance of clear and accurate minutes for director decision-making has never been greater.

IV. Support for Virtual Communications, Meetings and Decision-Making

In keeping with modern business practices, the Companies Law now expressly supports virtual communications, allowing companies (joint stock and limited liability) to hold board meetings and take decisions through modern means of communication. It has been common practice for companies to include such flexibility in their constitutional documents, but such codification in the new Companies Law is welcome.

V. Corporate Social Responsibility Incentives

The Companies Law seeks to encourage corporate social responsibility, although it does not yet provide granularity on the topic. Article 278 authorizes the Ministry of Commerce, or the Capital Markets Authority for listed companies, to propose and issue the necessary procedures and instructions for companies to undertake corporate social responsibility action. While there is currently no further guidance in the Companies Law as to how to pursue corporate social responsibility initiatives, the Implementing Regulations may provide further clarity.

VI. Automatic Dissolution

The Companies Law has removed the automatic dissolution by operation of law in the event losses of a company reach or exceed 50% of its share capital, and there is no members' resolution for the company to continue. This will be particularly useful in startup entities or joint ventures developing new lines of business, where there is often a significant outlay of capital in the early years after a company's formation, before it becomes revenue generating.

VII. Resolution of Disputes

Except for criminal matters, the Companies Law now allows any and all JSCs (Article 153) and LLCs (Article 173) to resolve disputes by arbitration or other alternative dispute resolution mechanism, provided that this is permitted by the relevant company's articles of association.

VIII. Shareholders' Agreement and Planning in Family Companies

The Companies Law now recognizes shareholders' agreements and addresses directly family-owned companies, with Article 11 introducing a family charter to regulate ownership, governance, management, work policy, relatives' employment and dividends distribution in family-owned companies. Both a shareholders' agreement and family charter would be binding, and may be incorporated in the articles of association or bylaws of the company.

Changes Applicable Only to JSCs

I. Share Capital

The Companies Law no longer requires the minimum capital requirement of SAR5 million for JSCs. Under Article 59, the minimum capital for a JSC shall be no less than SAR500,000. Further, under Article 60, JSCs can now have both an authorized and issued share capital, details of which would be specified in the JSCs bylaws.

II. Lock-up Period and IPO

The Companies Law no longer requires there to be a lock-up period following JSC incorporation (or conversion to a JSC) during which the founders' shares cannot be traded. Article 63 also allows a JSC to offer its shares to the public through an IPO at different stages, including during the JSC's incorporation stage. Both of these changes should allow companies to come to market more quickly, particularly younger or startup companies, or groups looking to insert a new TopCo for the purposes of procuring a listing. These changes may, therefore, improve the attraction of the Saudi Stock Exchange (Tadawul) as a destination for listings in the region.

III. JSC Board of Directors

The JSC board may not consist of less than three members, all of whom must be natural persons. The Companies Law also removes the board remuneration cap of SAR500,000, which should attract greater experience and talent to the boards of Saudi companies, potentially also raising the profile of the Saudi public market more generally.

IV. New Classes of Shares

Article 108 allows JSCs to issue different classes of shares: ordinary shares, preferred shares and redeemable shares. Within a class, each share should have the same rights and powers in accordance with any limitations on such rights and powers, as set by the bylaws. Subject to an extraordinary general assembly approval, classes of shares may also have "conversion rights" under Article 109. Such increased flexibility in capital arrangements should assist JSCs in accessing larger pools of capital.

V. Drag-along and Tag-along Rights

Article 113 allows JSC shareholders to include provisions in the bylaws that:

- allow shareholders owning 90% of the JSC's share capital to require the minority shareholders to sell their ownership interest to a third party (a "drag right")
- enable minority shareholders to sell their ownership to a third party interested in acquiring the majority shareholders' ownership interest (a "tag right")

It should be noted that this is not a codification of drag/tag principles – only an express permission by the Companies Law for such terms to exist. The same rights exist for LLC shareholders under Article 181.

VI. Sale of Assets

Article 75 requires shareholders' approval for the sale of all or substantially all of the JSC's assets, which is triggered when the value of the assets in question exceed 50% of the JSC's total assets, whether the sale takes place in a single transaction or a series of transactions.

VII. Squeeze-Outs

In the context of a takeover, Article 230 allows one or more shareholders who collectively hold 90% of the voting shares in a JSC to "squeeze-out" the remaining minority shareholder(s) and gain full ownership of the JSC.

Changes to LLCs

The Companies Law removes many of the restrictions on LLCs in the old law and has instead given shareholders more freedom to manage the shares and profits of the LLC.

I. Single Shareholder LLCs

The Companies Law removed the restriction on a single shareholder LLC owning another single shareholder LLC.

II. Share Transfer Restrictions

While the Companies Law retains the statutory right of first refusal on the transfer of shares to parties other than the shareholders, Article 178 affords shareholders the flexibility to agree on specific share transfer restrictions, which may be included in the articles of association, including:

- Prior approval, requiring a shareholder to first obtain approval from the other shareholders before transferring its shares to a third party
- Purchase option, requiring a shareholder to first offer its shares to the other shareholder
- First refusal rights, requiring a shareholder to first offer its shares to the other shareholders at the price and on the terms offered by a third party
- Mandatory buy-sell obligations (e.g., on deadlock or other specified contingencies), requiring a shareholder to purchase or sell its shares at a specified price

To take effect, a transfer of interest in an LLC must be registered with the Commercial Register at the Ministry of Commerce, which may, in practice, require the approval of all shareholders, including the transferring shareholder.

III. Tradable Debt Instruments

Article 179 permits LLCs to issue tradeable debt or sukuk instruments in accordance with the Capital Market Authority Law, which was not allowed under the old law. This is a welcome change, allowing shareholders of an LLC to have multiple avenues to finance the LLC's activities.

Other Points of Note

I. Simple joint stock company – The Companies Law introduces a new form of company, the simple joint stock company, which aims at meeting the needs of entrepreneurs, private equity and venture capitalists. Similar to JSCs, the capital of simplified joint stock companies is issued in negotiable shares for trading in the capital market. Unlike JSCs, there is no minimum capital requirement for simplified joint stock companies. Simplified joint stock companies also have simpler management structures and requirements, and can be managed by one or more managers, or board.

II. Non-profit companies – The Companies Law now governs other forms of companies, such as non-profit and professional companies. The Companies Law divides non-profit companies into public companies and private companies. Public non-profit companies must be JSCs and their purpose is limited to serving society. Private non-profit companies, on the other hand, can be (i) a JSC; (ii) an LLC; or (iii) a simplified joint stock company, and it can be for any non-profit (i.e., charitable) purpose.

III. Professional companies – Created principally to capture the provision of professional services, the Companies Law's chapter eight organizes professional companies from their establishment to the management and liability of their partners. These provisions of the Companies Law should apply in conjunction with and supplement the Professional Companies Law (issued under Royal Decree M/17 of 26/01/1441H).

IV. Statutory reserve requirement – The new Companies Law removes the minimum statutory reserve requirement (30%) and instead gives companies the option to create reserves as they may require.

V. Constitutional documents – The Companies Law continues to distinguish between the constitutional documents of JSCs (bylaws) and LLCs and partnerships (articles of association). However, the Companies Law now provides that single shareholder LLCs will be governed in accordance with bylaws as opposed to articles of association. For practical purposes, the distinction seems to be in terminology.

VI. Companies names – The Companies Law has removed some of the restrictions on the choice of companies' names. The Companies Law now allows the name to be in a language other than Arabic and the name can be derived from one or a combination of the company's purpose, its current or former shareholders, or any other distinctive name.

VII. External auditor requirement – The Companies Law exempts micro and small companies from the requirement to appoint an external auditor. While not defined under the Companies Law, the Small & Medium Enterprises General Authority (Monsha'at) designates those companies with one to five employees and revenues of up to SAR3 million as micro, while entities employing six to 49 employees and generating revenues between SAR3 million and SAR40 million are designated small. The Implementing Regulations may adopt a similar definition for micro and small companies.