



العنوان :

Limited Liability Company in the New Saudi Companies Law

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محكمة : نعم .

التاريخ الميلادي : ٢٠١٩ .

الشهر : أكتوبر .

الصفحات : ٢ – ٣٠ .

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Abstract

The main aim of the paper is to address the limited liability company in the Saudi Companies Law. The paper explores various positive and negative effects that are associated with the said laws. The law has been basically based on the knowledge structure of the business owners who at some time remains a critical concern for entrepreneurs before they start any given commercial enterprise. In short, the paper is trying to come up with various points that are meant to tackle the Saudi based businesses issues.

Limited Liability Company in the New Saudi Companies Law

The knowledge of structure that business owners would use remains a key concern for entrepreneurs before starting any commercial enterprise. It explains why most world's nations seem to exercise significant care to enact and implement regulations governing formation, incorporation, and management of commercial enterprises. Building on this rationale, the Saudi Kingdom concluded that a revised legal framework to govern companies would play a significant role towards stimulating investments inflow and thus national prosperity¹. The new law revises previous provisions to ease the incorporation and management of business structure in Kingdom of Saudi Arabia. The changes aim at delivering a firm establishment capable of contributing handsomely towards positive and welcoming environment for investments and commercial activities². The enactment of the new law confirms the government's intentions to position the Kingdom among nations with solid and fair

administrative framework for doing business.

¹Elaraby, M., Almasoud, S., Abdukhalilov, S., Elder, I., &Hundt, B. (2015, December 23).

Saudi Arabia: New Saudi Companies Law Approved.

Retrieved June 17, 2018, from

<http://www.mondaq.com/saudiarabia/x/453958/Shareholders/New+Saudi+Companies+Law+Approved>

² Baassiri, F. (2016, February 12). New Saudi Companies Law.

Retrieved June 17, 2018, from

<https://www.ashurst.com/en/news-and-insights/legal-updates/new-saudi-companies-law/>

The new law places dedicated pleasure to harmonize the Saudi commercial environment with specific requirements whose compliance is mandatory for companies. Clarity in corporation law eliminates confusion arising in limited partnership, cooperative and changeable capital companies³. It emphasizes submission of articles of association and related amendment and notarizing them as default to the appropriate authorities.

Secondly, article 12 makes documentation and document notarization default and whose violations translates to the nullification of agreement and related amendments⁴. Although exempting joint ventures, Article 12 mandates publicizing article of association and related amendments through the Commerce and Industry ministry's website compulsory. It gives legal validity to documents and data accessed from the website.

The new law eliminates decades long debates on the company's obligations regarding loss- making limits to the share capital. The new law addresses the uncertainty

associated with Articles 148 and 180 in the previous Companies Law. The New Companies Law tackles the ambiguities on accumulating loss reaching fifty-percent of the share capital. Specifically, Articles 181 requires the owner and managers record the losses event with the Companies

³ Chaisse, J., & Lisa Zhuoyue LI. (2016). Shareholder Protection Reloaded Redesigning the Matrix of Shareholder Claims for Reflective Loss. *Stanford Journal Of International Law* 52, no. 1: 51-94.

⁴ Hachem, W., & Antoury, J. E. (2016, January). The New Saudi Companies Law and its Implications for KSA Companies. Retrieved June 17, 2018, from <http://www.hfw.com/The-new-Saudi-companies-law-January-2016>

registry within ninety days of awareness of losses hitting the fifty percent mark. The law requires resolution on the future of the company or dissolve it. It revises the previous regulations that provided for lifting the corporate veil and place the managers liable for obligations when they fail to record the loss-making event. Although such would protect creditors and parties likely to unknowingly enter into transactions with the company, the current law deems such entity dissolved. The process to ascertain what makes up the awareness for the managers to know when the losses reach the limit to trigger Article 181 event is difficult. Failure to determine what constitutes awareness leaves the pronouncement made by Article 181 challenging to implement.

The new law eases the formation of a limited liability company to approve one-man entity. It removes the minimum requirement of two shareholders making it possible to establish a single shareholder company. Such leaves minimum and maximum members being one person. The introduction of one Person

Company marks a strong improvement for the family owned and controlled business operating on sole proprietorship structure⁵. Similar to its predecessor, sole trader, the one person company accords the single promoter full control over operations while protecting one's liability to the limit of contributions. The individual founding the company acts as both the director and shareholder. The law provides for nominee director whose power is triggered when the original director becomes incapable to enter contracts⁶. The law provides for

⁵ Patel, S. (2015, December). Saudi Arabia: New Companies Law 2015. Retrieved June 17, 2018, from <https://www.linkedin.com/pulse/saudi-arabia-new-companies-law-2015- update-sajid-patel>

⁶ OECD. (2016). *Global Forum on Transparency and Exchange of Information for Tax Purposes peer reviews: Saudi Arabia 2016: Phase 2: implementation of the standard in*

practice;

dissolving the company upon the death of the sole holder of the share capital. An exemption would arise if the shares are held by one heir or the heirs choose to run the company in other legal forms. The law facilitates the conversion of multiple Saudi Arabian sole proprietors into limited liability establishments. The transfer of the shares to legal heir occurs upon the death of owner in OPC or legal heir of the nominee in their absence. The law requires contractual arrangement between the owner of company with the nominee who will assume ownership and operations.

The new law eases the registration and management of limited liability companies by allowing the formation of one-person entity. The inclusion of one-person company broadens the opportunities to include family-based startups. In particular, Article 55 and 154 allows one to establish a limited liability company where a single individual has entire ownership of its shares. In such situation, the law considers the liability of such individual limited to the capital amount⁷. It bestows such person

with authorities and powers of the board of directors and shareholders' general assembly. The arrangement yields faster decision making and complete management

March 2016 (reflecting the legal and regulatory framework as at December 2015). Paris: OECD Publishing.

⁷ OECD. (2016). *Global Forum on Transparency and Exchange of Information for Tax Purposes peer reviews: Saudi Arabia 2016: Phase 2: implementation of the standard in practice; March 2016 (reflecting the legal and regulatory framework as at December 2015)*. Paris: OECD Publishing.

derived from full ownership. Similar to sole trader arrangement, restricting the one-person company to single directorship denies it diversity in its management and operations.

Negative Aspects of Saudi Arabia Law

The new law limits the possibility of a single individual establishing more than one limited liability companies.

Furthermore, LCCs established and owned by a single individual can neither form nor own other LCCs of a similar ownership structure. Allied to this, Article 152 obligates LCCs owned by a single individual to illustrate such in their names. Compliance with the requirements tags implies the one-person company is no equal to ordinary limited liability companies. The noteworthy addition to the law is Article 155 that lifts the corporate veil when the single LLC owner engages in ill-intentioned malpractices⁸. Its provisions hold such owners personally responsible for their ill intentions, ceasing operations or liquidating the company before

the fulfillment of its incorporation objectives. Also, such may arise if the individual fails to separate the LCC's business from other private operations⁹. For instance, such may arise where the owner engages in business transactions using the company's account before gaining its legal status. The provision makes the one-person company a tricky affair for the start-ups unable to operate on separated accounts.

⁸ Faraj, M., 2016. *Toward New Corporate Governance*

Standards in the Kingdom of Saudi Arabia: Lessons from Delaware. Tabuk: University of Tabuk Press.

⁹ Reardon, J. (2016, August). The New Saudi Companies Law: What You Need to Know.

Retrieved June 17, 2018, from

<http://www.tamimi.com/law-update-articles/the-new-saudi-companies-law-what-you-need-to-know-1/>

The new chapter introduced on holding companies recognize the Kingdom culture of successful family business presenting a strong foundation for the commercial enterprises. The chapter provisions in Article 182 requires the company name to bear holding term to illustrate its aim to control other joint stock and limited liability companies as its affiliates¹⁰. Article 183 considers the holding company to participate in the management of affiliate companies, invest funds, acquire properties and provide loans and guarantees. It extends to the acquisition of intellectual property rights alongside the provision of guarantee for the accomplishment of affiliate activities. Article 184 rules out ownership of shares by an affiliate in its holding company as such amounts to the transfer of stocks and shares. An LLC serving as a holding company must comply with Article 185 on the preparation of consolidated financial statements in full compliance with the accepted accounting standards¹¹.

The law offers a mixed bag of gains and restrictions to the one

person company. Firstly, it restricts the one person company from raising equity funding and issuing employee stock options. It imposes the burden of raising capital to the sole trader unlike in the previous limited

¹⁰ Hachem, W., &Antoury, J. E. (2016, January). The New Saudi Companies Law and its Implications for KSA Companies. Retrieved June 17, 2018, from <http://www.hfw.com/The-new-Saudi-companies-law-January-2016>

¹¹ Faraj, M., 2016. *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware*. Tabuk: University of Tabuk Press.

liability company¹². Also, the law requires conversion of the one-person company into either private or public limited company only after two years of their formation. It emphasizes the impermanence of the one person company structure making it a stepping stone for other models for successful business operations. The lack of permanency of the structure favors small startups and small entities whose cumulative success obligates compulsory conversion¹³. Such provision may leave the structure vulnerable to individuals seeking to avoid compliance with filing audited financial statements annually. The new arrangement prohibits one natural person from establishing multiple single-shareholder limited liability companies. Furthermore, the single-shareholder limited liability company can neither own nor establish another single-shareholder entity. Consequently, it offers partial benefits enjoyed previously under the previous regulations. It is noteworthy to note the absence of explicit ground restricting body corporates from

¹² Patel, S. (2015, December). Saudi Arabia: New Companies Law 2015. Retrieved June 17, 2018, from <https://www.linkedin.com/pulse/saudi-arabia-new-companies-law-2015-update-sajid-patel>

¹³ Faraj, M., 2016. *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware*. Tabuk: University of Tabuk Press.

establishing or owning one or more single-shareholder companies¹⁴. The position remains vague on the flexibility applicable to the administration of the aspect.

The conversion of the one-person company into joint stock or privately limited company demand compliance with the corporate governance structure. The governance structure will feature a complex arrangement of one director and one shareholder, with the same individual holding both positions. It features a board of managers or general manager appointed by the shareholders to serve for limited or unlimited term¹⁵. The law compels for the appointment of supervisory board in limited liability companies whose membership exceeds twenty shareholders. Such a board should, however, draw a minimum of three shareholders. The managers and directors should honor their stewardship role, failure to may lead to joint liability during violations of the law¹⁶.

¹⁴ Patel, S. (2015, December). Saudi Arabia: New Companies

Law 2015. Retrieved June 17, 2018, from
<https://www.linkedin.com/pulse/saudi-arabia-new-companies-law-2015-update-sajid-patel>

¹⁵ Patel, S. (2015, December). Saudi Arabia: New Companies

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¹⁶ Elaraby, M., Almasoud, S., Abdukhalilov, S., Elder, I., &Hundt, B. (2015, December 23).

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<http://www.mondaq.com/saudiarabia/x/453958/Shareholders/New+Saudi+Companies+Law+Approved>

The law requires that all suits to charge the managers should be filled within the five-year period with no limitation required for fraud.

The new law requires the limited liability company to hold the general assembly at least once each year but within four-months of concluding their financial year. The fulfillment of this requirement requires shareholders representative of half the contributed capital, auditor or the supervisory board capable of requesting the general meeting. The decisions reached during a general assembly require the simple majority¹⁷. The law requires a variation that, however, aligns to the provisions in the articles of association. The conversion into a joint stock company would necessitate request and vote of shareholders with more than fifty percent ownership in the LLC capital. Nevertheless, the law requires situations that involve the adjustment of the LLC nationality and alteration to the nominal value of shares, and new shares' issuance mandates unanimous approval¹⁸. Lastly,

the law requires shareholders holding at least three-quarters the capital to vote in the company favor during the amendment of the LLC's articles.

¹⁷ OECD. (2016). *Global Forum on Transparency and Exchange of Information for Tax Purposes peer reviews: Saudi Arabia 2016: Phase 2: implementation of the standard in practice; March 2016 (reflecting the legal and regulatory framework as at December 2015)*. Paris: OECD Publishing.

¹⁸ Faraj, M., 2016. *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware*. Tabuk: University of Tabuk Press.

The provision for sector-specific regulation on minimum capital requirement differs with the SAR 500,000 set for the joint stock companies. Also, there lacks pre-emption right applied to the share transfers. However, the absence of express provision allows the existing shareholders to purchase stocks at their fair value within thirty days of notice. Unlike in JSC where by-laws would restrict pre-emption rights, LLC utilize them to restrict share transfers¹⁹. The new law requires shareholders willing to transfer their shares to external parties to notify the existing. It involves giving them an opportunity of first purchase at their fair value within the thirty-day notice period. However, it permits the shareholders to consider utilizing a different valuation approach and period as stated in the company's articles of association²⁰. The law illustrates a gray area in the lack of specifying whether pre-emption right applies in shareholders' transactions.

The notable changes in the new provisions center on the company formation to eliminate generalized framework in the

previous law. Article 151 caps the maximum shareholders at fifty members. The article specifies that a membership exceeding the fifty mark would compel conversion of the LLC into a joint stock company (JSC) within a year of such violation. The

¹⁹ IBP (2016). *Saudi Arabia Customs Rules, Tariffs and Regulations Handbook - Strategic and Practical Information*. S.l.: IBPUSA.

²⁰ IBP (2016). *Saudi Arabia Customs Rules, Tariffs and Regulations Handbook - Strategic and Practical Information*. S.l.: IBPUSA.

failure to comply with the requirement would lead to a forceful expiration of LLC²¹. Besides, the article places the LLC with the sole responsibility of meeting its debts and commitments hence shielding shareholders' assets. Article 152 requires clarification in the naming of the limited liability company. It requires any LLC name should reflect the purpose of its formation. It would bar the inclusion of a person's name unless its purpose sought to invest in the patent registered in such manner²². The exemption extends to commercial enterprises acquired when using such names and those transformed into LLC.

The new provisions on capital and shareholding fail to mention of specific minimum capitalization requirement for the LLC. Instead, it mandates capital sufficiency aligned to the purpose for the company formation. Such appears a generalized requirement whose compliance would appear discretionary. The law risks turning joint ventures into experimental vehicles without allocation of sufficient capital. Additionally, such capital

requirement should be stated in the articles of association
submitted as earlier stated to the commerce and industry ministry
23.

²¹ Faraj, M., 2016. *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware*. Tabuk: University of Tabuk Press.

²² Reardon, J. (2016, August). The New Saudi Companies Law: What You Need to Know.

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²³ Courtney, T. B., Hutchinson, G. B., O'Leary, D., & Courtney, T. B. (2016). *The law of companies*.

The administration requirement reduces the statutory reserve percentage with Article 176 obligating at least ten percent of annual net profits allocated to statutory reserve. The shareholders are exempted from this requirement when the statutory reserve reaches thirty percent of the LLC's capital. Similarly, article 181 of the law further provides for LLC expiration when losses reach fifty percent of its capital employed. It compels the shareholders to meet when LLC experiences such circumstances within ninety days to examine the viability of continuation or dissolution²⁴.

The failure to reach a decision leads to the expiration of the LLC within the law. Such reveals an eroded protection to foreign investors who may become victims of sabotage from their domestic partners who may fail to meet.

²⁴ OECD. (2016). *Global Forum on Transparency and Exchange of Information for Tax Purposes peer reviews: Saudi Arabia 2016: Phase 2: implementation of the standard in practice; March 2016 (reflecting the legal and regulatory framework as at December 2015)*. Paris: OECD Publishing.

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Elaraby, M. et al., 2015. Saudi Arabia: New Saudi Companies Law Approved. 23 December .

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