Company Laws

The Companies Law is the principal body of legislation governing companies. Saudi company law recognizes eight forms of companies. The most common forms are limited liability companies (LLC), joint stock companies, general partnerships and limited partnerships. This Guide focuses on these four forms. The less common company forms are partnerships limited by shares and joint ventures. Apart from the above, Shari'a law specifies a number of other types of companies, which cannot, however, be used by foreign investors.

In practice, foreigners usually establish LLCs. Partnerships and joint stock companies are only established in exceptional cases.

Limited Liability Company

LLCs are a popular corporate vehicle among foreign investors in Saudi Arabia, because they are simple to establish and administer and the personal liability or each of the partners is limited to the individual partner's contribution to the company's share capital. Explained below are some of the important characteristics of LLCs under the Companies Law and the relevant Ministry of Commerce and Industry guidelines.

a. Memorandum of Association
   To increase the likelihood of the government's timely approval, acceptance and registration of an LLC, the memorandum of association, and the governing documents of the LLC should follow the model memorandum of association issued by the Ministry of Commerce and Industry.
   The memorandum of association must contain the following:
   1. Name and form of the company, and its objects and head office address;
   2. Name, address, occupation and nationality of the partners;
   3. Names of the manager(s), mentioning those who are also partners (optional);
   4. Names of the members of the supervisory board, if applicable;
   5. Share capital, amount of the contributions in cash and in kind, description of the contributions and names of the contributors;
   6. Method of profit distribution;
   7. Duration of the company; and
   8. The form of notices that may be issued by the company to its shareholders.
b. Minimum Capital
   The minimum capital of an LLC with foreign participation is SR 100,000 under the Foreign Investment Law. The required amount is increased to SR 5,000,000 for industrial projects and SR 25,000,000 for agricultural projects. The Board of Directors of SAGIA may reduce the minimum invested capital in projects established in areas specified by it or in export projects or those which require considerable technical experience. The share capital must be fully paid when the company is established. Cash contributions must be paid into an account with a local Saudi bank and are frozen, until the bank is presented with documents showing that the establishment formalities have been completed. The partners of the LLC are personally jointly liable to third parties for any inaccuracies in evaluation of contributions in kind to the share capital of the LLC.
c. Partners, Name
   An LLC must have at least two but not more than fifty partners who may be legal entities or individuals. A company will be automatically dissolved if the number of its partners falls below two. Foreign companies that intend to establish a Saudi LLC as a 100% subsidiary usually arrange for a minority stake to be held by a dependent company or by an individual of their choice. Others prefer to establish a permanent branch.

   The share capital of LLCs is divided into shares of a uniform nominal value. Transfers of shares to any third party are permitted, subject to pre-emption rights in favor of the other partners and the approval of SAGIA and the Ministry of Commerce and Industry. The company's SAGIA licence, Commercial Registration and Articles of Association must be amended following any share transfer. Certain other important obligations of the partners, which are not contained in the model statutes of association, such as agreements relating to the transfer of shares (e.g. pre-emptive rights, put or call options), side letters, funding and the exercise of voting rights are usually contained in a shareholders' or joint venture agreement. Such agreements, which are not registered with the Ministry of Commerce and Industry but are nevertheless

enforceable before the courts, are common practice, as they provide an opportunity for partners to agree to details regarding the administration of the company, which details may not be included in the model statutes. In many cases, a shareholders' agreement is the only protection for foreign partner(s) in an LLC. Shareholders' agreements existing outside of the LLC statutes, are permitted, enforceable, and encouraged as long as parties to such agreements remember the caveat that, like all other contracts in Saudi Arabia, the terms of the shareholders' agreements must not contravene the Shari'a and the mandatory provisions of the Companies Law. If, however, the shareholders' agreements contravene the registered Articles of Association then the most recent stipulation will prevail as between the shareholders, but not vis-à-vis third parties.

Unlike the legislation of other GCC states Saudi law does not limit the level of foreign participation allowed in Saudi LLCs. Companies which are owned by foreigners may also be registered in the Commercial Register. Moreover, the new Foreign Investment Law that entered into force in 1421 H.
[2000 G.] appears to encourage the establishment of 100% foreign-owned investment projects, be it in the form of companies, branches or individual establishments.

Miscellaneous issues to bear in mind are that the company's name may consist of partners' names or may reflect the company's object. The company's stationary should contain its Commercial Registration number, as well as the amount of the paid-up capital and the fact that the company is an LLC.

d. Management
An LLC may have one or more managers. There is no requirement that any manager be a Saudi national. If there is more than one manager all managers may be authorized by the partners to represent the company individually or collectively. The manager's representative authority generally encompasses all transactions and business relating to the company's normal corporate and business activities. According to the model statutes, specific transactions may, however, be subject to the prior approval of the partners. Usually, the restrictions are determined by the first partners meeting and are registered in the Commercial Register. A general manager is frequently designated for the supervision of the day to day business of the company. It is not a requirement that the general manger be a partner.

e. Fiscal Year
It should be noted that it is advisable to provide expressly that the fiscal year of the company is according to the Gregorian calendar, otherwise the fiscal year is by law twelve hijri calendar months. The partners are also free to choose the date of the start of the company's fiscal year.

f. Supervisory Board
If an LLC has more than 20 shareholders it must have a supervisory board consisting of at least three members. The supervisory board's main duty is to supervise the management of the company, to advise on issues referred to it by the managers, and to authorize assignment of assets belonging to the company, if foreseen in the company's statutes. The model statutes contain provisions relating to supervisory boards.

g. Transfer of Shares
Shares are transferred by a formal notarized agreement, unless the company's statutes provide otherwise. Transfers take place before a notary public after having obtained the approval of SAGIA and the Ministry of Commerce and Industry. Shares must be offered first to the other partners (in the proportion of their participation in the capital of the company) before they may be sold to third parties. A partners' resolution approving the sale and stating that the shares were offered to all of the other partners will be required. The statutes may contain further provisions and may modify the rights of the partners to some extent.

h. Liability of Partners
The liability of LLC partners towards third parties is limited by law. They are liable only to the extent of their investment in the capital of the company. Partners may be jointly liable towards third parties for the estimated value of contributions in kind for a period of three years. If the company becomes insolvent, the partners are theoretically only liable for their share of the company's capital. In practice, however,

this principle is normally not recognized by the courts because it is not supported by the corporate concepts of Shari'a law.

Under the Companies law partners are jointly personally liable to pay all of the company's debts if the company's losses exceed 75% of its stated capital and no resolution of the partners providing for the continuation of the company (and payment of certain of its debts) is

adopted within thirty days. Such resolution should either provide that the company shall continue, with the commitment of the partners to pay its debt, or that the company be dissolved.

i. Liability of Management
Under Article 168 of the Companies Law, the managers of an LLC are jointly liable for damages suffered by the partners, the company, or third parties due to any failure on their part to observe the provisions of the Companies Law or the LLC's governing documents. Except in cases of fraud, for which the Companies Law provides no statute of limitations this liability lapses three years after the discovery of the wrongful act.

Partnerships

While for foreign tax reasons it may, in some cases, be advantageous for foreign parties to operate in Saudi Arabia through partnerships foreigners may not currently establish or participate in partnerships under Saudi Arabian law. The following types of partnerships are recognized in Saudi Arabia:

- General Partnerships;
- Limited Partnerships; and
- Partnerships Limited by Shares.

a. General Partnerships
A general partnership is an association of two or more persons who are jointly and personally liable for partnership debts. The partnership is a separate legal entity and may transact business in its own name. Partners may not transfer partnership interests to other parties without the unanimous consent of the other partners. No minimum capital is required under the Companies Law for the establishment of a partnership; there are, however, minimum capital requirements under the Foreign Investment Law. Contribution terms are set out in the partnership agreement, which must be registered with the Ministry of Commerce and Industry. General partnerships are a common form of business organization used by Saudi nationals.

b. Limited Partnerships
Limited partnerships include two kinds of partners: general partners and limited partners. General partners are personally liable for partnership debts to the full extent of their personal assets. Limited partners are liable for partnership debts to the extent of their investment in the partnership. A limited partnership is registered in the same manner as a general partnership.

c. Partnerships Limited by Shares
A partnership limited by shares is a partnership consisting of at least one general partner who is personally liable for partnership debts to the extent of his personal assets, and at least four shareholders who are responsible for partnership debts only to the extent of their shares in the capital. The minimum capital of a partnership limited by shares is SR 1,000,000 under the Companies law. The partnership is managed by one or more general partners. A supervisory board elected by the partners' assembly supervises the acts of the general (managing) partner(s). The provisions for registering joint stock companies apply to the incorporation of a partnership limited by shares.

Joint Stock Companies

According to Article 52 of the Company Law, the establishment of joint stock companies generally requires an authorization from the Minister of Commerce after reviewing a proposed company's "feasibility" study. The law requires the authorization through a Royal Decree based on the approval of the Council of Ministers for the formation of any joint stock companies with concessions, undertaking public sector projects, receiving assistance from the State, in which the State or other public institutions participate or for joint stock companies engaging in a banking business.

In general, the provisions applicable to the administration of joint stock companies are more detailed than those applicable to limited liability companies. However, the requirements are not as strict as those found in certain Civil Law jurisdictions and, as a result, the costs of administration of a joint stock company are not significantly higher than those relating to the administration of a limited liability company.

a. Articles of Association
In order to avoid undue delay in formation of the joint stock company, the proposed articles of association of joint stock companies should follow a model issued by the Ministry of Commerce

and Industry. The model is generally used, without any major changes, in order to avoid delay in the registration of the company, and because the relevant laws only permit the articles of association of a joint stock company to deviate from the model "for reasons deemed acceptable by the Minister". Shareholders of joint stock companies frequently enter into shareholders' agreements in addition to the articles of association.

b. Minimum Capital and Shareholders

Joint stock companies must have a minimum capital of SR 2,000,000 (except where the Foreign Investment Law sets a higher requirement), divided into negotiable shares of equal value of at least SR 50. If the shares are to be publicly traded, joint stock companies must have a minimum capital of SR 10,000,000. Joint stock companies must have at least five shareholders, whose liability is limited to the amount payable on their shares. The shares may be either registered or "bearer" shares. Each shareholder is under an obligation to pay at least 25 % of the amount of the cash contribution at the time of the company's establishment. The total paid in capital at the time of incorporation must amount to at least 50 % of the authorized/issued capital.

Cash contributions must be paid into an account with one of the banks designated by the Minister of Commerce. The funds are frozen until the bank is presented with documents confirming that the formation formalities have been completed.

Joint stock companies may hold their own shares, but only under certain restrictive conditions. Examples are cases in which the company wishes to reduce its capital, or if the shares in question form part of the assets and liabilities of an estate to be acquired by the company.

c. Shares

In principle, all shares grant their owners equal rights. A joint stock company may have nominative or bearer shares and preferred shares. Nominative shares are issued in the name of the shareholder concerned. Bearer shares must be fully paid up on issue. Preferred shares conferring preferred rights in respect of profit distribution and on liquidation may be issued, but may not exceed 50% of the capital.

d. Saudi Participation, Name

Joint stock companies may be wholly owned by foreigners. The participation of a Saudi investor is no longer compulsory. The name of a joint stock company may not contain the name of a natural person, unless the company's object is the use of a patent or an invention registered in the name of that person or unless the company acquires a commercial firm and adopts the name of the latter as its own name. All official papers of the company, such as letterheads, contracts, invoices and other documents given to third parties must state the name, the type of company, the domicile, as well as the issued and the paid in capital of the company. Non-compliance with this obligation may, under certain circumstances, lead to unlimited liability of the person acting in the name of the company.

e. Management

Joint stock companies are managed by a board of directors, which must be composed of at least 3 directors. The board of directors must elect a chairman and a managing director among its members. A single director may hold both the office of chairman and managing director. There is no supervisory board in addition to the board of directors under Saudi law.

The day-to-day business of a joint stock company is usually carried out by the managing director or by an employee vested by the board of directors with the power to represent the company ("general manager") in its daily activities. The latter is not a member of the board of directors, but may apply to attend the meetings. Members of the board of directors may not appoint other members to act on their behalf by proxy in the board meetings, unless this is specifically authorized in the articles of association.

Resolutions of the board of directors are valid if at least half of its members are present and if the number of those present is not less than three, unless the company's bylaws require the attendance of a greater percentage or number of members of the board of directors. The minutes of the board meetings must be entered regularly after each meeting in a special, officially stamped register and must be signed by the chairman and the secretary. Members of the board of directors must own shares in the company's stock, of a nominal value of not less than SR 10,000. These shares should, within thirty days of the date of appointment of a director, be deposited in one of the banks designated by the Minister of Commerce, and are set aside as a guarantee against the individual directors' liability.

f. Shareholders' Meetings

Saudi law distinguishes between ordinary and extraordinary shareholders' meetings. An

ordinary shareholders' meeting must be held at least once a year, and at the latest within six months after the end of the company's fiscal year. Shareholders may exercise their voting rights in person or by proxy. A proxy may, however, only be issued to another shareholder who is not a director of the company. An ordinary shareholders' meeting shall only be valid if attended by shareholders representing at least 50% of the company's share capital, unless the articles of association of the company require a higher level of shareholder representation. Resolutions of ordinary shareholders' meetings are usually adopted by simple majority of votes present unless the statutes of the company provide for a higher proportion.

Extraordinary shareholders' meetings are convened in order to amend the articles of association of the company, with exception of the following amendments:

- Depriving shareholders of any of their basic rights as shareholders in the company;
- Amendments increasing the financial liability of any of the shareholders;
- Amendments to the object of the company;
- Transferring the registered office of the company from the Kingdom to a foreign country; and
- Changing the nationality of the company.

Extraordinary shareholders' meetings are convened by the board of directors upon request of shareholders representing at least 10% of the capital. Resolutions of extraordinary shareholders' meetings are adopted by a majority of two thirds of the shares represented at the meeting. If the resolution concerns an amendment to the statutes, such as an increase or decrease in capital, an extension of the company's term or a merger or dissolution, a majority of three quarters of the votes present is required.

g. Transfer of Shares

Shares in joint stock companies are freely transferable, with the exception of founders' shares, which may not be negotiated until after publication of the balance sheets for two complete financial years. Unlike shareholders of LLCs, the shareholders of joint stock companies have a right of pre-emption only if provided for in the company's Articles of Association or in any Shareholders' Agreements.