New dawn for professional companies in Saudi Arabia

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Introduction

The pace of legislative and regulatory change in Saudi Arabia has accelerated in recent years keeping all manner of advisors busy understanding, applying and advising across a broad spectrum of innovations. The latest change, however, will have a direct impact on those very advisors. The new Professional Companies Law of 2020 ('PCL') represents a sea-change in how professionals will be able to constitute their businesses.

All governmental authorities in Saudi Arabia are tasked with improving the business ecosystem in Saudi Arabia in order to fulfil the ambitious goals of Vision 2030. The Ministry of Commerce has taken the lead on the PCL. It is anticipated that this law will have a significant impact on the foreign investment climate and market competition.

The previous law dates from 1991 and, given the pace of change in the intervening period, needed refreshing to accommodate the realities of business practice in this highly complex sector. The old law presented a number of challenges to modern business practice, many of which are resolved in the new PCL. In this article we will briefly explain the key drawbacks of the old law and survey the key features of the new law.

So what is a ‘professional company’?

The PCL defines a professional company as:

> *“a civil company that operates independently, which is incorporated by an individual (or more) whom are licensed to legally carry out one (or more) profession, or with others, for the purpose of practicing professions.”*

The concept of ‘profession’ in Saudi law is therefore focussed on business activities which require a professional licence granted by a legally recognised regulatory body. This would include legal, audit, accounting, engineering and any other activities of a similar nature.

Drawbacks in the old law

The old law had a limited number of options when it came to the structure of the professional company: the sole permitted structure was a partnership. Direct, joint and several liability of the partners was inevitable. In addition, only individuals licensed in the specific profession were permitted to participate and only one such licensed activity was allowed. There was also a distinct grey area as regards foreign investment and participation in these services. These constraints limited investment options and curtailed the ability to innovate in service offerings. The new PCL addresses these issues and provides a platform for innovation, investment and growth in the sector.

A new dawn

The PCL addresses many of the issues that had been challenging in the past and provides many new features, including such innovations as formation by way of limited liability and joint stock companies as well as major changes in terms of shareholdings, activities and succession.

The PCL allows licensed professionals to partner with either individuals or corporate entities. This should improve investment opportunities in professional companies, as previously this was not permitted. Consistent with the new Companies Law introduced in 2016, it is now acceptable for a sole practitioner to incorporate a single-member limited liability company. Indeed, the PCL indicates that if there is anything that is not specifically stated or indicated in the PCL, reference can be made to the Companies Law for clarification.

Different professional activities now can be merged into one company to foster innovation and enhance competition and this could, for example, include a professional company that can legally practice two (or more) objectives such as legal and auditing activities. This innovation will have a great impact on the market in terms of the variety and sophistication of services and, as a consequence, on competition.

Under the old law, the trade name of the firm was generally limited to the names of the partners. Creative names were difficult to obtain in most cases. This has now been rectified and creative trade names are allowed and acceptable.

The PCL empowers the Minister of Commerce to mandate, in respect of certain activities, specific professional indemnity and other insurance policy requirements. Non-compliance will lead to penalties as stipulated in the PCL. The introduction of this insurance underwriting for regulated activities will provide clients of these companies with greater assurance and will require regulated professional companies to carefully review their risk management strategies with their insurance providers.

The new law addresses, in detail, scenarios where a practitioner's licence is temporarily suspended or revoked by the licensing authority. The consequences can include a total shutdown of the company within six months in cases where the relevant practitioner is the only practising partner or, if there are other partners or shareholders, the ability to continue trading conditional on the exit of the relevant individual or with their continued participation on a non-licensed basis as provided in the company's Articles.

Succession is generally a complex issue under Saudi law. The old law did not allow the inheritors of a deceased practitioner to continue his or her interest in the partnership. The rule was that the share would be evaluated and a cash sum paid to the heirs. The PCL allows heirs to inherit shares (in a limited liability company) and maintain an interest in the business: although clearly it will be a matter for the parties to determine the detail around how this works in practice (having regard, in part, to the threshold on non-professional participation discussed below).

The implementing regulation for the PCL has also recently been issued and provides further detail on key issues. For example, the implementing regulation provides that the maximum permitted percentage of a non-professionally licensed shareholding is 30 per cent.

There must also be a minimum 25 per cent Saudi participation in any professional company which includes foreign entities as participants.

The implementing regulation also provides detail on the constitution of multi-disciplinary practices.

For a professional company to carry out more than one activity the following criteria must be met:

1. non-objection by the relevant authorities;
2. the combination of the shareholders should include licensed practitioners in each of the activities the company is wishing to carry out;
3. there is no objection in the regulations that prohibit these specific activities to be jointly carried out in the same company or partnership; and
4. satisfying the requirements and obligations of the competent authorities in relation to the incorporation of any company or partnership that wishes to carry out more than one professional activity.

The implementing regulation also addresses the incorporation process and other governance and compliance matters such as partner or shareholder resolutions, publications, management and supervision of authorities.

Future developments

Although the implementing regulation gives the Minister of Commerce and the relevant professional authorities' discretion over the list of activities that are allowed to be jointly practised we anticipate that will include accounting and legal services, management consultancy and possibly audit services. The list may be much more extensive in scope in the future, but will need to balance considerations such as conflicts of interest (perhaps especially in the nexus between advisory and audit functions).

Needless to say, each profession has a regulator: legal services are regulated by the Ministry of Justice; engineering services are supervised by the Council of Engineers; the auditing and accounting services are under the Saudi Organization for Certified Public Accountants. Each of these regulators will rightly view themselves as custodians of the integrity of any given profession and will now have to collaborate in developing an increasingly consistent approach to issues such as professional ethics and governance.

Conclusion

The new PCL is going to improve the general options of the legal structures of professional companies and provide more options to investors. The law introduces a new methodology for professional companies which is going to lead the long awaited change.

The new law will affect the overall market for professional companies. In the long run there will be significant implications for clients and practitioners alike, with a higher level of supervision imposed over companies and more options for their clients from which to choose. Practitioners can now also have investors supporting them in their company, providing not only financial support but an external understanding of the market which as a result will affect the practice of the company in a positive way.

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