

An overview of capital reductions in Kuwait

by Hamzah Al Shammaa - h.alshammaa@tamimi.com -

May 2012

The global economic climate over the past several years has been tumultuous for many financial institutions, forcing organizations to make difficult decisions to remain competitive in times of uncertainty.

To ensure businesses continue to run efficiently, many companies have chosen to avoid insolvency by carrying out capital reductions. In the past, capital reductions were primarily fueled in the hopes of bringing value to shareholders by cancelling shares, which in turn increases the price of the remaining shares. In today's environment capital reductions are often initiated by institutions to cover financial losses they have sustained.

A capital reduction is essentially the practice of reducing the value of a company through share cancellations and share repurchases. The capital reduction is completed by companies for several reasons, including raising shareholder value and producing a more efficient capital arrangement. Normally after a capital reduction has been executed, the number of shares in the company will decrease by the reduction amount. In some instances, capital reductions will be prepared in a manner where shareholders receive a cash payment for the cancelled shares. However, in other instances, shareholders receive no payment and the capital reduction is equated to a financial loss, thus negatively impacting shareholders.

The legal framework and policy surrounding capital reductions carried out by shareholding companies in Kuwait are covered under Law No. 15 Promulgating the Commercial Companies Law. More recently, Resolution 515 of 2010 regarding Organization of Conditions and Procedures of Requesting Increasing and Reducing the Holding Companies Capital was passed, outlining the procedures for carrying out a capital reduction. Resolution 515 should be read in conjunction with the Commercial Companies Law to cover all aspects relating to capital reductions.

From a practical perspective, companies seek to ensure that completing a capital reduction will not expose them to future liability. Therefore, it is standard practice that clients seek the advice of legal counsel to compose a timeline to implement the capital reduction. The timeline will outline an activity, documents that must be completed, the date for completion and the individuals responsible for completion of the same.

Generally, one of the first steps in effectuating a capital reduction is to draft a Board of Directors resolution for the company reducing its capital. A board meeting is then initiated by the company where its chairman will sign and execute the Resolution. Under Article 3 of resolution 515, the company must also review and provide its last audited annual financial statements to the Ministry of Commerce and Industry (MOCI). The company's management and account controllers must approve the Financials prior to providing them to the MOCI.

Article 3 of Resolution 515 also states that the company reducing its capital must prepare a report that references the reasons for the capital reduction (e.g. accumulated losses). The company will then provide a letter to the MOCI requesting the capital reduction and attaching its financial statements and the report to substantiate the same. The MOCI must provide its consent prior to the company initiating the capital reduction plan. Once consent has been obtained by the MOCI, the company will prepare a draft agenda for an extra-ordinary general assembly meeting (EGM) for shareholders. Shareholders will vote on the proposed capital reduction plan (Agenda), which will include reasons for the capital reduction and a statement assuring that the reduced capital will not

be less than the legal minimum capital requirements set for the company. Usually, the company's legal counsel will discuss the Agenda with MOCI officials for their review and comments. Thereafter, the MOCI will set a date and time for the EGM. The company will then publish an invitation to shareholders in at least two daily Arabic newspapers fifteen days prior to the proposed shareholders meeting. The MOCI will, at least seven days prior to the proposed shareholders meeting, publish an invitation in the Official Gazette.

Under Article 160 of the Commercial Companies Law, the company's EGM will convene and if a quorum is established, requiring a number of shareholders holding at least seventy five percent of the company's shares, the EGM will proceed to vote to approve the capital reduction plan. A representative of the MOCI will be present at the meeting to supervise and ensure that procedures and the voting process are legally conducted. The company will subsequently prepare the EGM minutes, reflecting approval of the capital reduction plan, which is then submitted within a week to the MOCI for its review and approval. An internal memorandum is sent from the shareholder company department of the MOCI to the commercial registration department to validate the Ta'sheer (Notation). Lastly, the Ta'sheer is prepared reflecting the MOCI's approval of the capital reduction plan.

Additional steps may also be required depending on the percentage of the capital reduction from the paid up capital of the company.