

KSA: Supporting Companies in Accordance to the New Companies Law

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On the 2nd of May 2016, a new companies law came into force as issued by the Royal Decree no. M/3 dated 28-01-1437H corresponding 11-11-2015G (the “New Companies Law”).

This article considers a key provision within the New Companies Law, its effect on the Saudi corporate sector and whether it improves the overall regulatory framework.

Importantly, the New Companies Law includes provisions relating to corporate structuring and restructuring including the ability to establish a sole shareholder limited liability company and holding companies. One of the main provisions of interest is Article 181 which provides as follows:

- Of the losses of a limited liability company reach the half of its capital, the company director must record such occurrence in the Commercial Register and invite the shareholders to meet within a period of not more than ninety days from the date of being aware of the loss of such amount to consider whether to support and continue or dissolve the company.
- The shareholders’ decision, whether to support and continue or dissolve the company, must be published in the ways set forth in article (158) in the Law.
- The company shall be terminated by the Law if the Company’s director failed to invite the shareholders or if the shareholders failed to issue a resolution whether to support and continue or dissolve the company.

As noted, this article regulates the steps that should be taken when a company’s losses reach 50% of its share capital. From a practical perspective, at the end of each financial year, the auditor of the company must upload its financial statement to the Qawaem website, a program established by the Ministry of Commerce and Investment (“MoCI”) in cooperation with the Saudi Organization for Certified Accountants. Qawaem provides a set of services related to financial statements and a database for use by other governmental authorities, such as the General Authority for Zakat and Income Tax. Moreover, once the financial statement is uploaded to Qawaem website, it will be reviewed and studied by MoCI, and accordingly MoCI will decide whether the company is making a loss or not and, if so, the extent of those losses.

Director’s Liability

In our experience, the ninety days mentioned in Article 181 will commence from the date of MoCI’s decision that a company has incurred a loss of 50% or more of its share capital. This shall be the date that constitutes the “awareness” of the director (being the General Manager named on the commercial registration of the company) that the losses have been incurred.

The previous companies law, issued by the Royal Decree no. M/6 dated 22-03-1385H corresponding to 21-01-1965G (the “Old Companies Law”) did not specify a particular period of time for the director to invite the shareholders to assemble in order to pass the related resolution to support and continue the company or dissolve it. However, under the New Companies Law, the failure of the director to invite the shareholders to meet within the ninety days will cause the company to be dissolved. Nevertheless, the director will personally liable to indemnify the company, the shareholders or any applicable third parties against any damages they incur due to the director’s breach of his duties in accordance to the Articles of Association of the company or the New Companies Law, and any shareholders’ approval to release the director from any liability shall not prevent the director from incurring such a liability.

Shareholder Liability

In the above situation, the shareholders must assemble pursuant to the director's invitation to pass the relevant resolution. In the event that the shareholders decide to support the company continuing to operate, there is a prospect that they would be jointly responsible for the debts and the obligations of the company. In other words, the corporate veil will be lifted similar to the position that applied under the Old Companies Law.

Article 181 states that in the event that the shareholders fail to pass the required resolution, the company will be dissolved. The Old Companies Law provided that such resolution shall not be valid unless approved by shareholders holding at least 75% of the share capital. Article 181 does not state that a required percentage of the shareholders in order to pass the relevant resolution. Accordingly, we consider that 100% shareholder approval could be required. This may give rise to a deadlock between the shareholders unless the Articles of Association of the company states otherwise. This is an unfortunate lacuna in the law and it remains to be seen how the position will be interpreted.

Finally, on the assumption that the company continues to be loss making for more than a year, and the shareholders continue to issue support via shareholder resolutions, it begs the question as to how long can this situation can continue. The New Companies Law does not address this point.

In conclusion, the issuance of the New Companies Law was long awaited and it was hoped that it would comprehensively regulate the corporate sector. However, whilst it has made important changes, it has also left some unanswered questions that require to be addressed in due course.