The Legal System for the Conversion of Commercial Companies in the Light of the Rules of the Saudi Corporate System

Mohammad S. Alomari [1,*]

[1] College of Law and Judicial Studies, University of Jeddah
[1] m.s.alomari@hotmail.com*;
* corresponding author

(Received: June 29, 2022; Revised: July 15, 2022; Accepted: August 5, 2022; Available online: December 1, 2022)

Abstract

As Saudi Arabia gears towards economic advancement and openness, in line with its vision 2030, there is a need to have a suitable business environment that is favorable for commercial companies to thrive and create more job opportunities for the population. One way to achieve this, is by ensuring that there is a proper legal framework that allows for the conversion of commercial companies from one form to another, which suits the country's economic ambitions. This thus enables commercial companies to convert into legal structures that can adapt in the changing environment and ensure that they contribute greatly to Saudi Arabia's economy. Commercial companies that may have initially been operating via forms that rendered them ineffective, can convert into forms that allow them to operate efficiently and ensure that they have a strong and competitive position in the market while not necessarily changing their legal structures. This research paper thus examines and critically analyzes the legal framework in Saudi Arabia that governs the conversion of commercial companies as enshrined under the Saudi Arabia Company Law. This research paper aims to establish that a suitable legal system for the conversion of commercial companies in Saudi Arabia is crucial for the economic growth of the country.

Keywords: Saudi Arabia, Vision 2030, Company Law, Openness, Conversion, Transformation

1. Introduction

The Kingdom of Saudi Arabia has embarked on a quest to promote economic growth through ensuring that the business environment is stable and favorable for both local and foreign investors seeking to invest into the country. In particular, with Saudi Arabia's vision 2030, the country seeks to diversify the economy and ensure that there are economic and financial reforms that will usher in the new era. [1] As Amirat and Zaidi assert that Saudi Arabia seeks to diversify its economy from an oil dominated economy to a knowledge based economy that caters for all aspects such as technology, education, innovation and wealth creation, all to boost economic growth. [2] This means that by 2030, Saudi Arabia aims to have a diversified economy that incorporates all the other essential aspects of economic growth apart from oil.

One way it seeks to achieve this, is by creating a suitable environment through its regulatory framework that promotes economic growth by allowing local and international companies to thrive in the environment. Of particular interest to this paper is the legal framework that allows commercial companies to convert into business structures that enables them to thrive in the market as strong and competitive companies. Commercial companies are an essential aspect of Saudi Arabia's quest for economic growth, as Hassan and others note that with Saudi Arabia's vision 2030 and market liberalization, companies are an essential vehicle to this economic development. They thus state that there is a need for proper corporate ownership structures that enables the companies to thrive into the market. [3]

Therefore, for Saudi Arabia's economy to benefit from the commercial companies, it must provide an environment that allows them to convert into business forms that allows them to operate at their best and contribute to the economic growth of Saudi Arabia.

2. Research Methodology

This research paper in advancing the main concern which is on the "The legal system for the conversion of commercial companies in the light of the rules of the Saudi corporate system- a comparative legal study", relies on a scientific research methodology that seeks to examine the relevant provisions of the Saudi Law on the conversion of commercial companies. This shall involve a keen analysis of the provisions and their weaknesses in light of the role of company conversions in the economic growth and development of Saudi Arabia's economy.

A comparative analysis approach shall also be taken to compare and contrast the conversion of companies in other jurisdictions such as in Jordan, Egypt, Kuwait and the United Arab Emirates (UAE). This research study also utilizes an applied model for the conversion of commercial companies. The findings of the research study shall be included.

2.1. The Concept of Commercial Companies Conversions

As has been established, the conversion of companies to be at their best legal forms, allows them to contribute greatly to the economy as they will be operating in at their best and this will enable them thrive in the market. The conversion of a company connotes the alteration of the company's legal form and structures from for example a limited liability to a partnership company or from a private company to a public company and vice versa.[4] A good illustration is as articulated by Ibrahim who states that company conversion may occur where for instance, in a partnership arrangement, partners are constantly facing disputes, this may lead to the liquidation or termination of the company, however, instead of liquidating or terminating the company, the partners decide to instead convert it into another form of business that will still generate money and limit their liability.[5] Conversion thus allows the company to settle for the best legal structure that suits its operation and fits into the market and environment that is located.

2.2. Company Conversions under Saudi Arabia Companies Law: The Strengths and Weaknesses of the Saudi Arabia Law

The issue of company conversion is not novel in Saudi Arabia, and it is enshrined under its company law. Article 187 of the Saudi Company Law 2015 allows companies to transform into other forms in line with stipulations laid down for amendment of the company's articles of association or articles of incorporation. Further, that such a transformation meets the requirements laid down for incorporation, publication and registration in the commercial register of the form of business structure it has been transformed to.[6] In the context of Saudi Arabia's economic growth and development, article 187 is instrumental in allowing companies to transform themselves into business forms that will steer them into companies that are competitive and may withstand the economic reforms that the country seeks to carry out.

If partners or shareholders object the transformation, then they may request the disassociation from the company.[7] This means that is the company has decided to transform into a new business structure, then if the partners or shareholders are opposed to this decision to transform, then they may choose to end their relations with the company. When the transformation is meant for the good of the company, then article 187 (2) protects the transformation decision over the interests of those partners and shareholders objecting to such a decision. In light of the vision 2030, company transformations will be imminent due to the changing market dynamics in Saudi Arabia that might mandate businesses to convert to structures that will reflect of the new diversified economy.

Nonetheless, this provision may be considered as ignorant of the rights of the partners and shareholders. Partners and shareholders are crucial in any company and thus while the company might want to be converted, it would not be ideal to dismiss any partner or shareholder objections and call for their disassociation with the company [8]. Thus the provision fails to protect the minority shareholders and partners who form a crucial element in corporate governance, as Abdulaziz argues that the Saudi Companies Law fails to protect the minority shareholders and partners in a joint stake company during such transformation.[9, 10]

Article 187 (3) also provides that where partners who hold more than half of the capital or if the articles of incorporation require a lesser percentage, request that the company be transformed into a joint stock company, the company shall transform as requested, without prejudice to the rules of incorporation of such a company.[11] This thus allows partners with a majority holding of the capital, to request for transformation of the company into a joint stock company which would be owned jointly by shareholders and in Saudi Arabia, it would be subject to numerous regulations.[3]

Article 188 of the Companies law enshrines that even where the transformation has taken place, it will not result in the formation of a new legal person. The company still retains its initial rights and obligations before the transformation.[12] Thus even where a company has been transformed into a new form, it will not mean that the company is a new legal person, under this article the company still retains its initial rights and obligations. This is a suitable provision for those companies seeking to convert into new business forms but to retain its legal structure, rights and obligations in a manner that allows the company to keep up with the economic development and diversification that Saudi Arabia seeks to achieve by 2030 and further allows it to retain its legal structure.

However the provision might derail any objective transformations, it is argued that the purpose of the conversion is to move into a new business form that is different from the former and that will enable the company to move into a more suitable business form. This provision mandates that the new form shall still have elements of the initial business form and shall not be a new legal person.

Article 189 of the Companies law provides that even where a limited liability company or unlimited liability company has transformed, the partners will not be relieved from their liability with regard to the company's debts that existed prior to the transformation. This is subject to the exception that the creditors agree to the relief or if there is no objection from the directors within 30 days.[13] This means that where the company has been converted, the partners will still be liable for the company's debts that existed initially, this provision thus ensures that the transformation will not be a means that excuses the partners from liability for company debts.

Therefore the aforementioned provisions form the main legal framework for the conversion or transformation of companies in Saudi Arabia, and in light of Saudi Arabia's quest for economic openness and liberalization, conversion of companies will go the long way in ensuring economic growth and development. As has been stated, conversion allows companies to convert to the business form that fits their operations, this will provide an opportunity for the companies to opt for business forms that will align with Saudi Arabia's vision 2030.

2.3. Comparative Analysis

Other countries such as Egypt and Jordan have a legal framework that provides for conversion and it would be prudent to see how it compares with that of Saudi Arabia, and whether their approach can be incorporated into the Saudi Arabia framework to address some of the issues raised such as the neglect of minority shareholders and partners during conversions.

2.3.1. Egypt

In Egypt, the conversion of companies is governed by Law No.159/198 on Joint Stock Companies, Partnerships Limited By Shares & Limited liability Companies which was amended in 2018. Under article 136, a company of limited liability may change form on the decision of the general assembly or group of partners, with a majority of three quarters of the capital.[14] However something unique in the Egyptian law on conversions different from the Saudi Arabia law, is that the once the company has changed form, the partners in them will not pay taxes and other duties associated with the change.[15]

Under the Saudi Arabia regime, the change of form does not relieve the partners of their initial duties or liabilities and thus this is an element that differs. This paper sides with the Egyptian law and states that for some duties and liabilities, the change of form ought to negate them, however creditors should be protected as both laws have expressly provided for their protection.

2.3.2. Jordan

Companies' conversions in Jordan are governed by the Companies Law (Law No. 22 of 1997), which under article 215 provides that general partnerships may be transformed to limited partnerships and vice versa.[16] This is subject to the approval of all partners and in line with all the necessary laws. Thus unlike the Saudi Law, this provision

 ISSN 2776-8007

requires all partners to agree to the transformation and this might be a good provision as it will protect even the minority partners incase they object to the transformation. Article 221 is similar to the Saudi Arabia law as it provides that the transformation shall not result into a new entity and shall retain its initial corporate entity.[17]

2.3.3. United Arab Emirates

In UAE, company conversions are governed by the Commercial Companies Law (Federal Law No. (2) of 2015), which under article 273 provides that companies may transform into different forms and retain their initial corporate entity.[18] Article 274 provides that a public joint stock company may be transformed into a private joint stock company where a special resolution by the General Assembly has approved the transformation and that further, the special resolution must be passed by 90% of the shareholders (majority) and for transformation of partnerships to joint stock company or vice versa, there must be a unanimous agreement by the partners on the transformation.[19]

Therefore unlike the Saudi Law on conversions, the UAE law needs a majority agreement by partners and a majority vote by shareholders for joint stock companies, while the Saudi Law requires those holding more than half of the capital to agree to the conversion. Thus under the UAE law, the threshold for transformations is higher and for any company to be converted, they will have to rally a majority of the shareholders or partners.

2.3.4. Kuwait

In Kuwait, companies may transform to another form under article 250 of the Companies Law (Law No. (1) of 2016) which provides that companies may change form to another form, provided that at least two financial years have passed since the company's Registration in the commercial register.[20] Article 251 mandates that a partner who objects to the transformation may withdraw from the company and redeem the value of his membership interests or shares upon a request submitted to the company within sixty days of the date of Registration.[21] Article 254 provides that for shareholding companies that want to transform and have borrowed by issuing bonds, the approval for the transformation shall require two-third majority of the represented bonds.[22]

Thus unlike the Saudi Law, the Kuwait law introduces two new things, one is the period before a company may seek to transform, should be at least two years and the approval by two-third majority bondholders.

3. Conclusion

Thus this research study has established that company transformation or conversion is an essential element in Saudi Arabia's economic growth. Nonetheless, the law in place that governs transformations in Saudi Arabia, has some issues such as the lack of protection from minority shareholders. Through a comparative analysis, this paper has established that Egypt's law on transformations protects partners and shareholders even after transformation form liabilities such as tax and certain obligations.

Further, in UAE, the threshold for transformations is higher in a manner that before the transformation is approved, 90% of the shareholders or partners must agree to it, this means that before the change, all the parties must be involved as compared to the 50% requirement by Saudi Law. Therefore Saudi Law must be able to protect the minority shareholders and partners so that the transformation may not be detrimental to them, nonetheless, apart from that, conversations are essential for Saudi Arabia's economic growth in line with vision 2030. Conversions allow the companies to fit into Saudi Arabia's economic ambitions.

References

[1] Q. Aini, "Classification of Tweets Causing Deadlocks in Jakarta Streets with the Help of Algorithm C4.5," J. Appl. Data Sci., vol. 2, no. 4, pp. 143–156, 2021, doi: 10.47738/jads.v2i4.43.

[2] H. Hitoshi, "The Effectiveness of The Body of Knowledge Process in The Startup Analysis of Efficiency by Applying Startup Management Body of Knowledge (SUBOK) Guide," Int. J. Appl. Inf. Manag., vol. 1, no. 2, pp. 28–49, 2021, doi: 10.47738/ijaim.v1i2.11.

[3] T. Hariguna, H. T. Sukmana, and J. Il Kim, "Survey Opinion using Sentiment Analysis," J. Appl. Data Sci., vol. 1, no. 1, pp. 35–40, 2020, doi: 10.47738/jads.v1i1.10.

[4] A. M. Adiandari, "Financial Performance Innovation Since Digital Technology Entered Indonesian MSMEs," Int. J. Appl. Inf. Manag., vol. 2, no. 1, pp. 50–58, 2022.

[5] T. Astuti and B. Puspita, "Analysis of Customer Transaction Data Associations Based on The Apriori Algorithm," IJIIS Int. J. Informatics Inf. Syst., vol. 3, no. 1, pp. 23–28, 2020, doi: 10.47738/ijiis.v3i1.4.

[6] W. Paireekreng, J. Osathanukroh, and C. Supasak, "A Study of Influence Factors for Advertising on Messaging Applications Towards Mobile Buyer ' s Decision Making," IJIIS Int. J. Informatics Inf. Syst., vol. 2, no. 2, pp. 82–90, 2019.

[7] H. Mukhtar, W. Andi, N. Nuryanto, and R. A. Hafidz, Fahrizal Rahman, Mohammad, "Implementation of Knowledge Management in Different Industries," IJIIS Int. J. Informatics Inf. Syst., vol. 4, no. 2, pp. 103–111, 2021.

[8] G. Thelen, "Leadership in a Global World Management Training Requirement Using The Example of The Asian Studies Program at University of Applied Sciences (HTWG) Konstanz," Int. J. Appl. Inf. Manag., vol. 1, no. 3, pp. 125–135, 2021, doi: 10.47738/ijaim.v1i3.14.

[9] N. Tomura, "Construction of The E-Government Case Study of Japan and Estonia," Int. J. Appl. Inf. Manag., vol. 1, no. 3, pp. 145–151, 2021, doi: 10.47738/ijaim.v1i3.16.

[10] S. Al-Fatih and Z. F. Aditya, "Hoax and the principle of legal certainty in Indonesian legal system," 2019.

[11] J. McGrath and A. P. Morriss, "Online legal education & access to legal education & the legal system," Syracuse L. Rev., vol. 70, p. 49, 2020.

[12] V. M. Southerland, "The intersection of race and algorithmic tools in the criminal legal system," Md. L. Rev., vol. 80, p. 487, 2020.

[13] [A. Kornya, D. Rodarmel, B. Highsmith, M. Gonzalez, and T. Mermin, "Crimsumerism: combating consumer abuses in the criminal legal system," Harv. CR-CLL Rev., vol. 54, p. 107, 2019.

[14] D. E. Ufua, O. J. Olujobi, M. E. Ogbari, J. A. Dada, and O. D. Edafe, "Operations of small and medium enterprises and the legal system in Nigeria," Humanit. Soc. Sci. Commun., vol. 7, no. 1, pp. 1–7, 2020.

[15] W. Wagner and W. Walker, Incomprehensible!: a study of how our legal system encourages incomprehensibility, why it matters, and what we can do about it. Cambridge University Press, 2019.

[16] E. F. Loftus, "Eyewitness science and the legal system," Annu. Rev. Law Soc. Sci., vol. 14, no. 1, pp. 1–10, 2018.

[17] V. M. Pinheiro, M. Ilarraz, and M. T. Mestriner, "The impacts of the COVID-19 crisis on the Brazilian legal system–a report on the functioning of the branches of the government and on the legal scrutiny of their activities," Theory Pract. Legis., vol. 8, no. 1–2, pp. 193–212, 2020.

[18] I. I. Doron, A. Numhauser-Henning, B. Spanier, N. Georgantzi, and E. Mantovani, "Ageism and anti-ageism in the legal system: A review of key themes," Contemp. Perspect. ageism, pp. 303–319, 2018.

[19] F. Alfazzi, "A Knowledge Behavioral and Intelligence Management in Fostering Entrepreneurship for Modern Industries," Int. J. Appl. Inf. Manag., vol. 2, no. 4, pp. 95–105, 2022.

[20] C. d P. Duarte, L. Salas-Hernández, and J. S. Griffin, "Policy determinants of inequitable exposure to the criminal legal system and their health consequences among young people," Am. J. Public Health, vol. 110, no. S1, pp. S43–S49, 2020.

ISSN 2776-8007

[21] V. Lima and M. Gomez, “Access to Justice: Promoting the Legal System as a Human Right,” in Peace, Justice and Strong Institutions, Springer, 2019, pp. 1–10.

[22] K. Lorenz, A. Kirkner, and S. E. Ullman, “A qualitative study of sexual assault survivors’ post-assault legal system experiences,” J. trauma dissociation, vol. 20, no. 3, pp. 263–287, 2019.

[23] C. A. Golembeski et al., “Improving health equity for women involved in the criminal legal system,” Women’s Heal. Issues, vol. 30, no. 5, pp. 313–319, 2020.

[24] M. B. Kashyap, “Unsettling immigration laws: Settler colonialism and the US immigration legal system,” Fordham Urb. LJ, vol. 46, p. 548, 2019.