

META Monthly: Renewables Update - July 2019

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PROTECTING YOUR INVESTMENTS IN SAUDI ARABIA

The July 2019 issue of Meta Monthly provides a short overview on: (i) structuring foreign investment to ensure compliance with foreign investment rules in Saudi Arabia, (ii) protecting the investment through the insertion of dispute resolution clauses, and (iii) the use of bilateral or multilateral investment treaties to protect the investment.

In its Vision 2030 plan, the Kingdom of Saudi Arabia laid out an impressive plan to diversify its economy, which, currently, is largely dependent on oil revenues. By implementing the Saudi Vision 2030, the Kingdom is seeking to transform its economy by investing in its infrastructure, manufacturing base, housing initiatives, public transport, tourism, and its relatively emerging service and technology sectors. However, in order to make its economic reforms sustainable, Vision 2030 anticipates and welcomes greater foreign direct investment in the Kingdom, which will grow the role of private sector in the Saudi economy.

Ensuring Compliance with Saudi Rules on Foreign Investment

A foreign investor in Saudi Arabia must obtain a Foreign Investment License from the Saudi Arabian General Investment Authority (known as SAGIA) before commencing business in Saudi Arabia. SAGIA has recently relaxed its requirements to obtain a Foreign Investment License. The requirements relate to the applicant's minimum capital, past experience, and creditworthiness. SAGIA maintains a negative list, which sets out areas of activity that are excluded from foreign investment. Further approvals and authorisations may also be needed from various government bodies before establishing a corporate entity.

It is common for foreign investors to create a joint venture entity, in which they have an ownership stake and oversee management of the company. This entity typically takes the form of a Limited Liability Company (LLC) or a Joint Stock Company (JSC).

Pursuant to the Saudi Company Regulations that are in force as of 2 May 2016 (as amended), an LLC may have a minimum of one, and maximum of 50 shareholders. LLC's may not offer its shares for public subscription. In addition, although there is no statutory minimum capital requirement, companies operating in certain sectors are subject to

minimum capital requirements imposed by SAGIA. The liability of each shareholder of an LLC is limited to their capital contributions. Article 181 of the Saudi Companies Law provides that if an LLC incurs losses amounting to 50 percent or more of its share capital, the directors must either convene a shareholders' meeting within 90 days of acquiring knowledge of the losses, during which the shareholders will resolve to continue the company on the basis that they will be responsible for its debts or liquidate the company, otherwise, if they fail to meet or resolve anything, the company will be automatically dissolved.

JSC's, on the other hand, are subject to greater regulation and compliance requirements under Saudi company law. There are two types of JSCs: (i) "closed" JSCs, which are unlisted JSCs, and (ii) "public" JSCs whose shares can be sold to the investing public. All companies listed on the Saudi Stock Exchange are "public" JSCs and are subject to a higher degree of oversight, including by the Capital Market Authority. Saudi Arabia has recently relaxed the limit for foreign investors in shares of listed companies to 49 percent. Further, certain types of investments involving banking and finance must be carried out through a JSC. Unless SAGIA regulations provide otherwise, typically a JSC has a minimum capital requirement of SR 500,000 (which is equal to about USD 130,000). Further, a JSC must have a minimum of two shareholders. Importantly, to raise capital, JSC's may issue sukuks (i.e. Islamic bonds) and other debt instruments, which may be converted into negotiable shares. In addition, JSC's are permitted to buy-back or mortgage their shares.

It is important to note that under Saudi law, both LLC's and JSC's are permitted to be holding companies, provided none of their subsidiaries hold shares in the holding company. It is also important to note that in a shareholders' agreement for a Saudi LLC or JSC, clauses providing for options and rights of first refusal (and generally, clauses involving specific performance) are not enforceable in Saudi Arabia. Therefore, in a deadlock situation, it is important to include an option allowing liquidation of the joint venture company itself as a final resort. Alternatively, the investment can be structured through an offshore vehicle which holds 100 percent of the shares in the Saudi LLC or JSC, and which is located in a jurisdiction where such clauses are fully enforceable.

Dispute Resolution Issues for Foreign Investors

In the context of cross-border investment, joint venture and M&A activity in Saudi Arabia, it is important to plan for the eventuality of a dispute. Where the dispute involves a contractual counter-party (such as a commercial counter-party or a fellow shareholder) the contract should specify the method for the resolution of any disputes both in terms of the forum for resolving the dispute as well as the procedures to be followed.

In terms of the forum, foreign investors are well-advised to choose arbitration under the auspices of an established arbitral institution (e.g., the ICC, the LCIA, SIAC, etc.) in an offshore jurisdiction outside Saudi Arabia with a well-developed international arbitration law. This will ensure that the dispute is heard in a neutral forum with minimal risk of local court interference in the arbitral process. This will also allow the parties to tailor the arbitration procedures to suit their needs, for example by specifying the language of the arbitration, the number of arbitrators, the availability of emergency arbitrator procedures, and the like. Such awards in principle will be enforceable pursuant to an international treaty known as the New York Convention on Recognition and Enforcement of Arbitral Awards. Saudi law Royal Decree No. M/53 of 30 August 2012 concerning the Execution Law (in force since 27 February 2013) requires the Saudi courts to follow the procedures of the New York Convention for the recognition and enforcement of arbitral awards rendered outside the Kingdom.

That being said, where the counter-party is Saudi and its assets are located primarily or entirely in the Kingdom, there remains a risk that litigation and enforcement of an award in Saudi Arabia may prove complicated and protracted. As such, foreign investors are advised where possible to provide for some type of security (such as a security agreement, pledge agreement, etc.) to secure the performance of the counter-party's obligations. Such security instruments can be subjected to a foreign law and can provide for the collateral to be located in an offshore jurisdiction where enforcement may be more readily obtained.

Investor Protection Through Investment Treaties

Foreign investors in Saudi Arabia should also be aware of their potential rights under bilateral investment treaties or multilateral investment treaties, to which the Kingdom of Saudi Arabia is a party (e.g., the UK-Saudi BIT, the Arab League Investment Agreement or the EC-GCC Cooperation Agreement, etc.). These treaties give qualifying foreign investors a right to claim compensation against the host State when the State interferes with the investment in a manner that breaches the treaty, for example by taking State action which amounts to expropriation of the investment, or if it treats the investment in an arbitrary or discriminatory manner or in a manner that frustrates the investor’s reasonable investment-backed expectations. Such claims typically arise in the context of an investment that depends on rights, which have granted by the State itself (such as a mining concession, production sharing agreement, or a license), but have also been triggered through State regulation having a discriminatory or disproportionate impact on foreign investors. The forum for such claims is provided for in the relevant treaty and may include international arbitration under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID) in Washington, D.C. or the United Nations Commission on International Trade Law (UNCITRAL).

Conclusion

The Saudi government’s Vision 2030 is rapidly changing the nature of the Saudi economy and with greater FDI flows into Saudi Arabia. Foreign investors are wise to take steps to protect their investments at the outset, including by optimal structuring of the investments, ensuring a robust and effective dispute resolution mechanism, and being aware of foreign investor protections that may exist under international treaties to which the Kingdom of Saudi Arabia is a party.

For more information on structuring and protecting investments in the Kingdom of Saudi Arabia, please contact one of the attorneys listed below, or your usual Winston & Strawn contact. Content for this article was contributed by *Rudolf Goldschmidt*, partner at Hourani & Associates.

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