GLOBAL LEGAL INSIGHTS

Mergers & Acquisitions

2022

11th Edition

Contributing Editors: **Scott C. Hopkins and Lorenzo Corte**

glg global legal group

CONTENTS

Saudi Arabia

Abdulrahman Hammad & Samy Elsheikh
Hammad & Al-Mehdar Law Firm

Overview

The formation and operation of legal entities in Saudi Arabia is regulated, for the most part, by the Companies Law (*issued by Royal Decree No. M/3 dated 28/01/1437 H. (corresponding to 11/11/2015G)*). The main corporate entities commonly involved in acquisitions in Saudi Arabia are limited liability companies (LLCs) and joint-stock companies (JSCs). Holding companies, which are LLCs or JSCs created to control other LLCs or JSCs by owning more than 50% of their capital or controlling the formation of their boards of directors, are also often involved in acquisitions.

Foreign investment in Saudi Arabia is regulated by the Ministry of Investment of Saudi Arabia (MISA) or the Economic Cities Authority and is subject to the Foreign Investment Law (*issued by Royal Decree No. M/1 dated 05/01/1421 H. (corresponding to 10/04/2000G)*). Pursuant to a published negative list, certain economic activities are not permitted for foreign investment or ownership. However, in line with the government's Saudi Vision 2030 to diversify the economy and boost the private sector, most sectors are open to foreign investment, provided the foreign acquirer obtains a foreign investment licence. The MISA has an instant licence regime and investors can apply online for an immediate licence if they meet the requirements.

Where a transaction in or connected to Saudi Arabia results in economic concentration, the transaction is subject to the Competition Law (*issued by Royal Decree No. M/75 dated 29/6/1440 H. (corresponding to 06/03/2019G)*). Any entity that is contemplating a transaction that may lead to an economic concentration must notify the General Authority for Competition (GAC), an independent authority in charge of supervising the implementation of the Competition Law, at least 90 days prior to its consummation, where the aggregate annual turnover connected to Saudi Arabia of either transacting party exceeds SAR 100 million during the last complete fiscal year (Implementing Regulation, Article 12). To promote fair competition and prevent monopolistic practices that affect lawful competition, the GAC monitors the market to ensure the application of the Competition Law and its Implementing Regulation.

The most common ways to acquire a private business in Saudi Arabia are (i) share acquisition, and (ii) asset acquisition. The former is more common than the latter. Share acquisitions are considered more efficient than asset acquisitions due to several reasons, including but not limited to: (1) the continuity of the company's business operations in terms of existing supply and sale contracts; (2) the avoidance of time-consuming and costly processes of transferring employee sponsorships to the acquiring entity; (3) the avoidance of the time-consuming process of obtaining activity licences, permits, and vendor qualifications, which can take several months; and (4) a lower chance of VAT assessment of the transfer transaction.

Significant deals and highlights

Despite falling eight spots from 24th to 32nd place in the most competitive economy, in the *World Competitiveness Yearbook 2021* (published by the International Institute for Management Development (IMD)), the IMD World Competitiveness Center highlighted that the Kingdom is continuing to review its laws and regulations thoroughly to enable sectors such as e-commerce and tourism, and is (1) focusing on renewable energy, (2) developing and managing talents through labour and education, and (3) making efforts to facilitate small and medium-sized enterprises' (SMEs) access to funding in order to help enable youth and entrepreneurs to market their ideas and turn them into products and services.

In 2021, Saudi Arabia topped the chart of the MENA region in deals with a value of USD 47.4 billion out of a total of USD 99 billion.[1]

The major two deals the Kingdom witnessed were (1) the largest equity offering of Saudi Telecom's rights issuance of USD 3.2 billion after the public investment fund sold 6% of its stake,[2] and (2) the Saudi Aramco USD 15.5 billion lease and leaseback deal for its gas pipeline network with a group of companies led by BlackRock Real Assets and state-backed Hassana Investment Company.[3]

The MENA region in general faced an overall increase in value to reach USD 99 billion. Venture Capital (VC) deals in 2021 grew by 270% as the KSA VC ecosystem, as a startup, accumulated USD 548 million in funding across 139 transactions. The Kingdom also witnessed its first VC mega-deal with Unifonic, a Saudi company, raising USD 125 million.[4]

Key developments

<u>Foreign investment</u>

In recent years, the Kingdom has taken a number of steps to boost its attractiveness to foreign investors, and these continue to impact M&A activities. The recent promotion of the role of the Saudi Arabian General Investment Authority (SAGIA) to that of the MISA, signalled the increased importance that foreign investment will play in the Kingdom. The promotion has been well received by foreign investors and sovereign wealth funds.

This move follows an earlier decision in late 2017 to accept applications from foreign investors for 100% foreign ownership of trading activities in the Kingdom. While foreign investment was permitted in most services and industrial sectors up to 100%, the foreign ownership of businesses in trading sectors, which cover import and export of goods, distribution, and retail, was limited to 75%. In its continued drive towards economic diversification, Saudi Arabia removed such limitation.

In 2021, Saudi Arabia launched a number of initiatives to support private sector establishments and entrepreneurs, such as (1) deducting 80% of fines imposed as a result of violations noted during the authorities' inspections, and (2) extending the period of settling all fines.

Saudi Arabia has been in the process of launching special economic zones (SEZs) to attract multinational companies and offering certain fiscal and other incentives to different sectors for multinationals focusing on Saudi Arabia. Examples of launched and planned SEZs include NEOM, SPARK, and SEZ Taxonomy. Additionally, there are four economic cities currently under development and two planned for a later date. The four under development are (1) King Abdullah Economic City (KAEC) in Rabigh, (2) Prince Abdulaziz bin Musaid Economic City (PABMEC) in Hael, (3) Knowledge Economic City (KEC) in Madinah, and (4) Jazan Economic City (JEC) in the Jizan Province of the Kingdom of Saudi Arabia. The two SEZs planned for the future are Tabuk Economic City (TEC) and Eastern Province

Economic City (EPEC). One of the established SEZs is the Special Integrated Logistics Zone (ILBZ), which will rely mainly on the special tax rules provided by the General Authority of Civil Aviation (GACA) to grant ILBZ established companies: (i) a 50-year tax holiday, including VAT suspension; (ii) zero-rated corporate, income and withholding tax on certain payments; (iii) 100% foreign ownership; (iv) 100% suspension of customs and import restrictions; and (v) no restrictions on capital repatriation.[5] As ILBZ will be governed by GACA, it is aiming to be a home for companies in the shipping and logistics sector and will offer facilities to assist in cargo handling and provide government-sponsored training programmes in advanced cargo-tracking technology.

<u>Legislative and regulatory changes</u>

The Kingdom has taken several steps to strengthen its regulatory framework relating to investments in its effort to attract investors, with a view to demonstrate to financiers that their investment will be protected, and that the Kingdom's regulations are increasingly aligned with international best practices. We set out below the principal legislative and regulatory changes that took place over the past year.

Insolvency Law

The government has enacted Implementing Regulations to detail the implementation of the 2018 Insolvency Law, which focus on preserving enterprise value through the effective redeployment of capital. The law's objective is to provide a comprehensive approach to insolvency and to preserve enterprise value wherever possible. The new law differentiates between bankruptcy and insolvency, a major boon for investors who were wary about investing in a system traditionally hostile to debt and insolvency.

Recent decisions by the courts have not, however, been entirely convincing. One example of the Insolvency Law working in practice is in the case of the Saad Group and its founder Maan Al-Sanea, who are working with the commercial court to settle claims with bank creditors under the insolvency regime; in contrast to this, the commercial court in Dammam rejected two applications from conglomerate Ahmad Hamad Al-Gosaibi and Brothers (AHAB) to settle USD 22 billion in combined debt. Without this relief, AHAB have been forced to consider restructuring through other jurisdictions.

Competition Law

The Saudi Council of Ministers passed a new Competition Law in March 2019 to encourage new entrants to the market as well as overseas competitors. Through this legislation, the Council indicated willingness to support SMEs and focus on offering the Saudi consumer higher quality at fairer prices. The Competition Law strictly prohibits economic concentration, defined as "any act resulting in the whole or partial transfer of the title to the assets, rights, liabilities, shares or stocks of an entity to another, or the merger of two or more departments in one joint department", and bars any business with a dominant position from abusing its strong position to affect or restrict access to the market. Businesses are prohibited from colluding, whether explicitly or implicitly, to restrict fair competition in the market. A new specialised committee for the settlement of disputes has been established to hear cases against businesses that violate the law.

ILBZ legal framework

ILBZ entities will be managed by the Companies Regulation issued by GACA for ILBZ (*promulgated by Royal Order No.(A/7) dated 01/02/1440H*) and will have the Saudi nationality. Entities established in ILBZ will be subject to a separate employment regulation, the ILBZ Employment Regulations, which came into effect in January 2021, granting, amongst other provisions, more flexibility between employees and employers in terms of maternity leave, termination, and salary payments.

In November 2021, the local authorities announced that economic cities and free zone authorities will have independent budgets to give them more freedom to develop and attract more foreign investments.

Transparency measures

Finally, the government introduced a number of measures to boost transparency in both government and private-sector spending. In February 2019, a new Financial Reporting Office was launched within the General Auditing Bureau to fight corruption, imbued with the power (and supported by the Public Prosecutor) to monitor state and private-sector spending. The *Wathiqa* electronic platform was also launched as a transparent exchange of information and documentation between various governmental bodies, and offers free audit services for dozens of government agencies.

In October 2021, the Saudi Arabia General Ports Authority (Mawani) announced the signature of an agreement with Maersk Saudi Arabia to establish the largest integrated logistical area at Jeddah Islamic Port, aiming to boost Saudi non-oil export by 50%, which is in line with the Kingdom's economic diversification agenda guided by its Vision 2030.[6]

In December 2021, Saudi's attorney general issued a decision to establish units that will specialise in investigating financial fraud with the aim of countering financial crimes. The units will be formed of specialists in the field, including public prosecution members.[7]

Although there is still some way to go, efforts are clearly being made to create a more transparent rules-based environment, an approach that has been welcomed by investors.

Consultation on draft regulation to the Saudi Personal Data Protection Law

In September 2021, Saudi Arabia issued its first national data protection law to regulate the collection and processing of personal information; a significant step in line with Vision 2030, the new law is similar to the European Union's GDPR and applies to all data subjects who are domiciled in the Kingdom. Furthermore, the new law applies to the processing of personal data of Saudi residents by entities located outside of the Kingdom.

The new law touches on some important areas such as: (1) the knowledge of the collection of personal data; (2) the right to access personal data; (3) the right to amend or delete personal data; and (4) consent prior to processing. Additionally, violation of the new law in relation to the disclosure or processing of sensitive data may result in three years' imprisonment and a fine of up to SAR 3 million. In general, files of violations of the law vary between SAR 1 million and SAR 5 million.

On 10th March 2022, the Saudi Data and Artificial Intelligence Authority released a draft of the Implementing Regulation of the Personal Data Protection Law for public consultation, which ended on 25th March 2022.

Update on the real estate laws and transaction platform

In 2021, the Saudi government issued its comprehensive strategy for the real estate sector to allow non-Saudis' ownership of real estate, aiming to attract foreign capital.[8]

Non-Saudi individuals can now own real estate property in the Kingdom, subject to having a valid residency. There is a limit of one property that can be owned by individuals (this does not apply in Mecca and Medina). On 12th March 2022, the Tax and Customs Authority announced the update of the real estate platform to provide various services related to registration, applicable tax, and assisting in the ownership process.

Industry sector focus

Saudi Arabia continues to showcase strong efforts to diversify the economy away from its heavy dependence on oil and gas and towards investment in sectors with greater long-term economic sustainability. Buyers have followed suit, moving away from traditional government-backed sectors, such as oil and gas, construction, and infrastructure, and are instead focusing their investments in the industrial and e-commerce sectors, resulting in a growth of 492% in the number of closed transactions and a growth of 270% in funding in Saudi-based startups compared with 2020.

Additionally, the last 12 months continued to record ground-breaking levels of M&A activity in VC; Saudi Arabia overtook Egypt to rank second by amount of funding in MENA in 2021 and the number of investors in Saudi-based startups increased by 52%, hitting a record-high of 76 in 2021. This increase is largely a result of the government's diversification plans, but can also be attributed to the increased levels of family planning as high-net-worth individuals in the Kingdom share business decision-making with the next generation of investors. The government's implementation of a number of initiatives to support the startup ecosystem in 2021 resulted in positive numbers relating to the amount of deals and funding in the sector, as well as an increase in number of VC firms in the region.

The year ahead

The pandemic's impact is still affecting M&A activities and is expected to last through 2022. However, the Saudi market showed more resilience and already started to mature in new sectors such as VC Capital, by attracting global investors and increasing the number of VC firms locally. It is expected that the region in general will witness more M&A deals to streamline costs.

The year 2022 is expected to bring further developments and adoption of new laws and regulations that will aim to boost the Saudi business environment and empower and attract talent. The most notable of such developments is the enactment of a new Companies Law, which is expected to create new forms of legal entities – notably the simple JSC – simplify a number of administrative legal requirements enforced by the current law, and include within the law rules relating to professional companies, which are currently regulated by the separate Professional Companies Law. The new law is expected to have significant positive impact on M&A.

Industry watchers sense Saudi's Vision 2030 may operate as a long-term economic catalyst to spur deals from companies looking to achieve operational synergy through economies of scale, especially considering pre-COVID-19 shrinking margins and increasing operational costs witnessed across a number of sectors. We believe that a rise in M&A activity from strategic investors seeking to benefit and take advantage of depressed valuations during 2022 will be likely.

* * *

Endnotes

1. https://www.zawya.com/en/markets/menas-mamp-a-deals-hit-99bln-in-2021-says-ey-w425e00p.
2. https://www.thenationalnews.com/business/energy/2022/01/21/mergers-and-acquisition-deals-in-mena-jump-57-in-2021/.

3. https://www.thenationalnews.com/business/energy/2021/12/07/saudi-aramco-agrees-155bn-gas-pipeline-deal-with-global-consortium-led-by-blackrock/.
4. Magnitt Saudi Arabia VC report 2021.
5. https://gaca.gov.sa/scs/Satellite?c=GACA_Content_C&cid=1440409719677&locale=en_GB&pagename=GACA%2FGACA_Content_C%2FGACA_ContentDetailInvestm_CT.
6. https://intlbm.com/2021/11/01/mawani-announces-agreement-with-maersk-saudi-arabia-for-logistics-park-at-jeddah-port/.
7. https://www.almadina.com/article/765753/%D9%85%D8%AD%D9%84%D9%8A%D8%A7%D8%AA/%D8%A7%D9%84%D9%86%D9%8A%D8%A7%D8%A8%D8%A9-%D8%A7%D9%84%D8%B9%D8%A7%D9%85%D8%A9-%D8%AA%D9%88%D8%AC%D9%87-%D8%A8%D8%A7%D9%86%D8%B4%D8%A7%D8%A1-%D9%88%D8%AD%D8%AF%D8%A7%D8%AA-%D9%84%D8%AC%D8%B1%D8%A7%D8%A6%D9%85-%D8%A7%D9%84%D8%A7%D8%AD%D8%AA%D9%8A%D8%A7%D9%84-%D8%A7%D9%84%D9%85%D8%A7%D9%84%D9%8A.
8. https://english.aawsat.com/home/article/2918651/regulatory-framework-aims-encourage-foreign-ownership-real-estate-saudi-arabia.

Abdulrahman Hammad
Tel: +966 92 000 4626 / Email: abdulrahman.hammad@hmco.com.sa

Abdulrahman Hammad joined Hammad & Al-Mehdar Law Firm in 2015, and leads the firm's M&A and Projects practice. Mr. Hammad is a member of the New York State Bar. He earned his *Juris Doctor* degree with *magna cum laude* Honours from the University of Miami, USA, concentrating on securities, finance, and business law. Prior to that, Mr. Hammad earned a Bachelor of Science with *cum laude* Honours from Southern Illinois University, majoring in Finance – Investments. Mr. Hammad worked for a major U.S. law firm in New York, concentrating on energy, infrastructure, and project finance work. Mr. Hammad also worked at the Saudi Aramco Law Department, with a practice focusing on project development and M&A.

Samy Elsheikh
Tel: +971 50 157 5726 / Email: samy.elsheikh@hmco.com.sa

Samy Elsheikh joined Hammad & Al-Mehdar Law Firm in 2017. Samy is a qualified Egyptian lawyer. He earned his Master's degree in International Business Law from Paris I Panthéon-Sorbonne University. Prior to that, he earned a Bachelor of Laws from Cairo University and Paris I Panthéon-Sorbonne University. Prior to joining Hammad & Al-Mehdar, Samy worked in international and top-tier law firms in Doha, Qatar and Cairo, Egypt. Samy specialises in M&A and Projects in addition to corporate commercial work.

Hammad & Al-Mehdar Law Firm

King Road Tower, L-12, Office 1209, King Abdulaziz Road, Jeddah, Saudi Arabia
Tel: +966 92 000 4626 / Fax: +966 126 069 190 / URL: www.hmco.com.sa