

**EXIT RIGHTS AND PROTECTING MINORITY SHAREHOLDERS  
IN A SAUDI LIMITED LIABILITY COMPANY: A CASE FOR REFORM**

by

**ABDULLAH AL DOSSARI**

**A dissertation submitted in partial fulfillment of the  
Requirements for the degree of  
Doctor of Juridical Science (S.J.D.)**

**Brett McDonnell (Advisor)  
June 2019**

© 2019  
Abdullah Al Dossari  
All Rights Reserved

## **Acknowledgments**

I first offer thanks to Allah Almighty for the grace and blessings that encouraged and helped me to complete this dissertation. I also extend my sincere thanks and gratitude to my advisor, Professor Brett McDonnell, for his intellectual support and advice. Without his valuable guidance and assistance throughout the project, finishing this research would not have been possible.

## **Dedication**

*This thesis is dedicated, with my intense love and enduring respect, to my father and mother for their constant love and encouragement throughout my journey to pursue a higher education; without their assistance, I would not have completed this degree.*

## **Abstract**

The main purpose of this study is to suggest reforms to Saudi limited liability company (LLC) law that would better protect minority shareholders. The analysis emphasizes the present difficulties a dissatisfied minority LLC shareholder faces when seeking to sell his or her stake in a company. A lack of liquidity in the KSA's market for LLC shares is a major impediment to minority shareholders attempting to exit a business. The paper's research demonstrates that the Saudi Companies Regulation (SCR) inadequately protects LLC minority shareholder rights, leaving them vulnerable to majority oppression. The paper argues that the SCR should be reformed to incorporate more of the minority shareholder protections provided by United States' LLC laws. Specifically, the SCR should adopt two reforms that would be triggered by certain majority shareholder misconduct: (1) a statutory dissolution remedy and (2) mandatory buy-out rights for minority shareholders. The paper argues that these two protections are necessary to address the KSA's illiquid market for LLC shares, as well as the present uncertainty regarding the duties of loyalty and care owed by LLC shareholders and managers.

## Table of Contents

<i>Acknowledgments</i> .....	<i>i</i>
<i>Dedication</i> .....	<i>ii</i>
<i>Abstract</i> .....	<i>iii</i>
<i>Abbreviation List</i> .....	<i>viii</i>
<b><i>Chapter 1: Introduction and Overview of the Study</i></b> .....	<b>1</b>
<b><i>1.1. Background</i></b> .....	<b>1</b>
<b><i>1.2. Reasons for Choosing this Study</i></b> .....	<b>3</b>
<b><i>1.3. Significance of the Study</i></b> .....	<b>3</b>
<b><i>1.4. Research Methodology</i></b> .....	<b>7</b>
<b><i>1.5. Research Questions and Objectives</i></b> .....	<b>7</b>
<b><i>1.6. Research Structure</i></b> .....	<b>8</b>
<b><i>Chapter 2: The Saudi Legal System</i></b> .....	<b>11</b>
<b><i>2.1. Introduction</i></b> .....	<b>11</b>
<b><i>2.2. The Basic Law of Governance 1992</i></b> .....	<b>14</b>
<b><i>2.3. Sources of Law</i></b> .....	<b>15</b>
<b><i>2.4. Interpretive Sources</i></b> .....	<b>17</b>
<b><i>2.5. Authority of the State</i></b> .....	<b>19</b>
<b><i>A. The Executive Branch</i></b> .....	<b>19</b>
<b><i>B. Regulatory (Legislative) Branch</i></b> .....	<b>21</b>
<b><i>C. Judicial Branch</i></b> .....	<b>23</b>
1. The ordinary courts .....	24
2. Administrative Courts .....	30
<b><i>Chapter 3: Introductory Overview to the LLC in Saudi Arabia</i></b> .....	<b>33</b>
<b><i>3.1. Scope</i></b> .....	<b>33</b>
<b><i>3.2. Saudi Companies Regulation</i></b> .....	<b>33</b>
<b><i>A. Introduction</i></b> .....	<b>33</b>
<b><i>B. Enactment of the First Companies Regulation in 1965</i></b> .....	<b>34</b>
<b><i>C. The Issuance of the New Saudi Companies Regulation</i></b> .....	<b>36</b>
<b><i>3.3. Corporate Forms</i></b> .....	<b>36</b>
<b><i>3.4. The Number of Shareholders of LLC</i></b> .....	<b>38</b>

3.5.	<i>Capital and Shares</i> .....	39
3.6.	<i>The Statutory Reserve</i> .....	41
3.7.	<i>Piercing the LLC Veil</i> .....	41
	A. Capital Reduction.....	43
	B. Formation Defects.....	43
	C. Management Error and Violation of Law .....	46
	D. Single-Shareholder LLC.....	46
	E. Valuation of In-Kind Capital Contribution .....	47
	F. Fraudulent Act .....	48
3.8.	<i>Holding Companies</i> .....	49
3.9.	<i>Publication of LLC Articles of Association</i> .....	50
3.10.	<i>Issuing Sukuk and Other Debt Instruments</i> .....	50
3.11.	<i>Management Structure</i> .....	51
	A. The Managers.....	52
	B. The General Assembly .....	53
	C. The Supervisory Board.....	55
	D. <i>The Auditor</i> .....	56
3.12.	<i>Validity of Contracts Generating LLCs</i> .....	56
3.13.	<i>Mandatory or Default Rules</i> .....	58
	<i>Chapter 4: LLCs Transfer of Shares</i> .....	67
4.1.	<i>LLCs Transfer of Shares in General</i> .....	67
	A. Introduction.....	67
	B. Transferable Ownership.....	68
	C. Motivations for Restrictions on Transfers.....	69
4.2	<i>LLC Transfer of Shares in Saudi Arabia</i> .....	72
	A. Restrictions on Transfers (The 1965 SCR vs. The New SCR).....	73
	B. The Statutory Right of First Refusal (ROFR) .....	78
	C. Enforcing the Right of First Refusal .....	87
	D. The Limited Liability Company as Holder of The Right of First Refusal.....	90
	E. Corporate Mergers and Acquisitions Involving LLC Shareholders .....	92
	F. The Problem of Fair Value and <i>Bona Fide Offer</i> .....	97
	G. Alternative Valuation Methods.....	99
4.3	<i>LLC Transfers of Interest in the United States</i> .....	101
	A. Limitations on Transfer .....	101

<b>B.</b>	<b>The Nature of the Right of First Refusal (ROFR)</b> .....	<b>104</b>
<b>C.</b>	<b>Mergers and Acquisitions Involving LLC Members</b> .....	<b>106</b>
<b>D.</b>	<b>The Fair Value and Valuation Methods</b> .....	<b>109</b>
1.	Bona Fide Offer as A Valuation Methodology .....	109
2.	Appraisal Method.....	110
<b>E.</b>	<b>Payment Terms</b> .....	<b>112</b>
<b>4.4</b>	<b><i>Summary and Analysis</i></b> .....	<b>114</b>
<b>A.</b>	<b>The Statutory Provisions</b> .....	<b>114</b>
1.	<b>Should the rules governing the right of first refusal be mandatory or default rules?</b> <b>115</b>	
2.	<b>Is the U.S. approach of distinguishing between the transferability of controlling rights and economic rights an optimal model to apply in KSA?</b> .....	<b>118</b>
<b>B.</b>	<b>The Provisions of LLC Agreements</b> .....	<b>120</b>
	<b><i>Chapter 5: Withdrawal and Buyout Rights</i></b> .....	<b>124</b>
<b>5.1.</b>	<b><i>Introduction</i></b> .....	<b>124</b>
<b>5.2.</b>	<b><i>Why might a shareholder seek to withdraw and receive a capital return? .....</i></b>	<b>125</b>
<b>5.3.</b>	<b><i>The Adverse Impact of Share Withdrawal and Its Costs to Company Creditors</i></b> <b>126</b>	
<b>5.4.</b>	<b><i>The Case of Saudi Arabia</i></b> .....	<b>127</b>
A.	Shareholder’s Voluntary Withdrawal.....	127
B.	Shareholder’s Death .....	134
C.	Determining a Share’s Value .....	136
<b>5.5.</b>	<b><i>Withdrawal Rights in The U.S.</i></b> .....	<b>138</b>
A.	Voluntary Withdrawal.....	138
B.	The Fair Value, Fair Market value, and Minority Discounts.....	144
C.	Member’s Death.....	146
D.	Valuation of Member’s Interest Under the LLC Agreement.....	149
(a)	Formula Approach (Book Value).....	149
(b)	Formula Approach (Multiple of Earnings).....	150
(c)	Fixed Price Approach.....	151
(d)	Appraisal Approach.....	151
(e)	The Menu of Valuation Methods Under Template Buy-Sell Agreements .....	152
E.	Limitations on Distribution and Creditors Protection .....	153
<b>5.6.</b>	<b><i>Summary and Analysis</i></b> .....	<b>155</b>
	<b><i>Chapter 6: Judicial Dissolution</i></b> .....	<b>161</b>
<b>6.1.</b>	<b><i>Introduction</i></b> .....	<b>161</b>
<b>6.2</b>	<b><i>Judicial Dissolution in Saudi Arabia</i></b> .....	<b>162</b>
<b>A.</b>	<b>Majority Oppression and Judicial Dissolution</b> .....	<b>165</b>
<b>B.</b>	<b>Case Studies: An Analysis</b> .....	<b>166</b>



<b>1. Judicial Dissolution Case Study I: Acute Conflicts as “Serious Reasons” For the LLC’s Dissolution</b> .....	<b>167</b>
Background.....	167
Court’s Ruling .....	169
Analysis.....	170
<b>2. Judicial Dissolution Case Study II: Suspicion and Distrust as “Serious Reasons” For the LLC’s Dissolution - Deadlock between two LLC owners arising from alleged violations of the LLC agreement.</b> .....	<b>171</b>
Background.....	171
Court’s Ruling .....	172
Analysis.....	173
<b>3. Judicial Dissolution Case Study III: Minority Oppression as “Serious Reasons” For the LLC’s Dissolution</b> .....	<b>174</b>
Background.....	174
Court’s Ruling .....	175
Analysis.....	176
<b>4. Judicial Dissolution Case Study IV: Financial Infeasibility as “Serious Reasons” For the LLC’s Dissolution</b> .....	<b>176</b>
Background.....	177
Court’s Ruling .....	177
Analysis.....	178
<b>6.3 Managers’ Fiduciary Duties and Available Remedies</b> .....	<b>178</b>
<b>6.4. Judicial Dissolution in The United States</b> .....	<b>183</b>
<b>A. “Not Reasonably Practicable” As a Ground for Seeking the LLC’s Dissolution</b> .....	<b>186</b>
<b>B. “Oppressive and Unfairly Prejudicial Action” As a Ground for Seeking LLC Dissolution</b> .....	<b>191</b>
<b>6.5. Court Discretion to Order Alternative Remedies for Oppression Claims</b> .....	<b>197</b>
<b>6.6. Member’s Judicial Expulsion</b> .....	<b>198</b>
A. Wrongful Conduct as a Ground for Expulsion.....	199
B. Material Breach of LLC Agreement as a Ground for Expulsion.....	200
C. Not Reasonably Practicable as a Ground for Expulsion.....	201
<b>6.7. Summary and Analysis</b> .....	<b>202</b>
<b>Chapter 7: Conclusion</b> .....	<b>210</b>
<b>7.1. Summary</b> .....	<b>210</b>
<b>7.2. Recommendations</b> .....	<b>214</b>
<b>7.3. Implications for Future Research</b> .....	<b>216</b>
<b>Bibliography</b> .....	<b>218</b>

## **Abbreviation List**

CMA	The Capital Market Authority
CRR	Commercial Register Regulations
CRL	Commercial Register Law
DLLCA	The Delaware Limited Liability Company Act
IPO	Initial Public Offering
IRS	US Internal Revenue Service
GCC	Gulf Cooperation Council Member States
KSA	The Kingdom of Saudi Arabia
LCC	The Law of Commercial Court
MOCI	Ministry of Commerce and Investment
NCCUSL	US National Conference of Commissioners on Uniform State Laws
RULLCA	The Revised Uniform Limited Liability Company Act
ROFR	The Right of First Refusal
ROFO	The Right of First Offer
SAGIA	Saudi Arabian General Investment Authority
SAMA	Saudi Arabian Monetary Agency
SAR	Saudi Arabian Riyal
SCR	Saudi Companies Regulation
SCR 1965	Saudi Companies Regulation of 1965
ULLCA	The Uniform Limited Liability Company Act
U.S.	United States of America

## Chapter 1: Introduction and Overview of the Study

### 1.1. Background

Terminating the relationship between an individual shareholder<sup>1</sup>, the other shareholders, and an entire company often proves difficult for small and medium-sized, closely-held businesses like an LLC. In large publicly-traded corporations, individual shareholders can easily liquidate their interest and terminate the relationship with the business whenever they wish, unless specifically restricted from doing so by a shareholders' agreement.<sup>2</sup> Owning shares in public companies generally does not directly affect the business's activities or direction because such companies are typically managed by a board of directors and a board-selected group of officers. Additionally, public company shareholders are rarely involved in daily operations,<sup>3</sup> whereas LLC shareholders often hold the right to vote on major company decisions. In an LLC, controlling shareholders therefore possess the power to direct company decisions through their voting power. Resolutions passed with the required voting percentage of shareholders can have a great effect on company operations and potentially endanger minority shareholders in the process. A minority shareholder affected in this fashion may naturally wish to leave the venture and invest in a different company.<sup>4</sup>

---

<sup>1</sup> The term "shareholder" as used in this research includes an individual LLC owner in Saudi Arabia, consistent with Western literature's use of the term when referring to KSA LLC owners. Similarly, "shareholder" as used in the UK, France, Germany and many other European countries refers to an individual LLC owner. This differs with the term's use in the United States, where "shareholder" refers to individual corporation owners, and individual LLC owners are referred to as "members."

<sup>2</sup> Robert J. McGaughey, *Business Breakups: Terminating Ownership Interests in Closely Held Businesses*, *Insights Journal* (2011), Available at [http://www.willamette.com/insights\\_journal/11/summer\\_2011\\_7.pdf](http://www.willamette.com/insights_journal/11/summer_2011_7.pdf).

<sup>3</sup> Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 468 (2006). Available at [https://lawreview.law.ucdavis.edu/issues/40/2/articles/davisvol40no2\\_velasco.pdf](https://lawreview.law.ucdavis.edu/issues/40/2/articles/davisvol40no2_velasco.pdf).

<sup>4</sup> *Id.* at 309.

A delicate balancing of the interests of majority and minority owners is necessary, for the majority owners should not be chained to what they believe to be unsound business judgment; yet, neither should the minority owners be bound to remain shareholders when they have similar misgivings.<sup>5</sup>

Any difficulty in exiting an LLC can lead to an unfavorable outcome for minority shareholders who become locked into the company. To the extent that the majority owners are making company decisions based on their own personal interests,<sup>6</sup> regardless of the company's interest as a whole, a locked-in minority shareholder's interest may not be adequately protected.<sup>7</sup> Exit rights are therefore critical to protecting minority shareholders from majority misconduct, which can be a common occurrence.<sup>8</sup> Transfer of share rights (the right to sell to a third party) and withdrawal rights that entitle the exiting shareholder to a return of capital are therefore critical mechanisms from the standpoint of minority owners. This research examines the ability of Saudi LLC owners to exit a venture while retaining the value of their investment prior to the natural termination and dissolution of the business. The extent to which they can do this while avoiding litigation is also considered. The research additionally analyzes the corresponding withdrawal rights and interests under U.S. LLC statutes, as well as the remedies available to owners in both jurisdictions in the event of management deadlock or majority oppression.

---

<sup>5</sup> *Id.* at 310.

<sup>6</sup> Sandra K. Miller, *Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French Close Corporation Problem*, 30 CORNELL INT'L L.J. 382 (1997). Available at <https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1402&context=cilj>.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 391.

## 1.2. Reasons for Choosing this Study

This subject was chosen in light of the following:

- 1- Presently existing studies and legal literature on KSA business organizations only discuss LLCs in general terms, and typically do not deal at all with LLC shareholder rights. The existing studies focus primarily on establishing and running joint-stock companies. None of the literature has investigated or explored in-depth the legal relationships among LLC shareholders. A comprehensive study regarding LLC minority investor protections has yet to be completed.
- 2- The Saudi government's recent moves to encourage foreign and international investment make LLC shareholder rights in the KSA a particularly relevant topic. The government's efforts have increased both the overall number of companies operating in the Saudi market and, in particular, the number of LLCs. As investors require a favorable legal and economic climate in order to commit their funds, defining an LLC shareholder's rights is a matter of ongoing and growing importance.

## 1.3. Significance of the Study

The LLC is one of the most popular company structures in Saudi Arabia. The Kingdom's private sector, in particular, contains large numbers of LLCs (*sharikat that massouliyyah mahdoodah*). According to the Saudi Arabian Monetary Agency (SAMA), over 54,000 LLCs existed as of 2011, in comparison with fewer than 6,000 joint-stock

companies (corporations) (*sharikat musahamah*).<sup>9</sup> Of companies established in 2013, LLCs accounted for the highest share (63.2%) of total capital, followed by joint-stock companies, which accounted for 21.1% of capital.<sup>10</sup>

LLCs are broadly accepted in the business sector for a number of reasons. First, LLCs are subject to less internal supervision by official authorities than are JSCs.<sup>11</sup> Second, LLCs require a smaller initial capital contribution at formation.<sup>12</sup> While JSCs are required to have a minimum of SR 500,000<sup>13</sup> in start-up capital, in addition to submitting a feasibility study to the government, no minimum formation capital is required to establish an LLC.<sup>14</sup> Each of these features, along with the limited liability protection that shields LLC owners from personal liability for business debts and other obligations, plays a role in LLCs' popularity. Additionally, the quick and convenient formation of LLCs, combined with the broad sectors of the Saudi economy in which they can operate—despite some difficulties with insurance, savings, and banking operations—also contribute to their rapid proliferation in the Kingdom. Finally, LLCs are particularly suitable for family businesses, which form a significant part of the Saudi economy, and are primarily LLCs. SAMA notes that family businesses account for 95% of Saudi companies.<sup>15</sup>

Saudi family businesses represent 62% of the total wealth of family businesses in

---

<sup>9</sup> Saudi Arabian Monetary Agency (SAMA), *Forty-Eighth Annual Report 1433H*, (2012). Available at [http://www.sama.gov.sa/en-US/EconomicReports/AnnualReport/5600\\_R\\_Annual\\_En\\_48\\_2013\\_02\\_19.pdf](http://www.sama.gov.sa/en-US/EconomicReports/AnnualReport/5600_R_Annual_En_48_2013_02_19.pdf).

<sup>10</sup> Saudi Arabian Monetary Agency (SAMA), *Fiftieth Annual Report 1435H*, (2014). Available at [http://www.sama.gov.sa/en-US/EconomicReports/AnnualReport/5600\\_R\\_Annual\\_En\\_50\\_Apx.pdf](http://www.sama.gov.sa/en-US/EconomicReports/AnnualReport/5600_R_Annual_En_50_Apx.pdf).

<sup>11</sup> See Saudi Companies Regulation, Articles 56, 57, 58, and 59. Issued by Royal Decree No. (M/3) dated 28/1/1437 H. Corresponding to November 12, 2015.

<sup>12</sup> While the previous SCR required a minimum formation capital of SR 500,000, the amended SCR abolished the minimum capital requirement; *Id.* Art. 160.

<sup>13</sup> 1 US Dollar equals 3.75 Saudi Riyal. 500,000 SR equals 133347.56 USD.

<sup>14</sup> *Id.* at 54.

<sup>15</sup> Shehabaddin Al-Dubai, Ku Nor Izah Ku Ismail, & Noor Afza Amran, *Overview of family business in Saudi Arabia* (2012). Available at <https://www.researchgate.net/publication/281050775>.

the Middle East.<sup>16</sup> Such companies are also responsible for approximately 12% of Saudi Arabia's GDP, and 40% of its non-oil revenue. Moreover, foreign investment in Saudi Arabia most often flows to LLCs; 87% of foreign businesses in Saudi Arabia assume an LLC form.<sup>17</sup> KSA seeks to attract more foreign investment as a part of its Vision 2030 plan, seeking to diversify its economy and reduce its reliance on oil. In 2016 alone, the Saudi General Investment Authority (SAGIA) issued 1,999 business licenses to foreign establishments (industrial, service, and other), representing approximately SAR 500 billion in capital.<sup>18</sup> The vast majority of these newly-established companies take the form of LLCs.<sup>19</sup> The Kingdom has also announced the goal of doubling the number of LLCs, to 104,000, by 2020.<sup>20</sup>

---

<sup>16</sup> *Id.*

<sup>17</sup> *Supra* note 10.

<sup>18</sup> Saudi Arabian Monetary Agency (SAMA), 53rd. Annual Report 1438H (2017). Available at <http://www.sama.gov.sa/en-US/EconomicReports/AnnualReport/Fifty%20Third%20Annual%20Report.pdf>.

<sup>19</sup> *Id.*

<sup>20</sup> U.S. Commercial Service, *Doing Business in Saudi Arabia, 2017 Country Commercial Guide for U.S. Companies* (2017). Available at <https://sa.usembassy.gov/wp-content/uploads/sites/60/CCG-2017-Saudi-Arabia.pdf>.

Type of Company	2010		2011			Cumulative Total up to 2011		
	Number	Capital	Number	Capital	% Share in Capital	Number	Capital	% Share in Capital
<b>Joint-stock companies</b>	<b>361</b>	<b>66,229.2</b>	<b>403</b>	<b>4,349.7</b>	<b>16.7</b>	<b>5,076</b>	<b>1,707,555.6</b>	<b>85.3</b>
Saudi	320	66,017.2	360	4,334.6	16.7	4,565	1,692,848.7	84.6
Gulf	7	0.5	3	0.0	0.0	45	3,035.0	0.2
Arab	0	0.0	0	0.0	0.0	6	1,754.1	0.1
Joint-venture	7	50.0	4	0.0	0.0	40	6,867.7	0.3
Foreign	1	0.0	0	0.0	0.0	6	613.3	0.0
Foreign branches	26	161.6	36	15.1	0.1	414	2,436.8	0.1
<b>LLCs</b>	<b>5,713</b>	<b>15,565.4</b>	<b>6,412</b>	<b>21,624.4</b>	<b>83.1</b>	<b>54,294</b>	<b>280,534.6</b>	<b>14.0</b>
Saudi	4,588	5,822.5	5,275	14,858.3	57.1	44,625	168,424.8	8.4
Gulf	258	512.8	248	189.2	0.7	2,238	13,992.5	0.7
Joint-venture	457	8,668.6	458	2,229.2	8.6	4,542	77,923.9	3.9
Foreign	233	304.3	205	4,168.8	16.0	1,684	18,533.4	0.9
Foreign branches	177	257.2	226	179.0	0.7	1,205	1,660.0	0.1
<b>General Partnerships</b>	<b>199</b>	<b>34.0</b>	<b>393</b>	<b>45.2</b>	<b>0.2</b>	<b>5,854</b>	<b>3,927.2</b>	<b>0.2</b>
Saudi	194	33.9	387	37.9	0.1	5,731	3,844.7	0.2
Gulf	0	0.0	0	0.0	0.0	19	11.2	0.0
Joint-venture	0	0.0	1	0.5	0.0	23	15.4	0.0
Foreign	1	0.1	0	0.0	0.0	4	0.1	0.0
Foreign branches	4	0.0	5	6.8	0.0	77	55.8	0.0
<b>Limited Partnerships</b>	<b>94</b>	<b>72.3</b>	<b>152</b>	<b>6.1</b>	<b>0.0</b>	<b>2,767</b>	<b>9,939.2</b>	<b>0.5</b>
Saudi	92	71.7	147	4.6	0.0	2,696	9,857.9	0.5
Gulf	1	0.1	1	0.0	0.0	13	2.5	0.0
Joint-venture	0	0.0	0	0.0	0.0	8	21.9	0.0
Foreign	0	0.0	0	0.0	0.0	12	26.9	0.0
Foreign branches	1	0.5	4	1.5	0.0	38	30.0	0.0
<b>Total</b>	<b>6,367</b>	<b>81,900.9</b>	<b>7,360</b>	<b>26,025.4</b>	<b>100.0</b>	<b>67,991</b>	<b>2,001,956.6</b>	<b>100.0</b>



#### 1.4. Research Methodology

This study uses both critical analytical<sup>21</sup> and comparative research methods. The study applies critical analysis methods in evaluating the SCR provisions governing LLCs. Critical analysis is also employed with regard to the published cases, legal documents, and academic articles which help to interpret and apply the relevant SCR statutes. For comparative research purposes, reference is made to U.S. LLC laws—mainly the Uniform Limited Liability Company Act, the Revised Uniform Limited Liability Company Act, the Delaware Limited Liability Company Act, and their accompanying case law from different U.S. jurisdictions. The comparative approach is used to provide the Saudi legislature with specific, substantive examples for future domestic legal reforms.<sup>22</sup> To generate a comprehensive understanding of LLC shareholder rights in practice, the study also examines more than 30 KSA Articles of Association, as well as a number of U.S. LLC operating agreements.

#### 1.5. Research Questions and Objectives

It is generally believed that SCR does not offer adequate statutory protection for minority shareholders in closely held businesses, including LLCs.<sup>23</sup> This study aims to understand the different ways in which the U.S. and Saudi Arabia address protection of

---

<sup>21</sup> Critical Analysis of Law is a doctrinal method for studying the application, and interaction, of particular legal rules seen in actual statutes and court opinions. For more information about the Critical Analysis method *see* Markus D. Dubber, *Critical Analysis of Law: Interdisciplinarity, Contextuality, and the Future of Legal Studies* (June 2012). Available at <http://individual.utoronto.ca/dubber/CAL.pdf>

<sup>22</sup> Kai Schadbach, *The Benefits of Comparative Law: A Continental European View*, 16 B.U. INT'L L. J. 331, 422 (1998).

<sup>23</sup> FAHAD AL-MAJED, *A CONCEPTUAL FRAMEWORK FOR REFORMING THE CORPORATE GOVERNANCE OF SAUDI PUBLICLY HELD COMPANIES: A COMPARATIVE AND ANALYTICAL STUDY FROM A LEGAL PERSPECTIVE*, 338, 339 (1st ed. 2012).

minority LLC shareholders. This comparative methodology will identify potential reforms to Saudi Arabian LLC law. More specifically, this research aims to identify the main obstacles facing LLC minority shareholders seeking to exit a company by transferring or liquidating their investments, which is the primary way minority LLC investors protect their interests. In sum, the paper aims to answer the following questions: (1) Does Saudi law provide sufficient mechanisms for preventing LLC shareholders from becoming locked into a business? (2) Are there courses of action available to LLC minority shareholders if they find themselves vulnerable to majority owners' oppression or misconduct? (3) Do sufficient reasons exist to justify reforms to the Kingdom's protection for LLC minority shareholders? (4) In what ways do U.S. LLC laws suggest possible reforms to KSA LLC law? (5) Should Saudi Arabia adopt any specific provisions from U.S. LLC laws, and what benefits would be achieved by doing so?

#### 1.6. Research Structure

To thoroughly explore the research questions, this dissertation is divided into seven chapters. The current chapter introduces the project, describes the importance of the study, and identifies the research methodology, objects, and questions.

Chapter Two provides historical and cultural context for understanding Saudi Arabia and its legal system. The chapter includes a brief chronological narrative of the Kingdom, its establishment, and its unique legal system. It also discusses the Basic Law of Governance of 1992 (the constitution of Saudi Arabia), and its role in structuring the KSA's institutions and government. Finally, the chapter examines the primary and secondary sources of law, the Kingdom's authorities, and its competent courts.

Chapter Three introduces the Saudi Companies Regulation of 1965 and the current Saudi Companies Regulation (SCR). It also provides an introductory overview of LLCs in the Kingdom, including the potential liability of LLC managers, required formalities and publications, company management structures, and the validity of contracts establishing LLCs. The final section discusses the mandatory and default statutory rules.

Chapter Four describes the transfer of LLC shares and motivations for restricting such transfers. It examines restrictions on transfers under the 1965 SCR and the current SCR, the statutory right of first refusal, the legal consequences for breaching the right of first refusal, mergers and acquisitions involving LLC shareholders, the problem of fair value and bona fide offers, and the alternative valuation methodologies that exist in LLC agreements. Comparison to U.S. LLC laws is also made with regard to transferring interests and a member's ability to sell to third parties.

Chapter Five covers the challenges a shareholder faces in attempting a voluntary withdrawal from an LLC, share withdrawal's adverse impact and costs to company creditors, involuntary withdrawal caused by shareholder death or dissolution, calculating share value upon withdrawal, statutory limitations on distributions, and creditor protections. Comparison to U.S. laws is also made, regarding each of these subjects.

Chapter Six covers the effectiveness of various judicial protections for minority shareholders' rights. Such protections include judicial dissolution of the LLC in response to certain events, such as majority oppression or misconduct. The chapter also explores managers' fiduciary duties, available remedies in the KSA, the judicial dissolution process in the U.S., and the available courses of action for dissatisfied LLC members under certain circumstances.

Finally, Chapter Seven concludes the study by recommending specific amendments to correct gaps in the current SCR. The recommendations aim to improve the position of minority shareholders in Saudi LLCs.

## Chapter 2: The Saudi Legal System

### 2.1. Introduction

The Kingdom of Saudi Arabia is a relatively new country. It was founded in 1932 by King Abdulaziz ibn Saud. However, its legal origins date back more than 250 years.<sup>24</sup> Historically, the first Saudi state, named the Emirate of Dir'iya, was formed in 1744 when Prince Muhammad bin Saud, the ancestor of Saudi King Abdul Aziz, and Sheikh Mohammed bin Abdul Wahab, a religious reformer, created an alliance known as the Agreement of Dir'iya. They worked together to correct religious doctrine, apply Islamic law, and achieve monotheism. Thereafter, Prince Mohammed bin Saud became the Imam of the Muslims and his descendants have since ruled the Saudi Kingdom.<sup>25</sup> Sheikh Mohammed Ibn Abdul Wahhab's goal was to improve the behavior of the community by removing all innovations and superstitions that were widespread among the people in the Arabia Peninsula at that time.<sup>26</sup> Thus, the system of government in the first and second Saudi states was simple and relied on tribal traditions that modified the Hanbalite interpretations of Islamic law.<sup>27</sup> After the establishment of the third Saudi state, the Kingdom of Saudi Arabia, King Abdulaziz, developed a strong administrative system and the judiciary for the country.<sup>28</sup> In 1925, King Abdulaziz issued instructions during his

---

<sup>24</sup> FRANK VOGEL, A CASE COMPARISON: ISLAMIC LAW AND THE SAUDI AND IRANIAN LEGAL SYSTEMS, IN 6 ISLAM: MUSLIMS AND MODERNITY : CULTURE AND SOCIETY SINCE 1800, 302-303 (Robert W. Hefner ed., 2011).

<sup>25</sup> Muhammad ibn Abd al-Wahhab was a Sunni scholar of the Hanbali school, considered by his followers to be a Reformer of the Islamic religion on the Arabian Peninsula where he encouraged Muslims to get rid of innovations and myths, worship one God, and renounce polytheism. For more information about Sheikh Mohammed bin Abdul Wahhab and Wahhabism see: MUHAMMAD IBN GAALIH AL-'UTHAYMEEN, EXPLANATION OF THE THREE FUNDAMENTAL PRINCIPLES OF ISLAM *Available at:* [http://onthesunnah.com/Page\\_Knowledge/ebooks/3usul.pdf](http://onthesunnah.com/Page_Knowledge/ebooks/3usul.pdf)

<sup>26</sup> SATTAM AL TAYYAR, BUSINESS LAWS OF SAUDI ARABIA, 1-2 (First ed. 2010).

<sup>27</sup> S. A. SOLAIM, CONSTITUTIONAL AND JUDICIAL ORGANIZATION IN SAUDI ARABIA, 7-8 (First ed. 1970).

<sup>28</sup> Al Tayyar, *supra* note 27.

announcement of the temporary formation of the head of the judiciary, known as "temporary reform materials for the Islamic courts." The King then explained in his speech, published in the newspaper Umm al-Qura No. 32 on Aug 9<sup>th</sup>,1925, about the sources of judicial rulings, stating:

The provisions of Islam are the basis for all rulings, and in this fashion Islam will continue to provide the light guiding all believers. Islam serves as a faith intended to benefit all people in this world and the Hereafter; the truth of Islam and its provisions, therefore best ensure joy and happiness and well-being.<sup>29</sup>

Saudi Arabia is an Islamic state whose system of government is a monarchy. There is no law that supersedes Islamic law (Shari'a)<sup>30</sup>, which derives its rulings from the Qur'an, the book of God, and the Sunnah, which encompasses the traditions, speeches, and actions of the Prophet Muhammad (peace be upon him). The Qur'an and the Sunnah are considered the constitution of the Kingdom.<sup>31</sup> There is no formal, written constitution for the Kingdom of Saudi Arabia. However, I support the point of view of some who believe that the Saudi Basic Law of Governance meets all of the criteria and definitions of a constitution, and is equivalent to the Constitution in other countries because it describes the authority of the state and defines the powers of the King, his cabinet, government agencies, and the judiciary. All Saudi laws must adhere to the provisions of Islamic law on a broad scale including family law, criminal law, commercial law, contracts, and administrative law. Royal decrees are another basic source of law, but they are referred to as Regulations

---

<sup>29</sup> The Supreme Council of the Judiciary's portal, the Council, *a description of the judiciary*. See: <https://www.scj.gov.sa/about>. (In Arabic).

<sup>30</sup> Shari'ah is what Allah has decreed for Muslims which includes provisions, rules, and systems for the establishment of a just life and the maintenance of people's interests and security in the beliefs, worship, ethics, transactions and systems of life, with the appointment of various people to regulate the relationship of people with their God. See: M. Helmy, *Islamic Sharia and its moral virtues*, available at <http://www.alukah.net/sharia/0/43846/#ixzz4tAcilFrR>. In Arabic.

<sup>31</sup> DENNIS CAMPBELL, AND CHRISTIAN T. CAMPBELL., *LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST*, 157-159 (2nd ed, 2009).

(*nizam*) rather than laws, indicating that Shari'a prevails. Royal decrees are complementary to Shari'a, and all commercial matters dealing with companies, banking, and capital markets, are governed by modern regulations.<sup>32</sup>

Saudi law is unique in the Islamic world because it is not entirely codified. In a number of Islamic countries, Islamic law has been codified and preserved. However, in the Kingdom of Saudi Arabia, the state considers Islamic law, which is not codified as a whole, to be the law of the country, and prevents any law from conflicting with it. Saudi law is, therefore, unique not only in comparison with Western countries, but also in comparison with other Islamic countries. Non-codification leads to significant differences in interpretation and application of the law. In addition, judicial precedents and the concept of *stare decisis*, are not recognized, which may prompt judges to revert to ancient Hanbali texts and other Sunni schools<sup>33</sup> of jurisprudence or to apply their own judgment known as *Ijtihad*. Because of this, many legal scholars have argued for the codification and legitimization of Sharia to remove any ambiguity or doubt.<sup>34</sup>

---

<sup>32</sup> JONATHAN ERCANBRACK, *THE TRANSFORMATION OF ISLAMIC LAW IN GLOBAL FINANCIAL MARKETS*, 2-6 (First ed. 2014).

<sup>33</sup> Muslims in the world are divided into Sunnis and Shiites. Sunnis constitute the vast majority, estimated at about 85% of all Muslims, while Shiites constitute the smallest percentage of about 15%. The Sunnis are divided into four schools: Shaafa'is, Malikis, Hanafis, and Hanbalis. See Christopher M. Blanchard, *Islam: Sunnis and Shiites* at <https://fas.org/irp/crs/RS21745.pdf>. The Kingdom of Saudi Arabia follows the Hanbali school. This is confirmed by the royal decree of King Abdul Aziz in 1928 requiring the judges to rule under the Hanbali School in general. However, in cases when the Hanbali school is not applied, and instead, a judge is applying another school, the judge must mention the evidence and show justifiable reasons. See George Sayen, *Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia*, 24 *U. Pa. J. Int'l Econ. L.* 905, 958 (2003), available at: <https://www.law.upenn.edu/journals/jil/articles/volume9/issue2/Sayen9U.Pa.J.Int%27lBus.L.211%281987%29.pdf>.

<sup>34</sup> See ANDREA L. STANTON, ET AL., *CULTURAL SOCIOLOGY OF THE MIDDLE EAST, AFRICA, AND ASIA: AN ENCYCLOPEDIA* (SAGE. 2012).

## 2.2. The Basic Law of Governance 1992<sup>35</sup>

The promulgation of the Basic Law of Governance is one of the most prominent features in the current stage of the political and social development of the Kingdom of Saudi Arabia, a stage that we can label the stage *of development and reconstruction of systems and institutions* of the Kingdom of Saudi Arabia. Even though the Basic Law of Governance does not describe itself as the Constitution of the Kingdom of Saudi Arabia, it contains sufficient formalities and formal legal standards that allow it to be considered as the constitution of Saudi Arabia in accordance with the standards found in the constitutions of other countries.<sup>36</sup> The origin of the Basic Law of Governance and its source is Islamic law, and the Saudi Government and its judicial system are guided by the law of Islam in determining the nature of the state, its headquarters and its responsibilities. Islamic law also determines the relationship between the ruler and the governed. The first Article of the Basic Law of Governance states that the Kingdom of Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam, and its constitution shall be the Book of God and the Teachings of Muhammed (the Qur'an and the Sunnah).<sup>37</sup> Governance in the Kingdom of Saudi Arabia derives its authority from the Book of God and the Sunnah of his Messenger, both of which govern this Law and all the laws of the State.<sup>38</sup> The system of governance in the Kingdom of Saudi Arabia shall be monarchical. Only the sons of the Founder, King Abd-ALAziz ibn Abdul Rahman al-Faisal Al Saud, and the sons of his sons can be the monarchs of the Kingdom. Allegiance shall be pledged to the most suitable

---

<sup>35</sup> *The Basic Law of Governance (al-nizam al-asasi in Arabic)* issued on March 1<sup>st</sup>, 1992 under King Fahd bin Abdul Aziz Al Saud by royal decree, concerning the manner of governance in Saudi Arabia, and the law, in a simple manner, acts like the Constitution in other countries.

<sup>36</sup> TIM NIBLOCK, SAUDI ARABIA: POWER, LEGITIMACY AND SURVIVAL, 104, 105 (Illustrated ed. 2004).

<sup>37</sup> The Basic Law of Governance., *supra* note 36, Art. 1.

<sup>38</sup> *Id* Art. 7.



amongst them to reign on the basis of the Book of God Most High and the Sunnah of His Messenger (PBUH).<sup>39</sup> Although Article 44 of the statute explicitly states that the authorities in the Kingdom are divided into executive, regulatory, and judicial departments, it concludes that the King shall be their final authority. The King has the power to appoint and commend judges on the recommendation of the Supreme Council of the Judiciary (Articles 52).

### 2.3. Sources of Law

The Book of God<sup>40</sup> and the Sunnah of his Messenger Muhammad are the primary sources that govern all of the regulations promulgated in the Kingdom, and they apply to all acts of any kind without exception.<sup>41</sup> Islamic law is not limited to divine legislation, and the Sunnah is not the only source of Islamic law. Secondary sources, including texts

---

<sup>39</sup> Article 5 of the Basic Law of Governance defines the mechanism for the transfer of rule in Saudi Arabia, in addition to the "Allegiance Commission Law" which was issued by King Abdullah bin Abdul Aziz in October 2006 to select the King and the Crown Prince in the future. Article 5 states that "the King chooses the Crown Prince and exempts him by Royal Order." However, with the issuance of the "Allegiance Commission Law", this section of the Basic Law of Governance was canceled and replaced by another clause stating that Article 6 of the Allegiance Commission replaces the article and that "upon the death of the King, the Commission shall call for allegiance to the Crown Prince as the King of the country in accordance with this Statute and the Statute of Government." By this text, power was transferred to Prince Salman to be King of the country. In June 2017, King Salman bin Abdulaziz issued a royal decree that included an amendment to Article 5 of the Basic Law of Governance to read as follows: "The rule shall apply to the sons of the founding King Abdul Aziz bin Abdulrahman Al-Faisal Al-Saud and to the sons of the sons and the most promising of them to judge the Book of Allah and the Sunnah of His Messenger, Peace be upon him, and not apply to the sons of the founding King of the throne of the one branch of the offspring of the founding king." This means that the "sons of sons" the descendants of the founder, when they rule the kingdom, are not entitled to appoint a crown prince from the same branch to which they belong. See, Bureau of Experts at the Council of Ministers, *The Law of pledge of Allegiance Commission*, Saudi Law Compendium, available at:

<https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=8&VersionID=13>. The Basic Law of Governance, available at:

<https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=4&VersionID=240>.

<sup>40</sup> Means Qur'an.

<sup>41</sup> DENNIS CAMPBELL, *LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST*, 158 (Kluwer; West Pub. Co. 1986).

containing the consensus of opinion developed after Muhammad's death (*Ijma* in Arabic), the analogical reasoning (*Qiyas*), the jurisprudence and independent reasoning of the judges (*Ijtihad*), the public interest (*Maslahah Mursalah*), Custom (*Urf*), and the juristic preference (*Istihsan*) may also be referenced in judicial opinions or when drafting legislation.<sup>42</sup> Saudi Arabia and secondary sources of Islamic law give the King the power and the authority to issue regulations, by royal decree. However, the authority of the King to issue regulations is subject to the requirement that his decrees conform to the concept of *siyasa shar'iyya*.<sup>43</sup> The concept of *siyasa shar'iyya* implies that in order for decrees to be valid, they must be useful to the public, and not contradict the general principles of Islamic law.<sup>44</sup>

Pursuant to the Saudi Basic Law of Governance:

The courts shall apply to cases before them the provisions of Islamic Shari'ah, as indicated by the Qur'an and the Sunnah, and whatever laws not in conflict with the Qur'an and the Sunnah which the authorities may promulgate. (Article 48).

“The King shall run the affairs of the nation in accordance with the *siyasa shar'iyya*. He shall supervise the implementation of Islamic Shari'ah and the general policies of the State, and the protection and defense of the country.” (Article 55).

The process of enactment of regulations usually begins when a proposal is submitted by a Minister or a member of the Saudi Cabinet working in the Saudi

---

<sup>42</sup> JONATHAN G. BURNS, INTRODUCTION TO ISLAMIC LAW: PRINCIPLES OF CIVIL, CRIMINAL, AND INTERNATIONAL LAW UNDER THE SHARI'A (1st ed. 2013).

<sup>43</sup> *Siyasa Shar'iyya* means the ruler has the power to take any actions, including legislating and establishing administrative arrangements by means of *Qiyas*, *Istihsan*, *Maslahah Mursalah*, and *Urf*, to achieve the interests of the public and bring benefits or appropriate services to them, and to reduce harms or activities that are contrary to the general principles of Islamic law. For more information about this concept, see FRANK E. VOGEL, ISLAMIC LAW AND LEGAL SYSTEM: STUDIES OF SAUDI ARABIA 43, 44 (Brill. 2000).

<sup>44</sup> See Frank Vogel, *supra* note 25.

Government. The proposal is then reviewed by the Prime Minister who is also the King. If the proposed law is approved by the King, then the regulation shall be promulgated by Royal Decree, and published in official newspaper.<sup>45</sup> The Saudi Government has issued a broad range of regulations in all fields, including laws which regulate business transactions and corporate businesses. The following is a review of the regulations affecting the corporate business and investment environment in the Kingdom of Saudi Arabia:<sup>46</sup>

- (1) Companies Regulation
- (2) Commercial Agencies Regulation
- (3) Public Investment Fund Regulation
- (4) Commercial Books Regulation
- (5) Commercial Register Regulation
- (6) Settlement Against Bankruptcy Regulation
- (7) Foreign Investment Regulation
- (8) General Investment Authority Regulation
- (9) Trade Marks Regulation
- (10) Capital Market Regulation

#### 2.4. Interpretive Sources

Saudi legislation is often interpreted by reference to the principles of Sharia law and Islamic *Fiqh*.<sup>47</sup> Wherever there are gaps in the Saudi legislation, these gaps are generally supplemented by reference to Sharia law.<sup>48</sup> If any conflict arises between legislations and

---

<sup>45</sup> See Campbell, *Supra* note 32, at 159.

<sup>46</sup> See Bureau of Experts at the Council of Ministers, Browse the Saudi Laws Compendium, available at <https://www.boe.gov.sa/mainlaws.aspx?lang=en>.

<sup>47</sup> Jonathan Reardon & Asim Almalik, *Corporate governance and directors' duties in Saudi Arabia: overview* at [https://uk.practicallaw.thomsonreuters.com/8-608-8945?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/8-608-8945?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1).

<sup>48</sup> *Id.*

Sharia law, Sharia law is likely to prevail.<sup>49</sup> Nonetheless, the Judiciary and jurisprudence (*opinions of jurists*) are considered the two important interpretative sources of commercial law in Saudi Arabia. As an interpretative source of the law, the judiciary is the set of principles adopted by the courts in its past rulings, which are known as "The Legal Doctrines".<sup>50,51</sup> These principles guide judges in making rulings and formulating solutions to disputes that have no resolution in a consensual or customary text. The purpose of the judiciary is to bridge the lack of legislation, and not create new legal rules. The judiciary in Saudi Arabia does not have the power to legislate, but it can interpret and reconcile ambiguous legal texts.<sup>52</sup> It is important to recall that, unlike the situation in common law countries, the concept of *stare decisis* is not recognized in Saudi Arabia, which means that the prior decisions of a court or a judicial committee have no binding authority on a court considering another case involving similar facts.<sup>53</sup> The jurisprudence and opinions of the legal scholars are non-binding sources of commercial law in Saudi Arabia as well. A judge may be guided by these opinions, but he is not obliged to follow a particular opinion. Legal literature, research, and comments by jurists on the legal rules play a significant role in understanding the provisions of commercial and corporate law, especially when there is a new legislation.<sup>54</sup>

---

<sup>49</sup> Id.

<sup>50</sup> YAHYA SAID, AL-WAJEEZ IN SAUDI COMMERCIAL LAW, 32-35 (Al-Maktab Al-Arabi Al-Hadeeth, 7th ed. 2004). In Arabic

<sup>51</sup> The Legal Doctrines hold a certain persuasive literary power over the judiciary, but they are not binding in any way and a judge may choose not to follow them.

<sup>52</sup> MOHAMMED BIN HASSAN AL-JABR, SAUDI COMMERCIAL LAW, 29-30 (4th ed. 1996). In Arabic

<sup>53</sup> See Andrea L. Stanton, *supra* note 35.

<sup>54</sup> Al-Jabr, *supra* note 53.

## 2.5. Authority of the State

Article 44 of the Basic Law of Governance states that the authorities in the Kingdom shall consist of the judicial authority, the executive authority, and the regulatory authority.<sup>55</sup> Article 44 also stipulates that the authorities shall cooperate in the discharge of their functions in accordance with the Basic Law of Governance and other laws, and the King shall be their final authority.<sup>56</sup>

### A. The Executive Branch

The executive authority in the Kingdom of Saudi Arabia consists of the King as the President of the Executive Authority, as stipulated in Article 44 of the Basic Law of Governance, and the Council of Ministers.<sup>57</sup> The Council of Ministers is composed of Deputy Prime Ministers entrusted with the implementation of State regulations and decisions by the governmental departments. The Council of Ministers acts as a Cabinet of Advisors to the King. The Council of Ministers also participates in representing the regulatory authority of the country within the Shura Council<sup>58</sup>, and has the authority to draw up the internal, external, financial, economic, educational, and defense policies as well as conduct general affairs of State. It also has the executive power and the final authority in financial and administrative affairs of all ministries and other government

---

<sup>55</sup> The Legislative Branch.

<sup>56</sup> The Basic Law of Governance, *supra* note 36, Art. 44.

<sup>57</sup> The Council of Ministers is the supreme council of government in the Kingdom of Saudi Arabia.

<sup>58</sup> (Majlis Al Shura, in Arabic) is the formal advisory body of Saudi Arabia and is considered as the primary legislative authority of the state.

institutions.<sup>59</sup> The King is the Prime Minister,<sup>60</sup> and he has the absolute power to appoint ministers and deputy ministers, and can remove them from their positions by Royal Order as well.<sup>61</sup> The Council of Ministers plays a significant role in the supervisory aspect of the Government by supervising administrative work, applying regulations, and drafting instructions as required. Thus, the Council of Ministers functions within the framework of the executive powers granted by the Basic Law of Governance by:

- Monitoring the implementation of regulations, by-laws and resolutions.
- Creating and arranging public institutions.
- Following up on the implementation of the general plan for development.
- Forming committees for the oversight of the ministries' and other governmental agencies in their conduct of business. Those committees may also investigate any given case. The committees shall submit the findings of their investigations within a set time to the Council of Ministers, and the Council shall consider these findings. The Council shall also have the right to form committees of inquiry and to make final conclusions which take into consideration governmental regulations and stipulations of the by-laws of the various governmental organizations.<sup>62</sup>

Ultimately, the King, as the Prime Minister, seek guidance from the Council of Ministers and supervises the general policies and functioning of the State. The King also encourages coordination and cooperation among the various governmental agencies in the kingdom. He also supervises the Council of Ministers, the ministries and governmental agencies, and monitors the implementation of regulations.<sup>63</sup> There are currently twenty-

---

<sup>59</sup> The Council of Ministers Law, Article 19. Promulgated by Royal Order No. A/13 on August 21, 1993. See Bureau of Experts at the Council of Ministers, *The Law of The Council of Ministers*, available at <https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=6&VersionID=11>

<sup>60</sup> *Id.*, Article 1.

<sup>61</sup> The Basic Law of Governance, *supra* note 36, Art. 58.

<sup>62</sup> The Council of Ministers Law, *supra* note 60, Art 24.

<sup>63</sup> *Id.*, Art 29. There are currently twenty-three ministries and a number of other government agencies and institutions in the Kingdom of Saudi Arabia. The twenty-three ministries are as follows: Civil Service; Commerce and Investment; Communications and Information Technology; Defense; Economy and Planning; Education; Finance; Foreign Affairs; Hajj and Umrah; Health; Education; Interior; Islamic

three ministries and a number of other government agencies and institutions in the Kingdom of Saudi Arabia.

The Ministry of Commerce and Investment has the main role of supervising corporate activities in Saudi Arabia, and administering the implementation of regulations related to commercial and corporate activities.<sup>64</sup> In addition, the Saudi Arabian General Investment Authority SAGIA<sup>65</sup> is responsible for managing the investment environment in the Kingdom of Saudi Arabia, and providing investment licenses to foreign investors as well as coordinating their investment activities with other relevant government agencies.

#### B. Regulatory (Legislative) Branch<sup>66</sup>

Article 67 of the Basic Law of Governance provides that the regulatory authority shall have the authority to establish regulations to promote the interests of the State or avoid corruption in the affairs of the State in accordance with the rules of the Islamic Shari'a, The regulatory authority exercises its powers in accordance with this system and the regulations of the Council of Ministers and the Shura Council.<sup>67</sup> Article 67 does not explicitly define the responsibilities of the regulatory authority of the State, but it refers to the two laws establishing the Council of Ministers and the Shura Council. Pursuant to Articles 20, 21,

---

Affairs, Endowment, Dawa and Guidance; Justice; Labor and Social Development; Municipal and Rural Affairs; Petroleum and Mineral Resources; Social Affairs; Transport; Environment; Water and Agriculture; General Direction of Youth Welfare; National Guard; and the Ministry of Media.

<sup>64</sup> See The Ministry of Commerce and Investment, *Tasks And Responsibilities(2017)*, available at <https://mci.gov.sa/en/AboutMinistry/MinistryFunctions/Pages/default.aspx>.

<sup>65</sup> The Saudi Arabian General Investment Authority. Established in 2000, it works as a central agency for inward investment in the Kingdom. For more information about SAGIA see <https://www.sagia.gov.sa/en/Pages/default.aspx>

<sup>66</sup> Saudi Arabia uses the term "regulatory authority" rather than "legislative authority", in addition to its use of the term "regulation rather than law" as stipulated in the Basic Law on Governance, so as not to offend the country's conservative religious elements. See Ercanbrack, *supra* note 33.

<sup>67</sup> The Basic Law of Governance, *supra* note 36, Art. 67.

and 22 of the Saudi Council of Ministers Law, the Council of Ministers has legislative authority in addition to its original executive authority.

Article 20:

While deferring to *Majlis Ash-Shura* Law, laws, treaties, international agreements, and concessions shall be issued and amended by Royal Decrees after deliberations with the Council of Ministers.

Article 21:

The Council of Ministers shall study draft laws and regulations on the agenda and vote on them chapter by chapter and then as a whole, in accordance with the By-laws of the Council.

Article 22:

Every minister may propose a draft law or regulation related to the work of his ministry. In addition, every member of the Council of Ministers may propose what he deems worthy of discussion in the Council of Ministers' meetings after obtaining the approval of the Prime Minister.

The Shura Council shares with the Council of Ministers the regulatory authority of the Kingdom of Saudi Arabia. The Shura Council has the power to propose new draft regulations, or propose amending existing regulations, and study them in the Council.<sup>68</sup> The decisions of the Shura Council are then submitted to the King, who then decides what is to be referred to the Council of Ministers. If the Council of Ministers and the Shura Council agree, decisions shall be made after obtaining the approval of the King.<sup>69</sup> The Shura Council also has the authority to issue opinions on the general policies of the State

---

<sup>68</sup> The Law of the Shura Council, Royal Order No. A/91 (1st March 1992). Article 23. Available at: <https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=5&VersionID=10>

<sup>69</sup> *Id.*, Art. 17.



referred to it by the Prime Minister, including: discussing the general plan for economic and social development, expressing an opinion thereon; studying international laws, regulations, treaties and agreements; proposing interpretations of regulations; discussing annual reports submitted by ministries and other government agencies; and proposing anything it deems appropriate.<sup>70</sup> These texts, which are contained in the two laws establishing the Council of Ministers and the Shura Council, show that there is full cooperation between the executive and legislative branches in the Kingdom of Saudi Arabia, and there is no separation between them.

### C. Judicial Branch

Laws in the Kingdom of Saudi Arabia rely deeply on the opinions and sayings of the scholars (*Fiqh*),<sup>71</sup> and Saudi Arabia usually closely follows the Hanbali School.<sup>72</sup> The first step taken by King Abdul Aziz, after the establishment of the Kingdom of Saudi Arabia and the completion of the organizing of the Sharia courts, was the issuance of a Royal Decree in 1928 determining the sources of judicial rulings and the jurisprudence to be followed in the State. The Royal Decree issued in 1928 requires judges to rule pursuant to the Hanbali Jurisprudence, unless they show a justifiable reason to follow other ways, such as Shafi', Hanafi, or Maliki schools.<sup>73</sup>

---

<sup>70</sup> *Id.*, art. 15.

<sup>71</sup> *Fiqh* is an Arabic word which refers to the Islamic schools of jurisprudence. The Hanbali School is one of the four traditional Sunni Islamic schools of jurisprudence (*fiqh*), and is the school that Saudi jurists usually follow.

<sup>72</sup> Vogel, *supra* note 25. at 304.

<sup>73</sup> See George Sayen, *Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia*, 24 *U. Pa. J. Int'l Econ. L.* 905, 958 (2003), available at: <https://www.law.upenn.edu/journals/jil/articles/volume9/issue2/Sayen9U.Pa.J.Int%27lBus.L.211%281987%29.pdf>.

The Saudi judicial system is a dual judicial system<sup>74</sup>. This means that there are two judicial bodies in the state: (1) the ordinary court, which is linked to a supreme court that functions as a court of cassation, and (2) the administrative court (*Diwan AlMazalim*)<sup>75</sup>, that hears disputes involving government agencies. The ordinary court is competent to hear all disputes, except disputes that fall under the jurisdiction of the administrative courts. The administrative courts are also linked to a higher administrative court and a court of appeal on the second level.<sup>76</sup> Commercial and corporate disputes were previously considered under the jurisdiction of the Commercial Court that was established pursuant to the Saudi Commercial Court Regulation.<sup>77</sup> Then, in 1987 the Commercial Courts were replaced with the Board of Grievances.<sup>78</sup> In 2007, the new Judiciary Law enacted a further reorganization, transferring all commercial litigation from the Board of Grievances to the ordinary courts, which were to include a specialist commercial court. Although passed into law in 2007, this latest change ultimately went into effect as of 2017.<sup>79</sup> As a result, there has always been a competent judiciary in the Kingdom to hear corporate disputes, but its formal name has changed over the years.

### 1. The ordinary courts

---

<sup>74</sup> The judicial system in some countries consists of two parts. One of which is to adjudicate disputes solely between individuals or disputes between them and an administrative body of the government, if they are stripped of their privileges by a public authority. The other judicial body is competent to adjudicate administrative disputes that arise between individuals and the administration as a result of the exercise of its function as a public authority, the administrative judicial body. France is one of the first countries to adopt the idea of dual justice. It has established courts specifically to examine its dispute and distinguish it by special rules. See ABDULAZIZ BIN MOHAMMED AL-SAGHIR, *ADMINISTRATIVE LAW BETWEEN THE EGYPTIAN AND SAUDI LEGISLATURES* (First ed. 2015). In Arabic.

<sup>75</sup> Known as the Board of Grievances.

<sup>76</sup> See Joseph L. Brand, *Aspects of Saudi Arabian Law and Practice*, 17, 18. 9 B. C. Int'l & Comp. L. Rev. 1, 46 (1986).

<sup>77</sup> Issued by Royal Decree No. (32) dated 15/1/1350 H. Corresponding to 1931.

<sup>78</sup> The decision of the Council of Ministers No. (421) dated 26/10/1407 H. Corresponding to 1987.

<sup>79</sup> See *Figure 1.1*.

The judiciary in the Kingdom has developed significantly after the issuance of the new judicial law<sup>80</sup>, which brought huge changes to the system of litigation within the ordinary courts in 1975. Under the new system, for the first time, cases were heard on two levels. The ordinary courts in the Kingdom were divided into two groups: courts of first instance (trial courts); and courts of appeal which have the jurisdiction to hear disputes for the second time, through different chambers, concerning disputes that have been previously resolved by the first instance courts.<sup>81</sup> The new judicial law also created a Supreme Court to monitor the proper application of the provisions of Islamic Shari'a and the applicable regulations through its review and jurisdiction over judicial decisions issued or supported by the courts of appeal.<sup>82</sup> In general, the current system of ordinary courts consists of: The Supreme Court, the courts of appeal, and the courts of first instance, which include the general courts, criminal courts, family courts, commercial courts, and finally labor courts. The ordinary court system is organized hierarchically and expressed diagrammatically below in figure 1.1:

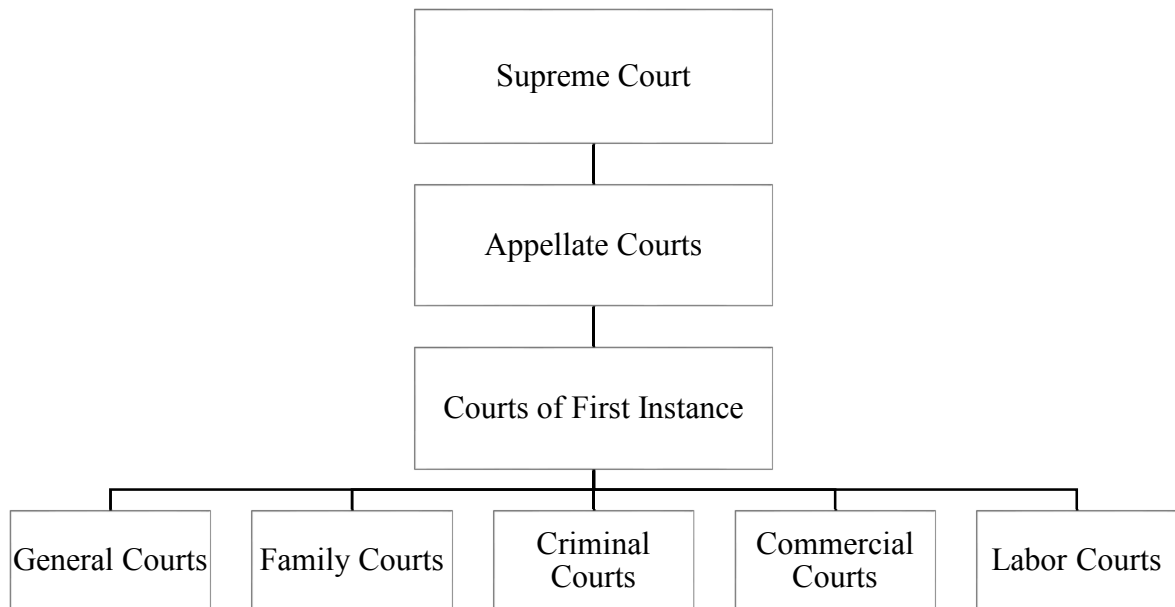
---

<sup>80</sup> The Law of Judiciary, Royal Decree No. M/78 dated 19/09/1428 H. Corresponding to 1 October 2007. See Bureau of Experts at the Council of Ministers, The Law of Judiciary, available at <https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=131&VersionID=160#search1>

<sup>81</sup> *Id.*, Article 9.

<sup>82</sup> *Id.*, Article 13.

Figure 1.1



*a. Supreme Court*

The Supreme Court is the highest judicial authority in the Kingdom of Saudi Arabia. According to the Judiciary Law, there is only one supreme court at the top of the judicial system in the Kingdom.<sup>83</sup> The Judiciary Law determines the jurisdiction and scope of review by the Supreme Court. Article 11 declares that the Supreme Court shall oversee the proper application of the provisions of Sharia and the laws issued by the King which

---

<sup>83</sup> *Id.*, Art. 10.

are not inconsistent with Sharia in cases under the jurisdiction of the ordinary courts in relation to the following:

- (1) Review of judgments and decisions issued or supported by courts of appeals relating to sentences of death, amputation, stoning, or *qisas* (lex talionis retribution) in cases of criminal homicide or lesser injuries.
- (2) Review of judgments and decisions issued or supported by courts of appeals relating to cases not mentioned in the previous paragraph or relating to ex parte cases or the like without dealing with the facts of the cases whenever an objection to the decision is based upon the following:
  - (a) Violating the provisions of Sharia or laws issued by the King which are not inconsistent with Sharia.
  - (b) Rendering of a judgment by a court improperly constituted as provided for in the provisions of this and other laws.
  - (c) Rendering of a judgment by an incompetent court or panel.
  - (d) An error in characterizing the incident or improperly describing it.<sup>84</sup>

*b. Appellate Courts*

Following the issuance of the new Judiciary Law in the Kingdom of Saudi Arabia in 2007, the Court of Appeal was established according to the new judicial system. The Courts of Appeal are divided into panels based on subject matter, such as Jural, Penal,

---

<sup>84</sup> *Id.*, Art. 11.

Family, Commercial, and Labor panels.<sup>85</sup> Courts of Appeal have jurisdiction over appealable judgments rendered by Courts of First Instance.<sup>86</sup>

*c. Courts of First Instance*

I. General Courts:

General courts consist of specialized panels that include panels for execution and for ex parte and similar cases.<sup>87</sup> The jurisdiction of the Courts of First Instance includes all cases and disputes except those explicitly excluded by the law. As general courts, they are particularly competent in the examination of property disputes and disputes relating to traffic accidents.<sup>88</sup>

II. Criminal Courts:

The criminal courts are concerned with all criminal cases, including cases of punishment, *Qisas (lex talionis)*, *Hadd* (Qur'anic prescribed punishment), and tortious cases as well as the adjudication of cases involving juveniles.<sup>89</sup> Each court is further composed of specialized panels, and each panel is composed of three judges except for cases determined by the Supreme Judicial Council which shall be reviewed by one judge.<sup>90</sup>

---

<sup>85</sup> *Id.*, Art. 16.

<sup>86</sup> *Id.*, Art. 17.

<sup>87</sup> *Id.*, Art. 19.

<sup>88</sup> Law of Procedure Before Sharia Courts, article 31. Royal Decree No. M/1 dated 22 / 1 / 1435 H. Corresponding to November 26, 2013. Available at

<https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=125&VersionID=303>

<sup>89</sup> Law of Criminal Procedure, article 28. Royal Decree No. M/2 dated 22 / 1 / 1435 H Corresponding to November 26, 2013. Available at

<https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=127&VersionID=304#search1>

<sup>90</sup> The Law of Judiciary, *supra* note 81, Art 20.

### III. Commercial Courts:

The administrative courts and the Board of Grievances (*Diwan AlMazalim*) were the competent authorities to deal with commercial and corporate disputes until the issuance of the new judicial system in 2007, which transferred the jurisdiction to the ordinary courts. As a result, the commercial courts became the competent authority to deal with commercial and corporate disputes. The commercial courts began to operate officially on Thursday September 21, 2017.<sup>91</sup> They deal with all cases and disputes resulting from the violation of commercial regulations, bankruptcy cases, and corporate disputes.<sup>92</sup> Commercial courts are composed of specialized panels, and each panel consists of one or more judges as determined by the Supreme Judicial Council.<sup>93</sup>

### IV. Labor Courts:

They deal with disputes relating to labor contracts, wages, and all cases resulting from violations of Saudi labor law.<sup>94, 95</sup> Labor Courts are composed of a number of specialized panels, and each panel consists of one or more judges as determined by the Supreme Judicial Council.<sup>96</sup>

### V. Family Courts:

---

<sup>91</sup> Even though the new judicial system was enacted in 2007, its actual implementation took more than 10 years, until the Ministry of Justice announced that it had officially enabled the commercial courts to start functioning. See Ministry of Justice, *News*, available at:

<https://www.moj.gov.sa/ar/MediaCenter/news/Pages/NewsDetails.aspx?itemId=359>

<sup>92</sup> Law of Procedure Before Sharia Courts, *supra* note 89, Art. 35.

<sup>93</sup> The Law of Judiciary, *supra* note 81, Art. 22.

<sup>94</sup> Law of Procedure Before Sharia Courts, *supra* note 89, Art 34.

<sup>95</sup> Labor Law, Royal Decree No. M/51 dated 23 / 8 / 1426 H. Corresponding to September 27, 2005. Available at:

<https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=186&VersionID=201#search1>

<sup>96</sup> The Law of Judiciary, *supra* note 81, Art. 22.

It deals with all matters of personal status such as marriage, divorce, inheritance, and other family matters.<sup>97</sup> Family Courts are composed of one or more panels, and each panel consists of one or more judges appointed by the Supreme Judicial Council, and may include specialized panels as needed.<sup>98</sup>

## 2. Administrative Courts

The Board of Grievances (*Diwan AlMazalim*)<sup>99</sup> is an independent administrative judicial court linked directly to the King, and it has only jurisdiction over claims against the Saudi Government.<sup>100</sup> The Administrative Courts are organized hierarchically as expressed diagrammatically below in figure 1.2:

---

<sup>97</sup> Law of Procedure Before Sharia Courts, *supra* note 89, Art 33.

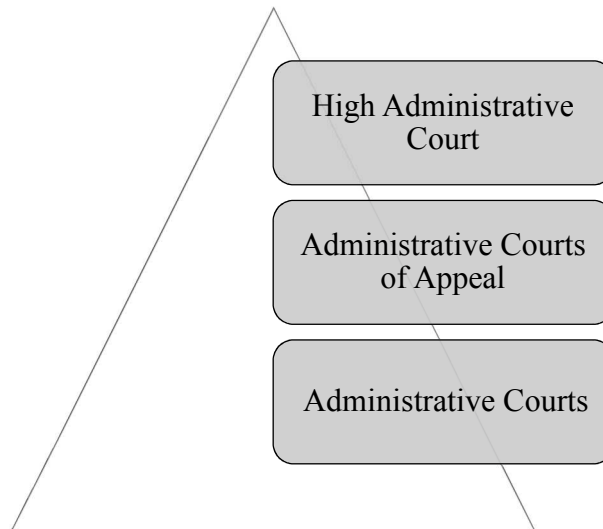
<sup>98</sup> The Law of Judiciary, *supra* note 81, Art. 21.

<sup>99</sup> Established pursuant to Royal Decree No. M/51, 17 Rajab 1402. Corresponding to 10 May 1982.

<sup>100</sup> Law of the Board of Grievances, article 1. Royal Decree No. M/78 dated 19 / 9 / 1428 H. Corresponding to 1 October 2007. Available at <https://www.boe.gov.sa/ViewSystemDetails.aspx?lang=en&SystemID=132&VersionID=161#search>



Figure 1.2:<sup>101</sup>



As in ordinary courts systems, the decisions of the highest court bind the lower courts.<sup>102</sup>

Article 13 of the Law of the Board of Grievances determines the Administrative Courts' jurisdiction which includes the following:

- (A) Cases relating to rights provided for in civil service, military service, and retirement laws for employees of the Government and entities with independent corporate personality.
- (B) Cases requesting revocation of final administrative decisions filed by the persons so affected where the appeal is based on the grounds of lack of jurisdiction, defect

---

<sup>101</sup> *Id.*, Art. 8.

<sup>102</sup> *Id.*, Art. 11. and Art. 12.

in form or cause, violation of laws and regulations, error in application or interpretation thereof, and/or abuse of power.

- (C) Tort cases initiated by the persons so affected against the administrative authority's decisions or actions.
- (D) Cases related to contracts to which the administrative authority is a party.
- (E) Disciplinary cases filed by the competent authority.
- (F) Requests for execution of foreign judgments and arbitration awards.<sup>103</sup>

---

<sup>103</sup> *Id.*, Art. 13.

## Chapter 3: Introductory Overview to the LLC in Saudi Arabia

### 3.1. Scope

In contrast to certain Western countries like the United States, which have enacted statutes specifically governing LLCs, the Kingdom of Saudi Arabia regulates all types of companies under one act (the Saudi Companies Regulation). Although some SCR sections pertain only to specific forms of business entity, many of its general provisions, such as penalty rules, apply to all companies equally. In comparison to the Companies Regulation of 1965, the new SCR introduced several changes to the rules governing LLCs. What follows is a historical explanation of the Companies Regulations' role in the Kingdom, as well an overview of key provisions applicable to LLCs. The chapter also discusses contractual obligations among company owners, the validity of contractual agreements forming LLCs, and mandatory and default statutory rules.

### 3.2. Saudi Companies Regulation

#### A. Introduction

The first law enacted in Saudi Arabia to regulate commercial transactions between traders in the kingdom was the Saudi Commercial Law (known as the Law of Commercial Court) in 1931.<sup>104</sup> This law is still in force today, but now its scope of application has become limited to a minimal number of businesses and commercial transactions since the

---

<sup>104</sup> The Law of Commercial Court issued by High Order No. 32 (15 Muharram 1350/June 2, 1931).

Saudi legislature introduced amendments to it. Some of the sections that regulated certain subjects, such as companies and commercial papers, were abolished in the Law of Commercial Court and are now governed by their own regulations. The first chapter of the Law of Commercial Court contained a special section that established very limited types of commercial companies.<sup>105</sup> However, over time, this law could not keep up with social developments or local and international changes to global trade, especially regarding corporate transactions. Thus, the first Companies Regulations was issued in 1965. Furthermore, in 2015, the Saudi legislature released the new Saudi Companies Regulation, introducing some noteworthy changes to certain types of companies, including LLCs.

#### B. Enactment of the First Companies Regulation in 1965<sup>106</sup>

The emergence of the oil industry in the Kingdom of Saudi Arabia and the kingdom's consequent renaissance in the middle of the last century affected all aspects of life, having a major impact on trade diversity and increasing the number of large urban projects. Often, it was necessary to establish companies with the financial, technical, and administrative capabilities to manage these projects.<sup>107</sup> Since these companies were in urgent need of laws to regulate their work and to provide adequate protections for investors (which the Law of Commercial Court had failed to do), the legislature had to develop new comprehensive regulations for companies. The Companies Regulations clarified the procedures for the formation of companies as well as the conduct of their activities and the

---

<sup>105</sup> *Id.*

<sup>106</sup> Saudi Companies Regulations issued by Royal Decree No. M/6 (1385/3/ 22 H. 1965).

<sup>107</sup> ALEXEI VASSILIEV, *THE HISTORY OF SAUDI ARABIA*, 462, 463 (1st ed. 1998).

dissolution and liquidation of their entities. The explanatory note in the Companies Regulations Proposal of 1965 stipulated the following:

Although the companies established in this short period were involved in all aspects of financial activities, whether commercial or industrial, having capital requirements of several hundred million SR, they increased the demand for interactions with government individuals and departments and the need for regulations to govern them. At that point, a few articles contained in the Commercial Court Law had not been sufficient to address all corporate issues at the time of corporate establishment, during the exercise of their business, or during their dissolution and liquidation.<sup>108</sup>

The Companies Regulations, therefore, introduced new types of business entities to the Kingdom of Saudi Arabia and organized them according to the requirements of the Saudi market and the needs of businesses at that time, which included the establishment of LLCs.<sup>109</sup> Even though these regulations have been modified several times since they were issued (more than fifty years ago),<sup>110</sup> they have become outdated, failing to meet recent requirements and increasing corporate responsibilities and complexities concerning shares, bankruptcy, and more complicated business transactions.<sup>111</sup> Therefore, the Saudi legislature considered the kingdom's needs when issuing the new Saudi Companies Regulation in 2015.

---

<sup>108</sup> Saudi Companies Regulations, explanatory note (1965).

<sup>109</sup> Saudi Companies Regulations, Art. 2 (1965).

<sup>110</sup> On July 17, 2007, the Saudi legislature issued amendments to two articles (158 and 180) of the previous Companies Regulations. These articles dealt with determining the capital of LLCs that required an immediate injection of capital when the capital decreases by fifty percent to avoid involuntary dissolution.

Article 158 of the previous Companies Regulations was amended to read as follows: "the capital of the LLC shall be determined by the shareholders in the Articles of Association" instead of "the capital of the LLC shall not be less than SR 500,000." In addition, Article 180 of the previous Companies Regulations was amended to require capital injections or dissolution when an LLC's amount of loss is half of the capital instead of three quarters of the capital. *See* Royal Decree No. M/60 (03 Rajab 1428/July 17, 2007).

<sup>111</sup> Saudi Companies Regulations (1965).

### C. The Issuance of the New Saudi Companies Regulation<sup>112</sup>

Due to fluctuations in oil prices and recent shocks to the Saudi economy, the Saudi government has moved to further support the private sector, lessening its dependence on oil revenues. The government issued the new Saudi Companies Regulation to build a more reliable platform for private sector investment. These regulations represent a significant step by the Saudi government to attract both Saudi and foreign investors. The new regulations aim to establish a set of principles and entities that will strengthen the commercial and investment sectors in the kingdom and to create sustainable economic development and institutions for the benefit of the business community and the nation. The following is a discussion of the most important changes introduced by the new Saudi Companies Regulation.

#### 3.3. Corporate Forms

The new Companies Regulation in the Kingdom regulates five types of business entities which include: General Partnerships (*sharikat al-tadamun*), Limited Partnerships (*sharikat al-tawsiya al-basita*), Joint Venture Companies (*sharikat al-mahasu*), Joint Stock Companies (JSC) (*sharikat al-musahama*), and Limited Liability Companies (LLC) (*al-sharika dhat mas'uliyya al mahdudah*).<sup>113</sup> The three types of corporate entities that were permitted by the previous regulations: Cooperative Companies (*al-sharika ta'awuniyya*), Partnerships Limited by Shares (*sharikat al-tawsiya bi'l ashum*), and Variable Capital

---

<sup>112</sup> The New Saudi Companies Regulations issued by Royal Decree No. M/3 (28/1/1437 H/November 12, 2015).

<sup>113</sup> Saudi Companies Regulations, Art. 3.

Companies (*al-sharika dhat ras al mal al qabil li tarir*), have been eliminated, and it is no longer possible to establish such companies.<sup>114</sup> Companies that were previously formed under the old regulations, and are now prohibited, must adopt another form of business entity permitted under the new regulations or they will be deemed null and void, and their partners will be held personally and jointly liable for the obligations of the voided company.<sup>115</sup> The new regulations related to general partnerships, limited partnerships, and joint ventures provided only limited changes to those entities the previous companies regulations, while significant changes have been made to the provisions regarding the JSCs and LLCs.

The different business entity forms used in the KSA each involve substantially different ownership rights. In partnerships, a partner can voluntarily withdraw and force the partnership's dissolution. This ability to exit and force a dissolution creates leverage that helps keep other partners honest. Joint stock company owners have access to public markets, providing a ready ability to sell if the company ceases to be a desirable investment. LLC shareholders, on the other hand, lack similar exit rights, and may not voluntarily withdraw and trigger a buy-out of their company shares. However, there are reasons for this difference in treatment. LLC owners are not given the right to voluntarily withdraw, and thereby trigger a buy-out right, because such an ability is viewed as prejudicial to LLC creditors. The right of partners to voluntarily withdraw does not present an equivalent concern. Partners are personally liable for partnership debts and therefore creditors have an alternative remedy.

---

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

### 3.4. The Number of Shareholders of LLC

Although it was not possible to form an LLC with less than a minimum of two shareholders under the old regime, the new SCR permit the formation of a single shareholder LLC.<sup>116</sup> The liability of an individual founder for the debts of the company is limited to the amount of funds allocated to the company's capital.<sup>117</sup> A single shareholder has the powers of the Manager, the Supervisory Board, and the General Assembly of the LLC.<sup>118</sup> Nevertheless, an LLC with a single shareholder is subject to the following:

- 1- A single-shareholder may only own one single-shareholder LLC.
- 2- Such an LLC may not incorporate or acquire another LLC owned by a single shareholder.<sup>119, 120</sup>

The number of shareholders in an LLC cannot exceed fifty, and if the number of shareholders goes beyond the maximum, the company must change its status to a JSC within one year. If it fails to do so, then it will be deemed dissolved by the operation of law.<sup>121</sup> The regime has excluded any increase in the number of shareholders (above fifty) if such increase results from inheritance or bequest.<sup>122</sup>

---

<sup>116</sup> Saudi Companies Regulations, Art. 154.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> The Saudi Companies Regulation, Article 55, also permits the formation of a single shareholder JSC in the following situations:

- The JSC is owned by the Saudi Government.
- Saudi Government establishments.
- Entities wholly owned by the Saudi Government.
- Any JSC with a minimum of SAR5m capital.

<sup>121</sup> Saudi Companies Regulations, Art. 151.

<sup>122</sup> *Id.*



### 3.5. Capital and Shares

The new SCR does not impose a minimum capitalization requirement on an LLC. Instead, IT states that the company's paid-up capital should be sufficient for the purpose for which the company was established, and that the company's paid-up capital should be determined in its Article of Association.<sup>123, 124</sup> Foreign investors are still subject to the rules of SAGIA (Saudi Arabian General Investment Authority) regarding the minimum paid-in capital requirement for foreign investors, depending on the type of industry that the LLC engages in and its business activity. SAGIA permits a foreign investor to own 100% of an LLC, but there are some exceptions to that permission. In certain types of business activities, SAGIA requires a minimum percentage of Saudi ownership in the foreign owned company.<sup>125</sup> The table below illustrates the minimum capital requirements and the percentages of Saudi ownership required in foreign investments according to the type of business activities:

---

<sup>123</sup> Saudi Companies Regulations, Art. 160.

<sup>124</sup> The new SCR also reduced the minimum share capital required for JSCs. The minimum share capital required for JSCs under the old regime was SR 2 million. The new SCR required JSCs to have SR 500,000. as the minimum share capital at start up (Article 54).

<sup>125</sup> Saudi Arabian General Investment Authority, *Investment Services Guide*, available at <https://www.sagia.gov.sa/en/InvestorServices/InvestmentServicesGuide/Documents/GENERALRULES.pdf>.

<b>Business Type</b>	<b>Minimum Capital</b>	<b>Minimum Saudi Ownership</b>
Industrial	SR 1,000,000 / USD 266,666	-
Commercial	SR 20,000,000 / USD 5,333,333	25%
Agricultural	SR 25,000,000 / USD 6, 666, 666	-
Communications	-	40%
Communications Value Added	-	30%
Real Estate Financing	SR 200,000,000 / USD 53, 333, 333	40%
Real Estate Development	SR 30,000,000 / USD 8,000,000	-
Management of Construction Projects, Detailed Engineering Design and EPC Contracts	-	25%

The primary legislative purpose for the minimum paid-up capital was to protect the LLC creditors and nurture confidence in financial markets.<sup>126</sup> Increasing the capital of an LLC requires the approval of both MoCI (The Ministry of Commerce and Investment) and all shareholders, while a decrease in capital requires approval by a super majority of shareholders, as well as MoCI.<sup>127, 128</sup> Additionally, a resolution to decrease capital requires LLCs to solicit potential objections from any and all creditors. If a creditor objects, the

---

<sup>126</sup> See Doing Business, *why are minimum capital requirements a concern for entrepreneurs?* at <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB14-Chapters/DB14-Why-are-minimum-capital-requirements.pdf>.

<sup>127</sup> Saudi Companies Regulation, Art. 174.

<sup>128</sup> Saudi Companies Regulations, Art. 177.

company shall pay him his debt if it is currently due, or, in the event of a future due date, provide a sufficient guarantee to fulfill it at that time.<sup>129,130</sup>

### 3.6. The Statutory Reserve

The statutory reserve of the company is used primarily to cover the company's losses or to increase its capital. The new Companies Regulations, as they were required under the old regulations, still mandate LLCs to set aside 10% of their yearly profits to fund the companies' statutory reserves.<sup>131</sup> LLCs were also required under the previous Companies Regulations to make contributions from the companies' profits to the statutory reserves, and these contributions were to continue until they reached 50% of the company's share capital.<sup>132</sup> Under the new Companies Regulations, the minimum total statutory reserve requirement has been reduced from 50% to 30% of the company's capital.<sup>133,134</sup>

### 3.7. Piercing the LLC Veil<sup>135</sup>

LLCs are generally considered separate legal entities, with a shareholder's liability limited to the amount of capital they have contributed to the company. Thus, no shareholder shall be liable for the debts of the company, obligations incurred or losses thereof, except

---

<sup>129</sup> *Id.*

<sup>130</sup> See the discussion in Chapter 5

<sup>131</sup> Saudi Companies Regulation, Art 176.

<sup>132</sup> The Saudi Old Companies Regulations, Art. 176.

<sup>133</sup> Saudi Companies Regulations, Art 176.

<sup>134</sup> The new SCR also reduced the minimum total statutory reserve requirement of the JSCs from 50% to 30% of a company's capital. Article 129.

<sup>135</sup> Refers to a situation in which the competent authority may disregard the separate corporate existence and impose personal liability on the managers (directors) or shareholders of the company.

to the extent of his or her capital contribution.<sup>136</sup> Once a shareholder pays the full amount of his share in the LLC capital contribution as required by the SCR, a shareholder's liability will be limited to this share and not beyond.<sup>137</sup> If a limited liability company incurs debts or losses that exceed its capital, and is unable to meet these debts or cover the loss, it becomes bankrupt. In such a scenario, creditors only have a claim against the company to the extent of its corporate assets. If the LLC fails to meet its obligations and faces liquidation, the personal assets of the individual owners are generally exempt from any claims or liabilities related to the LLC's business activities.

There are, however, certain exceptions to this general rule, such that shareholders or managers of a limited liability company can be personally and jointly liable for claims against the LLC.<sup>138</sup>

Specifically, the LLC corporate veil may be pierced in the event of misconduct, or negligent failure to act in a manner required by SCR. Such malfeasance or negligence not only subjects the officer or shareholder responsible to potential personal liability, but can also similarly affect other shareholders and managers in the LLC. It is therefore critical that LLC owners be aware of circumstances that may lead the LLC to lose its limitation on personal liability, as such awareness will be a significant help in avoiding such scenarios.<sup>139</sup>

---

<sup>136</sup> Saudi Companies Regulation, Art. 151.

<sup>137</sup> *Id.*, Art. 157.

<sup>138</sup> *Piercing the veil* of LLCs is an available remedy under the Saudi Companies Regulation. Under certain conditions, this remedy is available not only for third parties who are dealing with the LLC, but also for other affected partners and managers who incurred losses by reason of their participation in an LLC whose veil has been pierced.

<sup>139</sup> The joint and personal liability of shareholders and managers under the SCR is mandatory (public-order) in regard to all Managers, and as to any shareholders involved in actions causing the veil to be pierced. LLC owners cannot agree in their Article of Association to vary such liability. The SCR prohibits any agreement among shareholders to exempt any manager or shareholder from assuming personal or joint liability. *See* Saudi Companies Regulation (*Article 164*). The SCR also does not allow any agreement in the LLC Articles of Association exempting any shareholder from bearing losses in the event the LLC faces losses, even if such losses are limited to the shareholder's capital contribution, unless a shareholder's contribution to the business is a service. *See* Saudi Companies Regulation (*Article 9*).

What follows is an explanation of the specific circumstances that may trigger a piercing of the LLC veil under the SCR.

#### A. Capital Reduction

Under the old Companies Regulations, if the LLC's losses exceeded 50% of its capital, and the company's shareholders took no action to inject more capital, the shareholders could potentially lose their LLC limited liability protection.<sup>140</sup> The risk that a serious reduction in capital could lead to personal liability led many startup businesses to avoid forming LLCs. The new Companies Regulations, however, do not permit piercing the corporate veil in the event of such a reduction in capital. Under the new regulations, if a company's losses exceed 50% of its capital, and shareholders fail to take certain required legal steps within 90 days, the LLC is deemed dissolved by operation of law.<sup>141</sup> In such a scenario, managers of the LLC may still face criminal sanctions if they: (1) fail to take appropriate or legally required actions upon learning that losses have reached one half of the company's capital; (2) fail to make the required announcements; or (3) fail to call a shareholder meeting once company losses exceed 50% of its capital.<sup>142</sup>

#### B. Formation Defects

---

<sup>140</sup> The Old Saudi Companies Regulations, Art. 180.

<sup>141</sup> Saudi Companies Regulations, Art. 181.

<sup>142</sup> *Id.*, Art. 211.

Any defects in an LLC formation can also threaten the limitation on shareholder personal liability. A limited liability company that is established in violation of the provisions of the SCR is considered invalid. If the invalidity was determined as a result of the violation, the shareholders who caused it will be jointly liable to the rest of the shareholders in the LLC and third parties for the damage caused by such invalidity due to defects in an LLC formation.<sup>143</sup> The SCR requires that both the LLC Article of Association and any subsequent amendments be in writing, and authenticated by the competent authority.<sup>144</sup> Failure to do so renders the Article of Association or any amendment thereafter null and void.<sup>145</sup> To be valid, an LLC's Article of Association must also include all information specified under the SCR, and be signed by all shareholders. In particular, an LLC Article of Association must include the following information:

- (1) The type of company, its name, purpose and its head office.
- (2) The names of the shareholders, their places of residence, professions and nationalities.
- (3) The names of the members of the Supervisory Board, if any.
- (4) The amount of capital, the portion of capital in cash and the portion in kind, with a detailed description of the portions in kind, their value, and the names of their offering shareholders.

---

<sup>143</sup> *Id.*, Art. 159.

<sup>144</sup> Applications for approval of a company's formation agreement are submitted electronically via the Ministry of Commerce and Investment website. The formation agreements signed electronically must be authenticated by the nearest notary public, in order to document formation of the company. *See* Ministry of Commerce and Investment, *issuing a Contract for Establishing a Company (2016)*, available at <https://mci.gov.sa/en/ServicesDirectory/Pages/Companies-2015-02.aspx>.

<sup>145</sup> Saudi Companies Regulations, Art 12.

- (5) A ratification by the shareholders to distribute all shares of capital and to fulfill the full value of these shares.
- (6) The method of distributing profits.
- (7) The company's start and end date.
- (8) The form of notifications that may be sent by the company to the shareholders.<sup>146</sup>

The LLC Article of Association must also be published in order for the SCR to deem it effective in regard to third parties. The old Companies Regulations required the managers of LLCs, within thirty days of establishing or amending their Articles of Association, to publish said Articles of Association in the official gazette or a newspaper.<sup>147</sup> In addition, the company was required to list itself in the commercial register in accordance with the provisions of the Commercial Register Regulations.<sup>148</sup> The new Regulations require the publication of the Articles of Association only on MOCI's<sup>149</sup> (Ministry of Commerce's) website, and no longer require their publication in the official gazette or a local newspaper.<sup>150</sup> Nevertheless, an LLC's managers are still obliged to enter the company into the commercial register within 30 days of formation in order to comply with The Commercial Register Regulations.<sup>151</sup> An LLC will be deemed invalid if the Article of Association is not in writing, the required information is not included, or the Article is not signed by all shareholders.<sup>152</sup> In addition to causing SCR to deem the LLC invalid, violation of LLC formation rules will also lead to penal sanctions when the commission of

---

<sup>146</sup> *Id.*, Art. 156.

<sup>147</sup> The Saudi old Companies Regulations, Art. 164.

<sup>148</sup> *Id.*

<sup>149</sup> The Ministry of Commerce and Investment.

<sup>150</sup> Saudi Companies Regulation, Art. 158.

<sup>151</sup> *Id.*

<sup>152</sup> Saudi Companies Regulations, Art. 159.

a crime in which criminal responsibility is held is in place. Any person who fails to perform his or her duty with respect to publication of the company's establishment contract, any amendments thereof, or its registration in the commercial register in accordance with the SCR and CRL (Commercial Register Law) is subject to a fine of not more than five hundred thousand SR.<sup>153</sup>

### C. Management Error and Violation of Law

The same penalties apply to LLC managers if they become jointly liable by violating either the SCR itself, the company's Article of Association, or should they commit clear errors while performing their obligations.<sup>154</sup> By contrast, Supervisory Board members will not be liable for any actions taken by managers, and may not be questioned about them, unless they became aware of manager errors and failed to notify the General Assembly.<sup>155</sup> An LLC auditor will be liable for any damages his or her professional errors cause for the company, the shareholders or third parties. If more than one auditor caused the error, they will each be jointly liable for the damages resulting from their errors.<sup>156,157</sup>

### D. Single-Shareholder LLC

---

<sup>153</sup> *Id.*, Art. 213.

<sup>154</sup> *Id.*, Art. 165.

<sup>155</sup> *Id.*, Art. 172.

<sup>156</sup> *Id.*, Art. 136.

<sup>157</sup> Article 136 relates to provisions for the auditor of joint stock companies. The Saudi Companies Law Article 166 explicitly states that the auditor of a limited company is subject to the same provisions as an auditor in a joint stock company. Therefore, this article regarding the determination of civil liability for an auditor also applies to the auditor of a limited liability company.



The SCR explicitly states that the corporate veil of a single-shareholder LLC will be pierced and the owner of the company subject to personal liability for any company losses or obligations with respect to third parties, in the following situations:

- (a) The owner of a Single-Shareholder LLC liquidates the company in bad faith before its date of expiry or before the achievement of the purpose for which it was established.
- (b) If the business of the company and the owner's other private business are not separated.
- (c) If the owner has done business on behalf of the company prior to the LLC acquiring its legal personality.<sup>158</sup>

#### E. Valuation of In-Kind Capital Contribution

The SCR stipulates that all LLC capital contributions in cash must be deposited in a bank licensed by the Saudi Arabian Monetary Agency (SAMA), and said bank must not disburse such cash shares before completion of company attestation procedures and registration in the commercial registry.<sup>159</sup> As for contributions in kind, the application for LLC establishment and registration must be accompanied by a report prepared by an expert or an authorized appraiser, stating the fair value of such contributions.<sup>160</sup> The report must then be submitted to the General Assembly for consideration. If the Assembly decides to reduce the value set for the contributions in kind, such reduction must be approved during the meeting. If they refuse to approve the reduction, the company's articles of Association

---

<sup>158</sup> Saudi Companies Regulation, Art. 155.

<sup>159</sup> *Id.*, Art. 157.

<sup>160</sup> Saudi Companies Regulations, Art. 61.

will be considered null and void with regard to all its shareholders.<sup>161</sup> In that event, the shareholders will be personally and jointly liable toward third parties for the right estimation of the shares in kind. However, any claim of liability under this provision will only be considered if raised within five years from the date of fulfilling the registration procedures.<sup>162</sup>

#### F. Fraudulent Act

Article 165 of the SCR states clearly that LLC managers will be jointly liable for any losses or damages that their fraudulent conduct causes to the company, the shareholders, or third parties.<sup>163</sup> However, the SCR does not include any definition of what might constitute a "Fraudulent Act". The courts in this situation will most likely consider what constitute an act of fraud under the Shari'a, or Islamic, Law. Under Islamic law, fraud may be committed by way of actions, statements, or failures to disclose.<sup>164</sup> Islamic legal schools of thought generally agree that two major elements must be present to constitute an act of fraud:

- (1) Exploitation by means of trickery.
- (2) Inducement of the other party.<sup>165</sup>

---

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*, Art. 157.

<sup>163</sup> *Id.*, Art 165.

<sup>164</sup> See Accounting Research Institute & Faculty of Accountancy and UPENA Malaysian *Accountancy Research and Education Foundation, Tadlis In Islamic Transactions (2010) Universiti Teknologi MARA*. available at <http://ari.uitm.edu.my/main/images/MAR/vol09-2/chap4.pdf>

<sup>165</sup> *Id.*

Nevertheless, the concept of fraud in Islamic jurisprudence is a very broad one and its application within the context of corporate malfeasance under LLC law is unclear under the Saudi legal system.

### 3.8. Holding Companies<sup>166</sup>

Holding companies have, for the first time, been specifically recognized and provided for in the new SCR. The new Regulation permits LLCs and JSCs to choose to be characterized as holding companies by adding the word “holding” to the company's name. The revised SCR states that a holding company shall hold a controlling interest in its subsidiaries, either by owning more than half of such companies’ capital, or by controlling the subsidiaries’ board of directors.<sup>167</sup> The purposes of the holding company are also defined as follows:

- (a) Managing its subsidiaries or participating in the management of the companies it owns shares in and providing support to them.
- (b) Investing its funds in shares and other financial instruments.
- (c) Acquiring and utilizing industrial property rights, including patents, industrial and commercial trademarks, franchise rights, and other intangible rights, and leasing them to its subsidiaries or others.
- (d) Owning real estate and other movable properties that are deemed necessary to performing the company’s activities.

---

<sup>166</sup> *Holding Companies* have been defined by the Companies Regulations as joint stock or limited liability companies that aim to control other joint stock or limited liability companies called affiliated companies. Article 182.

<sup>167</sup> Saudi Companies Regulations, Art. 182.

- (e) Providing loans, guarantees, and financing to its affiliate companies.
- (f) Any other legitimate purpose that comports with the nature of the company.<sup>168</sup>

### 3.9. Publication of LLC Articles of Association

The old SCR required LLC managers, within thirty days of establishing or amending their Articles of Association, to publish the Articles in the official gazette or a newspaper.<sup>169</sup> They were additionally required to register the company in the commercial register in accordance with the provisions of the Commercial Register Regulations.<sup>170</sup> The new SCR requires publication of the Articles of Association only on MOCI's<sup>171</sup> website, and no longer requires official gazette or local newspaper publication.<sup>172</sup> LLCs managers are still obliged to enter the company into the commercial register within 30 days in order to comply with The Commercial Register Regulations.<sup>173</sup>

### 3.10. Issuing Sukuk<sup>174</sup> and Other Debt Instruments

---

<sup>168</sup> *Id.*, Art. 183.

<sup>169</sup> The old Saudi Companies Regulations, Art. 164.

<sup>170</sup> *Id.*

<sup>171</sup> The Ministry of Commerce and Investment.

<sup>172</sup> Saudi Companies Regulation, Art. 158.

<sup>173</sup> *Supra Id.*

<sup>174</sup> Sukuk are Islamic bonds, or so-called "Islamic securities." They are official documents and financial certificates equivalent in value to ownership shares of tangible assets relating to particular projects, such as a benefit or a right, or an amount of money or debt. The property involved is either already in existence or in the process of being established. When the Sukuk is issued, it is a legally binding contract. Sukuk allows investors to participate in the short or long-term financing of an investment project or process, and to share in profits and losses. In Saudi Arabia, Sukuk are widely traded and represent undivided shares in joint stock companies. For more information about Sukuk, see LAHSASNA A. ZADA N., SALEEM M.Y., ON SUKUK INSOLVENCIES: A CASE STUDY OF EAST CAMERON PARTNER, 32-35 (Palgrave Macmillan, Cham. 2016) Available at [https://doi.org/10.1007/978-3-319-33991-7\\_3](https://doi.org/10.1007/978-3-319-33991-7_3).

The SCR prohibits LLCs from entering into an initial public offering (IPO).<sup>175</sup> Therefore, LLCs cannot be established, increase their capital, or borrow for their account through an IPO, and may not issue shares or bonds that are offered to the public through an IPO or represented in tradable Sukuk.<sup>176</sup> It is clear that the Saudi legislature reached this decision after taking into account the nature of LLCs and the personal considerations of their shareholders. However, LLC shares themselves are not restricted from trading, and an LLC shareholder may assign his or her share to another shareholder or to third parties,<sup>177</sup> in accordance with the terms of the company's Articles of Association.<sup>178</sup> JSCs, on the other hand, are permitted to issue debt instruments or negotiable financing Sukuk, in accordance with CMA<sup>179</sup> regulations.<sup>180</sup>

### 3.11. Management Structure

An LLC is usually managed by one or more managers, typically referred to as general managers. In addition to its general managers, an LLC is also managed by a General Assembly,<sup>181</sup> comprising all of the company's shareholders. The LLC must also have an auditor, and, for LLCs with more than 20 shareholders, a Supervisory Board consisting of three or more shareholders is required. All required positions must be included in the

---

<sup>175</sup> Saudi Companies Regulation, Art. 153.

<sup>176</sup> *Id.*

<sup>177</sup> See the discussion in Chapter 4.

<sup>178</sup> *Id.*, Art. 161.

<sup>179</sup> (CMA) The Capital Market Authority of Saudi Arabia is the Saudi Government's financial regulatory authority responsible for capital markets in Saudi Arabia.

<sup>180</sup> Saudi Companies Regulations, Art. 105-125.

<sup>181</sup> Like JSCs, the Companies Regulations require LLCs to have a General Assembly comprising all of the company's owners, and a Supervisory Board when the number of the shareholders exceeds 20.

company's Articles of Association.<sup>182</sup> What follows is an explanation of LLC managing bodies under the SCR.

#### A. The Managers

The LLC's shareholders select the number of managers it will have.<sup>183</sup> The number chosen must be referenced in in the company's Articles of Association or in an independent document, with the number in effect for either a fixed or indefinite period of time.<sup>184</sup> If more than one manager is chosen, the SCR also authorizes an LLC, pursuant to shareholder approval, to form a Board of Managers.<sup>185</sup> The Articles of Association must specify the duties of the Board of Managers, as well as the voting percentage required for any of its decisions.<sup>186</sup> General Managers are required to prepare annual financial statements for the company, as well as a report on the company's activities and any management proposals regarding profit distribution. This information must be provided within three months of the close of the financial year.<sup>187</sup> Such documents, as well as a copy of the auditor's report, must also be sent to the MoCI and to each of the company's shareholders within one month of their preparation. Each shareholder has the right to request that General Managers call a meeting of the General Assembly of shareholders to discuss any of these documents.<sup>188</sup>

---

<sup>182</sup> Saudi Companies Regulations, Art. 172.

<sup>183</sup> An LLC in the United States is permitted to be run and managed by its owners without having to appoint a specific manager to be responsible for the company's operations. In contrast, LLCs in Saudi Arabia have more formalities in regard to the management of the company. Under Saudi law, LLCs are required to have at least one General Manager to run the LLC as well as the required company's General Assembly.

<sup>184</sup> Saudi Companies Regulations, Art. 164.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> Saudi Companies Regulations, Art. 175.

<sup>188</sup> *Id.*

## B. The General Assembly

Similarly to Joint Stock Companies, LLCs have a General Assembly where all shareholders are members. The General Assembly and its resolutions must comply with numerous legal requirements. The Assembly must meet at least once a year, within the four months following the end of the fiscal year, at the invitation of the LLC's manager and in accordance with conditions set out in company's Articles. The Assembly may also meet at any other time upon request of the company managers, the supervisory board, the auditor, or shareholders representing at least one-half of the company's capital.<sup>189</sup> Shareholder (or "partner") decisions are issued by the General Assembly. However, companies with fewer than 20 shareholders may solicit written opinions from the shareholders in lieu of a meeting. In such companies, the manager must send each shareholder a registered letter containing all proposed resolutions to be voted upon by the shareholder "in writing".<sup>190</sup> All shareholder decisions are valid only if approved by shareholders representing more than one-half of the company's capital, unless the company Articles require a larger majority.<sup>191</sup> In the event shareholders fail to reach the required majority when voting on decisions during their first deliberation and consultation, the law provides that the shareholders must be invited to a second meeting via registered letter. However, the decisions made at this second meeting must be approved only by a majority of shares represented at the meeting, whatever percentage of the company's capital they

---

<sup>189</sup> Saudi Companies Regulation, Art. 167.

<sup>190</sup> *Id.*, Art. 168.

<sup>191</sup> *Id.*

represent, unless the company's Articles of Association provides otherwise.<sup>192</sup> A decision to alter an LLC's nationality or increase its capital must be approved by all shareholders. A capital increase can be achieved either by raising the nominal value of existing shares or by issuing new shares. In the event an increase in capital is approved, all shareholders increase their capital contribution in proportion to their respective share of the capital.<sup>193</sup> All other amendments to the company's Articles of Association may be approved by shareholders representing at least three-quarters of the capital, unless the Articles provide otherwise.<sup>194</sup>

The SCR requires that the General Assembly's agenda at its annual meeting include the following items:

- (a) Hearing manager reports on the company's activities and financial position during the financial year, the report of the auditor, and the report of the Supervisory Board, if any.
- (b) Discussing and ratifying financial statements.
- (c) Determining the percentage of profit to be distributed to shareholders.
- (d) Appointing managers of the company or members of the Supervisory Board, if any, and determining their remuneration.
- (e) Appointing the auditor and determining his or her fees.
- (f) Discussing any other matters falling within the authority of the General Assembly under the SCR or the LLC's Articles of Association.<sup>195</sup>

---

<sup>192</sup> *Id.*

<sup>193</sup> Saudi Companies Regulations, Art. 174.

<sup>194</sup> *Id.*

<sup>195</sup> Saudi Companies Regulation, Art. 169.



The General Assembly may not deal with matters other than those on the agenda, unless necessary to address new facts which come to light during the meeting. If a shareholder requests that a particular issue be included in the agenda, the company's managers must respond to the request, as otherwise the shareholder will have the right to appeal to the General Assembly.<sup>196</sup> Each shareholder has the right to discuss issues on the General Assembly's agenda, and managers are obliged to answer shareholder questions.<sup>197</sup>

### C. The Supervisory Board

If an LLC contains more than 20 shareholders, the SCR requires a Supervisory Board be appointed and expressly designated in the company's Articles of Association. The Board must consist of at least three shareholders. If an LLC grows to include more than 20 shareholders after its formation, the Supervisory Board must be appointed at the earliest reasonable time.<sup>198</sup> The General Assembly may re-appoint Supervisory Board members after their terms of service expire, or it can choose to appoint different shareholders. The General Assembly may also remove board members at any time, if there is an acceptable reason. Company managers have no power to vote in the election or removal of any Supervisory Board member.<sup>199</sup> Supervisory Board authority includes the power to monitor company operations, to express its opinion on matters presented to it by the managers, and to designate the types of actions which require prior authorization from the Supervisory Board.<sup>200</sup> The Supervisory Board must also submit an annual report to the General

---

<sup>196</sup> *Id.*, Art. 170.

<sup>197</sup> *Id.*, Art. 171.

<sup>198</sup> *Id.*, Art. 172.

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

Assembly, at the end of each financial year, detailing the results of its monitoring activities. Supervisory Board members may not be held liable for any actions taken by LLC managers unless the members were aware of manager misconduct and failed to inform the General Assembly.<sup>201</sup> The SCR does not prevent an LLC with fewer than 20 shareholders from forming a Supervisory Board if it so desires.

*D. The Auditor*<sup>202</sup>

SCR Article 166 requires an LLC to have one or more auditors, in accord with the same provisions governing auditors of JSCs. The auditor must review and monitor company accounts. The auditor is entitled to inspect the company's books, records, and other documents, and to request additional information or clarification whenever he or she believes it necessary to ascertain the company's assets and liabilities.<sup>203</sup> The auditor is obligated to submit a report to the General Assembly regarding any issues on which he or she has sought necessary information or clarification from company managers.<sup>204</sup>

### 3.12. Validity of Contracts Generating LLCs

---

<sup>201</sup> *Id.*

<sup>202</sup> The auditor of the company must be authorized to work in the Kingdom. He or she operates with independence, must be competent and experienced, and have proper qualifications. The regulations with which an auditor must comply are as follows:

- (1) - Be a person authorized to work in the Kingdom.
- (2) - Not be a participant in the establishment of the company or a member of the Board of Managers or perform technical or administrative work for the company.
- (3) - Not be a partner of one of the founders of the company, a member of its board of managers, or an employee of any of them. (Article 133).

<sup>203</sup> Saudi Companies Regulation, Art. 134.

<sup>204</sup> *Id.*, Art. 135.

LLC agreements and contracts among shareholders are enforceable and valid only if the terms and provisions comply with Sharia law and Companies Law. For a contract to be valid under Islamic law (including contracts establishing and organizing companies), several features must be present.<sup>205</sup> Complete satisfaction and accord among the parties must occur regarding their willingness to enter into the contract, including their full approval of all contract terms, specifically the company's purpose, capital, and method of management. If a shareholder's consent is invalid, as in cases of coercion, fraud (*Tadlis*), mistake, or injustice, the company's Article of Association will be void.<sup>206,207</sup> Additionally, the company's founding purpose must be lawful and feasible, or else the company's formation will be deemed invalid. The SCR also prohibits LLCs from engaging in banking, finance and savings, or insurance activities; any LLC formed for these purposes is therefore void.<sup>208</sup>

An essential condition for a company's contracts to be valid is compliance with the multiplicity of shareholders rule resulting in the approval of two or more wishes to establish the company.<sup>209</sup> The multiplicity of shareholders is a general rule, and the SCR has introduced new exceptions with regard to the single-shareholder LLCs and a single-shareholder JSC. The Companies Law also requires delivery of each shareholder's capital

---

<sup>205</sup> MONZER KAHF, *ISLAMIC FINANCE CONTRACTS* 41–42 (1st ed. 2013).

<sup>206</sup> *Id.*

<sup>207</sup> Islamic law defines fraud more broadly and deeply than Western laws do, and any fraud associated with any contractual obligation has the inevitable consequence of voiding that contract. *See* Malaysian Accountancy Research and Education Foundation, *Tadlis in Islamic Transactions* (2010), <http://ari.uitm.edu.my/main/images/MAR/vol09-2/chap4.pdf>. “Fraud” may occur during the formation of the company contract if one party uses fraudulent methods or deceptions to induce another party to agree to the company contract. If fraud induced the latter party to enter the contract, the contract is voidable. A “mistake” may also occur when forming a company contract if there is an “illusion” or mistake of fact in the mind of one of the parties, leading that party to participate in the company contract. A mistake is an additional ground for nullification of a contract establishing the company (Article of Association) if it is essential. *See* KAHF, *supra* note 103.

<sup>208</sup> The New Saudi Companies Regulation, art. 153 (2015).

<sup>209</sup> *Id.* at art. 2.

contribution, whether the contribution is cash, in kind, or services, as delivery of capital is necessary to guarantee the company to creditors.<sup>210</sup> Furthermore, the company's contract must not contain any terms that prevent any of the shareholders from obtaining every share in the profits, and it must agree on the specified percentage of profit distribution, even if it is only a few portions. Moreover, the company may not exempt any of the shareholders from bearing losses incurred by the company, and any agreement that deprives any shareholder from sharing in either profits or losses from the company will be considered invalid.<sup>211</sup>

### 3.13. Mandatory or Default Rules

Part of this research involves examining the extent to which default or mandatory rules better serve the interests of minority LLC shareholders. Western legal literature contains extensive discussion on whether corporate regulations should be mandatory, and thus not subject to modification, or default, thereby permitting contractual modification if shareholders agree.<sup>212,213</sup>

Scholars in favor of mandatory corporate rules offer several justifications. First, shareholders may at times need protection from a company's board of directors, and minority shareholders may also need protection from controlling shareholders.<sup>214</sup> Non-

---

<sup>210</sup> *Id.* at art. 2, art. 5.

<sup>211</sup> *Id.* at art. 9.

<sup>212</sup> Brett H. McDonnell, *Sticky Defaults and Altering Rules in Corporate Law*, 60 S.M.U. L. Rev. 383, 440 (2007), <https://scholar.smu.edu/cgi/viewcontent.cgi?article=1448&context=smulr>.

<sup>213</sup> Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989), <https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=7236&context=yj>. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (First ed, 1991).

<sup>214</sup> McDonnell, *supra* note 213, at 397.

mandatory rules potentially enable controlling shareholders to devise resolutions which benefit the majority at the expense of minority shareholders, so long as they have the voting power to do so.<sup>215</sup> Further, minimum mandatory rules are essential to fill any gaps in a company's Articles and prevent controlling shareholders from misusing the Articles when unexpected situations arise.<sup>216</sup> Under this theory, an LLC agreement is a long-term relational contract in which benefits for all participants significantly depend on unstated assumptions, which cannot always be satisfactorily articulated in advance.<sup>217</sup> Since it would be impractical to expect parties to negotiate ahead of time for protection against all possible abuses which might arise, such unforeseeable circumstances argue for certain minimum, non-waivable standards enforceable by the courts.<sup>218</sup> Additionally, many small-business investors are not particularly sophisticated or experienced, and often invest at the behest of friends or family without considering all possible risks. Mandatory shareholder protections are thus important to guard against potential future oppression.<sup>219</sup> A second argument for mandatory rules is that they play a significant role in protecting third parties, and particularly a company's creditors.<sup>220</sup> Rules allowing piercing of the corporate veil, legal capital rules, and duties owed to creditors during a company's insolvency are all important protections for creditors and other third parties, and should be mandatory.<sup>221</sup>

Scholars who support the default approach argue that mandatory rules decrease flexibility and prevent shareholders from negotiating rules most appropriate for their own

---

<sup>215</sup> *Id.*

<sup>216</sup> Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 *Fordham L. Rev.* 1161 (2011). Available at: <http://ir.lawnet.fordham.edu/r/vol79/iss3/13>.

<sup>217</sup> *Id.*, at. 1198.

<sup>218</sup> *Id.*, at. 1185.

<sup>219</sup> *Id.*, at. 1163.

<sup>220</sup> McDonnell, *supra* note 213 at 399.

<sup>221</sup> *Id.*

individual company.<sup>222</sup> Imposing mandatory protections for minority investors in closely held companies dictates a uniform standard of conduct that considerably limits shareholder freedom.<sup>223</sup> Investors and businesspeople have diverse risk preferences and investment objectives, and accordingly differ extensively regarding the ideal set of governing rules.<sup>224</sup> Under this theory, the best protection against the threat of majority oppression is the particular agreement negotiated by the shareholders themselves, who know better than the government how to structure a company agreement suited to their unique circumstances. Non-waivable mandatory legal protections, under this view, are too burdensome and inefficient to fit every company's needs.<sup>225</sup> Economists and corporate scholars generally believe that private parties are best positioned to protect their own interests when entering into voluntary agreements, and mandatory rules only serve to unnecessarily complicate that process.<sup>226</sup> The ability of investors in closely-held companies to bargain directly with each other supports maximizing their contractual freedom.<sup>227</sup> Some contend that scholars arguing for mandatory minority shareholder protections are doing so because they mistakenly think courts cannot distinguish between knowing and voluntary contractual waivers, and unknowing or involuntary waivers.<sup>228</sup> Courts, however, are more than capable of determining whether minority shareholders have been clearly deprived of default

---

<sup>222</sup> Ige Omotayo Bolodeoku, *Contractarianism and Corporate Law: Alternative Explanations to the Law's Mandatory and Enabling/Default Contents*, 13 *Cardozo J. Int'l & Comp. L.* 433 (2005).

<sup>223</sup> Robert C. Illig, *Minority Investor Protections as Default Norms: Using Price to Illuminate the Deal in Close Corporations*, 56 *Am. U. L. Rev.* 275, 366 (2006). Available at <https://digitalcommons.wcl.american.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1273&context=aulr>

<sup>224</sup> *Id.*, at 277.

<sup>225</sup> *Id.*, at 278

<sup>226</sup> McDonnell, *supra* note 213, at 387.

<sup>227</sup> Illig, *supra* note 224, at 279.

<sup>228</sup> *Id.*

protections without any compensation for their increased risks.<sup>229</sup> Default rules therefore do not leave minority investors completely helpless, as any contractual waiver will be judicially scrutinized to make sure it comports with the parties' reasonable expectations.<sup>230</sup> Thus, the proper solution for the dilemma of minority investor vulnerability is not mandatory rules, but rather default rules which can be waived, but only knowingly.<sup>231</sup>

Another factor in analyzing the benefits of mandatory versus default rules is whether the country in question is a developed or developing one.<sup>232</sup> Some commentators argue that mandatory company rules are necessary in developing countries to offset the lack of existing institutions which might otherwise protect investors.<sup>233</sup> Countries lacking stable and reliable judicial systems, effective market institutions, knowledgeable and sophisticated market participants, and reliable internal corporate governance systems need the certainty of mandatory rules.<sup>234</sup> Under this view, countries that rely more heavily on default protections, such as the U.S. and other advanced economies, manage to do so only because of complementary institutions that make up for any deficits in negotiated corporate rules.<sup>235</sup> Paedreas maintains that an enabling/default corporate law structure will generally fail to protect minority shareholders in countries lacking reliable legal and economic institutions.<sup>236</sup> Therefore, Paedreas argues that adopting American-style corporate law only works for countries with American-style supporting institutions, and that developing

---

<sup>229</sup> *Id.*, at 381.

<sup>230</sup> Means, *supra* note 217, at 1210.

<sup>231</sup> Illig, *supra* note 224, at 281.

<sup>232</sup> Bolodeoku, *supra* note 223, at 476.

<sup>233</sup> *Id.*, at 441

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

<sup>236</sup> Troy A. Paedreas, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 *W. & MARY L. REV.* 1055 (2004).

nations should not seek to replicate U.S. corporate rules.<sup>237</sup> Bolodeoku, on the other hand, rejects this view, arguing that the country's development status should not dictate one approach over the other, and that purely mandatory or purely default systems are never ideal in the first place.<sup>238</sup> He contends that many countries have developed relatively well-functioning markets despite corrupt or inefficient judicial systems, and that extensive mandatory rules are not necessarily required.<sup>239</sup> Bolodeoku further argues that an extreme "defaultization" corporate law approach may encourage managerial despotism regardless of how well-developed a country's institutions are, leading to minority shareholder abuse.<sup>240</sup> Bolodeoku ultimately contends that some mixture of mandatory and default corporate law approaches is both necessary and unavoidable.<sup>241</sup>

The SCR generally contains more mandatory provisions than U.S. corporate legislation, which may be justified by the assumption that Saudi Arabian investors are less sophisticated than their American counterparts, and thus require more protection. Additionally, the SCR requires LLCs to use and file a specific form template for their Articles of Association, with parties retaining the right to modify and opt out of the non-mandatory provisions. This requirement could be justified by the KSA's relative lack of sophisticated attorneys capable of drafting business contracts when compared to the U.S., where more investors have access to competent counsel. Analysis of Saudi LLC Articles of Association shows such agreements virtually always follow the default template, despite the wide diversity of businesses which operate as LLCs, with different business purposes

---

<sup>237</sup> *Id.*

<sup>238</sup> Bolodeoku, *supra* note 223, at. 516.

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*, at. 439

<sup>241</sup> *Id.*



and objectives.<sup>242</sup> Shareholder discomfort in deviating from pre-drafted templates could be one of the reasons that Saudi corporate legislation contains more comprehensive mandatory rules than in the United States.

An additional issue debated in default regimes is the appropriate starting point in determining the legal provision for any particular issue. The most common stance regarding default rules is the majoritarian approach.<sup>243</sup> This approach selects the rule which the majority of relevant companies would prefer as a default if they had to address a specific controversy related to the rule.<sup>244</sup> Other scholars favor minoritarian rules as the starting point for default rules.<sup>245</sup> The minoritarian approach picks a default rule which benefits the weaker side in a potential controversy, thereby leaving it up to the more powerful interest to opt out of the default rules if they are able.<sup>246</sup> For example, Bebchuk and Hamdani argue that if a legislator must decide between two possible default arrangements, one which benefits a company's managers and the other that benefits its shareholders, the rule favoring shareholders should be the default. The reason is that management generally will have more power to circumvent and opt out of the rules if that is truly the better approach, whereas the shareholders might be stuck under the opposite default rule.<sup>247</sup> Some

---

<sup>242</sup> This study involved analyzing 30 selected LLC Articles of Association published in the official gazette of the Kingdom of Saudi Arabia (*Umm Al Qura* Newspaper). These Articles of Association belonged to companies established between 2013 and 2018, and included businesses across a wide range of industries. The businesses were in the fields of tourism, health care, education, manufacturing, trade, construction, food, and transportation. However, LLCs are not allowed to operate in the KSA in certain financial fields, including banking and insurance.

<sup>243</sup> McDonnell, *supra* note 213, at 390.

<sup>244</sup> Some commentators have disputed the "majoritarian" default rule examination of corporate law, indicating that corporate law also contains rules the individuals would not have desired. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87 (1989).

<sup>245</sup> Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 *Stan. L. Rev.* 1591 (1999), <https://pdfs.semanticscholar.org/2513/2d53c27cef9781a7773757bc0a606385dca1.pdf>.

<sup>246</sup> McDonnell, *supra* note 213, at 390.

<sup>247</sup> Lucian Arye Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 *Nw. U. L. Rev.* 489 (2002).

minoritarians argue that corporate and LLC statutes should include default or template agreement provisions which "nudge" shareholders to protect themselves against any potential majority oppression. Again, the reasoning is that majority interests will be able to opt out of such defaults when appropriate, but minority shareholders might not, arguing for a pro-minority "default".<sup>248</sup>

Another issue debated in the literature is the role that "menu options" should play in non-mandatory/enabling statutes governing corporate law.<sup>249</sup> Unlike default rules, which apply when corporate agreements are silent on a subject, menu options only govern if they are affirmatively selected by shareholders and included in their LLC agreement.<sup>250</sup> Some argue that menu options in corporate statutes are unnecessary, as investors and managers will address their business arrangements in the way best able to secure their desired outcome, regardless of which options a statute lists.<sup>251</sup> The counter-argument is that menu options reduce and minimize transaction costs, by providing clear choices for the parties to debate and select from.<sup>252</sup> Menu laws thus decrease the time and money spent formulating company arrangements.<sup>253</sup> Further, menu options serve to protect all parties, especially uninformed or unsophisticated ones, by making them aware of approaches that they might otherwise fail to consider.<sup>254</sup> Listokin contends that the presence or absence of corporate menu options leads to significant outcome variations, as do variations in default

---

<sup>248</sup> Benjamin Means, *supra* note 217, at 1183.

<sup>249</sup> Yair Listokin, *What Do Corporate Default Rules and Menus Do - An Empirical Examination*, 6 *J. Empirical Legal Stud.* 279 (1111). Available at <https://pdfs.semanticscholar.org/38f8/98799f4fcf2203d607727458af3d99a84b0c.pdf>

<sup>250</sup> *Id.*, at. 280.

<sup>251</sup> *Id.*, at. 281.

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> Ian Ayres, *Menus Matter*, 73 *U. Chi. L. Rev.* 3 (2006), available at <https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=5352&context=uclrev>

rules.<sup>255</sup> He contends that policymakers and judges cannot defer entirely to private arrangements between company managers and investors, but rather must seek to positively shape such agreements.<sup>256</sup> Legislators must therefore invest the time and effort to create "value-maximizing" menu options and default laws.<sup>257</sup> Such menu options should be responsive to the diverse operating conditions that corporations may encounter.<sup>258</sup>

Some scholars argue that mandatory rules are necessary to protect a company's creditors, as they are not parties to the company's agreement.<sup>259</sup> A notable example of mandatory rules designed to protect creditors are legal capital rules, such as that used in the KSA,<sup>260</sup> as explained earlier, imposing LLC minimum capital requirements by statute.<sup>261</sup> Others contend that mandatory legal capital rules are unnecessary, and that creditors can protect themselves through contractual obligations.<sup>262</sup> According to this view, contractual covenants are more adaptable and flexible, avoiding the excessively rigid company financial structures created by a mandatory legal capital rule.<sup>263</sup> Proponents of legal capital rules argue that only sophisticated and powerful creditors can protect their rights through contract, while other creditors, and especially involuntary creditors like tort victims, require mandatory protections.<sup>264</sup>

---

<sup>255</sup> Listokin, *supra* note 250, at. 307

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> McDonnell, *supra* note 213 at 399

<sup>260</sup> Chapter 5 of this dissertation (Withdrawal and Buyout Rights) discusses in greater detail the full protections available for creditors in both the KSA and United.

<sup>261</sup> Saudi Companies Regulations, Art. 160.

<sup>262</sup> HASAN ERDEM, CREDITOR PROTECTION IN PRIVATE EQUITY-BACKED LEVERAGED BUYOUT AND RECAPITALISATION PRACTICES: A COMPARATIVE ANALYSIS OF COMPANY AND INSOLVENCY LAW MECHANISMS IN ENGLAND, GERMANY, AND TURKEY, 36, 37 (VERLAG, FIRST ED 2014).

<sup>263</sup> *Id.*, at 37.

<sup>264</sup> LOUISE GULLIFER & JENNIFER PAYNE, CORPORATE FINANCE LAW: PRINCIPLES AND POLICY, 551 (BLOOMSBURY PUBLISHING, Second ed 2015).

Two questions addressed in this paper are whether corporate legal protections for minority shareholders should be mandatory or default, and, if default rules are preferable, the proper approach to setting those defaults.

## Chapter 4: LLCs Transfer of Shares

### 4.1.LLCs Transfer of Shares in General

#### A. Introduction

An ability to transfer shares is critical for a shareholder wishing to exit an LLC, and many LLC statutes (or the jurisdiction's relevant general statute) therefore protect the right to do so. Shareholders wanting to exit an LLC by selling their stake also often desire to sell to third parties.<sup>265</sup> However, the right to transfer shares is often subject to the consent of all co-owners, or at least to the consent of the majority of them.<sup>266</sup> Many LLC laws also impose other restrictions on shareholders' right to transfer shares. One such restriction guarantees the non-transferring shareholders a priority right to purchase the shares of a co-owner seeking to transfer shares to a third party. This is known as the right of first refusal (ROFR).<sup>267</sup> The greater the number of transferability restrictions, the more difficult it is for a shareholder to liquidate his stake and thereby exit the company.<sup>268</sup> A minority LLC owner seeking to sell is therefore often placed in a weak position, and vulnerable to the actions of majority owners.<sup>269</sup> This vulnerability can lead to a minority shareholder selling to the majority at a below-market price in order to exit the company.<sup>270</sup> A minority's lack of

---

<sup>265</sup> STEVEN C. ALBERTA, *LIMITED LIABILITY COMPANIES: A PLANNING AND DRAFTING GUIDE*, 106 (ALI-ABA. 2003).

<sup>266</sup> Jimmy G. McLaughlin, *The Limited Liability Company: A Prime Choice for Professionals*, 45 Ala. L. Rev. 231, 260 (1993).

<sup>267</sup> The Saudi Companies Regulation is one example. It provides for the right of first refusal, giving the non-transferring shareholders the priority right to purchase the shares of a transferring shareholder.

<sup>268</sup> Paul T. Geske, *Oppress Me No More: Amending the Illinois LLC Act to Provide Additional Remedies for Oppressed Minority Members*, 197 Chi.-Kent L. Rev. 185 (2015). Available at: <https://scholarship.kentlaw.iit.edu/cklawreview/vol190/iss1/9>

<sup>269</sup> *Id.*

<sup>270</sup> F. Hodge O'Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 Clev. St. L. Rev. 123 (1987). Available at: <http://engagedscholarship.csuohio.edu/clevstlrev/vol35/iss1/7>

leverage may place him or her at a disadvantage should any break in relations with the majority take place, as the only alternatives will be complying with majority wishes or selling for less than fair-market value.<sup>271</sup> Majority-minority shareholder disputes can therefore lead to litigation and material losses for shareholders as a whole, unless the company's Articles of Association (or Operating Agreement as it is known in the U.S.) provide clear procedures for addressing such disputes.<sup>272</sup>

## B. Transferable Ownership

Transferable ownership refers to rules governing the alienability of specific categories of property, such as shares in a business entity or real property.<sup>273</sup> In a business context, it commonly refers to a transfer of ownership between two parties in a business entity, such as a partnership, an LLC, or a corporation.<sup>274</sup> However, each form of business entity has a different ownership structure, and different rules that govern its transactions in a transfer or sale of an ownership interest.<sup>275</sup> LLC transfers of ownership interest (*shares*) are carried out in accordance with specific legal procedures, procedures that are typically described in the LLC's constitutional documents.<sup>276</sup> In Saudi Arabia, however,

---

<sup>271</sup> Paul T. Geske, *supra* note 269, at 197.

<sup>272</sup> Procedures and details of the sale are usually delineated in a separate contract between the co-owners, and the contract is referred to as a buy-sell agreement, or the shareholders agreement (*aitifaqiat alshuraka*), as it is known in Saudi Arabia.

<sup>273</sup> See The Michigan State Tax Commission, Transfer of Ownership Guidelines at [https://www.michigan.gov/documents/treasury/TransferOwnershipGuidelines\\_423898\\_7.pdf](https://www.michigan.gov/documents/treasury/TransferOwnershipGuidelines_423898_7.pdf).

<sup>274</sup> See Phillip L. Kunzel, et al., *Choosing the Right Business Entity* at <https://www.extension.umn.edu/agriculture/business/taxation/farm-legal-series/choosing-the-right-business-entity/docs/choosing-the-right-business-entity.pdf>.

<sup>275</sup> *Id.*

<sup>276</sup> Warren P. Kean & K&L Gates LLP, Common Mistakes and Oversights When Drafting and Reviewing LLC Operating Agreements at <https://apps.americanbar.org/buslaw/committees/CL690000pub/newsletter/200807/kean.pdf>.

shareholders often rely on default statutory rules which are then incorporated into the LLC agreement. Generally, ownership of an LLC share entitles a shareholder to (1) the right to receive distributions from the LLC, and (2) the right to participate in management.<sup>277</sup> Some jurisdictions, such as the U.S, limit the transferable LLC ownership interest, absent consent from the other shareholders, to only financial rights.<sup>278,279</sup> By contrast, a transferable LLC share in Saudi Arabia is defined to include both management and financial rights. The Saudi regime allows for the assignment of economic rights (the right to receive distributions from the LLC) to a third party, but management rights cannot be assigned to anyone besides an existing LLC shareholder.<sup>280</sup> Saudi LLC law thus includes a complete bar to transferring management rights to a non-owners, while most U.S. LLC statutes allow transfer of members' managerial authority to a non-owners upon the consent of the other members.<sup>281</sup>

### C. Motivations for Restrictions on Transfers

Restrictions on transfers are common in closely held businesses. Restricting the transfer of shares is one of the defining features of an LLC in most jurisdictions, although the type and nature of the restrictions vary considerably.<sup>282</sup> Most jurisdictions prohibit LLCs from

---

<sup>277</sup> RICHARD D. FREER & DOUGLAS K. MOLL, *PRINCIPLES OF BUSINESS ORGANIZATIONS*, 641 (West Academic 2nd ed. 2018).

<sup>278</sup> ROBERT W. HAMILTON, ET AL., *THE LAW OF BUSINESS ORGANIZATION*, 1299 (West Academic Twelfth ed. 2014).

<sup>279</sup> This chapter will later discuss in depth how the LLC statutes in the U.S. treat the membership management rights and financial rights separately.

<sup>280</sup> A LERRICK AND Q J MIAN, *SAUDI BUSINESS AND LABOR LAW*, 161 (Graham & Trotman. 1982).

<sup>281</sup> JAMES D. COX & THOMAS LEE HAZEN, *BUSINESS ORGANIZATIONS LAW*, 25 (West Academic Publishing 4th ed. 2016).

<sup>282</sup> Rachna Thaker, 'Private Company: Restriction On Transferability Of Shares', 2 *INTERNATIONAL MULTIDISCIPLINARY RESEARCH JOURNAL* (2015). Available at: <http://www.rhimrj.com/admin/upload/Rachna%20Thaker.pdf>

offering their shares as tradable instruments, turning to public offerings to increase their capital, or issuing negotiable shares or bonds.<sup>283</sup> The reasoning behind such prohibitions is preserving the “private” character of the LLC as a “close company” and protecting the entity’s shares from being used for risky, speculative ventures.<sup>284</sup> The restrictions also reflect the underlying purpose of the LLC as a business entity. That purpose is enabling investors, who may have personal ties to each other, to engage in business while limiting their personal liability to the amount of capital they contribute to the LLC.<sup>285</sup> Investors thereby benefit from both the closed nature of the company as well as their limited liability toward the company's obligations.<sup>286</sup>

Typical restrictions on the transferability of LLC shares include the requirement for the consent of the other shareholders and the right of first refusal, which gives existing shareholders the ability to prevent transfers to third parties. In some cases, both restrictions apply.<sup>287</sup> The restrictions are designed to prevent a newcomer from gaining controlling over company management.<sup>288</sup> Shareholders typically wish to avoid sharing management duties with outsiders whom they do not know and with whom they did not agree to act as co-owners. This resistance to sharing management duties is especially pronounced when the LLC is owned by a single family, who may view outsiders as threatening the

---

<sup>283</sup> GORDON H. BROUGH, *PRIVATE LIMITED COMPANIES: FORMATION AND MANAGEMENT*, 83 (Sweet & Maxwell revised ed. 2005).

<sup>284</sup> *Id.*

<sup>285</sup> Timothy Guinnane, et al., *Business Organization in the Long Run: Private Limited Companies Rule!* at <http://www.helsinki.fi/iehc2006/papers2/Guinnane.pdf>.

<sup>286</sup> *Id.*

<sup>287</sup> Michael K. Molitor, *Eat Your Vegetables (Or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses*, 14 *Fordham J. Corp. & Fin. L.* 491, 596 (2009). Available at: <https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1000&context=jcfl>.

<sup>288</sup> Stephen J. Leacock, *Share Transfer Restrictions in Close Corporations as Mechanisms for Intelligible Corporate Outcomes*, 3 *Faulkner L. Rev.* 109 (2011).



company's growth and stability.<sup>289</sup> Lécia Vicente's dissertation, "The Requirement of Consent for the Transfer of Shares and Freedoms of Movement: Toward the Liberalization of Private Limited Liability Companies," offers the following economic rationale for transfer restrictions:

"I maintain that criteria of economic rationality determine the inclusion of restrictions in the companies' articles. When partners incorporate these business associations they attribute a greater value to those restrictions than to the right to freely resign from the company. They attribute a greater value to restrictions on transfers than to the attainment of immediate gains as a result of the sale of shares in a public market. They view these restrictions as more valuable than the possibility of decreasing investment risks by means of a greater dispersal of the share capital. This is so because the value of human capital should be added to the share value of the corporation. It is important for a member to maintain a close relationship with her or his peers. Kinship, loyalty and trust are three other reasons for the inclusion of restrictions. PLLCs often emerge from family relationships. So, when a shareholder sells his or her shares without the company's prior consent they are inevitably depriving other shareholders of that accrued value. Furthermore, shareholders normally agree on the division of profits, the exclusion or entry of new shareholders, and the acquisition of shares in other corporations to guarantee that the integrity of the ownership structure and control of the company stay as they were initially envisioned".<sup>290</sup>

Restrictions on transfers, such as requiring company, managerial or shareholder consent for any such transfer, may sometimes lead to negative results, including more aggressive behavior between shareholders.<sup>291</sup> This is true because even when the law or articles of associations provide mechanisms for shareholders to avoid being locked-in to the business, a shareholder who nonetheless remains locked in can still be a source of conflict within the company.<sup>292</sup> An additional feature of transfer restrictions is that they

---

<sup>289</sup> *Id.*, at. 126.

<sup>290</sup> Lécia Vicente, *The Requirement of Consent for the Transfer of Shares and Freedoms of Movement: Toward the Liberalization of Private Limited Liability Companies*, 46-47, available at [http://cadmus.eui.eu/bitstream/handle/1814/32211/2014\\_Vicente\\_OA\\_AuthorsVersion.pdf?sequence=3](http://cadmus.eui.eu/bitstream/handle/1814/32211/2014_Vicente_OA_AuthorsVersion.pdf?sequence=3)

<sup>291</sup> *Id.*, at. 46.

<sup>292</sup> *Id.*

may be motivated by a desire to prevent one shareholder from assuming operating control over the company.<sup>293</sup>

The right of first refusal (ROFR) is a common transfer restriction device in both the U.S. and the KSA. ROFR is either provided for by statute, as in Saudi Arabia, or included in the corporate agreement, such as in the U.S. ROFR may lie either with the non-transferring shareholders, the company, or both, in each case granting the right holder the option to acquire any transferred shares before they can be sold to a third party. The ROFR does not absolutely bar transfers to a third party, but merely requires the transferring shareholder to first offer his or her shares to other shareholders or the LLC.<sup>294</sup> The ROFR restriction is typically designed to satisfy one or both of the following two objectives:

- (1) Discouraging outsiders, to a certain degree, from offering to purchase shares from existing shareholders. However, ROFR does not completely forbid third parties from making an offer.<sup>295</sup>
- (2) Granting the company control, by choosing to purchase the shares being transferred, over which outsiders it will allow to become new shareholders in the company.<sup>296</sup>

#### 4.2 LLC Transfer of Shares in Saudi Arabia

---

<sup>293</sup> Stephen J., *supra* note 289, at 127.

<sup>294</sup> Henry J. Jr. Lischer, *Buy-Sell Agreements for Closely Held Business Interests*, 52 Okla. B.J. 707, 714 (1981).

<sup>295</sup> Z. CHRISTOPHER MERCER, *BUY-SELL AGREEMENTS FOR CLOSELY HELD AND FAMILY BUSINESS OWNERS* (Peabody Publishing, LP. August 15, 2010).

<sup>296</sup> *Id.*

#### A. Restrictions on Transfers (The 1965 SCR vs. The New SCR)

Under Islamic *fiqh*<sup>297</sup>, a partner within a partnership is not permitted to transfer ownership of his interest to third parties. This is true regardless of whether such a transfer is with or without consideration, or whether the other partners consent to the transfer. Such a transfer simply terminates the partnership and requires that it be re-established by a new agreement listing the new joining partners.<sup>298</sup> Modern commercial and business practices are inconsistent with such a rule, and legislators have been pressured to modify its overly rigid requirements. Such reforms, though, have not entirely abandoned the general principle that partners to a partnership retain the right to bar entry to any new partner.<sup>299</sup> As a result, the SCR provides that a partner's interest in a general and limited partnership cannot be transferred to third parties without the consent of all partners, or without complying with any other terms and conditions established in the partnership agreement.<sup>300</sup> Regarding an LLC's transfer of shares, the SCR permits a shareholder to transfer his shares to a third party, but only upon complying with certain restrictions. These restrictions have undergone several changes throughout the drafting and revision process which created the SCR itself, and LLC law in particular.

---

<sup>297</sup> Muslim jurisprudence.

<sup>298</sup> NABIL SALEH, *THE GENERAL PRINCIPLES OF SAUDI ARABIAN AND OMANI COMPANY LAWS*, 93 (Namara Publication Limited. First ed. 1981).

<sup>299</sup> *Id.*

<sup>300</sup> The Saudi Companies Regulation, Art. 19, and Art. 41.

*Id.* Article 19 of the SCR, regarding general partnerships, provides that “A partner may transfer his share only upon the consent of all the partners, or in accordance with the conditions set forth in the partnership agreement. In this case, the assignment shall be published in the manner set forth in Article 13 of the Law. Any agreement, stipulating the unrestricted assignment of shares, shall be considered null and void. Nevertheless, a partner may assign to a third party the rights related to his share, but the effect of such assignment shall be restricted to the parties thereto.”

*Id.* Article 41, with regard to the limited partnership, provides that a “Dormant partner may assign his share to any other partner in the limited partnership or to any third party upon the approval of all the joint partners and dormant partners holding majority capital of the dormant partners, unless the limited partnership's agreement situates otherwise.”

A transfer of shares is the only lawful manner for leaving an LLC under Saudi regulations.<sup>301</sup> The SCR explicitly permits the transfer of shares to both an existing shareholder and to a third party. The rules governing the transfer of shares underwent several changes subsequent to the issuance of the new SCR. One of the most important changes in the new SCR relates to the requirement that the non-transferring shareholders approve a transfer of shares. The previous SCR required, by mandatory rule, the amendment of the LLC's Articles of Association whenever a shareholder sought to transfer shares in the LLC to a third party, as well as the prior approval of all non-transferring shareholders.<sup>302</sup> The notaries public further required the non-transferring shareholders to sign an amendment to the Articles of Association, giving them the right to veto any share transfers.<sup>303</sup> It was therefore impossible, under the original SCR, for a shareholder to transfer shares to a third party without the required consent of the remaining shareholders. This meant that a shareholder seeking a transfer might find himself in an unenviable position, locked into the business as long as he failed to find a buyer able to secure the necessary approval from the remaining shareholders. The veto right over third-party transfers was criticized as leaving many shareholders, and particularly minority shareholders, vulnerable to oppression by the majority.<sup>304</sup> For example, if minority shareholders were not satisfied with the financial position of the business, or with the other shareholders, they lacked the right to exit the LLC. Since the SCR did not permit a

---

<sup>301</sup> See *infra* Chapter 5.

<sup>302</sup> Latham & Watkins Corporate Governance Practice, *Saudi Arabia Issues New Regulations for Companies, Altering Regulatory Landscape* at <https://m.lw.com/thoughtLeadership/LW-Saudi-Arabia-new-companies-law>.

<sup>303</sup> *Id.*

<sup>304</sup> ABDULRAHMAN GORMAN, *THE PREEMPTIVE RIGHT IN THE LIMITED LIABILITY COMPANY: COMPARATIVE STUDY*, 82-83 (First Ed.1995). In Arabic.

shareholder seeking to exit the LLC any alternative to a transfer of shares, deadlock often resulted when such a shareholder failed to secure the required approval.

As a consequence, shareholders seeking to exit were inevitably forced to accept an undervalued offer from the remaining shareholders.<sup>305</sup> The only alternative for minority shareholders unable to secure approval for a third-party transfer was submitting to a permanent lock-in to the business. The remaining shareholders were not required to purchase the shares in the event they refused to consent to a third-party transfer, and typically would only do so on terms extremely favorable to them. There was also no mandate for the company itself to repurchase the shares, giving the other shareholders the absolute discretion to prevent the LLC from repurchasing the shares. The reason was that such a repurchase would result in reduction of the LLC's paid-in capital, and such reductions are subject to shareholder approval.<sup>306</sup>

The Saudi legislature recently amended this transfer restriction, and the consent of other shareholders is no longer required for sales to a third party. This amendment was clearly a response by the Saudi legislature to the problems experienced by minority shareholders trying to exit an LLC. The new law therefore does specifically address the imprisonment of an LLC shareholder blocked from exiting the company. The new law, however, does maintain the non-transferring shareholders' right to control the identity of the transferee, in order to bar the entry of undesirable individuals to the company, while at the same time seeking to protect the interest of the exiting shareholder who cannot secure approval for the new third-party transferee.<sup>307</sup> The law strikes this balance by giving the non-transferring

---

<sup>305</sup> *Id.*

<sup>306</sup> *Supra* note 128.

<sup>307</sup> The Saudi Companies Regulation, Art. 162.

shareholders hold two options. They have a choice of purchasing the shares proposed for transfer, or they can decline to exercise this ROFR within the time period specified by law, at which point the third-party transfer proceeds to completion.

Under the new SCR, LLCs are required to maintain a share register with the Ministry of Commerce and Investment (MoCI), record all transfers in the LLC share register, and then inform the Commercial Registrar of any such transfers in order for them to be valid and effective.<sup>308,309</sup> These recent reforms clearly grant shareholders far greater freedom than they had previously to exit the company and not continue as a co-owner in the business. The changes therefore provide greater protection to minority shareholders from potentially aggressive behaviors by the majority, such as arbitrary rejections of proposed third-party transfers. However, the new law's mandatory ROFR for existing shareholders, gives them the right to block any proposed transfer to a third party.<sup>310</sup> Thus, even under the new law, shareholders have no unrestricted right to freely transfer their shares to third parties. Any single remaining shareholder can prevent such a transfer by exercising the ROFR within the specified time period. The amended transfer law is ultimately an attempt to balance the LLC's ability to preserve its status as "close company" while still protecting minority shareholders from the worst abuses permitted under the previous law.<sup>311</sup> A shareholder wishing to exit can now do so, even if unable to win approval for a third-party

---

<sup>308</sup> *Id.*

<sup>309</sup> Shares may not be transferred, if one of the parties (transferor or transferee) is not a Saudi citizen, without the approval of SAGIA (Saudi Arabian General Investment Authority). Therefore, besides Commercial Registration and the amendment of the Articles of Association following any share transfer, the company's SAGIA license must be amended as well. See Saudi Arabian General Investment Authority, *Laws and regulations*, available at [https://www.sagia.gov.sa/en/InvestmentIncentivesandRegulations/LawsAndRegulations/SubCategory\\_Library/Company%20Laws.pdf](https://www.sagia.gov.sa/en/InvestmentIncentivesandRegulations/LawsAndRegulations/SubCategory_Library/Company%20Laws.pdf)

<sup>310</sup> The Saudi Companies Regulation, Art. 161.

<sup>311</sup> Sealy, L. S., Private Company. Restrictions on Transfer of Shares. Member's Remedies, *The Cambridge Law Journal*, vol. 21, no. 2, 1963, pp. 211–213

transfer. At the same time, the legitimate interest of the remaining shareholders in preventing unwanted partners is preserved, protecting the LLC from unwanted risks.<sup>312</sup>

The ROFR still presents difficulties for the transferring shareholder. The sale of a non-controlling minority share can already prove difficult, if not impossible, to accomplish,<sup>313</sup> and the ROFR only adds to the challenge by potentially discouraging third-party bidders.<sup>314,315</sup> While the SCR no longer requires unanimous shareholder consent in order to transfer shares, its transfer restriction rules continue to be interpreted broadly to allow such restrictions in LLC agreements. Shareholders who choose to include this restriction therefore retain the right to ban transfers which lack unanimous consent.<sup>316</sup> This study has found numerous examples of such restrictions in existing KSA LLC agreements.<sup>317</sup> In such cases, the transferring shareholder is also bound by the ROFR, in addition to the consent requirement. In sum, LLC owners are generally free to use the LLC agreement to impose whatever transfer restrictions they desire, and such restrictions are usually upheld by Saudi judicial rulings.<sup>318</sup> The only exception are clauses which create a complete ban on share

---

<sup>312</sup> Khalid Saad Al-habshan, *The Current Rights of Minority Shareholders in Saudi Arabia*, 6 INTERNATIONAL LAW RESEARCH (2017). Available at: <https://doi.org/10.5539/ilr.v6n1p185>.

<sup>313</sup> MARTIN M. SHENKMAN, ET AL., *STARTING A LIMITED LIABILITY COMPANY*, 114 (Wiley 2nd ed. 2003).

<sup>314</sup> David I. Walker, *Rethinking Rights of First Refusal*, 5 Stan. J.L. Bus. & Fin. 2, 3 (1999). Available at: [http://www.law.harvard.edu/programs/corp\\_gov/papers/No261.99.Walker.pdf](http://www.law.harvard.edu/programs/corp_gov/papers/No261.99.Walker.pdf).

<sup>315</sup> See *infra* note 359.

<sup>316</sup> KHALID ABDUL-AZIZ BAGHDADI, *STOCK TRADING AND LEGAL LIMITATIONS: COMPARATIVE STUDY*, 344, 345 (First ed. 2012).

<sup>317</sup> See the example of *published Article of Association of Abdulghani Erth Jewellery L.L.C, Um Al-Qura Newspaper, 1437/11/13, No. 4737, p 47*. Article 7 of this agreement state that “Transfer of shares is allowed between shareholders. No shareholder may transfer any shares to third parties, with or without consideration, unless the consent of the other shareholders has been obtained. The remaining shareholders may recover the share or shares that one of the shareholders wished to assign to others in accordance with Article 161 of the Saudi Companies Regulation” Also, see the example of *published Article of Association of Schindler Olayan Elevator Company L.L.C, Um Al-Qura Newspaper, 1439/3/6 No. 4699*. Article 8 of this agreement states that “The Transfer of shares is allowed between shareholders. No shareholder may transfer any of its shares to third parties, with or without consideration, unless the prior written consent of the other shareholders has been obtained. The remaining shareholders may recover the share or shares that one of the shareholders wished to assign to others in accordance with Article 161 of the Saudi Companies Regulation.”

<sup>318</sup> e.g. Board of Grievances, Case No. 788/3/G, Appeal Division Decision No. 3/T/489, 2006 (1427H).

transfers, as such clauses are not permitted.<sup>319</sup> What follows is an explanation of the legislative development of the ROFR under the Saudi Companies Regulation.

## B. The Statutory Right of First Refusal (ROFR)

The ROFR within an LLC, or the pre-emptive right as it is referred to in some jurisdictions<sup>320</sup>, is one of the essential characteristics of this type of business entity.<sup>321</sup> The right creates a restriction on the freedom of new owners to enter the LLC, with a corresponding restriction of the ability of shareholders to exit the company through a sale to third parties.<sup>322</sup> The Saudi legislature first recognized the LLC as a legal entity in 1965, almost ten years after the Egyptian legislature did so.<sup>323</sup> Saudi Arabia also adopted Egypt's mandatory restrictions on the transfer of shares to third parties, thereby following the French, who originated this approach.<sup>324</sup> The Saudi legislature adopted the LLC as an entity in order to address a need that traditional business entities failed to meet.<sup>325</sup> In particular,

---

*Id.* In this case, the court held that an LLC shareholder's transfer of his ownership shares to his daughter was not valid without the consent of the other shareholders, as the sale was regulated by Article VII of the LLC Article of Association, which required the consent of other shareholders.

<sup>319</sup> Baghdadi, *supra* note 317, at 345.

<sup>320</sup> e.g. French jurisprudence and some other EU jurisdictions, for instance, use "droit préemption" to describe the restriction imposed by the legislator on an individual LLC shareholder's ability to transfer shares to a third party without first offering them to existing shareholders. For more information, see Chan Park & Philippe Thiebaud, *Shareholders' Rights and Obligations*, MOLITOR Avocats à la Cour. at [http://molitorlegal.lu/wp-content/uploads/2018/01/20180109\\_Shareholders\\_Rights\\_Obligations\\_Luxembourg.pdf](http://molitorlegal.lu/wp-content/uploads/2018/01/20180109_Shareholders_Rights_Obligations_Luxembourg.pdf).

<sup>321</sup> Lécia Vicente, *supra* note 291, at 46.

<sup>322</sup> David I. Walker, *supra* note 315, at 3.

<sup>323</sup> ERNEST KAY, LEGAL ASPECTS OF BUSINESS IN SAUDI ARABIA, 43, 44 (Graham & Trotman First Ed. 1979).

<sup>324</sup> Saudi Arabia first adoption of the limited liability company was in 1965 which was under the first promulgated Saudi Companies Regulation. YAHYA SAEED, AL-WAJEEZ IN THE SAUDI COMMERCIAL LAW, 226, 227 (First ed. 2004).

<sup>325</sup> Fath El Rahman Abdalla El Sheikh, *The Legal Regime Of Foreign Private Investment In Sudan And Saudi Arabia*, 52, 53 (Cambridge University Press Revised ed. 2003).



small and medium-sized enterprises did not want to operate as a joint-stock company, which required a certain minimum number of shareholders. Such enterprises also did not want to form partnerships, as that would fail to limit shareholder's personal liability toward the company's debts. There was thus a demand for an entity which would address the previous two issues while still permitting a closely held company that could exclude unwanted outside owners who might destabilize the business.<sup>326</sup> Thus the LLC's limits on transfers to third parties were motivated chiefly by the desire to preserve the personal and intimate nature of the company.<sup>327</sup> Some argue that a second motivation for the transfer restriction was preventing speculation in LLC shares.<sup>328</sup> This view contends that protecting the closed nature of the LLC would require only a mandatory ROFR restriction, rather than a complete statutory ban on third-party transfers, and that the law could have left it to the LLCs themselves to decide if further transfer restrictions were warranted.<sup>329</sup> Therefore, it is likely that preventing speculation was one of the purposes behind the ban on share transfers to third parties. Ultimately, the legislature not only imposed a ROFR, but subjected the right to complex and detailed procedures which had the effect of slowing potential third-party transfers and therefore discouraging harmful speculation.<sup>330</sup>

The ROFR was labelled as a "right of preference" held by the non-transferring shareholders, and required the transferring shareholder to inform all other shareholders of the potential third-party transfer agreement.<sup>331</sup> The ROFR process consisted of two

---

<sup>326</sup> *Id.*

<sup>327</sup> MUSTAFA KAMAL TAHA, *BUSINESSES AND TRADERS, COMMERCIAL COMPANIES*, 551, 552 (First ed. 1988).

<sup>328</sup> *Id.*

<sup>329</sup> *Id.*

<sup>330</sup> AKTHAM AMIN AL-KHULI, *AL-MUJAZ IN COMMERCIAL LAW*, 597 (First ed. 1970).

<sup>331</sup> EDWARD BURTON, *BUSINESS AND ENTREPRENEURSHIP IN SAUDI ARABIA: OPPORTUNITIES FOR PARTNERING AND INVESTING IN EMERGING BUSINESSES*, 117 (John Wiley & Sons Illustrated ed. 2016).

stages.<sup>332</sup> The first stage granted non-transferring shareholders the right to consent, whereby any individual shareholder could object to the potential new third-party owner.<sup>333</sup> The second stage involved actual exercise of the ROFR, with the non-transferring shareholders required to purchase the shares originally intended for the third-party purchaser.<sup>334</sup> Failure to exercise the ROFR within the period specified either by statute or the LLC agreement terminates the right, permitting the third-party transfer to go forward. In such a case, the third-party transferee becomes a company shareholder with all financial and participatory management rights possessed by the transferring owner.<sup>335</sup>

The Saudi legislature has passed several revisions to the ROFR law since its original enactment. One important amendment recently made law affects the method for valuing shares acquired through ROFR. Under the previous version of the law, the shareholder proposing a transfer, for consideration, to a third party had to notify the remaining shareholders, via the LLC's manager, of all conditions of the transfer. Any shareholder could then exercise a ROFR within 30 days of notification, and thereby acquire the shares based on their "real value." If a shareholder contemplated a third-party transfer without consideration, the remaining shareholders could exercise a right to buy at a value previously approved in the company's most recent annual budget.<sup>336</sup> This procedure has now undergone two sets of revision. The first revision under the new SCR eliminated the reference to consideration in the proposed third-party transfer and set the ROFR purchase

---

<sup>332</sup> ANDREI GABOV, ET AL., *RUSSIAN COMPANY LAW: THE ESSENTIALS*, 129, 130 (AHO "Crapran". 2017).

<sup>333</sup> *Id.*

<sup>334</sup> *Id.*

<sup>335</sup> Stanley Santire, *Participation and Registration in the Kingdom of Saudi Arabia*, 15 Int'l L. 567, 568 (1981).

<sup>336</sup> ZUHAIR AL-HARBASH, *AL-WUJEEZ IN EXPLAINING THE SAUDI COMPANIES LAW*, 106, 107 (First ed. 2015).

price at the fair market value of the shares in question.<sup>337</sup> This change eliminated the vague, undefined concept of “real value” for pricing shares, which had led to numerous shareholder conflicts. The revised SCR permitted LLCs to employ a different valuation methodology and time period for exercising ROFR in their Articles of Association, eliminating “real value” as the default measurement.<sup>338</sup> The revision highlighted the importance of providing a clear valuation methodology in the LLC’s Articles of Association. Under this first version of the new SCR, Article 161 provided the following explanation:

If a shareholder wishes to transfer its shares to others, either with or without consideration, the shareholder must first notify the other shareholders of the transfer conditions through the LLC’s manager. In this case, any interested shareholder can buy the shares at fair value within 30 days of being notified, unless the shareholders have agreed on an alternative valuation method and duration in the LLC’s Articles of Association. If more than one shareholder exercises his or her right of first refusal, the shares must be divided among them in accordance with their proportion of shares in the capital of the LLC.<sup>339</sup>

The new law thus permitted ROFR purchase valuations to be contractually agreed upon between the shareholders, in the LLC’s Articles of Association (or shareholders’ agreement), rather than dictated by statute.<sup>340</sup> Upon the issuance of the revised SCR’s, however, a new question arose: was the shareholder’s right to transfer shares and depart the LLC a right that can be exercised as a right of first offer, by simply offering the shares to the other shareholders? Or was it only a right exercisable when the transferring shareholder succeeds in obtaining a third-party offer, as a ROFR? Some argued that the

---

<sup>337</sup> The Saudi Companies Regulation, Art. 161.

<sup>338</sup> *Id.*

<sup>339</sup> *Id.*

<sup>340</sup> *Heralding Change, country focus/KSA at [http://www.t-lawadvisors.com/uploads/published\\_articles/THE\\_OATH.pdf](http://www.t-lawadvisors.com/uploads/published_articles/THE_OATH.pdf).*

new SCR was unclear on whether such a right applied only as a ROFR, as opposed to including a right of first offer.<sup>341</sup> This ambiguity was ultimately resolved by the Saudi legislature's subsequent amendments to Article 161 of the new SCR, which governs LLC share transfers and the ROFR.<sup>342</sup> The following is the language of Article 161 as it reads following this second set of amendments:

A shareholder may transfer its share to other shareholders in accordance with the terms of the Company's Article of Association. If the shareholder wishes to transfer its share to others, it shall notify the other shareholders through the LLC Manager, including the name of the proposed buyer and the terms and conditions of sale. The LLC manager shall inform the other shareholder as soon as such notice is received. Any shareholder may request a redemption of the share being transferred within 30 days of a receipt of the manager's notice at the agreed price, unless the LLC Article of Association provides for another valuation methodology or a longer period for exercising the right of first refusal. If more than one shareholder requests the redemption, the shares shall be divided among them in accordance with their shares proportions in the company's capital. If no request is made during the said period, the shareholder has the right to transfer its shares to a third party.<sup>343</sup>

The second set of amendments to Article 161 thus entail two essential changes:

- (1) By stating explicitly that a transferring shareholder must state the name of the proposed buyer and the terms and conditions of the sale, the legislature clarified that the other shareholders hold a ROFR, and not a right of first offer.
- (2) In the absence of the LLC Articles of Association specifying an alternative valuation method, the default valuation of any share being transferred is determined by the third-party-offer, as the fair market value is no longer the default value.

---

<sup>341</sup> Khoshaim & Associates, *Back to Business, Kingdom of Saudi Arabia issues new Companies Regulations*, 7 at [http://gcbdi.org/Media/GCC%20Codes%20of%20CorpGov/1033675731-Back\\_to\\_Business\\_-\\_Kingdom\\_of\\_Saudi\\_Arabia\\_issues\\_new\\_Companies\\_Regulations.pdf](http://gcbdi.org/Media/GCC%20Codes%20of%20CorpGov/1033675731-Back_to_Business_-_Kingdom_of_Saudi_Arabia_issues_new_Companies_Regulations.pdf).

<sup>342</sup> Cabinet Decree No. (403) dated 1439/7/24 H. corresponding to April 10, 2018.

<sup>343</sup> The New Saudi Companies Regulations, Issued by Royal Decree No. (M/3) dated 28 / 1 / 1437 H. Corresponding to November 12, 2015. Amendment by Cabinet Decree No. (403) dated 1439/7/24 H. corresponding to April 10, 2018.

The new valuation method views the third-party purchase offer as the best method for determining market price in connection with a ROFR purchase. LLC shareholders can either incorporate this default valuation method into the company's Article of Association, or agree on a different ROFR valuation methodology.<sup>344</sup> Although the law therefore allows different methodologies and time periods for exercising the ROFR, the ROFR itself is a mandatory right of the non-transferring shareholders which LLCs cannot eliminate in their Articles of Association.<sup>345</sup> Clearly, Saudi law prioritizes the rights of non-transferring shareholders by requiring LLCs to provide for a ROFR, thereby restricting share transferability. One ambiguity in the SCR is whether the ROFR applies when one shareholder wishes to sell shares to a presently existing shareholder, as opposed to an outside third party. Some jurists believe the ROFR belongs to all LLC shareholders, any of whom may exercise this right, regardless of whether shares are being sold to a third party or to another shareholder.<sup>346</sup> Others argue that the ROFR does not apply to purchases by an existing shareholder, as long as the transfer will not lead to the remaining shareholders sharing management duties with an unapproved outsider.<sup>347</sup> My belief is that the latter view is the more plausible interpretation of when the Saudi legislature intended the ROFR to apply. SCR Article 161 states that ROFR is triggered only when a shareholder seeks to transfer shares to "others," meaning third parties, without any indication the requirement applies to an internal transfer among LLC shareholders.

---

<sup>344</sup> *Id.*

<sup>345</sup> MICHAEL O'KANE, *DOING BUSINESS IN SAUDI ARABIA*, 8, 9 (Michael O'Kane First ed. 2013).

<sup>346</sup> Baghdadi, *supra* note 317, at. 40.

<sup>347</sup> *Id.*

The governing court has adopted this interpretation, ruling that the ROFR under Article 161 does not apply to an internal transfer between shareholders. The case (No.1447/1/G.1426H)<sup>348</sup> involved an LLC refusing to approve a transfer sale between two existing shareholders, who happened to be brothers. The LLC claimed the transfer violated Article 161's ROFR provision, which the LLC had incorporated into its Articles of Association, interpreting the ROFR as applying to transfers between existing shareholders.<sup>349</sup> The court rejected the LLC's interpretation, reasoning that "[t]he right of first refusal shall only apply in cases where the transfer is made to a third party, other than an existing LLC shareholder. In this case, where one shareholder transfers shares to another shareholder, no ROFR exists. Applying the ROFR to internal transfers would be going beyond the legislative intent, which was empowering shareholders to prevent the entry of unwelcome outside owners".<sup>350</sup> The court thus grounded its reasoning on the principle that ROFR exists to protect the company from unwanted outside owners, a danger not present with an internal shareholder transfer. While this is undoubtedly correct so far as it goes, unrestricted internal transfers may alter the ownership percentage enjoyed by the transferring shareholders.<sup>351</sup>

Some scholars believe that the ROFR should extend to internal shareholder transfers, as such a restriction is necessary to preserve the balance of voting power within the company.<sup>352</sup> I agree with these scholars. It is true that the legislature intended ROFR be used to preserve the "private" and intimate character of an LLC, allowing shareholders to

---

<sup>348</sup> Board of Grievances, Case No. 1447/1/G, Appeal Division Decision No. 3/T/299, 2005 (1426H).

<sup>349</sup> *Id.*

<sup>350</sup> *Id.*

<sup>351</sup> Henry S. Jr. Drinker, *Preemptive Right of Shareholders to Subscribe to New Shares, The*, 43 Harv. L. Rev. 586 (1930)

<sup>352</sup> ALI YOURS, *COMMERCIAL COMPANIES: LIMITED LIABILITY COMPANIES, JOINT STOCK COMPANIES, AND PARTNERSHIPS LIMITED BY SHARES*, 79 (First ed. 1990). In Arabic.

prevent the entry of strangers. However, internal transfers which change the balance of a shareholder's proportionate voting powers pose a separate danger, potentially permitting one or more shareholders to take control of the business.<sup>353</sup> It is therefore important that the ROFR apply to such internal transfers, with all shareholders given an equal option to invoke it. As noted, however, Saudi LLCs cannot rely on the SCR if they wish to apply the ROFR to internal shareholder sales. Rather, they must place such a ROFR within the relevant section of the LLC's Articles of Association, in order to avoid any potential for misunderstanding or conflict in the future. The SCR explicitly states that the ROFR does not apply to, and cannot be exercised regarding, transfers of shares undertaken by a shareholder's heirs after his or her death<sup>354</sup>, or shares transferred via judicial ruling issued by a competent authority.<sup>355</sup>

One important question that may arise is the proper resolution when a shareholder seeking to disinvest from the company by transferring shares does not receive any offers, either from non-transferring shareholders or third parties. The new SCR has significantly increased an LLC shareholder's freedom to sell his or her shares without having to obtain approval from all other shareholders, once the period for exercising ROFR expires. However, the new law does not clarify the consequences when a transferring shareholder fails to get a purchase offer, as the ROFR potentially discourages third parties from making such offers.<sup>356</sup> The ROFR can at times make shares essentially unmarketable, as buyers resist bidding on shares that ROFR may ultimately prevent them from purchasing.<sup>357</sup> The

---

<sup>353</sup> Henry S, *supra* note 352.

<sup>354</sup> The majority view is that LLC Articles of Association can provide for a ROFR to be triggered in case of a shareholder death. This will be explained in depth in the next chapter (Chapter 5).

<sup>355</sup> The Saudi Companies Regulation, Art. 161.

<sup>356</sup> David I. Walker, *supra* note 315.

<sup>357</sup> *Id.* at. 30

reason is that a potential third-party purchaser must estimate the price of the specific shares, the possibility of a bid being successful, and the expenses associated with making that bid.<sup>358</sup> A ROFR imposes potentially uncertain negotiation costs for the prospective purchaser, thereby discouraging such bids.<sup>359</sup> The third-party purchaser also needs to gather information in order to assess share value.<sup>360</sup> Combined, information gathering and negotiation requirements form a large part of transaction costs.<sup>361</sup> Existing shareholders will also possess a significant informational advantage over third-party buyers.<sup>362</sup> This informational advantage must be factored into the third party's decision to bid.<sup>363</sup> The third party knows that if a share's actual value is higher than the third-party bid, the co-owner will exercise his or her ROFR.<sup>364</sup> Conversely, the co-owner will likely allow the third-party sale to proceed if the purchase price is excessive in relation to a stake's actual value.<sup>365</sup>

In addition to the disincentives to third-party buyers created by the ROFR, a shareholder seeking to exit the LLC faces the additional obstacle of finding a willing buyer for minority shares. An investor will seldom be willing to assume the risk of owning a minority LLC share.<sup>366</sup> Such shares lack sufficient voting power to control company operations, and of course face the same obstacles to re-sale experienced by the original minority shareholder.<sup>367</sup> As a result, minority shareholders seeking to exit are frequently

---

<sup>358</sup> *Id.*, at. 17

<sup>359</sup> *Id.*, at. 18

<sup>360</sup> *Id.*

<sup>361</sup> *Id.*

<sup>362</sup> DOUGLAS CUMMING, *VENTURE CAPITAL: INVESTMENT STRATEGIES, STRUCTURES, AND POLICIES*, 400, 401 (John Wiley & Sons, First ed. 2010).

<sup>363</sup> *Id.*

<sup>364</sup> *Id.*

<sup>365</sup> *Id.*

<sup>366</sup> Sandra K. Miller, *What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company*, 44 Am. U. L. Rev. 502 (1994).

<sup>367</sup> Douglas K. Moll, *Minority Oppression & (and) the Limited Liability Company: Learning (Or Not) from Close Corporation History*, 40 Wake Forest L. Rev. 899 (2005).



unable to secure fair value from third-party sales.<sup>368</sup> The absence of willing third-party purchasers, as mentioned, then fails to trigger ROFR for the existing shareholders. In practice, minority shareholders find themselves locked-in to a business they wish to exit and become vulnerable to majority oppression and other abusive majority conduct.

This issue was addressed by the Board of Grievances in a ruling (No. 96/T/3.1424H)<sup>369</sup> addressing a shareholder agreement to purchase shares of those wishing to sell, pursuant to an agreed upon valuation formula, even in the absence of a third-party offer. The Board ruled this provision did not conflict with SCR Article 161's requirement that LLC owners must obtain a third-party offer before the remaining shareholders can be compelled to purchase the shares in question. The court's decision thus creates one mechanism for preventing a shareholder without a third-party offer from being locked into the company.

### C. Enforcing the Right of First Refusal

One means by which LLC minority shareholders may protect themselves is to file an action requesting a court to enforce the ROFR procedures governing sales to non-LLC shareholders.<sup>370</sup> To prevail in such an action, the shareholder seeking to transfer must first comply with the required procedures and notifications needed to trigger the ROFR. The SCR requires that the following procedures take place:

---

<sup>368</sup> *Id.*

<sup>369</sup> Board of Grievances, Case No. 299/1/G, Appeal Division Decision No. 96/T/3, 2003 (1424H).

<sup>370</sup> Lécia Vicente, *supra* note 291, at 182.

- (a) A shareholder seeking the transfer shall first notify the non-transferring shareholders about his or her desire to transfer the share, including the name of the proposed buyer and the terms and conditions of the sale, and such notification shall be made through the LLC's manager.<sup>371</sup>
- (b) A shareholder seeking acquisition of the share being transferred shall make the request within 30 days of receipt of the manager's notice, at the agreed price, unless the LLC Article of Association provides for another valuation methodology, or for a longer period for exercising the ROFR.<sup>372</sup>
- (c) If the transferring shareholder has multiple shares to be transferred, and more than one shareholder wishes to acquire those shares, then the shares shall be divided among them in accordance with their respective proportion of the company's capital.<sup>373</sup>
- (d) If there is only a single share being transferred, and more than one shareholder requests the acquisition of the single share, then the share shall be allotted to all the shareholders seeking to acquire it. However, shareholders must remember that a single share of an LLC is indivisible<sup>374</sup>, and if there is more than one owner of a single share, an LLC reserves the right to suspend any rights relating to the share until its multiple holders decide who among themselves shall represent the others with regard to the share's managerial and economic rights.<sup>375</sup>

---

<sup>371</sup> The Saudi Companies Regulation, Art. 161.

<sup>372</sup> *Id.*

<sup>373</sup> *Id.*

<sup>374</sup> INTERNATIONAL BUSINESS SERIES, LEGAL ASPECTS OF DOING BUSINESS IN THE MIDDLE EAST, 167 § 5 (1986).

<sup>375</sup> The Saudi Companies Regulation, Art. 160.

Saudi law does not designate a specific deadline by which the transferring shareholder shall notify the remaining LLC shareholders about the proposed transfer and third-party offer. The notice must, however, include: (1) the name of the proposed buyer and (2) sufficient information about the proposed buyer to determine his identity, as the proposed buyer's identity plays a significant role in the remaining shareholders decision whether or not to approve the transfer.<sup>376</sup> The notice must also include the number of shares being transferred, as this information allows the remaining shareholders to determine whether the proposed transfer will affect their control over the company.<sup>377</sup> The SCR expressly requires that the transfer notice to the remaining shareholders be made through the LLC Manager.<sup>378</sup> The Saudi legislature adopted this requirement to avoid potential disputes over whether notice was properly given, particularly in LLCs which have close to the maximum allowed 50 shareholders. The SCR does not specify the manner or method of giving notice to the LLC manager, and thus any reasonable method of communication suffices.<sup>379</sup> A question that arises here is: would it be considered invalid notice if the transferring shareholder decided to communicate directly with each of the other shareholders? The most likely answer is that notifying other shareholders through the LLC Manager is not absolutely required, and communicating directly with the other shareholders would be sufficient. In such a situation, getting the signatures of the remaining shareholders would be one example of how to obtain the necessary proof of notice.<sup>380</sup> It is recommended that an LLC's Articles

---

<sup>376</sup> The Saudi Companies Regulation, Art. 161.

<sup>377</sup> Gorman, *supra* note 305, at 274.

<sup>378</sup> The Saudi Companies Regulation, Art 161.

<sup>379</sup> Ali Youns, *supra* note 353, at 77

<sup>380</sup> *Id.*

of Association specify the manner and the method of communications deemed acceptable under such circumstances.

Another issue is whether share transfers which fail to follow the ROFR procedures listed in the SCR would be deemed invalid. The most likely answer is that third-party transfers which violate Article 161 will be considered null and void by mandatory operation of law. The Court of Appeal reached just such a decision in case (No. 792/2/G.1419.H), holding that a share sale made in violation of Article 161 is legally invalid. The case involved a transferring shareholder who did not notify the company or other shareholders about the proposed transfer, in violation of both the company's Article of Association and the SCR.<sup>381</sup> The court ruled that the non-transferring shareholders had the right to nullify the sale to the third-party purchaser, as they were not given the opportunity to exercise ROFR prior to the sale.<sup>382</sup> The above-mentioned case makes clear that Article 161 requirements are mandatory as a matter of public policy, and any sale failing to comply with its provisions is legally invalid.<sup>383</sup> However, the ability to nullify the sale in question was a right reserved only to the non-transferring shareholders, as that is who Article 161 is designed to protect.<sup>384</sup>

#### D. The Limited Liability Company as Holder of The Right of First Refusal

The SCR does not specifically grant a ROFR to the LLC itself.<sup>385</sup> The majority view is that LLC shareholders can create such a right in their Articles of Association, the right

---

<sup>381</sup> Board of Grievances, Case No. 792/2/G, Appeal Division Decision No. 3/T/142, 2000 (1421H).

<sup>382</sup> *Id.*

<sup>383</sup> *Id.*

<sup>384</sup> *Id.*

<sup>385</sup> The Saudi Companies Regulation, Art. 161.

applying to situations where no existing shareholders seek to exercise ROFR themselves.<sup>386</sup> In such circumstances, the LLC can apply to purchase any shares being transferred to a third party, within either 30 days of receiving notice of transfer or any other time period specified in the LLC agreement.<sup>387</sup> Even with this right, however, the LLC faces the obstacle of financing the proposed purchase. The SCR does not specify how the LLC should finance such a purchase. However, several other principles govern the method of financing, with the most important of these principles being capital stability.<sup>388</sup> Capital stability serves as the company's minimum debt guarantee and is an important means of safeguarding LLC creditor and customer interests.<sup>389</sup> It is also based on the theory that creditors have claims only against the company, and not its owners, due to the limited liability LLC shareholders enjoy regarding company debts and obligations.<sup>390</sup> The question thus arises whether an LLC may permissibly use its statutory reserve funds to purchase shares. The prevailing view is that this is not permissible, as it would defeat the legislative purpose of ensuring minimum capital reserves to cover company losses and any unanticipated crises.<sup>391</sup> The LLC is required to contribute 10% of its annual profits to the statutorily-mandated reserve.<sup>392</sup> Such annual contributions may be suspended only if the statutory reserve has reached one-half of the LLC's paid-up capital.<sup>393</sup> Ultimately, then,

---

<sup>386</sup> Baghdadi, *supra* note 317, at. 252, 253.

<sup>387</sup> *Id.*

<sup>388</sup> MAAN JOYHAN, THE LAW OF CAPITAL REDUCTION OF PRIVATE COMPANIES: COMPARATIVE STUDY, 47, 48 (First ed. 2008).

*Id.* The principle of capital stability implies also that "the capital of the company shall remain as it is for the creditor who contracted with the company in its favor and the creditor has the right to object to any prejudice to it, as this would weaken the general guarantee determined by law for the benefit of the creditors."

<sup>389</sup> *Id.*

<sup>390</sup> *Id.*

<sup>391</sup> MOHAMMED AL-FAWZAN, THE GENERAL PROVISIONS OF COMPANIES, COMPARATIVE STUDY, 410, 411 (First ed. 2014).

<sup>392</sup> Saudi Companies Regulations, Art. 176.

<sup>393</sup> *Id.*

LLC share purchases can be financed only from the "voluntary" or "special" company reserves. "Special" reserves are created when shareholders agree to designate a percentage of LLC annual profits toward a fund which may then finance LLC share purchases through its ROFR.<sup>394</sup> Additionally, LLC profits may be used to directly purchase the shares in question.<sup>395</sup> However, in the absence of reserve profits allocated for share purchases, the LLC is limited to using its paid-up capital.<sup>396</sup> When using paid-up capital, LLC management must follow all required procedures for reducing such capital, including obtaining the approval of the shareholder General Assembly required when amending the Articles of Association.<sup>397</sup> Practically speaking, satisfying all the steps necessary to reduce LLC capital is extremely difficult, if not impossible.<sup>398</sup> If the LLC does successfully acquire the transferred shares, it must then abolish those shares.<sup>399</sup> In summary, although the SCR itself does not grant an ROFR to the LLC, it permits LLCs to create such a right through its Articles of Association. This enables the LLC to protect itself from unwanted shareholders in the event no individual shareholder exercises a ROFR.

#### E. Corporate Mergers and Acquisitions Involving LLC Shareholders

Mergers and acquisitions raise the question of whether the ROFR enables LLC shareholders to block sales of a parent company to a third party by exercising their right to purchase the parent company's LLC shares. The uncertainty arises because Saudi law

---

<sup>394</sup> Alfawzan, *supra* note 392, at. 451.

<sup>395</sup> *Id.*

<sup>396</sup> Maan, *supra* note 389, at. 218

<sup>397</sup> *Id.*

<sup>398</sup> The next chapter, "Withdrawal and Buyout Rights," will discuss in depth the impact of the capital rule on a shareholder's ability to withdraw from the LLC.

<sup>399</sup> MOHAMMED AL-GHINI, COMPANIES' SHARES AND ITS RULINGS IN ISLAMIC JURISPRUDENCE, 120, 121 (First ed. 2015).

permits outside business entities to hold shares in an LLC<sup>400</sup>, but the SCR does not address how the ROFR applies to the outside entity's shares if that entity itself is sold.<sup>401</sup> If the corporate LLC shareholder, for example, were acquired by another company, resulting in an indirect change in ownership of the LLC's shares, would the law give the LLC's other shareholders the right and priority to recover the shares owned by the acquired company? The question arises because the LLC shares themselves not being transferred, but a new (indirect) owner of the shares, who might be objectionable to the remaining shareholders, is now part of the LLC.

Under the SCR, a merger can assume one of two specific forms. In the first form, the annexing company completely absorbs the purchased company, and it ceases to exist. The absorbing company retains its legal personality and continue its operations, assuming all assets and liabilities of the absorbed company as of the date of annexation.<sup>402</sup> The second form is a merger by consolidation, where two or more companies merge to form a new entity, and the assets and liabilities of the merged companies become the property of the new entity.<sup>403</sup> The similarities between mergers and transfers of shares by individual shareholders, in terms of permitting new third-party owners into the LLC, create issues in two types of situations.

---

<sup>400</sup> HOSSAM EL-DIN TOUFIQ, GENERAL THEORY AND DEVELOPMENT OF COMPANIES, 362 (First ed. 2016).

<sup>401</sup> Professor Larry Ribstein has discussed this issue in his book "Unincorporated Business Entities" See LARRY E. RIBSTEIN, ET AL., UNINCORPORATED BUSINESS ENTITIES, 288-292 (LexisNexis Fifth ed. 2013).

<sup>402</sup> The Saudi Companies Regulations, Art. 191(1).

*Id.* this Article states that "The integration is conducted by the joining of one or more companies to another existing company, or by combining two or more companies into a new company. The integration contract determines the conditions, particularly with regard to the method of evaluating the security of the integrated company, and the number of stakes or shares belonging to it in the capital of the integrating company or the company arising out of integration."

<sup>403</sup> *Id.*

The first situation arises when a company is acquired by another company, and the shareholders of the absorbed company become new shareholders in the absorbing company. Is it permissible for the shareholders of the absorbing company to object to the entry of the new shareholders? The objection would be that the new shareholders from the absorbed company are "third parties," and that the existing shareholders therefore have a ROFR to purchase the newly issued shares. This argument, however, seems clearly invalid, if not frivolous.<sup>404</sup> The transfer of individual shares to a third party is not analogous to third parties entering the company through a merger, as the merger, unlike an individual transfer, is a collective action necessarily approved by the company itself.<sup>405</sup> Allowing the acquiring company's shareholders to purchase the new shares would undermine a fundamental principle of mergers, which is the transfer of all assets and liabilities to the absorbing company.<sup>406</sup> The acquiring company is compensating the owners of the absorbed company by issuing them new shares in exchange for their shares in the prior company which terminated upon the merger.<sup>407</sup> The acquiring company has legally obligated itself to this exchange, and only done so after approval by a general meeting of shareholders, as required for amending the Articles of Association.<sup>408</sup>

The second situation, which much more closely resembles an individual share transfer, occurs in either of the following two hypothetical scenarios:

---

<sup>404</sup> EILÍS FERRAN, *PRINCIPLES OF CORPORATE FINANCE LAW*, 138, 139 (First ed. 2008).

<sup>405</sup> PETRI MÄNTYSAARI, *THE LAW OF CORPORATE FINANCE: GENERAL PRINCIPLES AND EU LAW: VOLUME III: FUNDING, EXIT, TAKEOVERS*, 223, 224 (Illustrated ed. 2010).

<sup>406</sup> *Id.*

<sup>407</sup> Ferran, *supra* note 405.

<sup>408</sup> The Saudi Companies Regulations, Art. 191(3). The statute states that: "In all cases, the decision of integration shall be issued by every company taking part in such integration as per the requirements set for amending the articles of association."



- (1) Company (A) is acquired by company (B), and company (A) owns shares in the limited liability company (C). As a consequence of the merger, company (A) transfers its assets, liabilities, and shares to the absorbing company (B), which therefore becomes the new owner of company (A)'s shares in company (C). Should this transaction trigger a ROFR for company (C)'s shareholders, permitting them to purchase (B)'s shares?
- (2) Company (A) merges with company (B) to form company (C), a new company, and the assets and liabilities of both companies become the property of the new company (C). If one of the merged companies (A or B) owns shares in the limited liability company (D), company (C) thus becomes become a new shareholder of company (D). Does such an event trigger a ROFR for company (D)'s existing shareholders?

It certainly seems reasonable to contend that, in both hypothetical scenarios, the answer is “yes,” a ROFR will be triggered. The reason is that, in both cases, new owners entered a company without the consent of the existing shareholders, thereby threatening the private character of the LLC. The LLC's existing shareholders were not a party to the mergers in question, and therefore a ROFR is necessary to protect the LLC's right to be free of unwanted third-party owners.

The Saudi Board of Grievances, the former competent commercial court, issued an opinion interpreting SCR Article 161 in light of the ROFR issues raised by the preceding hypotheticals. The case (No.43/1/G 1419H)<sup>409</sup> involved plaintiffs who were minority LLC

---

<sup>409</sup> Board of Grievances, Case No. 43/1/G, Appeal Division Decision No. 3/T/238, 1998 (1419H).

shareholders seeking judicial enforcement of their ROFR when a parent company holding shares in their LLC was up for sale. The plaintiffs argued they should have a ROFR as to the parent company's LLC shares before the parent company's sale went through. The parent company (first corporate defendant) argued that no ROFR should exist because it was not transferring its LLC shares to a third-party, but rather was itself being purchased by an outside company (second corporate defendant).<sup>410</sup> The court ultimately rejected the plaintiffs' claims, holding that "rights of first refusal are only available in the event of a direct transfer of the LLC shares themselves, and not upon a change in ownership of the company holding the LLC shares."<sup>411</sup> The court found no such direct transfer had taken place, and thus no ROFR existed, enabling the defendants to prevail.<sup>412</sup>

The court's interpretation of Article 161 as described above leaves LLCs facing numerous potential issues. Failure to permit shareholders, who may be a minority in the LLC, to exercise the ROFR in such situations leaves them vulnerable to outside third-parties hoping to circumvent ROFR protections.<sup>413</sup> Allowing corporate entities to own shares in LLCs without providing some protection to the remaining shareholders in the event such entities change owners could lead LLCs to fall under the control of outside companies without regard to minority shareholder rights. Some Articles of Association I have examined include provisions controlling the extent to which the company can: (1) own shares in other companies or merge with them; and (2) participate with others in the establishment of joint stock companies or limited liability companies to carry out similar

---

<sup>410</sup> *Id.*

<sup>411</sup> *Id.*

<sup>412</sup> *Id.*

<sup>413</sup> Petri Mäntysaari, *supra* note 406, at 223.

or complementary activities.<sup>414</sup> However, such agreements do not protect the LLC and shareholders from unwanted transfers of shares occurring as a result of mergers and acquisitions involving a shareholder or shareholder's corporate parent. This exception to the ROFR should lead LLCs to think further about whether they truly wish to permit other business entities as shareholders. LLCs should also consider drafting their Articles of Association in a manner permitting such entities to own LLC shares, but also granting the remaining shareholders ROFR in the event the corporate shareholder changes ownership. Such provisions would help avoid the uncertainty and potential dispute that may arise when a corporate LLC shareholder is subject to a merger or acquisition. LLCs which consider this serious issue in advance will assist shareholders in keeping unwanted owners out of the LLC, thereby helping to prevent management conflict within the company.

#### F. The Problem of Fair Value and *Bona Fide Offer*

The new SCR values transferred shares based on the amount of the third-party offer, and also gives LLCs authority to set a different valuation method in their Articles of Association (or shareholders' agreement). New businesses may add the default SCR provision to their agreement, and this is most commonly done in the Gulf States.<sup>415</sup> The default provision allows LLC owners to transfer their shares to a third party, without consent and restriction from any other shareholders, but gives the non-selling shareholders

---

<sup>414</sup> About 35% of the examined Articles of Association contains such provisions regarding Mergers and Acquisitions, and the LLC's participation in other businesses. See the example of *published Article of Association of RTK Limited Liability Company, Um Al-Qura Newspaper 1439/2/21, No. 4697*. Article three of this agreement state that "The LLC may acquire shares in other existing companies or merge with it and have the right to participate with others in the establishment of joint stock companies or limited liability companies, after fulfilling the requirements of the regulations and instructions followed in this regard."

<sup>415</sup> Gulf States are the (GCC) Gulf Cooperation Council member states, which including Saudi Arabia, The United Arab Emirates, Bahrain, Oman, Qatar and Kuwait.

a ROFR at the price offered by the third-party purchaser.<sup>416</sup> This default arrangement, however, can lead to abuses. The transferring shareholder has an incentive to inflate the third-party offer, especially in family-run LLCs where the remaining shareholders will resist an outside owner under almost any circumstances.<sup>417</sup> The transferring shareholder might also artificially raise the price in order to block the remaining shareholders from acquiring the shares, as punishment for past quarrels between these shareholders.<sup>418,419</sup> Such abuses are possible because the SCR criminally penalizes shareholders for false valuation declarations regarding in-kind share contributions to the LLC, but has no such penalty for false statements regarding third-party sale offers.<sup>420</sup>

Under Islamic *fiqh*, *Al-Soriyah* is a concept prohibiting false claims regarding a contract's existence or any of its contents, including the price.<sup>421</sup> *Al-Soriyah* specifically forbids a seller and buyer from using deception to deprive third-parties of their preemption right to acquire the property in question. Such prohibited deceptions include exaggerating a purported sale price to prevent those with preemption rights from purchasing the property.<sup>422</sup> If such fraudulent conduct is proven, the underlying transfer contract will be deemed null and void, and those with preemption rights will be able to claim redemption at a fair value.<sup>423</sup> Still, despite Islamic jurisprudence's knowledge of *Al-Soriyah*, a

---

<sup>416</sup> Khaled Kano, *Shareholders Agreement and Exit Strategies* at <http://www.alyaum.com/article/4187551>. (February 8, 2018). In Arabic.

<sup>417</sup> MATHIAS SIEMS & DAVID CABRELLI, *COMPARATIVE COMPANY LAW: A CASE-BASED APPROACH*, 412, 413-415 (First Edition, 2018).

<sup>418</sup> *Id.*

<sup>419</sup> Such conduct is known as *Al-Soriyah* in Arabic, which means that the contract, or an apparent element of it, does not actually exist, but the contrary is claimed for the purpose of defrauding others.

<sup>420</sup> The Saudi Companies Regulation, Art. 212.

<sup>421</sup> Arafat Manadawi, *Al-Soriyah In Contract "comparative study"* at [https://scholar.najah.edu/sites/default/files/all-thesis/moot\\_contract.pdf](https://scholar.najah.edu/sites/default/files/all-thesis/moot_contract.pdf). In Arabic.

<sup>422</sup> *Id.*

<sup>423</sup> *Id.*

comprehensive rule applicable to different situations and circumstances has not been created.<sup>424</sup> As a result, *Al-Soriyah*'s application to ROFR violations among LLC shareholders is unclear under Saudi law. Moreover, even if an *Al-Soriyah* violation is proven, no set penalties are defined. This uncertainty underscores the importance of including appraisal provisions in LLC Articles of Association or Shareholder Agreements, thus limiting controversy regarding the true value of shares subject to third-party purchase offers. Without such appraisal provisions in place, valuation disputes complicate any potential settlement.<sup>425</sup>

#### G. Alternative Valuation Methods

The vast majority of Saudi LLCs do not consider the importance of appraisal provisions when establishing a company. Their Articles generally contain only very simple provisions, such as adopting SCR default provisions regarding the transfer and sale of shares.<sup>426</sup> As a result, valuation disputes among shareholders have been the subject of numerous cases in recent years. Such disputes can cause a business to collapse, and many legal voices have called for establishing an independent body for appraising fair share value at the time of transfer.<sup>427</sup> A few LLCs have attempted to address this concern by creating alternative valuation methods for transferred shares, independent of the alleged third-party purchase price.<sup>428</sup> One such method determines LLC share value according to the LLC's

---

<sup>424</sup> *Id.*

<sup>425</sup> Board of Grievances, Case No. 544/2/G, Appeal Division Decision No. 7/ES/592, 2009 (1430H).

<sup>426</sup> Mathias, *supra* note 418.

<sup>427</sup> Alyaum, *Legalists calling for the establishment of an independent body to conduct the appraisal of shares at <http://www.alyaum.com/article/4059732>*. (February 15, 2018).

<sup>428</sup> FALAH ALSHABAK, *THE THEORY OF ARBITRARINESS IN THE MANAGEMENT OF COMMERCIAL COMPANIES*, 131, 132 (First ed. 2016).

last annual budget and book value, which should be calculated from the company's Balance Sheet.<sup>429,430</sup> Common language establishing such a provision reads as follows: "The assignment, sale or other disposal of any asset or related group of assets of the company and its value shall be determined as previously approved in the company's last annual budget and according to the Balance Sheet."<sup>431</sup> The problem with using book value for determining the price of a transferring share is that book value rarely reflects the actual or fair value of the company.<sup>432</sup> Fair value, although difficult to define accurately, should reflect the actual value of the firm as a going concern.<sup>433</sup> A second method for valuing transferred shares stipulates that a general shareholder meeting shall determine the price, once the ROFR is triggered. The problem with this method is that share value is ultimately determined by the majority shareholders, leaving minority shareholders vulnerable to potential abuse.

Valuation challenges can arise even when an exit is approved and the general valuation method settled.<sup>434</sup> Questions such as whether an appraiser should settle disagreements as to fair market value, how many appraisers there should be, how they should be appointed and chosen, and who will bear the related expenses are all issues that shareholders would be wise to address at the time of the company's formation.<sup>435</sup> Such

---

<sup>429</sup> *Id.*

<sup>430</sup> The balance sheet shows the company's financial position; what it owns (assets) and what it owes (liabilities and net worth). FindLaw, *Financial Statements: The Balance Sheet*, at <http://smallbusiness.findlaw.com/business-finances/financial-statements-the-balance-sheet.html>.

<sup>431</sup> Contracts Arabia, *Shareholders Agreement* at [https://upload.wikimedia.org/wikipedia/commons/1/1a/Shareholders\\_Agreement%2C\\_with\\_Shareholder\\_Obligations%2C\\_Preview\\_0012.pdf](https://upload.wikimedia.org/wikipedia/commons/1/1a/Shareholders_Agreement%2C_with_Shareholder_Obligations%2C_Preview_0012.pdf).

<sup>432</sup> McDaniel & Park PC, *Book value is not fair value in partnership buyout* at <https://www.lexology.com/library/detail.aspx?g=fb4611d3-87f3-4b93-b722-c727db05a28c>. (February 18, 2018).

<sup>433</sup> *Id.*

<sup>434</sup> Kano, *supra* note 417.

<sup>435</sup> *Id.*

clauses prove beneficial when a shareholder and third party attempt to undermine the ROFR by claiming an exaggeratedly high offer price.<sup>436</sup> Permitting valuation methodology details to be settled at the time of a shareholder exit, or relying on the statutory provision alone, invites dispute.

#### 4.3 LLC Transfers of Interest in the United States

##### A. Limitations on Transfer

The United States historically treated transferability of unincorporated firm interests as subject to tax factors determined by the Internal Revenue Service (IRS)<sup>437</sup> and *Kintner* regulations.<sup>438</sup> The *Kintner* regulations evaluated four company characteristics in determining whether an entity is taxable as a corporation for federal income tax purposes: (1) continuity of life, (2) corporate-type management, (3) limited liability, and (4) free transferability of interests.<sup>439</sup> A business organization was classified as a corporation for tax purposes if it possessed three of these four characteristics.<sup>440</sup> A business organization, including an LLC, wishing to avoid double taxation and be taxed instead as a pass-through entity, could therefore possess no more than two of the *Kintner* characteristics, the two normally being centralized management and limited liability of its owners.<sup>441</sup> This test changed in 1997 when the IRS promulgated the “check-the-box” rule, which dropped the

---

<sup>436</sup> Mathias, *supra* note 418.

<sup>437</sup> The Internal Revenue Service is the nation's tax collection agency and administers the Internal Revenue Code enacted by Congress. Internal Revenue Service, *the Agency, its Mission and Statutory Authority*, available at <https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority>.

<sup>438</sup> *Kintner* refers to the analytical framework articulated in *United States v. Kintner*, 216 F.2d 418 (9th Cir. 1954).

<sup>439</sup> LARRY E. RIBSTEIN, ET AL., UNINCORPORATED BUSINESS ENTITIES, 18 (Fifth ed. 2013).

<sup>440</sup> *Id.*

<sup>441</sup> *Id.*, at. 19.

four characteristics approach, and allowed unincorporated firms to elect to be taxed as partnerships. As a result, an LLC with two or more members is subject to pass-through taxation by default unless it elects to be taxed and treated as a corporation.<sup>442</sup> In spite of this change, the partnership origins of LLCs have resulted in LLC statutes that continue to resemble partnership statutes. As a result, LLC statutes provide for free transferability of only economic (financial) rights, such as the right to LLC distributions and to a share in profits and losses, but not management (voting) rights, the transfer of which usually requires consent from all non-transferring members.<sup>443</sup> The majority of LLC statutes expressly exclude management rights when defining ownership interests, and therefore such rights cannot be freely transferred to third parties. The Uniform Limited Liability Company Act (ULLCA)<sup>444</sup> Sections 501 (A) and (B) and Section 502 state the following:

A member is not a co-owner of, and has no transferable interest in, property of a limited liability company. A distributional interest in a limited liability company is personal property and, subject to Sections 502 and 503, may be transferred in whole or in part. A transfer of a distributional interest does not entitle the transferee to become or to exercise any rights of a member. A transfer entitles the transferee to receive, to the extent transferred, only the distributions to which the transferor would be entitled.<sup>445</sup>

The Delaware Limited Liability Company Act (DLLCA) Sections 701 and 702 contain similar language:

---

<sup>442</sup> *Id.*, at. 19, 20.

<sup>443</sup> *Id.*, at 292.

<sup>444</sup> The Uniform Limited Liability Company Act (ULLCA) is a uniform act promulgated in 1995 by the US National Conference of Commissioners on Uniform State Laws ("NCCUSL") for the governance of limited liability companies by U.S. states. It has been amended in 1996 and 2006. The ULLCA was adopted in nine US jurisdictions, including California, the District of Columbia, Florida, Idaho, Iowa, Nebraska, New Jersey, Utah, and Wyoming. Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & Analysis*. at <https://ssrn.com/abstract=930417>. The Revised Uniform Limited Liability Company Act (RULLA), which the NCCUSL promulgated in 2006, has been adopted by 17 states to date. *Bench & Bar of Minnesota, Why You May Need an LLC Update in 2017* at <http://mnbenchbar.com/2017/06/llc-update/>.

<sup>445</sup> See UNIF. LTD. LIAB. CO. ACT (ULLCA) 501§ 502§ (1996).



A limited liability company interest is personal property. A member has no interest in specific limited liability company property. A limited liability company interest is assignable in whole or in part except as provided in a limited liability company agreement. The assignee of a member's limited liability company interest shall have no right to participate in the management of the business and affairs of a limited liability company except as provided in a limited liability company agreement or, unless otherwise provided in the limited liability company agreement, upon the vote or consent of all of the members of the limited liability company.<sup>446</sup>

U.S. LLC statutes therefore generally distinguish between economic rights, which are treated as transferable interests, and management rights. In contrast, U.S. corporations law provides that the transfer of stock shares as personal property entitles the transferee to acquire both financial and management rights. Such financial rights include the right to receive interim and liquidating dividends, and management rights include voting on the directors' election, M&A transactions, and corporate voluntary liquidation.<sup>447</sup> LLCs' lack of free transferability<sup>448</sup> in management rights, due to the consent requirement, potentially leaves LLC minority members stuck with an illiquid investment, and therefore vulnerable to management deadlocks and majority oppression.<sup>449</sup> However, the transferability limits on management rights is a default rule which LLCs can waive, thereby permitting the free and full transfer of a member's ownership interest.<sup>450</sup> The issue of potential management

---

<sup>446</sup> See DE ST TI 6 § 18-701, DE ST TI 6 § 18-702.

<sup>447</sup> Thomas E. Rutledge, *Assigning Membership Interests: Consequences to the Assignor and Assignee* *Journal of Passthrough Entities* at <https://ssrn.com/abstract=1470122>

<sup>448</sup> "An organization lacks free transferability of interests when [owners] cannot grant a transferee all of the [owner's] rights without the consent of the other [owners] of the organization." Douglas K. Moll, *Minority Oppression & (and) the Limited Liability Company: Learning (Or Not) from Close Corporation History*, 40 *Wake Forest L. Rev.* 883, 976 (2005)

<sup>449</sup> Sandra K Miller, *What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company*, 44 *Am. U. L. Rev.* 465, 536 (1994)

<sup>450</sup> Robert W., *Supra* note 31 at. 1299.

deadlocks has also been addressed by some LLC statutes which create a member right to voluntary dissociate from the LLC and receive the value of their interests.<sup>451</sup>

## B. The Nature of the Right of First Refusal (ROFR)

Generally, U.S. LLC statutes do not provide for a ROFR. As a result, American LLCs typically create a ROFR through provisions in their operating agreements.<sup>452</sup> American LLCs rarely impose an absolute ban on transferring membership interests. Instead, transferring membership interests is generally permitted if the other members agree to it, or in the event they refrain from exercising their ROFR on any proposed third-party transfer.<sup>453</sup> Besides members' ROFR, operating agreements also typically grant ROFR to the LLC itself.<sup>454</sup> However, giving a ROFR to the LLC alone, without an accompanying right for non-transferring members, might not protect minority shareholder interests if they cannot force the LLC to exercise that right in any given situation.<sup>455</sup> LLCs therefore prefer to give the non-transferring members a ROFR to be exercised in the event the LLC itself fails to exercise ROFR.<sup>456</sup>

By itself, a ROFR provision does not guarantee that a member will be able to transfer his share, either to the non-transferring members or to a third party.<sup>457</sup> Members, especially those holding minority interests in an LLC, may face difficulty in obtaining suitable third-

---

<sup>451</sup> See e.g. UNIF. LTD. LIAB. Co. ACT §§ 601-602, 6B U.L.A. 607 (1996).

<sup>452</sup> MARTIN M. SHENKMAN, ET AL., STARTING A LIMITED LIABILITY COMPANY, 106 (Wiley, 2nd ed. 2003).

<sup>453</sup> THERESE MAYNARD & DANA M. WARREN, BUSINESS PLANNING: FINANCING THE START-UP BUSINESS AND VENTURE CAPITAL FINANCING (2nd ed. 2014).

<sup>454</sup> *Id.*

<sup>455</sup> STEVEN C. ALBERTY, LIMITED LIABILITY COMPANIES: A PLANNING AND DRAFTING GUIDE, 109 (First ed. 2003)

<sup>456</sup> *Id.*

<sup>457</sup> ANTHONY MANCUSO & BETHANY K. LAURENCE, BUSINESS BUYOUT AGREEMENTS: PLAN NOW FOR ALL TYPES OF BUSINESS TRANSITIONS 34, 35 (NOLO, 7th ed. 2016).

party offers. For members who fail to obtain a third-party offer, no ROFR is triggered on behalf of the LLC or non-transferring members.<sup>458</sup> Moreover, if default rules on transferable membership interests apply, making only a member's financial rights in an LLC freely transferrable, and not any management rights, the price a third party will be willing to pay is accordingly reduced.<sup>459</sup> The price of a membership interest without voting rights will naturally be lower than the price of an interest with both economic and voting rights.<sup>460</sup> As a result, American LLCs, when wishing to guarantee a member the right to transfer his or her interest in the future, usually include a “Right-to-Force-Sale” clause in a separate agreement, typically a buy-sell agreement.<sup>461</sup> LLCs typically permit members to freely transfer their interest to a co-owner without triggering the ROFR, since such transfers do not result in the entry of a new stakeholder to the business.<sup>462</sup> However, an LLC operating agreement lacking any provisions governing transfers between co-owners could lead to one or more owners seizing control over the business. LLCs that understand this risk create provisions applying ROFR to transfers between co-owners, in addition to those with third parties.<sup>463</sup>

Less prevalent than the ROFR, the Right-of-First-Offer is another device that American LLCs include in their agreements.<sup>464</sup> In such an arrangement, members are permitted to offer their interests to a third party only after first permitting the LLC and other members the opportunity to purchase within a specified period of time.<sup>465</sup> Any sale to a third party

---

<sup>458</sup> *Id.*

<sup>459</sup> Steven C., *supra* note 456, at 110.

<sup>460</sup> *Id.*

<sup>461</sup> Mancuso, *supra* note 458, at. 86.

<sup>462</sup> *Id.*, at. 35.

<sup>463</sup> *Id.*

<sup>464</sup> PHILLIP L. JELSMAN & PAMELA EVERETT NOLLKAMPER, *THE LIMITED LIABILITY COMPANY*, 6-7 § 1 (James, 3rd ed. 2014).

<sup>465</sup> *Id.*

must then also contain same terms and conditions, and price, previously offered to and rejected by the LLC and other members.<sup>466</sup> ROFR clauses are generally seen as preferable to Right-of-First-Offer provisions, and are most commonly used by unincorporated business entities. The reason is that ROFR clauses give the company more control over share transfers, as ROFR situations will only arise when a member receives a bona fide third party offer to purchase the interest.<sup>467</sup>

### C. Mergers and Acquisitions Involving LLC Members

As in the KSA, U.S. LLCs permit other business entities, such as a corporation or another LLC, to become shareholders in the business.<sup>468</sup> Thus, it is very common for one corporation, which could be a subsidiary of another, larger corporation, to possess interests in an LLC.<sup>469</sup> In this situation, contractual provisions on the ROFR and transfer of interests play a significant role in permitting LLC members, and particularly minority interests, to control who they will permit to be co-owners.<sup>470</sup> American LLCs, and even other forms of business entities, usually take this issue into account when drafting the company's operating agreement. Doing so avoids the potential threat that their business could be controlled by a corporation with whom they have not chosen to conduct business.

However, if ROFR provisions are not clear as to what transactions should be restricted and what might trigger the ROFR, the holders of the ROFR could easily be

---

<sup>466</sup> *Id.*

<sup>467</sup> DAVID T. LEWIS & ANDREA C. CHOMAKOS, *THE FAMILY LIMITED PARTNERSHIP DESKBOOK: FORMING & FUNDING FLPS & OTHER*, 153 (2nd ed. 2008).

<sup>468</sup> ANTHONY MANCUSO, *LLC OR CORPORATION?: HOW TO CHOOSE THE RIGHT FORM FOR YOUR BUSINESS*, 17 (NOLO, Sixth ed. 2015).

<sup>469</sup> Larry E, *supra* note 440, at. 291.

<sup>470</sup> *Id.*, at. 292.

circumvented.<sup>471</sup> *In Northeast Communications of Wisconsin, Inc. v. CenturyTel, Inc.*, 516 F.3d 608 (C.A.7 (Wis.), 2008), the court held that the ROFR was not triggered when one member of a limited partnership switched corporate parents.<sup>472</sup> The parties to the lawsuit, Casco Telephone, Universal Cellular, Northeast Communications, Lakefield Communications, and Wayside Telecom., formed a limited partnership to operate as a joint venture and engage in the cellular communications market. Wisconsin RSA and the partnership agreement addressed and contained specific provisions governing the partnership's transfer of interests and the extent of ROFR applicability. These provisions were addressed in section 11.5 of the partnership agreement, which stated the following:

Any provision of Section 11.1 to the contrary notwithstanding, it is understood and agreed that Casco Telephone Company, Universal Cellular ... and Lakefield Communication, Inc. may transfer their respective partnership interest to one of their respective affiliates at any time without consent or restriction from any other partner. In the event of any sale, transfer, or other disposition of ownership or control by Casco Telephone Company, Universal Cellular... or Lakefield Communication, Inc. of their respective Partnership Interest, the non-selling entity, or affiliate of the non-selling entity, shall have, to the exclusion of all other partners, exclusive right for a period of thirty (30) days from the date of receiving notice from the selling partner of its interest to sell part or all Partnership Interest, the right to purchase the interest of the selling partner or a portion of said interest., .....Any interest not so purchased by Casco Telephone Company, Universal Cellular... or Lakefield Communication, Inc., or their respective affiliates, from the other or others at the termination of the 30-day period, shall be subject to purchase by any of the other partners. It is the intention of the parties that this paragraph shall apply only to sales by Casco Telephone Company, Universal Cellular... or Lakefield Communication, Inc. or their affiliates to each other, or their affiliates, so as to give each of these entities the first right and option to purchase additional interests in the Partnership.<sup>473</sup>

The district court based its ruling on the last sentence of section 11.5, "It is the intention of the parties that this paragraph shall apply only to sales by [the three determined

---

<sup>471</sup> Peter e. Fisch & Mitchell I. Berg, *Exceptions in Rights of First Refusal Provisions at* <https://www.paulweiss.com/media/3639387/13july2016fischbergnylj.pdf>.

<sup>472</sup> *Northeast Communications of Wisconsin, Inc. v. CenturyTel, Inc.*, 516 F.3d 608 (7th Cir. 2008)

<sup>473</sup> *Id.*

members], or their affiliates to each other, or their affiliates.” Since none of the three members mentioned in section 11.5 transferred any interest to another member specified in the section, the court ruled that no ROFR was triggered.<sup>474</sup> The court’s ruling emphasizes the importance of the parties to an agreement clarifying whether a change in a member’s ownership, or the corporate parent of a member, activates the ROFR regarding that member’s interest.<sup>475</sup>

LLC members could also lose their right to acquire the transferring shares when other provisions in the LLC agreement conflict with the ROFR. In *Minn. Invco of RSA # 7, Inc. v. Midwest Wireless Holdings, LLC*, an LLC’s minority members claimed that their ROFR in the LLC agreement should be triggered upon a parent company’s sale to a third party, giving them the right to purchase the parent company’s LLC shares.<sup>476</sup> The court rejected this claim, holding that the "drag along" provisions in the LLC agreement pre-empted the ROFR provisions, thereby permitting the parent company to “drag along” its shares to its new owner.<sup>477</sup>

In general, contractual obligation provisions on transfers of interest and the ROFR must clearly and explicitly state the events which will trigger the ROFR, such as:

- (a) A direct transfer of a member’s interest to a third party.
- (b) A transfer between members.
- (c) A corporate-level transaction resulting in a direct or indirect change of a member’s ownership.
- (d) A transfer to a member's affiliates.

---

<sup>474</sup> *Id.*

<sup>475</sup> Larry E, *supra* note 440, at 292.

<sup>476</sup> *Minn. Invco of RSA # 7, Inc. v. Midwest Wireless Holdings, LLC*, 903 A.2d 786, 787 (Del. Ch. 2006).

<sup>477</sup> *Id.*

(e) A transfer by a member's affiliate to another affiliate.<sup>478</sup>

In the United States, LLC members have the responsibility to be clear and explicit in their membership agreement about which events trigger the ROFR. This clarity will help holders of minority interests to avoid losing control over the business, as well as avoiding the possibility of litigation in the event of a controversial transaction.

#### D. The Fair Value and Valuation Methods

##### 1. Bona Fide Offer as A Valuation Methodology

The ROFR provision in LLC agreements typically selects the price being offered by a third-party purchaser as the fair value at which the ROFR holder may purchase a share from the transferring member.<sup>479</sup> American LLCs have faced issues when attempting to apply such provisions in practice. One difficulty is that even when a third-party offer seems genuine, determining the actual seriousness of the offer and the extent to which that third party is likely to complete the transaction is hard to measure.<sup>480,481</sup> Thus, a member seeking the transfer may be able to create a fictitious outside bid from a third party and successfully conceal its falsity, thereby raising the transferring interest price.<sup>482</sup> Nevertheless, LLCs that understand this potential problem when drafting their agreements are able to include

---

<sup>478</sup> Peter e. *supra* note 472.

<sup>479</sup> Martin M, *supra* note 453, at. 106.

<sup>480</sup> SHANNON P. PRATT, *THE LAWYER'S BUSINESS VALUATION HANDBOOK: UNDERSTANDING FINANCIAL STATEMENTS, APPRAISAL REPORTS, AND EXPERT TESTIMONY*, 163 (American Bar Association. 2003).

<sup>481</sup> See discussion, *supra*, at note 437.

<sup>482</sup> Anthony Mancuso, *supra* note 469, at. 31.

provisions protecting against abuse during the ROFR process, which may include some or all of the following:

- (a) Requiring a written and signed offer from a proposed purchaser submitted with the transferring member's Notice of Intent to Transfer to the other members and the company.<sup>483</sup> Generally, a prospective purchaser will not take the step of signing an offer sheet if there is no real intention of buying the interest.<sup>484</sup>
- (b) Requiring significant upfront payment by the proposed purchaser to the transferring member in a manner which can be documented for the non-transferring members, such as receiving a copy of the check from a proposed purchaser.<sup>485</sup>
- (c) An LLC agreement providing in advance a specific price (Agreement Price) that a transferring member will receive regardless of the actual value at the time of proposed transfer.<sup>486</sup> One drawback to an Agreement Price, however, is that the transferring member may sell at a price that is less than actual fair market value.<sup>487</sup>

## 2. Appraisal Method

As an alternative to valuation based on bona fide third party offer price, some ROFR agreements provide that the value of any share subject to ROFR be set by the appraisal method.<sup>488</sup> American LLCs often set the ROFR at a market price determined by an independent appraisal, which they could refer to in case of any disagreement as to the

---

<sup>483</sup> *Id.*

<sup>484</sup> *Id.*

<sup>485</sup> *Id.*

<sup>486</sup> *Id.*

<sup>487</sup> *Id.*

<sup>488</sup> MICHAEL SPADACCINI, *ULTIMATE LLC COMPLIANCE GUIDE: COVERS ALL 50 STATES*, 124 (1st ed, 2011).



interest's fair value.<sup>489</sup> There are a number of variations as to the appraisal methodology employed in such agreements. One commonly used appraisal provision provides that, in the event of a valuation dispute between buying and selling members which cannot be resolved within a set period of time, typically 30 days, the value shall be the average of valuations as determined by three independent appraisers.<sup>490</sup> Each party will be entitled to choose one appraiser, and the two appraisers will choose a third appraiser.<sup>491</sup> Some appraisal agreements add a further step and provide for the right to apply to a court for selection and appointment of an additional appraiser in the event the initial independent appraisers fail to conduct their process in the time and manner agreed to by the parties.<sup>492</sup>

Another commonly used appraisal provision states that the ROFR purchase price be equal to the purchase price offered by a third party purchaser only if such third party offer consists of cash or promissory note.<sup>493</sup> These agreements often require the selling member to accompany any Notice to Sell with a good faith estimate by the selling member of the fair market value of any non-cash consideration. The market value of the non-cash consideration shall then be determined to be equal to either (1) The Seller's Estimate, or (2) an amount determined by an independent appraiser selected by the managers (if the company is a manager-managed LLC), with the managers then having sole discretion to select between the amount as determined by the first or second method.<sup>494</sup>

---

<sup>489</sup> Robert K. Wise; Andrew J. Szygenda; Thomas F. Lillard, *First-Refusal Rights under Texas Law*, 62 *Baylor L. Rev.* 433 (2010), at <https://www.baylor.edu/content/services/document.php/117444.p>

<sup>490</sup> LARRY E. RIBSTEIN & ROBERT R. KEATINGE, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES*, A-3 (WEST 2nd ed. 2010).

<sup>491</sup> *Id.*

<sup>492</sup> Steven C., *Supra* note 456, at 163.

<sup>493</sup> ROBERT R. KEATINGE & LARRY E. RIBSTEIN, *RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES*, APP. B-1 ARTICLE 10.2 (Thomson Reuters Second ed. 2017).

<sup>494</sup> *Id.*

LLC appraisal agreements also often apportion the expenses of any appraisal carried out under the agreement, commonly assigning to each party involved the cost of their own selected appraiser and one-half of the cost of any mutually agreed upon appraiser.<sup>495</sup> For example, if three appraisers conducted an appraisal, each party would compensate the appraiser it appointed, with the third appraiser's expenses borne equally by each party.<sup>496</sup> Still, having an appraisal provision introduced by the members in their agreement whenever a ROFR option triggers will not always avoid problems. Most outside buyers will be unwilling to invest the time and money required for due diligence on a proposed purchase if they know that the company can step in and buy the interest regardless of the price offered by the outside purchaser.<sup>497</sup> As a result, many LLC agreements distinguish a member's voluntary transfer of a membership interest, where there is a third party offer, and an involuntary transfer, as in the case of a member's death, incapacity, or bankruptcy.<sup>498</sup> Such agreements state that, with a voluntary transfer, any bona fide third party offer shall determine the ROFR price.<sup>499</sup> In the case of an involuntary transfer, on the other hand, they will refer to the Purchase Price Section introduced in their agreements.<sup>500</sup>

#### E. Payment Terms

The method and instrument through which the payment is made is usually agreed upon in advance in the company's constitutional documents. The non-transferring owners are

---

<sup>495</sup> *Id.*, at App. B-3-25.

<sup>496</sup> *Id.*

<sup>497</sup> THERESE MAYNARD & DANA M. WARREN, BUSINESS PLANNING: FINANCING THE START-UP BUSINESS AND VENTURE CAPITAL FINANCING, (Second ed. 2014).

<sup>498</sup> For an example of this type of agreement, see the Operating agreement of Nautilus Poplar, LLC, available at <https://www.sec.gov/Archives/edgar/data/61398/000119312509209470/dex101.htm>.

<sup>499</sup> *Id.*

<sup>500</sup> *Id.*

often obliged by the LLC operating agreement to follow either the same method and mechanism as provided in the third party proposed offer, or the specific payment terms agreed upon in the LLC operating agreement. An example of the first approach is the following language:

Upon the exercise of a right to purchase and provided the right is exercised with respect to all of the Interest in the Company offered, the purchase shall be closed, and payment made on the same terms and conditions as those on which the Offeror proposes to transfer the Interest in the Company. If the proposed offer is for consideration other than cash or cash plus deferred payments of cash, the purchasing Members may pay the present value cash equivalent of such other consideration or may pay using the same instrument as contemplated by the proposed offer.<sup>501</sup>

Other LLC agreements follow the second approach and provide for remaining members the right to purchase, once the purchase option is triggered, at either the Agreement Price or at its fair value as determined by Payment Terms set out in the agreement. In this way, LLCs can agree on Deferred Payment<sup>502</sup> Terms once the right of first refusal is triggered, regardless of the payment instrument of the proposed offer.<sup>503</sup> An example of language dictating this second approach is the following:

The company and the non-transferring owners shall have the right to purchase the interest of the transferring owner at the Agreement Price (or at its fair value) and payment terms selected in the "Payment Terms" section of this agreement.<sup>504</sup>

---

<sup>501</sup> Derrick & Briggs LLP, *LLC forms*, available at <http://derrickandbriggs.com/resources/>. Last visited (March 21, 2018).

<sup>502</sup> Deferred payment generally refers to a temporary postponement of the payment of an outstanding bill or debt, usually involving repayment by instalments. *Oxford Dictionaries, Deferred Payment*, at [https://en.oxforddictionaries.com/definition/deferred\\_payment](https://en.oxforddictionaries.com/definition/deferred_payment). Last visited (March 21, 2018).

<sup>503</sup> *CONCORDIA PARTNERS, LLC v. Ward (Dist. Court, D. Maine 2013)*.

<sup>504</sup> Sample Buy-Sell Agreement, *Limiting the Transfer of Ownership*, available at [https://usagym.org/PDFs/Member%20Services/bestpractices/2015/1\\_1legalplanning.pdf](https://usagym.org/PDFs/Member%20Services/bestpractices/2015/1_1legalplanning.pdf). Last visited (March 21, 2018).

Agreements can thus have a plan requiring a down payment of a specific amount due at the time of transfer,<sup>505</sup> with the remaining balance divided over monthly or yearly installments until the entire purchase price is paid in full.<sup>506</sup>

#### 4.4 Summary and Analysis

##### A. The Statutory Provisions

The Saudi legislature has shown historical progress with regard to the transfer of LLC shares, as the consent of the other shareholders is no longer required for transferring a share to a third party. ROFR, however, still applies to any transfer proposal, thereby making it difficult for shareholders seeking a transfer, especially those holding minority shares in the LLC, to carry out their proposed transaction. Obtaining the consent of other shareholders to a new shareholder's entry is typically not the major obstacle to a third-party transfer, as a new minority owner could not affect business operations. Rather, the practical difficulty arises in finding a third-party willing to become a minority owner. The lack of ready third-party purchasers leaves minority shareholders vulnerable in company disputes, resulting in potential management deadlock, minority oppression, or other disruptions to company operations.

The difficulties of selling minority shares poses several additional questions. First, does Saudi law provide for other mechanisms through which a shareholder might avoid being locked-into a business? Second, are there any remedies available to an LLC minority

---

<sup>505</sup> STEVEN C. ALBERTA, LIMITED LIABILITY COMPANIES: A PLANNING AND DRAFTING GUIDE, 188 (1st ed. 2003).

<sup>506</sup> *Id.*

owner if they become vulnerable to majority owner misconduct?<sup>507</sup> U.S. LLC statutes, as explained, do not allow for the assignment of a member's management rights without the consent of the other members. Therefore, members holding minority interests in U.S. LLCs are vulnerable to management deadlock, as well as to majority owner misconduct. However, there are two fundamental differences between Saudi and U.S. LLC laws. The differences are: (1) The ROFR in Saudi law is a mandatory right that shareholders may not omit from their LLC agreements, in contrast to U.S. LLC law which leaves that determination up to the LLC members themselves; (2) U.S. LLC statutes separate management and economic rights in the event a member transfers his or her interest, in contrast to Saudi law which does not allow such a division in cases of transfer. Based on these differences, two questions then arise. First, should the rules governing ROFR be mandatory or default rules? Second, is the U.S. approach of distinguishing between the transferability of controlling and economic rights an optimal model to apply in KSA?

1. Should the rules governing the right of first refusal be mandatory or default rules?

The right of first refusal protects minority investors by providing them an opportunity to increase their position in the business, if desired, in order to avoid the risks associated with being a minority shareholder.<sup>508</sup> Such protection is especially important in closely held companies where minority owners have limited control over management of the business and lack a liquid market in which to sell their shares.<sup>509</sup> The essential ROFR

---

<sup>507</sup> *Infra* chapter 6.

<sup>508</sup> GARY R. TRUMAN, UNDERSTANDING BUSINESS VALUATION: A PRACTICAL GUIDE TO VALUING SMALL TO MEDIUM SIZED BUSINESSES, 576-577 (5th ed. 2017).

<sup>509</sup> Alison Bird, *Top Ten Minority Investors Protections at* <http://www.turinasbird.com/2016/01/12/corporate-law/minority-investor-protections>.

distinction between the US and KSA legal systems is that the SCR grants LLC shareholders a mandatory ROFR that the shareholders cannot waive in their Articles of Association, whereas US LLC statutes generally do not provide for such right. The US system thus grants LLC owners maximum freedom to include or not include ROFR provisions in their agreements.

There is currently great debate among corporate law scholars as to the extent corporate law statutes should contain default versus mandatory rules.<sup>510</sup> Those supporting mandatory rules offer several main arguments.<sup>511</sup> First, mandatory rules protect shareholders whose lack of sufficient information or foresight would otherwise lead to unfair or prejudicial agreements.<sup>512</sup> Second, mandatory rules also protect non-owners such as a company's creditors and consumers.<sup>513</sup> Scholars favoring default rules counter that private parties are generally in the best position to know their own interests, and that mandatory rules therefore limit contractual freedom to an unnecessary extent, particularly when company agreements have little effect on third-parties.<sup>514</sup> Pro-default rule scholars generally admit that the case for mandatory rules is much stronger with regard to third-party protections, such as piercing the corporate veil or the legal capital rule.<sup>515</sup> However, provisions such as the right of ROFR, where no third-party interest is threatened, should not be subject to mandatory rules.

---

<sup>510</sup> Brett H. McDonnell, Sticky Defaults and Altering Rules in Corporate Law, 60 S.M.U. L. Rev. 383, 384 (2007). Available at <https://scholar.smu.edu/cgi/viewcontent.cgi?article=1448&context=smulr>.

<sup>511</sup> *Id.*, at. 389. See the discussion in Chapter 3.

<sup>512</sup> *Id.*

<sup>513</sup> *Id.*

<sup>514</sup> *Id.*, at. 383.

<sup>515</sup> See the discussion in the next chapter about the legal capital rule.

Pre-emptive rights under U.S. law, which share certain similarities with the ROFR, have undergone several historical changes which are also important to our analysis.<sup>516</sup> Pre-emptive rights give shareholders the right to purchase any additional or subsequent shares that a company proposes to issue. Although not focusing on existing shares like ROFR agreements, pre-emptive rights serve a similar purpose by protecting minority investors whose interests may be threatened by any change in the ownership percentage of a company's shares.<sup>517</sup> It is therefore significant that the U.S. has gradually eliminated mandatory pre-emptive rights, giving parties the contractual freedom to include or omit them from company agreements.<sup>518</sup> Corporate laws in most U.S. states no longer include mandatory pre-emptive rights.<sup>519</sup>

The mandatory pre-emptive right as initially established by case law protected individual shareholder's ownership voting power.<sup>520</sup> Many doubts then emerged regarding the application of such mandatory pre-emptive rights.<sup>521</sup> Some scholars argued against the rule by pointing out that as the only function of such a rule was to protect shareholder voting rights, the rule had relevance to those holding non-voting shares.<sup>522</sup> Later, the mandatory pre-emptive rights rule became a tool to guard against aggressive behavior by majority owners, as most cases where the issuance of new shares harmed minority shareholders also involved breaches of fiduciary duty by the controlling shareholders or

---

<sup>516</sup> Amal Abu Awwad, *Shareholders' Preemptive Rights in Listed and Closely-Held Corporations and Shareholders' Protection Methods* at <https://ssrn.com/abstract=2739375>.

<sup>517</sup> Technical committee of The International Organization of Securities Commissions, *Protection of Minority Shareholders in Listed Issuers* at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD295.pdf>.

<sup>518</sup> Amal Abu Awwad, *supra* note 517, at. 12.

<sup>519</sup> Jesse M. Fried, *Cheap-Stock Tunneling Around Pre-emptive Rights*, 3 at [http://www.law.nyu.edu/sites/default/files/upload\\_documents/Equity%20Tunneling%20Around%20Pre%20Emptive%20Rights%204.11.16.pdf](http://www.law.nyu.edu/sites/default/files/upload_documents/Equity%20Tunneling%20Around%20Pre%20Emptive%20Rights%204.11.16.pdf).

<sup>520</sup> Amal Abu Awwad, *supra* note 517, at. 12, 13.

<sup>521</sup> *Id.*

<sup>522</sup> *Id.*

the board of directors.<sup>523</sup> Therefore, the U.S. today has eliminated the mandatory preemptive rights rule by reasoning that shareholder protection is ensured by fiduciary duties and market liquidity, eliminating the need for pre-emptive rights.<sup>524</sup> In closely held companies where minority stakeholders have no liquid market in which to sell, it is therefore more important that legal tools exist for protecting minority shareholders from diminished voting power.<sup>525</sup>

From my perspective, a similar analysis should apply to ROFR doctrine, as the desirability of mandatory ROFR depends upon the existence of other legal protections for the rights of minority investors, most importantly fiduciary duties. If the law provides clearly for fiduciary duties that managers and controlling shareholders owe to the LLC and other shareholders, then there is less need for mandatory ROFR. Lawmakers should therefore see that mandatory ROFR might not be the appropriate legal protection for LLC shareholders when other legal tools would provide equivalent protection while also respecting the contractual freedom of LLC owners to decide for themselves on ROFR desirability. Therefore, the ROFR should be a default provision, allowing parties to opt out if they feel their interests would be better served without this measure.

2. Is the U.S. approach of distinguishing between the transferability of controlling rights and economic rights an optimal model to apply in KSA?

---

<sup>523</sup> *Id.*, at. 14.

<sup>524</sup> *Id.*, at. 16.

<sup>525</sup> *Id.*, at. 15.



The LLC statutes of most U.S. states generally permit the free transferability of a member's economic rights.<sup>526</sup> The transfer, however, of a member's controlling rights<sup>527</sup> typically requires the consent of the other members.<sup>528</sup> Scholars have identified a historical reason for this distinction between economic and controlling rights.<sup>529</sup> Prior to the promulgation of the check-the-box rule, free transferability was a corporate characteristic for purposes of U.S. federal income tax law.<sup>530</sup> Thus, LLC statutes follow partnership law in distinguishing between a member's economic and management interests in order to avoid corporate double taxation.<sup>531</sup> The LLC rule is also intended to protect existing members from having to share management responsibilities with an outside person who might prove personally or managerially incompatible with current members,<sup>532</sup> while simultaneously providing a member with some level of liquidity.<sup>533</sup>

Whatever its merits, the approach has also been criticized in several respects. First, the restriction on transferability of management rights may leave LLC minority owners stuck with an illiquid investment, and vulnerable to management deadlocks.<sup>534</sup> Second, the restriction tends to discourage third party offers and add to the challenges of any sale. New investors often want to participate in LLC management and gain some control over company resolutions.<sup>535</sup> Under current law, a buyer may be forced make any purchase offer

---

<sup>526</sup> The buyer receives only the right to share in profits and capital distributions.

<sup>527</sup> This means the right to share in the LLC management responsibilities and voting power.

<sup>528</sup> THOMAS A. HUMPHREYS, LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS, 4-43 (First ed, 2017)

<sup>529</sup> *See supra*, note 441.

<sup>530</sup> Thomas, *supra* note 529.

<sup>531</sup> *Id.*

<sup>532</sup> *See* James J. Vlasic, *Limitations on Transfer of Limited Liability Company Membership Interests*, available at <http://www.bodmanlaw.com/Publications/articles/BLJ%20Spring%202011%20Vlasic.pdf>

<sup>533</sup> *Id.*

<sup>534</sup> Sandra K. Miller, What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company, 44 Am. U. L. Rev. 465, 536 (1994).

<sup>535</sup> STEVEN C. ALBERTA, LIMITED LIABILITY COMPANIES: A PLANNING AND DRAFTING GUIDE, 110 (First ed. 2003).

to a transferring member contingent upon obtaining the consent of all non-transferring members.<sup>536</sup> Such restrictions also significantly affect the price a transferor might receive.<sup>537</sup> The purchase price will be lower if the buyer acquires only the transferor's economic interests, as opposed to both the economic and controlling interests.<sup>538</sup> Thus, while the restriction on transferring management rights is intended to protect LLC members from management interference caused by to unwanted new members, it hinders any member seeking full market value for a transfer, as obtaining full market value requires the consent of non-transferring members. Also, in situations where an LLC member has successfully transferred all financial rights to a third party, the transferor remains able to impact company management. This raises the possibility that the transferor would not act in the best interests of the company, given the absence of any personal financial stake. Some U.S. LLC statutes attempt to address this last issue. For example, the Uniform Limited Liability Company Act (ULLCA) permits LLCs to expel any member has transferred all of his distributional (financial) interests in the LLC to third parties.<sup>539</sup> I believe that the KSA would be best served by not permitting a split between financial and management rights, and should therefore decline to follow the U.S. model.

## B. The Provisions of LLC Agreements

---

<sup>536</sup> *Id.*

<sup>537</sup> *Id.*

<sup>538</sup> *Id.*

<sup>539</sup> *See* UNIF. LTD. LIAB. CO. ACT (ULLCA) 601(5)(ii) § (1996). States that “A member is dissociated from a limited liability company upon the occurrence of any of the following events: ..... (5) the member's expulsion by unanimous vote of the other members if: (i) it is unlawful to carry on the company's business with the member; (ii) there has been a transfer of substantially all of the member's distributional interest, other than a transfer for security purposes or a court order charging the member's distributional interest which has not been foreclosed.”

LLC operating agreements in the United States pay notably more attention to regulating the procedures for transferring members' interests than do such agreements in KSA. For instance, in the ROFR context, U.S. operating agreements usually contain provisions clarifying whether corporate-level transactions, such as mergers and acquisitions, resulting in an indirect change of ownership for the LLC, trigger the ROFR.<sup>540</sup> Such provisions protect LLCs as well as their minority owners from being controlled or directed by corporations not originally parties to the LLC agreement. In contrast, and despite many complicated cases arising in the courts as a result, Saudi LLCs agreements generally lack provisions regulating corporate-level transactions involving one or more LLC shareholders. Regarding valuation methods for transferred shares, American LLCs adopt several different models. One commonly used method, as previously discussed<sup>541</sup>, determines the price of a transferring member's interest based on a third party bona fide offer. U.S. operating agreements have created innovative solutions to minimize any potentially fictitious bid from a third party. One solution is requiring a written, signed offer from a proposed purchaser to be submitted along with the transferring member's Notice of Intent to Transfer. A second solution is requiring a significant upfront payment by the proposed purchaser, in a manner which can be documented for the non-transferring members.<sup>542</sup>

American LLC agreements frequently adopt the appraisal method for determining the actual value of a transferring interest.<sup>543</sup> I agree with those who argue that this use of the appraisal method discourages third party offers. It seems clear that most outside buyers

---

<sup>540</sup> *Supra* note 469.

<sup>541</sup> *Supra* note 480.

<sup>542</sup> *Id.*

<sup>543</sup> *Supra* note 489.

will be unwilling to invest the time and money required for due diligence on a proposed purchase where the company can then buy the interest itself, regardless of the price offered by the third party. Perhaps the ideal model in U.S. LLC operating agreements is that which uses an appraisal method only in cases of a member's interest being involuntary transferred.<sup>544</sup>

LLC agreements in KSA that I have analyzed generally do not address valuation matters in advance. As a result, they do not guard against the problem of false or inflated third-party offers, as also do not provide in advance for valuation methods in cases of involuntary transfers. This lack of foresight leaves many valuation issues to be decided on a case-by-case basis, which often invites disputes between shareholders. Another significant aspect of American LLC agreements is the determination of payment terms for transferred shares, such as dividing the payment into monthly or yearly installments.<sup>545</sup> This proves important, especially when a share's market value is very high, making purchase through a single payment difficult within the limited period for exercising ROFR. Despite its importance, the LLC Articles of Association in the KSA do not include similar provisions. Without such a provision, members risk losing the option of acquiring transferred shares when the price is high, as the courts in such situations are likely to require full payment to the transferring shareholder. However, certain provisions and restrictions clauses permitted in American LLC agreements, such as "drag-along" and "tag-along" rights, may be unenforceable under Sharia Law, and thus do not exist in Saudi LLC

---

<sup>544</sup> *Supra* note 500.

<sup>545</sup> *Supra* note 502.

agreements.<sup>546</sup> Because the provisions in question fail to provide the necessary certainty required in business transactions, they remain untested in Saudi Arabian courts.<sup>547</sup>

---

<sup>546</sup> See Martin Creek, *Venture capital investment in Saudi Arabia: market and regulatory overview* at [https://uk.practicallaw.thomsonreuters.com/w-008-6787?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&comp=pluk&bhcp=1](https://uk.practicallaw.thomsonreuters.com/w-008-6787?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1).

<sup>547</sup> *Id.*

## Chapter 5: Withdrawal and Buyout Rights

### 5.1. Introduction

Withdrawing from an LLC can be challenging, as it may require the individual to not only withdraw his or her investment, but also to liquidate the entity or impose on the company a sizeable payout. Thus, while the right of voluntary withdrawal from an LLC provides significant protection for a shareholder's rights, exercising it can have a negative effect on the corporate entity and may lead to investor losses.<sup>548</sup> Notwithstanding this downside, the right of voluntary withdrawal remains highly important in resolving disputes between owners, especially when mutual continuation within the LLC becomes impossible.<sup>549</sup> Even when a shareholder's ability to transfer LLC shares is not restricted by law or a company's constitutional documents, minority shareholders still face practical difficulties in transacting the sale. As discussed previously, the principal difficulty is finding someone willing to purchase minority shares at a fair price and become the new minority shareholder of the company.<sup>550</sup> Therefore, a minority shareholder might prefer to seek withdrawal and receive a capital return, as opposed to facing possible losses through the sale of minority shares. LLC statutes vary as to whether a shareholder (or a member) has a right to withdraw from the LLC prior to the date of its dissolution. They also differ

---

<sup>548</sup> Albert O. IV Saulsbury, *Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company*, 71 La. L. Rev. 685 (2011).

<sup>549</sup> Norman D. Lattin, *Minority and Dissenting Shareholders' Rights in Fundamental Changes*, 23 Law & Contemp. Probs. 307, 324 (1958).

<https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2753&context=lcp>

<sup>550</sup> Sandra K. Miller, *Discounts and Buyouts in Minority Investor LLC Valuation Disputes Involving Oppression or Divorce*, 13 U. Pa. J. Bus. L. 607, 684 (2011). Available at [https://www.law.upenn.edu/journals/jbl/articles/volume13/issue3/Miller13U.Pa.J.Bus.L.607\(2011\).pdf](https://www.law.upenn.edu/journals/jbl/articles/volume13/issue3/Miller13U.Pa.J.Bus.L.607(2011).pdf)

on when such a withdrawal is allowed and whether the withdrawing shareholder is entitled to a buy-out, dissolution, or neither option.<sup>551</sup>

## 5.2. Why might a shareholder seek to withdraw and receive a capital return?

Besides a minority investor exercising withdrawal rights to avoid abuse or misconduct by majority owners, there are a number of other reasons which could lead a shareholder to withdraw from the LLC and seek a capital return. The following are some of the possible reasons:

- (1) An LLC shareholder may seek withdrawal because the purpose for which the company was established cannot be achieved.<sup>552</sup>
- (2) Other shareholders have breached the LLC Agreement, or failed to perform as required and agreed upon in the LLC agreement.<sup>553</sup>
- (3) A shareholder cannot agree with the other shareholders on a business strategy.<sup>554</sup>
- (4) Desiring to invest in another business, if the LLC is no longer making an adequate profit.<sup>555</sup>
- (5) Shareholder personal or business conflicts.<sup>556</sup>
- (6) The disability of the shareholder.<sup>557</sup>

---

<sup>551</sup> RICHARD A. MANN & BARRY S. ROBERTS, *ESSENTIALS OF BUSINESS LAW AND THE LEGAL ENVIRONMENT*, 603 (CENGAGE LEARNING 011 ED. 2012).

<sup>552</sup> Tarik J. Haskins, *Exit Stage Left: Getting out of Your Limited Liability Company, 2*, available at [http://www.mnat.com/files/01\\_haskins\\_authcheckdam1.pdf](http://www.mnat.com/files/01_haskins_authcheckdam1.pdf)

<sup>553</sup> *Id.*

<sup>554</sup> *Id.*

<sup>555</sup> ANTHONY MANCUSO, *YOUR LIMITED LIABILITY COMPANY: AN OPERATING MANUAL*, 156 (NOLO EIGHTH ED. JULY 29, 2016).

<sup>556</sup> *Id.*

<sup>557</sup> *Id.*

Whether a shareholder's reason for seeking withdrawal relates to the business, other shareholders, or a personal situation, withdrawal is a significant exit mechanism, allowing a shareholder to depart the LLC and protect his or her investment whenever the need arises.

### 5.3. The Adverse Impact of Share Withdrawal and Its Costs to Company Creditors

Although voluntary withdrawal offers significant protections for a shareholder's rights, exercising such a right can lead to negative consequences for the LLC. Depending on the size of the withdrawing shareholder's stake, the required capital distribution to the withdrawing owner may undermine the company's financial integrity.<sup>558</sup> In a worst-case scenario, the LLC may not survive.<sup>559</sup> Even if the company can afford the withdrawal payment, large capital reductions can affect the LLC's ability to efficiently operate, and particularly its ability to invest or expand.<sup>560</sup> Large capital withdrawals may also increase the risks for LLC creditors.<sup>561</sup> As a result, many jurisdictions, including the KSA, impose LLC minimum capital requirements under a statutory Legal Capital rule.<sup>562</sup> The Legal Capital rule functions primarily as a creditor-protection device which prevents the debtor LLC from arbitrarily reducing assets through shareholder distributions.<sup>563</sup> The tension between the interests of company shareholders and those of its creditors is the motivation behind the Legal Capital rule, as it is presumed that shareholders will otherwise be free to

---

<sup>558</sup> Albert O. IV Saulsbury, *Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company*, 71 La. L. Rev. 685, 686 (2011).

<sup>559</sup> ALI-ABA'S PRACTICE CHECKLIST MANUAL ON ADVISING BUSINESS CLIENTS III: CHECKLISTS, FORMS, AND ADVICE FROM THE PRACTICAL LAWYER, 68 (AMERICAN LAW INSTITUTE-AMERICAN BAR ASSOCIATION 1ST ED. 2004).

<sup>560</sup> Albert O. IV Saulsbury, *supra* note 559, at. 686, 687.

<sup>561</sup> JAMES D. COX & THOMAS LEE HAZEN, BUSINESS ORGANIZATIONS LAW, 508 (WEST ACADEMIC PUBLISHING 4TH ED. 2016).

<sup>562</sup> *Id.*

<sup>563</sup> *Id.*



take advantage of their limited liability in order to act against the interests of company creditors.<sup>564</sup> The legal capital rule thus serves as a statutory margin of error protecting company creditors from default.<sup>565</sup> The United States has, however, gradually eliminated the legal capital rule, preferring other devices for protecting creditors.<sup>566</sup> Most U.S. LLC statutes presently rely on individual shareholder liability rules, such as piercing the corporate veil, as well as improper distribution rules, to protect company creditor interests.<sup>567,568</sup> U.S. creditors also have the option of protecting themselves from shareholder actions through restrictive covenants.<sup>569</sup> This chapter will later discuss in greater detail the full protections available for creditors in both the KSA and United States.

#### 5.4. The Case of Saudi Arabia

##### A. Shareholder's Voluntary Withdrawal

Following the French Company Law approach, which much of the Saudi Companies Law is modeled after,<sup>570</sup> a single shareholder has no absolute right to withdraw

---

<sup>564</sup> HASAN ERDEM, CREDITOR PROTECTION IN PRIVATE EQUITY-BACKED LEVERAGED BUYOUT AND RECAPITALISATION PRACTICES: A COMPARATIVE ANALYSIS OF COMPANY AND INSOLVENCY LAW MECHANISMS IN ENGLAND, GERMANY, AND TURKEY, 36, 37 (BWV VERLAG, FIRST ED 2014).

<sup>565</sup> *Id.*

<sup>566</sup> See John Armour, *Legal Capital: An Outdated Concept?* Centre for Business Research, University of Cambridge. (2006) available at [https://www.cbr.cam.ac.uk/fileadmin/user\\_upload/centre-for-business-research/downloads/working-papers/wp320.pdf](https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp320.pdf)

<sup>567</sup> See ULLCA § 407; RULLCA § 406; DLLCA § 18-607(b).

<sup>568</sup> Under most U.S. LLC statutes, distributions to members are legal as long as a company would still be able to pay its debts as they became due in the ordinary course of business, and the company's total assets would be less than the sum of its total liabilities. See ULLCA § 406; RULLCA § 405; DLLCA § 18-607(a).

<sup>569</sup> THEO VERMAELEN, SHARE REPURCHASES, ISSUE 3; ISSUE 2005, FOUNDATIONS AND TRENDS IN FINANCE, 30-31 (Illustrated ed, 2005).

<sup>570</sup> YOUSEIF AL-ZAHRAN, RIGHTS OF SHAREHOLDERS UNDER SAUDI COMPANY LAW 1965, 11 (BRUNEL UNIVERSITY 2013 ED. 2013). Available at <https://bura.brunel.ac.uk/bitstream/2438/8284/1/FulltextThesis.pdf>.

from the LLC before its date of expiry.<sup>571</sup> The most natural manner for a shareholder to exit from the LLC is to transfer his or her shares to an existing shareholder, or a third party, as explained in the previous chapter.<sup>572</sup> There is, however, an important legal distinction between a shareholder's unilateral withdrawal without the consent of the other shareholders, and one which obtains such consent. Saudi Arabian law on a shareholder's ability to join and withdraw from a company is largely influenced by the nature and type of the company, as well as the effect any changes in capital might have on its viability.<sup>573</sup> Companies are generally classified as either companies with fixed capital<sup>574</sup> or companies with variable capital.<sup>575</sup> A fixed-capital company, such as the LLC, must retain its paid-in capital as stipulated in either its original Articles of Association or the latest amended version.<sup>576</sup> Under the Saudi Companies Regulation ("SCR"), an LLC may therefore not decrease the paid-in capital amount listed in its Articles of Association unless it follows the full procedures for amending the Articles, including obtaining both shareholder and Ministry of Commerce and Investment ("MoCI") approval.<sup>577,578</sup> Fixed-capital companies thus provide shareholders with less freedom to join or exit the company, as issuing new shares or re-buying existing shares will likely increase or reduce its paid-in capital.<sup>579</sup> Should a company be unable to complete the procedures for increasing or reducing the

---

<sup>571</sup> Von Dréano & Jeantet Associés, *Shareholders' rights in private and public companies in France: overview* at [https://uk.practicallaw.thomsonreuters.com/8-614-6926?transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/8-614-6926?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1).

<sup>572</sup> *Id.*

<sup>573</sup> MAAN JOYHAN, *THE LAW OF CAPITAL REDUCTION OF PRIVATE COMPANIES: COMPARATIVE STUDY*, 47, 48 (FIRST ED. 2008).

<sup>574</sup> *e.g.* Limited liability companies and joint stock companies are two forms of business entities which require a fixed capital.

<sup>575</sup> *Id.*

<sup>576</sup> PETRI MÄNTYSAARI, *THE LAW OF CORPORATE FINANCE: GENERAL PRINCIPLES AND EU LAW: VOLUME III: FUNDING, EXIT, TAKEOVERS*, 178, 179 (SPRINGER SCIENCE & BUSINESS MEDIA, ILLUSTRATED ED 2010).

<sup>577</sup> The Saudi Companies Regulation, Art. 174

<sup>578</sup> *Id.*, Art. 177.

<sup>579</sup> Mäntysaari, *supra* note 577.

LLC's subscribed capital, the company may not make distribution to a withdrawing shareholder. The end result is a shareholder who cannot exit the company unless he or she finds a new shareholder to purchase the shares. The legal capital rule thus constrains cash payments to LLC shareholders, and any withdrawal of shares requires approval by a general meeting of shareholders as well as obedience to the creditor protection mechanism.<sup>580</sup> In this fashion, fixed-capital companies become characterized not only by stable capital, but also by stable shareholders. Variable capital companies, by contrast, may alter their paid-in capital capacity, with a corresponding ability to alter their shareholders as well. A fixed-capital company is called a closed company, while a variable-capital company is called an open company.<sup>581</sup> In Saudi Arabia, a shareholder's freedom to exit a closed company, such as an LLC, is quite limited.

Significantly, the SCR's only reference to shareholder withdrawal from an LLC is the withdrawal permitted once the LLC reaches the expiration date specified in its Articles of Association. Reaching the expiration date terminates the company, and no extension of the company's term is permitted before it completes an exit process which includes disbursement of all company equity to the departing shareholders.<sup>582</sup> Whether a shareholder's withdrawal is legal under Saudi partnership law depends partly on whether the entity in question is a term or perpetual-existence company. Under the General Partnerships law (*sharikat al-tadamun*), a partner in a perpetual-existence partnership may withdraw at any particular time.<sup>583</sup> In a term partnership, however, where an expiration

---

<sup>580</sup> *Id.* at. 329, 330.

<sup>581</sup> *Id.*

<sup>582</sup> The Saudi Companies Regulation Art. 180.

<sup>583</sup> The Saudi Companies Regulation, Art. 36.

*Id.* SCR Article 36 states that "In case of definite term companies, the partner may only withdraw from the company based on a reasonable cause to be accepted by the competent judicial authority. In case of indefinite term companies, the partner's withdrawal shall be made in good faith and the partner shall

date is specified in the partnership agreement, a partner may not withdraw at any time prior to that expiration date.<sup>584</sup> The reasoning behind this distinction is that a partner withdrawing from a perpetual-existence company does not violate the original agreement, as the firm was created to last only so long as its owners desired.<sup>585</sup> Early withdrawal from a term partnership, on the other hand, violates the original agreement, discarding the mutually-agreed upon ending date.<sup>586</sup> A single partner's right to withdraw from a perpetual-existence partnership cannot be extinguished by law because losing that right would infringe on personal freedom, locking the partner into an unwanted legal relationship for life.<sup>587</sup>

The question then arises whether Saudi Arabia permits the establishment of a perpetual-existence LLC, where there is no expiration date in its formation documents. The answer is that such an LLC is not permitted. The SCR explicitly states that an LLC's Articles of Association must contain both a starting and an expiration date before being submitted to the MoCI for ratification and approval.<sup>588</sup> In short, establishing an LLC with an unlimited term is not possible in Saudi Arabia.

The SCR's failure to reference any means of withdrawing from an LLC aside from withdrawal upon expiration might be explained by the above-mentioned impossibility of

---

announce such withdrawal to the remaining partners at an appropriate time. Otherwise, the competent judicial authority may oblige him to continue in the company and to pay compensation when required.”

*Id.* Article 2 of the SCR states the following: "A company is defined as a contract under which two or more persons undertake to participate in an enterprise for profit, by contributing a share in the form of money or work, or both of them, with a view to dividing any profits (realized) or losses (incurred) as a result of such enterprise."

<sup>584</sup> *Id.*

<sup>585</sup> ERNEST KAY, LEGAL ASPECTS OF BUSINESS IN SAUDI ARABIA, 21, 22 (GRAHAM & TROTMAN, FIRST ED. 1979).

<sup>586</sup> *Id.*

<sup>587</sup> *Id.*

<sup>588</sup> The Saudi Companies Regulation, Art. 156.

creating a perpetual-existence LLC. However, even if it were theoretically possible for an LLC shareholder to withdraw prior to LLC expiration, the LLC's legal capital requirement would frustrate the object of such a transaction. It would do so by preventing the LLC from repurchasing the shares of the withdrawing shareholder. However, the SCR does not explicitly prohibit LLC owners agreeing to a shareholder's withdrawal prior to the expiration date. In order to accomplish this action, though, specific procedures for maintaining the LLC's legal capital must be followed, as the most important Saudi restrictions on LLC shareholder withdrawal relate to capital stability. Withdrawals that do not reduce capital, on the other hand, such as the departing shareholder assigning shares to an existing shareholder or outside third party, are not problematic.<sup>589</sup>

As mentioned, withdrawals that would result in returning the departing shareholder's capital contribution must comply with several specific procedures. The withdrawing shareholder must obtain the consent of the other shareholders, as well as their approval for reducing the LLC's subscribed capital. LLC shareholders must therefore vote in the general meeting to approve the particular number of shares that the LLC will acquire, as well as the price the company will pay for them. More specifically, reduction in the LLC's capital can only be accomplished by completing the following procedures:

- (a) The general assembly must approve both the withdrawal of shares and reduction of the company's subscribed capital. Such approval must be authorized by shareholders representing at least three-quarters of the LLC's capital.<sup>590</sup>

---

<sup>589</sup> Ernest Kay, *supra* note 586.

<sup>590</sup> This requirement is found in Article 174 of the Saudi Companies Law, which states that the unanimous consent of all shareholders must be obtained prior to changing the nationality of the company or increasing its capital. All other resolutions requiring amendment of the company's Articles of Association, including a reduction in capital, can take place with the consent of shareholders representing at least 75% of the company's capital. *The Saudi Companies Regulation*, Art. 174.

- (b) The resolution to reduce capital must be published in a daily newspaper distributed in the city where the company's head office is located. In addition, the company's creditors must be invited to submit their objections, if any, to the shareholders' decision within sixty days from the date of publication. If a creditor objects and provides proof of such objection, the company must pay any debt that is due, or provide a sufficient guarantee of future payment if the debt is not yet due.<sup>591</sup>
- (c) The LLC owners must provide the MoCI a draft amendment of the company's Articles of Association, including any language reducing the company's capital. A detailed and certified disclosure statement must be submitted by the company's auditor, stating the names and addresses of the creditors who objected to the decision to reduce capital, as well as the name of each creditor whose debt was repaid or provided with a sufficient guarantee of future payment. Furthermore, the draft amendment must be accompanied by a shareholder declaration of solidarity and joint responsibility for any debts that have not been included in the detailed disclosure statement.<sup>592</sup>
- (d) If the company does not have any debts, the owners may submit to the MoCI a declaration, approved by the auditor, stating their joint responsibility for any debts accumulated after the approval of the amendment of the Articles of Association. In such a case, the shareholders are exempted from undertaking a creditors' notification and the reduction in capital procedure may be completed.<sup>593</sup>

---

<sup>591</sup> The Saudi Companies Regulation, Art. 177.

<sup>592</sup> *Id.*

<sup>593</sup> *Id.*

As the required procedures make clear, the main legislative purposes behind restricting LLC capital reductions are protecting its creditors and therefore maintaining public confidence in financial markets. The restrictions are seen as the cost companies must pay in order to gain the benefits of limited liability.<sup>594</sup> LLC shareholders with debt will otherwise have large potential inducements to behave opportunistically at the expense of the company's creditors.<sup>595</sup> Shareholders might distribute assets to themselves in a number of ways, such as share buybacks or assuming exorbitant salaries.<sup>596</sup> Such distributions would reduce company equity below the level creditors relied upon when originally deciding to extend credit.<sup>597</sup> Limited liability is deemed a privilege enjoyed by shareholders, while obviously having drawbacks from creditors' point of view.<sup>598</sup> The Legal Capital rule is thus inherently linked with limited liability, requiring shareholders to make certain capital contributions to the company which may not be returned during the LLC's existence, except as provided by law.<sup>599</sup>

One downside to the restrictions on share repurchases is a possible increase in the costs associated with any LLC shareholder conflicts.<sup>600</sup> The restrictions will at times preclude a company from acquiring a dissenting shareholder's shares, increasing the chances of shareholder deadlock which might affect company operations.<sup>601</sup> The restriction on share

---

<sup>594</sup> Hasan Erdem, *supra* note 565, at 36.

<sup>595</sup> Luca Enriques and Jonathan R. Macey, *Creditors Versus Capital Formation: e Case against the European Legal Capital Rules*, 86 *Cornell L. Rev.* 1165 (2001). Available at: <http://scholarship.law.cornell.edu/clr/vol86/iss6/1>.

<sup>596</sup> *Id.* at. 1169.

<sup>597</sup> *Id.*

<sup>598</sup> THOMAS BACHNER, *CREDITOR PROTECTION IN PRIVATE COMPANIES: ANGLO-GERMAN PERSPECTIVES FOR A EUROPEAN LEGAL DISCOURSE*, 94-97 (CAMBRIDGE UNIVERSITY PRESS, FIRST ED 2009).

<sup>599</sup> *Id.*

<sup>600</sup> EILIS FERRAN & LOOK CHAN HO, *PRINCIPLES OF CORPORATE FINANCE LAW*, 8, 9 (OXFORD UNIVERSITY PRESS, REVISED ED 2014).

<sup>601</sup> Luca Enriques, *supra* note 596.

buy-backs also makes investments in LLCs less liquid, reducing their attractiveness to external investors.<sup>602</sup> LLCs may reduce capital in order to make distributions to an individual shareholder seeking to withdraw, but the numerous procedural hurdles, including creditor veto power, increase the transaction costs.<sup>603</sup> The creditor veto power also potentially encourages creditors to opportunistically insist on side payments in order to consent to the capital reduction.<sup>604</sup> Thus, under the Saudi legal system, a shareholder's ability to withdraw from an LLC prior to expiration, while theoretically possible, faces numerous practical obstacles.

#### B. Shareholder's Death

Under the SCR, the death of an LLC shareholder does not, of itself, cause the LLC's dissolution, unless the operating agreement provides otherwise.<sup>605</sup> Moreover, a shareholder's death does not grant the surviving shareholders a right to buyout<sup>606</sup> the deceased shareholder's heirs or devisees.<sup>607</sup> Rather, the shares of the deceased shareholder will be transferred, by operation of law, directly to his heirs or any other beneficiaries of his will.<sup>608</sup> If the new owners succeeding to the deceased shareholder's shares hold such shares jointly, the SCR requires them to designate a sole owner for purposes of dealing

---

<sup>602</sup> *Id.*

<sup>603</sup> REINIER KRAAKMAN, *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, 126 (OXFORD UNIVERSITY PRESS, THIRD ED 2017).

<sup>604</sup> *Id.*

<sup>605</sup> *Id.*, Art. 179.

<sup>606</sup> Article 161 of the SCR expressly excludes transfers of shares by inheritance or bequest from being subject to the right of first refusal.

<sup>607</sup> *Id.*, Art. 161.

<sup>608</sup> NABIL SALEH, *THE GENERAL PRINCIPLES OF SAUDI ARABIAN AND OMANI COMPANY LAWS: STATUTES AND SHARI'A*, 148 (NAMARA First Ed. 1981).



with the LLC and representing the shares' managerial and economic rights in the LLC.<sup>609</sup> Thus, the decedent's heirs may exercise the full rights of an LLC shareholder, including all management (voting) and financial rights possessed by the original shareholder. The transfer of any shares to the heirs or beneficiaries of the deceased shareholder must be recorded in the company's register in order to be made effective.<sup>610</sup> The surviving shareholders have no right to either deny the new owners entry to the LLC or to restrict their management or other shareholder rights in any fashion, unless such restrictions are expressly provided for in the LLC agreement.<sup>611</sup> On the other hand, the heirs are also responsible for any debt, obligation or other liability the decedent owed to the LLC or the other shareholders at the time of his death.<sup>612</sup> The SCR is generally silent about the right of LLC shareholders to restrict the transfer of a deceased member's shares in the company to his heirs or other beneficiaries. However, the majority view is that an LLC agreement can provide for such restriction and also give the surviving shareholders the right to buyout the heirs of the deceased shareholder, if such a buyout is made for a fair value.<sup>613</sup> Thus, an LLC's shareholders can prevent the entry of a deceased member's beneficiaries to the LLC by providing for such a restriction in the LLC agreement, thereby protecting the company's intimate character while also entitling the heirs to an immediate distribution. Similarly, an LLC agreement may provide for the entity's dissolution upon the death of any of the shareholders.<sup>614</sup>

---

<sup>609</sup> A LERRICK & Q J MIAN, SAUDI BUSINESS AND LABOR LAW: ITS INTERPRETATION AND APPLICATION, 162 (GRAHAM & TROTMAN. 1982).

<sup>610</sup> The Saudi Companies Regulation, Art. 162.

<sup>611</sup> ABDULRAHMAN GORMAN, THE PREEMPTIVE RIGHT IN THE LIMITED LIABILITY COMPANY: COMPARATIVE STUDY, 230 (First Ed.1995). In Arabic.

<sup>612</sup> *Id.*, 231.

<sup>613</sup> *Id.*, at. 240.

<sup>614</sup> *Id.*

### C. Determining a Share's Value

Article 161 of the SCR provides LLC shareholders with the right to acquire any share being transferred to a third-party,<sup>615</sup> at the same price proposed by the prospective buyer.<sup>616</sup> In such a situation, determining the share's value proves relatively easy, as the price is determined by the third-party offer, unless the shareholders provided for another valuation method in the LLC agreement. When no such offer exists, determining share value is more difficult. One transfer scenario with no third-party offer is a shareholder's death, when the shareholders have agreed that such a death triggers ROFR under the LLC agreement, and one or more shareholders exercise their ROFR toward the decedent's shares. Similarly, the withdrawal of an LLC shareholder at the LLC's expiration date can also create a valuation issue, as this event will trigger a vote for continuing the company's business to avoid dissolution of the LLC, with the decision resting in the hands of the majority shareholders.<sup>617</sup> SCR Article 180 expressly states that an LLC shareholder wishing to withdraw at the expiration period has the right to do so by selling his share to a third-party, if one can be found, and, if not, to have his share purchased at fair value by the remaining shareholders, or as stipulated in the LLC's agreement.<sup>618</sup> When no third-party offer materializes, the question of what price to attach to the withdrawing share presents itself.

Because many Saudi Articles of Association that I have examined contain terms as low as five years,<sup>619</sup> situations often arise where minority shareholders seek to withdraw

---

<sup>615</sup> See the discussion in the previous chapter.

<sup>616</sup> The Saudi Companies Regulation, Art. 161.

<sup>617</sup> *Id.*, Art. 180.

<sup>618</sup> *Id.*

<sup>619</sup> At least 25% of the examined Articles of Association provided for such relatively short terms.

and, for reasons discussed earlier, no third party makes an offer.<sup>620</sup> In this scenario, many Articles of Association employ the default rule of SCR Article 180, which entitles the withdrawing shareholder to receive “fair value,” but does not specify the method for determining such a value.<sup>621</sup> Other LLC agreements stipulate that a share’s “fair value” shall be determined by the company’s auditors at the end of each financial year, with the auditor’s report then requiring approval at the annual shareholder general assembly meeting.<sup>622</sup> The problem that arises under the latter method is that the determination of share value is ultimately determined by the majority shareholders, leaving minority shareholders vulnerable to potential abuse. Another question which arises under this method is how to determine share value if no particular value achieves a majority. In light of these uncertainties, it is imperative that shareholders seriously consider the valuation methodology to be applied in such circumstances. Failure to do so will likely lead to disputes with minority shareholders at the time of withdrawal, or with heirs in the event of a shareholder’s death.

---

<sup>620</sup> See the Published Article of Association of *Metsu Plant Saudi Arabia Limited Liability Company*. Um Al-Qura Newspaper, 1438/9/9, No. 4673.

<sup>621</sup> See the Published Article of Association of *Nesma Onor Contracting Limited Liability Company*, Um Al-Qura Newspaper, 1438/9/2, No. 4672, p. 41. Also, See the Published Article of Association of *RTK limited liability company*, Um Al-Qura Newspaper, 1439/2/21, No. 4697.

<sup>622</sup> See A Lerrick & Q J Mian, *supra* note 610, at. 160, 161.

## 5.5. Withdrawal Rights in The U.S.

### A. Voluntary Withdrawal

In the absence of a relevant provision within an LLC operating agreement, state law generally governs member withdrawal rights in the United States.<sup>623</sup> There is presently considerable variation among statutory default rules governing both members' withdrawal rights, and the related right to receive a distribution upon withdrawal.<sup>624</sup> The Uniform Limited Liability Company Act (ULLCA) permits a member to "dissociate"<sup>625</sup> from an LLC at any time, simply by expressing the desire to withdraw.<sup>626</sup> Under the original ULLCA first promulgated in 1995, the effect of a member's withdrawal depends on the duration and management structure<sup>627</sup> specified in the LLC's operating agreement.<sup>628</sup> Duration and management structure control how withdrawal affects a member's management and financial interests, as well as the continuing viability of the entity.

Regarding duration, an LLC can be either at-will, meaning without a specified length of existence, or for a specific term.<sup>629</sup> Upon a member's voluntary withdrawal from an at-will company, the LLC must purchase the withdrawing member's interest at its fair value,

---

<sup>623</sup> See Sandra K. Miller, A New Direction for LLC Research in a Contractarian Legal Environment, 76 S. Cal. L. Rev. 351, 432 (2003). At <http://www-bcf.usc.edu/~usclrev/pdf/076202.pdf>.

<sup>624</sup> *Id.*

<sup>625</sup> "Dissociation" as used in the ULLCA refers to all situations where the LLC member is no longer associated with the business, including the withdrawal or death of a member. See Laurel Wheeling Farrar; Susan Pace Hamill, *Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box-Era*, 49 Ala. L. Rev. 909, 940 (1998). At <https://www.law.ua.edu/pubs/lrarticles/Volume%2049/Number%203/farrar.pdf>.

<sup>626</sup> UNIF. LTD. LIAB. Co. ACT §§ 601-602, 6B U.L.A. 607 (1996). Section §601(1) states that: A member is dissociated from a limited liability company upon the occurrence of any of the following events: (1) the company's having notice of the member's express will to withdraw upon the date of notice or on a later date specified by the member. Section § 602(a) states that: Unless otherwise provided in the operating agreement, a member has the power to dissociate from a limited liability company at any time, rightfully or wrongfully, by express will.

<sup>627</sup> In the U.S., LLCs can choose to be either Manager-Managed or Member-Managed.

<sup>628</sup> See Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & (and) Analysis*, 51 Bus. Law. 51, 84 (1995).

<sup>629</sup> *Id.*, at 73.

which is determined at the time of withdrawal.<sup>630</sup> The manner of this purchase, however, depends on the at-will LLC's management structure.<sup>631</sup> Withdrawal from a member-managed LLC will generally cause the company's dissolution, absent an agreement to continue reached by the remaining members within ninety days of the member's withdrawal.<sup>632</sup> Absent such agreement, the LLC is required to wind up its business and perform a liquidation distribution to each of its members.<sup>633</sup> If a majority of the remaining members agree to avoid dissolution, then the LLC must purchase the withdrawing member's interest at its fair value.<sup>634</sup> A purchase offer must be delivered to the withdrawing member within thirty days of the withdrawal date.<sup>635</sup> If the company fails to purchase the dissociated member's distributional interest, ULLCA preserves the member's right to petition a competent court for the company's dissolution.<sup>636</sup>

By contrast, a member's withdrawal from a manager-managed LLC will not generally trigger company dissolution, unless the withdrawing member also holds a managerial position.<sup>637</sup> Returning to duration, withdrawing from a specific-term LLC does not trigger dissolution, and the withdrawing member is not entitled to a buy-out until the LLC's expiration date.<sup>638</sup> In sum, the effects of a member's withdrawal under original ULLCA

---

<sup>630</sup> See UNIF. LTD. LIAB. Co. ACT §§ 601-602, 6B U.L.A. 607 (1996). Section § 701(a)(1).

<sup>631</sup> See Carter G. Bishop, *Treatment of Members upon Their Death and Withdrawal from a Limited Liability Company: The Case for a Uniform Paradigm*, 25 Stetson L. Rev. 255, 310 (1995)

<sup>632</sup> *Id.*, at 269.

<sup>633</sup> See UNIF. LTD. LIAB. Co. ACT §§ 601 (a), 602, 603, 6B U.L.A. 607 (1996). Section § 802(a) and Section § 806(b). Section 806 (b) of ULLCA states the following: "Each member is entitled to a distribution upon the winding up of the limited liability company's business, consisting of a return of all contributions which have not previously been returned and a distribution of any remainder in equal shares."

<sup>634</sup> *Id.*, § 701(a)(1).

<sup>635</sup> *Id.*, § 701(b)

<sup>636</sup> *Id.*, § 801(4)(iv).

<sup>637</sup> See Carter G. Bishop, *supra* note 629, at. 268.

<sup>638</sup> *Id.*

depend on whether the LLC is at-will or for a specified term, and whether it is member-managed or manager-managed.

The U.S. National Conference of Commissioners on Uniform State Laws (NCCUSL) subsequently amended the section concerning the effect of an individual member's withdrawal.<sup>639</sup> As amended, ULLCA holds that withdrawal from an LLC will no longer cause its dissolution, regardless of the company's management structure.<sup>640</sup> The LLC's duration designation will still affect the timing of when the LLC is obligated to purchase the withdrawing member's interest.<sup>641</sup> A member's premature withdrawal from a term company will not generally lead to dissolution or require a vote on continuation, as the withdrawal itself is considered wrongful.<sup>642</sup> The withdrawing member will be liable to both the company and the remaining members for any resulting damages.<sup>643</sup> ULLCA Section 701(f) states the following:

Damages for wrongful dissociation under Section 602(b), and all other amounts owing, whether or not currently due, from the dissociated member to a limited liability company, must be offset against the purchase price.<sup>644</sup>

Besides the potential liability and loss of purchase value that the withdrawing member may incur, wrongful withdrawal will also not trigger a buy-out of the dissociated member's interest prior to the LLC expiration date in effect at the time of withdrawal.<sup>645</sup>

---

<sup>639</sup> National Conference of Commissioners on Uniform State Laws (NCCUSL) adopted first amendment to the ULLCA in 1996.

<sup>640</sup> UNIF. LTD. LIAB. Co. ACT § 603.

<sup>641</sup> *Id.* § 602.

<sup>642</sup> *Id.* § 601 and § 602(b).

<sup>643</sup> *Id.* § 602(c).

<sup>644</sup> *Id.* § 701(f).

<sup>645</sup> *Id.* § 701(a)(2). This section state that "A limited liability company shall purchase a distributional interest of a member of a term company for its fair value determined as of the date of the expiration of the

By contrast, a member lawfully withdrawing from an at-will company triggers a right to a timely buy out. Additionally, the wrongfully dissociated member of a term company is treated as a transferee of a member, with no further right to participate in LLC management, due to no longer owing a fiduciary duty to the company and other members.<sup>646</sup> The withdrawn member will, however, be entitled to receive distributions from the LLC to the same extent as any other transferee prior to LLC dissolution.<sup>647</sup>

Under the Revised Uniform Limited Liability Company Act<sup>648</sup> (RULLCA) the default rule is that an LLC member has the right to withdraw from the LLC rightfully or wrongfully, and if wrongfully, the disassociated member will be liable to the company and the other members for the damages caused thereby.<sup>649</sup> The withdrawing member is required only to submit to the company a notice of his or her intent to withdraw.<sup>650</sup> RULLCA does not require written notice of the member's intent to withdraw in order for the withdrawal to be valid.<sup>651</sup> As a result, it is possible disputes may arise over whether or not a withdrawing member has provided the required notice of express will to withdraw.<sup>652</sup> A member's withdrawal would be considered wrongful if: (1) The withdrawal is in violation of an express provision of the LLC's operating agreement; (2) The withdrawal occurs before the termination of the company and the member either withdraws by express will,

---

specified term that existed on the date of the member's dissociation if the expiration of the specified term does not result in a dissolution and winding up of the company's business".

<sup>646</sup>*Id.*, § 603(b).

<sup>647</sup>*Id.*, § 503(e)(1).

<sup>648</sup> The new Uniform LLC Act which the US National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated in 2006.

<sup>649</sup> RULLCA § 601(a).

<sup>650</sup> *Id.*, 602(1).

<sup>651</sup> See Pablo Tagre, *Withdrawal from a Limited Liability Company LLC Under the Revised Uniform Limited Liability Company Act (RULLCA)(2013)*. Available at <http://www.tagrelaw.com/news/withdrawal-from-a-limited-liability-company-llc-under-rullca/>.

<sup>652</sup> *Id.*

is expelled by judicial order, becomes a debtor in bankruptcy, or is dissolved or terminated.<sup>653</sup> If the LLC and the other members incur damages as a result of the member's wrongful withdrawal, the withdrawing member will be liable for such damages.<sup>654</sup> However, it should be noted that under RULLCA, a member's withdrawal does not entitle the member to receive distributions from the LLC and does not, by itself, trigger a buy-out.<sup>655</sup> This contrasts with ULLCA, which granted the withdrawing member the right to receive fair value for his or her interest upon withdrawal.<sup>656</sup> Under RULLCA, there are generally two special effects of the member's withdrawal. First, the member no longer has the right to participate in the management and the operation of the company.<sup>657</sup> Second, in a member-managed LLC, the member's fiduciary duty to the company and other members terminates upon the member's withdrawal.<sup>658</sup> The withdrawing member is treated as a transferee of a member and retains the right to receive distributions from the LLC to which the transferor would otherwise be entitled.<sup>659</sup> RULLCA Section 603(a)(3) states the following:

Any transferable interest owned by the person immediately before dissociation in the person's capacity as a member is owned by the person solely as a transferee.<sup>660</sup>

---

<sup>653</sup> UNIF. LTD. LIAB. Co. ACT § 601(b).

<sup>654</sup> *Id.*, 601(c).

<sup>655</sup> *Id.*, 404(b).

<sup>656</sup> *Id.*, § 603.

<sup>657</sup> RULLCA § 603(a)(1).

<sup>658</sup> *Id.*, § 603(a)(2).

<sup>659</sup> *Id.*, § 502(b).

<sup>660</sup> *Id.*, § 603(a)(3).



The dissociation rules under RULLCA are not mandatory provisions, and LLCs can modify or exclude them in the LLC operating agreement.<sup>661</sup> Thus, an operating agreement has the power to provide for a buy-out of a member's transferable interest in connection with the member's withdrawal.<sup>662</sup>

Under the Delaware Limited Liability Company Act (DLLCA), a member has the right to withdraw prior to dissolution only if the LLC Agreement expressly provides for such a right.<sup>663</sup> Absent the operating agreement affirmatively asserting the member's right to withdraw, withdrawal rights will be governed by the default rules of DLLCA, meaning a member is not allowed to withdraw prior to dissolution.<sup>664</sup> Where withdrawal takes place with the permission of the LLC operating agreement, the member is entitled by DLLCA default rules to receive a distribution equal to the fair value of the member's interest as of the date of withdrawal, unless another valuation method is provided for in the LLC agreement.<sup>665</sup> DLLCA, therefore, grants LLC members the contractual flexibility to draft withdrawal provisions in the LLC Agreement that will satisfy member objectives.<sup>666</sup> Payment for a withdrawing member's interest must be delivered within a reasonable time period following withdrawal.<sup>667</sup>

The three U.S. LLC statutes discussed reflect three different approaches with regard to a member's right to withdraw and resign from the LLC prior to dissolution, as well as the member's right to receive a distribution for the value of his or her interest upon

---

<sup>661</sup> See Darren T. Freedman, et al., *Drafting Considerations Under RULLCA*, 17 at <https://www.troygould.com/wp-content/uploads/2017/09/Pub-119.pdf>.

<sup>662</sup> *Id.*

<sup>663</sup> See DEL. CODE ANN. tit. 6, §§ 18-603. 18-603.

<sup>664</sup> LARRY E. RIBSTEIN, ET AL., UNINCORPORATED BUSINESS ENTITIES, 516 (Lexisnexis Fifth Ed. 2013).

<sup>665</sup> See DEL. CODE ANN. tit. 6, § 18-604.

<sup>666</sup> See Tarik J. Haskins, *Exit Stage Left: Getting out of Your Limited Liability Company*, at [https://www.americanbar.org/publications/blt/2013/07/01\\_haskins.html](https://www.americanbar.org/publications/blt/2013/07/01_haskins.html).

<sup>667</sup> See DEL. CODE ANN. tit. 6, § 18-604.

withdrawal. Under the ULLCA approach, a member's withdrawal is permissible upon notice from the member, and the member receives a fair value distribution upon withdrawal. The RULLCA (or transferee) approach treats a withdrawing member as a transferee of a member, with no distribution right upon the member's withdrawal. Finally, the Delaware approach gives a member no right to withdraw, unless permitted by the LLC agreement.

#### B. The Fair Value, Fair Market value, and Minority Discounts

A "minority discount" is the term for the difference in share value between minority and majority shares in a privately held company.<sup>668</sup> Given this reality, should the buyout price of an LLC minority member's interest be lower than that of an equivalent-sized majority interest? ULLCA and Delaware LLC Act both state that the withdrawing member shall receive the "fair value" of the member's interest upon withdrawal. U.S. courts provide different definitions for "fair value" and "fair market value."<sup>669</sup> The courts define "fair market value" as the price which a purchaser would be willing to pay to a willing seller in light of all market-related factors.<sup>670</sup> The "fair value," on the other hand, is viewed as the member's pro-rata share at the time of withdrawal.<sup>671</sup> As a result, a distribution corresponding to the "fair market value" of a minority member's interest will generally be

---

<sup>668</sup> See Sandra K. Miller, *Discounts and Buyouts in Minority Investor LLC Valuation Disputes Involving Oppression or Divorce*, 13 U. Pa. J. Bus. L. 607, 684 (2011). Available at [https://www.law.upenn.edu/journals/jbl/articles/volume13/issue3/Miller13U.Pa.J.Bus.L.607\(2011\).pdf](https://www.law.upenn.edu/journals/jbl/articles/volume13/issue3/Miller13U.Pa.J.Bus.L.607(2011).pdf).

<sup>669</sup> *Id.*, at. 611.

<sup>670</sup> *Id.*

<sup>671</sup> See Albert O. IV Saulsbury, *Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company*, 71 La. L. Rev. 675 (2011). Available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1906428](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1906428)

lower than a distribution equal to its "fair value."<sup>672</sup> The Pennsylvania Committee Comments to Section § 8933<sup>673</sup> of the Pennsylvania LLC Act specifically addresses this potential discrepancy with regard to a withdrawing member's distribution<sup>674</sup>, as follows:

The "fair value" of the interest of the member is to be fixed generally with reference to the right of the member to share in distributions from the company. As such, it should not include discounts for lack of marketability or minority interest and thus is different from "fair market value," which term has been specifically avoided.<sup>675</sup>

Accordingly, an LLC member under ULLCA and DLLCA generally will not be subject to the "minority discount," since the withdrawing member is entitled to "fair value" regardless of what a buyer would be willing to pay in the market.<sup>676</sup> Instead, an LLC minority member will receive upon withdrawal an amount equal to his ownership interest in the overall value of the company.<sup>677</sup> The "fair value" standard under ULLCA and DLLCA accordingly provides minority members with greater protection in the event they withdraw.

---

<sup>672</sup> *Id.*, at. 689.

<sup>673</sup> Section § 8933 of Pennsylvania LLC Act provides the following: "Upon the occurrence of an event of dissociation which does not result in the dissolution of the limited liability company, a dissociating member is entitled to receive any distribution to which the member is entitled under the operating agreement on the terms provided in the operating agreement and, within a reasonable time after dissociation, the fair value of the interest of the member in the company as of the date of dissociation based upon the right of the member to share in distributions from the company." 15 PA. CONS. STAT. § 8933 (1995).

<sup>674</sup> *See* Albert O. IV Saulsbury, *supra* note 672, at. 689.

<sup>675</sup> *Id.*

<sup>676</sup> *Id.*

<sup>677</sup> *See* Sandra K. Miller *supra* note 669, at. 612.

### C. Member's Death

Under ULLCA, an LLC member's death is considered a form of dissociation.<sup>678</sup> Unless the death leads to the LLC's dissolution, the company is required to purchase the interest of the deceased member.<sup>679</sup> The decedent's heirs in an at-will company are entitled to receive the distributions of the decedent member's interests immediately.<sup>680</sup> In an LLC formed for a specific term, the company must purchase the decedent's interest only at the end of the specified term.<sup>681</sup> The heirs of a fixed-term LLC member may therefore be compelled to wait for years before receiving any distribution from a buy-out.<sup>682</sup> The heirs or estate of the dead member will be deemed transferees, and unless they are accepted as LLC members, they generally lack any management rights.<sup>683</sup> As transferees of the member's interest, though, heirs retain the right to petition a court for judicial dissolution if the managers or other members in control act in a manner deemed illegal, oppressive, fraudulent, or unfairly prejudicial to them.<sup>684</sup>

RULLCA also deems a member's death to be a dissociating event.<sup>685</sup> Unlike under ULLCA, such a death does not entitle the heirs or estate to a buy-out or any special distribution of the deceased member's interest.<sup>686</sup> The heir will be treated as transferees of the member's interest,<sup>687</sup> and accordingly will retain the right to receive any interim

---

<sup>678</sup> See UNIF. LTD. LIAB. Co. ACT § 601(8)(i).

<sup>679</sup> See Susan Kalinka, *Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform*, 66 La. L. Rev. 365 (2006). Available at <https://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=6127&context=lalrev>

<sup>680</sup> *Id.*, at 386.

<sup>681</sup> *Id.*

<sup>682</sup> See Carter G. Bishop, *supra* note 629, at 80.

<sup>683</sup>

<sup>684</sup> See UNIF. LTD. LIAB. Co. ACT § 801(4)(v).

<sup>685</sup> See REVISED UNIF. LTD. LIAB. Co. ACT § 602(6)(A).

<sup>686</sup> *Id.*, § 603 cmt.

<sup>687</sup> *Id.*, § 102(22).

distributions from the LLC that the deceased member would have received.<sup>688</sup> An LLC operating agreement has the power to opt-out of this default rule and provide for the buy-out of a member's transferable interest in the event of the member's death.<sup>689</sup> Unless admitted as members of the LLC, under RULLCA the heirs will have no right to participate in LLC management, conduct any of the company's activities,<sup>690</sup> or retain any fiduciary duties with regard to matters arising after the member's death.<sup>691</sup> The member's death also not absolve the heirs or estate of any debt, obligation or other liability to the LLC incurred by the member.<sup>692</sup> As transferees, the heirs have no right to inspect the company's records or to receive any information from the LLC concerning the company's activities or its financial condition.<sup>693</sup> The heirs and estate may, though, have access to any information to which the decedent member was entitled while a member, if the information pertains to the period during which the member was alive.<sup>694</sup>

Under DLLCA, a member's death terminates membership and does not of itself lead to the LLC's dissolution, unless the operating agreement provides otherwise.<sup>695</sup> The personal representative of a deceased member may exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power under a LLC agreement for an assignee to become a member.<sup>696</sup> The DLLCA defines a "personal representative" as the executor, administrator, guardian,

---

<sup>688</sup> *Id.*, § 502(b).

<sup>689</sup> *See* REVISED UNIF. LTD. LIAB. Co. ACT § 603 cmt.

<sup>690</sup> *Id.*, 603(a)(1).

<sup>691</sup> *Id.*, 603(a)(2).

<sup>692</sup> *Id.*, 603(b).

<sup>693</sup> *Id.*, 410(a). This section of clearly determines that the Revised Uniform Limited Liability Company Act retains such right exclusively from the LLC existing members.

<sup>694</sup> *Id.*, 410(c).

<sup>695</sup> *See* DEL. CODE ANN. tit. 6, §§ 18-801(b).

<sup>696</sup> *Id.*, § 18-705.

conservator, or other legal representative of a natural person, and the legal representative or the successor to a person other than a natural person.<sup>697</sup> The decedent member's executor, administrator, or other legal representative is therefore treated as an assignee of the decedent's interest in the LLC, and is not entitled to exercise the rights or powers of a member.<sup>698</sup> As an assignee, the personal representative is entitled only to receive distributions as authorized by the operating agreement, to share in LLC profits and losses, and to receive allocations of LLC income, gain, loss, deduction, and credit.<sup>699</sup> The deceased member's estate will remain liable for any promised capital contribution to the LLC, regardless of whether the promised capital contribution is in the form of cash, property, or services.<sup>700</sup> The personal representative, as an assignee, may also not become a member or exercise any of the rights or powers of a member, unless the LLC's operating agreement provides otherwise.<sup>701</sup> Therefore, the legal representative of a decedent, unless admitted as a member, will lack any right to participate in the management of the LLC or to inspect any of its records<sup>702</sup>, as DLLCA grants such rights exclusively to members.<sup>703704</sup> Under DLLCA, the personal representative may not be able to appropriately safeguard the estate's interest in the LLC due to the lack of management and inspection rights.

---

<sup>697</sup> *Id.*, § 18-101(13).

<sup>698</sup> *Id.*, §18-702(b)(1).

<sup>699</sup> *Id.*, §18-702(b)(2).

<sup>700</sup> *Id.*, § 18-502(a).

<sup>701</sup> *Id.*, §18-702(b)(1).

<sup>702</sup> Section §18-702(a) of DLLCA provides that: "The assignee of a member's limited liability company interest shall have no right to participate in the management of the business and affairs of a limited liability company except as provided in a limited liability company agreement or, unless otherwise provided in the limited liability company agreement, upon the vote or consent of all of the members of the limited liability company."

<sup>703</sup> Section §18-305 of the DLLCA expressly provides for inspection rights to each LLC member.

<sup>704</sup> Section §18-101(11) of DLLCA defines "Member" as a person admitted to an LLC as a member.

#### D. Valuation of Member's Interest Under the LLC Agreement

If LLC members elect to require the purchase of a dissociating member's interest upon his or her withdrawal, U.S. operating agreements incorporate various models for determining the purchase price of the interest. Sometimes these valuation methods are incorporated into a separate agreement referred to as a "Buy-Sell agreement." The following are some of the most commonly used valuation methods:

##### (a) Formula Approach (Book Value)

Many LLC agreements use an accounting-based book value for determining the purchase price of the withdrawing interest.<sup>705</sup> This method is popular due to its simplicity and economy.<sup>706</sup> The book value is measured as the total assets reflected on the balance sheet of the company minus the total liabilities.<sup>707</sup> The disadvantage of this method is that the book value often bears little resemblance to the market value, with the market value often significantly greater than what shows in the company's balance sheet.<sup>708</sup> For example, a company may have intangible assets not reflected on a balance sheet.<sup>709</sup> Additionally, a company's balance sheet is prepared in accordance with Generally Accepted Accounting Principles (GAAP), which typically are recorded on an original cost basis.<sup>710</sup> The original cost basis is frequently not reflective of present value.<sup>711</sup> Thus, while relatively

---

<sup>705</sup> Berson Bryan L., *Buy-sell agreements: be prepared for the day your co-owner leaves*, Quality, Vol.51(3), p.18(1) (2012)

<sup>706</sup> *Id.*

<sup>707</sup> JEFFREY M. RISIUS, *BUSINESS VALUATION: A PRIMER FOR THE LEGAL PROFESSION*, 23 (AMERICAN BAR ASSOCIATION. 2007).

<sup>708</sup> *Id.*, at. 24.

<sup>709</sup> *Id.*

<sup>710</sup> See Scott R. Miller & Robert F. Reilly, *The Asset-Based Approach: The Adjusted Net Asset Value Method* at [http://www.willamette.com/insights\\_journal/18/winter\\_2018\\_3.pdf](http://www.willamette.com/insights_journal/18/winter_2018_3.pdf).

<sup>711</sup> *Id.*, at. 29.

straightforward and inexpensive, using book value may lead to a significant deviation from fair market value.

(b) Formula Approach (Multiple of Earnings)

Agreements also frequently include a formula for determining purchase price, such as a multiple of a certain profit measure. The formula approach is a popular and frequently used one in the U.S., as the parties view it as simple and easy to apply.<sup>712</sup> A multiple of earnings formula focuses the valuation inquiry on company income, rather than its balance sheet.<sup>713</sup> Because newly established companies have no profit history, LLCs typically do not employ this method until they develop an earning record.<sup>714</sup> Despite its apparent simplicity, though, the formula approach can lead to valuation controversies unless its formula inputs are both specific and precise.<sup>715</sup> Additionally, because the formula does not automatically account for company and market condition changes over time, it runs the risk of becoming irrelevant.<sup>716</sup> Consequently, a formula that provides a reasonable valuation at the time of the LLC agreement will not necessarily do so if a triggering event occurs years in the future.<sup>717</sup>

---

<sup>712</sup> STEPHEN R. AKERS & MYRON E. SILDON, A PRACTICAL GUIDE TO BUY-SELL AGREEMENTS, 120 (illustrated, 2002).

<sup>713</sup> *Id.*, at 121.

<sup>714</sup> MICHAEL A. YUHAS & ERIC A. MANTERFIELD, DISCOUNTING AND VALUING FAMILY LIMITED PARTNERSHIP INTERESTS, AND BUY-SELL AGREEMENTS, 26, 27 (First edition, 2009)

<sup>715</sup> JAMES JURINSKI, GARY A. ZWICK, TRANSFERRING INTERESTS IN THE CLOSELY HELD FAMILY BUSINESS, 144, 145 (ALI-ABA, 2002)

<sup>716</sup> Stephen R. Akers, *supra* note 713, at 120.

<sup>717</sup> *Id.*



### (c) Fixed Price Approach

Other LLC agreements provide for a fixed price to determine the value of the dissociated member's interests in the company, with such stipulated price to be updated periodically.<sup>718</sup> A fixed-price agreement typically involves little expenditure and is considered simple to negotiate.<sup>719</sup> The issue that may arise from using this method is that company owners often neglect to update the price, as required by the agreement,<sup>720</sup> and thereby over time the price become unrealistic and unfair to apply.<sup>721</sup> If LLC owners elect the fixed-price approach, they must be conscientiousness about updating the price regularly, and at least once a year.<sup>722</sup> An additional downside to the fixed-price method is that it may leave minority shareholders vulnerable to abuse if the price is determined by majority vote.

### (d) Appraisal Approach

The previous chapter discussed use of the appraisal method under ROFR provisions, which the parties could employ in case of any disagreement as to the interest's fair value. The appraisal method is also used in cases of withdrawal-triggered buyouts, as many LLC agreements specify that an independent appraiser shall determine a share's value.<sup>723</sup> Such agreements often provide that the company and the dissociated member each shall elect

---

<sup>718</sup> Anne Warren, *Buy-Sell Agreements: A Key Element of Business Succession and Preservation* at <https://www.bbh.com/resource/blob/22292/a1152fd3a3d88fbde566d8f6f1c6de16/q2-2017-buy-sell-agreements--a-key-element-of-business-succession-and-preservation-pdf-data.pdf>.

<sup>719</sup> Donald R. Parker, *Buy/Sell Agreements: A Business Valuation Perspective* at <https://images.template.net/wp-content/uploads/2016/04/07053722/Sample-Business-Buy-Sell-Agreement-Template.pdf>.

<sup>720</sup> *Id.*

<sup>721</sup> Morton A. Harris, *Buy-Sell Agreements For Closely Held Family Businesses: Tax and Practical Considerations*, 7 at <https://www.americanbar.org/content/dam/aba/events/taxation/taxiq-fall11-harris-buysell.authcheckdam.pdf>.

<sup>722</sup> Anne Warren, *supra* note 719.

<sup>723</sup> *Id.*, at. 4.

one appraiser, and the two appraisers then choose a third appraiser.<sup>724</sup> The fair market value of the member's interest is then determined by majority vote among the appraisers, and that valuation is deemed final and binding among the parties.<sup>725</sup> One downside to this approach is the considerable time and money often required for an appraisal.<sup>726</sup> In addition, if the agreement does not specify a time period within which each party must designate their chosen appraiser, the selection process itself may become a means of disrupting the buy-out process.<sup>727</sup> Well-written agreements provide a clear time period of time for appointing appraisers, and any party failing to meet the deadline risks having the company appoint the party's appraiser itself.<sup>728</sup>

#### (e) The Menu of Valuation Methods Under Template Buy-Sell Agreements

Some of the template buy-sell agreements used in the U.S. list more than one sample valuation method, typically three to five methods, requiring company owners to then choose one for inclusion in the agreement.<sup>729</sup> For example, the template buy-sell agreement may list as options Agreed Value (the Fixed Price), Book Value, Multiple of Book Value, and Appraised Value.<sup>730</sup> The template indicates that the chosen method shall be used for determining the price of individual ownership interests under the agreement.<sup>731</sup> Having a

---

<sup>724</sup> See LARRY E. RIBSTEIN & ROBERT R. KEATING, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES, APP. B-3-25 § 2 (Thomson Reuters. 2017).

<sup>725</sup> *Id.*

<sup>726</sup> STEPHEN R. AKERS & MYRON E. SILICON, A PRACTICAL GUIDE TO BUY-SELL AGREEMENTS, 123,124 (American Law Institute-American Bar Association.).

<sup>727</sup> *Id.*

<sup>728</sup> *Id.*

<sup>729</sup> See the *Sample Buy-Sell Agreement*, at [https://usagym.org/PDFs/Member%20Services/bestpractices/2015/1\\_1legalplanning.pdf](https://usagym.org/PDFs/Member%20Services/bestpractices/2015/1_1legalplanning.pdf)

<sup>730</sup> *Id.*

<sup>731</sup> *Id.*

list of suggested options works as a guide to assist the company's owners in making their choice.

#### E. Limitations on Distribution and Creditors Protection

Even though U.S. LLC statutes provide a default limited liability rule for managers and members, the statutes frequently contain provisions that also protect creditors to a certain degree.<sup>732</sup> ULLCA, RULLCA, and DLLCA all provide that an LLC member may be liable to a creditor for any unpaid contribution to the company, even if such contribution obligation has been waived by the other members.<sup>733</sup> In addition, statutes typically include provisions imposing liability on those who consent to any improper distribution, as well as on anyone receiving such distributions.<sup>734</sup> Under ULLCA, a distribution is deemed illegal if, after making such a distribution, the LLC would be unable to pay its debts as they become due in the ordinary course of business, or its total assets would be less than the sum of its total liabilities.<sup>735</sup> Members or managers who vote for or otherwise consent to an unlawful distribution will, if also in violation of the standards of conduct,<sup>736</sup> be held personally liable for any portion of the distribution exceeding the maximum lawful distribution.<sup>737</sup> Members knowingly receiving an unlawful distribution are also personally liable to the extent that the received distribution exceeds the amount that could have been

---

<sup>732</sup> RICHARD D. FREER & DOUGLAS K. MOLL, *PRINCIPLES OF BUSINESS ORGANIZATIONS*, 613, 614 (West Academic Publishing 2nd Ed. 2018).

<sup>733</sup> *Id.* See ULLCA § 402(b); RULLCA § 403; DLLCA § 18–502(b).

<sup>734</sup> *Id.*

<sup>735</sup> See ULLCA § 406(a).

<sup>736</sup> LLC members and managers owe to the company and to the other members and managers the fiduciary duties of loyalty and care, and the obligation of good faith and fair dealing. See ULLCA § 409.

<sup>737</sup> ULLCA § 407 cmt.

properly paid to such members.<sup>738</sup> RULLCA contains similar language with regard to the limitations on distributions and the liability of LLC members and managers for illegal distributions.<sup>739</sup>

DLLCA prohibits an LLC from making member distributions that cause the company's liabilities to exceed the fair value of the company's assets.<sup>740</sup> LLC members may therefore receive distributions only to the extent that the fair value of the company's assets will be at least equal to its liabilities.<sup>741</sup> The Delaware Court of Chancery has stated that "this section prohibits the stripping of limited liability company assets so as to render an LLC insolvent."<sup>742</sup> However, DLLCA has no provision making managers personally liable for authorizing improper distributions.<sup>743</sup> Only a member who knows at the time of receiving a distribution that it is unlawful will be personally liable to the LLC for the amount of the distribution.<sup>744</sup> Actions for unlawful distributions under the DLLCA must be brought within three years of the unlawful distribution date, or such an action will be barred.<sup>745</sup>

---

<sup>738</sup> *Id.*

<sup>739</sup> See RULLCA § 405; RULLCA § 406.

<sup>740</sup> DLLCA § 18-607(a).

<sup>741</sup> ROBERT L. SYMONDS & MATTHEW J. O'TOOLE JR., SYMONDS AND O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES, 7-3, 7-4 (Aspen Publishers, 2006).

<sup>742</sup> *Id.* See the *Pepsi-Cola Bottling Company of Salisbury, Maryland v. Handy, C.A. No. 1973-5, slip op. at 11 (Del. Ch. Mar. 15, 2000).*

<sup>743</sup> NCBA Business Law Section, *A Comparative Study of the Corporate and LLC Laws of North Carolina and Delaware* at <https://www.ncbar.org/media/82216/Corporate-And-LLC-Laws-of-NC-and-Delaware.pdf>.

<sup>744</sup> DLLCA § 18-607(b).

<sup>745</sup> *Id.*, § 18-607(c).

## 5.6. Summary and Analysis

In the U.S., LLC state laws vary regarding a member's ability to withdraw, and generally fall into one of three approaches. The first approach gives the member the right to withdraw and requires purchase of the member's interest at a fair value (ULLCA). The second (transferee) approach, provides for a member's right to withdraw, but does not grant an accompanying right to a buy-out (RULLCA). The third approach grants no right of withdrawal unless permitted by the operating agreement (DLLCA). The KSA LLC law is similar to the third, or Delaware, approach in that it bars voluntary unilateral withdrawal. Unlike in Delaware, however, withdrawal either through the consent of the other shareholders or by the terms of the company agreement is not practical, due to the strict prohibition on reducing capital. The KSA approach, similar to Delaware, requires a member seeking unilateral withdrawal to wait until the expiration of the LLC term, or the satisfaction of other conditions stipulated in the LLC agreement.<sup>746</sup> The consequence of this approach is that minority shareholders do not enjoy the same flexibility as members in an ULLCA state have.<sup>747</sup> To what extent this may be problematic depends on the availability of alternative exit options for an individual. Even though the SCR no longer requires unanimous shareholder consent in order to transfer shares, the rule is often still interpreted to allow stricter restrictions on transfers, including an absolute ban on transfer without obtaining the consent of the other shareholders.<sup>748</sup> We have seen examples where LLC owners in the KSA place restrictions in LLC agreements requiring the unanimous

---

<sup>746</sup> Albert O. IV Saulsbury, *Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company*, 71 La. L. Rev. 699 (2011).

<sup>747</sup> *Id.*

<sup>748</sup> Gorman, *supra* note 612, at. 290.

consent of the other shareholders for permitting a transfer.<sup>749</sup> By permitting the inclusion of such restrictions, Saudi LLC law makes shareholder withdrawal incredibly challenging, given that unilateral withdrawal is not permitted. Although the ULLCA approach works better for the withdrawing member, there is a disadvantage to this approach.<sup>750</sup> The LLC becomes vulnerable to a potentially fatal depletion of its capital, especially where the withdrawing member indeed owns a high percentage of the LLC's interest.<sup>751</sup> Still, the ULLCA approach does the best job of protecting minority shareholders. The RULLCA (transferee) approach, while permitting withdrawal, does not entitle the withdrawing member to receive an immediate distribution. The result is that the withdrawing member loses all membership rights, including voting and inspection rights<sup>752</sup>

Regarding a member's death, under both DLLCA and RULLCA, the heirs and the estate of the decedent member will be in the weakest position. The death does not entitle the heirs or estate of the member to a buyout, to receive any special distribution of the deceased member's interest, to participate in the management of the LLC, to inspect any of its records, or to receive any information concerning the company's activities or financial condition. The estate, heirs, or the legal representative will likely be unable to protect the

---

<sup>749</sup> See the example of *published Article of Association of Abdulghani Erth Jewellery L.L.C*, *Um Al-Qura Newspaper*, 1437/11/13, No. 4737, p 47. Article 7 of this agreement state that "Transfer of shares is allowed between shareholders. No shareholder may transfer any shares to third parties, with or without consideration, unless the consent of the other shareholders has been obtained. The remaining shareholders may recover the share or shares that one of the shareholders wished to assign to others in accordance with Article 161 of the Saudi Companies Regulation" Also, see the example of *published Article of Association of Schindler Olayan Elevator Company L.L.C*, *Um Al-Qura Newspaper*, 1439/3/6 No. 4699. Article 8 of this agreement states that "The Transfer of shares is allowed between shareholders. No shareholder may transfer any of its shares to third parties, with or without consideration, unless the prior written consent of the other shareholders has been obtained. The remaining shareholders may recover the share or shares that one of the shareholders wished to assign to others in accordance with Article 161 of the Saudi Companies Regulation."

<sup>750</sup> See Saulsbury, *supra* note 747, at. 690.

<sup>751</sup> *Id*, 691.

<sup>752</sup> *Id*, 694.

interests of the decedent member's share. In addition, as their interests in the LLC may be held for a period of years, they will be vulnerable to the risk of market devaluation, as the purchase price will be determined at the end of the specified duration.<sup>753</sup> ULLCA, by requiring the immediate purchase of the deceased member's interest in at-will company, protects heirs far better. The Saudi LLC law, however, gives the heirs the most protection of all, granting a default right to take all the power of an LLC shareholder, including management and voting rights. Here there is a great contradiction in how the SCR treats ordinary share transfers and how it treats shares transferring through death. Any third-party transfer of shares is subject to mandatory ROFR, while shares transferring through death carry the full rights of an LLC shareholder. This is despite the fact that the risk LLC shareholders may face from third parties is no greater than that they may face from the decedent's heirs. From my prospective, it seems irrational to allow third parties (heirs) to enter the company without the consent of other shareholders simply because the shares transferred through death. The ULLCA approach is thus most preferable, as it provides heirs and the beneficiaries of the decedent shareholder with a buyout right while at the same time protecting the LLC and its remaining shareholders.

In determining which withdrawal rules function best, it is important to remember that a Saudi LLC's ability to return shareholder capital via share repurchases is limited by the legal capital rule, as explained earlier.<sup>754</sup> The United States, on the other hand, has revoked the legal capital rule, deeming it no longer necessary for creditor protection.<sup>755</sup> U.S.

---

<sup>753</sup> Carter G. Bishop, *The Uniform Limited Liability Company Act: Summary & (and) Analysis*, 51 Bus. Law. 80 (1995).

<sup>754</sup> See *Supra* note 591.

<sup>755</sup> John Armour, *Legal Capital: An Outdated Concept?* Centre for Business Research, University of Cambridge. (2006) available at [https://www.cbr.cam.ac.uk/fileadmin/user\\_upload/centre-for-business-research/downloads/working-papers/wp320.pdf](https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp320.pdf)

creditors must therefore contract for safeguards against actions that may threaten the security for their loans.<sup>756</sup> In closely held companies such as LLCs, creditors may also obtain a personal guarantee from the LLC owners.<sup>757</sup> As we have seen, U.S. LLC statutes create additional creditor protection through liability rules, such as piercing the corporate veil.<sup>758</sup> Personal liability against LLC managers and members who improperly reduce company assets, along with the other measures just mentioned, provide security for creditors without necessitating the rigidity of the legal capital rule.<sup>759</sup>

Given the U.S. position, one must question whether the legal capital doctrine is still necessary in the KSA. Scholars offer several reasons for abandoning the legal capital rule.<sup>760</sup> One view is that contractual obligations would provide sufficient alternative protection for creditors.<sup>761</sup> The argument is that contractual covenants are more adaptable and resilient for particular needs, avoiding the excessively rigid company financial structures under the legal capital rule.<sup>762</sup> However, the covenant method itself can lead to limitations somewhat at odds with the overall U.S. approach of favoring a self-regulating and efficient-market as a major source of creditor protection.<sup>763</sup> Covenants can limit a company's freedom to make new investments or distribute assets in ways unforeseen at

---

<sup>756</sup> Det Juridiske Fakultet, *Protecting Creditors and Investors - Capital Maintenance in the European Private Company*, University of Osloensis. (2009) Available at: <https://www.duo.uio.no/bitstream/handle/10852/22314/97185.pdf?sequence=1>

<sup>757</sup> Luca Enriques, *supra* note 596, at 1188.

<sup>758</sup> *Id.*, at 1185.

<sup>759</sup> Under most U.S. LLC statutes, distributions to members are legal only if the company would still be able to pay its debts as they became due in the ordinary course of business, and the company's total assets remain less than its total liabilities. See ULLCA § 406; RULLCA § 405; DLLCA § 18-607(a).

<sup>760</sup> Luca Enriques and Jonathan R. Macey, *Creditors Versus Capital Formation: The Case against the European Legal Capital Rules*, 86 Cornell L. Rev. 1165 (2001) Available at: <http://scholarship.law.cornell.edu/clr/vol86/iss6/1>

<sup>761</sup> Hasan Erdem, *supra* note 565, at 37.

<sup>762</sup> *Id.*

<sup>763</sup> *Id.*



their formation, which may lead to unanticipated and unintended losses.<sup>764</sup> However, contractual covenants can generally be more comprehensive and sophisticated in avoiding such consequences than the legal capital rule would be.<sup>765</sup> A second objection to contractual covenants as an alternative to legal capital rules is that only sophisticated and powerful creditors can in fact protect their rights through contract. Other creditors in a weaker position, such as company employees, or involuntary creditors such as tort victims are generally unable to protect themselves by contract.<sup>766</sup> The legal capital rule is therefore superior from the point of view of such creditors.<sup>767</sup>

It is therefore debatable whether contractual protections alone are sufficient to protect creditor interests.<sup>768</sup> However, the United States, as noted, has created additional statutory creditor protections without needing to rely on the legal capital rule.<sup>769</sup> In addition to liability rules like piercing the corporate veil, most U.S. jurisdictions impose fiduciary duties upon directors and LLC managers toward their creditors' interests.<sup>770</sup> The U.S. also has high levels of protection for secured creditors who hold claims on company assets via contract, making contractual remedies themselves especially strong.<sup>771</sup> The Uniform Fraudulent Transfer Act and insolvency procedures such as company reorganization under

---

<sup>764</sup> *Id.*

<sup>765</sup> Luca Enriques, *supra* note 761 at 1172

<sup>766</sup> LOUISE GULLIFER & JENNIFER PAYNE, *CORPORATE FINANCE LAW: PRINCIPLES AND POLICY*, 551 (BLOOMSBURY PUBLISHING, Second ed 2015).

<sup>767</sup> *Id.*

<sup>768</sup> See Wood, Justin "Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan," *Penn State International Law Review*: Vol. 26: No. 1, Article 5, 139 (2007). Available at: <http://elibrary.law.psu.edu/psilr/vol26/iss1/5>

<sup>769</sup> *Id.*

<sup>770</sup> Keith H. Berk & George J. Spats, *Understanding Fiduciary Obligations Applicable To Delaware Limited Liability Companies at* [https://www.hmblaw.com/media/71174/understanding\\_fiduciary\\_obligations\\_the\\_practical\\_lawyer.pdf](https://www.hmblaw.com/media/71174/understanding_fiduciary_obligations_the_practical_lawyer.pdf).

<sup>771</sup> Simon Deakin, et al., *Varieties of creditor protection: insolvency law reform and credit expansion in developed market economies at* <https://academic.oup.com/ser/article/15/2/359/2890786>.

chapter 11 of the U.S. bankruptcy code provide still further creditor protection.<sup>772</sup> In sum, U.S. creditor protection combines contractual and statutory rights to form a comprehensive regime. By contrast, the Saudi regime relies primarily on the legal capital rule to protect the interests of the company's creditors. Therefore, arguing that the KSA should abandon the legal capital rule in favor of rules based on U.S. LLC statutes fails to take into account the full scope of U.S. creditor protections that exist in addition to LLC law. Replacing the legal capital rule without fully accounting for these differences would leave company creditors with inadequate protection.

---

<sup>772</sup> *Id.*

## Chapter 6: Judicial Dissolution

### 6.1. Introduction

Judicial remedies constitute a significant source of protection for LLC owners facing management deadlocks, majority oppression, or other shareholder disputes that may affect the company's affairs.<sup>773</sup> Potential judicial remedies an LLC owner might seek include a court-ordered dissolution of the company, as well as less severe remedies such as the buy-out of an individual's shares.<sup>774</sup> As explained earlier, an LLC minority shareholder seeking to sell in the KSA may experience great difficulty finding a willing buyer at a fair price, due to the statutory restriction of the ROFR and the lack of market for his or her shares.<sup>775</sup> The lack of a shareholder buy-out right and restrictions on the LLC's ability to repurchase its shares often leaves the majority LLC shareholders as the only available buyer. The price the majority owners are willing to pay in such a situation is often far below the share's fair value. Given the lack of alternative options, however, the minority shareholder seeking to exit will often have to accept the below-market price offered. Such a situation illustrates why judicial intervention is an essential protection for minority shareholders and therefore necessary for resolving certain shareholder disputes. This chapter will discuss the grounds available for LLC shareholders seeking the judicial

---

<sup>773</sup> Sandra K. Miller, *What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company*, 44 AM. U. L. REV. 465 (1994).

<sup>774</sup> Sandra K. Miller, *Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French Close Corporation Problem*, 30 CORNELL INT'L L.J. 381, 428 (1997). Available at: <http://scholarship.law.cornell.edu/cilj/vol30/iss2/4>.

<sup>775</sup> See the discussion in Chapter 4.

dissolution of the company and other judicial remedies that the court may award to dissatisfied LLC owners.

## 6.2 Judicial Dissolution in Saudi Arabia

The SCR states that a company shall be dissolved, and its activities concluded, in the event that any of the following occur:

- (1) The company achieves the purpose for which it was established, or achieving that purpose becomes impossible.
- (2) The affirmative vote or consent of all shareholders to dissolve the company before the expiry of its term;
- (3) Reaching the date specified for dissolution in the LLC Agreement;
- (4) Entry of a judicial decree of dissolution upon the request of a shareholder.<sup>776</sup>

When an LLC shareholder fails to reach agreement with the other shareholders on an avenue for exiting the company, and he or she no longer wishes to remain a member of the company, SCR Article 16 permits that shareholder to seek a court order dissolving the company. However, judicial dissolution in Saudi Arabia is a discretionary, rather than mandatory, remedy. The SCR permits company owners to petition for judicial dissolution of the business when “serious reasons” justify the request, and it is up to the court to determine whether the “serious reasons” are sufficient enough to order dissolution.<sup>777</sup> A judicial order dissolving a company on the "serious reasons" ground is based on the idea

---

<sup>776</sup> Saudi Companies Regulation, Art 16.

<sup>777</sup> *Id.*

that the objective of establishing a company is for it to function normally.<sup>778</sup> Dissolution is therefore appropriate when this objective is no longer feasible.<sup>779</sup> The right to a judicial dissolution is a mandatory, non-waivable right required in all LLC owner agreements, and each individual shareholder has the ability to bring a judicial action for dissolution if there are legitimate reasons justifying the request.<sup>780</sup> However, the "serious reasons" requirement for seeking dissolution is subject to criticism as an excessively vague and imprecise standard for guiding both shareholders and courts during dissolution proceedings. The SCR neither defines the term "serious reasons" nor enumerates any examples of what might constitute sufficient grounds for a court to dissolve a company.<sup>781</sup> Some defend the "serious reasons" term as necessarily general in order to cover all circumstances which might justify dissolution, as the reasons a company might require termination are too numerous and unpredictable to be listed in a statute.<sup>782</sup> Others, however, argue that the lack of statutory guidance gives courts too much discretion to decide when dissolution is appropriate, leading to widely varying and unpredictable outcomes in dissolution proceedings.<sup>783</sup> The term's vagueness has also been criticized on the ground that it provides too much incentive for shareholders to sue for dissolution without any reasonable justification, leading to lengthy and unnecessary litigation.<sup>784</sup> The opposite problem can also occur, where owners

---

<sup>778</sup> NABIL SALEH, *THE GENERAL PRINCIPLES OF SAUDI ARABIAN AND OMANI COMPANY LAWS: STATUTES AND SHARI'A*, 139 (Namara, First Ed. 1981).

<sup>779</sup> *Id.*

<sup>780</sup> Article 16 of the Saudi Companies Regulation state that "*A final judicial decree dissolves a company upon the request of any of the company's owners or any interested party, and any terms that deprives the use of this right are considered void*". Saudi Companies Regulation, Art 16.

<sup>781</sup> *Id.*

<sup>782</sup> Nabil Sale, *supra* note 779, at. 139.

<sup>783</sup> *Id.*

<sup>784</sup> Abdel Halim Ammar, *Liquidation of Commercial Companies in Saudi Arabia*, HAZIM AL MADANI LAW FIRM, <https://www.hg.org/legal-articles/liquidation-of-commercial-companies-in-saudi-arabia-46683>.

who have legitimate reasons for seeking dissolution are prevented from doing so.<sup>785</sup> Even the recent updates to the SCR did not include any further guidance on what might constitute the "serious reasons" justifying a decree for judicial dissolution. In the majority of cases decided by courts, the "serious reasons" ground for dissolution was rejected whenever the company showed strong profits, notwithstanding the presence of other factors which might justify dissolution.<sup>786</sup> The court has absolute discretion in determining whether the existing circumstances justify dissolving the company, and it therefore may reject the request for termination or order other, alternative remedies even where strong reasons support dissolution.<sup>787</sup> In spite of this broad discretion, though, there are a number of situations where courts are likely to find sufficient grounds for dissolution, and order the company's termination upon request. The circumstances widely seen to justify termination include:

- (a) A shareholder who has failed to supply his required capital contribution to the company.
- (b) The disability of a shareholder who promised capital contribution to the company in the form of services or labor.
- (c) Acute conflicts between the shareholders where cooperation between them has become practically impossible.
- (d) A company has suffered a financial crisis or circumstance that impedes its ability to perform its commercial activities.<sup>788</sup>

---

<sup>785</sup> *Id.*

<sup>786</sup> Nabil Sale, *supra* note 779, at 140.

<sup>787</sup> Board of Grievances, Case No. 227/4/T. Appeal Division Decision No. 24/T/3, 2001 (1421.H).

<sup>788</sup> Nabil Sale, *supra* note 779, at 139, 140.

## A. Majority Oppression and Judicial Dissolution

The SCR does not specifically authorize a minority shareholder to seek dissolution on the ground of shareholder oppression. Minority shareholders do, however, have the right to seek judicial dissolution if the reason for the request is deemed sufficient under Article 16 of the SCR. The Court's sufficiency analysis primarily depends on the amount and type of damages suffered by the minority and the absence of suitable alternative solutions or remedies to dissolution, as well as the totality of the circumstances regarding the company's activity.<sup>789</sup> The majority shareholders' exercise of power derives from a contractual obligation that is matched by the minority's commitment to accept majority rule.<sup>790</sup> Majority rule, as a principle, entails substantial power being placed in the hands of the shareholders who control more than half of the voting power at a given shareholder meeting.<sup>791</sup> Minority shareholders must therefore accept majority shareholder decisions, and also acknowledge that this majority power is legally enjoyed by those holding more shares.<sup>792</sup> On the other hand, when the majority uses its power to pursue personal interests as opposed to those of the company, or in a way which harms minority interests, the majority breaches its obligations under the law.<sup>793</sup> In such a situation, the court holds discretionary authority to dissolve the company in response to a minority shareholder petitioning for dissolution.<sup>794</sup> In practice, however, it is quite rare for a court to order dissolution on the basis that the majority shareholders have abused the minority.<sup>795</sup> In most

---

<sup>789</sup> FALAH ALSHABAK, *THE THEORY OF ARBITRARINESS IN THE MANAGEMENT OF COMMERCIAL COMPANIES*, 249 (Al Manhal, First ed. 2016).

<sup>790</sup> *Id.*, at 250

<sup>791</sup> M. Rishi Kumar Dugar, *Minority Shareholders Buying Out Majority Shareholders - An Analysis*, 22 NAT'L L. SCH. INDIA REV. 105, 110 (2010)

<sup>792</sup> *Id.*

<sup>793</sup> *Id.*

<sup>794</sup> Falah Ashabak, *supra* note 790.

<sup>795</sup> *Id.*

cases, the court rules that any damages caused to minority shareholders can be remedied by rescinding or invalidating the particular action in dispute, by compensating the minority shareholder, or allowing minority shareholders to sell their shares to third parties and thereby exit the company.<sup>796</sup> This last alternative remedy is particularly unhelpful to an oppressed minority shareholder, as restrictions on transfer and the lack of a liquid market make it difficult to sell at fair value. Many commentators argue that Saudi courts generally play a weak role in protecting minority shareholders from majority abuse.<sup>797</sup> The insufficient judicial response typically results from either perceived deficiencies in the minority shareholder case or the lack of clear legal authority for resolving such cases.<sup>798</sup> As a result, judges in KSA often end up exercising their discretion in vastly differently ways, depending on the views of the particular judge and the individual circumstances of the case.<sup>799</sup> Dissolution is only ordered when the majority behavior at issue has caused the company's failure to the point that future operations are impracticable.<sup>800</sup> Judicial dissolution is thus an extraordinary remedy infrequently awarded to minority shareholders alleging majority shareholder oppression.<sup>801</sup>

## B. Case Studies: An Analysis

Since the Saudi legislature does not provide a definition for 'serious reasons' and the courts have considerable discretion in determining, on a case-by-case basis, when

---

<sup>796</sup> Mahmoud H. Almadani, *The Reform Of Minority Shareholder Protection In Saudi Arabia And Dubai Private Companies*, 120, 121, (2011) (unpublished thesis, The University of Leeds).

<sup>797</sup> *Id.* at. 122.

<sup>798</sup> *Id.*

<sup>799</sup> *Id.*

<sup>800</sup> Falah Ashabak, *supra* note 790, at. 245.

<sup>801</sup> *Id.*



termination is justified, examining specific case results is necessary in order to understand the legal standard. Because the SCR does not include a specific statutory remedy for LLC owners in the event of management deadlocks or minority oppression, a particularly important question is whether either of these situations constitute "serious reasons" sufficient to permit judicial dissolution. A related question is whether the court may order alternative remedies, such as a forced buy-out of the allegedly oppressed minority owner, under the "serious reasons" ground instead of ordering dissolution. At least nine published cases interpret "serious reasons" in the context of a plaintiff seeking judicial dissolution, providing some answers to these questions. The four presented here were selected because they each involve slightly different issues. However, the cases not discussed are consistent with these four in that the financial position of the company is always the dominant factor courts consider in deciding whether to order dissolution.

*1. Judicial Dissolution Case Study I: Acute Conflicts as "Serious Reasons" For the LLC's Dissolution*

In this case (*No.261/1/G.1418.H*), the Board of Grievances, which was formerly the competent court under the SCR, granted a shareholder petition for LLC dissolution on the basis that shareholder conflicts were acute enough to render achievement of company objectives unfeasible.<sup>802</sup>

*Background*

---

<sup>802</sup> Board of Grievances, Case No. 261/1/G. Appeal Division Decision No. 126/T/3, 2001 (1421.H).

The dispute underlying the dissolution petition arose when the defendant took actions which the plaintiff felt were detrimental to both his interests and those of the LLC. The parties' business relationship then deteriorated to the point of mutual hostility and mistrust, undermining company operations. The LLC in question began in 1985 as a company producing advertising billboards, in particular as related to the advertising needs of foreign companies. The LLC Article of Association provided that the defendant would hold the position of LLC Chief Executive Manager. The position empowered him to supervise the company's operations in exchange for compensation amounting to five percent of the company's net profit, after setting aside the LLC statutory reserve. In July 1997, the plaintiff, the defendant's co-owner, initiated an action alleging that the defendant was taking company actions without informing the plaintiff or obtaining the consent of the LLC general assembly, as required by the Article of Association. The plaintiff further alleged that the defendant had obtained a license to set up a rival company in the same line of business, and that the defendant had used the existing LLC's headquarters and address to obtain the license. The defendant had then rented his own office, where he began to operate the rival company, causing severe damage to the original company and the plaintiff's interests. The defendant also attempted to poach the existing LLC's clients by asking them to transfer their business to his new company. Finally, the plaintiff claimed the defendant attempted to convince the LLC's employees to leave their positions and transfer to the rival company. The plaintiff's action sought: (1) judicial dissolution of the LLC, (2) compensation for the damages caused by the defendant's acts, pursuant to SCR Article 32, which states: "The manager shall compensate any damage caused to the company, shareholders or third parties that stems either from violating the terms of the

company's agreement or any negligent errors committed during performance of his work".<sup>803</sup>

The defendant responded by rejecting the petitioner's claims and alleging various counterclaims. Specifically, the defendant alleged that the plaintiff was responsible for the company's decline in profits since mid-1996 by preventing the defendant from carrying out his duties, converting company assets to the plaintiff's own account, and assigning company employees to spy on the defendant. The defendant also argued that he informed the plaintiff about his desire to withdraw from the business, but that the plaintiff frustrated his withdrawal by attempting to dictate unreasonable separation terms. While the defendant acknowledged that he had established another company operating in the same field, he defended that decision as necessary in light of the plaintiff's hostile acts. He further argued that his professional expertise was in billboard advertising, and that he set up the rival company as the only means of continuing his career.

### *Court's Ruling*

The court ordered dissolution of the company, finding "serious reasons" justified its decision and requesting that a receiver be appointed to wind down the LLC's business.

In reaching its decision that judicial dissolution of the company was warranted, the court focused extensively on the company's financial position and business operations. It held that the shareholder disputes had led to a complete collapse in business operations, affecting the LLC's relationships with both clients and its employees, and that dissolution was therefore inevitable. The court articulated its reasoning as follows:

---

<sup>803</sup> Saudi Companies Regulation, Art. 32.

“The basis of any company’s existence is mutual trust and cooperation between its participants. The case at bar illustrated this point, as the shareholders here suffer from the absence of the required trust and mutual cooperation, which has led to the company’s financial deterioration. The dispute between LLC owners has reached the point where it is impossible for the company to continue its business operations. Further operations will only serve to expand the circle of controversy and lead to a further erosion of LLC assets. Accordingly, the court exercises its discretion to find that sufficiently serious reasons justify dissolution as provided for under Article 16 of the Saudi Companies Regulation. The court orders the company to dissolve, and wind down its business as appropriate in order to mitigate damages and reduce losses.”

### *Analysis*

This case illustrates that the court will examine the following circumstances in deciding whether to order dissolution: (1) whether shareholders conflicts are acute; (2) whether the conflicts have negatively affected the entity, its financial position, and the operation of its businesses; (3) whether carrying on operations is financially feasible. In light of the court’s decision, shareholders petitioning for dissolution should focus their arguments on those three considerations.

As the plaintiff did not raise the issue, the court did not address whether a manager establishing a rival business could constitute a breach of fiduciary duty. The case

nonetheless appears to involve a clear breach of the fiduciary duty of loyalty, as the defendant directly bolstered a competitor of the company where he served as manager. Despite this apparent breach, the court did not order compensation to the plaintiff for any resulting damages. The court also denied the plaintiff's request for compensation pursuant to SCR Article 32, which permits damages for violations of the LLC agreement, as well as for any managerial negligence.

2. *Judicial Dissolution Case Study II: Suspicion and Distrust as "Serious Reasons" For the LLC's Dissolution - Deadlock between two LLC owners arising from alleged violations of the LLC agreement.*

The court in this case (*No.2906/2/G.1424. H.*) denied the plaintiff's request to dissolve the LLC, concluding that distrust, suspicion, or disagreement among shareholders, standing alone, are insufficiently "serious reasons" to warrant judicial dissolution of an entity.<sup>804</sup>

*Background*

The case involved an LLC formed in August 2001 by its two owners, the eventual parties to the lawsuit, to operate a tourism, hospitality, and hotel management business wherein each held a fifty percent ownership share. Soon after the LLC's formation, and prior to processing of its application for Commercial Registration, the two owners had a falling out. The plaintiff subsequently brought an action alleging that his co-owner has violated several provisions of the Articles of Association and ignored all written and verbal requests to correct the offending behavior. The plaintiff also contended that he asked the

---

<sup>804</sup> Board of Grievances, Case No. .2906/2/G. Appeal Division Decision No. 622/T/7, 2007 (1428.H).

defendant not to move forward with the company's registration procedures, as the defendant's violations and other non-cooperation made the company's continuation impossible. Finally, the plaintiff argued that the defendant had acted in bad faith by not only failing to halt registration procedures as requested, but in fact attempting to accelerate issuance of the company's commercial register as well as then pursuing a business license. The petition contained claims for: (1) the dissolution and liquidation of the company on the grounds that cooperation between the owners was no longer possible and (2) recovery of the plaintiff's share of LLC capital contributions in the amount of two hundred and fifty thousand S.R.

The defendant moved to dismiss the proceeding for judicial dissolution of the LLC, arguing, in part, that all letters he received from the plaintiff had been written after the issue date of the LLC's Commercial Register. He also claimed that the plaintiff had implicitly approved continuing the company's business operations by attending an owners' meeting in early October 2003, more than two months after issuance of the company's Commercial Register. The defendant maintained that, during the meeting, the parties discussed and agreed upon a plan for future business operations. As for the alleged Articles of Association violations, the defendant denied them, responding that the plaintiff was incorrectly confusing their hotels operations agreement with the LLC Article of Association. The defendant's final contention was that the LLC agreement specified all circumstances that would trigger dissolution, and that non-compliance with the hotel operations agreement was not one of the agreed upon circumstances.

### *Court's Ruling*

The court denied the petition for dissolving the company, finding that the petitioner's claims were insufficient to satisfy the "serious reasons" ground for dissolution.

In reaching its decision, the court made a number of factual findings. First, the court found that the parties signed the LLC Article of Association and that those articles were then legally approved by the governing authority. Second, the LLC agreement provided the LLC's duration and expiration date and articulated the circumstances which would trigger dissolution. The court further held that the plaintiff's stated reasons for seeking dissolution were operational and management disputes which did not harm the company's finances or involve violations of the LLC agreement. The court ultimately ruled that "loss of confidence, distrust, and disputes alone are not serious reasons warranting judicial dissolution. Only managerial disputes so acute that they affect the company's financial position are sufficient for dissolution."

### *Analysis*

The court's decision confirmed that mistrust, loss of confidence, suspicion, and non-cooperation among shareholders will not warrant dissolution unless those issues affect the company's profitability. The decision is therefore consistent with the first case examined, where the court ordered dissolution due to the LLC becoming economically unviable. The two decisions make clear that shareholders seeking dissolution must argue that the company's internal discord is affecting company finances, and constitutes an existential threat to the LLC's future operations and profitability.

3. *Judicial Dissolution Case Study III: Minority Oppression as “Serious Reasons” For the LLC’s Dissolution*

The third case (*No.167/2/G.1420.H.*) involved an LLC minority shareholder seeking dissolution under the “serious reasons” ground where the majority shareholders failed to perform certain obligations as required by the LLC agreement. The court ruled that non-fulfillment of a shareholder’s obligations under the LLC agreement is a matter that can only be raised by a company’s management body, and that the petition did not therefore prove “Serious Reasons” requiring dissolution.<sup>805</sup>

*Background*

In 1976, the petitioner formed an LLC with two co-owners to construct and operate a medical center, each of them holding a one-third ownership share. The petitioner agreed to act as the general contractor for the project and be responsible for all construction. The other two owners, who became the defendants in the case, agreed to provide the land for the medical center as well to provide continuing capital contributions over the course of the construction. After several years of delay in the construction work, the plaintiff filed an action demanding dissolution on the grounds that the co-owners had failed to provide the agreed upon land as well as their required capital contributions. The plaintiff additionally claimed that the defendants refused to accept his calls requesting a meeting that would decide whether they would meet their obligations or agree to dissolve the company. Finally, the petition contended that the defendants had attempted to force the

---

<sup>805</sup> Board of Grievances, Case No. 167/2/G. Appeal Division Decision No. 224/T/3, 2001 (1422.H).



plaintiff to sell them his share at an unreasonably low price. The plaintiff sought: (1) judicial dissolution and liquidation of the company under the “serious reasons” ground and (2) compensation for losses the plaintiff suffered as a result of the defendants’ refusal to honor their LLC agreement obligations. The petition cited for support SCR Article 7, which states that: “Each shareholder shall be liable to the company for the capital contributions that he has undertaken to provide, and if such capital is not delivered within the specified period, a shareholder shall be liable to the other shareholders for the damage caused by such delay.”<sup>806</sup>

The defendants moved to dismiss the claim on the ground that the LLC Article of Association states that any dissolution resolution requires unanimous consent, that the defendants object to the proposed dissolution, and that the required unanimity was therefore not present.

### *Court’s Ruling*

The court rejected the petition for dissolving the company, holding that the petitioner's claims did not constitute serious reasons for dissolution as required by SCR Article 16.

The court reasoned that the petitioner’s alleged grounds for dissolution, including the failure of his co-owners to comply with the LLC agreement, should all have been raised through the company’s management body. The court also noted that, since most of the company's projects have been completed, dissolution would cause financial damage to the LLC. The court further held that the LLC Agreement clearly stated that any resolution for

---

<sup>806</sup> Saudi Companies Regulation, Art. 7.

dissolving the company required the unanimous consent of shareholders, and that the required unanimity was not shown. The court specifically noted that "whoever is committed to something, is obliged to do so," referring to the plaintiff's agreement in the LLC articles that all dissolution petitions must be unanimous.

### *Analysis*

Although the petitioning minority shareholder successfully proved that the majority owners committed misconduct against him, he failed to secure the requested dissolution. The ruling makes clear that the SCR's text, as interpreted by the courts, provides no legal remedy against majority oppression. By leaving it to the company management to decide whether to bring an action for shareholder violations, the court is only encouraging an increase in majority misconduct. This case therefore represents a significant threat to minority shareholder interests.

#### *4. Judicial Dissolution Case Study IV: Financial Infeasibility as "Serious Reasons" For the LLC's Dissolution*

Saudi Courts have consistently held LLC financial difficulties to be the most acceptable ground for dissolving the company pursuant to SCR Article 16. Case (381/2/G.1410 H) was one such example, as the court ordered the LLC's dissolution and requested appointment of a liquidating trustee when LLC losses reached three-quarters of its paid-up capital.<sup>807</sup>

---

<sup>807</sup> Board of Grievances, Case No. 381/2/G. Appeal Division Decision No. 283/2/G, 1994 (1415.H).

### *Background*

The petitioner brought an action seeking dissolution based on several circumstances. First, plaintiff alleged that the company was incapable of continuing operations due to the sale of its only factory. The plaintiff additionally alleged that one of the shareholders, a foreign national, had abandoned the company and left the country. Since this shareholder was primarily responsible for company operations and management, his departure caused significant losses reaching three-quarters of the LLC's paid-up capital. Petitioner contended that the circumstances he alleged should be sufficient to establish serious reasons justifying dissolution under Article 16.

The defendants moved to dismiss the petition on the ground that the LLC agreement expressly stipulated the LLC term and date of expiry, and reaching that expiration date, along with a shareholder then desiring to end the business, was the only legal way to dissolve the company.

### *Court's Ruling*

The court granted the petition for dissolution and requested the parties appoint a trustee to liquidate the business. The court reasoned that there were sufficient signs of the LLC's financial distress to warrant dissolution. Specifically, the court found that closing the company's only factory, which supplied most of its goods for sale, combined with financial losses totaling three-quarters of the company's capital constituted serious reasons for dissolution.

## *Analysis*

The holding is again consistent with those previously discussed, with the company's financial viability serving as the key factor courts use in deciding whether to order dissolution. Courts may consider other factors in determining whether company operations should continue, but financial condition plays the most vital role. There are certainly reasons to question the courts' narrow focus on company finances in any dissolution decision. Financial status is clearly a relevant and important factor in contemplating dissolution.<sup>808</sup> However, it seems misguided to focus on that one factor, to the seeming exclusion of all other considerations. A court should not reject any appropriate form of relief solely on the ground that the company is profitable.<sup>809</sup>

### 6.3 Managers' Fiduciary Duties and Available Remedies

Fiduciary duty law presents a potential alternative source of remedies in shareholder oppression cases. The SCR itself offers few details regarding the fiduciary duties owed by LLC managers.<sup>810</sup> Saudi courts, however, do not necessarily interpret the SCR's lack of specificity to mean LLC managers owe no such duties.<sup>811</sup> Rather, KSA judges at times draw on fiduciary rules applying to other sorts of companies, as well as Shari'a law, to

---

<sup>808</sup> Sandra K. Miller, What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company, 44 AM. U. L. REV. 527 (1994).

<sup>809</sup> *Id.*

*Id.* MINN. STAT. ANN. § 322B.833 Subd. 3. states that: "In determining whether to order relief under this section and in determining what particular relief to order, the court shall take into consideration the financial condition of the limited liability company but shall not refuse to order any particular form of relief solely on the ground that the limited liability company has accumulated or current operating profits."

<sup>810</sup> See *LLC directors in Saudi Arabia - do they have fiduciary duties?*, CLIFFORD CHANCE, (June 2, 2014), [https://www.cliffordchance.com/briefings/2014/06/llc\\_directors\\_insaudiarabia-dottheyhav.html](https://www.cliffordchance.com/briefings/2014/06/llc_directors_insaudiarabia-dottheyhav.html).

<sup>811</sup> *Id.*

define an LLC manager's duties.<sup>812</sup> SCR Article 165 is one of the few legal provisions addressing LLC manager responsibilities. It states that such managers shall be individually and jointly liable to the LLC and its shareholders for damages caused by negligence, violations of the SCR or the LLC Articles of Association, or any other wrongful action committed while performing their duties.<sup>813</sup> As a result, some argue that Article 165 create implicit fiduciary duties requiring that LLC managers act with due care, within the scope of their powers, and in good faith while carrying out their duties.<sup>814</sup>

The SCR also specifies fiduciary duties owed by managers in other types of companies, such as JSC directors, which might be interpreted as applying to LLC managers as well. These duties include avoiding conflicts of interests<sup>815</sup>, refraining from participating in competing businesses<sup>816</sup>, and maintaining confidentiality.<sup>817</sup> Moreover, while the SCR does not explicitly provide that JSC directors owe a general duty of loyalty, the duties it does expressly create have been interpreted to create an implicit loyalty duty owed to the company and other shareholders. The SCR never addresses one way or another whether the provisions defining a JSC director's duties also apply to LLC managers. The SCR's silence on this subject has therefore led to some uncertainty over whether any or all of a JSC director's fiduciary duties should also apply to such managers.

As mentioned, Saudi courts also consider relevant Shari'a law rules in determining the scope of duties an LLC manager owes to the LLC and its shareholders. Shari'a law is invoked through the mechanism of agency theory (agent-principal), which separates

---

<sup>812</sup> *Id.*

<sup>813</sup> *Id.* Saudi Companies Regulation, Art.165.

<sup>814</sup> Clifford, *supra* note 810.

<sup>815</sup> *Id.* Art. 71

<sup>816</sup> *Id.*

<sup>817</sup> *Id.*

shareholders not involved in the company's management from those who are.<sup>818</sup> Shari'a law imposes on LLC managers, and all other management bodies for any type of company, the additional duty to conform with principles of accountability, trust, fairness, and transparency.<sup>819</sup> <sup>820</sup> Shari'a law also imposes a general duty of care upon those persons in positions of responsibility or authority.<sup>821</sup> Islamic law further prohibits self-dealing when a conflict of interest arises, as well as an agent's self-interested use of information.<sup>822</sup> The SCR explicitly prohibits, under any circumstance, the elimination or modification (contracting out) of LLC manager obligations and responsibilities. Any provisions in the LLC agreement to the contrary will be considered void.<sup>823</sup> LLC managers are jointly liable for any damages suffered by the LLC and its shareholders resulting from a breach of the LLC agreement, the SCR or any other fiduciary duty.<sup>824</sup> The SCR also provides for significant criminal penalties in cases where an LLC manager or JSC director breaches a

---

<sup>818</sup>Clifford, *supra* note 810.

<sup>819</sup> MONDHER BELLALAH, *ISLAMIC BANKING AND FINANCE*, 227-228 (Cambridge Scholars Publishing, June 1, 2013).

<sup>820</sup> *Id.* In Islamic law, contracts must be established based on fairness, accountability, trust, and transparency, and those principles form the basis for corporate governance and determine the responsibilities of managers in Islamic law, according to its agency theory. "The essential elements of the agency contract are the same as the general Islamic contract, except the nature and scope of the authority are subject to certain conditions". Quoted from Zelhuda Shamsuddin and Abdul Ghafar Ismail, *Agency Theory in Explaining Islamic Financial Contracts*, 530-545 at [https://www.idosi.org/mejsr/mejsr15\(4\)13/10.pdf](https://www.idosi.org/mejsr/mejsr15(4)13/10.pdf). Fairness is one of the most important principles under the Shari'a law explicitly stated in the Quran. "God orders justice and good conduct and giving to relatives and forbids immorality and bad conduct and oppression" Surah An-Nahl [16: 90]. "O you who have believed, be upholders of justice" Surah An-Nisa [4:135]. Shari'a law also establishes the principle of transparency, requiring all dealings be conducted with the utmost honesty and accuracy. The principle of transparency is imposed by the Quran as follows: "Give full measure whenever you measure, and weigh with a balance that is true, this will be for your own good, and best in the end." Surah Al-Isra [17:35]

<sup>821</sup> *Id.*

<sup>822</sup> *Id.*

<sup>823</sup> Saudi Companies Regulation, Art.165.

<sup>824</sup> Nabil Issa, James Stull & Sayf Shuqair, *An Overview On Directors' Duties and Liabilities in Saudi Arabia*, RISK & COMPLIANCE, [https://s3.amazonaws.com/kslaw-staging/attachments/000/003/988/original/11-16-16\\_Risk\\_\\_Compliance.pdf?1494907302](https://s3.amazonaws.com/kslaw-staging/attachments/000/003/988/original/11-16-16_Risk__Compliance.pdf?1494907302).

fiduciary duty, including imprisonment of up to five years, and a fine of up to five million Saudi Riyals.<sup>825</sup>

Both LLC manager negligence and misconduct can create a cause of action for an individual shareholder to bring a suit for damages. Article 165 of the SCR provides for two types of actions against LLC managers. The first is a shareholder suing on an individual basis for any personal harm suffered as a result of the manager's actions, and the second is a derivative action brought by a shareholder on behalf of the company.<sup>826</sup> Due to the inability of managers to avoid or waive their fiduciary duties, an agreement among shareholders to discharge managers from any liability will not bar a subsequent suit for damages.<sup>827</sup> A general meeting resolution to discharge managers from liability will not, therefore, have any binding legal effect.<sup>828</sup> Further, while a shareholder is compelled to inform the general meeting of shareholders of any individual action he or she intends to bring, the approval of the general meeting is not required.<sup>829</sup> However, in accordance with LLC law, damages are typically the sole remedy a court will provide minority shareholders when they allege majority shareholder breaches. Injunctive relief and specific performance are rarely ordered as judicial or adjudicative remedies under Saudi law.<sup>830</sup> For example, a minority shareholder proving he was unjustly removed from a management position will not receive judicially-ordered reinstatement, but rather be limited to monetary

---

<sup>825</sup> *Id.*

<sup>826</sup> Saudi Companies Regulation, Art.165(2).

<sup>827</sup> *Id.* Art.165(3).

<sup>828</sup> By contrast, U.S. LLC statutes permit owners to restrict or entirely waive the fiduciary duties that managers and controlling members owe to the LLC and other members. For further discussion, see Peter Molk, *Protecting LLC Owners While Preserving LLC Flexibility*, 51 U.C.D. L. REV. 2129, 2190 (2018). Available at [https://lawreview.law.ucdavis.edu/issues/51/5/Articles/51-5\\_Molk.pdf](https://lawreview.law.ucdavis.edu/issues/51/5/Articles/51-5_Molk.pdf).

<sup>829</sup> MESHAL FARAJ, TOWARD NEW CORPORATE GOVERNANCE STANDARDS IN THE KINGDOM OF SAUDI ARABIA: LESSONS FROM DELAWARE, 169, 170 (Sabic Chair for Ifms. 2016).

<sup>830</sup> Clifford, *supra* note 810.

compensation, as expressly provided in the SCR.<sup>831</sup> Additionally, in most cases the court did not examine or discuss whether or not a legitimate business reason existed for removing a minority owner from management, so long as the procedures used by the majority did not violate the SCR or the LLC agreement. In the case (No. 5475/1/G. 1434H), petitioner, a minority LLC shareholder, sought a preliminary injunction preventing majority shareholders from terminating his managerial position, as well as punitive damages, by arguing that the decision violated the majority vote requirement in the LLC agreement.<sup>832</sup> Specifically, petitioner alleged that his removal required the assent of a supermajority of LLC shareholders, constituting at least 75% of the outstanding company shares. As he himself owned 30% of the shares, such a supermajority did not exist.<sup>833</sup> The court disagreed, finding that petitioner had previously sold 5% of his stake to other shareholders, and that the required supermajority had been achieved.<sup>834</sup> Since this majority shareholder decision did not violate the LLC agreement, the court held the petitioner was not entitled to any relief.<sup>835</sup>

In an additional case (No. 8684/1/G. 1435H), the petitioning minority shareholder-employee filed suit against the majority shareholder seeking cancellation of his allegedly wrongful termination as an LLC employee.<sup>836</sup> The minority shareholder alleged his termination violated the LLC agreement, which required supermajority approval for removing managers and expressly held that the supermajority must consist of more than one shareholder, even if that one shareholder held sufficient shares on his own.<sup>837</sup> The court

---

<sup>831</sup> Saudi Companies Regulation, Art.165(1).

<sup>832</sup> Board of Grievances, Case No. 5475/1/G. Appeal Division Decision No. 1935/G, 2015 (1436.H).

<sup>833</sup> *Id*

<sup>834</sup> *Id*

<sup>835</sup> *Id*

<sup>836</sup> Board of Grievances, Case No. 8684/1/G. Appeal Division Decision No. 4105/G, 2015 (1436.H).

<sup>837</sup> *Id*.



found for the petitioner, holding that his termination resolution received support from only one shareholder, in violation of the LLC agreement. The court further ordered injunctive relief, invalidating the termination resolution and directing that the minority shareholder be reinstated as manager.<sup>838</sup> Interestingly, in both of the above-mentioned cases, the court did not discuss whether the terminations were for legitimate business reasons or whether the controlling shareholders breached any fiduciary duty. Instead, the courts focused on whether internal LLC procedures were properly followed. The failure to examine potential breaches of fiduciary duties owed by the majority to the minority is significant, as oftentimes minorities do not participate significantly in company management, lack access to company information and may not receive financial returns. When majority shareholders then attempt to buy out minority shareholders, this power and information imbalance enables them to do so at unreasonably low prices.<sup>839</sup> The lack of established market for minority shares may then leave the minority shareholder locked in, forced to either endure majority abuse or sell at an unfairly low price.<sup>840</sup>

#### 6.4. Judicial Dissolution in The United States

In the U.S., statutory and judicial remedies exist for resolving disputes among LLC members and protecting minority owners from unlawful, abusive, and oppressive majority owner actions.<sup>841</sup> The available remedies include judicial dissolution of the company, as

---

<sup>838</sup> *Id.*

<sup>839</sup> Jeffrey M. Leavitt, *Burned Angels: The Coming Wave of Minority Shareholder Oppression Claims in Venture Capital Start-up Companies*, 6 N.C. J.L. & TECH. 229, 230 (2005). Available at [http://ncjolt.org/wp-content/uploads/2016/09/14\\_6NCJLTech2232004-2005.pdf](http://ncjolt.org/wp-content/uploads/2016/09/14_6NCJLTech2232004-2005.pdf).

<sup>840</sup> *Id.*

<sup>841</sup> Sandra K. Miller, *Minority Shareholder Oppression in the Private Company in the European Community: A Comparative Analysis of the German, United Kingdom, and French Close Corporation*

well as less severe alternative actions a court can order.<sup>842</sup> Virtually all the state-level U.S. LLC statutes provide particular grounds upon which LLC members may pursuing judicial dissolution.<sup>843</sup> The most common ground for dissolution under state LLC statutes is a finding that it is no longer reasonably practicable for the LLC to carry on operations in conformity with its constitutional documents.<sup>844</sup> ULLCA, RULLCA, and the Delaware LLC Act each contain the "not reasonably practicable" standard for when a court may decree dissolution of the company.<sup>845</sup> None of the statutes, however, have elaborated on how a court should apply or interpret the "not reasonably practical" standard when ruling on a petition for dissolution.<sup>846</sup> Case law, however, has analyzed the standard and provided guidance concerning what type of events should warrant dissolution under the standard.<sup>847,848</sup> The LLC statutes differ regarding an LLC's ability to modify the "not reasonably practical" standard in its operating agreement. ULLCA and RULLCA both explicitly forbid an LLC's operating agreement from waiving or eliminating member or

---

*Problem*, 30 CORNELL INT'L L.J. 386, 387 (1997) Available at:  
<http://scholarship.law.cornell.edu/cilj/vol30/iss2/4>

<sup>842</sup> *Id.*

<sup>843</sup> Douglas K. Moll, *Judicial Dissolution of the Limited Liability Company: A Statutory Analysis*, 19 TENN. J. BUS. L. 83, 85 (2017).

<sup>844</sup> *Id.*, at 84.

<sup>845</sup> ULLCA §801(iii) states that "A limited liability company is dissolved, and its business must be wound up, on application by a member or a dissociated member, upon entry of a judicial decree that it is not reasonably practicable to carry on the company's business in conformity with the articles of organization and the operating agreement." RULLCA §701 (a)(4)(B) provides, in similar language, that "A limited liability company is dissolved, and its business must be wound up, on application by a member, the entry by the appropriate court of an order dissolving the company on the grounds that it is not reasonably practicable to carry on the company's activities and affairs in conformity with the certificate of organization and the operating agreement." Delaware LLC Act §18-802 states that "On application by or for a member or manager the Court of Chancery may decree dissolution of a limited liability company whenever it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement."

<sup>846</sup> John D. Cromie & Noel D. Humphreys, *Popular Approaches to Judicial Dissolution of an LLC Under RULLCA "Not Reasonably Practicable" Standard*, US LAW, <https://web.uslaw.org/wp-content/uploads/2013/10/John-D.-Cromie-Noel-D.-Humphreys-USLAW-mag-article.pdf>.

<sup>847</sup> *Id.*

<sup>848</sup> This chapter will later discuss cases which identify the circumstances under which a court will consider the "not reasonably practicable" ground triggered.

manager rights to seek judicial dissolution.<sup>849</sup> By contrast, the Delaware Court of Chancery has held that the state's LLC Act permits LLC agreements to waive the right of a member or a manager to apply for judicial dissolution under §18-802.<sup>850</sup> The court noted that Delaware LLC Act §18-1101(b) clearly states that the Act's policy is to give parties the maximum freedom of contract in the making and enforcing of LLC agreements, unless explicitly forbidden by statute.<sup>851</sup>

A second common statutory ground for seeking judicial dissolution is unlawful, fraudulent, illegal, or oppressive actions by managers or controlling members.<sup>852</sup> This ground implies that managers and members in control have an affirmative duty to avoid acting in an oppressive manner toward the other members.<sup>853</sup> The Delaware LLC Act does not state a specific remedy for the LLC minority member claiming oppression.<sup>854</sup> The statute does, however, explicitly enforce fiduciary obligations which managers and controlling members of an LLC owe to the other members, unless the LLC agreement itself alters those obligations.<sup>855,856</sup> Although the right to seek judicial dissolution is generally confined to the LLC's members, ULLCA also allows disassociated members to seek dissolution in certain circumstances, such as when the disassociated member's interest was not immediately required to be purchased, as in a term company.<sup>857</sup> A member seeking

---

<sup>849</sup> See UNIF. LTD. LIAB. Co. ACT §801 cmt; REVISED UNIF. LTD. LIAB. Co. ACT § 701 cmt.

<sup>850</sup> *R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, C.A. 3803-CC, 2008 WL 3846318 (Del. Ch. Aug. 19, 2008).*

<sup>851</sup> *Id.*

<sup>852</sup> See UNIF. LTD. LIAB. Co. ACT §801(4)(v); REVISED UNIF. LTD. LIAB. Co. ACT § 701(a)(5)(A)(B).

<sup>853</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 701 cmt.

<sup>854</sup> JR. SYMONDS, ET AL., SYMONDS AND O'TOOLE ON DELAWARE LIMITED LIABILITY COMPANIES, 9-59, 9-60 (Aspen Publishers. 2006).

<sup>855</sup> *Id.*

<sup>856</sup> The Delaware approach permits the elimination of fiduciary duties. Still, the implied duties of good faith and fair dealing cannot be waived in LLC agreements.

<sup>857</sup> See UNIF. LTD. LIAB. Co. ACT §801 cmt.

dissolution generally has the burden to prove the circumstances warranting dissolving the company.<sup>858</sup> Even when that burden of proof is satisfied, some LLC statutes give courts the discretion to order alternative remedies, including ordering the purchase of the distributional (economic) interest of the petitioner or another LLC member.<sup>859</sup> What follows are selected cases which illustrate the circumstances that, in practice, trigger the "not reasonably practicable" ground as well as the "unlawful, fraudulent, illegal, or oppressive action" ground for seeking judicial dissolution in the United States.

*A. "Not Reasonably Practicable" As a Ground for Seeking the LLC's Dissolution*

Uniform acts, as well as most state LLC statutes, provide for dissolving the LLC on the ground that it is not reasonably practical for the LLC to carry on operations in conformity with its formation documents. While the statutes themselves do not typically outline what factors or situations courts must consider in deciding whether it is "not reasonably practicable" for an LLC to continue operations, case law provides further interpretation of the term. Courts typically view dissolution as an extreme remedy requiring a strong showing that further operations are no longer feasible.<sup>860</sup> *In Re: Arrow Investment Advisors, LLC*, involved a petition for dissolution filed under Delaware LLCA § 18-802.<sup>861</sup> The petitioner alleged that the LLC's managers failed to satisfy the initial business plan and objectives outlined in the LLC Agreement.<sup>862</sup> The Delaware Court of Chancery dismissed the petition, holding that, for purposes of evaluating a dissolution request on

---

<sup>858</sup> *Id.*

<sup>859</sup> *See e.g.* UNIF. LTD. LIAB. Co. ACT §801 cmt.

<sup>860</sup> *In Re: Arrow Investment Advisors, LLC, C.A. No. 4091-VCS, 2009 WL 1101682 (Del. Ch. April 23, 2009).*

<sup>861</sup> *Id.*

<sup>862</sup> *Id.*

grounds that operations are no longer reasonably practical, the court should look to the broad purposes outlined in the LLC agreement. That is, rather than focusing on specific business plans that any rational shareholder would understand might evolve over time, the court should confine itself to asking whether the LLC was behaving consistently with the general purpose articulated in the LLC agreement.<sup>863</sup> The court noted that judicial dissolution is an extreme remedy, to be granted only in exceptional situations, and dissolving the LLC in question was not warranted simply because the LLC has not attained immediate profitability or that events have not turned out precisely as the LLC's owners initially intended.<sup>864</sup> The court further found that a hair-trigger dissolution measure would disregard market realities and frustrate the expectations of reasonable investors that entities will not be judicially dissolved merely because of unexpected market disturbance.<sup>865</sup>

In *Haley v. Talcott*, however, a Delaware court held that DLLCA § 18-802 should provide relief in the event that an LLC genuinely cannot perform and operate consistently with its chartering agreement.<sup>866</sup> The petitioner in *Haley* was one of two LLC members, each of whom held a 50 percent interest in the company. The petitioner claimed that DLLCA § 18-802 required termination because it was no longer reasonably practicable for the LLC to continue operations in conformity with the LLC founding documents.<sup>867</sup> The court agreed, finding that a deadlock between two 50 percent LLC owners hindered the company from operating as provided for in its funding agreement, and that sufficient grounds for dissolution under the statute therefore existed<sup>868</sup> Defendant Talcott, Haley's

---

<sup>863</sup> *Id.*

<sup>864</sup> *Id.*

<sup>865</sup> *Id.*

<sup>866</sup> *Haley v. Talcott*, 864 A.2d 86, 89 (Del. Ch. 2004).

<sup>867</sup> *Id.*

<sup>868</sup> *Id.*

co-owner, had argued that Haley should be limited to the contractually-provided exit mechanism specified in the LLC agreement, which called for buying out the petitioner and therefore allowing the LLC to continue to exist.<sup>869</sup> The court ultimately rejected this argument, but did note that “[i]f an equitable alternative to continued deadlock had been specified in the LLC Agreement, arguably judicial dissolution under § 18-802 might not be warranted.” The buyout remedy in this case was inadequate, the court held, because it provided no means of relieving the petitioner of his burden as a personal guarantor for the company's mortgage, as he would remain liable for the mortgage debt even after exiting.<sup>870</sup> Accordingly, with no adequate exit mechanism available to the petitioner, judicial dissolution became the only practical deadlock-breaking remedy available.<sup>871</sup> In reaching this decision, the court applied, by analogy, the corporate law principals under Del. Code Ann. tit. 8, § 273, which set forth three pre-requisites for a judicial order of dissolution: (1) two 50 percent owners (2) engaged in a joint venture (3) who are unable to agree on a business direction, each of which the court found present in *Haley*.<sup>872</sup>

In *Fisk Ventures, LLC*, the court identified three factors to be considered when deciding whether a court shall order judicial dissolution under DLLCA § 18-802. The three factors are: (1) whether the members’ vote is deadlocked at the Board level; (2) whether the LLC agreement provides for means other than dissolution to resolve the deadlock; and (3) whether the company’s financial condition permits continued operations.<sup>873</sup> In evaluating the "not reasonably practicable" standard, the court emphasized that no one

---

<sup>869</sup> *Id.*

<sup>870</sup> *Id.*

<sup>871</sup> *Id.*

<sup>872</sup> *Id.*

<sup>873</sup> *Fisk Ventures, LLC v. Segal, C.A. No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008).*

factor is dispositive, and all three do not necessarily need to be present for a court to find the standard for dissolution satisfied.<sup>874</sup> Instead, the factors function merely as guides for evaluating whether it is reasonably practicable for the business to continue in conformity with its specified purpose.<sup>875</sup> The court further noted that a petitioner need not prove that the LLC's purpose has been wholly frustrated in order to meet the standard for dissolution.<sup>876</sup> Ultimately, the court concluded that because the LLC had no office, no employees, no operating profits, no prospects of equity or debt infusion, and a board with a long history of deadlock, more than sufficient reason existed to warrant judicial dissolution.<sup>877</sup> The respondent argued that the petitioner had a "put right" under the LLC agreement, under which a shareholder may force the company to purchase their interest at any time, and at the shareholder's sole discretion.<sup>878</sup> Therefore, respondent contended, the LLC agreement contained a viable alternative exit mechanism to judicial dissolution, and the LLC should continue its operations after buying out petitioner.<sup>879</sup> The court rejected this argument, finding that "it would be inequitable to force a party to exercise its option when that party deems it in its best interests not to do so, and that the court is not permitted to second-guess a party's business decision in choosing whether or not to exercise its previously negotiated option rights."<sup>880</sup>

An entity's financial prosperity does not preclude dissolution when other circumstances warranting the dissolution exist. In *Meyer Natural Foods LLC*, the petitioner argued for judicial dissolution under DLLCA § 18-802 by alleging the LLC's

---

<sup>874</sup> *Id.*

<sup>875</sup> *Id.*

<sup>876</sup> *Id.*

<sup>877</sup> *Id.*

<sup>878</sup> *Id.*

<sup>879</sup> *Id.*

<sup>880</sup> *Id.*

inability to continue its business in conformity with its original agreement.<sup>881</sup> The Court granted the petitioner partial summary judgment, holding that it was no longer reasonably practicable for the company to continue operating in conformity with the LLC agreement's specified purpose.<sup>882</sup> While noting that there was no deadlock between the LLC owners and the company was financially viable, the court nonetheless concluded that "financial viability does not preclude dissolution of a limited liability company".<sup>883</sup>

In *Matter of 1545 Ocean Ave., LLC*, the court held that, for dissolution of an LLC pursuant to Limited Liability Company Law § 702, the petitioning owner must establish, by referencing the terms of the operating agreement, that (1) company management is unwilling or unable to reasonably pursue the entity's stated purpose, or (2) that continuing business operations is financially unfeasible.<sup>884</sup> The court further affirmed that the test for dissolving a company is whether it is "reasonably practicable" for the business to continue operating, and not whether it is impossible.<sup>885</sup> The test therefore does not require a showing that the company's purpose, as stated in the operating agreement, be entirely frustrated. Instead, the "reasonably practicable" standard implies that the company remain capable of pursuing the purpose specified in its operating agreement.<sup>886</sup>

In a few jurisdictions, a court that finds it "unreasonably practicable" for a company to continue operating may order alternative remedies to dissolution, such as a buyout. In *Mizrahi v. Cohen*, the New York Supreme Court found sufficient grounds existed to order an LLC's dissolution.<sup>887</sup> The court nonetheless rejected dissolution as the remedy, instead

---

<sup>881</sup> *Meyer Natural Foods LLC v. Duff*, 2015 WL 3746283 (Del. Ch. June 4, 2015).

<sup>882</sup> *Id.*

<sup>883</sup> *Id.*

<sup>884</sup> *Matter of 1545 Ocean Ave., LLC*, 72 A.D.3d 121 (2d Dept. 2010).

<sup>885</sup> *Id.*

<sup>886</sup> *Id.*

<sup>887</sup> *Mizrahi v. Cohen*, 961 N.Y.S.2d 538 (N.Y. App. Div. 2013).



ordering one member to buy-out the other member. Underscoring a judicial reluctance to order dissolution, the court reasoned, after conferring with the parties, that a buyout option was preferable despite finding that it was no longer reasonably practicable for the LLC to continue operations.<sup>888</sup>

*B. “Oppressive and Unfairly Prejudicial Action” As a Ground for Seeking LLC Dissolution*

LLC judicial dissolution on the grounds of oppressive action by managers or members in control of the company is permitted by LLC statute in twenty-four U.S. states.<sup>889</sup> The oppression doctrine initially developed in the context of closely held corporations, to safeguard the interests of minority owners.<sup>890</sup> A common form of minority oppression is the freeze-out, where majority owners deny minority shareholders certain participatory or financial rights.<sup>891</sup> Examples of such practices include removing a minority owner from company management, denying them distributions, or refusing them access to company records.<sup>892</sup> When LLC minority owners lack exit rights, they are particularly vulnerable to such practices, and judicial oversight is necessary to prevent abuse.<sup>893</sup> Historically, minority oppression first arose in closely held corporations, as minority shareholders, for practical reasons, lacked the ability to sell, demand a buyout, or trigger dissolution.<sup>894</sup> In

---

<sup>888</sup> *Id.* For more information and discussion about this case see Claudia M. Landeo; Kathryn E. Spier, *Irreconcilable Differences: Judicial Resolution of Business Deadlock*, 81 U. CHI. L. REV. 203, 228 (2014)

<sup>889</sup> Douglas K. Moll, *Judicial Dissolution of the Limited Liability Company: A Statutory Analysis*, 19 TENN. J. BUS. L. 87 (2017).

<sup>890</sup> *Id.*, 98.

<sup>891</sup> *Id.*

<sup>892</sup> *Id.*

<sup>893</sup> Sandra K. Miller, *What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company*, 38 HARV. J. ON LEGIS. 431 (2001).

<sup>894</sup> Moll, *supra* note 844, at. 102.

response, U.S. state legislatures and courts over time devised certain avenues of relief for oppressed shareholders in closely held companies.<sup>895</sup> For example, a number of states revised their corporate dissolution statutes to make oppression by controlling shareholders a ground for triggering involuntary dissolution.<sup>896</sup> Because minority members in LLCs are often similarly situated to those in closely held companies, particularly in terms of lacking exit rights, many states' LLC statutes, especially those modelled after ULLCA and RULLCA, now provide similar remedies for minority oppression.<sup>897</sup> ULLCA authorizes judicial dissolution of an LLC when the managers or members in control act in an illegal, fraudulent, oppressive, or unfairly prejudicial manner toward the petitioning member.<sup>898</sup> RULLCA, using similar language, provides for judicial dissolution when managers or members in control (1) have acted or are acting in a manner that is illegal or fraudulent, or (2) have acted or are acting in a manner that is oppressive and was, is, or will be directly detrimental to the petitioner.<sup>899</sup> Under these uniform acts, as well as other, similar U.S. LLC statutes, minority members therefore have a remedy against majority oppression.<sup>900</sup> RULLCA also prohibits LLC owners from agreeing to eliminate this judicial power to order dissolution.<sup>901</sup> Accordingly, even if an LLC agreement stipulates that certain acts are authorized and therefore not illegal, a court under RULLCA could still order dissolution if

---

<sup>895</sup> Douglas K. Moll, *Minority Oppression & (and) the Limited Liability Company: Learning (Or Not) from Close Corporation History*, 40 WAKE FOREST L. REV. 883, 892 (2005).

<sup>896</sup> *Id.*

<sup>897</sup> *Id.*

<sup>898</sup> UNIF. LTD. LIAB. Co. ACT § 801(4)(v).

<sup>899</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 701(a)(5)(A)(B).

<sup>900</sup> Andrea Sullivan & Steven Gladis, *New Remedies for LLC Members, Oppression and Fiduciary Duties Under The Revised Uniform Limited Liability Company Act*, NEW JERSEY LAWYER MAGAZINE 2014. Available at

[https://www.greenbaumlaw.com/media/publication/121\\_NewJerseyLawyer%20April%202014%20AJS%20SBG.pdf](https://www.greenbaumlaw.com/media/publication/121_NewJerseyLawyer%20April%202014%20AJS%20SBG.pdf).

<sup>901</sup> REVISED UNIF. LTD. LIAB. Co. ACT §110(c). This section of RULLCA provides that “An operating agreement may not...vary the power of a court to decree dissolution in the circumstances specified in Section 701(a)(4) and (5).”

it finds the acts served to oppress minority members.<sup>902</sup> An LLC agreement can, however, agree to restrict or eliminate remedies for minority oppression other than dissolution.<sup>903</sup>

In the absence of uniform legislative guidance, U.S. states have adopted various standards for defining oppression or determining when oppressive acts have occurred. New York, for instance, uses a "reasonable expectations" test for identifying and measuring minority oppression. This test, first articulated by the case *in re Kemp & Beatley*, defines oppression as majority conduct which “substantially frustrates expectations that, objectively viewed, were both reasonable under the circumstances and were fundamental to the petitioner's decision to join the venture.”<sup>904</sup> A minority shareholder must therefore demonstrate how his or her reasonable expectations were undermined by majority shareholder or manager actions.<sup>905</sup> Such a standard thus does not require a minority owner to prove fraudulent or unlawful conduct in order to trigger judicial remedies.<sup>906</sup> Other jurisdictions define oppression as burdensome, harsh, wrongful, and dishonest conduct, or an apparent departure from the standards of fair-dealing and contravention of the conditions of fair play.<sup>907</sup> U.S. LLC statutes generally do not specifically define the term "unfairly prejudicial." Historically, though, "unfairly prejudicial" has been adopted as a replacement for "oppressive," with many U.S. states making the change due to concern that courts were interpreting “oppressive” too narrowly. In particular, courts viewed “oppressive” as requiring some indication of bad faith.<sup>908</sup> In *Roemmich v. Eagle Eye Dev., LLC*, the court addressed the legislative intent behind the change, stating that "it is clear

---

<sup>902</sup> REVISED UNIF. LTD. LIAB. Co. ACT §110 cmt.

<sup>903</sup> *Id.*, § 701 cmt.

<sup>904</sup> *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984).

<sup>905</sup> *Brenner v. Berkowitz*, 134 NJ 488 (1993).

<sup>906</sup> *Bonavita v. Corbo*, 692 A.2d 119(N.J. 1996).

<sup>907</sup> *Baur v. Baur Family Farms, Inc.*, 832 NW2d 663 (Iowa Sup. Ct. 2013).

<sup>908</sup> *Roemmich v. Eagle Eye Dev., LLC*, 2006 WL 2433410 (D.N.D.2006)

that the term "unfairly prejudicial" is to be construed liberally to cover virtually any form of unreasonable conduct that has an unfair impact, even though the conduct may not have been fraudulent or illegal and regardless of whether there has been bad faith."<sup>909</sup> Unfairly prejudicial conduct has therefore been deemed to include a broad variety of circumstances, such as conduct amounting to a minority freeze-out, extreme cases of mismanagement, and majority conduct which unfairly deprives minority members of their "reasonable expectations".<sup>910</sup>

While most U.S. states have created dissolution remedies for oppressed minority shareholders in closely held corporations, far fewer have done so with regard to LLCs. For a possible explanation of why this is the case, Professor Douglas Moll offers the following:

*"In the corporation setting, directors and officers traditionally owe fiduciary duties to the corporation itself, but not to individual shareholders. By contrast, in the LLC setting, many jurisdictions indicate (either by statute or judicial decision) that a manager owes a fiduciary duty to an individual member as well as to the LLC itself. See, e.g., RULLCA § 409 (2006). A member's ability to bring a breach of fiduciary duty claim on his own behalf lessens the need for an oppression action, as the oppression action is also designed to allow a minority owner to assert, on his own behalf, that he has been unfairly treated."*<sup>911</sup>

---

<sup>909</sup> *Id.*

<sup>910</sup> Kiriakides v. Atlas Food Sys. & Servs., Inc., 541 S.E.2d 257 (SC 2001)

<sup>911</sup> Douglas Moll, *Minority Oppression in the LLC*, BUS. LAW PROF BLOG (June 29, 2016), [https://lawprofessors.typepad.com/business\\_law/2016/06/minority-oppression-in-the-llc.html](https://lawprofessors.typepad.com/business_law/2016/06/minority-oppression-in-the-llc.html).

As a result, LLC statutes which provide that managers owe a fiduciary duty to individual members, as well as the LLC, provide an alternative vehicle (the fiduciary duty action) for protecting minority owner from oppression.<sup>912</sup> New York, for example, is a state which grants statutory dissolution protections to oppressed minority shareholders in close corporations, but not to LLC members.<sup>913</sup> New York LLC Law § 409(a), on the other hand, states that managers of a manager-managed LLC and members of a member-managed LLC owe fiduciary duties of loyalty and care to individual members, and not just to the LLC.<sup>914</sup> This raises the important question of the remedies available to an individual LLC member suing for breach of fiduciary duty where the LLC statute does not provide a dissolution-for-oppression remedy. In *Matter of Felzen v PEI Mussel Kitchen, LLC*, petitioner, a minority LLC member, brought an action for dissolution, claiming breach of fiduciary duty, looting, and oppression by the majority LLC member, all of which are available grounds for dissolution under the New York Business Corporation Law.<sup>915</sup> Petitioner argued that dissolution should be a proper remedy where an LLC has operated exclusively for the defendant member's benefit.<sup>916</sup> Petitioner further contended that the defendant's dishonest conduct and self-dealing rendered the company incapable of carrying on operations in conformity with the LLC operating agreement.<sup>917</sup> The court rejected the petitioner's claim seeking dissolution.<sup>918</sup> The court held that the "not reasonably practicable" ground for LLC dissolution remains the standard, requiring a showing that (1)

---

<sup>912</sup> *Id.*

<sup>913</sup> *Id.*

<sup>914</sup> N.Y. LTD. LIAB. CO. LAW § 409(a).

<sup>915</sup> *Matter of Felzen v Pei Mussel Kitchen, LLC*, 2017 N.Y. Misc. LEXIS 3263, \*7, 2017 NY Slip Op 31831(U), 4.

<sup>916</sup> *Id.*

<sup>917</sup> *Id.*

<sup>918</sup> *Id.*

the company's management is unable or unwilling to reasonably authorize or promote the specified purpose of the business to be realized or achieved, or (2) continuing the entity's business is financially unfeasible.<sup>919</sup> The petitioner's inability to make either of these two showings caused the court to dismiss the dissolution action for failure to state a claim upon which relief could be granted.<sup>920</sup> This decision made clear that oppressive LLC majority conduct which breaches a fiduciary duty, but nonetheless fails to meet the general standard for dissolution, will not trigger dissolution. This is the case even if the same conduct would warrant dissolution if brought by a minority shareholder in a close corporation.<sup>921</sup> It also remains true that the numerous U.S. LLC statutes which hold that managers or controlling members owe a fiduciary duty to individual members lack a uniform standard for the remedies available once those duties are breached.<sup>922</sup> The most commonly awarded remedies for breach of the fiduciary duty owed to individual LLC members are damages or equitable relief as to that member.<sup>923</sup> A small number of jurisdictions, however, also provide for forced buy-outs of minority members as a remedy for fiduciary violations.<sup>924</sup>

---

<sup>919</sup> *Matter of 1545 Ocean Ave., LLC*, 72 A.D.3d 121 (2d Dept. 2010). *Matter of Felzen v Pei Mussel Kitchen, LLC*, 2017 N.Y. Misc. LEXIS 3263, \*10, 2017 NY Slip Op 31831(U), 6.

<sup>920</sup> *Id.*

<sup>921</sup> For more information see Franklin C. McRoberts, *LLC's Purpose Being Achieved? Business Doing Fine? Good Luck Getting Judicial Dissolution*, FARRELLFRITZ: N.Y. BUS. DIVORCE (October 2, 2017), <https://www.nybusinessdivorce.com/2017/10/articles/grounds-for-dissolution/lles-purpose-achieved-business-fine-good-luck-getting-judicial-dissolution/>.

<sup>922</sup> S. Mark Curwin, *Fiduciary Duty and the Minnesota Limited Liability Company: Sufficient Protection of Member Interests*, 19 WM. MITCHELL L. REV. 989, 1018 (1993). Available at: <http://open.mitchellhamline.edu/wmlr/vol19/iss4/6>.

<sup>923</sup> Thomas M. Madden, *Do Fiduciary Duties of Managers and Members of Limited Liability Companies Exist as with Majority Shareholders of Closely Held Corporations*, 12 DUQ. BUS. L.J. 211, 258 (2010).

<sup>924</sup> *Id.* The buy-out is less common with breaches of fiduciary duties. In *Brodie v. Jordan*, Petitioner, the owner of a minority amount of shares in a close corporation, sued the corporation's two other shareholders, alleging that defendants had frozen her out in violation of defendants' fiduciary duties. The trial court held that the majority shareholders had breached their fiduciary duty and ordered that they purchase the petitioning shareholder's shares. The Massachusetts Appeals Court, however, rejected the awarded remedy, concluding that it was an error to order a buyout. *Brodie v. Jordan*, 66 Mass. App. Ct. 371, 384-387 (2006).

## 6.5. Court Discretion to Order Alternative Remedies for Oppression Claims

As noted, certain U.S. jurisdictions provide for judicial dissolution of an LLC when the managers or members in control act in an oppressive manner toward other LLC members.<sup>925</sup> Dissolution, however, is not the only available remedy for an oppressed LLC member. Several states have provided, through either statute or case law, for less severe remedies as an alternative to dissolution.<sup>926</sup> RULLCA, for example, lists the specific equitable remedies available to an oppressed LLC member.<sup>927</sup> One such remedy is court appointment of one or more provisional managers, if such an appointment would be in the best interest of both the members and the LLC itself.<sup>928</sup> Another important remedy is a court-ordered buyout of the victimized member.<sup>929</sup> The court has the discretion to decree the sale of a member's interests, who is a party to the lawsuit, if such an order would be fair and equitable to all parties under the totality of the circumstances.<sup>930</sup> One issue with buyouts is that most LLC statutes authorizing them as an alternative remedy to dissolution fail to include meaningful valuation guidelines for a court to employ.<sup>931</sup> U.S. courts typically respond to this lack of guidance by referring to statutes and cases dealing with oppressed minority shareholders in the corporate context.<sup>932</sup> RULLCA also states that court authority to order a remedy other than dissolution is a default rule which can be

---

<sup>925</sup> *Supra* note 890.

<sup>926</sup> Paul T. Geske, *Oppress Me No More: Amending the Illinois LLC Act to Provide Additional Remedies for Oppressed Minority Members*, 90 CHI.-KENT L. REV. 185 (2015). Available at: <https://scholarship.kentlaw.iit.edu/cklawreview/vol90/iss1/9>

<sup>927</sup> REVISED UNIF. LTD. LIAB. Co. ACT §701(a)(5)(B).

<sup>928</sup> *Id.*

<sup>929</sup> *Id.*

<sup>930</sup> *Id.*

<sup>931</sup> Sandra K. Miller, *Discounts and Buyouts in Minority Investor LLC Valuation Disputes Involving Oppression or Divorce*, 13 U. PA. J. BUS. L. 607, 684 (2011). Available at: <https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1384&context=jbl>

<sup>932</sup> *Id.*

overridden by a contrary provision in an LLC agreement.<sup>933</sup> Members may therefore agree to eliminate or otherwise restrict a court's authority to craft a lesser remedy, even if that has the effect of limiting the court to the 'all-or-nothing' remedy of dissolution.<sup>934</sup> This choice is consistent with RULLCA's underlying purpose of promoting LLC members autonomy to structure their relationship, rights, and obligations as they see fit, thereby maximizing freedom of contract.<sup>935</sup> The main limit on this freedom is RULLCA's provision preventing an LLC agreement from eliminating a court's authority to order dissolution upon application by an oppressed member.<sup>936</sup>

#### 6.6. Member's Judicial Expulsion

In the U.S., judicial removal of an LLC member from the company can be an effective means of avoiding dissolution, when that member is responsible for the specific harm alleged by the plaintiff. Such involuntary disassociation of a member is permitted under such certain circumstances, such as the member in question breaching his or her fiduciary duty or engaging in other wrongful conduct toward the LLC or an individual member. Both the complaining member and the LLC itself can petition for such a remedy.<sup>937</sup> RULLCA specifically authorizes expulsion as a remedy in certain situations.<sup>938</sup> The revised act states that a court may remove any member whose misconduct adversely and materially affects

---

<sup>933</sup> REVISED UNIF. LTD. LIAB. Co. ACT §701 cmt.

<sup>934</sup> *Id.*

<sup>935</sup> Joan MacLeod Heminway, *The Ties at Bind: LLC Operating Agreements as Binding Commitments*, 68 SMU L. REV. 811 (2015). Available at: <http://scholar.smu.edu/smulr/vol68/iss3/20>

<sup>936</sup> REVISED UNIF. LTD. LIAB. Co. ACT §701 cmt.

<sup>937</sup> Dennis A. Nowak; Caitlin M. Trowbridge, *Involuntary Expulsion of Troublesome Members under Florida's Revised LLC Act*, 91 FLA. B.J. 9, 14 (2017). Available at: <http://www.rumberger.com/90F6E0/assets/files/lawarticles/Involuntary%20Expulsion%20of%20Troublesome%20Members%20Under%20Florida%27s%20revised%20LLC.pdf>

<sup>938</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 602(6)



LLC operations, or who willfully or persistently commits material breaches of member duties or the LLC operating agreement.<sup>939</sup> Expulsion is also permitted when the member's conduct makes it no longer reasonably practicable for the company to carry on operations with that person as a member.<sup>940</sup> Involuntary judicial removal thus serves as a significant and useful alternative to the more intrusive remedy of dissolution.<sup>941</sup> In many cases, removal of the offending member allows the company to move forward while protecting the interests of the remaining members.<sup>942</sup> Some jurisdictions, however, such as New York and Delaware, do not permit judicial expulsion, with dissolution that only available remedy for a company whose operational ability has become compromised.<sup>943</sup> For states which do permit judicial expulsion, the most common permissible grounds are as follows:

#### A. Wrongful Conduct as a Ground for Expulsion

Under RULLCA, judicial expulsion is permitted when the individual LLC member's wrongful conduct materially and adversely affects the company's business activities or operations.<sup>944</sup> Interestingly, the limited number of cases which have addressed judicial expulsion have not offered a clear interpretation of "wrongful conduct" under the relevant LLC statute.<sup>945</sup> Some argue that removal for wrongful conduct is unlikely to generate much controversy because the concept is well-developed under tort law.<sup>946</sup> "Wrongful conduct"

---

<sup>939</sup> *Id.*

<sup>940</sup> *Id.*

<sup>941</sup> Joan MacLeod Heminway, *supra* note 936.

<sup>942</sup> Patrick Shanahan, *Goodbye and Good Luck: Member Dissociation by Judicial Order under Iowa's Revised Uniform Limited Liability Company Act*, 61 DRAKE L. REV. 535, [viii] (2013). Available at: [https://lawreviewdrake.files.wordpress.com/2015/07/irvol61-2\\_shanahan.pdf](https://lawreviewdrake.files.wordpress.com/2015/07/irvol61-2_shanahan.pdf).

<sup>943</sup> *Id.*

<sup>944</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 602(5)(a)

<sup>945</sup> Nowak, *supra* note 938.

<sup>946</sup> *Id.*

can include misappropriation of company assets, taking business opportunities that belong to the company, competition with the company, or, most commonly, breach of the member or manager's fiduciary duties.<sup>947</sup> In *IE Test, LLC v. Carroll*, the New Jersey Supreme Court held that expulsion for “wrongful conduct” under section 24(b)(3)(a) of New Jersey’s LLC law requires a finding that the conduct has materially and adversely affected the company's business.<sup>948</sup> The court further found that the “wrongful conduct” must have already created definitive damage to LLC operations in order to justify expulsion.<sup>949</sup> Once that standard is met, the LLC and its other members will have a cause of action for judicial expulsion.

#### B. Material Breach of LLC Agreement as a Ground for Expulsion

Limited liability companies are mainly creatures of contract.<sup>950</sup> When analyzing and examining an LLC agreement, courts employ the same principles used when interpreting and construing other contracts.<sup>951</sup> A material breach is a breach which excuses the performance of a contract.<sup>952</sup> A mere disagreement between LLC members over the terms of an operating agreement does not necessarily justify expulsion of the dissenting member.<sup>953</sup> Whether any particular contract breach will be deemed 'material' is typically a fact-intensive inquiry.<sup>954</sup> A breach is considered material only if it pertains to a matter of vital significance, undermining the essence of the contract or frustrating the purpose of the

---

<sup>947</sup> DANIEL S. KLEINBERGER, *AGENCY, PARTNERSHIPS, AND LLCs: EXAMPLES AND EXPLANATIONS*, 559 (Aspen Publishers. 2008).

<sup>948</sup> *IE Test, LLC v. Carroll*, 140 A.3d 1268 (N.J. 2016).

<sup>949</sup> *Id.*

<sup>950</sup> *Godden v. Franco*, 2018 Del. Ch. LEXIS 283 (Del. Ch. Aug. 21, 2018).

<sup>951</sup> *Id.*

<sup>952</sup> *Eureka VIII, LLC v. Niagara Falls Holdings, LLC*, 899 A2d 95 (Del Ch 2006).

<sup>953</sup> *IE Test, LLC v. Carroll*, 140 A.3d 1268 (N.J. 2016).

<sup>954</sup> *Kriesch v. Vilsack*, 931 F. Supp. 2d 238 (U.S. Dist. 2013). (*Headfirst Baseball LLC v. Elwood*, 239 F. Supp. 3d 7, 16, 2017 U.S. Dist. LEXIS 30211, \*19.

non-breaching party.<sup>955</sup> Among the factors courts frequently consider in determining the materiality of a breach include: whether the plaintiff is deprived of a benefit reasonably anticipated from the contract, the extent to which the injured party can be compensated for the lost benefit, the possible forfeiture of the defendant, the defendant's ability to cure the breach, such as with reasonable assurances, and the extent to which the defendant complied with the requirements for good faith and fair dealing.<sup>956</sup> In *Headfirst Baseball LLC v. Elwood*, the court held that an LLC member's expulsion was justified by his willful and material breach of the LLC agreement in converting LLC funds to his own benefit, which included a breach of the agreement's requirements for good faith and fair dealing.<sup>957</sup> Material breach of the LLC agreement as a basis for judicial expulsion thus constitutes an important additional protection for LLC members who wish to avoid terminating a successful company based on a particular member's misconduct.

### C. Not Reasonably Practicable as a Ground for Expulsion

RULLCA provides that an LLC member may be judicially expelled for conduct which makes it no longer reasonably practicable for the company to continue operations with the member in question.<sup>958</sup> The statute indicates this is an independent ground for expulsion, separate from the "wrongful conduct" ground discussed previously.<sup>959</sup> The separate

---

<sup>955</sup> *Id.*

<sup>956</sup> *Kriesch v. Vilsack*, 931 F. Supp. 2d 238, 253, 2013 U.S. Dist. LEXIS 40055, \*39-40, 2013 WL 1173978 (D.D.C. March 22, 2013).

<sup>957</sup> *Headfirst Baseball LLC v. Elwood*, 239 F. Supp. 3d 7, 10, 2017 U.S. Dist. LEXIS 30211, \*3 (D.D.C. March 03, 2017).

<sup>958</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 602(5)(c).

<sup>959</sup> Steven R. Klein, 'No Fault' Removal of an LLC Member, 184 N.J.L.J. 154 (2006). Available at <http://m.coleschotz.com/2B7963/assets/files/News/5.pdf>.

grounds likely reflect the legislature’s intent to provide a “no-fault” basis for expulsion.<sup>960</sup> The statutory language therefore suggests expulsion can be justified merely on a showing of inadequate performance, harm to customer relationships, or any other conduct making it not reasonably practicable for the business to continue with the particular member.<sup>961</sup> In *IE Test, LLC v. Carroll*, the court confirmed that RULLCA distinguishes between the showing required for a “wrongful conduct” expulsion and one on “not reasonably practicable” grounds.<sup>962</sup> A “wrongful conduct” expulsion requires the court to find that the member's wrongful conduct has materially affected the business and caused definitive past harm.<sup>963</sup> A "not reasonably practicable" expulsion requires no finding of material harm to the business, and evaluates the member’s continued presence on a prospective basis, as it relates to the company’s future prospects.<sup>964</sup> The court also held that only member conduct relating to the LLC’s business is relevant, as the Legislature did not intend for disputes between members with no bearing on company operations to become a basis for expulsion.<sup>965</sup>

## 6.7. Summary and Analysis

Analysis of current trends in Saudi Arabia concerning corporate dissolution reveals that Saudi legislators and courts prioritize a company’s long-term existence and interests, the societal interest in the company’s continuing operations, and the protection of creditors.

---

<sup>960</sup> *Id.*

<sup>961</sup> *Id.*

<sup>962</sup> *IE Test, LLC v. Carroll*, 226 N.J. 166, 181, 140 A.3d 1268, 1278, 2016 N.J. LEXIS 722, \*29.

<sup>963</sup> *Id.*

<sup>964</sup> *Id.*

<sup>965</sup> *Id.*

The interests of minority shareholders, on the other hand, are given relatively little protection. As discussed previously, individual shareholders seeking a court-ordered dissolution must show that future company operations are financially infeasible. Any lesser showing is virtually certain to result in the court dismissing the petition. While the SCR permits court-ordered LLC dissolution upon a finding that “serious reasons” justify that step, it fails to address situations where majority shareholders’ abusive conduct harms minority shareholders, but the business still remains profitable and able to carry on. Because the SCR does not explicitly provide for a dissolution-for-oppression remedy, courts tend to reject such claims. It is not clear whether abuse of minority shareholders could ever be deemed “serious reasons,” as the cases analyzed show courts rejecting dissolution whenever the company shows substantial profits. The KSA needs explicit remedies for shareholder oppression in order to offset the absence of withdrawal and buy-out rights, and the difficulty of selling minority shares in closely held businesses on the open market.<sup>966</sup> Stronger exit rights could compensate for the lack of oppression-specific rights, as minority shareholders could protect themselves by withdrawing and receiving a fair-value buyout,<sup>967</sup> which they cannot do under current capital rules.<sup>968</sup> Some argue that LLC managers and controlling shareholders owe fiduciary duties to individual shareholder, as well as the LLC, and may this be liable for any breaches. However, the remedies for such a breach are limited to damages, or on occasion the court invalidating the oppressive action by the majority, as other mechanisms such as forced-buyouts are not available.

---

<sup>966</sup> Paul T. Geske, *Oppress Me No More: Amending the Illinois LLC Act to Provide Additional Remedies for Oppressed Minority Members*, 90 CHI.-KENT L. REV. 185, 187 (2015). Available at: <https://scholarship.kentlaw.iit.edu/cklawreview/vol90/iss1/9>.

<sup>967</sup> Douglas K. Moll, *Judicial Dissolution of the Limited Liability Company: A Statutory Analysis*, 19 TENN. J. BUS. L. 8, 103 (2017)

<sup>968</sup> See Chapter 5.

U.S. LLC statutes, on the other hand, provide more protection for minority owners, enabling them to pursue judicial dissolution or other remedies on a much more widespread basis. For example, many LLC statutes provide a dissolution-for-oppression remedy, in addition to “not reasonably practicable” grounds for dissolution. Nevertheless, the absence of withdrawal and/or buyout rights in many U.S. jurisdictions still leaves minority potentially locked-in to a business, and these states should consider adopting dissolution-for-oppression provisions. The “not reasonably practicable” standard for dissolution is not necessarily applicable in many oppression cases, which leaves minority members potentially vulnerable.<sup>969</sup> For example, freeze-out cases where a minority member is removed from a managing position, or denied distributions, will not necessarily create an obstacle to further LLC operations, and thus not meet the requisite legal standard.<sup>970</sup> Partly in response to such situations, the number of U.S. states with current oppression-related dissolution provisions in their LLC statutes has increased from eight to twenty four.<sup>971</sup> These statutory oppression provisions remain an important check on managers or majority members who might otherwise harm the interests of minority owners.<sup>972</sup>

---

<sup>969</sup> Thomas F. Knab, *Oppressive conduct insufficient to support LLC dissolution*, THE DAILY REC. (Sept. 16, 2013), [https://underbergkessler.com/sites/default/files/article\\_docs/Oppressive%20Conduct%20Insufficient%20to%20Support%20LLC%20Dissolution.pdf](https://underbergkessler.com/sites/default/files/article_docs/Oppressive%20Conduct%20Insufficient%20to%20Support%20LLC%20Dissolution.pdf).

*Id.* In *Matter of Nunziata*, a decision from the New York Supreme Court, a member requesting to dissolve an LLC claimed that the two managing members had: failed to allow him to vote and participate in business meetings; excluded him from all aspects and control of the business and engaged in oppressive conduct toward him. The court held that the plaintiff’s allegations of being excluded from the LLC’s operations and affairs were insufficient to establish that it was no longer “reasonably practicable” for the company to carry on its business. The court reasoned that plaintiff failed to show that the company management was unable or unwilling to reasonably permit or promote the stated purpose of the company, or that continuing the business was financially unfeasible.

<sup>970</sup> *Id.*

<sup>971</sup> Douglas K. Moll, *supra* note 968, at 98.

<sup>972</sup> Wayne M. Gazur, *The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role*, 58 LAW & CONTEMP. PROBS. 135, 186 (1995)

In KSA the financial prosperity of a company generally precludes judicial dissolution, regardless of other circumstances. The U.S., on the other hand, permits court-ordered dissolution in various situations, even with profitable companies.<sup>973</sup> Allowing even a profitable entity to continue operations is not always in the best interest of the LLC and its members, especially when majority abuse is taking place. However, dissolution is a major step, and it makes sense that courts would consider it only when alternative remedies are inadequate.<sup>974</sup>

A final important provision in U.S. LLC statutes is the ability of courts to order a member's expulsion in cases of wrongful conduct, LLC agreement breaches, or other actions making it not reasonably practicable for the company to continue operating with the specific member.<sup>975</sup> Judicial expulsion is important for cases where the company could continue operating successfully once the problematic member is removed, making dissolution unwarranted.

The key difference between U.S. and Saudi law concerning remedies for oppressed shareholders is the different emphasis the two place on protection of creditor interests. The critical inquiry is thus whether or not ordering dissolution will hurt creditors more than would a buy-out. In most cases it seems reasonable to assume that allowing share repurchases, whatever the motivation, will prejudice creditor interests, and especially the interests of unsecured creditors, whose only protection is the company's paid-up capital.<sup>976</sup> By contrast, a dissolution and liquidation of company assets gives creditors a preferential

---

<sup>973</sup> See *supra* note 882.

<sup>974</sup> Paul T. Geske, *supra* note 967.

<sup>975</sup> See *Supra* note 938.

<sup>976</sup> Tim Gardner, *Company Purchase of Own Shares under the Companies Bill 1990 - A Sheep in Wolf's Clothing*, 22 *Victoria U. Wellington L. Rev.* 159, 192 (1992).

right to those assets, before any distribution to shareholders or shareholders' personal creditors.<sup>977</sup> Dissolution therefore offers greater protection to creditor interests than does a buy-out. In sum, the dissolution-for-oppression remedy does not undermine creditor protection, as company liquidation rules in the KSA provide creditors the ability to seek repayment in full prior to distributions to any other party.

American corporate law in general and LLC law in particular are decidedly libertarian, preferring default over mandatory rules in almost every area. This emphasis on freedom of contract provides great flexibility in structuring nearly every aspect of an LLC's internal governance. One notable exception to the general preference for default rules is the judicial resolution remedy, which numerous U.S. states and certain uniform LLC acts make mandatory. One must therefore ask whether there is something about judicial resolution that makes a mandatory rule more preferable, even in generally default jurisdictions. Some argue that the history of majority oppression in closed companies justifies this mandatory protection for minority LLC shareholders.<sup>978</sup> Another theory is that such minimum mandatory rules are essential to fill the gaps in the parties' agreement, restricting the potential for abuse when unexpected situations arise.<sup>979</sup> This theory posits that LLCs are long-term relational contracts whose viability often depends on unstated assumptions; the impracticality of devising an agreement which addresses all potential contingencies therefore justifies courts applying mandatory rules to protect these unstated assumptions.<sup>980</sup> Under this view, an optimal LLC statute is one which provides contractual freedom in

---

<sup>977</sup> NABIL SALEH, *THE GENERAL PRINCIPLES OF SAUDI ARABIAN AND OMANI COMPANY LAWS: STATUTES AND SHARI'A*, 102,103 (Namara First Ed. 1981).

<sup>978</sup> Sandra K. Miller, *What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company*, 44 *Am. U. L. Rev.* 465 (1994).

<sup>979</sup> Benjamin Means, *A Contractual Approach to Shareholder Oppression Law*, 79 *Fordham L. Rev.* 1161 (2011). Available at: <http://ir.lawnet.fordham.edu/r/vol79/iss3/13>.

<sup>980</sup> *Id.*, at. 1198.



general, but retains a core of mandatory provisions to avoid majority abuses which the parties may prove unable to contractually protect against.<sup>981</sup> Such a perspective is also mindful that many small-business investors are not particularly sophisticated or experienced, and often invest at the behest of friends or family without considering all possible risks. Mandatory shareholder protections are thus important to guard against potential future oppression.<sup>982</sup>

One common argument against the mandatory law approach among Western scholars is that existing non-legal remedies for minority shareholders lessen the need for explicit legal protections.<sup>983</sup> This argument is made most commonly in the context of family-run businesses. Researchers have documented that company ownership, even in prosperous markets, is most often controlled by a founder or his or her descendants.<sup>984</sup> A family-owned company is also the world's most prevalent form of business, and the argument is that family businesses provide adequate shareholder protection regardless of the legal rights present in a particular jurisdiction.<sup>985</sup> That is, family-run companies adapt to fluctuating legal protections, and in particular create certain informal safeguards that make up for the lack of public regulations in developing countries.<sup>986</sup> <sup>987</sup> The explanation is that family relationships are often, although not always, defined by confidence, trust, open-ended

---

<sup>981</sup> Sandra K. Miller, What Buy-Out Rights, *Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company*, 38 *Harv. J. on Legis.* 413 (2001).

<sup>982</sup> *Id.* at 1163.

<sup>983</sup> Schulze, W. S. and Gedajlovic, E. R., *Whither Family Business?* *Journal of Management Studies*, 47: 191-204. (2010). Available at <http://www.sfu.ca/~erg/research/whither.pdf>.

<sup>984</sup> *Id.*

<sup>985</sup> *Id.*

<sup>986</sup> *Id.*

<sup>987</sup> Bhaumik, S., Driffield, N., Gaur, A., Mickiewicz, T., & Vaaler, P., *Corporate governance and MNE strategies in emerging economies*, *Journal of World Business* (2019). Available at <https://doi.org/10.1016/j.jwb.2019.03.004>.

mutuality, and an appreciation for fairness and impartiality.<sup>988</sup> Family businesses also frequently involve concentrated long-term ownership that promotes managerial motivation and oversight.<sup>989</sup> Such firms also facilitate collaboration among shareholders, and between shareholders and their managerial agents, as family members regularly perform both functions.<sup>990</sup> Further, the likelihood of repeat transactions induces mutual altruism, decreasing the need for legal contract protections.<sup>991</sup>

In Saudi Arabia, family businesses dominate the market, and are especially well-represented among LLCs, the typical first choice entity for family-run companies. An argument can therefore be made that the KSA's lack of LLC shareholder protection is due to the non-legal safeguards which family businesses effectively provide. There are several reasons, however, to question the conclusion that legal protections are not needed. First, long-term firms increase the possibility that minority shares may be ultimately inherited by new owners less known or trusted than the previous owners.<sup>992</sup> The initial company agreement, moreover, may have been specially tailored to those individuals who originally established the business.<sup>993</sup> Shareholders who inherit their shares or otherwise join the company years after its formation may lack the foresight or power to renegotiate the underlying agreement.<sup>994</sup> Second, Saudi LLCs are increasingly the favorite vehicle for non-family businesses, particularly those involving foreign investors, and non-legal protections may therefore prove irrelevant or inadequate to a growing percentage of LLCs. Ultimately, then, the presence of many family-owned LLCs in KSA does not diminish the importance

---

<sup>988</sup> *Id.*

<sup>989</sup> *Id.*

<sup>990</sup> *Id.*

<sup>991</sup> *Id.*

<sup>992</sup> Miller, *supra* note 982.

<sup>993</sup> Means, *supra* note 980.

<sup>994</sup> *Id.*

of establishing adequate legal protections for minority owners. Minority LLC shareholders truly require legal remedies, such as the oppression remedy used in the U.S., to guard against majority abuses.

## Chapter 7: Conclusion

### 7.1. Summary

A comparative study of LLC structures, as well as the available remedies for shareholder disputes and minority oppression, shows significant differences between the U.S. and the KSA. However, LLC exit rights in both jurisdictions involve certain similarities, with both the U.S. and KSA restricting a member's right to sell shares and limiting withdrawal and/or buyout rights.

The analysis from chapter 4 shows that the Saudi legislature, for example, maintains a mandatory ROFR, limiting the ability of minority investors, in particular, to freely sell their shares. Most U.S. LLC statutes permit the free transferability of a member's economic rights, but require member consent for transfers of management rights.<sup>995</sup> One of the most prominent attempts in the new SCR to address majority abuses is its abolition of the requirement that shareholders must approve sales to a third party. Despite this reform, however, minority shareholders still struggle to obtain fair value when selling to a third party, with such a task often proving impossible in practice.

There are several reasons minority shareholders encounter problems trying to sell to third parties. First, there is the issue of determining a fair share price in the absence of a liquid market. Then, even when such a price can be reasonably determined, an outside buyer willing to become a new minority owner can be difficult to find. Potential investors fully understand the risks inherent to minority investments, captured in the expression: "Only a fool would purchase a minority interest in a closed company."<sup>996</sup> Given that reality,

---

<sup>995</sup> See the discussion in Chapter 4.

<sup>996</sup> GREGOR BACHMANN ET AL., *REGULATING THE CLOSED CORPORATION: VOLUME 4 OF EUROPEAN COMPANY AND FINANCIAL LAW REVIEW - SPECIAL VOLUME*, 35 (Walter de Gruyter, 2013).

the existing majority shareholders often prove the only potential buyer for a minority shareholder seeking to liquidate. The U.S. addresses this problem by permitting the LLC itself to repurchase shares, pursuant to shareholder buy-out rights. SCR Article 177, however, forbids such LLC repurchases.<sup>997</sup> The end result is that Saudi majority owners are frequently the only potential buyers for minority shares, leaving the minority owner with little chance of receiving anything close to fair value. The KSA further restricts LLC share sales with the mandatory ROFR, adding an additional barrier to owners hoping to sell their share to an outside buyer.

Chapter 5 illustrated a major difference between the two countries regarding an LLC investor's ability to withdraw at will, with the difference attributable to contrasting approaches to the legal capital rule. The Saudi legal capital rule limits an LLC's ability to return shareholder capital. LLCs may reduce capital in order to make distributions to an individual shareholder seeking to withdraw, but numerous procedural hurdles, including a creditor veto power, increase the transaction costs. The restrictions will at times preclude a company from acquiring a dissenting shareholder's stake, increasing the chances of shareholder deadlock which might affect company operations. The restriction on share buy-backs also makes investments in KSA LLCs less liquid, reducing their attractiveness to external investors. On the other hand, the legal capital rule serves to protect company creditors, and may be viewed as a necessary price to pay for the benefits of limited liability protection. Such a view assumes that LLCs with large debts will otherwise be incentivized to behave opportunistically at the expense of company creditors.<sup>998</sup> Saudi LLC

---

<sup>997</sup> See the discussion in Chapter 5.

<sup>998</sup> Luca Enriques and Jonathan R. Macey, *Creditors Versus Capital Formation: e Case against the European Legal Capital Rules*, 86 Cornell L. Rev. 1165 (2001). Available at: <http://scholarship.law.cornell.edu/clr/vol86/iss6/1>.

shareholders lack the protections enjoyed by KSA partnership members, where any partner can voluntarily withdraw and force the partnership's dissolution. The LLC shareholder also lacks the liquidity advantages of joint stock company shareholders. Both the partnership and joint stock company thus provide investors with remedies for majority oppression not enjoyed by LLC members. A partner's ability to exit and force dissolution provides leverage to keep other partners honest. A joint stock company owner's access to public markets provides a ready ability to sell if the company ceases to be a desirable investment. The lack of LLC shareholder exit rights, combined with the doctrine of majority rule, fails to offer LLC minority shareholders equivalent protection.

There are reasons for this difference in treatment. LLC owners are not given the right to exit at will by voluntarily withdrawing, and thus triggering a buy-out right, because such an ability is viewed as prejudicial to LLC creditors.<sup>999</sup> The right of partners to voluntarily withdraw from a partnership does not present an equivalent concern because partners are personally liable for partnership debts, giving creditors an alternative remedy. Even accounting for this creditor concern, however, the KSA should enact specific statutory guidelines articulating when minority shareholders are entitled to judicial relief.

The discussion from chapter 6 shows that the U.S., in general, provides greater protection for minority shareholders than does the KSA. It is true that U.S. LLC members lack free transferability in management rights and certain limits on withdrawal and/or buy-out rights. Other statutory protections, however, provide U.S. minority owners with stronger rights than their Saudi counterparts. For example, ULLCA and RULLCA both permit LLC members to seek dissolution in the event of specified majority misconduct and

---

<sup>999</sup> See the discussion in Chapter 5.

oppression.<sup>1000</sup> U.S. LLC statutes also enable courts to order remedies less severe than dissolution, providing greater flexibility in addressing minority shareholder concerns. RULLCA lists specific equitable remedies available to an oppressed LLC member,<sup>1001</sup> including court appointment of a provisional manager when it would be in the best interests of both the members and the LLC.<sup>1002</sup> Another important remedial tool is a court-ordered buyout of the victimized member.<sup>1003</sup> Moreover, although some U.S. jurisdictions do not specifically provide a remedy for majority oppression, they do enforce fiduciary duties or standards of care to guide LLC members' conduct, including a duty of loyalty owed to both the LLC and other members.

In contrast to the relatively strong protections for minority shareholders in the U.S., the KSA's new SCR, despite its many amendments to LLC rules, fails to sufficiently address the needs of minority shareholders. This is true despite the widespread problems encountered by minority shareholders under the previous SCR. This paper has shown the obstacles minority shareholders currently face when seeking court-ordered remedies for majority misconduct. As discussed in this research, individual shareholders seeking a court-ordered dissolution must show that future company operations are financially impracticable. Any lesser showing is virtually certain to result in the court dismissing the petition.

The overall analysis in chapters 4 through 6 demonstrates the insufficiency of current protections for KSA LLC minority shareholders. Chapter 4 revealed the difficulty facing an LLC investor seeking to sell to a third party. Chapter 5 demonstrated the legal

---

<sup>1000</sup> UNIF. LTD. LIAB. Co. ACT § 801(4)(v). REVISED UNIF. LTD. LIAB. Co. ACT § 701(a)(5)(A)(B).

<sup>1001</sup> REVISED UNIF. LTD. LIAB. Co. ACT § 701(a)(5)(B).

<sup>1002</sup> *Id.*

<sup>1003</sup> *Id.*

capital rule's role in preventing shareholders from withdrawing at will. Chapter 6 explained the difficulty in obtaining judicial dissolution for any reason other than financial deterioration.

## 7.2. Recommendations

The first proposal for addressing inadequate minority shareholder protection in the KSA is a statute specifying the situations where judicial dissolution is mandatory. The current approach, giving courts wide discretion in deciding when to dissolve a company, has failed to sufficiently protect minority interests. The SCR should also be amended to broaden the remedies a court can order short of dissolution. This expansion is necessary to prevent judges from having to decide between ordering no remedy at all and ordering the harsh remedy of dissolution. In cases involving illegal, oppressive, or fraudulent conduct, a KSA court should have the authority to approve a shareholder's withdrawal, combined with an order that the LLC or remaining shareholders purchase the withdrawing shares at a court-determined price. If the company's capital would be reduced in the event the buyer is the LLC itself, the court would need to ensure that all creditor interests are protected. The ability to order purchases of minority shares at fair market-value prices, combined with mandatory dissolution in cases of extreme majority misconduct, would enable courts to protect minority shareholders far better than they do today. Adopting such reforms in the KSA is especially important due to the illiquidity of minority LLC shares, as well as the uncertainty regarding what duties of loyalty and care LLC managers and shareholders presently owe.



The second proposal is making the ROFR an optional default rule. The mandatory ROFR, as has been discussed, excessively burdens the marketability of LLC shares. It dissuades outsiders from investing the time and money needed for due diligence on shares when they know the ROFR might ultimately block their purchase. The involved parties should be the ones able to decide if they need a ROFR provision, as there is no reason to limit their contractual freedom when no risk to third parties is present. However, making the ROFR an optional default rule would not entirely solve the problems faced by minority shareholders seeking to sell.

A third reform proposal is revising the standard Articles of Association template to provide a menu of options suitable for different objectives and business purposes. Such options are especially critical with regard to valuing shares in the event of an owner withdrawal, either when the LLC's duration period comes to an end, or due to an involuntary withdrawal, such as shareholder death, when there is no third-party offer. As demonstrated in this paper, the typical small Saudi investor virtually always relies on the template form provided by the MoCI. This is true because the KSA lacks an adequate supply of attorneys sophisticated enough to draft specialized Articles of Association. The result is much greater reliance on the standard form than is the case in countries like the United States, where even less sophisticated investors typically have access to capable counsel. A more flexible template, providing a menu of options similar to template LLC agreements available in the U.S., would therefore be especially beneficial in the KSA. The template's valuation provisions are particularly important. The menu options should include choices such as Agreed Value (the Fixed Price), Book Value, Multiple of Book Value, or Appraised Value. By giving the parties the ability to select a valuation method

*before* any shareholder disputes arise, many future problems could be avoided. Another menu option that should also be included in the standard template is a choice to opt out of the ROFR, allowing the parties to understand their ability to select this approach.

### 7.3. Implications for Future Research

This research paper has focused on one particular comparative law approach, examining and contrasting the legal protections for minority shareholders in the KSA and U.S. The overall purpose was developing suggested reforms that might make Saudi Arabia's business environment more attractive for domestic and foreign investors. It is important to note that other comparative law approaches exist within the Western literature, such as the LLSV. The LLSV articles, however, follow a broader approach when comparing legal protections between jurisdictions, beyond merely examining the specific laws themselves.<sup>1004</sup> This literature looks to the roots of the legal system in each country, and in particular the differences between common-law countries, which derive their system from English law, and civil-law countries, which are inspired by French law.<sup>1005</sup><sup>1006</sup> In adopting such a framework, the LLSV maintain that common-law countries are better able to protect shareholder and creditor rights than are civil-law jurisdictions.<sup>1007</sup> One study remarks on the consistently encouraging results for investors in common-law countries.<sup>1008</sup> The paper argues that the weak investor protection in French civil-law countries stems from the remarkably concentrated ownership in large public companies, leaving small investors

---

<sup>1004</sup> Porta, Rafael La, et al. "Law and Finance." *Journal of Political Economy*, vol. 106, no. 6, (1998). Available at <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.615.3690&rep=rep1&type=pdf>.

<sup>1005</sup> *Id.*

<sup>1006</sup> *Id.*

<sup>1007</sup> *Id.*

<sup>1008</sup> *Id.*

less likely to be important.<sup>1009</sup> In such countries, close to half of the ownership in public companies is controlled by the three largest shareholders. The paper contends that this heightened concentration is the result of weaker minority protections, and that strong minority shareholder protections correspond to less concentrated ownership.<sup>1010</sup> Because data shows that French civil-law countries provide weaker protection for minority shareholders than do common law countries, LLSV argues that the two systems are completely distinct legal environments.<sup>1011</sup> LLSV analysis ultimately concludes that strong legal protection for shareholders is a substantial predictor of financial growth.

In future research it will be important to study how Saudi Arabia's need for stronger minority protections relates to the broader relationship between different types of legal systems and financial development. Further study should address at least two specific issues. First, the Saudi legal system and commercial statutes have civil-law origins, but Islamic Law and the principles of *Shari'a* influence and govern all laws in the Kingdom.<sup>1012</sup> The question would be whether the Saudi system can be fairly classified along with other civil-law countries, or are there major differences in investor and creditor protections that differentiate it? Second, most literature focuses on publicly traded companies. Since this study examined shareholder protections in closely-held businesses, what, if any, impact should that have for LLSV findings?

---

<sup>1009</sup> *Id.*

<sup>1010</sup> *Id.*

<sup>1011</sup> *Id.*

<sup>1012</sup> Maren Hanson, *The Influence of French Law on the Legal Development of Saudi Arabia*, 2 *ARAB L.Q.* 272, 291 (1987).

## Bibliography

### Books

- Al-Fawzan, M. (2014). *The General Provisions of Companies, Comparative Study* (First Ed.), 410–411.
- Al-Jabr, M. B. H. (1996). *Saudi Commercial Law* (Fourth Ed.).
- Al-Majed, F. (2012). *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (First Ed.).
- Al-Saghir, A. B. M. (2015). *Administrative Law Between the Egyptian and Saudi Legislatures* (First Ed.).
- Alberta, S. C. (2003). *Limited Liability Companies: A Planning and Drafting Guide*, 106. Ali-Aba.
- Alshabak, F. (2016). *The Theory of Arbitrariness in the Management of Commercial Companies* (First Ed.), 249. Al Manhal.
- Alsunaid, O. N. (2016). *Corporate Governance Regulations and Board Independence: Case Studies from the United States and Saudi Arabia* (First Ed.).
- Bachmann, G., et al. (2013). *Regulating the Closed Corporation: Volume 4 of European Company and Financial Law Review—Special Volume*, 35. Walter de Gruyter.
- Bachner, T. (2009). *Creditor Protection in Private Companies: Anglo-German Perspectives for a European Legal Discourse* (First Ed.), 94–97. Cambridge University Press.
- Baghdadi, K. A. (2012). *Stock Trading and Legal Limitations: Comparative Study* (First Ed.), 344–345.

- Bellalah, M. (2013 June 1). *Islamic Banking and Finance*, 227–228. Cambridge Scholars Publishing.
- Brough, G. H. (2005). *Private Limited Companies: Formation and Management* (Revised Ed.), 83. Sweet & Maxwell.
- Burns, J. G. (2013). *Introduction to Islamic Law: Principles of Civil, Criminal, and International Law Under the Shari'a* (1st Ed.).
- Burton E. (2016). *Business and Entrepreneurship in Saudi Arabia: Opportunities for Partnering and Investing in Emerging Businesses* (Illustrated Ed.), 117. John Wiley & Sons.
- Campbell, D. (1986). *Legal Aspects of Doing Business in the Middle East*, 158. Kluwer; West Pub. Co.
- Cox, J. D., & Hazen, T. L. (2016). *Business Organizations Law* (Fourth Ed.), 25, 508. West Academic Publishing.
- Cumming, D. (2010). *Venture Capital: Investment Strategies, Structures, and Policies* (First Ed.), 400–401. John Wiley & Sons.
- El Rahman, F., & El Sheikh, A. (2003). *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia* (Revised Ed.), 52–53. Cambridge University Press.
- Ercanbrack, J. (2014). *The Transformation of Islamic Law in Global Financial Markets* (First Ed.), 2–6.
- Erdem, H. (2014). *Creditor Protection in Private Equity-Backed Leveraged Buyout and Recapitalisation Practices: A Comparative Analysis of Company and Insolvency Law Mechanisms in England, Germany, and Turkey* (First E.), 36–37. Bwv Verlag.

- Faraj, M. (2016). *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware*, 169–170. Sabic Chair for Ifms.
- Ferran, E., & Ho, L. C. (2014). *Principles of Corporate Finance Law* (Revised Ed.), 8–9, 138–139. Oxford University Press.
- Freer, R. D., & Moll, D. K. (2018). *Principles of Business Organizations* (Second Ed.), 641. West Academic.
- Gabov, A., et al. (2017). *Russian Company Law: The Essentials*, 129–130. АНО "Стартап".
- Gullifer, L. & Payne, J. (2015). *Corporate Finance Law: Principles and Policy* (Second Ed.), 551. Bloomsbury Publishing.
- Hamilton, R. W., et al. (2014). *The Law of Business Organization* (Twelfth Ed.), 1299. West Academic.
- Humphreys, T. A. (2017). *Limited Liability Companies and Limited Liability Partnerships* (First Ed.), 4–43.
- Jelsma, P. L. & Nollkamper, P. E. (2014). *The Limited Liability Company* (Third Ed.). James.
- Joyhan, M. (2008). *The Law of Capital Reduction of Private Companies: Comparative Study* (First Ed.), 47–48.
- Jurinski, J., & Zwick, G. A. (2002). *Transferring Interests in the Closely Held Family Business*, 144–145. Ali-Aba.
- Kay E. (1979). *Legal Aspects of Business in Saudi Arabia* (First Ed.), 21, 22. Graham & Trotman.
- Keatinge, R. R., & Ribstein, L. E. (2017). *Ribstein and Keatinge on Limited Liability*

- Companies* (Second Ed.), App. B–1 Article 10.2. Thomson Reuters.
- Kraakman, R. (2017). *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Third Ed.), 126. Oxford University Press.
- Lerrick, A., & Mian, Q. J. (1982). *Saudi Business and Labor Law*, 161. Graham & Trotman.
- Lewis, D. T., & Chomakos, A. C. (2008). *The Family Limited Partnership Deskbook: Forming & Funding Flps & Other* (Second Ed.), 153.
- Mancuso A., & Laurence, B. K. (2016). *Business Buyout Agreements: Plan Now for All Types of Business Transitions* (Seventh Ed.), 34–35. Nolo.
- Mann, R. A., & Roberts, B. S. (2012). *Essentials of Business Law and the Legal Environment* (Eleventh Ed.), 603. Cengage Learning.
- Mäntysaari, P. (2010). *The Law of Corporate Finance: General Principles and EU Law: Volume III: Funding, Exit, Takeovers* (Illustrated Ed.), 223– 224.
- Maynard, T., & Warren, D. M. (2014). *Business Planning: Financing the Start-Up Business and Venture Capital Financing* (Second Ed.).
- Mercer, Z. C. (2010 August 15). *Buy-Sell Agreements for Closely Held and Family Business Owners*. Peabody Publishing, Lp.
- Niblock, T. (2004). *Saudi Arabia: Power, Legitimacy and Survival* (Illustrated Ed.), 104– 105.
- O'Kane, M. (2013). *Doing Business in Saudi Arabia* (First Ed.), 8– 9. Pratt, S. P. (2003). *The Lawyer's Business Valuation Handbook: Understanding Financial Statements, Appraisal Reports, and Expert Testimony*, 163. American Bar Association.

- Ribstein, L. E., & Keatinge, R. R. (2010). *Ribstein and Keatinge on Limited Liability Companies* (Second Ed.), A-3. West.
- Ribstein, L. E., et al. (2015). *Unincorporated Business Entities* (Fifth Ed.), 288–292. Lexisnexis.
- Risius, J. M. (2007). *Business Valuation: A Primer for the Legal Profession*, 23. American Bar Association.
- Said, Y. (2004). *Al-Wajeez In Saudi Commercial Law* (Seventh Ed.), 32–35. Al-Maktab Al-Arabi Al-Hadeeth.
- Saleh, N. (1981). *The General Principles of Saudi Arabian and Omani Company Laws: Statutes and Shari'a* (First Ed.), 93, 148. Namara Publication Limited.
- Shenkman, M. M., et al. (2003). *Starting a Limited Liability Company* (Second Ed.), 114. Wiley.
- Siems, M. & Cabrelli, D. (2018). *Comparative Company Law: A Case-Based Approach* (First Ed.), 412–415.
- Solaim, S. A. (1970). *Constitutional and Judicial Organization in Saudi Arabia* (First Ed.), 7–8.
- Spadaccini, M. (2011). *Ultimate Llc Compliance Guide: Covers All 50 States* (First Ed.), 124.
- Stanton, A. L., et al. (2012). *Cultural Sociology of the Middle East, Africa, and Asia: An Encyclopedia*. Sage.
- Symonds, J., et al. (2006). *Symonds and O'Toole on Delaware Limited Liability Companies*, 9–60. Aspen Publishers.
- Taha, M. K. (1988). *Businesses and Traders, Commercial Companies* (First Ed.), 551–



552.

Truman, G. R. (2017). *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses* (Fifth Ed.), 576–577.

Vogel, F. E. (2000). *Islamic Law and Legal System: Studies of Saudi Arabia*, 43–44.  
Brill.

Vogel, F. E. (2011). *A Case Comparison: Islamic Law and the Saudi and Iranian Legal Systems*, in *6 Islam: Muslims and Modernity: Culture and Society Since 1800* (Robert W. Hefner, Ed.), 302–303.

Youns, A. (1990). *Commercial Companies: Limited Liability Companies, Joint Stock Companies, And Partnerships Limited by Shares* (First Ed.), 79.

Yuhas, M. A. & Manterfield, E. A. (2009). *Discounting and Valuing Family Limited Partnership Interests, and Buy-Sell Agreements* (First Ed.) 26–27.

### **Articles**

Ayres, I., & Gertner, R. (1989). Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules. *Yale Law Journal*, 99, 87.

Ayres, I. & Gertner, R. (1999). Majoritarian vs. Minoritarian Defaults. *Stan. L. Rev.*, 51, 1591.

Bebchuk, L. A., & Hamdani, A. (2002). Optimal Defaults for Corporate Law Evolution. *Nw. U. L. Rev.*, 96, 489.

Bishop, C. G. (1995). The Uniform Limited Liability Company Act: Summary & (and) Analysis. *Bus. Law.*, 51, 80.

Bishop, C. G. (1995). Treatment of Members upon Their Death and Withdrawal from a

- Limited Liability Company: The Case for a Uniform Paradigm. *Stetson L. Rev.*, 25, 255, 310.
- Bolodeoku, I. O. (2005). Contractarianism and Corporate Law: Alternative Explanations To the Law's Mandatory and Enabling/Default Contents. *Int'l & Comp. L.*, 13, 433.
- Brand, J. L., (1986). Aspects of Saudi Arabian Law and Practice. *B. C. Int'l & Comp. L. Rev.*, 17(18.9), 1, 46.
- Drinker, Jr., H. S. (1930). The Preemptive Right of Shareholders to Subscribe to New Shares. *Harv. L. Rev.*, 43, 586.
- Dugar, M. R. K. (2010). Minority Shareholders Buying Out Majority Shareholders—An Analysis. *Nat'l L. Sch. India Rev.*, 22, 105, 110.
- Enriques, L., & Macey, J. R. (2001). Creditors Versus Capital Formation: e Case against the European Legal Capital Rules. *Cornell L. Rev.*, 86, 1165.
- Farrar, L. W., & Hamill, S. P. (1998). Dissociation from Alabama Limited Liability Companies in the Post Check-the-Box-Era. *Ala. L. Rev.*, 49, 909, 940.
- Gardner, T. (1992). Company Purchase of Own Shares under the Companies Bill 1990—A Sheep in Wolf's Clothing. Victoria U. *Wellington L. Rev.*, 22, 159, 192.
- Gazur, W. M. (1995). The Limited Liability Company Experiment: Unlimited Flexibility, Uncertain Role. *Law & Contemp. Probs.*, 58, 135, 186.
- Geske, P. T. (2015). Oppress Me No More: Amending the Illinois LLC Act to Provide Additional Remedies for Oppressed Minority Members. *Chi.-Kent L. Rev.*, 90, 85, 185, 187.
- Heminway, J. M. (2015). The Ties at Bind: LLC Operating Agreements as Binding

- Commitments. *SMU L. Rev.*, 68, 811.
- Illig, R. C. (2006). Minority Investor Protections as Default Norms: Using Price to Illuminate the Deal in Close Corporations. *Am. U. L. Rev.*, 56, 275, 366.
- Kalinka, S. (2006). Dissociation of a Member from a Louisiana Limited Liability Company: The Need for Reform. *La. L. Rev.*, 66, 365.
- Landeo, C. M., & Spier, K. E. (2014). Kathryn E. Spier, Irreconcilable Differences: Judicial Resolution of Business Deadlock. *Chi. L. Rev.*, 81, 203, 228.
- Leacock, S. J. (2011). Share Transfer Restrictions in Close Corporations as Mechanisms for Intelligible Corporate Outcomes. *Faulkner L. Rev.*, 3, 109.
- Leavitt, J. M. (2005). Burned Angels: The Coming Wave of Minority Shareholder Oppression Claims in Venture Capital Start-up Companies. *N.C. J. L. & Tech.*, 6, 229–230.
- Listokin, Y. (2011). What Do Corporate Default Rules and Menus Do—An Empirical Examination. *J. Empirical Legal Stud.*, 6, 279.
- McDonnell, B. H. (2007). Sticky Defaults and Altering Rules in Corporate Law. *S.M.U. L. Rev.*, 60, 383–384.
- McLaughlin, J. G. (1993). The Limited Liability Company: A Prime Choice for Professionals. *Ala. L. Rev.*, 45, 231, 260.
- Means, B. (2011). A Contractual Approach to Shareholder Oppression Law. *Fordham Law Review*, 79, 1161.
- Miller, S. K. (1994). What Remedies Should be Made Available to the Dissatisfied Participant in a Limited Liability Company. *Am. U. L. Rev.*, 44, 465, 536.
- Miller, S. K. (1997). Minority Shareholder Oppression in the Private Company in the

- European Community: A Comparative Analysis of the German, United Kingdom, and French Close Corporation Problem. *Cornell International Law Journal*, 30, 381, 386–387, 428.
- Miller, S. K. (2001). What Buy-Out Rights, Fiduciary Duties, and Dissolution Remedies Should Apply in the Case of the Minority Owner of a Limited Liability Company. *Harv. J. on Legis.*, 38, 413, 431.
- Miller, S. K. (2003). A New Direction for LLC Research in a Contractarian Legal Environment. *S. Cal. L. Rev.*, 76, 351, 432.
- Miller, S. K. (2011). Discounts and Buyouts in Minority Investor LLC Valuation Disputes Involving Oppression or Divorce. *U. Pa. J. Bus. L.*, 13, 607, 684.
- Molitor, M. K. (2009). Eat Your Vegetables (Or at Least Understand Why You Should): Can Better Warning and Education of Prospective Minority Owners Reduce Oppression in Closely Held Businesses. *Fordham J. Corp. & Fin. L.*, 14, 491, 596.
- Molk, P. (2018). Protecting LLC Owners While Preserving LLC Flexibility. *U. C. D. L. Rev.*, 51, 2129, 2190.
- Moll, D. K. (2005). Minority Oppression & the Limited Liability Company: Learning (Or Not) from Close Corporation History. *Wake Forest Law Review*, 40, 883, 892.
- Moll, D. K. (2017). Judicial Dissolution of the Limited Liability Company: A Statutory Analysis. *Tennessee Journal of Business Law*, 19, 8, 83, 85, 87, 103.
- Nowak, D. A., & Trowbridge, C. M. (2017). Involuntary Expulsion of Troublesome Members under Florida's Revised LLC Act. *Fla. B. J.*, 91, 9, 14.
- Paedreas, T. A. (2004). A Systems Approach to Corporate Governance Reform: Why

- Importing U.S. Corporate Law Isn't the Answer. *W. & Mary L. Rev.*, 45, 1055.
- Santire, S. (1981). Participation and Registration in the Kingdom of Saudi Arabia. *Int'l L.*, 15, 567–568.
- Saulsbury, A. O. (2011). Catch You on the Flip Side: A Comparative Analysis of the Default Rules on Withdrawal from a Louisiana Limited Liability Company. *La. L. Rev.*, 71, 675.
- Sayen, G. (2003). Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia. *U. PA J. Int'l Econ. L.*, 24, 905, 958.
- Shanahan, P. (2013). Goodbye and Good Luck: Member Dissociation by Judicial Order under Iowa's Revised Uniform Limited Liability Company Act. *Drake L. Rev.*, 61, 535, [viii].
- Velasco, J. (2006). The Fundamental Rights of the Shareholder. *U.C. Davis L. Rev.*, 40, 407, 468.
- Wise, R. K., Szygenda, & A. J., Lillard, T. F. (2010). First-Refusal Rights under Texas Law. *Baylor L. Rev.*, 42, 433.
- Wood, J. (2007). Director Duties and Creditor Protections in the Zone of Insolvency: A Comparison of the United States, Germany, and Japan. *Penn State International Law Review*, 26(1), Article 5, 139.
- Zarban, A. N. (2017). Corporate Governance and Board of Directors Responsibility in Appointing Senior Managers: A Case in Saudi Arabia. *Int'l J. Bus. & Mgmt.*, 13, 183.

## **Academic Thesis**

- Al-Zahran, Y. (2013). Rights of Shareholders Under Saudi Company Law (unpublished dissertation). Brunel University.
- Almadani, M. H. (2011). The Reform of Minority Shareholder Protection in Saudi Arabia and Dubai in Private Companies (unpublished thesis). The University of Leeds, 120, 121.
- Alrasheed, B. (2014). Corporate Governance of The Saudi Arabian Publicly Traded Companies: An Appraisal and Proposals for Improvement (unpublished dissertation). University of Pittsburgh.
- Vicente, L. (2014). The Requirement of Consent for the Transfer of Shares and Freedoms of Movement: Toward the Liberalization of Private Limited Liability Companies (unpublished dissertation). European University Institute.

## **Legislations**

### **Saudi Arabian Legislations**

- Law of Procedure Before Sharia Courts, Royal Decree No. M/1 dated 2013.
- The Basic Law of Governance of Kingdom of Saudi Arabia, issued by Royal Order No.A/90 of 1992.
- The Law of Judiciary, Royal Decree No. M/78 dated 2007.
- The Law of the Board of Grievances, Royal Decree No. M/78 dated 2007.
- The Law of the Council of Ministers, issued by Royal Order No. A/13 of 1993.
- The Law of the Shura Council, issued by Royal Order No. A/91 of 1992.
- The Saudi Commercial Court Regulation, Issued by Royal Decree No. 32 dated 1931.

The Saudi Companies Regulation, issued by the Royal Decree No: M/6 dated 1965

The Saudi Companies Regulations, issued by Royal Decree No. M/3 dated 2015.

### **United States Legislations**

The Delaware Limited Liability Company Act

The Revised Uniform Limited Liability Company Act

The Uniform Limited Liability Company Act

### **Cases**

#### **Saudi Arabian Cases**

Board of Grievances, Case No. 1447/1/G, Appeal Division Decision No. 3/T/299,  
2005 (1426H).

Board of Grievances, Case No. 299/1/G, Appeal Division Decision No. 96/T/3, 2003  
(1424H).

Board of Grievances, Case No. 792/2/G, Appeal Division Decision No. 3/T/142, 2000  
(1421H).

Board of Grievances, Case No. 43/1/G, Appeal Division Decision No. 3/T/238, 1998  
(1419H).

Board of Grievances, Case No. 544/2/G, Appeal Division Decision No. 7/ES/592,  
2009 (1430H).

Board of Grievances, Case No. 227/4/T. Appeal Division Decision No. 24/T/3, 2001  
(1421.H).

Board of Grievances, Case No. 261/1/G. Appeal Division Decision No. 126/T/3, 2001  
(1421.H).

Board of Grievances, Case No. .2906/2/G. Appeal Division Decision No. 622/T/7,  
2007 (1428.H).

Board of Grievances, Case No. 167/2/G. Appeal Division Decision No. 224/T/3, 2001  
(1422.H).

Board of Grievances, Case No. 381/2/G. Appeal Division Decision No. 283/2/G,  
1994 (1415.H).

Board of Grievances, Case No. 5475/1/G. Appeal Division Decision No. 1935/G,  
2015 (1436.H).

Board of Grievances, Case No. 8684/1/G. Appeal Division Decision No. 4105/G,  
2015 (1436.H).

Board of Grievances, Case No. 788/3/G, Appeal Division Decision No. 3/T/489, 2006  
(1427H).

### **United States Cases**

Northeast Communications of Wisconsin, Inc. v. CenturyTel, Inc., 516 F.3d 608 (7th  
Cir. 2008)

Minn. Invco of RSA # 7, Inc. v. Midwest Wireless Holdings, LLC, 903 A.2d 786,  
787 (Del. Ch. 2006).

R & R Capital, LLC v. Buck & Doe Run Valley Farms, LLC, C.A. 3803-CC, 2008  
WL 3846318 (Del. Ch. Aug. 19, 2008).

In Re: Arrow Investment Advisors, LLC, C.A. No. 4091-VCS, 2009 WL 1101682



(Del. Ch. April 23, 2009).

Haley v. Talcott, 864 A.2d 86, 89 (Del. Ch. 2004).

Fisk Ventures, LLC v. Segal, C.A. No. 3017-CC, 2008 WL 1961156 (Del. Ch. May 7, 2008).

Meyer Natural Foods LLC v. Duff, 2015 WL 3746283 (Del. Ch. June 4, 2015).

Matter of 1545 Ocean Ave., LLC, 72 A.D.3d 121 (2d Dept. 2010).

Mizrahi v. Cohen, 961 N.Y.S.2d 538 (N.Y. App. Div. 2013).

In re Kemp & Beatley, Inc., 473 N.E.2d 1173, 1179 (N.Y. 1984).

Brenner v. Berkowitz, 134 NJ 488 (1993).

Bonavita v. Corbo, 692 A.2d 119 (N.J. 1996).

Baur v. Baur Family Farms, Inc., 832 NW2d 663 (Iowa Sup. Ct. 2013).

Roemmich v. Eagle Eye Dev., LLC, 2006 WL 2433410 (D.N.D.2006)

Kiriakides v. Atlas Food Sys. & Servs., Inc., 541 S.E.2d 257 (SC 2001)

Matter of Felzen v Pei Mussel Kitchen, LLC, 2017 N.Y. Misc. LEXIS 3263, \*7, 2017 NY Slip Op 31831(U), 4.

IE Test, LLC v. Carroll, 140 A.3d 1268 (N.J. 2016)

Godden v. Franco, 2018 Del. Ch. LEXIS 283 (Del. Ch. Aug. 21, 2018).

Eureka VIII, LLC v. Niagara Falls Holdings, LLC, 899 A2d 95 (Del Ch 2006).

Kriesch v. Vilsack, 931 F. Supp. 2d 238 (U.S. Dist. 2013)