Towards Legal Reform of Saudi Law of Directors' Duties and of Enforcement by Derivative Action

Abdullatif Mohammed Aleshaikh

LL.M (Distinction) and LL.B (Hons.)

Submitted in Fulfilment of the Requirement for the Degree of Doctor of Philosophy in Law

School of Law

College of Social Sciences

University of Glasgow

June 2018

Abstract

Directors' duties of care and loyalty and their enforcement by derivative action, are important elements in the company law system. Such mechanisms are introduced to ensure that directors are subject to a satisfactory level of accountability and control while managing a company. This research employed the comparative law approach to identifying problems in, and to proposing reform for, the Saudi Arabian law of directors' duty to act with care and in good faith in the company's general interests, and to avoid conflicts of interest, with particular focus on the corporate opportunities and self-dealing transactions and the Saudi law of derivative actions.

The main objective of this study was to propose a reform of Saudi law of directors' duties and of derivative actions. By using the company law of the United Kingdom (UK) as benchmark, this study evaluates the clarity, certainty and accessibility of Saudi law and identifies weaknesses and deficiencies. The feasibility of transplanting selective legal ideas and rules from the UK company law to its Saudi counterpart in order to develop a framework for legal reform in Saudi Arabia is examined.

The argument here is that the Saudi law of directors' duties of care and loyalty and derivative actions suffers from serious deficiencies, despite the introduction of the new Companies Law of 2015. While the new Saudi Corporate Governance Regulations 2017 have tackled some issues in the areas of directors' duties, there is still room for improvement. The uncertainty in the law of directors' duties and enforcement is sufficient in itself to justify the reform of law. Moreover, the limits of other legal and non-legal mechanisms of accountability in the Saudi context suggest that alternative mechanisms would not adequately ensure the accountability of directors.

Throughout the examination of the feasibility of reform by way of legal transplantation, the study takes into account that the UK legal model is only transferable if it can be adapted to fit within the institutional structure and legal environment in Saudi Arabia. This is necessary to ensure proper reception of foreign rules by the new environment of the host country. The finding is that transferability of most UK legal models and rules is feasible. Throughout this consideration of a reform agenda for the Saudi law of directors' duties and derivative actions, the research has been guided by a policy that requires striking a balance between the need to increase directors' accountability and the need to protect the directors' exercise of their managerial authority.

Contents

Tables

Abbreviations

AGM	Annual General Meeting
BGL 1982	Board of Grievances Law (Saudi)
BGL 2007	Board of Grievances Law (Saudi)
BLG 1992	Basic Law of Governance (Saudi)
CA 1985	Companies Act 1985 (United Kingdom)
CA 2006	Companies Act 2006 (United Kingdom)
CCL 1931	Commercial Court Law (Saudi)
CEO	Chief Executive Officer
CGC 2016	Corporate Governance Code (United Kingdom)
CGRs 2006	Corporate Governance Regulations 2006 (Saudi)
CGRs 2017	Corporate Governance Regulations 2017 (Saudi)
CL 1965	Companies Law 1965 (Saudi)
CL 2015	Companies Law 2015 (Saudi)
CLRSG	Company Law Review Steering Group (United Kingdom)
CMA	Capital Market Authority (Saudi)
CML 2003	Capital Market Law 2003 (Saudi)
CPL 2013	Criminal Procedure Law 2013 (Saudi)
CRSD	Committee for the Resolution of Securities Disputes (Saudi)
EGM	Extraordinary General Meeting
FCA	Financial Conduct Authority (United Kingdom)
GOSI	General Organisation for Social Insurance (Saudi)
IPO	Initial Public Offering
JL 1975	Judiciary Law 1975 (Saudi)
JL 2007	Judiciary Law 2007 (Saudi)
LR	Listing Rules (United Kingdom)
LRs 2004	Listing Rules 2004 (Saudi)
MARs 2007	Merger and Acquisition Regulations 2007 (Saudi)
MOCI	Ministry of Commerce and Investment (Saudi)
Model Articles	Model Articles for Public Companies (United Kingdom)
PBUH	peace be upon him
PIF	Public Investment Fund (Saudi)
PPA	Public Pension Agency (Saudi)
SAR	Saudi Riyal

SPL 2000	Sharia Procedure Law 2000 (Saudi)
SPL 2013	Sharia Procedure Law 2013 (Saudi)
Table A	Table A articles of association (United Kingdom)
USD	United States Dollar

Legislations

United Kingdom legislations

Statutes

Companies Act 1985

Companies Act 2006

Insolvency Act 1986

Codes and Regulatory Rules

Civil Procedure Rules

Corporate Governance Code 2016

Listing Rules

Saudi Arabian Legislations

Statutes

Basic Law of Governance 1992

Board of Grievances Law 1982

Board of Grievances Law 2007

Capital Market Law 2003

Commercial Court Law 1931

Companies Law 1965

Companies law 2015

Criminal Procedure Law 2013

Judiciary Law 1975

Judiciary Law 2007

Sharia Procedure Law 2000

Sharia Procedure Law 2013

Codes

Corporate Governance Regulations 2006

Corporate Governance Regulations 2017

Listing Rules 2004

Merger and Acquisition Regulations 2007

Executive Decrees and Orders

Council of Ministers Decree No. 241 dated 23/6/1987

Council of Minsters' Decrees No. 17 dated 30/10/1981

Council of Minsters' Decrees No.80 dated 22/1/1985

Decree of Minster of Commerce and Investment No.423 dated 6/2/1989

High Order No. 23975 dated 22/3/ 2015

High Order No. 23975 dated 22/3/ 2015

Royal Decree No. (M/78) dated 01/10/2007

Royal Decree No.63 dated 23/7/1987

Royal Order No. (A/20) dated 30/11/2014

Cases

Aberdeen Rail Co v Blaikie Brothers (1843-60) All ER Rep 249

Aronson v. Lewis (1984) 473 A2d 805

Automatic Self-Cleansing Filter Syndicate Co. Ltd. v Cuninghame (1906) 2 Ch 34

Bairstow & Ors v Queens Moat Houses plc (2002) BCC 91

Bamford v Harvey (2013) Bus LR 589

Barrett v Duckett (1995) 1 BCLC 243

Boardman v Phipps (1967) 2 AC 46

Boulting v Association of Cinematograph, Television and Allied Technicians (1963) 2 QB 606

Breckland Group Holdings Ltd. v London & Suffolk Properties Ltd (1988) 4 BCC 542

Bristol and West Building Society v Mothew (1997) Ch 1

Charitable Corporation v Sutton (1742) 2 Atkyns 400

Charterbridge Corporation Ltd. v Lloyds Bank Ltd. (1970) Ch 62

Cobden Investments Limited v RWM Langport Ltd (2008) EWHC 2810

Cook v Deeks (1916) 1 AC 554

Cullen Investments Ltd v Brown (2015) BCC 539

Daniels v Daniels (1978) Ch 406

Edwards and Another v Halliwell (1950) 2 All ER 1064

Equitable Life Assurance Society v Bowley (2003) BCC 829

Foss v Harbottle (1843) 67 ER 189

Franbar Holdings Ltd v Patel (2008) BCC 885

Fulham Football Club Ltd & Ors v Cabra Estates plc (1992) BCC 836

George Bray v John Rawlinson Ford (1896) AC 44

Greenhalgh v Arderne Cinemas (1951) Ch 286

Hook v Sumner (2016) BCC 220

Hutton v West Cork Railway Co (1883) 23 ChD 654

Iesini v Westrip Holdings Ltd (2010) BCC 420

Imperial Mercantile Credit Association v Coleman (1871) L.R. 6 Ch App 558

Jaybird Group Ltd v Greenwood (1986) BCLC 319

John Shaw and Sons v Shaw and Shaw (1935) 2 KB 113

Kleanthous v Paphitis (2012) BCC 676

Lagunas Nitrate Company v Lagunas Syndicate (1899) 2 Ch 392

Madoff Securities International Limited (In Liq.) v Raven (2013) EWHC 3147

Marshall's Valve Gear Co. Ltd. v Manning, Wardle & Co. Ltd. (1909) 1 Ch 267

Norman & Anor v Theodore Goddard & Ors (1992) BCC 14

North-west Transportation v Beatty (1887) 12 AppCas 589

Nurcombe v Nurcombe (1985) 1 WLR 370

O'Donnell v Shanahan (2009) BCC 822

Parke v Daily News Ltd. (1961) Ch 927

Quarter Master UK Ltd v Pyke (2004) EWHC 1815

Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker (2000) 1 BCLC 523

Re Barings plc and others Secretary of State for Trade and Industry v Baker (1998) All ER (D) 659

Re Bhullar Bros Ltd (2003) BCC 711

Re Bradcrown Ltd, Official Receiver v Ireland (2001) 1 BCLC 547

Re Brazilian Rubber Plantations and Estates Ltd (1911) 1 Ch 425

Re Brian D Pierson Ltd. (1999) BCC 26

Re Cameron's Coalbrook Railway Co (1854) 18 Bev 339

Re Cardiff Savings Bank (Marquis of Bute's Case) (1892) 2 Ch 100

Re City Equitable Fire Insurance Company Ltd. (1925) Ch 407

Re Continental Assurance Co of London plc (in liquidation) (No 4) Singer v Beckett (2007) 2 BCLC 287

Re D'Jan of London Ltd (1993) BCC 646

Re Kirby Coaches Ltd (1991) BCC 130

Re Paycheck Services 3 Ltd (2009) STC 1639

Re Sherborne Associates Ltd. (1995) BCC 40

Re Smith and Fawcett Ltd. (1942) Ch 304

Re Walt Disney Co. Derivative Litigation (2005) 907 A2d 693

Re Westmid Packing Services Ltd (No. 3) (1998) BCC 836

Re Wishart (2009) CSOH 20

Regal (Hastings) Ltd. v Gulliver (1967) 2 AC 134

Regentcrest plc (in liq.) v Cohen & Anor (2001) BCC 494

Richmond Pharmacology Ltd v Chester Overseas Ltd (2014) Bus LR 1110

Secretary of State for Trade and Industry v Tjolle (1998) BCC 282

Singh v Singh (2013) EWHC 2138

Smith v Croft (1986) 1 WLR 580

Smith v Croft (No.2) (1988) Ch 144

Smith v Van Gorkom (1985) 488 A2d 858

Stainer v Lee (2011) BCC 134

Stimpson v Southern Private Landlords Association (2010) BCC 387

Towers v premier Waster Management Ltd (2012) BCC 72

Wallersteiner v Moir (No. 2) (1975) QB 373

Wishart v Castlecroft Securities Ltd (2009) CSIH 65

Saudi Arabian Cases

Board of Grievances, Case No. 1129/3/Q, Appeal Division Decision No. 7/AS/838, 2010 (1431H)

Board of Grievances, Case No. 592/1/S, Appeal Division Decision No. 7/V/940, 2007(1429H)

Board of Grievances, Case No. 6504/1/Q, Appeal Division Decision No. 1/AS/331, 2010 (1431H)

Board of Grievances, Case No. 725/1/Q, Appeal Division Decision No. 4/T/85, 1996 (1415H)

Acknowledgements

Foremost, all praises and thanks be to Allah Almighty for providing me with the strength, peace of mind, good health and His blessing to complete this study.

I should like to express my sincere thanks to Professor Iain MacNeil to whom I owe a massive debt of gratitude for his valuable advice and guidance, helpful comments, and unreserved support during the period of my research. I am highly indebted to Dr Matteo Solinas for his fruitful comments and valuable suggestions on the earlier drafts of this research. I extend my sincere thanks to the University of Glasgow and the School of Law for their constant support and guidance.

I should like to express my deep gratitude towards my family for their encouragement which assisted me in finalising this work: my parents, the most precious gift from Allah, for their endless love and prayers; my beloved and supportive wife, Nouf, who is always by my side, especially in times when I needed her most and she encouragingly helped me to concentrate on conducting my research; my loveable children, Khalid and Sara, who served as my inspiration to pursue this study; and my dear brothers and sisters for their positive words of encouragement and support.

I feel duty bound to offer my warmest appreciation to King Saud University and the Saudi Arabian Cultural Bureau in London for sponsoring this research.

I also wish to extend my thanks and appreciations to my friends and people who have generously helped me with their suggestions and advice.

Author’s Declaration

“I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.”

Printed Name: __Abdullatif Aleshaikh________________________

Signature: __________________________

Introduction

It is a fundamental feature of an organisation such as a company to vest the decision-making authority in its board of directors.[1] This wholesale delegation of decision-making power to directors can be rationalised on the basis that there are practical challenges for shareholders to engage in the day-to-day management of the company's business, either due to their large numbers or their lack of proficiency.[2] Since the way that directors run the company will affect the interests of shareholders, the company's growth and, more generally, its economic prosperity, the question of how companies should be governed is a matter of critical concern for any given company because the system of corporate governance is expected to affect the corporate behaviour and the process of decision-making within the company.[3] In this regard, a good system of corporate governance might be understood as one that involves rules and processes that ensure that directors do not misuse their managerial powers,[4] holding them accountable for abusive practices,[5] and create incentives for them to act effectively and appropriately.

Directors' duties of care and loyalty, as mechanisms of corporate governance and accountability, can be described as legal norms that control directors' behaviour when exercising their discretion.[6] These mechanisms are designed to provide directors with behavioural norms and a legal basis for disciplining them for non-compliance with such norms of conduct. Importantly, the efficacy of such duties depends on the availability of mechanisms of enforcement when they have been breached.[7] A derivative action through which shareholders, especially minority shareholders, can sue directors for their

[1] J Armour, H Hansmann and R Kraakman,'What is Corporate Law?' in R Kraakman et al. (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009) 5.
[2] P Davies and S Worthington, *Gower Principles of Modern Company Law* (10th edn, London, Sweet & Maxwell 2016) 350.
[3] Seemingly, *corporate governance* is not an easy concept to describe and has been defined in different ways since scholars have approached the topic from a variety of disciplinary perspectives, including law, economics, management and political science, see generally S Turnbull,'Corporate Governance: Its Scope, Concerns and Theories' (1997) 5 Corporate Governance: An International Review 180. One of respected definitions of *corporate governance*, at least in the UK, is to define it as 'the system by which companies are directed and controlled', see Report of the Committee on the Financial Aspects of Corporate Governance, *The Cadbury Report* (UK, December 1992) para. 2.5, <http://www.ecgi.org/codes/documents/cadbury.pdf> accessed 1 September 2017.
[4] J Birds et al., *Boyle & Birds*' *Company Law* (8th edn, Bristol, Jordans 2011) 363.
[5] J Solomon, *Corporate Governance and Accountability* (3rd edn, Chichester, John Wiley & Sons 2010) 6.
[6] A Keay, *Directors*' *Duties* (2nd edn, Bristol, Jordans 2014) 5–6.
[7] A Keay, 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33 Civil Justice Quarterly 76, 76.

wrongdoing on behalf of the company is an essential mechanism to enforce the company's rights and ensure directors' accountability.[8]

The central problem lies where the company law involves serious aspects of uncertainty and deficiency in designing directors' duties in addition to establishing an inaccessible derivative action that brings directors who misbehave to account. The law of Saudi Arabia, which is the subject of this thesis, is an example of such company law that suffers from ambiguity brought about by an absence of detailed regulation of directors' duties, along with a lack of clear judicial guidance. Arguably, poorly suited standards and rules for legal liability might provide directors with incentives to act disloyally and incompetently. Despite the enactment of the new Companies Law 2015 (CL 2015) and even with the introduction of new Saudi Corporate Governance Regulations 2017 (CGRs 2017), there is still room for reform to ensure that directors' exercise of powers is subject to sufficient control and accountability. Similarly, the CL 2015 fails to design a clear derivative action regime that could enhance directors' accountability towards the company and its shareholders, especially minority shareholders. With inaccessible derivative action, the system of enforcement of breaches of directors' duties will be lacking a mechanism that creates incentives for directors to comply with their duties by holding them accountable for misconduct,[9] given the possible role of derivative actions to deter directors from breaches of their duties and to protect the company and shareholders.[10] Indeed, the argument for sound law of directors' duties and derivative actions, as will be illustrated,[11] is further borne out by the limits and drawbacks of other main mechanisms of control and accountability in Saudi Arabia.

The main objective of this research is to propose reform of the law of directors' duties and of derivative actions. By employing the United Kingdom (UK) company law as a benchmark, this study evaluates the clarity, certainty and accessibility of Saudi law of directors' duties of care, loyalty and of private enforcement by litigation, identifying weaknesses and deficiencies in this area of law. It also explores causes and effects of legal uncertainty and deficiency found in the Saudi law of directors' duties and private enforcement by derivative actions. This research examines why there is a need for legislative intervention to promote the role of directors' duties and enforcement by derivative actions in enhancing the directors' accountability and providing greater legal

[8] A Reisberg, *Derivative Actions and Corporate Governance* (Oxford, OUP 2007) 18.
[9] Ibid 52.
[10] See generally ibid 51–63.
[11] See generally the discussion in Chapter 2 in this thesis.

protection for shareholders, including minority shareholders. The centrality of a sound company law regime that establishes well-designed duties, reinforced by accessible derivative litigation, in relation to the reform of corporate governance in Saudi Arabia is emphasised by evaluating the role of other principal legal and non-legal mechanisms that operate within the accountability framework for directors.

Of the key contributions this research makes is to offer recommendations for legal reform by examining the extent to which the Saudi legislature can benefit from the experience of the UK law of directors' duties and of derivative actions. To be specific, the feasibility of transplanting selective legal ideas and rules from the UK company law to its Saudi counterpart is investigated from the theoretical point of view, given the institutional infrastructure and legal environment in Saudi Arabia. The research addresses the question of whether selective UK legal models and rules can be adopted in the Saudi context, and if so, to what extent can foreign rules be adapted, if necessary, to fit with the new environment of a host country (Saudi Arabia). One of the central arguments presented is that while considering the remedy of deficiencies identified in the Saudi law, the proposed legal reform should be designed in a way that increases directors' accountability without damaging their incentives to exercise their managerial powers effectively.

The primary reasons behind the conduct of this research in the area of directors' duties and enforcement by derivative actions are as follows: First, the uncertainty within this area of Saudi company law, due to the absence of a clear detailed legislative statement and inactive role of courts in developing the law, is one of the main justifications for proposing statutory reform. In this regard, it is necessary to take on the commitment, as a comparative Saudi legal scholar, to search for the most effectual model of corporate governance as a means of reforming the researcher's own legal system and examine the feasibility of legal transfer of foreign models to his own country. Indeed, the principal presupposition is that reform of Saudi law of directors' duties and derivative actions should be the top priority for Saudi lawmakers.

Second, it seems that there is clear intention from the Saudi state to reform its company law system, especially in relation to directors' accountability and legal protection for shareholders. This is best exemplified by the recent legal development taking place in the area of corporate governance by the introduction of CL 2015 and the new CGRs 2017.

Following the announcement of the new Saudi Vision 2030,[12] Saudi Arabia, with a view to developing vibrant equity markets, attracting more domestic and foreign investment, and improving the business environment, will not hesitate to reform laws, including those shaping the corporate governance system to accomplish the goals of the 2030 Vision. Thus, this research attempts to offer recommendations that would contribute to the promotion of a good corporate governance system by designing a law that creates incentives for directors to act competently and honestly by imposing legal liability on those who do not. Arguably, legal reform that establishes well-formulated duties of directors accompanied by effective mechanism of enforcement is likely to enhance the legal protection for shareholders. This would consequently increase the investors' willingness to invest in the market and therefore contribute to the development of equity markets.[13]

Third, a legal reform approach based upon legal transplantation can be regarded as a good way of importing the highest-quality legal solutions for solving deficiencies in the Saudi law of directors' duties and the enforcement thereof.[14] The UK has developed one of the best corporate governance systems in the world[15] in which substantial levels of protection for investors is offered.[16] Further, the UK has a long-established duty of care[17], fiduciary duties[18] and derivative actions[19] within the context of company law. Consequently, the UK experience would appear to offer reasonable solutions to the legal uncertainty and deficiency identified in the Saudi company law.

It is essential to define the scope of the research and articulate the specific issues that are explored within this thesis. Directors are subject to a number of obligations. As the aim of

---

[12] The Saudi Vision 2030 is a comprehensive development plan that involves, *inter alia*, a set of economic policies that are aimed at diversifying the sources of national revenue of economy and ending excessive dependence on oil-based revenue. It is a significant part of the vision to build a thriving economy that would enhance the contribution of the private sector to the economy. This will be accomplished by seven avenues of which the formation of advanced capital markets and the attraction of foreign investment are main elements. Saudi policy-makers have set a number of implementing and transformative programmes that help the Kingdom to achieve the goals of the vision. For more details, see the website of Saudi Vision 2030 at http://vision2030.gov.sa/en

[13] See R la Porta et al., 'Investor Protection and Corporate Governance' (2000) 58(3) Journal of Financial Economics 15–17.

[14] This argument is put forward by many legal writers to justify the legal change by means of legal transplants; see, for example, J Fedtke, 'Legal Transplants' in J Smits (ed), *Elgar Encyclopedia of Comparative Law* (2nd edn, Edward Elgar Publishing 2012) 550.

[15] See, for example, A Shleifer and R Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737, 737.

[16] Ibid 769.

[17] See, for example, *Charitable Corporation v Sutton* (1742) 2 Atkyns 400, which is one of the early company cases regarding the duty of care.

[18] See, for example, *Re Cameron's Coalbrook Railway Co* (1854) 18 Bev 339, which is one of the early company cases regarding fiduciary duties.

[19] See, for example, *Foss v Harbottle* (1843) 67 ER 189.

this research is to provide an in-depth analysis of the law of directors' duties, while acknowledging that there is an increasing body of literature in this area of law, there is accordingly necessity for narrowing down the scope of detailed analysis to specific forms of directors' duties. This thesis only addresses general obligations owed to the company, excluding those obligations personally owed to shareholders and or creditors…etc. In addition, the research only concerns the duties of care and of loyalty. Regarding the latter, the focus will primarily be on the following elements: (i) the duty to act in good faith in the general interest of the company; (ii) the duty to avoid conflicts of interest with particular focus on the exploitation of corporate opportunities; and (iii) the duty to avoid conflicts of interest in self-dealing transactions. These issues are selected on the basis that they pose particular problems in the Saudi context. Concerning the enforcement of directors' obligations, the scope of this research is limited to breaches of duties owed to the company and, accordingly, to the company's actions against directors and litigation commenced by a shareholder on behalf of the company (i.e., derivative litigation). An analysis of personal actions brought by shareholders against directors is not within the scope of this thesis.

Another point worth mentioning is that among statutory forms of commercial companies found in the Saudi CL 2015, this thesis mainly focuses on the governance system of joint stock companies, the only type of company that is allowed to be listed in the Saudi stock market.[20] It should, however, be stressed here that unless otherwise stated the proposed reforms are relevant to all joint stock companies, listed or not, because the legal system of directors' duties and private enforcement actions, as an element of corporate law, is technically applicable to all companies. That said, the discussion pays more attention to joint stock companies listed in the Saudi stock market due to the availability of information. Furthermore, the subject of corporate governance for publically traded companies attracts much more attention in most economies with the emergence of financial crises and corporate scandals that not only negatively affect the large segment of investors, employees and creditors, but also the economy as whole.[21]

As the main objectives of this study are to employ the UK model of directors' duties and derivative actions for evaluating the Saudi law and examining the feasibility of transferring some rules to the Saudi law, a comparative law approach was adopted in this research. It is

[20] See article 11 of Saudi Listing Rules 2004 (LRs 2004).
[21] The economic costs of corporate scandals are best illustrated by the wave of corporate bankruptcies and scandals that swept through the United States of America (US) at the beginning of the current millennium; see C Garham, R Litan and S Sukhtanker, 'Cooking the Books: The Costs to the Economy' (Brookings Policy Brief Series, Brookings Institution, August 2002) < https://www.brookings.edu/research/cooking-the-books-the-cost-to-the-economy/ > accessed 11 May 2017.

an important element of this approach that the comparison of similar ‘legal institutions’, or rules employed to solve similar legal problems in two or more legal systems, also takes into account the wider contexts in which those rules operate.[22] This involves the formulation and clarification of differences and similarities between various legal systems as well as that the particular legal issues.[23] An essential aspect of a comparative study is that it identifies weaknesses in the laws of one country and so can serve as a basis for considering practicable legal solutions. To be specific, a comparatist might go beyond the mere description and analysis of differences and similarities between jurisdictions and evaluates the potential of learning from foreign laws and applying that learning to solve legal problems at home.[24] This element of comparative law concerns the study of legal transplant and the reception of foreign rules, which often explains the process in terms of the ‘fit’ between transplanted law and local conditions.[25]

Given the universal nature of the problems in company law,[26] it seems beneficial to take lessons from other jurisdictions by conducting comparative research through which solutions that contribute to law reform might be located and made available for legislatures to import from foreign jurisdictions into their own.[27] For example, Beach, who was one of the members of the team formed to draft the Saudi Capital Market Law 2003 (CML 2003), also emphasises the importance of comparative law research in legal reform by pointing out that ‘drafting [the CML 2003] was a priceless opportunity to show how comparative legal studies can be used to produce practical results’.[28] Thus, legal research may be regarded as one of the catalysts of legal change.[29]

Following the detection of defects in the current Saudi law of directors’ duties and enforcement by derivative actions, the present research addresses the question of the feasibility of legal transplantation as a strategy for reform in Saudi Arabia. The movement of legal models and ideas from one country to another, which is well known as a ‘legal

[22] See K Zweigert and H Kotz, *An Introduction to Comparative Law* (T Weir tr, 3rd edn, Clarendon Press 1998) 4–5.
[23] See M Siems, *Comparative Law* (Cambridge, Cambridge University Press 2014) 20.
[24] Zweigert and Kotz (n 22) 15–17.
[25] Siems (n 23) 198-199.
[26] D Donald, ‘Approaching Comparative Company Law’ (2008) 14 Fordham Journal Corporate and Financial Law 83, 89 (footnote 28).
[27] See B Grossfeld, *The Strength and Weakness of Comparative Law* (T Weir tr, Clarendon Press 1990) 15–18.
[28] J Beach, ‘The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets’ (2005) 41 Stanford Journal of International Law 307, 355.
[29] See P Mitchell, ‘Patterns of Legal Change’ (2012) 65 Current Legal Problems 177, 197–200.

transplant',[30] might be considered as 'the most fertile source of development' of legal systems.[31] The body of comparative law literature on the concept of legal transplants, however, shows that it is a controversial issue among jurists and legal thinkers, particularly in relation to the capability of legal patterns and ideas to be *successfully* diffused across national frontiers.

Watson suggests that the growth of legal systems can largely be attributed to the borrowing of foreign legal rules[32]and many legal-historical examples support his position.[33]Most importantly, Watson claims that the law is largely independent from surrounding social structures; in other words, the close link between the rule of law and the society in which they operate is almost absent.[34] Thus, the practice of legal transplantation, as Watson argues, 'is socially easy'.[35] Watson's theory has attracted strong criticism from various standpoints on the basis that the law is relatively isolated from its 'context'.[36] The strongest criticism was expressed by Legrand, who pointed out that the meaning of a legal rule is unique to a particular culture.[37] Legrand suggests that as long as the rule is not an 'autonomous entity unencumbered by historical, epistemological, or cultural baggage',[38] it cannot be diffused across national frontiers without being changed.[39] Accordingly, Legrand concluded that legal borrowing was 'impossible'.[40] In fact, on the basis of evidence currently available, it seems reasonable to disagree with Legrand's viewpoint, as there are many successful cases of legal transplantation.[41]

In the literature on legal transplants, several moderate viewpoints stand between Watson's hypothesis and Legrand's theory. Those intermediate positions tend to focus on highlighting various aspects of the process of transplantation, such as identifying factors that may influence the receptivity of legal rules, and specifying key conditions for the success and failure of legal transplantation.[42] For example, Kahn-Freund opines that the

[30] A Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, Athens, University of Georgia Press 1993) 21.
[31] Ibid 95.
[32] Ibid.
[33] Ibid 6–7.
[34] A Watson, 'Comparative Law and Legal Change' (1978) Cambridge Law Journal 37 313, 314–315.
[35] Watson (n 30) 95.
[36] O Kahn-Freund, 'On Use and Misuse of Comparative Law' (1974) Modern Law Review 37 1, 27.
[37] See P Legrand, 'The Impossibility of Legal Transplants' (1997) Maastricht J Eur & Comp L 4 111, 117.
[38] Ibid 114, 115–117.
[39] Ibid 117.
[40] Ibid 114.
[41] For instance, for Japanese importation of directors' duty of loyalty from the US corporate law, see H Kanda and C Milhaupt, 'Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law' (2003) 51 The American Journal of Comparative Law 887.
[42] Siems (n 23) 197– 200.

‘transferability’ of foreign models is possible; however, the principal question to address concerns the benchmark to which the success or failure of adoption is measured.[43] Khan-Freund put forward the view that since there is a close relationship between the law and its geographical, economic, social and, importantly, political environment,[44] the transferability of legal rules depends on whether or not the foreign rule can be adjusted to the environment of the host country.[45] It is also submitted that there is a need to ensure compatibility between the foreign law and the legal environment of the host country as a key condition for successful legal transplant.[46] More importantly, it has been asserted that legal rules vary in relation to their cultural and societal context.[47] This line of argument suggests that rules that are culturally and societally embedded are more difficult to transfer across legal systems than those that are not bound to a particular society.[48] In this regard, company law is generally seen as falling within the category of laws that is not strongly linked to cultural values and therefore such law will be much easier to ‘move relatively freely’ across cultural frontiers.[49]

Given the above viewpoints, it could be said, as a starting point, that legal transplantation is theoretically possible, at least in relation to the field of laws such as the company law. Nevertheless, this research does not recommend the blind copying of the law from the UK to Saudi Arabia without having regard to the appropriateness of imported rules in the Saudi context. By using legal transplantation, this thesis tests what kind of cross-border movement of corporate rules is feasible within the legal context of Saudi Arabia. In other words, the research will examine to what extent the Saudi law, as a Sharia-based law, can adopt the Anglo-American model of corporate law. Based on the above viewpoints about the possibility of legal transplantation, the methodology developed here concerns the examining the feasibility of transplantation using Saudi company law as a case study. It will be argued in this research that the test used for examining the feasibility of legal transferability demonstrates that substantial legal transplantation form the UK is largely possible in the context of Saudi company law but with key caveats.

---

[43] Kahn-Freund (n 36) 6.
[44] Ibid 7–8 and 12.
[45] Ibid 6.
[46] See generally, D Berkowitz, K Pistor And J Richard, ‘Economic Development, Legality, and the Transplant Effect’ (2003) 47 European Economic Review 165.
[47] Ibid 13, where Khan-Freund gives examples of family law that show ‘the diminishing strength of environmental obstacles to transplantation’.
[48] Ibid 17.
[49] See, for example, R Cotterrell, ‘Is There a Logic of Legal Transplants’ in D Nelken and J Feest (eds), *Adapting Legal Cultures* (Hart Publishing 2001) 81–82.

The methodological approach adopted was that a foreign rule is only feasible if it can be adapted to fit within the institutional structure and legal environment in Saudi Arabia.[50] For example, for the purpose of this thesis, it is necessary to consider whether a relevant UK rule is compatible with Islamic (Sharia) instructions, which is the paramount law of Saudi Arabia.[51] The disparity in the roles and capabilities of courts between the UK and Saudi Arabia is also taken into account to ensure that rules imported from the UK concerning duties of directors and the enforcement of its breaches through derivative litigation are likely to fit within the Saudi legal infrastructure. While designing the proposed reform, the differences in the typical patterns of ownership structure in the UK and Saudi Arabia are taken into consideration where necessary to ensure greater protection for minority shareholders. It should also be noted here that while the UK law belongs to the common law, Saudi law has rules of Islamic origin and tends to be influenced by the French civil law tradition, at least in relation to commercial law.[52] Although the UK and Saudi belong to different legal families, this would not represent an insurmountable barrier to legal importation because it might be true to say that the practical evidence of movement of legal ideas across borders has blurred the theoretical distinction between various legal families.[53]

One point to consider is that the comparative study *principally* used the doctrinal approach in discussing problems in, and potential solutions to, the Saudi legal system of directors' duties and derivative actions. This suggests that all relevant primary and secondary resources in the UK and Saudi Arabia are crucial sources of data in this research. It should be noted here that although the Saudi judiciary has recently adopted a policy to publish previous judicial decisions, only few selective judgments were made available to the public and there have been no judgments among the published decisions published that were relevant to the subject matter of the present research.[54] Thus, when analysing the Saudi law, and in relation to general assumptions that would also apply to joint stock companies,

[50] See Berkowitz, Pistor and Richard (n 46).
[51]See section (1.2), Chapter 1 in this thesis.
[52] See, for example, M Hanson, 'The Influence of French Law on the Legal Development of Saudi Arabia' (1987) 2 Arab LQ 272.
[53] Some scholars have put this argument forward; see, for example, Fedtke (n 14) 550. For examples of movements of rules across jurisdictions of different legal families, see K Pistor et al., 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' (2003) 18 The World Bank Research Observer 89, 99–101.
[54] The researcher examined judicial rulings in the field of company law published on the website of the Board of Grievance for the years 1987–2012. There are only a few cases on matters relating to joint stock companies and there is no decision related to the topic of the research. It should be also noted that judgments and judicial principles are not published systemically and periodically.

the research referred to two judgments related to limited liability companies[55] to clarify the position of Saudi law.

This thesis is structured into six chapters. Chapter 1 provides a general overview of the Saudi legal system within which joint stock companies operate. Chapter 2 rationalises why there is a need to reform the company law in the field of directors' duties and in relation to judicial mechanisms of enforcement. It assesses the current board accountability framework in Saudi Arabia with the purpose of establishing where directors' duties and formal enforcement thereof sit within the entire framework. The evaluation covers the main mechanisms of board accountability and control: monitoring by blockholders, shareholders' internal mechanisms at the general meeting, the role of independent directors and markets.

In Chapter 3 the argument of legal uncertainty is developed throughout the comparative analysis of director's duty of care in the UK and Saudi Arabia, exploring the areas of deficiency that need to be reformed in Saudi Arabia. Similarly, Chapter 4 offers a critical analysis of three forms of duty of loyalty: (i) the duty to act in good faith in the general interest of the company; (ii) the duty to avoid conflicts of interest with particular focus on the exploitation of corporate opportunities; and (iii) the duty to avoid conflicts of interest in its application in the area of self-dealing transactions. The main argument presented in Chapters 3 and 4 is that the absence of a detailed legislative statement on directors' duties coupled with the inactive role of courts in developing the law has given rise to serious levels of uncertainty in Saudi law compared to its UK counterpart. Chapter 5 evaluates the UK and Saudi laws, exploring significant areas of inaccessibility and deficiency in the private enforcement action in general and derivative action in particular. In this chapter public enforcement is assessed with the purpose of emphasising the important role that private enforcement action plays in complementing public enforcement.

Following the identification of legal deficiencies in Saudi law, Chapter 6 considers the reform agenda by way of legal transplantation. To this end, the thesis examines the feasibility of transplanting selective legal ideas and rules from the UK law to Saudi law, taking the institutional structure and legal environment of Saudi Arabia into consideration.
In the final part of the thesis conclusions are drawn and comments are made that are relevant to the proposed reform and to any future study that is required.

[55] It is equivalent to UK private company limited by shares, see footnote 162, Chapter 1 in this thesis.

Chapter 1: An Overview of the Saudi Legal Framework for Joint Stock Companies

1.1 Introduction

Generally speaking, a business firm does not operate in an institutional vacuum, but rather under formal and informal constraints.[56] The corporate governance and the way in which the firm operates are influenced by a set of forces external to the firm such as the legal system of the country,[57] and by a set of internal factors that determine the relationships between the key members in the firm[58] (e.g., directors' duties and shareholders' rights).[59] Importantly, the internal regulations of corporate governance are strengthened by external laws and institutions, which provide rules and standards for conduct, and legal mechanisms for enforcing duties and rights.[60] This suggests that legal rules and institutions must operate effectively in a country in order to determine the efficacy of the internal mechanisms of a company's corporate governance, such as directors' duties.

When discussing the Saudi legal framework, it is necessary to take into account the religious characteristics of Saudi law. Islam retains a significant influence over Saudi society, and pervades various aspects of individual and communal life.[61] The Saudi state can be categorised as a good example of a typical Muslim society where the political system, culture and law are based upon Islamic principles. Nevertheless, the increasing demand for economic and social growth, coupled with a lack of legal infrastructure, has led to the Saudi state modernising the legal system by supplementing Sharia with a body of legislation of foreign origin, such as those governing business organisations (e.g., joint stock companies). These changes also resulted in new government institutions responsible for the enforcement of applicable rules, which is an important pillar of the entire legal framework.[62]

---

[56] Institutions (i.e., humanly devised constraints) can be classified into 'informal constraints' (e.g., customs and traditions) and 'formal rules' (e.g., laws), see D North, 'Institutions' (1991) 5 Journal of Economic Perspectives 97, 97.
[57] M Iskander and N Chamlou, *Corporate Governance: A Framework for Implementation* (World Bank Publication, Washington, May 2000) 4–5, <http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/09/08/000094946_00082605593465/Rendered/PDF/multi_page.pdf > accessed 1 May 2015.
[58] Ibid 4–5.
[59] Ibid 5–6.
[60] Ibid 5.
[61] F Vogel, *Islamic Law and Legal System : Studies of Saudi Arabia*, (Leiden, Brill 2000) xiv–xv.
[62] This is illustrated by the recent significant reform of the judicial system in 2007, see section (1.5) in this Chapter.

This chapter provides a brief overview of the current legal framework for joint stock companies in Saudi Arabia, and determines the external structure of governance for this type of company. It identifies the main characteristics of the overall Saudi legal system and concisely surveys its unique aspects in order to provide an accurate understanding of the current legal framework for joint stock companies. The chapter is divided into four main sections. First, the significance and influence of Sharia law within the Saudi legal system are established and explored. Second, the status of the state legislation, as a source of legal obligations, is analysed, scrutinising the relationship between the law of Islamic origin and the state laws of foreign origin. In the third part, the chapter shifts its focus to consider the main laws and regulations that inform the regulatory structure of companies, namely the Companies Law 2015 (CL 2015), the Capital Market Law 2003 (CML 2003) and the Corporate Governance Regulations 2017 (CGRs 2017). Finally, the main formal enforcement institutions, namely the courts and the main regulators, which are made up of the Ministry of Commerce and Investment (MOCI) and the Capital Market Authority (CMA), which are assumed to be responsible for the enforcement of directors' duties, are described.

1.2 The Primacy of Sharia in the Saudi Legal System

The significance of Sharia, as the paramount law of the Saudi state, had been made clear even before the deceleration of the Kingdom's unification in 1932, when King Abdulaziz announced that the Holy *Qur'an*, the Sunnah (Traditions of the Prophet)[63] and the Fiqh (Islamic Jurisprudence) were the main sources of Saudi law.[64] The primacy of Sharia has remained in the Saudi state and was further confirmed by the Basic Law of Governance 1992 (BLG 1992),[65] the first written constitution of Saudi Arabia.

The influence of Sharia on the content of the BLG 1992 is evidenced by the fact that the role of Sharia is explicitly referred to in relation to the determination of the Kingdom's identity,[66] the structure of its governance,[67] the basis of Saudi society,[68] its economic

[63] The *Qur'an* and the Sunnah are together referred to as *Sharia*, see section (1.2.1) in this Chapter.
[64] The King's Announcement published in the Official Gazette of Umm Al-Qura on 9/12/1924.
[65] An English translation of the BLG 1992 is found at <http://www.boe.gov.sa/ViewStaticPage.aspx?lang=en&PageID=25> accessed 28 August 2017.
[66] See article 1 of the BLG 1992.
[67] Articles 5–8 of the BLG 1992.
[68] Articles 9–11 and 13 of the BLG 1992.

principles,[69] and the state's rights and duties.[70] Sharia indisputably remains the source of legal obligations[71] and the paramount law in Saudi Arabia. The BLG 1992 affirms that the Saudis' 'constitution shall be the Book of *Allah* [*Qur'an*] and the *Sunnah*',[72] and further states that courts are required to apply the cases before them to *Qur'anic* and Sunnah provisions. The BLG 1992 and other legislation rank lower than the *Qur'an* and the Sunnah, which maintain their status as the primary sources of Saudi law and the basis of the Kingdom's governance.[73]

As Vogel correctly notes, Islamic law is generally more prevalent in Saudi Arabia, compared with other Islamic states.[74] It is a combination of historical and socio-political factors that has led to the dominance of Sharia law within the Saudi legal structure. For example, the position of Saudi Arabia as the birthplace of Islam and the homeland of two Holy Mosques;[75] the function of Islamic religion in safeguarding the legitimacy of the Saudi political system;[76] Saudis' wish to be governed by Sharia (as many tend to regard Islamic law as their 'indigenous law');[77] the long history of the application of Sharia in the Arabian Peninsula,[78] and the historical fact that Saudi Arabia was not subject to Western colonisation,[79] have all participated in establishing and perpetuating the primacy of Sharia law within the Saudi legal system. Having established this, it is now useful to clarify the nature and main elements of Islamic law, as this will help to define how Sharia will be understood within this research.

1.2.1 Sharia law as a main source of legal obligations

Sharia law, which is technically 'the canon law of Islam',[80] is characterised by the divine source of its injunctions and principles.[81] *Sharia law* may be defined as 'the entire system

[69] Articles 17 and 21 of the BLG 1992.
[70] See, for example, articles 23, 26 and 38 of the BLG 1992.
[71] M Al-Jaber, *Saudi Commercial Law* (Arabic), (5th edn, Riyadh, 2000) 24.
[72] See Articles 1 and 48 of the BLG 1992 respectively.
[73] See article 7 of the BLG 1992.
[74] Vogel (n 61) xiv.
[75] A Al-Shalhoub, *The Constitutional System in the Kingdom of Saudi Arabia Between Islamic* Sharia *and Comparative Law* (Arabic) (Riyadh, King Fahd National Library 1999) 37.
[76] F M Al-Saud, 'Political development in the Kingdom of Saudi Arabia: An Assessment of the Majlis Ash-Shura' (PhD thesis, University of Durham 2000) 12 and 38–39.
[77] Vogel (n 61) xiv.
[78] Ibid.
[79] Ibid.
[80] J Schacht, 'Islamic Law in Contemporary States' (1959) 8 The American Journal of Comparative Law 133, 136.
[81] The divine sources of Islamic law are the *Qur'an* and the Sunnah.

of law and jurisprudence associated with the religion of Islam,[82] including (1) the primary sources of law (Sharia), and (2) the subordinate sources of law and the methodology used to deduce and apply the law (Islamic jurisprudence)'.[83] According to Islamic law literature, there are primary and secondary sources of Sharia law, both of which are described briefly below.

1.2.1.1 Primary sources of Sharia law

The *Qur'an* and the Sunnah are the primary sources of Islamic law. With regard to the *Qur'an*, it is the first and most important source of law due to the fact that it is the actual words of Almighty Allah revealed to the Prophet Mohammed (peace be upon him (PBUH)). Consequently, Muslims believe that any activity or action that does not contradict the *Qur'an* is deemed to be permissible.[84] In terms of the classification of *Qur'anic* provisions, while there is a set of purely religious rules[85] and moral principles,[86] a number of the verses in the *Qur'an* are concerned with what can be regarded by Western jurists as legal material. This includes injunctions and principles relating to the spheres of family and inheritance, crimes and penalties, trade, business, and contracts.[87] In relation to business transactions, the *Qur'an* involves a number of injunctions and principles. For example, Muslims are religiously required (i) to fulfil their contractual obligations,[88] and to comply with the principles of honesty, trustworthiness, truthfulness and justice[89] in all their affairs, including business transactions.[90]

The Sunnah is the second source of Islamic law after the *Qur'an* and its binding nature is indicated in many *Qur'anic* verses.[91] The Sunnah refers to the Prophet's 'sayings' and 'deeds', in addition to practices that received his 'silence and [so] tacit approval'.[92] The

---

[82] The law in Islam is inseparable from the religion, see I Abdal-Haqq, 'Islamic Law: An overview of its Origin and Elements' (1996) 1 The Journal of Islamic Law 1,12.
[83] Ibid 5.
[84] S Ramadan, *Islamic Law: Its Scope and Equity* (London, PR Macmillan 1961)31–33.
[85] This includes the Islamic creed and faith, and daily praying.
[86] For example, the kind treatment of one's parents, see *Qur'an* 17:23.
[87] See Al-Shalhoub (n 75) 90–91.
[88] See *Qur'an* 5: 1).
[89] See *Qur'an* 83:1–3); *Qur'an* 55:9; *Qur'an* 4:58. It is worth noting here that such business–legal principles mentioned and their implications on the directorial decisions and actions will be considered, where relevant, in this thesis.
[90] L Miles and S Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities: Prospects for Convergence?' (2010) 2 Journal of Business Law 126, 132–133; A M Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles' (2009) 20 Critical Perspectives on Accounting 556, 561 and 562.
[91] See for example, *Qur'an* 4:80.
[92] S Mahmassani, *Falsafat Al-Tashri Fi Al-Islam: The Philosophy of Jurisprudence in Islam* (English) (Leiden, Brill, 1961) 71.

function of the Sunnah is to complete, or in some cases interpret, some of the general provisions set forth in the *Qur'an* and to regulate other additional matters.[93] As with the *Qur'an*, the Sunnah contains a number of legal principles regarding the conduct of business, such as the prohibition of g*harar*[94] (i.e., ambiguity and uncertainty)[95] where Sharia law forbids a transaction if there is excessive uncertainty around the pillars and conditions of the transaction.[96]

1.2.1.2 Secondary sources of Sharia law

Where the *Qur'an* and the Sunnah provide no guidance on a particular issue, it is the role of Muslim jurists to give their legal opinion by drawing on secondary sources of law. Ijma (consensus of *all* Muslim jurists at any time after the death of Prophet)[97] and Qiyas (analogical reasoning)[98] are binding sources of law but come below the *Qur'an* and Sunnah in the hierarchy of Islamic legal sources.[99]

In seeking solutions to legal problems, Jurists may also refer to other, less significant, sources, which themselves have been the subject of much debate in the literature of Islamic jurisprudence.[100] These sources are employed to form new rules on the strength of equity and justice in the general interests of society.[101] This category of sources of Islamic law mainly comprises Masalih Mursalah (public interest), Istihsn (preference[102] or equity and justice[103]), Istidlal and Istis'hab (deduction and presumption of continuity),[104] Urf (local custom)[105], and Sadd Al-tharaea (a means of blocking rules that lead to undesirable ends).[106] It is necessary to emphasise that the recourse to this group of sources by several Muslim states, including Saudi Arabia, has been key to meeting the needs of their

---

93 See Al-Shalhoub (n 75) 92.
94 It was narrated that Abu Hurairah said: 'The Messenger of Allah forbade . . . the *gharar* sale', Sahih Muslim (Book 21, Hadith No. 1513 707).
95 M Saleem, *Islamic Commercial Law* (Singapore, Wiley 2013) 3.
96 Ibid 3– 4.
97 M Al-Uthaymeen, *A System of Roots of Jurisprudence and Its Principles* (Arabic) (3rd edn, Riyadh, Dar Ibn Al-Jawzi 2012) 208.
98 Mahmassani (n 92) 79
99 Al-Uthaymeen (n 97) 208
100 See R A Al-Shoronbassy, *The Introduction to Islamic Jurisprudence: Development, Schools, Sources, Doctrines and Theories* (Arabic) (2nd edn, Alexandria, 1983) 227.
101 Mahmassani (n 92) 83–84.
102 Ibid 85.
103 See F A Hassan, 'The Sources of Islam Law' (1982) 76 American Society of International Law Proceedings 65, 68.
104 Mahmassani (n 92) 85–91.
105 Al-Shoronbassy (n 100) 240.
106 Ibid 250.

societies, and many states introduced their legal reform agendas on the basis of public interest.[107]

Notwithstanding the established hierarchy of Islamic sources of law, the development of Sharia law can be mainly attributed to the jurists' recourse to Ijtihad (endeavour to formulate a legal rule or interpretation),[108] in the absence of detailed guidance in the *Qur'an* and the Sunnah.[109] Hence, Sharia law is regarded as 'a jurists' law' because it is the task of jurists to 'expound law' via the use of interpretation.[110] Ijtihad can be exercised through numerous methodologies such as analogical reasoning, preference, public interest and so on.[111] As a result of the differences between jurists in their understanding of Sharia, and in the methodologies applied to deducting rules, various schools of thought have emerged within Islamic jurisprudence.[112] It suffices to say here that in Islamic Sunni jurisprudence, there are four main orthodox schools of thought (Madhahib al Fiqhiya): (i) Hanafi, (ii) Maliki, (iii) Shafi'i and (iv) Hanbali.[113] While it is true that differences in opinion exist between the schools, they also exist between jurists who belong to the same school.[114]

1.2.2 Sharia law in practice: General considerations

It is necessary from the outset to consider that Sharia tends to provide only general principles in relation to commercial and corporate matters, leaving the formulation of detailed rules to the society concerned according to the level of development.[115] Thus, the state is empowered to introduce detailed rules to supplement general principles of Sharia.[116] This by implication means that any deficiency identified in Saudi company law cannot be attributable to Sharia because any deficiency is necessarily attributable to the

---

107 See the discussion in section (1.3) in this Chapter.
108 See, for example, Al-Shoronbassy (n 100) 253; B Weiss, 'Interpretation in Islamic Law: The Theory of Ijtihad' (1978) 26 The American Journal of Comparative Law 199, 200–201.
109 Abdal-Haqq (n 82) 35.
110 Weiss (n 108) 201.
111 Mahmassani (n 92) 92.
112 Abdal-Haqq (n 82) 44–45.
113 Ibid 44.
114 See R Peters, 'From Jurists' Law to Statute Law or What Happens When the Shari'a is Codified' (2002) 7 Mediterranean Politics 82, 84–86.
115 Thus, the Saudi corporate statute, as will be shown in this Chapter, is the main source of law governing joint stock companies, including various relationships within the company such as the relationship between directors and shareholders; see generally G Hagel, 'A Practitioner's Introduction to Saudi Arabian Law' (1983) 16 Vand J Transnat'l L 113 .
116 See B Seaman, 'Islamic Law and Modern Government: Saudi Arabia Supplements the Shari'a to Regulate Development' (1979) 18 Columbia Journal of Transnational Law 413, 415; for more deatlis, see section (1.3) in this Chapter.

state legislator and its inability to provide the detailed rules necessary to promote legal certainty.

As far as the application of Sharia law in Saudi Arabia is concerned, two important factors should be taken into account. First, judges are not bound, in theory, to follow a particular view or school, and they have the discretion to 'judge by what [they believe] to be the truth'.[117] In practice, courts mostly adopt the views of the Hanbali School when adjudicating disputes,[118] and it is generally acknowledged that Saudi Arabia in its application of Sharia law adheres to Hanbali jurisprudence.[119] Nevertheless, this wide judicial discretion has, among other things,[120] given rise to inconsistent applications of Sharia law and accordingly to the presence of legal uncertainty within Saudi law. This is the case despite the courts' adherence, in general, to the interpretations of Hanbali jurisprudence,[121] as different solutions to the same legal problem exist within the school.[122]

Second, there is no codification of Sharia rules[123] as there are in the civil law model. The Saudi state has neither a civil nor penal code and the absence of codified Islamic rules was initially due to the resistance of religious scholars (Ulama).[124] The lack of codification has contributed to inconsistency in judicial decisions.[125] As such, it can be suggested, as many do,[126] that the codification of Islamic rules would be extremely advantageous in the Saudi legal context. Codification would limit judges' discretion by establishing a set of rules that

---

[117] Vogel (n 61) 83 in reference to the statement of former President of the Permanent Board of the Supreme Judicial Council.
[118] Ibid 10, 83 and 118.
[119] See A Ansary, 'A Brief Overview of the Saudi Arabian Legal System' (Hauser Global Law School Program, July 2008) 10 <http://www.nyulawglobal.org/globalex/saudi_arabia.htm#_Toc200894559> accessed 26 August 2017.
[120] For example, the absence of judicial precedents in Saudi law.
[121] R B Khnayn, 'A Viewpoint About the Compilation of Preponderant Views of Jurists' (Arabic) (1991) 33 Journal of Islamic Research 26, 26 <http://www.alifta.net/Fatawa/FatawaDetails.aspx?languagename=ar&View=Page&PageID=4602&PageNo=1&BookID=2> accessed 1 February 2015.
[122] Al-Shoronbassy (n 100) 291–296.
[123] See, for example, Seaman (n 116) 440.
[124] G N Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 Am J Comp L 729, 732–733. The Board of Senior Ulama, in its 2001 recommendation, gave several reasons for their opposition to codification, see The General Presidency of Scholarly Research and Ifta, *the Board of Senior Ulama* (2001) 231–239 available in Arabic at <http://www.alifta.net/Search/ResultDetails.aspx?languagename=ar&lang=ar&view=result&fatwaNum=&FatwaNumID=&ID=297&searchScope=1&SearchScopeLevels1=&SearchScopeLevels2=&highLight=1&SearchType=exact&SearchMoesar=false&bookID=&LeftVal=0&RightVal=0&simple=&SearchCriteria=allwords&PagePath=&siteSection=1&searchkeyword=216170216175217136217138217134#firstKeyWordFound> accessed 26 August 2017.
[125] Vogel (n 61) 348–349.
[126] See, for example, F M Almajid, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective' (PhD thesis, University of Manchester 2008) 166.

would be recognised and consistently applied, thereby reducing uncertainty within the legal system.

To this end, the Saudi regulator has recently decided to address this issue. Based upon the approval of the Board of Senior Ulama, a specialised committee has been formed to prepare a draft of a ‘Compendium of Judicial Rulings’ in relation to Sharia matters that are necessary for judicial work.[127] Owing to the paucity of information regarding the committee’s work, this move towards the compilation of judicial rulings has raised several questions as to the nature and content of the Compendium. Crucially, it is unclear whether the Compendium will have a binding effect or only provide guidance to the courts. Furthermore, there are doubts concerning whether or not the Compendium will contain a comprehensive account of Islamic jurisprudence as the committee has been given the discretion to determine which matters are *necessary* for judicial work.

1.3 State Legislation as a Source of Legal Obligations

It would be inaccurate and misleading to suggest that Sharia law is the law of Saudi Arabia. While this is, to large extent, correct, it does not reflect the exact content of Saudi law since the scope of Saudi law is wider than Sharia law; in other words, Saudi law consists of rules of Islamic origin, as well as laws and regulations of foreign origin, which are adapted so that they do not conflict with Sharia. Perhaps the most precise account of the Saudi legal system is given by Vogel who describes it as having two categories of rules: one founded in Islamic law and the other a category of ‘man-made’ law (positive law).[128] Vogel further notes that while the former is ‘fundamental and dominant’, the latter is ‘subordinate’.[129]

Remarkably, the BLG 1992 lacks clear mention of legislation as a source of law in Saudi Arabia. Nonetheless, the regulator’s entitlement to enact laws and the binding characteristic of state legislation can be inferred from the BLG 1992. For example, the Law clearly recognises the jurisdiction of Legislative (Regulatory) Authority to introduce new laws[130] and additionally charges the King, as head of state, with the duty to oversee the

[127] Section 1 of the Royal Order No. (A/20) dated 30/11/2014. The recent Royal Order was based on the Board of Senior Ulama Decision No. 236, dated 4 February 2010.
[128] F E Vogel, ‘Islamic Governance in the Gulf: A Framework for Analysis, Comparison, and Prediction’ in G Sick and L Potter (ed), *The Persian Gulf at the Millennium: Essays in Politics, Economy, Security, and Religion* (London, Macmillan Press Ltd 1997) 275–276.
[129] Ibid
[130] See article 67 of the BLG 1992.

implementation of state laws.[131] Furthermore, courts are statutorily required to apply 'laws not in conflict with the *Qur'an* and the Sunnah'.[132] Although legislation as a source of law is not explicitly recognised, the Saudi legislature, through the use of Islamic principle of public interest (*al-maslaha al-mursalah*), has the right, recognised by Sharia, to pass laws and regulations to meet the needs of modern society.[133] The public interest as a basis of law-making is established by the BLG 1992,[134] so long as the exercise of legislation produces laws that fall within the Sharia framework.[135] In fact, the flexible nature of Islamic law, which includes the general principle that 'all things not specifically prohibited are allowed', clears the way for the codification of foreign legal ideas in Saudi Arabia.[136] It should again be stressed that the legitimate exercise of legislation on the basis of public interest is only valid for 'supplementing', but not 'contradicting' Sharia,[137] an important consideration that will be taken into account later when examining the feasibility of reforming the Saudi law of directors' duties by way of legal transplantation.[138]

It is unquestionable that the economic development of the Kingdom has been a major contributing factor to legal change and reform.[139] As the government's revenues from oil products rose and the Saudi economy began to develop, the Saudi rulers attempted to harmonise Islamic rules with economic, social and industrial growth, by producing a body of statutory laws to deal with a vast range of areas, such as constitutional and criminal matters, judiciary and human rights, health and education, and commerce and finance.[140] It is worth mentioning that French law inspired most laws introduced during the early period of Saudi legal reform.[141] This influence was attributable to the fact that the drafting of those laws was done by Egyptian legal experts who followed the French legal tradition. As they worked in close collaboration with Saudi scholars who also received their legal education from schools of law in France, Egypt, Syria and Lebanon,[142] it is easy to see the logic behind the influence of French law over the content of many Saudi laws, including those

[131] See article 55 of the BLG 1992.
[132] See article 48 of the BLG 1992.
[133] See Ansary (n 119) 5.
[134] See article 67 of the BLG 1992.
[135] Ansary (n 119) 5.
[136] Hanson (n 52) 289.
[137] R Aba-Namay, 'The New Saudi Representative Assembly' (1998) 5 Islamic L & Soc'y 235, 236 – 237.
[138] This issue will be further discussed in Chapter 6 in this thesis.
[139] See Sfeir (n 124) 733–734; Hanson (n 52) 272.
[140] The first piece of legislation enacted in the history of Saudi Arabia was the CCL1931. The list of primary laws as well as main secondary statutes issued by the Council of Ministers are on the website of Beureau of Experts at the Council of Ministers <www.boe.gov.sa.>
[141] Hanson (n 52) 288.
[142] Ibid 288–289. Legal systems of aforementioned Arab countries are influenced by French civil law tradition, see Zweigert and Kötz (n 22)110–111.

that fall within the area of commercial law. This is exemplified by the CCL 1931[143] and the CL 1965,[144] which are largely inspired by French law. Hence, it has become common to describe Saudi law, at least in relation to its commercial law, as a French-based legal system.[145] However, this does not mean that Saudi lawmakers were confined to following the French civil legal system and were reluctant to adopt legal ideas found in other legal systems. For example, Saudi benefits from the Anglo-American model and experiences in respect of the reform of capital market law and corporate governance regulation. According to Beach, who had a direct hand in shaping the content of the CML 2003, the law includes rules based upon existing securities laws from US, European, Asian and Middle Eastern sources.[146] Recently, the MOCI, which has participated with the CMA in preparing the new CGRs 2017, clearly stated that many foreign and international documents and reports in respect of corporate governance (e.g., the UK Corporate Governance Code) had been drawn on while preparing the new draft of the CGRs.[147]

1.4 Main Saudi Laws Determining the Governance of Joint Stock Companies

Since the corporate form is considered a fundamental basis for 'industrialization, the creation of viable market economies, and ultimately economic prosperity',[148] the law of business organisations was one of the areas covered by the Saudi governmental agenda of legal reform. Similar to other developing economies,[149] Saudi lawmakers passed the first corporate statute in the mid-1960s (the CL 1965), importing the law of companies from other jurisdictions.[150] This move towards the promulgation of a new corporate statute by way of transplantation was justified, *inter alia*, by the fact that there was no recognition of the Western legal notions of corporation, legal personality and limited liability in the

[143] See Sfeir (n 124) 732 and 739.
[144] Hanson (n 52) 290. Hanson gives an example of the French influence over the regulation of companies by pointing out that the types of company mentioned in the CL1965 directly match their French counterparts set forth in the pre-1966 Code of French Companies.
[145] See, for instance, J L Brand, 'Aspects of Saudi Arabian Law and Practice' (1986) 9 B C Int'l & Comp L Rev 1, 25 and 26; N Foster, 'Islamic Perspectives on the Law of Business Organizations: Part 1: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-style Law' (2010) 11 European Business Organization Law Review 3, 34.
[146] Beach (n 28) 308.
[147] See the MOCI statement, available on the website of the Ministry of Commerce and Investment at <http://mci.gov.sa/LawsRegulations/Projects/Pages/cg.aspx#0> accessed 20 April 2017.
[148] Pistor et al. (n 53) 89.
[149] There are many examples of developing and transition economies that receive their laws *primarily* from either one of the major legal families (England, France and Germany) or the United States; see, for instance, ibid, 94 and 99–101.
[150] See footnotes 141–145 and accompanying text in this Chapter.

classic Islamic law literature, as Muslim jurists were only familiar with a partnership with unlimited liability and with interdependent legal personality.[151]

Company law, which is the arena for determining legal rights and obligations of various corporate constituencies, is one of the central pillars of effective corporate governance. Law and regulation are understood as external formal institutions of corporate governance that have a significant role in governing and disciplining the conduct of insiders, whether directors or shareholders.[152] Under Saudi law, there are three laws that are the most germane to the discussion of this study: The CL 2015, as a major source of corporate governance, involves the majority of statutory rules governing joint stock companies, and is particularly concerned with the rights of shareholders, directors' duties and the enforcement mechanisms thereof. In addition to the corporate legislation, since joint stock companies are the only type of company that can be listed on the Saudi Stock Exchange, such companies are subject to the CML 2003, which aims to protect capital market participants, particularly investors.

As an additional source of corporate governance, a number of Implementing Regulations issued by the CMA in which the Corporate Governance Regulations (i.e., the CGRs 2017 is the recent version of the Regulations) are designed to establish the regulation of different relationships within the company, namely those between directors, managers, shareholders and stakeholders.[153] The inclusion of the CGRs 2017 in the discussion of this study is due to the fact that it contains important rules that shape the regulation of directors' duties, which is the main theme of this study, in addition to a set of *ex ante* mechanisms introduced to protect shareholders against directors' abuse of power.

1.4.1 Primary legislation for companies: The Company Law 2015

Under Saudi law, the *company* (*sharika*) is statutorily defined as 'a contract pursuant to which each of two or more persons undertake to participate in an enterprise aiming at profit, by offering in specie or/and as work a share, for sharing in the profits or losses

[151] It has been said that the concept of *partnership* tends to be insufficient for the 'emerging banking, mass transportation, and manufacturing sectors', see generally T Kuran, 'The Absence of the Corporation in Islamic Law: Origins and Persistence' (2005) 53 The American Journal of Comparative Law 785, 786–787; Foster (n 145) 29–33.
[152] See Iskander and Chamlou (n 57) 3, 5.
[153] See the CMA's statement regarding the issuance of new CGRs 2017, published on the website of the CMA at <https://cma.org.sa/en/MediaCenter/PR/Pages/NewCGR.aspx> accessed 29 August 2017.

resulting from such enterprise'.[154] It can be inferred from this definition that since statutory companies are set up by a contract and that the Saudi law of contacts is subject to the rule of Sharia,[155] this means that Sharia law ultimately affects Saudi company law. As an example of this: if the subject matter of a contract is unlawful from the perspective of the *Qur'an* and the Sunnah, this results in the invalidity of the contract.[156] Thus, the company will be invalid due to the unlawfulness of its objective.[157] It should also be noted that all types of statutory company are considered profit firms in which profitability is the main reason for the formation of the business enterprises, as set forth in the CL 2015.

The forms of business organisation mentioned in the CL 2015 are:[158] general partnerships,[159] limited partnerships,[160] syndicate partnerships (these are formed for specific transactions and have no legal personality and no need to be disclosed),[161] limited liability companies[162] and joint stock companies.

With regard to joint stock companies, the CL 2015 contains an entire chapter containing 98 articles (52–150) that cover the central regulation of joint stock companies in the Kingdom. The CL 2015 defines this type of company as one whose capital is divided into transferable shares of equal value, where the liability of its members for the company's debt is limited to the value of their shares.[163] Saudi corporate law provides joint stock companies with a legal form that possesses the core legal characteristics of a large modern company:[164] (i) a separate legal personality,[165] including limited liability of members for the

[154] Article 2 of the CL 2015. Since there is no official English translation of the CL 2015, the researcher has translated the new CL 2015 with the assistance of the translated text of the CL 1965 taken from MOCI after making the necessary amendments to reflect the new version of the law.
[155] See C Childress, 'Saudi Arabian Contract Law: A Comparative Perspective' (1990) 2 St Thomas Law Forum 69.
[156] See S E Rayner, *The theory of Contracts in Islamic Law* (Arab and Islamic Laws Series, London, Graham & Trotman 1991) 91 and 95.
[157] Al-Jaber (n 71) 194.
[158] Article 3 of the CL 2015.
[159] See particularly articles 17–37 of the CL 2015.
[160] See specifically articles 38–42 of the CL 2015.
[161] See 43 of the CL 2015.
[162] See particularly articles 151–181 of the CL 2015. It is worth mentioning here that partners of limited liability companies are not responsible for the company's debt other than their shares in the company's capital. The management of the limited liability company is statutorily delegated to at least a single manager who is formally distinct from its members. Shares are only transferable in accordance with conditions set down in the company's memorandum. Unlike joint stock companies, it is prohibited for limited liability companies to resort to the initial public offering (IPO). Arguably, a limited liability company can be categorised as a closed company in which it is much closer to the UK private company limited by shares which is grouped with the French SARL in the book of Kraakman et al., see Armour, Hansmann and Kraakman (n 1) 17. Surely, the limited liability company corresponds directly to its French counterpart (SARL), see Hanson (n 52) 290.
[163] Article 52 of the CL 2015.
[164] Armour, Hansmann and Kraakman (n 1) 1, 5–16.
[165] Article 14 of the CL 2015.

company's debt;[166] (ii) full transferability of shares;[167] (iii) the delegation of management to the board;[168] and (iv) the relationship between the right of its members to control the company and to receive the profit in return for the supply of the company's capital.[169] In this regard, the Saudi joint stock company can be considered in the category of large corporate enterprises such as UK public companies by shares, which have similar core legal characteristics to the modern corporate form.[170] Similar to UK law,[171] under the Saudi law, for the firm to offer its shares to the public, it must be established as, or converted into, a joint stock company[172] in accordance with the provisions of the CL 2015.[173]

Within the structure of the joint stock company, two fundamental elements are identified in the CL 2015. The first is the establishment of the body of shareholders. In this regard, although the CL 2015 does not give a definition of a shareholder, there is a close link between equity ownership and the acquisition of the capacity of a shareholder,[174] in which a shareholder can be described as any person[175] who owns at least one share of the company's capital stock. The second essential organisational element of joint stock companies is that the main power over the company's affairs must be vested in a delegated board structure, namely the board of directors.[176] According to article 68 (1), the number of directors appointed to the board must be no fewer than three and no more than eleven.

The CL 2015, as with its predecessor of 1965, does not define the term *director*. However, it seems that a director is understood in Saudi law to refer to any person formally appointed as a member of the board of directors.[177] By contrast, the UK Companies Act 2006 (CA 2006) defines the 'director' as 'any person occupying the position of a director'.[178] In UK law, directors can be divided into *de jure* directors and *de facto* directors. While the

---

[166] Article 52 of the CL 2015.
[167] Article 52 of the CL 2015. This does mean free tradability of shares as the law may impose or allow for restriction on the transferability of shares, see articles 107 and 108 of the CL 2015.
[168] Article 68(1) of the CL 2015.
[169] See particularly articles 11(1), 88(a)(1), 110, 113(1) of the CL 2015.
[170] See Davies and Worthington (n 2) 10–11.
[171] A public company is one that is allowed to offer its securities to the public, see ibid 12; see also section 755 of the CA 2006.
[172] A S Awwad, 'Legal Regulation of the Saudi Stock Market: Evaluation, and Prospects For Reforms' (PhD thesis, University of Warwick 2000) 85; see also article 11(a) of LRs 2004.
[173] See particularly articles 56–67 of the CL 2015 which are devoted to the company's incorporation.
[174] See The Board of Grievances, Case No. 592/1/S, Appeal Division Decision No. 7/V/940 2007(1429H), <http://bogcases.bog.gov.sa/JudicialRules/1428/classification2/Volume1/Folder2/57_1.pdf> accessed 1 February 2015.
[175] This includes both natural persons or legal persons, such as corporate entities, see S Yahea, *The Brief in Saudi Commercial Law* (Arabic), (6th edn, Arabian Modern Office 2010) 147.
[176] Article 68(1) of the CL 2015.
[177] See article 68(1) of the CL 2015.
[178] See section 250 of the CA 2006.

former has been properly and 'formally' selected,[179] the latter is referred to as a director who has not been formally appointed.[180] Under the common law, for a person to be a *de facto* director, the person needs to participate in the management of the company and carry out the same functions as other directors would;[181] otherwise, he/she will not be considered as a *de facto* director regardless of whether he/she is called as a director.[182] In the UK, the statutory definition of a director set out in section 250 of the CA 2006, as Keay points out, comprises the *de facto* director[183] in which the general statutory duties can also be applied to the *de facto* director.[184] In addition to the recognition of the *de jure* director and the *de facto* director, there is an additional type of director recognised by the UK law: the shadow director.[185] The CA 2006 makes it clear that the shadow director is subject to the general duties of directors set forth in Part 10 of the CA 2006.[186] In contrast with the UK, given the absence of statutory definition of 'director' in Saudi law, there is no clear recognition of the concepts of '*de facto* director', or of 'shadow director', and this would raise uncertainty as to where the directors' duties lie.[187]

It is clear under the Saudi law, as mentioned above, that the concept of director refers to any person who is formally appointed as a member of the board. This, by implication, means that the directors' duties apply to various types of board member (i.e., executive director, non-executive director and independent director).[188] However, while the CL 2015 does not place directors into various categories,[189] a question could be raised about whether different functions undertaken by directors are recognised in terms of the application of directors' duties; an important consideration that will be addressed later.[190] It should be noted that the board might include a nominee director, such as the government representative to the board.[191] The nominee director, under the Saudi law, is undoubtedly

[179] See *Secretary of State for Trade and Industry v Tjolle* (1998) BCC 282, 288–289.
[180] Ibid.
[181] Ibid. 282–283
[182] Ibid.
[183] See Keay (n 6) 15–16.
[184] Ibid 16.
[185] See section 251 of the CA 2006, which defines the shadow director under sub-section (1) as 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'.
[186] See section 170 (5) of the CA 2006.
[187] Although it is important for ensuring the accountability of directors to define the director broadly to include a *de facto* director, this issue is beyond the scope of the analysis carried out in this research as it will not be dealt with in the proposed reform of the Saudi law of directors' duties.
[188] It is noteworthy that since the board is entitled to delegate particular powers and functions to non-members, the latter is subject to the same rules on duties and responsibilities that apply to directors, article 75(1) of the CL 2015.
[189] This is also the case in relation to their predecessor of 1965. However, the CGRs have recognised those types of directors since the first version issued in 2006, see section (2.7), Chapter 2 in this thesis.
[190] This is particularly relevant to the application of duty of care, see section (3.4), Chapter 3 in this thesis.
[191] Examples of companies with nominee directors are mentioned in section (2.5.3), Chapter 2 in this thesis.

subject to those duties applied to other members of the board of directors.[192] This is also the case in the UK law where the nominee director owes the same obligations owed by other directors.[193]

1.4.2 Primary legislation for listed companies: The Capital Market Law 2003[194]

For the purpose of ensuring greater fairness and transparency in the trading of securities and giving investors more protection and confidence in the market, the Saudi legislator decided to reset the regulatory and supervisory framework of the market through the introduction of the CML 2003, which was developed by way of legal transplantation.[195] With regard to the scope of the CML 2003, the law applies to dealings relevant to securities listed or to be listed on the stock market. According to the CML 2003, a non-exhaustive list of securities governed by the law is set down in article 2, and includes the company's shares.[196] The Saudi securities law makes it clear that instruments such as cheques, bills of exchange and insurance policies do not fall within the statutory definition of securities and therefore are not subject to the CML 2003.[197]

One of the most significant aspects of the CML 2003 is the creation of the market regulator (CMA),[198] which is solely responsible for supervising and controlling Saudi market operations. The CMA has law-making power in order to accomplish the statutory objectives of the CML 2003.[199] Through using these regulative powers, the CMA has introduced a number of regulations[200] such as the Listing Rules 2004 (LRs 2004) and the Merger and Acquisition Regulations 2007 (MARs 2007).[201] What is more germane to the discussion of this thesis is the introduction of the recent version of CGRs in 2017, which repeals the 2006 version.

---

192 See the Decree of Minster of Commerce and Investment No. 423 6 February 1989, the Council of Minsters' Decrees No. 17 30 October 1981 and No. 80 2 January 1985.
193 See Keay (n 6) 12.
194 An English translation of the CML 2003 is on the website of the CMA <https://cma.org.sa/en/RulesRegulations/CMALaw/Pages/default.aspx> accessed 31 August 2017.
195 Beach (n 28) 355.
196 See article 2 of the CML 2003.
197 Article 3 of the CML 2003.
198 See article 4 of the CML 2003. The CMA will be considered in section (1.6) in this Chapter.
199 Article 5 of the CML 2003.
200 The regulations have been subject to amendments, where necessary, by the CMA. An English translation of recent version of regulations is on the website of the CMA <https://cma.org.sa/en/RulesRegulations/Pages/default.aspx>.
201 See the website of the CMA <http://www.cma.org.sa/en/Pages/home.aspx>.

Given the legal status of joint stock companies, the CML 2003 clearly provides for the establishment of the ‘Saudi Stock Exchange’(Tadawul).[202] The Tadawul is the primary market available for the trading of securities in Saudi Arabia. The Saudi stock market has witnessed a significant growth following the new regulatory and legal framework established by the CML 2003.[203] This is illustrated by the increase in numbers of listed companies from 73 in 2000[204] to more than 171 companies at the end of 2015.[205] Recently, a parallel equity market (Nomu) was lunched in Saudi Arabia with less strict listing requirement. This will provide an alternative platform for companies, especially small and medium enterprises, to go public.[206] At present, there are only nine companies listed on Nomu.[207]

1.4.3 Secondary legislation: The Corporate Governance Regulations 2017

The CGRs were initially introduced in 2006 in response to the collapse of the Saudi stock market in the same year. This event underlined for the state the need for better corporate governance practices.[208] The CGRs 2006 were repealed with the introduction of CGRs 2017, which have been introduced with the aim of promoting the governance of listed companies, which will, in turn, contribute significantly to economic growth.[209] Unlike the 2006 version,[210] the CGRs 2017[211] include greater detail regarding the governance of listed companies. It is not possible here due to the limited space and purpose of this thesis to consider every provision but only those relevant to the analysis carried out in the subsequent chapters.

The central question to be posed concerns the binding nature of the provisions contained in the CGRs 2017. It is clear from article 2(b) that the CGRs 2017 are ‘mandatory to

---

[202] Article 20(a) of the CML 2003.
[203] For more discussion, see Almajid (n 126).
[204] See K Al-Abdulqader, G Hannah and D Power, ‘A Test of the Weak-form of the Efficient Markets Hypothesis for the Saudi Stock Market’ (2007) 6 Journal of Emerging Market Finance 167,171.
[205] See the Statistical Report, published in *Alarabiya* (9 March 2017) (Arabic) <https://www.alarabiya.net/ar/aswaq/2017/03/09/110-ارتفاعا-بعدد-الشركات-المدرجة-في-تداول-بـ10-سنوات.html> accessed 26 August 2017); see also Table (2.1), Chapter 2 in this thesis.
[206] For brief overview about Nomu, see the website of Tadawul <https://www.tadawul.com.sa/wps/portal/tadawul/knowledge-center/about/parallel-market> accessed 1 September 2017.
[207] See the website of Tadawul <https://www.tadawul.com.sa/wps/portal/tadawul/markets/equities> accessed 1 September 2017.
[208] See K Falgi, ‘Corporate Governance in Saudi Arabia: A Stakeholder Perspective’ (Phd Thesis, University Of Dundee 2009) 2.
[209] See the announcement of CMA, dated 15/02/2017 <https://cma.org.sa/en/MediaCenter/PR/Pages/NewCGR.aspx> accessed 1 September 2017.
[210] The CGRs 2006 only consist of 19 articles.
[211] While the CGRs 2017 applies to listed companies, there is an identical draft of the CGRs 2017 that applies to unlisted joint stock companies, but is voluntary in nature.

companies except the provisions that contain a reference of being guiding'.[212] This means that the company has no option other than to incorporate the mandatory rules of the CGRs 2017 into its own corporate governance code.[213] Given the mandatory nature of the CGRs 2017, the subsequent point to consider concerns how the regulations will be implemented. A closer look at the CMA's approach to the mandatory provisions of the CGRs 2006 indicates that these mandatory rules will be implemented on a 'comply or be penalised' basis. Unlike the new regulations, the CGRs 2006 are not, in nature, legally binding[214] and *most* of the provisions are implemented on a 'comply or explain' basis,[215] as it is in the UK where the Corporate Governance Code is based upon the principle of 'comply or explain'.[216] However, not *all* provisions of the previous CGRs 2006 are voluntary. The CMA was given the discretionary power to render any particular rule compulsory,[217] and it took the 'comply or be penalised' approach to enforcing mandatory provisions; for example, the CMA imposed a fine of SAR 50 thousand (more than USD 13,000) on the Fawaz Abdulaziz Al-Hokair Company for failing to conform with mandatory art 12(e) of the CGRs 2006, which required the appointment of independent directors on the board of the company.[218] Given the CMA's approach to enforcing mandatory rules in the CGRs 2006, one may assume that the CMA would perhaps implement mandatory provisions on the comply or be penalised basis; this an important consideration to take into account while assessing the public enforcement of breaches of directors' duties later in this thesis.[219]

---

[212] As a matter of fact, most provisions of the CGRs 2017 are mandatory except some provisions that are clearly referred to as non-binding, such as sub-article 66(b), articles 83 and 85.
[213] See article 94 of the CGRs 2017.
[214] Article 1(b) of the CGRs 2006.
[215]As an exception of the voluntary nature of the Regulations, article 1(c) of the CGRs 2006 provides that 'a company must disclose in the Board of Directors' report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them'.
[216] Since the first version of the Code which was produced in the Cadbury Report in 1992, the Code has retained adherence to the 'comply or explain' principle, as a basis for the corporate governance regulation, although the Code has since then been subject to several amendments, see *The Cadbury Report* (n 3) paras 1.3, 1.10 and 3.7; for the most recent version of the Code, see the UK Corporate Governance Code 2016, section 'Comply or Explain', <https://www.frc.org.uk/getattachment/ca7e94c4-b9a9-49e2-a824-ad76a322873c/UK-Corporate-Governance-Code-April-2016.pdf> accessed 1 September 2017. For an analysis of the UK approach of 'comply or explain', see I MacNeil and X Li, ''Comply or Explain': Market Discipline and Non-compliance with the Combined Code' (2006) 14 Corporate Governance: An International Review 486.
[217] See article 1(b) of the CGRs 2006.
[218] See the Board of CMA's decision dated on 14/10/2012, available in English at <http://www.cma.org.sa/En/News/Pages/CMA_N_1221.aspx> accessed 29 May 2013.
[219] See section (5.2), Chapter 5 in this thesis.

1.5 Judicial Institutions in Saudi Arabia

In order for any formal legal system to make a significant contribution to the processes of economic and social development, it is critical to establish a business-friendly legal framework. A strong system of enforcement is a fundamental pillar of that framework.[220] The enforcement of law and the resolution of disputes, to a large extent, depend upon the effectiveness and fairness of the judicial branch which, as Shihata correctly points out, 'serves as a final arbiter of a functioning legal system', and which in return has an essential role to play in a system based on the rule of law.[221] Hay, Shleifer and Vishny stressed the important role of the judiciary when they asserted that in a system based on the rule of law people learnt 'what the legal rules say, [structure] their economic transactions using these rules, [seek] to punish or obtain compensation from those who break the rules, and [turn] to the public officials, such as the courts . . . to enforce these rules'.[222] Accordingly, to develop an effective legal framework at the national level, it is necessary to establish a well-functioning judiciary that is staffed by trained judges, is bound to apply laws[223] and will supply a predictable decision without onerous delay.[224]

The presence of fair and efficient courts is particularly seen as necessary in order to provide investors with remedies in the case of a breach of legal rules.[225] The role of judges as legal enforcers tends to acquire further importance when the discussion turns to directors' breaches of their obligations of care and loyalty (open-ended standards), since judicial intervention in the process of enforcement of directors' duties, as will be seen later in this thesis, tends to be necessary in establishing the boundaries of directors' obligations[226] and assessing, or even influencing, directorial decisions *ex post*.[227] Thus, it is necessary to give a brief account of the Saudi judicial system as the analysis below will be essential to understanding the argument presented in the thesis.

---

[220] I Shihata, 'The Role of Law in Business Development' (1996) 20 Fordham Int'l LJ 1577, 1579–1582
[221] Ibid 1582.
[222] R Hay, A Shleifer and R Vishny, 'Toward a Theory of Legal Reform' (1996) 40 European Economic Review 559, 559.
[223] IShihata (n 220) 1582.
[224] Ibid 1582–1583; Hay, Shleifer and Vishny (n 222) 560.
[225] B Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2000) 48 UCLA L Rev 781, 790, 803–804 and 807; See also R la Porta et al., 'Law and Finance' (1998) 106 Journal of Political Economy 1113, 1140.
[226] K Pistor and C Xu, 'Fiduciary Duty in Transitional Civil Law Jurisdictions Lessons from the Incomplete Law Theory' (ECGI - Law Working Paper No. 01/2002) 4 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480> accessed 1 June 2017.
[227] J Armour, H Hansmann and R Kraakman, 'Agency Problems and Legal Strategies' in R. Kraakman et al. (ed), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009) 39–40

It is important to make it clear from the outset that Saudi Arabia has no system of publishing judicial rulings. The judiciary only publishes selectively what they think should be made available to the public. Nevertheless, this can be seen as a stepping stone towards more predictability and transparency compared to the period before the 2007 judicial reform. One of the significant features of the Saudi court system is that no Saudi court applies judicial precedent (*stare decisis*)[228] as there is nothing in the law compelling judges to follow such a doctrine and judicial rulings make no reference to precedent. By implication, this means that Saudi judges are not bound by previous decisions or the decisions of a superior court.[229] To clarify the role of judges, it might be beneficial to distinguish between the two main bodies of law in Saudi Arabia: Sharia law and the state laws. In relation to non-codified rules of Islamic origin, judicial rulings are not considered to be a source of Sharia law and the authority to develop the Islamic law, as stated above, belongs to jurists rather than judges who refer to the former for statements of law.[230] Accordingly, given the lack of judicial precedent, Islamic law is best described as a 'jurists' law', not a 'judges' law'. [231] With respect to codified rules of foreign origin, in the absence of the doctrine of judicial precedent, Saudi judges seemingly have relatively limited power within the context of written legal codes since they simply tend to enforce codified rules. The courts' power is limited to interpreting the law and does not extend to the entitlement to change the law, as the power to introduce new laws and amend existing rules lies with the Saudi regulatory branch.[232] It can therefore be inferred that, similar to the civil law traditions, there is no system of binding judicial precedent in Saudi Arabia and the court often adheres to the formal application of written rules without deviation. This understanding of the tradition of Saudi courts will be relevant to the discussion regarding the role of the court in filling the legislative vacuum, and the feasibility of transferring the UK standards and rules for directors' duties to a legal system influenced by, or similar to, the civil law court tradition.[233]

---

[228] See D J Karl, 'Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know' (1991) 25 George Washington Journal of International Law and Economics 131, 149.
[229] Ibid.
[230] See the above discussion in sections (1.2.1.2) and (1.2.2) in this Chapter. For more details about the practice of Saudi courts in applying the Sharia, see Vogel (n 61).
[231] Ibid 24.
[232] See A Al-Jarbou, 'Judicial Independence: Case Study of Saudi Arabia' (2004) 19 Arab Law Quarterly 5, 51 who points out that court will not even have the power to nullify the unconstitutional provision and its authority will be limited to notify the Legislative (Regulatory) Branch with regard to the unconstitutionality of a statutory provision.
[233] See the discussion in Chapters 3, 4 and 6 in this thesis.

1.5.1 The major features of the court system: The 2007 project for reform

A considerable stride towards overhauling the court system was made with the introduction of the Judiciary Law 2007 (JL 2007) and the Board of Grievances Law 2007 (BGL 2007)[234] which repealed the Judiciary Law 1975 (JL 1975) and the Board of Grievances Law 1982 (BGL 1982) respectively.[235] According to Saudi officials, the Saudi government allocated a budget of SAR 7 billion (over USD 1.8 billion) to carry out the project for judicial reform.[236] The money was used (and is still being used) to upgrade judicial facilities and services, including the construction of buildings for new courts, and to train and appoint judges and other judicial and administrative staff.[237] The reform project also involves the revision of judicial statutes.[238] In practice, this comprehensive reorganisation of the existing judicial infrastructure cannot be completed quickly and the judicial system has remained in a period of transition since 2007.[239] This is clearly illustrated by the fact that the Board of Grievances retained jurisdiction over commercial proceedings (including company law cases) until the completion of the commercial courts' facilities in September 2017.[240]

One of the main features of the post-2007 judicial branch is that it contains two main judicial bodies: the Ordinary Judiciary (Ordinary Courts System)[241] and the Board of Grievances (the Administrative Courts system). While the former has jurisdiction over civil, criminal and commercial disputes,[242] the latter has jurisdiction over administrative disputes.[243] Another significant development in the implementation of the new judicial reform project is the gradual transfer of quasi-judicial committees entitled to hear civil and commercial disputes and criminal cases to the Ordinary Judiciary.[244] However, such judicial arrangements are not aimed at transferring specific administrative tribunals that

[234] An English translation of the Laws are on the website of Beureau of Experts at the Council of Ministers <http://www.boe.gov.sa>.
[235] See article 85 of the JL 2007 and article 26 of the BGL 2007.
[236] See the interview with the Deputy Minister of Justice, *Alriyadh Newspaper* (06 October 2007) <http://www.alriyadh.com/iphone/article/284896> accessed 22 December 2014.
[237] See the Implementation Mechanism of the Judiciary Law and The Board of Grievances Law (Implementation Mechanism 2007) issued by the Royal Decree No. M/78 dated 01 October 2007, available in Arabic at <https://www.moj.gov.sa/Documents/Regulations/pdf/03.pdf> accessed 2 September 2017.
[238] Ibid paras 1/9/1 and 3/9. For example, the Sharia Procedure Law 2013 (SPL 2013) and the Criminal Procedure Law 2013 (CPL 2013) were passed as part of the agenda to reform the judicial system.
[239] Implementation Mechanism 2007 (n 237) para 3/1.
[240] Ibid para 1/8/6. See section (1.5.2) in this thesis.
[241] This type of court was previously known as *Sharia courts*. However, unlike the JL 1975, the 2007 Law does not name them as such and it simply refers to them as 'courts'. Since the Kingdom has adopted a dual system of judiciary, it might be accurate to describe courts introduced under the JL 2007 as 'ordinary courts' in order to distinguish them from the administrative courts established by the BGL 2007.
[242] Implementation Mechanism 2007 (n 237) section 2; for more details, see section (1.5.2) in this Chapter.
[243] See particularly articles 1 and 13 of the BGL 2007.
[244] Implementation Mechanism 2007 (n 237) para 1/9/1.

have already been exempted from falling within the domain of the Ordinary Judiciary.[245] The status of these committees is supposed to remain unchanged until the Supreme Judiciary Council has reached its decision, in the form of a recommendation, as to whether any of the committees should be abolished and so transfer their responsibilities to the ordinary courts.[246]

One of the quasi-judicial committees that falls outside the jurisdiction of the Ordinary Judiciary is the Committee for the Resolution of Securities Disputes (CRSD), which was set up by the CML 2003 to have exclusive jurisdiction over claims and disputes concerning the application of the CML 2003, its Implementing Regulations and instructions from the CMA or the Saudi Stock Exchange.[247] The CRSD is statutorily entitled to hear legal proceedings brought by a private actor against another if the causes of the action are, for example, liability for material misrepresentation in 'a prospectus',[248] or in 'the sale or purchase of a security'.[249] The jurisdiction of the CRSD extends to hearing claims made by the CMA to enforce the capital market's rules[250] and claims brought against the CMA's decisions.[251] The committee holds 'all necessary powers to investigate and settle complaints and suits'[252] in which it is, for example, entitled to issue subpoenas, give rulings, impose sanctions, order the provision of evidence[253] and award damages.[254] The CML 2003 established a two-tier litigation system in which the decisions of the committee can be appealed against before the Appeal Panel,[255] the decisions of which are final and definitive.[256]

1.5.2 The Ordinary Judiciary: The founding of specialised courts

It is important to pay specific attention to the new reorganisation of the Ordinary Judiciary within whose jurisdiction company law cases fall. The most significant contribution of the JL 2007 lies in the creation of the Supreme Court (Cassation Court), which sits at the top of a pyramidal structure of ordinary courts.[257] As the highest court in the Kingdom, the

[245] Ibid para 1/9/1.
[246] Ibid para 3/2.
[247] Article 25(a) of the CML 2003.
[248] Article 55(a) of the CML 2003.
[249] Article 56(a) of the CML 2003.
[250] See article 59(a) of the CML 2003.
[251] Article 25(c) of the CML 2003.
[252] Article 25(a) of the CML 2003.
[253] Article 25(a) of the CML 2003.
[254] Article 25(c) of the CML 2003.
[255] Article 25(f) of the CML 2003
[256] Article 25(g) of the CML 2003
[257] See article 9 of the JL 2007.

Supreme Court is statutorily responsible for reviewing appeal courts' judgments and decisions in relation to certain situations set forth in the JL 2007.[258] In addition, the 2007 law makes it clear that the Supreme Court, through its General Assembly, has the authority to establish general principles in respect of judicial matters.[259] In this regard, the Supreme Court could play a significant role in confronting the inconsistency of judicial rulings by adopting legal principles that can be applied consistently.[260]

Under the new judicial reform, in the first instance, courts are grouped into five categories:[261] (i) general courts,[262] (ii) criminal courts,[263] (iii) personal status (family) courts,[264] (iv) commercial courts and (v) labour courts.[265] Indeed, one of the main features of the JL 2007 is the creation of specialised first instance courts within the domain of the Ordinary Judiciary.[266] These courts are expected to 'have limited and frequently exclusive jurisdiction' in a particular area of law.[267] This might consequently contribute to fewer appeals against judgments.[268]

Another significant aspect of the JL 2007 is the adoption of a new system for the courts of appeal. The law requires that at least one court of appeal operates in every Saudi province.[269] Each appeal court performs its judicial tasks through specialised divisions[270] grouped as follows: civil divisions, criminal divisions, personal status (family) divisions, commercial divisions and labour divisions.[271] Importantly, the court of appeal, instead of having limited power of reversal,[272] is entitled to make its own judgment, giving it the power to affirm, modify, or reverse the lower court decision,[273] or remand the case to the court of first instance for trial.[274]

---

[258] See article 11(1) and (2) of the JL 2007.
[259] See article 13(2) (a) of the JL 2007.
[260] Vogel's interview with Dr M Al-Nafisa, 25–26 May 1986, see Vogel (n 61) 356.
[261] Article 9 of the JL 2007.
[262] Article 19 of the JL 2007
[263] Article 20 of the JL 2007
[264] Article 21 of the JL 2007
[265] Article 22 of the JL 2007
[266] See articles 20–22 of the JL 2007.
[267] M Zimmer, 'Overview of Specialised Courts' (2009) 8 International Journal for Court Administration 1, 1.
[268] Ibid 1–2.
[269] Article 15(1) of the JL 2007. In fact, under the umbrella of pre-existing law, only two courts were located in Riyadh and in Makkah, see A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235, 239, footnote 16.
[270] Article 15(1) of the JL 2007.
[271] Article 16 of the JL 2007.
[272] See particularly articles 187 and 188 of the repealed Sharia Procedure Law 2000 (SPL 2000).
[273] See article 190(2) of the SPL 2013 and article 197(2) of the CPL 2013.
[274] See article 192 of the SPL 2013.

The founding of independent commercial courts with specialised appeal divisions, which are intended to adjudicate commercial disputes, including company law cases, is important for the purposes of the present research.[275] This means that the Board of Grievances should no longer have jurisdiction over disputes arising from the application of the CL 2015.[276] According to the Implementation Mechanism 2007, the effect of the new judicial system is that the jurisdictions of the commercial first instance and appeal divisions of the Board of Grievances have been transferred to the new commercial courts and commercial appeal divisions respectively.[277] It follows that the commercial courts are now staffed by the same judicial staff who have been deciding commercial cases up to this point[278] and who are expected to have familiarity and long-standing expertise in corporate matters.[279] It is useful to note that since the launch of commercial courts on 22 September 2017, the Board of Grievances no longer has jurisdiction over commercial cases, including corporate matters.[280]

There is no doubt that the establishment of specialised commercial courts is considered to be one of the major benefits of the judicial reforms. In the words of Kechichian, the creation of commercial courts within the justice system is intended to 'ensure that everyone operate[s] within a sound investment climate, [and] to protect businesses from the vagaries of periodic disputes'.[281] Arguably, the commercial courts have the potential to contribute significantly to the codification of Sharia rules and principles in the field of commercial law. It could also be claimed that one of the major obstacles to increased foreign investment has been the lack of specialised commercial courts. Provided that such courts are staffed by well-trained judges specialised in commercial matters, the existence of the courts could promote fair and prompt litigation.[282] This, in turn, could attract domestic and foreign investment, and increase investors' confidence in the justice system and judicial rulings.

[275] For a non-exhaustive list of the commercial courts' jurisdictions over commercial proceedings, see article 35 of the SPL 2013.
[276] See the Council of Ministers Decree No. 241, 23 June 1987 which gave the Board of Grievances the jurisdiction to hear the commercial cases that fell within the jurisdiction of the Settlement of Commercial Disputes Committee which was abolished the Royal Decree No. 63, 23 July 1987.
[277] Implementation Mechanism 2007 (n 237) para 1/8/6.
[278] Ibid para 1/8/6.
[279] The Commercial Divisions in the Board of Grievances have had exclusive jurisdiction over company law disputes since 1987.
[280] See the Decision of the Supreme Judicial Council, No. 967/C, 22 September 2017.
[281] J A Kechichian, *Legal and Political Reforms in Saudi Arabia* (Abingdon, Routledge 2013) 29.
[282] This is one of the underlying purposes behind the creation of specialised courts, see Zimmer (n 267) 2.

It is worth mentioning that while adjudicating disputes, commercial courts are expected to apply state commercial legislations (e.g., the CL 2015), terms of contract and commercial customs.[283] In the absence of statutory provision governing the relevant matters falling within the scope of legislation, commercial courts should refer to general rules derived from Islamic law to resolve relevant disputes.[284] However, as will be explored throughout the chapters of this thesis, the role of the court in filling the legislative vacuum sufficiently is questionable as far as the application of directors' duties is concerned.[285]

1.6 Main Regulators of Corporate Governance

There are two main regulatory authorities that have a role in the public enforcement of rules of corporate governance: (i) the MOCI and (ii) the CMA. With the passing of the new Saudi corporate legislation in 2015, both regulators have a role to play in ensuring the compliance and proper implementation of the CL 2015. While the MOCI has responsibility for all types of companies, including unlisted joint stock companies, the CMA is the competent authority for ensuring the proper implementation of the CL 2015 by companies listed in the Saudi market.[286] In this regard, the MOCI and CMA, each according to its competence, has the power to pass resolutions and secondary regulations necessary for implementing relevant provisions of the law.[287] The supervision and monitoring function is one of the important tasks assigned to the regulators;[288] for example, the competent authority is entitled to initiate an investigation and inspect the company's accounts and other related documents.[289] Under the CL 2015, the competent authority has the power to refer violators to the public prosecutor in relation to conventions set out in articles 211 and 212,[290] along with the power to impose fines without referral to the public prosecutor on those committing any violation set out in article 213.[291]

It should be borne in mind regarding the Saudi securities market that the CMA was founded with the purpose of protecting investors and fostering market integrity.[292] To this end, the CMA has the necessary powers to fulfil its statutory responsibilities, which

[283] Al-Ghadyan (n 269) 244.
[284] Al-Jaber (n 71) 23–25.
[285] See the analysis carried out in Chapter 3 and 4 in this thesis.
[286] See articles 1 and 219 of the CL 2015.
[287] Article 225 of the CL 2015.
[288] Article 220 of the CL 2015.
[289] Article 220 of the CL 2015.
[290] Article 215 of the CL 2015
[291] Article 216 of the CL 2015
[292] In the UK the Financial Conduct Authority (FCA) is deemed to be equivalent to the CMA in the Saudi securities system.

include the regulation and development of the Exchange;[293] the regulation and monitoring of all matters relating to the issuance and trading of securities;[294] the protection of investors from unfair and illegal activities in the stock market;[295] achieving 'fairness, efficiency and transparency in securities transactions';[296] and ensuring investors' receipt of full and continuous disclosure of information in relation to securities and their issuers.[297] One of the main powers vested in the CMA as a public enforcer is either to impose penalties on wrongdoers liable for any breach of the CML 2003 and its Implementing Regulations, or request the CRSD to do so.[298] The CMA is also entitled to bring legal action before the CRSD against violators of securities law and regulations, and seek any of the sanctions from the non-exhaustive list set out in article 59 (a) of the CML 2003.[299]

1.7 Concluding Remarks

This chapter has given an overview of the legal system in which Saudi joint stock companies operate. It has highlighted the fact that Sharia has a strong influence over the general legal context and is the paramount law of Saudi Arabia. The primacy of Sharia is best illustrated by the requirement that the exercise of legislation is only legitimate when it produces laws that fall within the Sharia framework. Meanwhile, the fact that the Saudi legal system includes laws developed with the support of other jurisdictions' experience, demonstrates the flexible nature of Sharia, which permits the importation of rules of non-Islamic origin as long as they do not conflict with fundamental principles of Sharia. This overview has stressed that a joint stock company is a corporate form of organisation that has been established in statute. The corporate legislation (i.e. the CL 2015, as the recent version of the CL) is the main source of law governing joint stock companies, including various relationships within the company, such as the relationship between directors and shareholders. Once a joint stock company goes public, it is also subject to the CML 2003 and its Implementing Regulations in which the new CGRs 2017, unlike its predecessor of 2006, is legally binding. This, by implication, means that it should be implemented on the 'comply or be penalised' basis.

[293] Article 5(1) of the CML 2003.
[294] Article 5(2) of the CML 2003.
[295] Article 5(4) of the CML 2003.
[296] Article 5(5) of the CML 2003.
[297] Article 5(6) of the CML 2003; the Law devotes particularly articles 40–48 to the issue of disclosure concerning the securities and their issuers.
[298] See article 59(b) of the CML 2003.
[299] Article 59(a) of the CML 2003.

This chapter has also considered two main public enforcers of corporate governance, namely the Saudi court system and the main regulatory agencies (the MOCI and the CMA). The analysis has shown that Sharia and the state legislators are the main sources of legal obligations and the power of judges is often limited to enforcing rules found in those sources. Similar to the civil law tradition, Saudi judges tend to apply, not to make, the law; a valid consideration that should be taken into account when discussing the feasibility of legal transplantation of directors' duties. It has also been stressed that the recent reorganisation of the court system can be seen as a great stride forward in promoting an effective judicial system and encouraging fair and prompt litigation. Finally, the chapter then focused on the fact that both MOCI and the CMA are responsible for ensuring the proper implementation of the provisions contained in the CL 2015. While unlisted companies are under the supervision and monitoring of the MOCI, the CMA is responsible for ensuring listed companies' compliance with the CL 2015, in addition to its original role, as a public enforcer of securities law and regulations.

Having given an overview of the legal framework of joint stock companies, the focus will now shift to assessing where the directors' duties and formal their enforcement sit within the system of corporate governance. An evaluation of the mechanisms of accountability of directors is presented in Chapter 2.

Chapter 2: An Assessment of the Main Problems Within the Directors' Accountability Framework

2.1 Introduction

In any modern company, management powers are delegated to the board of directors because there are practical challenges, including a general lack of proficiency, that prevent shareholders from engaging in the day-to-day management of a company's business.[300] Even if shareholders possessed the necessary skills and expertise to fulfil the tasks of the management, they tend to lack the incentives necessary for involving themselves in day-to-day management,[301] or engaging in the complexities of reaching optimal decisions.[302] Therefore, it is less costly and more efficient to empower a central decision-making body (in the present case the board of directors) to run the company.[303] In order to achieve 'the best possible decision-making', it is inevitable that the directors require wide discretionary powers while managing the company.[304] The primary problem with wide powers is that directors may misuse them in ways that damage the interests of shareholders.

Thus, there is a need for mechanisms that ensure the proper use of powers and hold directors accountable for any misuse. The control and accountability framework for directors includes a number of mechanisms,[305] of which directors' duties and the private enforcement action (e.g. derivative actions) are important elements.[306] In this regard, company law is important because it is concerned with establishing directors' duties and associated mechanisms of enforcement. This suggests that if a significant degree of uncertainty and deficiency exists in this area of law, this will undermine the effectiveness

---

[300] Davies and Worthington (n 2) 349–350.
[301] F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Cambridge, Harvard University Press 1996). The authors claim that 'no shareholder, no matter how large his stake, has the right incentives unless that stake is 100 percent'.
[302] See B Sharfman, 'What's Wrong with Shareholder Empowerment?' (2012) 37 The Journal of Corporation Law 903, 904–905 and 908.
[303] According to theorists such as Kenneth Arrow, given the high costs of transmission of dispersed information within the organisation, 'the centralisation of decision-making serves to economise on the transmission and handling of information', K Arrow, *The Limits of Organization* (New York, W.W. Norton 1974) 68 –70; see also M Dooley, 'Two Models of Corporate Governance' (1992) 47 The Business Lawyer 461, 467.
[304] A Keay, *Board Accountability in Corporate Governance* (London, Routledge 2015) 261.
[305] For example, shareholder voting and markets; see R Jones, 'Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance' (2006) 92 Iowa Law Review 105; mechanisms of accountability also include (independent) non-executive director institution and monitoring by blockholders, see N Brennan and J Solomon, 'Corporate Governance, Accountability and Mechanisms of Accountability: An Overview' (2008) 21 Accounting, Auditing & Accountability Journal 885.
[306] Keay (n 304) 206, 219.

of such mechanisms within the system of corporate governance. Specifically, this uncertainty will weaken the role of the law of directors' duties and derivative actions, which create incentives for directors to act competently and loyally by imposing legal liability on those who fail to do so. This issue of uncertainty tends to attract much more attention when other corporate governance mechanisms are ineffective, or at least operate within limits, which supports the need to establish a sound legal liability system (i.e. directors' duties accompanied by private enforcement action) within the accountability framework for directors.

This chapter identifies the major problems that prevail within the current board accountability framework in Saudi Arabia with the purpose of defining where directors' duties and their enforcement sit within the entire framework. In carrying out this task, the chapter assesses four main mechanisms of board accountability and control: (i) monitoring by blockholders; (ii) shareholders' internal mechanisms at the general meeting; (iii) the role of independent directors; and (iv) the markets. With regard to the structure, the chapter starts by considering how the law allocates decision-making power within the company, followed by a discussion why there is a need for director accountability. The causes and impacts of legal uncertainty in the law of directors' duties and private enforcement action are then examined. The remainder of the chapter is devoted to exploring the drawbacks and limitations of the four mechanisms mentioned above.

2.2 The Division of Decision-Making Power in Company Law

Legally speaking, decisions concerning the management of a company are normally taken in two ways: (i) at the general meeting of shareholders or (ii) by the board of directors. In theory, depending upon the type of corporate decision, authority to make it could be directly conferred on either of the company's two organs or could be shared by, for instance, granting the board the power to make decisions subject to the approval of the general meeting.

In the UK the CA 2006 does not include a general statement determining the distribution of decision-making power between the board and the general meeting. The only mention of this matter is found in the Model Articles for Public Companies (Model Articles) issued pursuant to the CA 2006, which allocates the power as a default rule.[307] This was also the situation before the CA 2006, where Table A pursuant to the CA 1985 provides a default

[307] See articles 3–5 of the Model Articles.

rule of the division of decision-making power.[308] In the UK the distribution of powers between the board and the shareholder body 'rests on contract', mainly the company's bylaw,[309] in which the source of the company's authorities comes from the shareholder body which can, in theory, withhold powers from the board.[310] Under Table A and the Model Articles, the company's articles of association will typically confer on the board responsibility for corporate management and permit the board to exercise all corporate powers[311] with the right to delegate power to executive directors and managers.[312] As a default rule, the shareholder body, by special resolution, reserves the right to instruct the board to act in a particular way.[313] Importantly, the majority of cases in the UK have enforced the division of powers as determined by the company's articles of association, giving no enforceability to any instruction issued by shareholders to the board at the general meeting, except for an instruction issued by the passing of a special resolution.[314]

As far as Saudi company law is concerned, in contrast to UK company law, the board's authority to manage a company is statutorily provided for[315] and this cannot be altered by the company's bylaws. The CL 2015, like its predecessor of 1965,[316] further makes it clear that the board shall possess the broadest powers while managing the company's affairs and may delegate any of its powers to one or more of its members or to non-members, namely senior managers.[317] This leads one to assert that under the Saudi law it is the statute not the shareholder body that confers powers on the board of directors.

While the powers of a company are primarily held by the directors, the Saudi corporate statute, like UK company law, requires the approval of the shareholder body for the most fundamental corporate decisions such as amendments to the company's articles[318] and mergers.[319] Importantly, the general meeting is also entitled to increase the number of decisions that require shareholder approval by inserting provisions that reserve additional

[308] See section 70 of Table A.
[309] K. Wedderburn, 'Control of Corporate Actions' (1989) 52 Modern Law Review 401, 402.
[310] D Kershaw, *Company law in context : text and materials*, (2nd edn, Oxford, Oxford University Press 2012) 191–192.
[311] See section 70 of Table A and article 3 of the Model Articles.
[312] See section 72 of Table A and article 5 of the Model Articles.
[313] See article 4 of the Model Articles.
[314] See, for example, *Automatic Self-cleansing Filter Syndicate Co. Ltd v Cuninghame* (1906) 2 Ch 34 , 38, 40, 43 and 44; *John Shaw and Sons v Shaw and Shaw* (1935) 2 KB 113 , 134. Seemingly, it has been generally accepted that this is the position of UK common law, see Davies and Worthington (n 2) 358–360; Kershaw (n 310) 200. But for contrary views, see, for instance, *Marshall's Valve Gear Co. Ltd. v Manning, Wardle & Co. Ltd.* (1909) 1 Ch 267 , 272–274.
[315] See article 68(1) of the CL 2015, which has affirmed the ruling under article 66 of the CL 1965.
[316] Article 73 of the CL 1965
[317] Article 75(1) of the CL 2015.
[318] For the Saudi law, see article 88(1) of the CL 2015. Regarding the UK, see section 21 of the CA 2006.
[319] See article 94(4) of the CL 2015. Concerning the UK, see section 907 (1) of the CA 2006.

powers for the general meeting into the company's articles.[320] As an exception to this rule, article 75(2) of the CL 2015[321] enables a majority of shareholders by an ordinary resolution to impose limitations on the board's exercise of certain powers mentioned in sub-article 2 (e.g., selling or mortgaging the company's assets). This exception is only valid in the absence of express provision in the company's articles that empower the board to exercise the relevant powers in article 75(2). In any event, it is noteworthy that even if more decision-making powers can be gained through changing the articles of association, it is significant that the default position in Saudi Arabia means that the shareholder body would need to withdraw some powers from directors, thus widening the scope of their approval rights. In practice, it appears that the articles of associations of many companies invest the board of directors with very wide authority in making various corporate decisions including some of, if not all, those mentioned in article 75(2) of the CL 2015.[322]

When the balancing of powers between the board of directors and the general meeting of shareholders is opened up for discussion, it is necessary to recall that the board of directors being given management powers is the fundamental component of corporate law. Although the legal source of allocation of powers may differ from one jurisdiction to another, this does not much change the reality that the decision-making power ultimately resides in the board of directors. For example, in jurisdictions like the United States (particularly in the Delaware corporate law), the board's power to manage the company is derived from the corporate statute and this has been used as a basis to argue for director primacy.[323] Bainbridge, a leading advocate of director primacy in corporate governance, argues in answering the question of whether shareholder primacy, which *inter alia* assumes ultimate shareholder control over the corporation,[324] prevails in US Delaware corporate law that 'there is no such thing as shareholder primacy – it exists in neither law nor fact'.[325] In public companies, director primacy has been created by rules vesting ultimate decision-

[320] See particularly article 75(1) of the CL 2015.
[321] It is similar to its immediate predecessor article 73 of the CL 1965. The main difference between the two provisions is that article 75(2) of the CL 2015 grants certain powers, as a default rule, to the board of directors, whereas article 73 of the CL 1965 prohibits the exercise of such powers unless otherwise stipulated in the company's articles of association.
[322] See, for instance, section 20 of Saudi British Bank's bylaw <http://www.sabb.com/en/about-sabb/about/>; section 16 of Jarir Marketing Co.'s bylaw <http://www.jarir.com/sa-en/jarir-company-profile>; and section 15 of Zamil Industrial Investment Co.'s bylaw <http://www.zamilindustrial.com/?lang=en>. The articles of associations of the aforementioned companies are available on the websites of the respective companies, accessed 29 March 2016.
[323] S Bainbridge, *The New Corporate Governance in Theory and Practice*, (Oxford, Oxford University Press 2008) 34–36.
[324] According to Bainbridge's explanation, the concept of *shareholder primacy* can be divided into two branches, namely (i) the shareholder wealth maximisation norm, as an objective of the company; and (ii) the ultimate shareholder control, see ibid 53.
[325] S Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 Northwestern University Law Review 547, 574.

making authority in the board of directors.[326] Furthermore, director primacy, as has been said, can be inferred from the limited scope of powers reserved for the general meeting of shareholders.[327]

In contrast with the United States, the legal source of the board's authority in the UK, as mentioned above, is the company's article of association,[328] which supports the prevalence of shareholder primacy in the UK.[329] Furthermore, unlike the US legal model of corporate governance, the UK model is deemed to be much more 'shareholder-centric'.[330] Nevertheless, it can be claimed that the UK law, in reality, arguably includes underlying aspects of directors' primacy.[331] To explain this point, Moore argued that although directors derive their decision-making power from shareholders, the board's supreme role in managing the company is not merely seen as a 'responsibility' but, more importantly, as a 'constitutional right' that 'is consequently defensible by the board against [shareholders]' who try to challenge 'the board's executive prerogative'.[332] This argument, as Moore points out, is further upheld by the position of the UK case law, which opposed the hierarchical relationship between the board and the general meeting of shareholders, in which no corporate body enjoys constitutional primacy over the other;[333] the case law rather considers it to be "a reciprocal one between contracting equals".[334] On the contrary, it has been said that the board's primacy over the company's management is confirmed by the UK law by showing that shareholders, in most circumstances, remain 'formally' subject to 'the prerogative of the board' on a day-to-day basis.[335] Furthermore, while shareholders under the UK law enjoy the right of instruction, the shareholders' interference in the authority attributed to the board, as mentioned above, is not permitted unless the right of instruction is exercised according to a specific procedure,[336] which might be highly

---

[326] Ibid 559–560.
[327] Ibid 559 and 569.
[328] See footnotes 307 – 312 and accompanying text in this Chapter.
[329] See S Watson, 'The Significance of the Source of the Powers of Boards of Directors in UK Company Law' (2011) 6 Journal of Business Law 597, 606 and 611.
[330] See M Moore, *Corporate Governance in the Shadow of the State* (Oxford, Hart Publishing 2013) 28.
[331] See ibid 29; S Galletti, 'The Existing Division of Corporate Decision-Making Power in the UK, USA and Europe: A Comparative Perspective' (2015) Corporate Governance Journal, Bond University 2–4 <http://epublications.bond.edu.au/cgej/36> accessed 22 April 2016. In the view of Watson, although the board of directors derives its management power from the company's articles of association in the UK, the legal source of board authority has little or no practical importance unless there is a clear evidence linking the legal source of the board's authority and the amount of power given to directors, see Watson (n 329) 611–612.
[332] Moore (n 330) 25.
[333] Ibid 28.
[334] See ibid 28 where Moore refers to *John Shaw and Sons v Shaw and Shaw* (n 314) as an example of the case law on this particular issue.
[335] Moore (n 330) 29.
[336] See footnotes 313 – 314 and accompanying text in this Chapter.

impractical. As a matter of fact, the shareholder instruction provision (i.e., section 70 of Table A or article 4 of the Model Articles) is rarely embraced by public companies in the UK.[337] As one commentator asserts, if this provision were widely adopted into the bylaws of public companies, it would 'entrench shareholder primacy in a manner not yet achieved'.[338] The argument in favour of director's supremacy can be further supported by the fact that the shareholders' power to declare dividends is formally subject to the board's recommendation concerning the amount of dividends.[339]

The Saudi law approach to distributing powers between the shareholder body and the board of directors does not differ much from other jurisdictions. The law noticeably tilts the balance of power towards the board of directors. This assumption can be inferred from the fact that the board derives its management power from the statute rather than the shareholders. Even though the law permits shareholders to reserve certain decisions for themselves through the bylaw amendment, this does not change the fact that the default position is set in favour of the board of directors. In addition, while Saudi corporate statute, as a mentioned above, vests wide and discretionary powers of management in the board of directors, shareholder voting rights are basically limited to the election and removal of directors[340] and the granting of their approval in relation to very limited corporate matters.[341] In terms of formality, most general meeting resolutions, such as those relating to the change in the company's capital,[342] mergers,[343] the payment of dividends[344] and self-dealing transactions[345] require the board's recommendation before shareholder engagement is possible. Even the shareholders' selection of directors is indirectly affected or shared by the board of directors.[346] This is also the case in relation to the shareholders' appointment

---

[337] See Watson (n 329) 612.
[338] Ibid.
[339] See article 70 (2) of the Model Articles.
[340] Article 68(3) of the CL 2015.
[341] See, for example, articles 11 and 12 of the CGRs 2017.
[342] See 'Procedures and Phases of Establishing Joint Stock Companies and of Amending Their Capital in Accordance with the Companies Law and the Capital Market Law' issued by the Minister of Commerce and Investment and the Chairman of the CMA's Board in 2005 and published on the website of CMA at <http://cma.org.sa/Ar/News/Pages/CMA_N124.aspx> accessed 23 April 2016.
[343] In relation to companies listed on the Tadawul, see particularly article 3(f), (i) and (k) of the MARs 2007.
[344] The law requires *ex ante* shareholder approval for the payment of dividends to shareholders (article 131(2) of the CL 2015) according to the proposed method for the distribution of dividends mentioned in the Board's annual report, see article 126(2) of the CL 2015. In practice, a general meeting resolution approving the payment of dividends will be based upon a recommendation of the board of directors; see, for example, the results of the general meeting of *Riyadh Bank* held 6 April 2015 and the results of the general meeting of Arabian Cement Company held 28 April 2016), which were announced and published on the website of Tadawul at <https://www.tadawul.com.sa>.
[345] Article 71(1) of the CL 2015.
[346] See particularly section (2.6.2) in this Chapter.

of auditors, who are indirectly selected by the board based upon the recommendation of the audit committee.[347]

Therefore, the above discussion suggests that the allocation of power between the general meeting of shareholders and the board of directors favours the latter from a legal standpoint, and decision-making powers reside in the board of directors in Saudi law. This further indicates that directors are given substantial discretionary powers to run the company's affairs.

2.3 Rationale for Board Accountability

As a result of extensive discretionary powers being conferred on the board of directors, there must be effective mechanisms to ensure the board's accountability, guarding the company (practically shareholders) against the risk of misuse of management powers. The necessity of accountability can be based on various rationales, of which the following are the most significant. More generally, it can be contended that the presence of accountability mechanisms is a prerequisite for promoting a good system of corporate governance.[348] To be sure, the enhancement of effective corporate governance, as has been frequently claimed, would also bring about a strong corporate performance.[349] Arguably, board accountability is, therefore, expected to deter many serious errors and to encourage careful exercises in decision-making,[350] which can, in turn promote good corporate performance.[351]

One of the principal arguments put forward as a basis for accountability is to connect the latter with the concept of power.[352] One commentator points out that accountability can be regarded as 'a norm of governance', establishing manners of wielding power and responses to power.[353] In the corporate governance context, accountability has to be present in exchange for the granting of power to the board [354] in order to ensure that the power is

---

347 See article 81 of the CGRs 2017, which is similar to article 16 of the CGRs 2006 in this regard.
348 Keay (n 304) 173.
349 See H Hutchinson, 'Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm' (2004) 36 Loy U Chi LJ 1111, 1132.
350 See C Hurt, 'The Duty to Manage Risk' (2014) 39 Journal of Corporation Law 253, 273.
351 Keay (n 304) 174.
352 A Licht, 'Accountability and Corporate Governance' (September 2002) 17–22 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=328401> accessed 1 April 2016.
353 Ibid 17.
354 A Keay And J Loughrey, 'The Framework for Board Accountability in Corporate Governance' (2015) 35 Legal Studies 252, 260.

exercised in a way that does not harm shareholders' interests.[355] It can further be said that the presence of accountability legitimates the exercise of powers given to the board.[356] If there was no accountability, shareholders would distrust any decision made by the board[357] because directors being 'beyond challenge would make them all suspect'.[358] This lack of shareholders' trust in the board of directors might in the end lead to shareholders' reluctance to invest additional capital.[359] Indeed, given the fact that directors' actions and decisions can considerably affect shareholders' interests, it is not surprising to see shareholders dissatisfied if directors are able to exercise their wide powers without the potential of being held accountable for their actions.

Another reason for accountability can be drawn from the agency theory, as many emphasise the function of accountability in reducing agency costs (i.e., pursuing goals and objectives that impose costs on shareholders) caused by the delegation of management power to a group of individuals other than shareholders.[360] In this regard, there are two main types of directorial wrongdoings. First, is what is referred to as a 'shirking' which is described as the director's failure to make the required effort in managing the company's affairs.[361] In fact, this failure does not normally result from the aversion of work but rather from the strong wish to conduct other activities at the expense of taking time and effort to manage the company.[362] The second type of self-interest conduct that imposes costs upon shareholders is 'stealing', which refers to the act of 'diverting some or all of the firm's assets placed under his management to his personal and exclusive benefit'.[363] As far as stealing is concerned, the directors' diversion of corporate wealth can take a number of forms in which the engagement in self-dealing transactions and the appropriation of corporate opportunities are the most important.[364] According to the agency theory of the company, one of the key objectives of the corporate governance system is to reduce conflicting interests within the agency relationship by putting in place mechanisms that

---

[355] Ibid.
[356] Moore (n 330) 41.
[357] Keay and Loughrey (n 354) 263.
[358] S Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (Aldershot, Ashgate 2007) 73.
[359] Moore (n 330) 40–41; Keay (n 304) 174–175.
[360] See, for example, Bainbridge (n 323) 101 and 111–113; Keay (n 304) 175; Licht (n 352) 20.
[361] See A Pacces, *Rethinking Corporate Governance: The Law and Economics of Control Powers* (Routledge 2012)99; M Jensen and W Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305, 313.
[362] B Cheffins, *Company Law: Theory, Structure and Operation* (Oxford, Clarendon Press 1997) 123.
[363]See Pacces (n 361) 96.
[364] For different methods of diversion of corporate assets, see, for example, L Enriques, G Hertige and H Kanda, 'Related-Pparty Transactions' in R. Kraakman et al. (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009) 153.

align the interests of agents (i.e., directors) with the principal's interests (shareholders).[365] The failure to do so, as the theory assumes,[366] is likely to give rise to directors' engagement in stealing and/or shirking,[367] and to produce disincentives for directors to maximise shareholders' interests.[368] Therefore, some commentators maintain that directors' accountability is needed to ensure that directors do not involve themselves in advancing their self-interest (i.e., opportunism or stealing) or failing to exert the utmost effort to preserve the interests of the company and its shareholders (i.e., shirking).[369] Directors' accountability can be seen as a significant factor in ensuring the directors' proper performance of their obligations and to enhance their loyalty to the company.[370]

2.4 Legal Uncertainty in the Directors' Duties System: Causes and Effects

Duties of care and loyalty imposed upon company directors can be seen as an essential element in the system of accountability for directors. These duties intend to place constraints on the director's exercise of managerial powers.[371] As has been correctly claimed in relation to the duty of loyalty, in the absence of fiduciary principles that apply to a director, he/she 'would have no broad criterion of accountability by which to determine the overall propriety of [his/her] conduct' when using his/her discretionary powers.[372] Importantly, there is no doubt that duties of directors tend be inadequate without a mechanism of enforcement.[373] If directors had breached their duties of care and loyalty, and the law failed to provide an accessible mechanism of enforcement, this would consequently undermine the accountability of directors towards the company and its shareholders.[374] Put differently, the company law system can enhance the accountability of the board through a well-designed framework of the duties of care and loyalty, coupled with an effective mechanism of private enforcement action.[375]

---

365 See generally Jensen and Meckling (n 361).

366 The agency theory posits that both parties (agents and principals) are 'utility maximisers' and therefore there is significant temptation for agents (directors) to advance their interests at the expense of the principals (shareholders), see ibid 308.

367 Keay and Loughrey (n 354) 258.

368 See Dooley (n 303) 468.

369 Keay (n 304) 175.

370 Ibid.

371 Keay (n 6) 5-6.

372 Moore (n 330) 218–219.

373 See I Millstein, 'Non-Traditional Modes of Enforcement', *Enforcement and Corporate Governance: Three Views* (Focus 3 Global Corporate Governance Forum, 2005) 6. <http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGo%20v3.pdf?MOD=AJPERES> accessed 28 February 2017.

374 Keay (n 304) 207.

375 See I M Ramsay, *Corporate Governance and the Duties of Company Directors* (Centre For Corporate Law and Securities Regulation, University of Melbourne 1997) 4 and 7 (arguing that a good legal system of

In this regard, it should be borne in mind that it is the main purpose of a corporate law system to promote certainty in the rules and standards that apply to various corporate participants and relationships. By designing an effective regulation of directors' duties and derivative actions in the statutory law, this would produce legal system of directors' duties in Saudi that works for all companies not only for a particular company. The value of improving certainty in the law of directors' duties can be identified by considering the legal uncertainty associated with an alternative regulation of directors' duties. To explain this point: in addition to its role in saving the parties (e.g. shareholders) the transaction costs they would incur if they had to supply such regulation privately,[376] the codification of directors' duties and derivative actions with a clear and effective set of rules and standards would reduce legal uncertainty.[377]

Further, the design of standards for duties and derivative actions by individual companies may take different forms, resulting in the development of an inconsistent and incoherent body of law. In contrast, specifying the standards for duties with clear accessible derivative actions in the statutory law, would promote certainty in the legal system of directors' duties for all companies, and therefore lead to the coherent and consistent application of the entire law of directors' duties. In addition, a coherent and consistently applied system of company law would significantly lower the costs of the corporate community needing to learn the content of the law due to the increase in the predictability of judicial decisions.[378]

Furthermore, in jurisdictions like Saudi Arabia where there is an absence of judicial precedent (*stare decisis*),[379] the legal predictability and stability in the regulation of directors' duties and derivative actions will be best achieved by reserving the law-making competence to the legislature, which should clearly specify legal norms in the statutory law. One benefit of codification of rights and duties is that 'the rules only need to be looked up'.[380] A sound drafting of rules would simplify the understanding of the content of the law, providing effective enforcement of legal duties and largely ensuring the consistent

directors' duties can lead to 'less reliance' on some other accountability mechanisms) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=924312> accessed 28 February 2017.

376 See C Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999) 62 Mod L Rev 697, 704.

377 The private contracting, known as the 'self-help' method, is an approach that can be used to regulate the conduct of directors, see ibid.

378 The accessibility of law by those subject to it is an important factor in establishing legal certainty, see generally L Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 42 Duke LJ 557. For different understandings of legal certainty, see footnotes 384 – 388 and accompanying text in this Chapter.

379 See footnotes 228 – 232 and accompany text in Chapter 1.

380 See S Wrbka, 'Comments on Legal Certainty from the Perspective of European, Austrian and Japanese Private Law' in M Fenwick and S Wrbka (eds), *Legal Certainty in a Contemporary Context Private and Criminal Law Perspectives* (Tokyo, Springer 2016) 11.

application of the law.[381] Arguably, with the absence of a clear system of statutory rules, judge's decisions are less predictable, which increases the costs incurred by the corporate community as they are required to understand the content of law in advance. Having said that, this means that the certainty of law does matter in determining the effectiveness of the legal system of directors' duties (i.e., substantive rules and standards for directors' duties and the private enforcement thereof by way of lawsuits). Indeed, significant aspects of uncertainty and deficiency in the law related to directors' duties would lead to a decrease in the accountability of directors.[382]

Generally speaking, the certainty and clarity in law governing commercial and business matters are important because businesspeople need to 'know where they stand'.[383] According to one commentator, the concept of *legal certainty* can be understood from two sides. First, it can refer to the idea of 'legal clarification' involving 'clarity', 'predictability', 'stability' and 'transparency', which prompts the question of whether the law exists in the first place or if it does exist, 'to which extent the legal norms should (or actually do) leave room for interpretation'?[384] This means that the legal uncertainty, on the one hand, and the 'unpredictability of law' and lack of stability, on the other hand, are two sides of the same coin; in other words, the law is considered certain if it is predictable and 'treat[s] similar cases consistently'.[385] Second, legal certainty can be viewed as a notion of 'value-oriented justice' in which the certainty of law will be satisfied if the law is accessible, practicable and enforceable.[386] This understanding of certainty will allow room for interpretation and a certain degree of flexibility in the application of the law, which is necessary to establish a properly working legal structure that can accommodate unpredictable circumstances.[387] In this regard, one of the difficulties faced by lawmakers is to draw an appropriate balance between legal clarity and the flexibility to take into consideration unforeseen events.[388]

It has been said that the manner in which the law is designed determines the degree of legal uncertainty.[389] Put differently, the law comprises a combination of rules and principles.

---

381 For different aspects of legal certainty, see footnotes 384 – 388 and accompanying text in this Chapter.
382 See the analysis conducted in Chapters 3, 4 and 5 in this thesis.
383 L S Sealy and R Hooley, *Commercial Law: text, Cases, and Materials* (4th edn, Oxford, Oxford University Press 2009) 10.
384 Wrbka (n 380) 13.
385 I MacNeil, 'Uncertainty in Commercial Law' (2009) 13 Edinburgh Law Review 68, 69.
386 Wrbka (n 380) 13.
387 Ibid.
388 Ibid 14.
389 MacNeil (n 385) 72.

While the former is a precise statement that concerns ‘relatively specific acts’, the latter is a general statement that applies to ‘highly unspecific actions’.[390] Arguably, one of the features of the principle is its flexibility to capture a variety of situations by broadening the application of the law.[391] This has led legal scholars to adopt the view that principles are linked with less certainty compared with rules.[392] As a result, it has been suggested that the law should be structured in such a manner that it contains ‘rules as much as possible’ due to the greater certainty and predictability involved in their application.[393] The issue of whether or not rules are more certain than principles or vice versa is controversial in legal scholarship.[394] Without going into detail, it suffices to say at this stage that both rules and principles could involve a certain degree of uncertainty in which principles in some cases could be more certain than rules and the reverse is true.[395]

With regard to Saudi company law, one of its main issues is the presence of legal uncertainty. As a general source of legal uncertainty, unforeseen contingencies that were unexpected at the time of law making contribute to the difficulty of predicting *ex ante* ‘how the law will be applied ex post by the [enforcer]’.[396] Furthermore, a number of Saudi corporate legal provisions were drafted in an unclear fashion, including those relating to directors’ duties and enforcement. A closer look at the content of the CL 1965 uncovers a large number of outdated rules, which would be suitable for regulating the business environment in the 1960s, but would definitely not accommodate the current growing environment of investment. Therefore, the CL 2015 has been introduced to reformulate many rules providing more certainty in the application of the law. Nevertheless, some issues remain unresolved and uncertain. For instance, there is no proper formulation of the rules and standards of conduct and review for the duties of care and of loyalty to act in the company’s interests. To explain this point, the aforementioned duties are properly formulated in the sense that the law designs duties that strike the right balance between control/accountability and discretion/authority in a particular context. Clearly, a law that

---

390 J Raz, ‘Legal Principles and the Limits of Law’ (1972) 81 The Yale Law Journal 823, 838.
391 Ibid 838 and 841–842.
392 This observation about the general assumption in legal theory is made by some legal scholars; see, for example, J Braithwaite, ‘Rules and Principles: A Theory of Legal Certainty’ (2002) 27 Austl J Leg Phil 47, 50.
393 Raz (n 390) 841.
394 See, for example ibid, arguing rules are likely to be more certain and predictable; see, for example J Braithwaite (n 392), claiming that principles generate more certainty in regulating ‘complex actions in changing environments where large economic interests at stake’.
395 See generally Braithwaite (n 392); see also Kaplow (n 378) 584–590, which examines to what extent the law should be designed by its *ex ante* creation (i.e., rules) or its *ex post* creation (i.e., standards). He claims that there are situations in practice where rules could be more certain than principles and vice versa.
396 See, for example, G Dari-Mattiacci and B Deffains, ‘Uncertainty of Law and the Legal Process’ (Amsterdam Center for Law & Economics Working Paper No 2005/10, 2005) 4–5 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=869368> accessed 2 June 2016.

does not draw a distinction between the duty of care and the duties of loyalty in terms of the remedy required when the duty is breached, lacks legal clarity. Another aspect of legal uncertainty is illustrated by the failure of the Saudi corporate statute to clarify the scope of the duty to avoid conflict of interests, which consequently leaves questions unanswered as to the effectiveness of the law to deal with some instances of opportunistic activity. Those issues will be explored further throughout the comparative study in Chapters 3 and 4. The vagueness and ambiguity are further evident in the content of article 78 of the CL 1965 and its new version in the CL 2015 (article 80), which fails to clearly define a derivative action, as a mechanism of enforcement of directors' duties.[397] In addition, Saudi company law contains a combination of rules and principles. Though a law that contains open-ended concepts and standards might be appropriate to jurisdictions where the enforcer (e.g., courts) have strong 'residual law making power',[398] which includes the recognition of legal precedent as a source of law, this is not the case in Saudi Arabia.[399] Open-ended legal norms normally require an enforcer who possesses the capability to exercise 'wide discretion to deal with matters as they fit on a case-by-case basis', which, again, is problematic within the Saudi context.[400] This issue is returned to in Chapter 6 when the reform of Saudi law is examined.

Some effects can be detected as a result of legal uncertainty in Saudi law. First, generally, it is unlikely to promote an effective environment for business and investment without accessibility to laws defining rights and obligations. This argument is made in the following terms by Tom Bingham: 'No one would choose to do business, perhaps involving large sums of money, in a country where the parties' rights and obligations were vague or undecided'.[401] Second, in the absence of legal clarity, doubts will remain among those subject to the law about whether or not a particular behaviour will be captured or protected by the provisions of law. For example, as will be discussed in Chapter 4, the lack of sufficient clarity concerning the directors' duties to act in good faith in the general interest of the company and to avoid the exploitation of corporate opportunities could affect the expectations of shareholders and directors alike as to the legal consequences of directorial conduct.[402] Third, it has been said that legal uncertainty tends to constrain

[397] This issue will be discussed in detail in section (5.6), Chapter 5 in this thesis.
[398] See generally, K Pistor and C Xu, 'Incomplete Law: A Conceptual and Analytical Framework and its Application to the Evolution of Financial Market Regulation' (Working Paper No. 204, 2002) 4, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=310588> accessed 2 June 2016.
[399] See Dari-Mattiacci and Deffains (n 396) 9 and 10.
[400] See Cheffins (n 362) 282.
[401] See T H Bingham, *The Rule of Law* (London, Allen Lane 2010) 38.
[402] See the analysis conducted in Chapter 4 in this thesis.

decision making.[403] This can possibly occur when the decision-making depends on the perspective of the law in relation to a particular matter.[404] For example, directors should make decisions based on 'complete' information and in the interest of the 'company'.[405] The uncertainty about what constitutes 'complete' may limit their ability to make informed decisions that satisfy this legal obligation. Similarly, what is meant by the elusive concept of 'company' may affect the director's discretion while managing the company.[406] Fourth, another cost of uncertainty is to weaken the effectiveness of law in guiding and controlling managerial behaviour. Even if directors have strong incentives to comply with the law, uncertainty and confusion about the exact meaning of law suffice to lead them to behave differently from the way they should. Importantly, it could also increase opportunistic actions on the part of directors. Fifth, the ill-defined and vague provisions set down in company law tend to weaken the enforcement of rules by the courts,[407] an issue that will be taken into account while considering the reform of directors' duties in Chapter 6.

The argument of legal uncertainty will be developed throughout the analysis of Saudi law of directors' duties and of private enforcement by litigation in Chapters 3, 4 and 5. While revealing several grounds for the presence of deficiency and ambiguity would be sufficient to justify the reform of law, the need for sound law of directors' duties and enforcement thereof is further borne out by the limits and drawbacks of other mechanisms of accountability. Indeed, the legal framework of directors' duties has been well-recognised as a last resort, when other monitoring mechanisms and market forces fall short as mechanisms for board accountability.[408]

The rest of this chapter assesses the major mechanisms of accountability found in the Saudi corporate governance system that are intended to monitor and discipline those responsible for managing the company. The main argument put forward in the coming sections is that these mechanisms of controlling directors' behaviour tend to be inadequate. Even if it was claimed that effective devices of monitoring do exist, such mechanisms operate within limits and so this cannot mask the need to enhance the board's accountability through effective rules and standards for directors' duties coupled with an accessible private enforcement action in the form of derivative litigation.

---

403 MacNeil (n 385) 72.
404 Ibid.
405 Article 30(17) of the CGRs 2017.
406 This issue will be considered in sections (4.2.3.3) and (4.2.3.4), Chapter 4 in this thesis.
407 B Black and R Kraakman, 'A Self-enforcing Model of Corporate Law' (1995) 109 Harv L Rev 1911, 1925–1926.
408 Jones (n 305) 118.

2.5 Blockholder and Control of Companies

The role of shareholders in exercising corporate control is closely linked to the proportion of shares owned. The importance of corporate ownership, as an internal mechanism of monitoring and disciplining managers, has been theoretically established in the literature. For example, as several studies illustrate, depending upon the nature of the ownership structure, shareholders will often have either too little or too much incentive and power to monitor and control the management.[409] In the following subsections, an outline of the financial and legal literature on ownership and control is given; following which, the pattern of share ownership and the resultant degree of control in Saudi companies are explored. This will be followed by a discussion of scenarios where ineffective monitoring of management may occur due to the presence of a blockholder (i.e., government agency).

2.5.1 Models of corporate ownership and control: General analysis

Broadly speaking, companies can be mainly categorised according to the pattern of ownership into either companies with dispersed share ownership or companies with concentrated share ownership.[410] From many studies of ownership structures, scholars conclude that the vast majority of large companies around the world have concentrated ownership and the presence of diffused ownership seems to be the exception rather than the rule.[411]

Dispersed share ownership refers to the ownership structure where the company's equity capital is held diffusedly and there is no single large shareholder capable of controlling the company's affairs.[412] The diffuse share ownership seems to be the predominant structure of most public companies in the UK and US;[413] for example, in the UK[414] a recent study conducted by Faccio and Lang reported on the basis of data from 1996 that approximately

---

409 See, for example, A Shleifer and R Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461; Shleifer and Vishny (n 15).

410 R la Porta, F Lopez-de-Silanes and A Shleifer, 'Corporate Ownership around the World' (1999) 54 The Journal of Finance 471.

411 See for instance, ibid 474, 496.

412 I MacNeil, *An Introduction to the Law on Financial Investment* (2nd edn, Oxford, Hart Publishing 2012) 308.

413 See, for example, La Porta, Lopez-de-Silanes and Shleifer (n 410) 496 and 493.

414 There is some similarity between the US and the UK in relation in the structure of ownership and control. Therefore, it suffices here to devote the analysis to the ownership pattern in the UK.

63% of 1,953 publically traded companies were widely held.[415] In jurisdictions where diffuse share ownership is the norm, there would be a lack of strong incentive on the part of a shareholder to participate actively in corporate governance because a small shareholder 'will have to bear the cost while other shareholders will share the benefits'.[416] This results in giving directors/managers a 'free hand to manage' while shareholders distance themselves from playing an active role in monitoring the company's management.[417] It can broadly be said that shareholders in diffusedly held companies are rationally apathetic, leading to corporate control being in the hands of directors/managers.[418]

Unlike in the UK and the US, the pattern of corporate ownership that prevails in most jurisdictions is the *concentrated share ownership*.[419] This ownership structure refers to the situation where a company with publicly traded shares has at least one shareholder with sufficient voting powers to influence the company's management.[420] Empirical research indicates that the concentrated ownership is the norm in most continental European companies in which share ownership is concentrated in the hands of wealthy families and other firms.[421] Similarly, the concentrated ownership structure prevails in most firms in East Asia, as demonstrated by Claessens et al. in their survey of 2980 publically traded companies in nine Eastern Asian countries.[422]

In the case of companies with concentrated share ownership, cash flow and control interests can provide a single large shareholder with the necessary power and motivation to participate actively in corporate governance because he/she will be the actual beneficiary from this direct intervention,[423] otherwise known as *a voice*.[424] To be specific, the controlling shareholder tends to be sufficiently armed with the power and incentive to

---

[415] M Faccio and L Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 Journal of Financial Economics 365, 368 (footnote 5) and 379.
[416] MacNeil (n 412) 308.
[417] B Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 The Journal of Legal Studies 459, 461
[418] Pacces (n 361) 28; M Goergen and L Renneboog, 'Strong Managers and Passive Institutional Investors in the UK' in F Barca and M Becht (eds), *The Control of Corporate Europe* (Oxford, Oxford University Press 2002) 259.
[419] La Porta, Lopez-de-Silanes and Shleifer (n 410) 474 and 491.
[420] Shleifer and Vishny (n 409) 754.
[421] See, for example, M Becht and C Mayer, 'Introduction' in F Barca and M Becht (eds), *The Control of Corporate Europe* (Oxford, Oxford University Press 2002) 2-3; Faccio and Lang (n 415) 378–388.
[422] This does not apply to Japan where public companies are generally widely held, see S Claessens, S Djankov and L Lang, 'The Separation of Ownership and Control in East Asian Corporations' (2000) 58 Journal of Financial Economics 81, 103.
[423] MacNeil (n 412) 308–309.
[424] A Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, (Cambridge, Harvard Univ. Press 1970).

engage with the company's management through sitting on the board of directors,[425] and so is able either to bring about changes in the company's policies and actions,[426] or to remove directors or managers in response to poor performance.[427] Hence, the corporate control based upon concentrated ownership is likely to be one of shareholder control.[428] Within the controlling shareholder system, the classic form of control, which the majority of corporate governance literature assumes, is a majority control pattern.[429] It refers to the scenario where a blockholder (or group of blockholders acting together) owns more than 50% of the company's shares.[430] However, the company could also be under shareholder control even though the shareholder holds less than 50% of the cash flow rights attached to the company's equity, this form of control is known as 'minority control'.[431] In this situation, the blockholder with a significant holding of shares, can in fact exercise a form of working control when the company's remaining shares are diffused and no competitor has sufficient shares to challenge them successfully.[432] This suggests that the exercise of control by shareholder can be maintained without the need to hold a majority of a company's shares and cash flow interests.

2.5.2 The pattern of ownership and control in Saudi companies

Saudi Arabia is not an exception to the domination of concentrated ownership in most countries. In the Saudi stock market the concentrated share ownership, as shown below, tends to be the norm in the Saudi stock market.[433]

---

[425] For example, an empirical study conducted by La Porta et al. has shown that the controlling shareholders particularly families are part of the top management of the firm; see La Porta, Lopez-de-Silanes and Shleifer (n 410) 500, 511.

[426] Markus P Urban, *The Influence of Blockholders on Agency Costs and Firm Value: An Empirical Examination of Blockholder Characteristics and Interrelationships for German Listed Firms* (wiesbaden, Springer 2015) 105; A Edmans, 'Blockholders and Corporate Governance' (2014) 6 Annual Review of Financial Economics 23.

[427] From the theoretical point of view, a dominant shareholder with sufficient voting control can change the company's board of directors through launching takeover bids or proxy fights or through informal negotiations with existing management (i.e. a jawboning mechanism), see Shleifer and Vishny (n 409).

[428] See Pacces (n 361) 28.

[429] See, for example, M Roe, 'Corporate Law's Limits' (2002) 31 The Journal of Legal Studies 233, 238, which analyses how a blockholder holding the controlling stock attempts not to lose control by owning at least 51% of the company's equity.

[430] Majority control was considered a first step towards 'the separation of ownership and control', see A A Berle and G C Means, *The Modern Corporation and Private Property*, (New York, Macmillan Company 1933) 70–72

[431] Ibid 80.

[432] Ibid.

[433] The share ownership is mostly concentrated in the hands of government funds and wealthy families, see, for example, J Piesse, R Strange And F Toonsi, 'Is There a Distinctive MENA Model of Corporate Governance?' (2012) 16 J Manag Gov 645; M Alghamdi, 'Family Business Agency Problems, Ownership Concentration and Corporate Performance: Theory and Evidence from Saudi Arabia'(Proceedings of the 26th International Business Research Conference, Imperial College, 7–8 April 2014) <

As mentioned earlier, a joint stock company is the only type of company that is statutorily allowed to list its equity shares on the Saudi Stock Exchange (Tadawul).[434] Unfortunately, information as to the ownership structure of unlisted joint stock companies is not publically available. Therefore, this section will only focus on analysing the ownership and control of joint stock companies listed in Tadawul because the CMA requires the disclosure of the identity and the holdings of investors who own 5% or more of a listed company's stock, including any change in the owners' equity above this threshold.[435] This data will assist in the task of determining the structure of ownership and control in listed companies and the degree of control exercised by a blockholder, if present.

Since concentrated ownership is the typical pattern of corporate ownership in the Saudi equity market, this means that most companies have a blockholder. This then raises the question as to the level of control exercised by the blockholder. In order to give a clear picture of levels of control exercised by the shareholder, it is useful to examine various ownership thresholds that determine shareholders' rights. The first threshold is a *holding of at least 2%*,[436] which enables shareholders to submit a request to the competent authority[437] to call for an annual general meeting (AGM) in any of circumstances set down in corporate statute.[438] The next threshold occurs with *ownership of 5% or more*, which gives relevant shareholders the right to call an AGM[439] and put forward a motion to the court for the order of inspection over the company in the case that they suspect anything suspicious in relation to the directors' management of the company or the auditors' independence and credibility.[440] *Ownership of at least 25%* confers on a shareholder(s) a blocking minority and veto power concerning vital corporate resolutions that require a super majority to be passed. In particular, the respective shareholder(s) have the power to block an extraordinary general meeting's (EGM) decision in relation to capital increase or reduction, the extension of company's terms, the termination of the company or the merger

---

https://wbiworldconpro.com/uploads/london-conference-2014/finance/1396842795_322-Al-Ghamdi.pdf > accessed 11 March 2017.

[434] See, section (1.4.1), Chapter 1 in this thesis.

[435] See article 45 of the LRs 2004.

[436] This ownership threshold will not be taken into account in the following analysis because there is no information available on the shareholders' ownership at this threshold.

[437] It refers to the MOCI. However, with regard to companies listed in the equity market, it refers to the CMA.

[438] See article 90(3) of the CL 2015.

[439] Article 90(1) of the CL 2015.

[440] Article 100(1) of the CL 2015.

of the company into another one.[441] *Ownership of 33% and more* additionally provides the shareholders with a further veto power in the EGM[442] and enables them, for instance, to block the amendment of the company's articles of association,[443] the issuance of preference shares and the issuance of debt instruments.[444] The next threshold is a *holding of at least 50%* representing the simple majority, which empowers respective shareholders to decide on all resolutions at the AGM.[445] It, *inter alia*, grants them the right to appoint and remove members of the board of directors,[446] approve the acts of directors in relation to conflict of interest transactions,[447] and commence a lawsuit against errant directors.[448] The final significant control thresholds occur with *at least a two-thirds ownership* and with a *shareholding of 75% or more*, this enables shareholders to exercise a wide discretion on the most vital decisions of the EGM. While the former confers, for instance, the power to amend the company's articles of association, the 75% threshold provides owners with specific control rights such as the right to increase the corporate capital and approve mergers.

In the light of the ownership levels and associated rights outlined above, it is important to explore if blockholders in Saudi listed companies can reach these levels because this determines the capability of blockholders to monitor directors, at least from the legal point of view. Table 2.1 provides details of 171 companies listed in Tadawul that have a blockholder (or a group of blockholders)[449] with an ownership equal to or above the aforementioned thresholds. Here, it is not uncommon to detect at least one blockholder holding 5% or more of a company's equity. The data demonstrates that approximately 91% of listed companies have a shareholder with ownership of at least 5%. The large number of companies with a shareholder who is able to block the most important decisions at the general meeting is illustrated by the fact that about half of the companies (49%) have a shareholder with a blocking minority of 25%, and, additionally, more than one-third of the companies (34%) have a blockholder with a blocking minority of 33%. In the Saudi stock market, only 22 companies, accounting for nearly 13%, appear to be governed by a simple

[441] The law requires a special resolution passed by a majority of 75% votes cast in the EGM with regard to *only* the aforementioned matters, see article 94(4) of the CL 2015.
[442] Except for those stated in the immediately preceding footnote, resolutions of the EGM must be approved by a two-thirds majority of votes cast, see article 94(4) of the CL 2015.
[443] Article 88(1) of the CL 2015.
[444] Articles 114 and 122 (2) of the CL 2015.
[445] Article 93(3) of the CL 2015.
[446] Article 68 (3) of the CL 2015.
[447] Articles 71 and 72 of the CL 2015.
[448] Article 79 of the CL 2015.
[449] This means that the ownership of shares by individuals within the same family, as well as shares owned by different government agencies, are aggregated into one group in this survey.

majority shareholder. There are also very few companies under the control of a supermajority shareholder whether the supermajority threshold is two-thirds (seven companies) or three-quarters (four companies).

Table 2.1: Distribution of the blockholders (B) according to significant control thresholds in the Saudi Stock Market in December 2015

Blockholder's ownership size (Control threshold)	**Distribution of the blockholders (B) in the sample companies**	
	Number	**Percentage**
5% ≤ B	156	91.2
25% ≤ B	84	49
33% ≤ B	59	34.5
50% ≤ B	22	12.8
66% ≤ B	7	4
75% ≤ B	4	2.3

Source: The own survey of 171 companies listed in the Saudi Stock Market (Tadawul) based upon official data published the Tadawul website (December 2015) [450]

It can be seen from these figures that while a shareholder is able to reach the blocking minority thresholds in a considerable number of companies, it is uncommon to find a shareholder with a holding of 50% or 75% of the company's shares. As a matter of fact, out of 171 companies listed in the market, 134 have a blockholder whose voting power does not exceed the 50% voting rights. Furthermore, no shareholder in 72 companies enjoys voting control in excess of a quarter of the voting rights. From the legal perspective, although there are many companies with at least one shareholder holding a blocking minority, this does not offer them direct power to affect decisions taken in the general meeting. As the data illustrates, there are only 22 companies where a blockholder, in legal terms, appears to have sufficient power to exercise control over decisions taken in the general meeting and so monitor directorial actions and decisions.

However, this does not prevent the possibility of shareholders exercising *actual* control over the company's affairs even without holding the majority of the company's shares. This can perhaps be measured by the ability of blockholders to appoint board members in a manner that is disproportionate to their equity ownership[451] and in which the blockholder exercises *de facto* control rather than a *de jure* one. According to Piesse et al., a blockholder, especially in some family-controlled companies, tends to have the ability to disproportionately influence board nominations beyond his ownership rights.[452]

[450] In this survey, the ownership of shares by individuals within the same family is regarded as a single group. This is also the case in relation to shares owned by different government agencies.
[451] Piesse, Strange and Toonsi (n 433) 663.
[452] Ibid.

Additionally, it has been observed that there is disproportionate board representation in some companies controlled by families or individuals; for example, a blockholder (i.e., family controller) with a shareholding of 20% in Zamil Industrial Investment Company has nominated 40% of the board members.[453] Another example is Dar Alarkan Real Estate Development Company, which shows the ability of a blockholder (i.e., an individual) with ownership of only 6.44% of the company's shares to appoint more than 35% of the members of the board of directors.[454] This seemingly explains why blockholder ownership does not usually exceed the 50% control threshold.

Under the system of concentrated ownership, the problem of rational apathy (i.e., the absence of incentive and of power) is presumably solved due to the presence of a large shareholder.[455] However, it should be borne in mind that in every direct intervention, a free-rider problem arises because the dominant shareholder bears all the costs of voice mechanism while only gaining 'a fraction of the benefits'.[456] The impact of the free-ride problem hinges on the size of the shareholding block; in other words, it has been argued that a larger block is needed in order to minimise the effect of the free-ride problem and maximise incentives to intervene in corporate governance.[457] Since the degree of simple control by a single shareholder is relatively low in the Saudi market (only 22 companies out of 171 have a majority shareholder), the strength of voice and the blockholder's incentive to intervene could be affected by the size of the shareholding block. Another point that should be taken into account is that the data suggest that most companies are under minority control, a model that assumes the presence of a single shareholder owning less than 50% with no competitor having sufficient shares to challenge them successfully.[458] The literature suggests that a single shareholder with a larger block is needed to overcome the incentive problem in order to intervene.[459] However, this perception might be affected by the existence of companies held by multiple blockholders.[460] As has been argued, the problem of the free-rider worsens in the case of

---

[453] See the profile of Zamil Industrial Co. (Building and Construction Sector) on the Tadawul website at <http://www.tadawul.com.sa> accessed 20 December 2015.
[454] The blockholder is a board member along with other family members who have been elected as directors, see the profile of Dar Al Arkan Co. (Real Estate Development Sector) on the Tadawul website at <http://www.tadawul.com.sa> accessed 20 December 2015.
[455] See, for example, Shleifer and Vishny (n 409) 753–754; Urban (n 426) 101–102.
[456] See Edmans (n 426) 25.
[457] Ibid 35; Urban (n 426) 102.
[458] See Berle and Means (n 430) 80.
[459] See, for example, Shleifer and Vishny (n 409); E Maug, 'Large Shareholders as Monitors: Is There a Tarde-off between Liquidity and Control?' (1998) 53 The Journal of Finance 65, where their models assume the presence of a single blockholder.
[460] There are many Saudi companies that are held by more than a single blockholder; see, for example, the profiles of the following companies: Emaar (Sector of Real Estate Development), Taiba (Sector of Real

‘splitting block between multiple investors’, which consequently weakens the strength of the voice mechanism or reduces the blockholders’ incentive to intervene.[461]

As long as the discussion is related to the ownership structure as an internal mechanism of corporate governance, it is clear that the ownership structure tends to determine the types of agency conflict that should be regarded as the most serious in public companies. Agency conflict refers to the problems that arise when the interest of one party (principal) hinges upon actions taken by another (agent). A divergence of interests between the principal and the agent would, theoretically, incentivise the agent to act in his own interest at the expense of the principal.[462] Put differently, where the diffusion of corporate ownership is the norm in most public companies, corporate control is likely to be in the hands of directors or managers and the interests of the controlling board of directors may be incompatible with those of shareholders (director/shareholder agency problem).[463] By contrast, in jurisdictions where corporate ownership is normally concentrated in large-block shareholders, the corporate management will be under their control and the interest of non-controlling shareholders tends to be ignored (majority/minority shareholder agency problem).[464] This suggests that in countries with concentrated ownership it is assumed that the presence of large-block shareholders should handle the agency conflict between directors and shareholders. Nevertheless, even if the blockholder has the incentive and capability to monitor the management, this does not undermine the importance of sufficient legal protection for shareholders, including the minority shareholder, in developing an effective corporate governance system.[465] Further, it should always be the job of the state to ensure that a director (who could be a controlling shareholder) is accountable for his/her misconduct regardless of the ownership structure. In this regard, Davies, in considering whether the different structure of shareholdings in large companies (concentrated and diffused ownership) leads to the different corporate governance problems faced by EU member states, made an interesting remark:

> In both countries with fragmented shareholdings across the board and countries with concentrated stakes but also fragmented non-controlling shareholding, there is at one level a similar corporate governance problem. That can perhaps best be expressed in

---

Estate Development), Buba Arabia (Insurance sector) and Amiantit (Building and Construction Sector), available on the Tadawul website at <https://www.tadawul.com.sa/wps/portal/tadawul/home> accessed 20 December 2015.

461 Edmans (n 426) 26.

462 Jensen and Meckling (n 361) 308.

463 See O Hart, ‘Corporate Governance: Some Theory and Implications’ (1995) 105 The Economic Journal 678, 680–681.

464 Ibid 683–684.

465 See Shleifer and Vishny (n 15) 739.

> terms of ensuring the accountability of management to the non-controlling shareholders.[466]

This means that an effective enforcement of directors' duties, reinforced by a clear and proper framework of standards, would ensure board accountability towards even non-controlling shareholders in the case where directors are under the control of shareholders. Therefore, any failing or uncertainty in the legal system of directors' duties tends to significantly undermine the board's accountability and, more generally, the availability of good corporate governance.

While the pattern of the ownership structure is irrelevant when it comes to the need to ensure the legal accountability of directors, the following section will show that the identity of the blockholders does matter in relation to their incentive to monitor the management. Hence, the presence of blockholders may not be in and of itself sufficient to reduce agency costs that result from the delegation of management powers to the board of directors.

2.5.3 The state as a blockholder: A model of ineffective monitoring

As explained above, conventional wisdom suggests that the director/shareholder agency problem is not an issue where concentrated share ownership is the norm in most companies. This can, however, be challenged. Depending on the identity of the blockholder, issues can arise in terms of their incentive to intervene and their capability to monitor the management effectively.[467] The following discussion will illustrate that there can be significant disparity between the interests of directors and shareholders when the state is a blockholder.

The state, through its government agencies, is considered to be the largest investor in the Saudi stock market.[468] There are three government entities investing in the market: the Public Investment Fund (PIF), which is a blockholder in 19 listed companies;[469] the General Organisation for Social Insurance (GOSI), which is a blockholder in 31 listed

---

[466] P Davies, *Corporate Governance*, (Acts of the Conference on Company Law and the Single Market: European Comission, 15 and 16 December 1997) 62 <http://ec.europa.eu/internal_market/company/docs/otherdocs/actes_en.pdf> accessed 3 January 2016.
[467] See, for example, Piesse, Strange and Toonsi (n 433) 656.
[468] This information is based upon the financial report drawn up by *Aleqtisadiah* in July 2014, see T Al-Sayah, *Aleqtisadiah* Newspaper (edn 7577, 10 July 2014) (Arabic) <http://www.aleqt.com/2014/07/10/article_865848.html> accessed 7 March 2016.
[469] See T Al-Sayah, *Aleqtisadiah* Newspaper (edn 7983, 20 August 2015) (Arabic) <http://www.aleqt.com/2015/08/20/article_983393.html> accessed 7 March 2016.

companies;[470] The Public Pension Agency (PPA), is a blockholder in 20 out of 171 companies listed in the market.[471]According to recent reports published in 2015, the market value of shares owned by the state through its funds and institutions in the stock exchange amount to approximately SAR 700 billion (about USD 186.6 billion).[472] This has shown that listed companies where the state is a blockholder are the major forces in the Saudi stock market, and their problems are consequently important and critical to market growth.

The PIF, GOSI and the PPA, as the investment arms of the government, are state-owned, under its *de facto* control, and ultimately managed by government bureaucrats and salaried employees.[473] One of the central issues revolving around state-controlled companies is that officials (agents) appointed to monitor or be involved in the governance of such companies, unlike shareholders, do not typically have 'personal equity stake' in the company.[474] For example, the Saudi government's representatives on the board of directors or in the general meeting do not normally own shares at all in any relevant company,[475] and this also the case in relation to those who monitor and appoint them. This consequently means that they neither bear any economic risk of corporate failure nor directly benefit from the company's success.[476] As a result, there might be a lack of sufficient incentives on the part of government's representatives to manage the company diligently and adequately supervise directorial performance.[477] This incentive problem is worsened by the lack of monitoring, which is sometimes referred to as the *absence of an owner*.[478] It has been contended that since citizens (in this case Saudis) are the real owners, the ownership is widely diffused, resulting in poor monitoring of the company due to the 'free-rider'

---

470 Ibid.
471 Ibid.
472 See the Statistical Report, published in *CNBC Arabiya* (23 May 2015) (Arabic) <http://www.cnbcarabia.com/?p=226299> accessed 29 February 2016.
473 For example, PPA is administratively connected to the Ministry of Civil Service and its board is headed by the Minister of Civil Service. The PIF had been formally part of the Ministry of Finance since its establishment in 1971 until recently the PIF has become under the supervision of the Council of Economic and Development Affairs (CEDA) in which the PIF's Board of Directors is chaired by the Head of CEDA, see High Order No. 23975 dated 22/3/2015, <http://www.spa.gov.sa/viewstory.php?lang=ar&newsid=1341658> accessed 1 May 2016.
474 See OECD Proceedings, *Corporate Governance, State-Owned Enterprises and Privatisation*, (Paris, OECD Publishing 1997) 41 <http://www.keepeek.com/Digital-Asset-Management/oecd/governance/corporate-governance-state-owned-enterprises-and-privatisation_9789264162730-en#page39> accessed 11 May 2016.
475 See, for example, the board's annual report of Riyadh Bank in 2014; the board's annual report of SABIC in 2015; the board's annual report of Yanbu Cement Co. in 2015; and the board's annual report of Qassim Cement Co. in 2015, which can all be viewed Tadawul website through the profile of each company at <http://www.tadawul.com.sa> accessed 12 March 2016.
476 D Chen, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience*, (Cheltenham, Edward Elgar 2013) 94.
477 OECD Proceedings (n 474) 41.
478 D Clarke, 'Corporate Governance in China: An Overview' (2003) 14 China Economic Review 494, 499–500.

problem.[479] The lack of effective monitoring can also be expected from the government agencies that hold the shares on behalf of citizens, mainly due to the absence of economic motivation.[480] Therefore, it could be suggested that the presence of imperfect monitoring on the part of a governmental blockholder probably gives rise to wide management discretion and poor corporate performance.[481] It is worth saying that in some cases preferential policies are granted to state-controlled companies, such as for purchasing raw materials from the government at a subsidised price,[482] or the receipt of subsidies in the form of grants[483] or loans.[484] This, consequently, could assist the market performance of a state-controlled company to remain at a high level, even without effective monitoring. In other words, although directors/managers exploit the company's resources due to the engagement in conflicted transactions or the lack of due diligence in the company's management, such behaviours are unlikely to be strong enough to undermine the overall performance of a state-controlled company. In such conditions, there might be insufficient incentives for officials in government funds to increase monitoring to reach a standard that would otherwise be achieved with little effort. It should be also taken into account that the state adopts a long-term investment strategy in the market and its shares of ownership have not been sold for a long time.[485] Put differently, it can be argued that the threat of takeover, as a mechanism of disciplining incumbent directors or managers, tends not to be available to state-controlled companies.[486]

The final issue to consider is that state-owned enterprises, whether listed or not, are likely to be managed by unqualified and inexperienced officials.[487] In Saudi Arabia this view seems to be sometimes true in relation to listed companies with governmental blockholders. Government bureaucrats selected as board members are generally viewed as

---

479 M Shirley and P Walsh, 'Public versus Private Ownership: The Current State of the Debate' (Policy Reserch Working Paper 2420, The World Bank, August 2000) 23 <http://documents.worldbank.org/curated/en/2000/08/693336/public-versus-private-ownership-current-state-debate> accessed 2 May 2016.
480 OECD Proceedings (n 474) 41.
481 See Shirley and Walsh (n 479) 32.
482 Piesse, Strange and Toonsi (n 433) 659.
483 For example, the Ministry of Agriculture grants two land plots to the Saudi Fisheries Company whose 40% of its equity capital is owned by the PIF; see the announcement of the Company published publicly, <http://www.argaam.com/ar/article/articledetail/id/385670> accessed 13 May 2016.
484 See OECD, *State-owned Enterprises in the Middle East and North Africa*, (Paris, OECD Publishing 2013) 67 <http://www.oicexchanges.org/docs/third-meeting-istanbul/mena-soes-eng.pdf> accessed 22 September 2017.
485 See newspaper article by R Al-fozan, 'The State Is Investor, and a Seller' *Alriyadh* Newspaper (edn 17226, 23 August 2015)<http://www.alriyadh.com/1075718> accessed 22 May 2016.
486 Shirley and Walsh (n 479) 33–34; OECD Proceedings (n 474) 39.
487 A Arrobbio, *Corporate Governance of State-owned Enterprises: A Toolkit* (Washington, DC, World Bank Group 2014) 14–15 <http://documents.worldbank.org/curated/en/2014/10/20286791/corporate-governance-state-owned-enterprises-toolkit> accessed 23 March 2016.

lacking sufficient qualifications[488] and appropriate expertise in the company's fields of business.[489] They are also seen as not devoting sufficient time and effort to the work of the board.[490] One possible explanation for this dilemma is that the selection of officials onto the board is usually based upon favouritism and political connection rather than competence and meritocracy.[491] Indeed, like other governments in the region, the Saudi government does not follow a structured nomination process when nominating their representatives for a company's board of directors, and this opens the door for the selection of board members who do not possess the capability to actively supervise and positively affect the performance of companies.[492]

It can be concluded that the absence of an ultimate owner (weak owner) in state-controlled companies is likely to produce a situation where the company is under the control of management without any effective monitoring.

2.6 Shareholders and Exercising Accountability at the General Meeting

As discussed above in relation to Saudi law,[493] the decision-making powers allocated to the board of directors and shareholders through the general meeting can only be used in matters that fall within the competence of the AGM or EGM, as set out in the statute or the articles of association. The importance of the general meeting can be inferred from the fact that it is the mechanism by which shareholders can hold directors accountable and restrict the board's power.[494] Given the limited range of powers that can be exercised by the shareholder body,[495] doubt can be cast upon the role of the general meeting as an effective mechanism of board accountability. Legal obstacles, reinforced by other non-legal factors,[496] have contributed to weakening the monitoring role of shareholders through the general meetings, opening the door for the board of directors, in some circumstances, to accrue more powers. As one commentator states, the legal rules determine whether or not

[488] Piesse, Strange and Toonsi (n 433) 659.
[489] Falgi (n 208) 151; see also M Alamri, 'Corporate Governance and the Board of Directors in Saudi-listed Companies' (PhD Thesis, University of Dundee 2014) 147–148 who reveals that most government independent directors do not have the necessary expertise to provide a beneficial input to boards.
[490] Falgi (n 208) 137.
[491] Piesse, Strange and Toonsi (n 433) 659.
[492] OECD, *Towards New Arrangements for State Ownership in the Middle East and North Africa* (Paris, OECD Publishing 2012) 40–41 <http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/50087769.pdf> accessed 22 September 2017.
[493] See section (2.2) in this Chapter.
[494] MacNeil (n 412) 311.
[495] See section (2.2) in this Chapter.
[496] The decision-making by shareholders at the general meeting is usually associated with the collective action problem, see Easterbrook and Fischel (n 301) 66–67.

shareholder voting is a perfect constraint on directors or managers in which the effects of shareholder size should be considered as being of secondary importance.[497] The following subsection shows the internal mechanisms that are available to shareholders at the general meeting to monitor and discipline directors. The limits and drawbacks of such mechanisms are emphasised, and the effectiveness of the general meeting of shareholders as a watchdog of activities carried out by directors (who may also be blockholders) is questioned.

2.6.1 Directors' removal

One of the main powers available to shareholders to discipline directors is the removal of errant directors.[498] The question here is how secure the position of the director is against dismissal. According to Saudi law, directors will be selected to serve for the period mentioned in the company's bylaw, provided that the directorial term does not exceed three years.[499] The length of the membership term is important in this regard because a longer term would secure the position of directors from temporary shareholder majorities.[500] Another aspect of the dismissal right is the power to dismiss directors before the end of their membership. Saudi law makes it clear that shareholders, through the general meeting, can remove directors at any time and without cause even if the company's bylaw states otherwise.[501] Although the removal right appears to be powerful, some underlying factors should be taken into account, which could weaken its exercise in practice.

The first point to consider is that the cost of removing and replacing an errant director may not serve the collective interest of shareholders. This is because the removal of a director does not deprive him/her of compensation from the company.[502] In addition, since shareholders can only exercise the removal right through a general meeting, this rule securing a director against dismissal tends to 'dilute the power of shareholders to remove directors'.[503] This consequently suggests that the easily exercisable power to convene the

[497] See B Black, 'Shareholder Passivity Reexamined' (1990) 89 Michigan Law Review 520, 522.
[498] See L Enriques, H Hansmann and R Kraakman, 'The Basic Governance Structure: The Interests of Shareholders as a Class' in R Kraakman et al. (ed), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009) 60.
[499] See article 68(3) of the CL 2015.
[500] Enriques, Hansmann and Kraakman (n 498) 60.
[501] Article 68(3) of the CL 2015. This was also the position of Saudi law under the pre-exiting corporate statute; see article 66 of the CL 1965.
[502] Article 68(3) of the CL 2015.
[503] P Davies, *The Board of Directors: Composition, Structure, Duties and Powers*, (Paper on Company Law Reform in OECD Countries, OECD 2000) 7, <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf> accessed 15 September 2017.

general meeting to remove directors does matter in determining the strength of the removal right.[504] According to Saudi law, the call to convene a general meeting requested by shareholders (representing at least 5% of equity capital) shall be addressed to the company's board of directors[505] and shareholders are not entitled to convene the general meeting by themselves. Under any circumstances, it is a matter for the board of directors to assess the reasons for requesting the meeting and determine accordingly. As has been pointed out, the Saudi CL 1965 remained silent about the legal effect of a board's refusal of the application and the possibility of appeal against the board's decision.[506] Therefore, the legal uncertainty around such issues, together with many others, created a situation where there was a high potential for the board to abuse its power at the expense of shareholders.[507] As a response to this issue, the new CL 2015 has given the competent authority (the MOCI for unlisted companies and the CMA for listed companies) the discretionary power to call for the convening of a general meeting if the board has not done so after one has been requested by the shareholders.[508] Nevertheless, by requiring the minimum shareholding ownership of 5%, it suggests that the right to request the board to call for a general meeting seems to be only available for wealthy shareholders. In listed companies, the threshold of 5% or even 2% of the company's equity would represent hundreds or even millions of Saudi riyals in market value of shareholding.[509] This will perhaps make it practically difficult to call a general meeting for dismissing errant directors.

Furthermore, even if it is assumed that shareholders have sufficient power to dismiss directors, this cannot be seen as a sufficient accountability mechanism because accountability is about holding directors responsible while they still hold their position. Unlike the private enforcement by way of civil litigation (e.g., derivative action), the mechanism of removal does not, for instance, compensate the company and its shareholders for damage resulting from the director's breach of his/her duties or oblige wrongdoers to disgorge profit made out of unauthorised activities. Such remedies can only

---

[504] Ibid.
[505] Article 90(1) of the CL 2015; see also article 87 of the previous CL 1965.
[506] Y Alzahrani, 'Critical Evaluation of Minority Shareholders' Rights in General Shareholders Meeting Underthe Saudi Company Law No.1965' (2014) 14 Global Journal of Human Social Science 37, 38-39.
[507] Ibid.
[508] See article 90(2)(d) of the CL 2015. It is worth mentioning that the new CL 2015 has referred to other circumstances where the competent authority may call for a general meeting, see sub-articles 90(2)(a), (b) and (c).
[509] See Annual Statistical Report 2015 issued by Saudi Stock Exchange (Tadawul), which shows the market capitalisation of listed companies as on 31 December 2015 <https://www.tadawul.com.sa/wps/portal/tadawul/markets/reports-%26-publications/periodical-publications> accessed 15 September 2017.

be sought through the initiation of a lawsuit.[510] Furthermore, as an *ex post* mechanism of accountability, removal is unlikely to minimise directors' incentives to become involved in one-shot misappropriation of corporate assets (called *steal-and-run transactions*[511]) in the first place. In addition, the law of directors' duties will retain its important role in determining what constitutes misconduct on the part of directors in which the exercise of removal, at least in theory, may not be related to poor performance. Moreover, it is very rare in practice that shareholders call for a general meeting in order to dismiss a director, which suggests that the option of removal is not frequently used and many directors remain in their positions despite corporate losses.[512]

2.6.2 Nomination and election of directors

Under Saudi law, shareholders, through general meetings, are given the right to appoint directors by passing an ordinary resolution.[513] Nevertheless, at least in relation to listed companies in Tadawul, the appointment of directors is indirectly affected by the board because one of the responsibilities of the board's committee of nomination is to recommend nominees for the board at the next general meeting of shareholders.[514] Before the introduction of the CGRs 2017, the boards of directors in many listed companies did not disclose the names and backgrounds of candidates before elections.[515] This might be seen as a part of the directors' advantage in controlling how shareholders vote, weakening the shareholders' positon to challenge the directors' control over elections. Although the new CGRs 2017 require the company to disclose detailed information about the nominees for the board membership on the websites of Tadawul and the relevant company,[516] this does not change the fact that directors (who could be blockholders) control the voting at the general meeting. For example, while every shareholder has the right to nominate a board member and to inform the board during the nomination period,[517] it appears that shareholders during the meeting cannot choose candidates other than those recommended

---

[510] See, for example, article 71(2) of the CL 2015; article 80 of the CL 2015.
[511] Enriques, Hertige and Kanda (n 364) 155.
[512] See R Al-fozan, 'Board Member: From where did you get this?' *Alriyadh* Newspaper (edn 15519, 20 December 2010) <http://www.alriyadh.com/587034> accessed 20 May 2016, which reported the first incidence of removing a director in the Saudi stock market.
[513] Article 68(3) of the CL 2015; see also article 66 of the CL 1965.
[514] Article 65(2) of the CGRs 2017. This procedural rule was also stated in the previous Regulations, see article 15(c)(1) of the CGRs 2006.
[515] See the General Meeting Announcements of the following companies: Wafrah for Industry and Development Company (Wafrah) (19 April 2016); Tabuk Agriculture Development Company (TADCO) 24 April 2016); Arabian Shield Cooperative Insurance Company (16 June 2016); Electrical Industries Co. (EIC) (28 April 2016) on the Tadwaul website <https://www.tadawul.com.sa/wps/portal/tadawul/home> accessed 20 July 2016.
[516] Article 8(a) of the CGRs 2017.
[517] Article 68(2) of the CL 2015.

and filed by the board.[518] Given the fact that there is nothing compelling the nomination committee to nominate more candidates than the number of available seats on the board of directors, this significantly restricts the power of the shareholders.[519]

With all this in mind, doubts could be raised concerning the influence of shareholders upon the decision not to re-elect directors following their poor performance. If the method of re-election could be regarded as a mechanism of accountability,[520] the board's control over the process of nomination for its membership weakens the enforcement mechanism. This, in turn, could undermine the accountability of directors, especially towards non-controlling shareholders.

2.6.3 The shareholders' right to question

Saudi law makes it clear that every member of the company has a statutory right to discuss any matter listed on the agenda of the meeting and to seek explanation from the board of directors or auditor about such matters.[521] However, a director has the choice of whether or not to answer the question as the law confers on him/her the right to refuse to answer an enquiry that may harm the interests of the company.[522]

The problem that exists here lies in the uncertainty around circumstances that pose harm to the company if the director answers the question. The Saudi corporate statute does not offer any guidance in relation to this issue, leaving this matter completely to the court to decide on a case-by-case basis. In contrast to Saudi law, the UK CA 2006 is more certain in regulating this issue by specifying certain circumstances where the company may refuse to answer the question.[523] In contrast, it has been argued that some directors in Saudi companies may show a 'lack of seriousness' in addressing shareholders' inquiries in which the refusal to answer or an inadequate explanation is based on unconvincing justifications.[524] In this regard, the law would indirectly weaken shareholders' participation (especially non-controlling shareholders) in ensuring the accountability of directors due to

---

[518] See article 8(c) of the CGRs 2017.
[519] See sub-article 66(b) of the CGRs 2017, which recommends that the number of nominees for the board membership, whose names are presented to a general meeting, should be more than the number of available seats on the board. This sub-article (b) is one of the provisions that is referred to as a non-binding provision.
[520] See Keay (n 304) 211.
[521] See article 96 of the CL 2015 and its immediate ancestor article 94 of the CL 1965.
[522] Article 96 of the CL 2015. This was also the case under the provision of article 94 of the CL 1965.
[523] See section 319A of the CA 2006.
[524] Alzahrani (n 506) 45.

the lack of clear rules governing the functioning of the general meeting. This again allows directors to capture control from shareholders.

2.7 Board Structure and Composition: The Independent Member System

One of the primary features of the Anglo-American corporate governance model (e.g., the UK) is the one-tier structure of the board of directors; in this model, the board consists of executive members and non-executive members who collaborate in a single organisational tier and who are elected by shareholders.[525] Like the Anglo-American model, all Saudi joint stock companies, at least companies listed on Tadawul have, as a matter of fact, a single-tier board.[526] Presumably, the board has two functions: (i) a management one which involves the decision-making phases of 'initiation' and 'implementation', and (ii) the function of supervising decisions, which comprises the stages of 'ratification' and 'monitoring' of delegated tasks.[527] Since Saudi companies tend to have a single-tier board of directors, there is a possibility of conflicts between the management and monitoring functions of single-tier boards, because the concept of delegation of power presumes that the delegator, who is required to supervise the use of delegated powers, is not the same person who is delegated to.[528] The two roles must be separate, otherwise there is a likelihood that directors will perform in their own interests.[529] As a response to this issue, the board is expected to be composed of a combination of different types of members, namely executive directors and non-executive directors (who could be independent directors).[530]

The literature on corporate governance assigns a central task to independent non-executive directors. Since supervision and oversight are some of the board's functions, independent directors are expected to monitor and oversee the executive management,[531] a task that

---

[525] See, for example, C Jungmann, 'The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany' (2006) 4 ECFR 426, 435–437. This theoretically differs from the two-tier model that prevails in continental European jurisdictions (e.g., Germany), where there are two governing bodies: the management board and the supervisory board, see 432–433.

[526] See the profiles of listed companies on the Tadawul website which shows the structure of the boards of directors <www.tadawul.com.sa> accessed 20 December 2015.

[527] MacNeil (n 412) 338; see Article 75(1) of the CL 2015 which permits the board to delegate any of its powers any person.

[528] See Kershaw (n 310) 234.

[529] MacNeil (n 412) 338.

[530] Ibid.

[531] W Ringe, 'Independent Directors: After the Crisis' (2013) 14 European Business Organization Law Review 401,408.

cannot be performed effectively without independence.[532] The dimension of the conflict of interests within management emphasises the significance of independence which is considered a prerequisite for 'ensuring ex ante that board decisions are not tainted by arbitrary considerations'.[533] Independent members of the board are regarded as trustees for shareholders to alleviate managerial agency problems through controlling conflicted transactions entered into by executive directors.[534] Arguably, the standards strategy (i.e., duty of loyalty) often 'operates in conjunction with trusteeship strategy'[535] in which independent directors are employed to ensure compliance with the duty of loyalty.[536] It has been further argued that independent directors could be seen as a tool to deal with shareholder conflicts of interests in the concentrated ownership system.[537] Some advocates of the stakeholder model even go as far as claiming that independent directors can be employed to further the interests not only of shareholders, but of all non-shareholder constituencies (e.g., creditors and employees).[538] Consequently, it is true to say that the independence of the board is a crucial theme in the modern philosophy of corporate governance.

The subsequent question that might be asked is how Saudi company law regulates the composition of the board. Similar to the UK CA 2006,[539] the Saudi corporate statute does not distinguish between executive and non-executive directors, and the statute remains silent on how many non-executive directors should be on the board and what the functions of different types of directors are. This suggests that it is the task of each company's articles of association to deal with these matters. With regard to companies listed on the Saudi stock exchange, the CGRs 2017, as with the CGRs 2006,[540] explicitly recognise three types of board members, namely (i) executive directors, (ii) non-executive directors and (iii) independent directors.[541] All companies listed in the market are obliged to appoint non-executive members who must account for the majority of the board's members.[542] According to sub-article 16(3) of CGRs 2017, there must be at least two independent

---

[532] D Clarke, 'Three Concepts of Independent Directors'(2007) 32 Delaware Journal of Corporate Law 73, 84.
[533] Ringe (n 531) 408.
[534] Armour, Hansmann and Kraakman (227) 43; Enriques, Hansmann and Kraakman (n 498) 64.
[535] Enriques, Hertige and Kanda (n 364) 174.
[536] Ibid; R. Nolan, 'The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report' (2005) 6 Theoretical Inquiries in Law 413, 415 & 443–444.
[537] Ringe (n 531) 413; Clarke (n 532) 80.
[538] Beleya et al., 'Independent Directors and Stakeholders Protection: A Case of Sime Darby'(2012) 2 International Journal of Academic Research in Business and Social Sciences 422, 424.
[539] In contrast, the UK CGC 2016 expressly recognises different types of directors, see footnote 545 and accompany text in this Chapter.
[540] Article 2 of the CGRs 2006.
[541] Article 1 of the CGRs 2017.
[542] See article 16(2) of the CGRs 2017.

directors among members of the board or they must account for 'one-third of the board members, whichever is greater'. Like their predecessor,[543] the CGRs 2017 make it clear that committees must be formed of an adequate number of non-executive directors (regardless of whether they meet the independence requirement or not) if such committees deal with actions that possibly comprise conflict of interest, for example 'ensuring the integrity of the financial and non-financial reports, reviewing related party transactions, nomination to membership of the board, appointment of senior executives, and determining the remuneration'.[544] In the UK the board of a public company listed on the London Stock Exchange should consist of executive and non-executive directors (particularly independent directors) in which 'half' of the board members, except for smaller companies, must be independent non-executive directors.[545]

According to the CGRs 2017, the description of *executive director* refers to those who are responsible for the day-to-day management of the company.[546] The difference between non-executive directors and independent directors is that while the former is defined as a director who is not engaged in the day-to-day management of the company,[547] the latter is referred to as a member who 'enjoys complete independence' in his status and judgement.[548] The question that may be then raised is: On what criteria is the independence of directors to be determined? Both the Saudi and the UK laws provide a non-exhaustive catalogue of criteria that formally disqualify a person from being an 'independent board member'. As with the situation in the UK,[549] the independence standards set forth in the CGRs 2017 are ongoing requirements in which the board through 'the nomination committee' is annually required to ensure the independence of each independent director.[550]

According to the Saudi definition of *independence*, a member of the board will not meet the independence standards if he/she owns or represents a legal person who owns 5% or more of the stock of company or any of its group.[551] This means that the CGRs 2017 do not consider share ownership as a bar to independent judgement, but they do regard significant ownership of shares (i.e., holding 5% or more) as an infringement of independence. It can

543 See article 13(c) of the CGRs 2006.
544 Article 51(a) of the CGRs 2017.
545 See paras (B.1) and (B.1.2) of the CGC 2016.
546 Article 1 of the CGRs 2017.
547 Article 1 of the CGRs 2017.
548 Article 1 of the CGRs 2017.
549 Para (B.1.1) of the CGC 2016.
550 Article 65(7) of the CGRs 2017; article 20(b) of the CGRs 2017.
551 Article 20(c)(1) and (2) of the CGRs 2017.

be inferred from this fact that the *main* function of independent directors should be to ensure that there is no management abuse damaging the interests of the minority shareholders. Similarly, the UK CGC 2016 regards the representation of a 'significant shareholder' on the board as a reason for disqualifying a director from being independent. However, it can be clearly noticed that the director's ownership of a significant shareholding per se is not a barrier to being selected as an independent board member.[552] In addition, the independent status cannot be granted if the person is a director of another company within the company's group.[553] This is also the case if the board member is or has been an employee, or is or has been a controller (i.e., owns at least 30% of the voting power)[554] 'of the company, of any party dealing with the company or [group]' within the past two years.[556] The independence requirement will not be met if the director receives additional financial remuneration apart from the membership fees,[557] or has engaged in self-dealing transactions or in businesses that are in competition with the company.[558] As a non-binding condition, a director may not be considered independent if he/she 'served for more than nine years' as a director of the company.[559] Since a family relationship is likely to influence the independent judgement of any person, the CGRs 2017, like the 2006 version of the Regulations,[560] expressly provide that the independence criteria will not be met if a board member is a relative of any director or senior executive of the company or group.[561] In the same way, but in broader terms, 'close family ties with any of the company's advisers, directors, or senior employees' is considered in the UK as a bar to independence.[562] As a matter of fact, the phrase 'close family ties' is not defined in the UK CGC 2016 but is left to the board to determine whether or not a particular family relationship can influence the independent judgement of a board member. In contrast to the UK, the term 'relative' has been defined in the CGRs 2017 to include the director's spouse, children, grandchildren, parents, grandparents, siblings, nephews or nieces.[563]

Nevertheless, the question that arises concerns the effectiveness of an independent director in checking and monitoring the company's management and in protecting shareholders' interests (especially minority shareholders). Although this thesis can only provide limited

[552] See para (B.1.1) of the CGC 2016.
[553] Article 20(c)(5) of the CGRs 2017.
[554] See article 1 of the CGRs 2017.
[556] Article 20(c)(6) of the CGRs 2017.
[557] Article 20(c)(8) of the CGRs 2017; for the UK, see para (B.1.1) of the CGC 2016.
[558] Article 20(c)(7) and (9) of the CGRs 2017
[559] Article 20(c)(10) of the CGRs 2017; for the UK, see para (B.1.1) of the CGC 2016.
[560] See article 2(b), (4)(5) of the CGRs 2006.
[561] Article 20(c)(3)(4) of the CGRs 2017.
[562] Para (B.1.1) of the CGC 2016.
[563] See article 1 of the CGRs 2017.

detail, it appears that since the adoption of the independent director institution in the CGRs 2006, there have been doubts about its effectiveness within the Saudi corporate governance system.[564]

First, there are questions over the 'true independence' of board members appointed as independent directors. While the meaning of 'relative' has been expanded compared with its definition under the CGRs 2006,[565] the Saudi regulation omits the potential influence of other family connections such as uncles, aunts, cousins or family members by marriage (e.g., parents-in-law) on the independence of directors. This is a valid consideration given the fact that Saudi society is characterised by strong family and tribal ties.[566] Furthermore, the possible influence of long-standing friendship on the independence of directors is not recognised by the CGRs 2017. An empirical study reported that it is common in Saudi Arabia to appoint family members or friends to sit on the board as non-executive directors, particularly independent members, in companies controlled by families.[567] The second point to consider is that the mechanism of nomination of independent directors, under Saudi law, could have an impact on their independent judgements regarding corporate matters.[568] Concerning Saudi listed companies, they are required to set up a board committee (nomination committee)[569] which is, *inter alia*, responsible for presenting its recommendations to the board of directors regarding the nomination of its members.[570] While the new CGRs 2017 clearly prevent an executive director from being a member of such a committee, there is nothing in the Regulations preventing a non-executive director, who could be also a controlling shareholder, or a person connected to the controlling shareholder, from being a member of the nomination committee.[571] This means that independent members of the board are likely to be nominated by co-directors and controlling shareholders and this might undermine their independence.[572] Generally, any director, irrespective of whether he/she is independent in the legal sense, would tend to act in the interest of those who select him/her.[573] Third, it should be further noted that the

---

[564] See, for example, Falgi (n 208); Alamri (n 489).
[565] See article 2(b) of the CGRs 2006.
[566] Falgi (n 208) 128–129.
[567] Piesse, Strange and Toonsi (n 433) 663.
[568] See, for example, M Gutierrez and M Saez, 'Deconstructing Independent Directors' (2013) 13 Journal of Corporate Law Studies 63, 85–86.
[569] Article 64(a) of the CGRs 2017. It is noteworthy that the nomination committee and remuneration committee can be combined into a single committee, see article 50(7) of the CGRs 2017.
[570] Article 65(2) of the CGRs 2017.
[571] See articles 51(b) and 64(a) of the CGRs 2017.
[572] As has been reported, it is a common practice that controlling shareholders and executive directors 'bring in familiar faces' to sit on the board as independent directors, see Piesse, Strange and Toonsi (n 433) 663.
[573] See J Coles, N Daniel and L Naveen, 'Co-opted Boards' (September 2013) 4–5 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1699272> accessed 7 September 2017 who argue that

effectiveness of the independent director system depends on the quality of the liability rules, of which well-formulated standards for directors' duties and effective mechanisms of private enforcement are important elements. Indeed, in the absence of a strong system of legal liability, independent directors cannot effectively carry out their monitoring obligations.[574] As one study suggests, independent non-executive directors are likely to play a limited role in disciplining poorly-performing managers in a setting where directors' duties are not effectively and adequately enforced.[575] Therefore, the independent director system can be regarded as complementary to effective legal regulation where the law creates incentives for independent directors to behave effectively by imposing legal liability on those who do not.[576]

2.8 The Limited Role of Market Mechanism

It is generally accepted that the institution of the market is one of the accountability mechanisms that works as a check on directors' exercise of discretionary powers.[577] The market-based accountability mechanisms that monitor and discipline directors include the product market, labour market, the capital markets (e.g., the stock market) and the market for corporate control.[578] Simply, the role of markets as a corporate governance institution is mainly based upon disciplining low-performing companies and simultaneously rewarding high-performing companies.[579] For the purposes of the present research it suffices to explain briefly the nature of each market mechanism.

The idea of product market discipline is that if the company performs poorly due to bad management, it will be unable to sell its products and this will result in the loss of its market and sooner or later the directors will be replaced.[580] The directors' poor performance will damage their reputation, making it difficult to secure further employment

---

not all independent directors effectively perform their task. 'Those who are co-opted by the CEO [i.e., directors who joined the board after the CEO assumed office] are associated with weaker monitoring, while the independent directors who join the board before the CEO assumes office, that is, the directors who hired the CEO, are associated with stronger monitoring'.

574 For similar argument about the role of law, see Gutierrez and Saez (n 568) 91.

575 J Franks, C Mayer and L Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 Journal of Financial Intermediation 209, 241 and 245.

576 See Gutierrez and Saez (n 568) 87.

577 See for instance Jones (n 305) 118; Brennan and Solomon (n 305) 887–888.

578 Keay (n 304) 232.

579 M Roe, 'The Institutions of Corporate Governance' (The Harvard John M Olin Discussion Paper Series No 488, 8/2004) 6 <http://www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf> accessed 22 September 2017.

580 Ibid 6 and 7; B McDonnell, 'Professor Bainbridge and The Arrowian Moment: A Review of The New Corporate Governance in Theory and Practice' (2009) 34 Del J Corp L 139, 172.

(labour market discipline).[581] With regard to the role of capital markets, such as the stock market mechanism, the philosophy behind this mechanism is that if the company performs badly and the share price decreases, it will be difficult for the company to raise capital and develop its business.[582] For this market mechanism to operate effectively, the market should be 'semi-strong efficient',[583] that is, it can incorporate 'all publically available information' into the price of the company's shares. Further, there must be enough sophisticated and wealthy investors willing to buy and sell their shares in response to the available information in order to adjust the share price appropriately.[584] As far as the market for corporate control (i.e., the takeover market mechanism) is concerned, with poor corporate performance the company's value and share price will presumably decrease. This, in theory, creates a profit-making opportunity for any individual to purchase shares, take control of the company and elect new directors.[585]

One common argument is that the availability of effective non-legal, market-based accountability mechanisms would lead to shareholders relying less on legal accountability mechanisms.[586] This raises the question of whether markets are effective enough to provide sufficient protection for shareholders in Saudi Arabia, as there would then be only a very limited need for legal intervention to ensure the accountability of directors. The main argument presented below is that there are limits and obstacles associated with market-based accountability mechanisms that render markets ineffective in holding directors accountable. This then suggests that the enhancement of a liability rules system, accompanied by effective enforcement mechanisms, is crucial for providing sufficient protection for the company and its shareholders. This suggestion is supported by the following arguments:

First, while some studies in several developed economies point out that shareholders are primarily protected from managerial abuse by non-legal market mechanisms of accountability that are all expected to place pressures upon directors and managers to run

---

[581] D Kershaw, 'Web Chapter A: The Market for Corporate Control' in D Kershaw (ed), *Company Law in Context: Text and Materials* (OUP 2010) 2 <http://global.oup.com/uk/orc/law/company/> accessed 14 October 2014.
[582] Roe (n 579) 7–8.
[583] This concept of efficiency is well-known as 'efficient capital markets hypothesis', a theory suggested by Eugene Fama. Besides the semi-strong form, there are the strong-form efficiency, where prices reflect all public and private information, and the weak form efficiency, where prices change instantaneously to new information; see E Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 Journal of Finance 383.
[584] Kershaw (n 581) 3.
[585] Ibid 7.
[586] A general observation made by McDonnell (n 580) 171.

the business in the best interests of shareholders,[587] this might not be the case in developing economies.[588] Market institutions in emerging markets such as Saudi Arabia, can be characterised as incomplete or incompetent and doubts can be cast upon the contribution of market institutions to the development of corporate governance systems. This has been pointed out by one commentator, who found in his study that 'the Saudi Arabian market is not mature yet'.[589] Bukhari adds that in emerging economies such as Saudi Arabia where corporate governance is still in its infancy, the influence of markets in promoting the system of corporate governance tends to be weak and ineffective.[590] For example, Piesse et al. have specifically stressed that there is no active market for corporate control in Saudi Arabia.[591] With regard to the capital market discipline, although there is no agreement among economists about the efficiency of a particular market,[592] an empirical study conducted by Awan and Subayyal concluded that all Gulf stock markets (including the Saudi stock exchange) are inefficient.[593] This would largely undermine the operation of the capital market as a device for disciplining directors of low-performing companies. From the empirical evidence above, it can be submitted that market institutions in Saudi Arabia are still some way away from being capable of constraining the actions of insiders (e.g., directors).

Second, market-based accountability mechanisms have some inherent flaws.[594] Consider, for example, the labour market. McDonnell emphasises the limits to this market by saying that it is not often possible to 'disentangle the contributions of individual managers to firm success'.[595] Furthermore, the negative outcomes of one director's conducts may not come to light until he has already secured a very well-paid position elsewhere.[596] In the corporate governance literature, the limits to the market for corporate control (i.e., the market of takeover) in disciplining managers have also been highlighted. As has been pointed out, most instances of managerial misconduct do not normally result in a large enough

[587] T Paredes, 'A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer' (2004) 45 William & Mary Law Review 1055, 1074 and 1085; Roe (n 579) 6–8.
[588] Paredes (n 587) 1142–1143.
[589] Bukhari's interview with the Head of Compliance Division in one of the Saudi banks, see M Bukhari,'The Impact of Institutions on the Development of Corporate Governance in Saudi Arabia' (PhD thesis, University of Nottingham 2014) 228–229.
[590] Ibid.
[591] Piesse, Strange and Toonsi (n 433) 656.
[592] U Awan and M Subayyal, 'Weak Form Efficient Market Hypothesis Study: Evidence from Gulf Stock Markets' (June 2016) 6 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2787816> accessed 21 September 2017.
[593] Ibid 12.
[594] McDonnell (n 580), 171–174; Roe (n 579) 7-8.
[595] McDonnell (n 580) 171.
[596] Ibid.

reduction in the company's shares to justify a hostile takeover.[597] Even if the misconduct led to a significant reduction in the company's share price, Coffee opines that internal mechanisms of accountability will be employed before any intervention by a hostile bidder.[598] Frank and Mayer, in their empirical study, question the function of the takeover market, as a disciplinary device in the UK, finding no notable relationship between the hostile bid and poor management.[599] Moreover, since there is no evidence that the improvement of corporate governance will necessary occur following takeovers, Singh et al. argue that the underlying motivation behind takeovers is to build business empires rather than discipline poor-performing managers.[600] It should be further borne in mind that for the takeover market to operate efficiently, there must be a large amount of information broadly available to market participants and this is not easy to obtain; an issue that tends to be more significant in developing countries.[601]

Third, even in the presence of effective markets, the role of law is still important in controlling directors' behaviour while managing the company. In this regard, Roe gives an example of how market institutions may be more effective in combating *shirking* on the part of directors, but tend to be poor at reducing directorial *stealing*;[602] for example, the market does not deter a director from exploiting a corporate opportunity, and even if he/she lost his/her job as a result of such behaviour, he/she 'will leave rich'.[603] In relation to stealing, the law is likely to play a more significant role in deterring directors from acting opportunistically.[604] This means that legal mechanisms might be better at dealing with one-off instances of misappropriation, which can negatively affect the company's growth. Furthermore, unlike legal accountability, market mechanisms have no role in punishing directors through, for instance, paying compensation for loss and damage caused by their misconduct, disgorging unauthorised profits, nullifying illegal actions,[605] and paying financial penalty for the violation of law.[606]

---

[597] J Coffee, 'Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145, 1200.
[598] Ibid 1202–1203.
[599] J Franks and C Mayer, 'Hostile Takeovers and the Correction of Managerial Failure' (1996) 40 Journal of Financiai Economics 163, 180.
[600] A Singh, A Singh and B Weisse, 'Corporate Governance, Competition, the New International Financial Architecture and Large Corporations in Emerging Markets' (MPRA Paper No. 53665, August/ 2002) 23, <https://mpra.ub.uni-muenchen.de/53665/1/MPRA_paper_53665.pdf> accessed 21 September 2017.
[601] Ibid 22.
[602] Roe (n 579) 7.
[603] Ibid.
[604] Ibid.
[605] For Saudi law, see article 71(2) of the CL 2015; article 80 of the CL 2015.
[606] For Saudi law, see, for example, article 211 of the CL 2015.

From the discussion above, it can be argued that the lack of mature markets in Saudi Arabia requires the corporate law, accompanied by legal mechanisms of enforcement, to play a much greater role in protecting shareholders from a directors' abuse of managerial power. In this regard, Paredes suggests that for the promotion of capital markets in developing countries, there is considerable need to design a sound legal system that offers strong legal protection for shareholders (including minority shareholders) and places tight constraints on directorial discretion.[607] This is simply because markets in developing countries are unable to fill the regulatory gaps created by the absence of robust legal protection.[608] Even if a country is in the process of moving towards the privatisation or the adoption of market-based corporate governance, it does not immediately follow that markets will function properly in terms of controlling agency costs because the development of the necessary institutions takes a long time.[609]

In Saudi Arabia the government has begun to offer part of its shareholding in several companies to the IPO with the aim of gradually transferring more equity shares to the public.[610] Since the government is aiming to make the Saudi stock market more attractive to domestic and foreign investors under its 2030 Vision plan,[611] there is also a pressing need to reform the legal and institutional pillars of the stock market. Nonetheless, since the preparation of good corporate law is a time-saving task compared with the creation of complex non-legal institutions, it is easy to see the logic behind the policymakers' choice to reinforce the legal protection given to shareholders as a priority in their reform agenda. The main point to make here is that like other developing countries, the design of a sound corporate law system that relates to creating and enforcing mechanisms of accountability, is important in the Saudi context in order to provide the company and its shareholders with greater legal protection against abusive practices by directors.

2.9 Concluding Remarks

This chapter presented an assessment of current corporate governance mechanisms designed to monitor director's discretion and ensure accountability for misuse of those

---

607 Paredes (n 587) 1125–1126.

608 Paredes, 'Importance of Corporate Law: Some Thoughts on Developing Equity Markets in Developing Economies' (2006) 19 Pac McGeorge Global Bus & Dev LJ 401, 407.

609 Paredes (n 587) 1124–1125.

610 See Report on the Development of Private Sector and the Privatisation Policy, *Achievements of the Development Plans: Facts and Figures* (2013) 76–77 <http://www.mep.gov.sa> accessed 12 April 2015.

611 See Kingdom of Saudi Arabia Vision 2030, 'An Overview of Strategic Objectives and Vision Realisation Programs', available in the website of Saudi 2030 Vision <http://vision2030.gov.sa/en/node> accessed 22 September 2017.

powers. The Saudi law noticeably tilts the balance of decision-making power between the general meeting and the board of directors in favour of the latter. Consequently, mechanisms of board accountability should be put in place. The chapter has highlighted the fact that legal uncertainty is the main problem associated with the law of directors' duties and their enforcement, which undermines the effectiveness of the legal liability system as a mode of accountability. As the analysis has shown, the argument for the need to address this legal uncertainty is borne out by the limits and drawbacks associated with other mechanisms of monitoring and accountability in the Saudi context.

Within the accountability framework for directors, the chapter questioned whether blockholders' monitoring (the shareholders' internal mechanisms at the general meeting) of the board's composition of independent non-executive directors and markets can replace the need for a sound legal system of directors' duties in Saudi Arabia. It is clear that there are flaws in the four mechanisms that have been discussed above. It might be true to say that reliance on these mechanisms will not ensure that directors are subject to an adequate level of control and accountability. A sound corporate governance system cannot be established without a robust regulation of liability standards and rules that deal effectively with stealing and shirking by directors, who may simultaneously be blockholders. This must be accompanied by an accessible private enforcement action that enables the company and its shareholders, especially the minority shareholders, to enforce breaches of duties. The final point to emphasise is that this chapter is not intended to marginalise the importance of building up non-legal institutions or other legal institutions as part of the Saudi corporate governance reform. It is rather an attempt to emphasise the centrality of a strong corporate law regime that establishes well-designed duties, reinforced by accessible private enforcement litigation, in relation to the reform of corporate governance in Saudi Arabia.

Chapter 3: An Evaluation of the Director's Duty of Care

3.1 Introduction

The director's conduct concerns either decision making or action taking. While a decision will usually be made collectively through the board of directors at the meeting, an individual director will often take an action.[612] Within the context of corporate governance, a mechanism must be employed to deal with the issue of ensuring that those responsible for the company's management show appropriate levels of diligence and care, act only on an informed basis, and consider prudently the probable outcome of their decisions and actions.[613] The directors' failure to make the required effort in taking a decision or action, which is referred to as *shirking*, is one of the primary forms of directorial wrongdoing.[614] To limit directors' engagement in shirking, the law places them under a legal obligation to exercise a certain degree of care while managing the company's affairs.

The main concern associated with the duty of due care is that the directors' duty of care is a standard, a type of regulatory strategy, that 'leave[s] the precise determination of compliance to adjudicators after the fact'.[615] However, the law has to play a central role in reducing uncertainty about the substantive content of the duty so that it does not undermine overall accountability. While discussing Saudi law, questions about the precise behavioural expectation that the duty of care imposes upon directors and the availability of additional standards of the director's liability remain unanswered, bringing about a state of uncertainty in the law. Furthermore, directors can perform different kinds of roles and functions depending upon the type of directorship, and the type and the size of the company.[616] The central point here is this: since directors perform various functions, the court should take into account such diversity of roles and functions when applying the standard of care.[617] Another source of concern is that the duty of care should not be overly

---

[612] A typical example of actions taken by directors includes the purchase or sale of company assets.
[613] C Gerner-Beuerle, P Paech and E Schuster, 'Study on Directors' Duties and Liability' (A paper prepared by LSE for the EC, Apirl 2013) 74 <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf> accessed 16 July 2016.
[614] See footnotes 361–362 and accompanying text, Chapter 2 in this thesis.
[615] See Armour, Hansmann and Kraakman (n 227) 39.
[616] This remark was made in the reform discussion of directors' duty of care in the UK, see The Law Commission and the Scottish Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating and Statement of Duties* (Law Com No. 261 and Scot Law Com No. 173, September 1999) para 5.15 <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc261_Company_Directors.pdf> accessed 23 July 2016.
[617] This concern was expressed in relation to UK law, which must be taken into account when examining the duty of care in the context of Saudi law, see Riley (n 376) 699.

onerous so the liability risk faced by directors is too high;[618] in the meantime, the standard for the duty should not be too low, encouraging directors to act unreasonably because of low risk of liability.

In this chapter directors' duty of care under the Saudi law is evaluated, and deficiencies and uncertainties in the law are identified. Saudi law is critically analysed mainly in comparison with UK law. Regarding the structure, the chapter is divided into four main sections. First, the legal recognition of the duty of care in the UK and Saudi law is explored. The second section concerns an investigation into the standard of care requirement. Then factors affecting the court's determination of what constitutes a breach of an objective standard of care is analysed. In this section the main underlying obligations of directors, namely monitoring, keeping themselves informed and avoiding undue reliance on others will be considered in order to define the components of the duty of care obligation. The fourth section deals with possible responses to the issue of a single high standard of care.

3.2 The Legal Recognition of Directors' Duty of Care

The breach of duty of due care in almost every jurisdiction renders directors responsible to the company and its shareholders.[619] In this section the recognition of the directors' duty of care is examined in the UK and Saudi Arabia.

3.2.1 The codification of the duty of care in the United Kingdom

Directors' duty of care is codified under section 174(1) of the CA 2006, which places directors under the obligation to act with 'reasonable care, skill and diligence'. It had been well established that directors owed such an obligation to the company even before the enactment of the CA 2006 and the common law played an important role in recognising and framing directors' duty of care and skill. In *Re City Equitable Fire Insurance Co.*[620] the court asserted that for directors to avoid the liability for breaching their duties they were expected to 'exercise some degree of both skill and diligence' besides acting *bona fide*.[621] It is important to say that the duty of care and the duty of loyalty generated independent

[618] Ibid.
[619] Enriques, Hansmann and Kraakman (n 498) 79.
[620] *Re City Equitable Fire Insurance Company Ltd.* (1925) Ch 407 (CA)
[621] Ibid 408, see particularly Romer J at 427. The directors' duty to act *bona fide* along with the duty to avoid conflicts of interests are primary elements of the duty of loyalty, which is examined in Chapter 4 in this thesis.

bodies of case law. Historically, while duties of loyalty[622] were developed in accordance with fiduciary rules and principles, the duty of care is based on common law principles of negligence.[623] At present this division between fiduciary obligations and the duty of care does not exist in the CA 2006. The duty of care is one of the seven general duties set out in the CA 2006. Nevertheless, in relation to remedies for the breach of the duty, the CA 2006 makes it clear that the duty of care is not a fiduciary obligation since the Act provides that the fiduciary remedies applying to statutory duties set out in Chapter 2 of Part 10 of the Act do not apply to the duty of care, which is governed by the relevant common law rules.[624]

It is worth noting that despite the codification of directors' duties, the common law remains relevant in the interpretation and application of general duties set forth in the Act.[625] There might also be situations where the obligation of care overlaps with other general statutory directors' duties;[626] in other words, the potential of breaches occurring in more than one duty is expressly recognised in section 179 of the CA 2006.

3.2.2 The recognition of the duty of care in Saudi law

While the directors' duty of care in the UK is codified in the CA 2006, neither the CL 1965 nor the CL 2015 includes a single provision that explicitly requires directors to manage the company with care and due diligence. Nevertheless, the duty can be said to have derived from two sources.

First, shareholders may insert an express clause in the company's articles of association requiring directors to act diligently, which derives its binding force upon directors from the Saudi corporate statute.[627] It is important to note that the Saudi Model Articles of Association for Joint Stock Companies lacks any reference to the directors' duty of care.[628]

[622] Traditionally, company law textbooks discussed fiduciary duties as a main component of the duty of loyalty; see, for example, L C B Gower, *Principles of Modern Company Law* (3rd edn, Stevens and Sons 1969).
[623] Davies and Worthington (n 2) 478.
[624] See section 178 of the CA 2006. The compensatory remedy is the one given to the company in the case of a breach of duty of care in which fiduciary remedies (e.g., rescission or restitution) are not available; see, for example, *Bristol and West Building Society v Mothew* (1997) Ch 1 , 17–18.
[625] See section 170(4) of the CA 2006.
[626] See the Explanatory Notes to the Companies Act 2006, para 311 <http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen_20060046_en.pdf> accessed 1 August 2016.
[627] Article 78(1) of the CL 2015.
[628] This observation is true in relation to the Model Articles of Association issued pursuant to the CL 1965 as well as its successor, the CL 2015. The new version of the Saudi Model Articles of Association has recently

The question raised here concerns the extent to which such an obligation can be implied even in the absence of clear recognition in the Saudi statute and in the company's articles of association. At the outset, statutory companies, including joint stock companies, are established by contract.[629] Given the role of state legislation in regulating corporate governance, this means that Saudi contract law, drawing on rules of Sharia*,* would influence the regulation of companies.[630] According to some Arab writers, directors are seen as agents of the company (i.e., technically shareholders)[631] and their responsibility towards the company is governed by rules similar to the agent's responsibility towards its principal.[632] This legal description of the director–company relationship is also consistent with the view of many Islamic law writers who regard a company director as an example of an agent who acts on behalf of the company.[633] Having said that, the body of Sharia rules governing the agent–principal relationship may be relevant in filling the gap in the current law and in a company's articles.

In the Islamic legal literature agents (in this case directors) are not responsible for damage to entrusted property unless they have been negligent or transgressed.[634] This means that the exercise of a certain degree of care, while managing the company on behalf of the directors, is needed to avoid liability. Nonetheless, in order to draw a clear picture as to the position of Saudi law regarding the recognition of directors' duty of care, it is important to explore whether the court will imply such a duty into the company's articles of association. As a matter of fact, it must be acknowledged that liability cases brought by joint stock companies against directors are not reported in Saudi law.[635] Furthermore reported cases on the liability of directors of joint stock companies are few and far between.[636] However, from the few available cases on liability brought against those responsible for managing

---

been issued and published in the website of the Ministry of Commerce and Investment (in Arabic only) at <http://mci.gov.sa/cl2015/Documents/06.pdf> accessed 6 August 2016.

[629] See article 2 of the CL 2015.

[630] See footnotes 154–157 and accompanying texts, Chapter 1 in this thesis.

[631] When it comes to the issue of remedies, shareholders act on behalf of the company to enforce the breach of the duty of care.

[632] See S Jobran, *The Board of Directors of Joint Stoke Company in Saudi law* (Arabic) (Beirut, Librairie Juridique Al-Halabi 2006) 324–325; A Yunus, *Commercial Companies* (Arabic) (Cairo, 1991) 245. It is worth noting that there are some discrepancies between the general provisions of agency law and rules governing the relationship between the company and its directors, such as those in relation to rules governing delegations and the appointment of agents, see Al-Jaber (n 71) 212. This means that the agency law is modified in such a way that makes it applicable to directors.

[633] Saleem (n 95) 70; A Al-Kyat, *Companies in Islamic* Sharia *and Positive Law* (vol 2 4th edn, Beirut, Al-Ressalh Publishers 1994) 184.

[634] M AlBahuti, *Explanation of Muntaha al-Iradat* (A Al-Turki ed, 3rd vol, Al-Resalah, 2000) 535.

[635] The researcher examined judicial rulings in the field of company law published on the website of the Board of Grievance and did not find a reported case in this regard.

[636] For example, in the three volumes of selected judgments and judicial principles in corporate matters for the years 1987– 2003 there are only a handful of cases on matters relating to joint stock companies.

limited liability companies, the court's approach to recognising the duty of care for directors of joint stock companies can be gleaned.

The reference to judicial decisions on limited liability company disputes is useful to the analysis of joint stock companies for the following reasons: (i) the close resemblance in fundamental characteristics between the two companies;[637] and (ii) the directors of joint stock companies and the managers of limited liability companies all perform their duties in accordance with a standard agency relationship[638] and presumably are subject to the same legal basis for conduct and review. Thus, returning to the question of whether Saudi courts can extrapolate the directors' duty of care in the absence of express terms in the company's articles, it appears that directors have no option other than to manage the company diligently in order to avoid legal accountability. In the reported case (number 1129/3/Q)[639] the court addressed the question of whether a manager of a limited liability company in fact mismanaged the company's affairs. In its reasons for judgment, the court recalled the principle that those appointed in the company's memorandum of association are responsible for the management of the company and so are liable for compensating the company for any damage that results from their negligence.[640] This means that any negligence on the part of managers is one of the grounds for liability towards the company. Put differently, from the court's point of view the exercise of a certain degree of care while managing the company is an implied duty placed upon managers even in the absence of express reference to that duty in the company contract. Accordingly, the same conclusion can be drawn in relation to joint stock companies. If the company's articles of association do not explicitly require the director to act diligently, the court will expect the director to do so because the mismanagement of the company arising from negligence will expose the director to the legal risk of being liable towards the company and its shareholders.

Second, although there is no explicit mention of the directors' duty of care in the Saudi corporate statute, it can be argued that the duty has been statutorily established in a rather vague and abstract way where the corporate statute implicitly requires directors to take due care while managing the company. It is indisputable that directors will not be immune from being sued in cases of a fault in the management of the company because the

---

[637] See footnote 162, Chapter 1 in this thesis.
[638] See Saleem (n 95) 70.
[639] The Board of Grievances, Case No. 1129/3/Q, Appeal Division Decision No. 7/AS/838, 2010 (1431H) 638.
[640] Ibid 661.

presence of *fault* on the part of directors, as the CL 2015 affirms,[641] is a cause of action for the company and its shareholders against directors.[642] The directors' fault, which is one of the central grounds of the legal liability of directors,[643] results mainly from the following three scenarios:[644] (i) a violation of the corporate statute, (ii) a breach of the company's articles of association or (iii) the 'mismanagement of the company's affairs'.[645] It is the last-mentioned (i.e., the mismanagement of the company's business or a managerial fault) that is likely to attract significant attention due to some judicial difficulties in assessing this type of 'fault' in the absence of a violation of the law or of a company's bylaws. Noticeably, the meaning of *fault* is not specified in the Saudi corporate statute, and is left to scholars and judges to define.

It is important here to recall that the development of Saudi corporate law has historically been affected by French law.[646] The importation of the concept of *fault*, as a requirement of civil liability, is a case in point. In this regard, it seems that the notion of 'fault' in French law denotes the failure to conform to a rule of conduct imposed by, for instance, legislation or contractual agreement, or to observe the general duty to exercise due diligence.[647] Interestingly, with reference to Islamic law commentators, it appears that the concept of *fault* (*khata* in Arabic) as technically understood by civil law lawyers does not exist in Sharia law.[648] Nevertheless, as some point out, jurists have developed the notion of *ta'adi* in Islamic jurisprudence, as almost the equivalent of the concept of fault as defined by civil law lawyers.[649] As has been noted, that development has reached the level where some

---

[641] This was also the case prior to the new CL 2015, see article 77 of the CL 1965.
[642] Article 79 of the CL 2015.
[643] See, for example, Al-Jaber (n 71) 339. The fault is one of the main elements of civil liability (i.e., tort or contractual); for a general discussion of the concept of fault, see A Amkhan, 'The Concept of Fault in Arab Law of Contract' (1994) 9 Arab Law Quarterly 171; A Al-Sanhuri, *Al-Wasit: Commentary on the New Civil Code: Sources of Obligation* (Arabic) (vol 1, Beirut, Dar Alturah Arabi).
[644] In addition, members of the board could be exposed to the risk of being liable where a fraudulent and deceptive act is committed while managing the company. Directors' liability for fraudulent acts are not expressly mentioned in the Saudi corporate statute. However, it has been said the concept of fault is wide enough to capture such illegal acts, see S Jobran (n 632) 326. This view is borne out by the fact that article 229(6) of the CL 1965 (article 211(a) of the CL 2015), for example, imposes sanctions on directors in the case of deliberate provision of false information in the company's financial reports which can be regarded as a fraudulent act.
[645] See article 78 of the CL 2015, which is identical to article 76 of the CL 1965 in this regard. There are circumstances where the directors' fault might be considered a violation of the company's articles of association and mismanagement of the company, such as a director entering into a contract that does not fall within the object clause.
[646] See footnotes 141–145 and accompanying texts, Chapter 1 in this thesis.
[647] G Bermann and E Picard, *Introduction to French law* (Alphen on the Rhine, Kluwer Law International 2008) 247–248.
[648] See, for example, A Al-Qasem, 'The Injurious Acts under the Jordanian Civil Code' (1989) 4 Arab Law Quarterly 183, 191.
[649] Ibid 191–192; see, for instance, W A-Zuhayli, *Theory of Reparation* (9th edn, Damascus, Dar Al-Fikr 2012) 24–26, 49.

scholars have referred to the notion of *ta'adi* by using the term 'fault'.[650] In the literature *ta'adi* can be described as exceeding the limits that should be adhered to by '[Sharia] law, custom and practice',[651] and as the failure to exercise due care in the conduct of certain actions.[652] Returning to the meaning of fault in the context of directors' liability in corporate law, since directors are seen as being in an agency relationship with the company, many suggest that *ta'adi* (fault in the technical sense), *inter alia*, denotes *negligence* on the part of agents (in this case directors).[653] Having said that, directors as agents will be liable for *ta'adi* (i.e., negligence) as long as they have fallen short of due care whilst managing the company.[654] According to the writings of many company law commentators, it is generally accepted that the term *fault*, in the context of directors' civil liability, includes negligence or a breach of the obligation to act with care.[655] Thus, it can be asserted that the CL 2015, as with its predecessor of 1965, tacitly recognises the demand for managing the company with due care and diligence in order to avoid being sued for fault in the narrow sense (i.e., negligence).

While the Saudi corporate statute does not explicitly recognise directors' duty of care, the situation is completely different in relation to companies listed on the Saudi stock market. The CCRs 2017 require in article 30(17) that each director act diligently and in article 21(a) that the board manage the company with care.[656] Article 21(a) refers to the 'board' instead of 'individual directors' while imposing the duty of diligence. Accordingly, there is a disconnect between the decision making by the board and the liability set out in article 21(a). While a decision is usually made collectively by directors (at the board meeting), the liability for relevant decisions should be imposed individually, meaning each director is under an obligation of care and the failure to meet the care requirement may expose him/her to liability for breach. Therefore, it might be true to say that the wording of article 21(a) perhaps gives rise to a state of uncertainty about the nature of liability because collective decision making by the board does not reflect the idea that article 21(a) supports the individual liability of directors.

---

[650] Al-Qasem (n 648) 192.
[651] Ibid (n 648) 192; A-Zuhayli (n 649) 24, 26; Al-Haboob, 'The Contractual Liability (Arabic)' (2011) 3 Al-Qadhaiyah Journal 278, 286.
[652] Al-Qasem (n 648) 192.
[653] See Al-Sanhuri, *Sources of Right Under the Law and Islamic Jurisprudence* (Arabic) (vol 6 Beirut, Dar Alturah Arabi 1954)105; Al-Haboob (n 651) 292–293.
[654] Al-Sanhuri (n 653) 105–116.
[655] See, for example, Al-Jaber (n 71) 339; Jobran (n 632) 338.
[656] This was also the case in relation to their predecessors of 2006, where article 11(c) of the CGRs 2006 requires only the board to manage the company diligently.

It is important to mention that the Saudi corporate statute does not require a special skillset or long-standing experience for a person to be elected as a member of a board, but leaves this matter to the company's articles of association to determine. For listed companies, there is a recommendation to appoint a board member who has experience, financial knowledge and competency.[657] Concerning the board's committees, article 54(a) of the CGRs 2017 requires the appointment to the audit committee of a specialist in finance and accounting matters.

3.3 The Standard of Care: State of the Company Law

One of primary contributions of the legal regulation of the directors' duty of care is to design a standard of liability by which directors failure to perform their required functions can be judged. The law, as will be illustrated in the Saudi and UK contexts, includes a choice between either a purely objective or a dual subjective/objective standard. Before embarking upon the analysis of Saudi and UK law, it is important to bear in mind that directors' own behaviour, rather than the outcomes produced, should be the focus of the judicial inquiry. A convincing explanation for this has been offered by Riley who correctly points out that poor results (e.g., a decrease in the company's share price) could also be attributable to other exogenous factors (e.g., stock market crashes) rather than the quality of the directors' behaviour.[658] Thus, the main reason why the court in determining the director's compliance with duty of care will assess the directors' conduct, regardless of the outcome of that conduct, is to 'avoid . . . allocating . . . exogenous risks to the director'.[659] Put differently, the liability of directors for the breach of their duty of care should be based on the way in which they act, not on the results of that action.

3.3.1 The United Kingdom law: Dual subjective/objective standards

Directors' conduct will be reviewed in accordance with a test set out in section 174(2) of the CA 2006, which provides that a reasonably diligent director is supposed to have both of the following:

> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

[657] Article 18 of the CGRs 2017.
[658] Riley (n 376) 706.
[659] Ibid 707. Riley explains that 'exogenous risks' is a type of risk that occurs 'beyond directors' control', and argues that such risks should be 'assigned to the company [rather] than to directors', see ibid 705.

(b) the general knowledge, skill and experience that the director has.

This section introduces both objective and subjective standards of care.[660] While section 174(2)(a) contains an objective standard of a reasonable person acting to fulfil the function of a director, section 174(2)(b) refers to a subjective standard of the general knowledge, skill and experience of the director concerned. For directors to avoid liability for a breach of duty, they seemingly have to pass both tests. This means that directors must perform as a reasonable person might when carrying out their directorial functions (the objective requirement) and act in a way that one would reasonably expect of someone with the appropriate skills and knowledge (the subjective requirement). To clarify this point, the statutory standards, by implication, do not remove liability from highly skilled directors if they only meet the objective requirement of a reasonable person performing corporate functions assigned to them, but fail to act as a reasonably diligent person with their skill.[661] Similarly, very unskilled and inexperienced directors cannot avoid liability by merely acting as a reasonable person with their skill and experience would have done, if they fail to do as a reasonable person would in their position.[662] It should be noted here that directors appointed to a specialist position such as finance director would have their behaviour judged against the standard of proficiency expected of a person with the appropriate skills and qualification.[663]

It is noteworthy that section 174(2) is a codification of the common law standards of care and skills expressed in the leading cases of *Norman v Theodore Goddard*[664] and of *Re D'Jan of London Ltd*.[665] In the aforementioned cases, Hoffmann noted that the common law test of directors' duty of care 'was accurately stated in sec. 214(4) of the Insolvency Act 1986', which contained a dual objective/standard test[666] using the objective standard in consideration of the 'subjective circumstances' of the directors concerned.[667] Before the cases of *Norman v Theodore Goddard* and of *Re D'Jan of London Ltd*, it seems that early company law cases provided both an objective standard when asserting that reasonable

[660] Keay (n 6) 212.
[661] Ibid 212–213.
[662] Ibid.
[663] See, for example, *Re Brian D Pierson Ltd.* (1999) BCC 26 , 55.
[664] *Norman & Anor v Theodore Goddard & Ors* (1992) BCC 14 .
[665] *Re D'Jan of London Ltd* (1993) BCC 646 .
[666] See *Norman & Anor v Theodore Goddard & Ors* (n 664) 15; *Re D'Jan of London Ltd* (n 665) 646. It is worth saying that the purpose of section 214 of the Insolvency Act 1986 is to oblige the director to take into account the benefits to creditors; for more details, see D Arsalidou, 'The impact of Section 214(4) of the Insolvency Act 1986 on Directors' Duties' (2000) 22 Company Lawyer 19.
[667] J Ipp, 'The Diligent Director' (1997) 18 Co Law 162, 166. It is worth mentioning that the wording of section 174(2) (a) and (b) of the CA 2006 is almost the same as the wording of section 214(4)(a) and (b) of the Insolvency Act 1986.

care would be measured in accordance with what 'an ordinary man might be expected to take in the same circumstances in his own behalf', as well as a subjective standard when reference was made to the director's knowledge and experience.[668] However, the way that the law was applied by courts suggested that the early common law adopted a considerably low standard of care,[669] resulting in the fact that directors could only breach their duty of care when there was evidence of 'gross negligence'[670] or, as one commentator argued, 'the grossest negligence'.[671] This lenient approach towards directors used by the courts in early cases was illustrated by the ruling in *Re Brazilian Rubber Plantations and Estates Ltd,* which stated that directors were not required to engage in any role in relation to the conduct of the company's dealings;[672] it was also not necessary to have particular qualifications or knowledge about the subject matter of the company's activity in order to occupy a director's position;[673] and, that directors would not be responsible for errors of judgement under any circumstance.[674]

The early case law was criticised on the basis that it imposed a relatively undemanding duty of care on directors who were not obliged to show continuous attention to the company's business and who were not subject to the objective standard of skill[675] (i.e., 'no general professional standard of expertise were required of directors').[676] The prevalent belief was that 'no floor or baseline of care' was imposed on unskilled and unknowledgeable directors; if they had no competence or experience, the standard of care was most likely to be low.[677] In addition, in the past, the court usually considered directors, particularly non-executive directors, as 'amateurs'[678] who solely worked part time,[679] who were not obliged to attend meetings[680] and whose duties were seen as intermittent.[681] Indeed, the old case law required non-executive directors to play a limited role in the

---

[668] See, for example, *Re Brazilian Rubber Plantations and Estates Ltd* (1911) 1 Ch 425, 437; *Re City Equitable Fire Insurance Company Ltd* (n 620) 427–428.
[669] Davies and Worthington (n 2) 478.
[670] See *Charitable Corporation v Sutton* (n 17) 403; *Re Brazilian Rubber Plantations and Estates Ltd* (n 668) 425.
[671] V Finch, 'Company Directors: Who Cares About Skill and Care?' (1992) 55 The Modern Law Review 179, 179.
[672] *Re Brazilian Rubber Plantations and Estates Ltd* (n 668) 437.
[673] Ibid.
[674] Ibid.
[675] Riley (n 376) 697–698.
[676] A Hicks, 'Directors' Liabilities for Management Errors' (1994) 110 LQR 390, 390.
[677] See Kershaw (n 310) 425 when the author said that the subjective standard may be described as the standard of 'amiable lunatic'.
[678] B Clark, 'The Director's Duty of Skill and Care: Subjective, Objective or Both?' (1999) 27 SLT 239, 239.
[679] Keay (n 6) 206.
[680] *Re Cardiff Savings Bank (Marquis of Bute's Case)* (1892) 2 Ch 100 , 108–109.
[681] *Re City Equitable Fire Insurance Company Ltd* (n 620) 429.

management of the company,[682] and that the judicial approach is not consistent with the importance of his role in the corporate governance codes.[683] Before the noticeable change brought about by *Norman v Theodore Goddard* and of *Re D'Jan of London Ltd*, it had been claimed that the lenient way that duty of care was applied had led to the assumption that the standard of care was only subjective, although there was a clear objective aspect to the standard.[684] As Hicks pointed out, the development in the case law in the early 1990s arguably did not bring about a major change in the law, but pushed the court to not use the 'minimalistic standard of competence'.[685]

Having said that, this leads to an important question as to the value of the codification of the common law duty of care in the context of company law. With reference to the Final Report of the Company Law Review Steering Group (CLRSG)[686] in 2001 (the Final Report 2001), the main justification for the legislative intervention was to achieve greater clarity on 'the nature of the standards of care and skill demanded of directors' which has contributed to the enhancement of the standards of corporate governance.[687] It also rationalises the state's promulgation of duty of care by saying that it will provide '[a] clear, accessible and authoritative guidance for directors on which they may safely rely . . . on the basis that it will bind the courts and thus be constantly applied'.[688] Following the statutory codification of the standards of care and skill, there is no dispute about the nature of the standard, leaving no room for judicial discretion to depart from the law stated in the CA2006.[689] However, it should be borne in mind that the question of what degree of care must be shown cannot be statutorily articulated; in other words, each case concerning a breach of section 174 will be decided on its merits taking into account the facts of the case.[690]

---

682 Davies and Worthington (n 2) 478.
683 See, for example, *The Cadbury Report* (n 3) paras 4.10–4.17.
684 Hicks (n 676) 393.
685 Ibid.
686 The CLRSG was established in 1998 to review the UK company law; see CLRSG, Modern Company Law for a Competitive Economy, *Final Report* (vol 1, June 2001) paras 1.1 and 1.3.
687 Ibid para 3.7.
688 Ibid para 3.9.
689 See *Richmond Pharmacology Ltd v Chester Overseas Ltd* (2014) Bus LR 1110, 1124 where the court stressed the lack of necessity to refer to 'any authority on the scope of this duty [of care]' because 'it seems clear that . . . the test [in section 174] is an objective one'.
690 Keay (n 6) 215.

3.3.2 The Saudi law: Purely objective standard

Since the Saudi corporate statute omits explicit recognition of the directors' duty of care, the inevitable outcome is the lack of legislative guidance on how the directors' behaviour will be assessed. This is in contrast with the UK law where the standard of due care is defined in the CA 2006 in rather detailed terms. The role of Saudi case law is also modest, if not absent, in developing a clear standard of care.[691] In such a legislative and judicial vacuum reference to general rules of civil liability is therefore necessary. Unlike other Arab states, there is no civil law code that can be resorted to in order to fill the legislative void. Alternative guidelines can be found in the non-codified rules of Sharia to reduce the uncertainty in this area of law. In Sharia law the failure to take due care, as mentioned above, falls within the concept of *ta'adi*. However, the criterion on which *ta'adi* is established is not defined in traditional Islamic jurisprudence.[692] In this case reference should be made to customary rules generally practised by members in society as a source of Islamic law.[693]

In general, the benchmark of care that an agent is required to fulfil is the standard of the ordinary reasonable man. Failure to act accordingly will trigger the liability of the agent on the ground of a breach of his/her duty of care.[694] Clearly, this standard of care is an objective one.[695] In relation to the duties of directors, Al-Jaber points out that directors' behaviour will be assessed pursuant to the ordinary reasonable man test,[696] in which the directors have to take the reasonable care that an ordinary careful director would in order to satisfy the due care requirement.

Having adopted a purely objective test, two observations can be made. First, the purely objective standard suggests that the lack of knowledge or skill on the part of a defendant director cannot be considered as an excuse for not meeting the objective standard of an ordinary careful person.[697] Second, it also indicates that a highly experienced director would be able to avoid liability by simply acting as an ordinary prudent person would have

[691] Al-Jaber (n 71) 339–340.
[692] Al-Haboob (n 651) 288.
[693] M C Bassiouni and G M Badr, 'The Shari'ah: Sources, Interpretation, and Rule-Making' (2001) 1 UCLA J Islamic & Near E L 135, 157–158.
[694] Al-Sanhuri (n 653) 105.
[695] Ibid.
[696] Al-Jaber (n 71) 339.
[697] See Al-Sanhuri (n 653) 781–782, who points out the attributes of an objective standard of care in civil liability.

done, even if he/she did not act as a reasonable person with his/her experience.[698] This second statement is inconsistent with the UK law on duty of care and skill where a director, as mentioned above, will be judged by two tests (i.e., an objective and subjective standard). Under Saudi law, since the CL 1965 and 2015 do not require any qualification or long-standing experience for a person to be elected as a member of a board, it is not clear whether the court would take into account directors' skill and knowledge in determining their compliance with the due care requirement. The omission of 'knowledge, skill and experience' of directors as a factor to be considered by the court does not keep pace with the changing practice in the corporate community. With regard to listed companies, it is common to witness a corporate governance code of a listed company requiring a certain level of qualification and experience for a person to be appointed as a board member.[699] Indeed, given the fact that directors are usually selected for certain skills and experience that they can bring to the board, it seems fair to suggest that they should be judged against the degree of skill and experience reasonably expected of a person with their expertise and knowledge.[700]

Negligence, as a cause of action against directors, can be ordinary or gross, where gross negligence involves a much greater absence of care than ordinary negligence. In the old UK case law there was a tendency to distinguish between the two degrees of negligence and it was assumed that a breach of the director's duty of care was based solely upon gross negligence.[701] However, the court did not define the term 'gross negligence' as a basis of directors' liability for the breach of duty of care. This distinction, which courts have acknowledged as being difficult to define,[702] is no longer a part of the current law.[703] This is borne out by the fact that the current regulation of derivative actions states that mere negligence on its own is a cause of action.[704] In Saudi law it has been claimed that directors are liable for the breach of their obligation of due care if they are *grossly* negligent.[705] From the foregoing statement, two issues can be raised. First, there is no clear line between

---

698 See Clark (n 678) 242, who opines that with the purely objective standard a director will not be held liable for the additional skills and experience.
699 See, for example, the Corporate Governance Code of SAPTCO: section 19. <https://www.saptco.com.sa/About-Us/Government-Regulation/saptco2-CV01.aspx> accessed 30 August 2016; the Corporate Governance Code of Taiba: sections 24 and 25 <http://www.taiba.com.sa/pdf/gov.pdf> accessed 30 August 2016.
700 A similar argument is put forward in relation to the UK law, see R Reed, 'Company Directors: Collective or functional Responsibility' (2006) 27 Company Lawyer 170, 172.
701 See, for example, *Lagunas Nitrate Company v Lagunas Syndicate* (1899) 2 Ch 392 , 418 and 435; *Re Brazilian Rubber Plantations and Estates Ltd* (n 668) 425 and 431.
702 *Re City Equitable Fire Insurance Company Ltd* (n 620) 427–428;
703 Keay (n 6) 217.
704 Section 260 (3) of the CA 2006. For more details about the statutory regulation of derivative actions in the UK, see section (5.5), Chapter 5 in this thesis.
705 Jobran (n 632) 339.

what constitutes gross negligence and negligence. Given the vagueness of the concept of gross negligence, the scarcity, if not the absence, of reported cases on directors' duty of care contributes to the uncertainty and ambiguity of this area of law. Second, having said that directors' liability is based upon gross negligence, perhaps indicates that directors could fall considerably short of the standard of an ordinary prudent person and may nevertheless escape liability. This is another source of confusion that undermines the legal accountability of directors. The primary observation derived from the said issues is the great degree of uncertainty concerning the substantive content of the directors' duty of care.

3.4 Circumstances Affecting the Determination of What Constitutes a Breach of the Objective Standard of Care

As has been seen, there is an element of objectivity in the duty of care in the UK as section 174 provides both a subjective and objective standard. This is, to a larger degree, the case in Saudi Arabia where directors' behaviour tends to be assessed by a purely objective test. One may question what the objective standard of care entails. Put differently, what kinds of factors would be considered a guide for the court when determining whether a director satisfies the duty's requirements?

Given the scarcity of reported cases in Saudi Arabia on the breach of directors' duty of care in joint stock companies, the answer as to whether the court considers particular circumstances, such as the specific function of each director, when it comes to determining the directors' liability, will be uncertain. In spite of the absence of legislative and judicial guidance, it could be argued that in determining what reasonable conduct is expected from directors, Saudi courts should take into consideration, where appropriate, what the CL 2015 and the CGRs 2017 provide regarding directors' roles and responsibilities. Undoubtedly, a possible limitation to this proposition is that recourse to the provisions of the CGRs 2017 is limited to issues concerning companies listed in the Saudi stock market, and non-listed companies are not subject to the legally binding Regulations of 2017.

Concerning UK law, this is not the case, as the law tends to be more certain on this issue than its Saudi counterpart. The UK courts are required by section 174 of the CA 2006 to take into account 'functions carried out by the director in relation to the company'.[706] In this regard, the recognition that the extent of care obligation may vary depending upon the

[706] Section 174 of the CA 2006.

function of the director in question has been well established in the case law;[707] for example, in the case of *Re Barings plc*,[708] Jonathan Parker rightly asserted that the extent of the duty cannot possibly be designed in a way that 'will apply to every situation, since differing situations will call for differing levels of action or reaction'.[709] As has generally been accepted, the functions of directors tend to vary according to a number of factors, such as the size and nature of the company[710] and the type of directors (executive or non-executive).[711]

Having taken the functions and roles of directors into consideration, it is necessary, as a starting point, to move away from the supposition that all directors bear equal responsibility for corporate failure (i.e., collective board responsibility), towards the notion of functional responsibility of individual directors, in which the behaviour of directors will be evaluated according to the functions given to them and the experience or skill that they have.[712] This means that the meeting of the due care requirement should be examined at the level of the individual director despite the collective nature of the board's acts and decisions. In the UK literature on the mode of responsibility concerning directors' obligations it has been pointed out that the judicial shift towards the functional responsibility of individual directors enables the court 'to distinguish between directors according to their job descriptions', such as a finance director and non-executive director.[713] Reed emphasises the importance of functional responsibility by saying that if the court assesses the behaviour of non-executive directors on the basis of collective responsibility, in which the skill and experience jointly held as well as the degree of care necessarily exercised for effectively collective supervision are to be taken into account, the standard is likely to be 'unfeasibly high'.[714] In the view of Hoffman, the application of an over-demanding standard to non-executive directors 'pitted against the executives with their superior access to information and the familiarity with the corporate culture', coupled with increasing the vulnerability of non-executives to the risk of legal action, are liable to

[707] As long as section 174 the Companies Act 2006 supports the development brought by the *Norman v Theodore Goddard* and *Re'D Jan* cases and submits that the standard of the common law duty of care is that mentioned in section 214(4) of the Insolvency Act 1986, it means that it has been clearly established since the aforementioned cases that the objective assessment has to reference the directors' roles and responsibilities.
[708] *Re Barings plc and others Secretary of State for Trade and Industry v Baker* (1998) All ER (D) 659 . The facts of the case are set out in section (3.4.1) in this Chapter.
[709] Ibid section IV (Part 2).
[710] *Re City Equitable Fire Insurance Company Ltd.* (n 620) 426–427.
[711] Riley (n 376) 708.
[712] This argument has been raised in the UK law of directors' duty of care which is also valid in relation to the Saudi law, see generally Reed (n 700).
[713] A Walters, 'Directors' Duties: The Impact of the Company Directors Disqualification Act 1986' (2000) Company Lawyer 110, 113.
[714] Reed (n 700) 176.

deter truly independent persons from accepting a company directorship.[715] Given the important role of non-executive directors in corporate governance,[716] it can be concluded from the above arguments that there is an essential need for moving away from collective board responsibility and allowing the functional responsibility of individual directors to be the basis of cases brought against directors for corporate failure.

Returning to Saudi law, it is the board of directors, as a collective entity, that is responsible for the management of the company. In theory, the decisions and actions of the board are to be carried out collectively. However, this principle is subject to exceptions in which responsibility is allocated to individual directors. This model of responsibility can be found in company law, which frequently refers to 'members of the board of directors' in relation to some provisions of the Saudi corporate statute. The clear example of individual responsibility is the legislative permission for the board to delegate certain actions to any member of the board.[717] This indicates that individuals bear responsibility for performing delegated tasks. Another significant source of individual responsibility is the possibility of enforcement against directors. The Saudi CL 2015 grants the company and shareholders the right to sue any member of the board for a fault committed whilst managing the company.[718] It also involves criminal sanctions that can be imposed on individual directors in the case of violations of the CL 2015.[719] From the above examples it can be implied that the Saudi courts could apply the duty of care at the level of individual regardless of the collective nature of the board's conduct.

The directors' need to monitor the company's business, keeping themselves informed and avoiding complete reliance on others are important factors affecting the courts' determination of whether or not there has been a breach of the duty of care. This will be discussed below.

3.4.1 The duty of monitoring

It is important to begin by saying that from a practical point of view, the board would not be able to manage the company on a daily basis and usually leaves this task to executive

[715] L Hoffmann, 'The Fourth Annual Leonard Sainer Lecture: The Rt Hon Lord Hoffmann' (1997) 18 Company Lawyer 194, 196.
[716] For more discussion, see section (2.7), Chapter 2 in this thesis.
[717] Article 75(1) of the CL 2015.
[718] See articles 79 and 80 of the CL 2015.
[719] See, for example, article 213 of the CL 2015.

directors and employees.[720] Therefore, the board's delegation of its managerial responsibilities has been recognised in both jurisdictions (the UK and Saudi Arabia).[721] It should be noted here that the nature of that delegation in Saudi Arabia can concern particular powers and functions, but cannot be the task of management itself,[722] for instance, the board may delegate its power to purchase and sell property or to take a loan to the Chief Executive Officer (CEO) or another member of the board.[723] Furthermore, shareholders, through the company's articles of association, might give the board chairman the right to delegate certain tasks or responsibilities to any person.[724] Similarly, in the UK, while directors are allowed to delegate some functions to managers below board level,[725] they cannot delegate the management function itself completely absolving themselves from the responsibility.[726]

Thus, it is one of the essential functions of the board to monitor the management of the company.[727] As has been stated in Chapter 2,[728] in one-tier systems such as Saudi Arabia and the UK, the board of directors consists of executives and non-executives (independent directors). The prevailing trend to appoint more non-executive and independent members to the board of directors in order to enhance the monitoring function of the board is apparent in both the Saudi CGRs 2017 and UK CGC 2016. Non-executive and independent directors have been considered an essential monitoring tool for ensuring that there is no management abuse.[729] The obligation of monitoring, as a fundamental element of the directors' duty of care,[730] involves the responsibility of overseeing business risk in which directors, particularly independent non-executives are expected to limit companies' excessive risk taking.[731] In the wake of the global financial crisis of 2007–08, the

[720] Hoffmann (n 715) 194.
[721] For more details, see footnotes 307–317 and accompanying texts, Chapter 2 in this thesis.
[722] See M Al-Jaber (n 71) 335.
[723] See the Saudi Electricity Company's articles of association, section 16(2) <https://www.se.com.sa/en-us/Pages/ArticlesOfAssociation.aspx> accessed 9 September 2016.
[724] See the SIDC's articles of association section 21 <http://sidc.com.sa/site13/wp-content/uploads/2013/06/النظام-الأساسي.pdf> accessed 9 September 2016.
[725] This has been well recognised in the UK case law; see, for example, *Re City Equitable Fire Insurance Company Ltd* (n 620) 408, where the court asserted that the management of a large company required matters to 'be left to the managers, the accountants and the rest of the staff'.
[726] See *Re Barings plc and others Secretary of State for Trade and Industry v Baker* (n 708) 569. The Court of Appeal has also agreed with Jonathan's ruling in this regard; see *Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker* (2000) 1 BCLC 523 , 536.
[727] P Davies and K Hopt, 'Corporate Boards in Europe-Accountability and Convergencet' (2013) 61 Am J Comp L 301, 311.
[728] See footnotes 525–545 and accompanying texts, Chapter 2 in this thesis.
[729] See particularly footnotes 531–538 and accompanying texts, Chapter 2 in this thesis.
[730] J Loughrey, 'The Directors' Duty of Care and Skill and the Financial Crisis' in J Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (Cheltenham, Edward Elgar Publishing Limited 2013) 21.
[731]Ringe (n 531) 402–404; Loughrey (n 730) 25.

effectiveness of the monitoring role of company directors (especially independent directors) has been questioned since the directors' failure to conduct effective risk monitoring within the companies contributed, or worsened, the financial crisis.[732] It seems clear that it is in the interest of the company to ensure that directors monitor the risk management of the company,[733] question the co-director, and seek information from the executives or accountants'[734] in other words, the monitoring duty requires that directors do not remain passive in dealing with the company's affairs and issues.

In terms of the position of UK law, it can confidently be said that the court will examine the extent of reasonableness when determining whether or not there is a breach of the duty of care. In *Re Westmid Packing Services Ltd*[735] the court provided that the director was under the obligation to engage with co-directors in monitoring the company.[736] It also asserted that the director should not allow his co-director to have control over the operation of the company.[737] The director is required to not give other directors or senior managers the opportunity to manage the company as if it is their own.[738] In the leading case of *Re Barings plc*,[739] the bank of Barings collapsed due to unauthorised trading activities conducted by a trader called Leeson. This disqualification case was brought against three directors on the basis that they were not fit to be in the company directorship because of their failure to show the due degree of competence in managing the company.[740] To be specific, the three directors were taken to court for the failure to monitor the work of Leeson. Jonathan Parker found[741] that the three directors were unfit to be in the company's management because they had breached their duty of care by failing to monitor Leeson's trading activities reasonably.[742]The range of files submitted to the court highlighted no imposition or enforcement of risk limits on Leeson's trading,[743] no proper examination of the way that Leeson's dealings had produced high profitability[744] and the failure to respond to avoid obvious risks.[745] In summary, directors are held liable for a breach of the duty of

[732] Ringe (n 531) 403–404.
[733] Ibid 404–405.
[734] Keay (n 6) 219.
[735] *Re Westmid Packing Services Ltd (No. 3)* (1998) BCC 836 .
[736] Ibid 842.
[737] Ibid.
[738] Ibid 841–842.
[739] *Re Barings plc and others (No 5)*, *Secretary of State for Trade and Industry v Baker* (n 726); *Re Barings plc and others Secretary of State for Trade and Industry v Baker* (n 708).
[740] The facts of the case of *Re Barings plc* are written down as mentioned in the headnote of the case.
[741] The Court of Appeal upheld the ruling of Jonathan, see *Re Barings plc and others (No 5), Secretary of State for Trade and Industry v Baker* (n 726) 524–525.
[742] *Re Barings plc and others Secretary of State for Trade and Industry v Baker* (n 708) 569.
[743] Ibid (Part 3).
[744] Ibid.
[745] Ibid.

care if they completely absolve themselves from the responsibility to monitor the company's affairs, and do not take the necessary steps to avoid obvious risks.[746] As Keay observes, the elementary mistakes on the part of directors in the process of monitoring, make it much easier to establish their negligence.[747] This means that passive directors are likely to be held liable.[748] Thus, in order to protect themselves from liability, directors should make the necessary effort to monitor, and raise questions and concerns about certain matters relating the management of the company.

A closer look at Saudi company law reveals that the CL 2015, as with its predecessor of 1965, does not contain clear demands on an individual director to monitor the management of the company's business reasonably. Nevertheless, from articles 101 and 103 of the new CL 2015, it can be inferred that there is a legislative recognition of the monitoring task as an important element in a sound corporate governance system. The new CL 2015, unlike the CL 1965, requires the formation of an 'audit committee' in a joint stock company, with the primary responsibility of supervising the company's affairs.[749] For listed companies, the monitoring of managers and employees is clearly relevant to the board's duty to establish and supervise the implementation of risk management systems,[750] and internal control systems.[751] The CGRs 2017 clearly establish the board's duty to monitor the performance of senior managers below board level.[752] Importantly, it requires each board member to monitor the performance of senior management,[753] review performance-related reports,[754] and ensure the integrity of financial and non-financial statements.[755] As with the CGRs 2006,[756] the important monitoring role of non-executive directors has also been confirmed as the new CGRs 2017 require the board's audit committee to be formed of non-executives.[757] According to article 55 of the CGRs 2017, the board's audit committee is responsible for 'monitoring the company's activities and ensuring the integrity and effectiveness of the reports, financial statements and internal control systems'.

[746] Loughrey (n 730) 25–26.
[747] Keay (n 6) 221.
[748] As Ipp said, directors should not 'shut their eyes to what is going on around them'; see Ipp (n 667) 164.
[749] See articles 101 and 103 of the CL 2015. The law makes it clear that the committee should be formed from shareholders or others rather than executive directors. This indicates that non-executive directors (including independent directors) could be members of the committee.
[750] Article 22(1)(a) of the CGRs 2017.
[751] Article 22(2) of the CGRs 2017.
[752] See article 25 of the CGRs 2017.
[753] Article 30(2) of the CGRs 2017.
[754] Article 30(3) of the CGRs 2017.
[755] Article 30(4) of the CGRs 2017.
[756] See article 14(a) of the CGRs 2006
[757] Articles 51(a) and 54(a) of the CGRs 2017

Some concerns could be raised in relation to directors' duty of monitoring as a component of duty of care in Saudi law. First, the Saudi CL 2015 remains silent about requiring each director to monitor the company's affairs and his/her colleagues' activities in order to avoid liability for the breach of his/her duty of care. For companies that are not subject to the provisions of the CGRs 2017, this would create legal uncertainty about whether courts will have regard to the fulfilment of monitoring obligations when assessing directors' compliance with the duty of care. Second, although the CGRs 2017, as mentioned above, establish the board members' duty of monitoring, it restricts this to the monitoring of senior managers below board level. It does not suggest that the obligation should include the need for each director to monitor the conduct of their co-director or ensure the proper performance of delegated tasks by co-directors. The failure to establish a wider scope for the monitoring obligation may encourage directors not to commit to effective monitoring,[758] but to accept the conduct of their colleagues, an issue that will be discussed below.[759] Third, in spite of the absence of judicial guidance, it is presumed that if directors fail to discharge their duty of monitoring, as an ordinary prudent person would, they could be liable for a breach of the duty to exercise reasonable monitoring. In this regard it should be stressed that even if the board was collectively responsible for the monitoring of the senior management, the liability for the board's failure to monitor should be imposed individually, not collectively.

3.4.2 Directors' duty to keep themselves informed

One of primary issues faced by non-executive directors in particular is that their ability to monitor might be limited by the lack of availability of sufficient information on the company's business.[760] This is perhaps a result of executive directors' control over the flow of information transmitted to non-executive directors in which they might provide the board with 'selective, scanty, outdated and distorted information'.[761] In its response to the lack of adequate data, the CGRs 2017 make it clear that executive managers are required to provide all board members, particularly non-executive directors and committees 'with all of necessary information . . . provided that they shall be complete, clear, correct, and non-

[758] See, for example, Falgi (n 208)151, who conduct empirical research showing that government representatives appointed as board members are generally viewed as not giving sufficient time and effort to the board's tasks.
[759] See section (3.4.3) in this Chapter.
[760] See R Esen, 'Managing and Monitoring: The Dual Role of Non-Executive Directors on U.K. and U.S. Boards' (2000) 11 International Company and Commercial Law Review 202, 204; Easterbrook and Fischel (n 301) 92.
[761] Esen (n 760) 204.

misleading, in due course'.[762] Similarly, in the UK the recent CGC 2016 also provides that 'accurate, timely and clear information' should be given to directors to enable them to discharge their obligations.[763]

In contrast, directors, especially non-executives, need to ensure that they keep themselves informed and aware of the company' business. According to Keay, for the monitoring task to be performed effectively, directors have to fully understand the nature of the company's business and methods of managing its affairs, along with keeping themselves continuously informed of the current developments of the business.[764] While this view was expressed in relation to UK law, it should also be valid in relation to the directors' duty under the Saudi law. This means that the court should take into account the extent to which directors have made themselves aware of the company's affairs in order to affirm compliance with the duty of care.

As far as the position of UK case law is concerned, the Court of Appeal in *Re Westmid Packing Services Ltd* stressed the fact that each director, regardless of whether he/she is an executive or non-executive,[765] is under the obligation to inform himself/herself of the company's business, especially concerning its financial position.[766] In the case of *Re Barings plc*,[767] the Court of Appeal clearly agreed that directors were under a continuing obligation 'to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors'.[768] For directors to understand the current financial position of their company, they would usually need to be aware of the company's accounting policies. This might raise the question of whether directors are required to possess specialist accounting expertise. The court, in *Re Continental Assurance Company of London plc* (in liquidation) (No. 4), absolved directors, even executives, from the requirement to possess specialist knowledge of accountancy.[769] Instead, they were only required to exercise the skill of 'intelligent laymen' with 'knowledge of what the basic accounting principles' relevant to their business are and

---

762 Article 40 of the CGRs 2017; see also article 27(1) of the CGRs 2017, which places the chairman of the board under the obligation to ensure the flow of information within the board of directors.
763 See para B.5 of the CGC 2016.
764 Keay (n 6) 223.
765 The absence of distinction between executives and non-executives can be inferred from the court statement although it was not explicitly mentioned in the court's judgment.
766 *Re Westmid Packing Services Ltd (No. 3)* (n 735) 836, 842.
767 *Re Barings plc and others (No 5)*, *Secretary of State for Trade and Industry v Baker* (n 726).
768 Ibid 536.
769 *Re Continental Assurance Co of London plc (in liquidation) (No 4) Singer v Beckett* (2007) 2 BCLC 287, 401–403, 443.

should be able to inform themselves of the company's accounts with guidance.[770] The court also opined that only a specialist director (i.e., finance director) should exercise a higher degree of skill and knowledge than other directors, and so the former might have been found liable for a breach of his/her duty of care even if the other directors had not.[771]

Concerning Saudi law, there is nothing in the CL 2015 requiring directors to keep themselves informed of the company's business. For Saudi listed companies, it is recommended that training and preparation should be given to newly appointed directors explaining the company's business, particularly its financial and legal aspects.[772] It is one of the responsibilities of directors to develop their knowledge of the company's business.[773] This suggests that directors are expected to act with diligence and care in acquiring and maintaining adequate information about the company's business. Importantly, the CGRs 2017 make it clear that directors' conduct should rely on 'complete information'.[774] It seems that the reference to 'complete information' involves a significant degree of uncertainty as it is unclear what constitutes 'complete' information. Also, given executive directors' control over the flow of information, there is no option for non-executive directors (including independent members) but to make their decisions based on the available information, which might not be complete from the CGRs 2017 perspective. Indeed, such a requirement does not reflect reality, in which doubts could be thrown on the enforceability of the director's need to base their decision on 'complete' information. Hence, the wording of article 11(c) of the previous CGRs 2006, which requires a decision to be based upon 'sufficient information', [775] is more realistic and applicable in practice. In any event, from the above provisions of the CGRs 2017, there is an emphasis on the importance of a business decision being informed, and so requires directors to inform themselves of all necessary information available to them, prior to taking action.

3.4.3 The issue of reliance on directors and professionals

One may question whether the board, particularly non-executive and independent members, can solely rely on professional advice or information given to them by the executive management without any inquiry or verification; in other words, will an absolute

[770] Ibid 402–403.
[771] Ibid 402, 444.
[772] See article 39 of the CGRs 2017, which is not a legally binding provision.
[773] Article 30(19) of the CGRs 2017.
[774] Article 30(17) of the CGRs 2017.
[775] See article 11(c) of the CGRs 2006.

reliance on information by non-executives absolve them from the duty to act with due care in relation to the quality or correctness of information received from executives?

In an early UK case law, the duty of care tended to be undemanding. In *Re City Equitable*[776] it was said that it was reasonable in a practical sense to leave some duties to other officials. The directors then were 'in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly' and in relying on them and their reasonable judgement.[777] As has been observed, in the old case law if non-executive directors had no doubts about the trustworthiness of an executive manager, they could rely upon the delegate's performance of his/her functions without any monitoring.[778] However, the ruling of *Re City Equitable* probably, as has been said in *Equitable Life Assurance Society v Bowley*,[779] does not represent the modern law of duty of care, at least if it is read as meaning 'unquestioning reliance upon others to do their job'.[780] This is because non-executives are expected to make independent judgements and monitor the work of executives.[781] Meanwhile, the court, in the case of *Re Sherborne Associates Ltd*,[782] accepted that non-executives might rely upon highly skilled executive directors.[783] Thus, this area of UK law of directors' duty of care remains uncertain as there is no clear line between what constitutes a reasonable reliance and what leads to holding directors liable for the reliance on others.

The problem of reliance is 'a matter of degree',[784] in which the court's determination of whether or not there is a reasonable reliance upon executives and other professionals depends on the facts of the case concerned.[785] One further point to bear in mind is that directors should, if necessary, seek professional advice (e.g., solicitors or accountants).[786] However, as the court asserted in the *Re Bradcrown Ltd* case, complete reliance on

[776] *Re City Equitable Fire Insurance Company Ltd.* (n 620).
[777] Ibid. 429–430.
[778] Kershaw (n 310) 434–435.
[779] *Equitable Life Assurance Society v Bowley* (2003) BCC 829 .
[780] Ibid 830, 837.
[781] Ibid.
[782] *Re Sherborne Associates Ltd.* (1995) BCC 40 .
[783] Ibid 55.
[784] Keay (n 6) 236.
[785] See *Equitable Life Assurance Society v Bowley* (n 779) 837 in which it was said that the issue of reliance was 'fact-sensitive'.
[786] See *Re D'Jan of London Ltd* (n 665) 648 when the court said that '[i]f [the director] signs an agreement running to 60 pages of turgid legal prose on the assurance of his solicitor that it accurately reflects the board's instructions, he may well be excused from reading it all himself'.

professional advice, without raising reasonable questions, does not prevent directors from being held liable.[787]

In the Saudi jurisdiction the position of corporate law with respect to this matter is highly unclear since there is no judicial guidance about whether the court should follow a lenient or strict approach to the issue of reliance. Nevertheless, since the board of directors, as mentioned earlier, is entitled to delegate functions to directors or manages, this indicates that the board can rely on them to carry out delegated tasks; for example, the audit committee is responsible for studying and reviewing the financial statements and accounting policies before submitting their recommendations to the board of directors.[788] In such circumstances, it is sensible for the board to rely on the committee's recommendations when discharging its duties. However, this should not mean that the board should be absolutely reliant on the committee's work; in other words, reasonable inquiries should be made to verify information about the company's financial position, which has been provided by the audit committee.

Another example of directors' liability, which might result from the reliance on others, is provided in article 78(1) of the CL 2015.[789] The article states that in cases where a decision is taken by a majority of votes, objectors at the board meeting shall not be liable for the decision when they explicitly expressed their objection in the minutes of the meeting. It can be inferred from this statutory provision that an individual director could be exposed to liability if he/she acted passively, relying upon co-directors without making any reasonable enquires or questioning the company's affairs at the board meeting. Directors should ensure that their concerns are expressed and recorded in the minutes of the board meeting.

The final example to consider in relation to the issue of reliance concerns the extent to which directors can rely on professionals to perform their duties. As article 54(a) of the CGRs 2017 provides,[790] a specialist in finance and accountancy must be appointed to the board's audit committee. Although a high degree of uncertainty revolves around the court's position, it seems that members of the committee could rely on information presented by a specialist financial member whose task is limited to ensuring the integrity of

[787] *Re Bradcrown Ltd, Official Receiver v Ireland* (2001) 1 BCLC 547 , 547–548.
[788] Article 55 of the CGRs 2017.
[789] This sub-article of the new CL 2015 and article 76 of the previous CL 1965 are exactly the same in content.
[790] The same requirement was also mentioned in article 14(a) of the CGRs 2006.

the financial and non-financial reports, especially from the technical perspective.[791] In this regard, if the court were to take the report of a specialist member, non-specialist members would only be responsible for evaluating the information and check the extent of its precision.

Given the legislative and judicial vacuum in Saudi, questions remain unanswered as to the judicial approach to the issue of directors' reliance on others. The duty of care will necessarily be less demanding if the court is reluctant to question whether directors' reliance on professionals and co-directors is reasonable or not. Therefore, the court should not exempt directors from liability for breach of the duty of care if these directors, while making a decision, solely relied on information that an ordinary careful director, in the same circumstances, would not have relied on. This is justified on the basis that the directors, as mentioned above,[792] will be liable for damage caused by their fault (i.e., negligence), if they do not take reasonable care while performing their responsibilities.

3.5 The High Standard of Care: Problems and Responses

One of serious concerns faced by directors is the risk of being personally liable for their conduct in the course of business. One frequent argument in Anglo-American literature is that if the standard of care is low, this will probably lead, as a criticised above,[793] to the imposition of an undemanding duty of care upon directors. In contrast, in a situation where the law provides a single high standard of care, it is likely to produce an effect of impelling directors to make low risk decisions in order to avoid the liability or of discouraging individuals from accepting a directorship due to the greater likelihood of being liable for the breach.[794] Directors' concerns perhaps result from the court's review of business decisions with the benefit of hindsight,[795] a problem that the will be considered in Chapter 4.[796] The main point of such an argument is that directors are better positioned to make business judgements compared to judges, who are often less experienced and less

[791] This is one of the main responsibilities of the board's audit committee, see article 55(a) of the CGRs 2017.
[792] See section (3.2.2) in this thesis.
[793] See the discussion above in relation to the common law approach prior to the legal change brought by the cases of *Norman v Theodore Goddard* and of *Re D'Jan of London Ltd*, see footnotes 669–685 and accompanying text in this Chapter.
[794] W T Allen, J B Jacobs and L E Strine, 'Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem' (2002) 96 North Western University Review 449, 449, 452–454; M A Eisenberg, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 Fordham L Rev 437, 444–445.
[795] S Bainbridge, *Corporate Law* (2nd edn, New York, Foundation Press 2009)106–107.
[796] The problem of hindsight bias associated with the court's review of managerial decisions will be further considered while examining the standard for the duty of loyalty to act in good faith in the general interests of the company, see footnotes 952–956 and accompanying text, Chapter 4 in this thesis.

familiar with the complexities of commercial and financial operations.[797] Therefore, there is a need to reduce the possibility of judicial review of business decisions. In this regard Kershaw clarifies the relationship between duty of care and the judicial review of business decisions. He suggests that directors must take due care in the decision-making process, which is at the centre of the duty of care. If the court finds directors liable for breaching their duty of care, this would necessarily lead to the court's review of the decision itself to determine whether damage has occurred and whether the directors were liable for that damage.[798] Kershaw further argues that the nature of the standard of care is significant because it operates as a gatekeeper to the business decision review.[799] To be specific, if the standard of care is high, there would be a greater possibility of directors' decisions being reviewed by the court. In contrast, if the duty of care is less demanding (a low standard of care), the duty of care is expected to operate as a much more combative gatekeeper, blocking the judicial review of business decisions.[800]

Therefore, one possible solution to reduce the possibility of directors' decisions to be reviewed by the court is to design a duty of care that performs two roles, namely (i) to establish a standard of behavioural expectation of care (standard of conduct) that has to be adopted by directors and (ii) a standard of liability for the breach of duty, 'the standard of review'.[801] While the former should be of a high standard, the latter is presumed to be a 'less stringent' standard of liability,[802] and only the failure to comply with the liability standard will have a legal effect on directors.[803] The obvious example of this approach is US corporate law, in particular Delaware corporate law, where the divergence between the standard of conduct and the standard of review in relation to the issue of compliance with duty of care has been recognised.[804] Since it is beyond the scope of this thesis to discuss US law in depth, it suffices to say that while the Delaware case law refers to the standard of conduct expected of directors as the objective standard of an ordinarily prudent person,[805]

---

[797] C Paz-Ares, *Directors' Duties and Directors' Liabilities: A Framework for the Law Reform in Latin America*, (OECD, The Third Meeting of the Latin American Corporate Governance Roundtable, April 2002) 37 <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/2085788.> accessed 22 September 2016).
[798] Kershaw (n 310) 474.
[799] Ibid 475.
[800] Ibid.
[801] See Eisenberg (n 794).
[802] Ibid 441.
[803] Allen, Jacobs and Strine (n 794) 449.
[804] In US Delaware law, compliance with the duty of care will be assessed through the judicial application of the business judgement rule of which acting on an informed basis is one of its preconditions to apply, see S Bainbridge, 'Smith v. Van Gorkom' (Law-Econ Research Paper No. 08-13, May 2008) 16, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1130972##> accessed 23 September 2016.
[805] *Re Walt Disney Co. Derivative Litigation* (2005) 907 A2d 693, 748.

the standard by which directors' actions are reviewed is the gross negligence standard.[806] It is indisputable that the gross negligence standard employed by Delaware courts to determine the breach of duty of care is less stringent than the standard of the ordinary prudent person.[807] This means that under the gross negligence standard, the directors will be less vulnerable to the risk of being held liable for the breach of duty of care.

The US approach to regulating duty of care was not adopted in the UK and Saudi Arabia in the sense that both jurisdictions, as the foregoing discussion demonstrated, have not recognised this divergence between the standard of conduct and the standard of review. This means that there is only one standard of care that will be applied to assess the care taken and to enforce liability upon directors. The conflation of the two standards to the one standard of the reasonable person may expose the directors more greatly to liability for the breach of the duty of care[808] because of the difficulty in meeting the standard of ordinary negligence compared with the gross negligence standard. The core problem, as mentioned earlier, is the much higher review standard of care used by the court, leading to the much higher possibility of directors' decisions being subject to court scrutiny. Nevertheless, it seems that given the fact that other mechanisms (e.g., markets) tend to fall short of offering strong constraints on directors' behaviour,[809] in jurisdictions such as Saudi Arabia there is a greater need to prevent shirking by directors through the formulation of well-suited standards of liability, which creates incentives for directors to act competently.[810] Indeed, the lower standard of liability for breach of duty of care may encourage directors to act incompetently and therefore undermines their accountability. Even in the UK any concerns over the higher possibility of judicial review because of a high standard of care can be challenged by the fact that UK courts tend to be reluctant to engage in second-guessing what directors have decided or acted upon while managing the company.[811]

In any event, the following sub-sections will highlight methods that the law can introduce to reduce the effects of a single standard of the reasonable man.

---

[806] See, for example, *Aronson v Lewis* (1984) 473 A2d 805 , 812; *Smith v Van Gorkom* (1985) 488 A2d 858 , 873.
[807] Allen, Jacobs and Strine (n 794) 449.
[808] Ibid 454.
[809] See generally sections (2.5), (2.6), (2.7) and (2.8), Chapter 2 in this thesis.
[810] This is in line with the argument presented earlier in this thesis concerning the need for stronger legal protection for shareholders in developing economies; see particularly footnote 607–608 and accompanying text, Chapter 2 in this thesis.
[811] Riley (n 376) 710.

3.5.1 Non-judicial methods of indemnifying directors

In the UK directors' duties (including the duty of care) under the CA 200, are regarded as mandatory rules that cannot be departed from.[812] This is clearly expressed in sections 232(1) and (2) of CA 2006 which state, as a general principle, that any provision that intends to either exempt directors from, or indemnify them against, any liability (including breach of statutory duty) 'is void'. This means that directors cannot be indemnified or benefit from exculpatory clauses for breaches of due care.[813]

Nevertheless, this general rule is subject to statutory exceptions. One of those is s 233 of CA 2006, which states that the company may enter into a contract with an insurer in order to provide insurance cover to protect directors from personal liability while managing the company. This type of insurance contract is called 'directors and officers insurance (D&O insurance)'.[814] Given the fact that directors are likely to be asked to take more responsibility for corporate failure, D&O insurance cover is potentially highly valuable.

The main concern with the recourse to D&O insurance is the potential for minimising the deterrent effects of the law on directors' obligations.[815] A connected criticism, often repeated, concerns the influence of D&O insurance on directors' conduct in which insured directors could 'become less careful'.[816] In this regard, Davies and Worthington suggest that the level of insurance cover, which the insurers are generally able to offer, would identify the effect of s 233.[817] The director's liability is usually insured against a claim based on 'breach of duty, breach of trust or neglect, plus errors [and] omissions',[818] but inevitably there will be a range of claims excluded from the insurance coverage.[819] It is most likely that the insurers will not cover the breach of duty relating to dishonesty, fraud or intentional misconduct.[820] In addition, the insurer can insert a provision in the D&O

---

[812] Davies and Worthington (n 2) 576.
[813] Kershaw (n 310) 452.
[814] C Baxter, 'Demystifying D&O Insurance' (1995) 15 Oxford J Legal Stud 537.
[815] Evidence from the US shows that D&O insurance indirectly weakens the deterrent effects of corporate and securities law liability; see, for example, T Baker and S Griffith, 'The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer' (2007) 95 Geo LJ 1795.
[816] C Parsons, 'Directors' and Officers' Liability Insurance: A Target or Shield?' (2000) 21 Company Lawyer 77, 84.
[817] Davies and Worthington (n 2) 579.
[818] Baxter (n 814) 549–550.
[819] Ibid 550–554.
[820] This is a fundamental rule in the English law of insurance, see J Birds, B Lynch and S Milnes, *MacGillivray on Insurance Law: Relating to All Risks Other Than Marine* (13th edn, London, Sweet & Maxwell/Thomson Reuters 2015) paras 14–29; particularly, see Baxter (n 814) 551; Parsons (n 816) 81.

policy as a means of monetarily limiting its liability for claims for damages.[821] Such considerations can be seen as a means of retaining the deterrent effect.[822] It is worth mentioning that this type of insurance is not 'as common in the UK as in the US' and not all companies purchase D&O insurance for directors despite the high risks surrounding the company's management.[823]

Concerning Saudi law, similar to section 232 (1) and (2) of CA 2006, the company law clearly makes the potential directors' liability for damages non-voidable. According to the CL 2015, any provision in the articles of association that purport to exempt directors from any liability[824] or to prevent a shareholder from bringing a legal action against them, is null and avoid.[825] This indicates that the Saudi law bans an exculpatory clause and obviates the potential for securing directors from the legal responsibility for a breach of their duties towards the company and shareholders. Unlike UK law, neither the CL 1965, nor the CL 2015 expressly provides exceptions to the general rule preventing indemnification by the company. This is not to suggest, however, that it is not a possible mode of indemnification available to the company,[826] but it has not yet been developed in the Saudi business community.[827]

3.5.2 Judicial relief from liability

This refers to a situation where the court has granted the discretionary power to release directors from their liability for breach of their duty towards the company. This form of liability waiver has not been recognised under Saudi law in which the court has no authority to grant such relief. In the UK the situation is completely different since section 1157 the CA 2006 permits the court discretion to grant relief to directors found

[821] Under the D&O insurance, there are many examples of excluded risks such as payment of fines, penalties and punitive damages. There might also be limited cover for certain claims in which the liability, to some extent, remains personally with the directors, see Parsons (n 816) 82, 84.
[822] Davies and Worthington (n 2) 580.
[823] See A Felsted, 'The Danger of Being an Executive', *Financial Times* (16 October 2006), <https://www.ft.com/content/2fc9618a-5d13-11db-9d15-0000779e2340> accessed 23 September 2016.
[824] Article 78(1) of the CL 2015.
[825] Article 88(1)(a)(5) of the CL 2015.
[826] The D&O insurance is one of insurance products provided by the CHUBB Arabia Cooperative Insurance Co. in Saudi Arabia, see the company's website at <https://www2.chubb.com/sa-en/> accessed 1 October 2017.
[827] A Blom, I Shah and R Wynn, 'Personal Risks Facing Board Members in the Middle East', *Financier Worldwide* (November 2011) <http://www.financierworldwide.com/personal-risks-facing-board-members-in-the-middle-east/#.V_Ds0mO9h0c> 28 September 2016.

accountable for the breach of their general duties, as well as other breaches and defaults.[828] It is worth mentioning that although the scope of section 1175 is wide enough to include cases other than negligence, it has been noted that this provision will usually be taken into account in the case of a breach of the duty of care.[829]

For the court to provide liability relief in the case of a directors' breach of their duty, the court must ensure that certain requirements are satisfied. First is that the directors acted *honestly*; second is that they acted *reasonably*; finally, in consideration of all circumstances of the case concerned, the court must exercise its discretion to decide whether the directors ought to, as matter of *fairness,* be relieved of their liability.[830] Directors carry the responsibility for proving that they acted reasonably and that they ought to be excused.[831] Concerning the honesty requirement, directors are presumed to have performed honestly unless evidence provided suggests otherwise.[832] It is worth mentioning here in relation to the breach of the duty of care that there is no dispute about whether the honesty factor has been established. The court will further devote its focus to address the question of whether the directors had acted reasonably.[833]

In *Re D' Jan of London Ltd* case,[834] the court was required to decide whether the directors' liability for the breach of the duty of care could be relieved in accordance with the predecessor of section 1157 (section 727 of the Companies Act 1985). In his judgment, Hoffmann accepted that it appeared to be 'odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably.'[835] However, the judge asserted that the directors' behaviour might be reasonable despite the failure to pass the reasonable care test in the common law.[836] In this case Hoffmann found the directors liable for the breach, but held that they ought to be relieved of liability pursuant to the predecessor of section 1157.[837] The court decided that the directors had acted reasonably despite the fact that they were found negligent, as the

---

828 The exception brought by section 1157 was established by its immediate ancestor section 727 of the CA 1985. This means that the case law prior to the introduction of CA 2006 is relevant to the analysis of section 1157.
829 Keay (n 6) 529.
830 Section 1157 (1) of the CA 2006.
831 See *Re Kirby Coaches Ltd* (1991) BCC 130, 131.
832 Ibid.
833 Keay (n 6) 542.
834 *Re D'Jan of London Ltd* (n 665).
835 Ibid 649.
836 Ibid.
837 Ibid 648–649.

directors' negligence was not considered 'gross' and 'it was the kind of thing which could happen to any busy man'.[838]

It can be noted, as mentioned in the *Re Brian D Pierson Ltd* case, that for the purpose of the predecessor of section 1157 the condition of reasonableness was at a lower standard than the common law standard for the obligation of care.[839] Although it is strange that the director who had been found accountable for the breach of the duty of care was relieved according to the reasonableness standard of section 1157, the way that the case law interprets the term 'reasonableness' is justifiable because if the court used the statutory standard of care for the purpose of section 1157, all directors in breach of the duty would be excluded from being qualified to apply for judicial relief from liability.[840]

In relation to the court's discretion in determining whether it is fair to relieve directors, the court may take into account 'economic realities' of the case;[841] for example, in *Re D' Jan of London Ltd* Hoffmann asserted that the fact that the director had 99% of the company's issued shares is relevant to the court's exercise of the discretion under the predecessor of section 1157.[842] In addition, whether the director who sought professional advice (e.g., solicitors or accountants) prior to the conduct that gave rise to the breach of duty, seems to be important in granting liability relief under section 1157.[843] In the *Re Paycheck Services* case the Court of Appeal considered the failure to seek professional advice before performing the act that led to the breach of duty as a reason for refusing relief under the predecessor of section 1157.[844]

It is noteworthy that the court has the discretion to grant directors either whole or partial relief of liability for the breach.[845] Although the court cannot exercise its discretion to grant relief without satisfying the conditions of honesty and reasonableness,[846] it has been granted a wide discretionary power in the sense that it may believe that the directors ought not to be relieved despite the fact that the honesty and reasonableness tests were satisfied.[847] Having said that, there is a high degree of legal uncertainty in terms of the

838 Ibid 649.
839 *Re Brian D Pierson Ltd.* (n 663) 48–49.
840 R Edmunds and J Lowry, 'The Continuing Value of Relief for Directors' Breach of Duty' (2003) 66 Mod L Rev 195, 210.
841 *Re D'Jan of London Ltd* (n 665) 649.
842 Ibid.
843 Edmunds and Lowry (n 840) 213.
844 *Re Paycheck Services 3 Ltd* (2009) STC 1639 , 1665.
845 *Re D'Jan of London Ltd* (n 665) 648–649; see section 1157(1) of CA2006.
846 *Bairstow & Ors v Queens Moat Houses plc* (2002) BCC 91 , 92.
847 See Keay (n 6) 527.

judicial approach to relieving directors of the liability. This high unpredictability associated with the court's discretion would hinder many from seeking a judicial relief of liability. It should be also borne in mind that the court, as has been noted,[848] rarely applies the rule under section 1175 in reported cases coupled with the fact that there not many cases considering the application for judicial relief of liability.[849]

3.6 Concluding Remarks

This chapter evaluated the effectiveness of the Saudi law of directors' duty of care compared with the UK and identified certain areas of deficiency and uncertainty. The elimination of uncertainty in this area of law is a difficult task because in order to answer the question of how much a degree of care must be shown cannot be set down statutorily and largely depends on the facts of each case. However, the law has to play a central role in reducing such uncertainty so that it does not undermine the accountability of directors.

The absence of codification of the duty, coupled with the modest, if not absent, role of the courts in filling the legislative vacuum have fuelled speculation concerning the precisely substantive content of duty of care. One area of uncertainty concerns the standard by which the directors' actions are reviewed. While it is said that directors will only be liable for gross negligence, others assert that directors are expected to meet the objective standard of the ordinary prudent person. The core problem exists in the absence of a clear line between what constitutes gross negligence and what it is considered negligence. In addition, the assumption that gross negligence is the standard of care, especially where the standard of conduct and of review are combined, would give rise to an undemanding duty of care.

Another area of deficiency is that unlike the UK, the failure to recognise the subjective standard of skill, as an addition to the objective standard, does not accommodate the development of business practice where directors are appointed for the experience and skills that can they bring to the board. The possible outcome is that highly experienced directors would be able to avoid liability by simply acting as an ordinary prudent person would have done, even if they did not act as a reasonable person with his/her equivalent experience and skill.

[848] Ibid 527.
[849] For a work that evaluates the judicial relief of liability under section 1157's predecessor, see Edmunds and Lowry (n 840).

Although the UK case law has always been active in filling the gaps in law, legislative intervention has achieved greater clarity and ensured the steady application of the law. This is not the case in Saudi Arabia where case law plays a modest role in shaping the law.

Nevertheless, the Saudi legislator refrains from intervening to clarify the law and the corporate community will pay the costs of its inaction; for example, neither the CL 1965 or 2015, unlike the CA 2006 with the aid of case law, clearly refers to the functions of directors as a factor that should be taken into account in assessing compliance with the duty of care. As has been pointed out, the extent of care obligation depends upon the function and the role assigned to directors. Since the Saudi corporate statute fails to recognise 'functions conducted by a director' as a factor affecting the application of law, it is uncertain whether the court will distinguish between executives and non-executives in terms of the degree of care they have to exercise; a distinction that is necessary for the consideration of fairness.

The emphasis must be placed upon designing the duty of care in such a way that expresses the high expectation placed on directors, and uses the liability for breaching that expectation as a tool to push directors to act appropriately. However, it is valid to consider not making the duty overly onerous and thereby exposing directors to an unnecessarily high risk of legal liability. This chapter has shown that the UK law, unlike the Saudi law, contains a mechanism, namely judicial relief of liability, to address directors' concern about a single high standard of care. Nevertheless, whether the UK's allowance of judicial relief of liability is a good law has been questioned in terms of legal certainty because of the wide discretion given to the court. The infrequent cases where the court has granted or even considered relief of liability would raise questions about the value of such a rule within the legal liability system.

Chapter 4: An Evaluation of Directors' Duties of Loyalty

4.1 Introduction

While the duty of care as a mechanism to deal with directors' negligence in managing the company was considered in Chapter 3, the focus of this chapter is on the duty of loyalty. This obligation can be described as the duty to 'maximise the investors' wealth rather than one's own'.[850] Being in a loyal relation with the firm simply means that directors are required to exercise their powers in a way that maximises the value of the firm[851] and to avoid any act that diverts the firm's wealth for their personal benefit.[852]

One possible breach of the duty of loyalty occurs when directors act (in bad faith) against the general interest of the company. Directors' liability might also be triggered by engagement in conflict of interest situations such as the exploitation of a corporate opportunity and a self-dealing transaction, which are examples of detrimental diversion of corporate wealth.[853] In this regard, the law has to play an essential role in establishing and clarifying the substantive content of duty of loyalty because this does matter in terms of enhancing directors' accountability, which is essential in establishing a robust system of corporate governance. The law that does not properly establish a legal standard for conduct and review in relation to the decision and action taken, lacks clarity and fails to regulate the directors' exercise of discretion for the benefit of shareholders. Equally important, if the boundaries of the duty to avoid conflict of interests are ill-defined, a law may not succeed in capturing various situations where directors utilise corporate resources and assets to benefit themselves at shareholders' expense. It may also suggest that the law does not sufficiently protect the company and its shareholders from the opportunism of directors. Indeed, the deficiencies in the law governing the duty of loyalty could encourage directors to engage in more self-interest activities, allowing them to escape liability in cases where they should have been liable for a breach.

In this chapter, the UK law will be compared with the Saudi law on directors' duty of loyalty, and the serious areas of uncertainty and deficiency in the law, which require pressing responses, will be explored. It is important to note that this chapter will focus on

850 Easterbrook and Fischel (n 301)103.
851 Ibid.
852 Pacces (n 361) 96.
853 Enriques, Hertige and Kanda (n 364) 153.

analysing three forms of directors' breach of the duty of loyalty, namely (i) non-compliance with the obligation to act in good faith in the interests of the company; (ii) the exploitation of a corporate opportunity and (iii) the engagement in a self-dealing transaction. The last two forms constitute breaches of the directors' duty to avoid conflicts of interest.

Regarding the structure of this chapter, it is divided into four main sections. First, the affirmative duty to act in good faith in the general interests of the company is explored. Then, the focus of the analysis moves to the underlying principles that shape the features of duty to avoid conflict of interests, which are no-conflict and no-profit rules. After that, the legal regulation of corporate opportunities, and of corporate self-dealings will be analysed under the UK and Saudi laws.

4.2 The Affirmative Duty to Act in Good Faith in the Company's Interests

One of the aspects of the duty of loyalty is to ensure that those responsible for the management of a company exercise their powers to further the firm's interests.[854] While this is the main job of directors appointed by shareholders, the formulation and definition of the affirmative duty of loyalty differs among jurisdictions. In the following sub-sections, the development of the statutory duty found in section 172(1) of the CA 2006 and its relevance to the previous case law (section 4.2.1) will be considered. The extent to which the main components of the duty of loyalty is established in Saudi law (section 4.2.2) is then explored. In the third part (section 4.2.3) the interpretation and application of the main elements of the duty of loyalty are analysed in both the UK and Saudi law.

4.2.1 Section 172 of the Company Act 2006: The codification of the duty to act in good faith

One of new provisions introduced by the CA 2006 is the duty found in section 172. It provides, in sub-section (1), that '[a] director of a company must act in the way he[/she] considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole'; the sub-section goes on to assert that the director is to do so while having regard for, *inter alia*, a non-exhaustive list of factors,[855] such as the

[854] See O Hart, 'An Economist's View of Fiduciary Duty' (1993) 43 The University of Toronto Law Journal 299, 303–303.
[855] Section 172(1), sets out six factors in paragraphs (a)–(f) to be considered by company directors.

long-term consequences of his/her conduct[856] and the interests of the company's employees.[857] It is useful to mention that the general duty laid down in sub-section 172 (1) upon which the analysis focuses, is subject to two statutory exceptions. The first one refers to a situation where a company has purposes other than to benefit its shareholders and the directors are required to run the company in a way that achieves that purpose[858] (e.g., charitable companies).[859] The second exception is found in section 172(3), which clearly recognises that directors, in certain circumstances, are expected to take into account the interest of the company's creditors in the course of their decision-making.[860]

While it is not possible here to detail the background of the enactment of sub-section 172(1), it is useful to say a few words about this matter in order to understand why it is drafted in such a way. The Company Law Review Steering Group (CLRSG) developed section 172 in the course of a review of directors' duties.[861] One of the issues addressed by the CLRSG was to consider in whose interests a company's business is managed.[862] The CLRSG assumed that the shareholder value (also known as 'shareholder wealth maximisation'[863]) was the approach adopted by UK company law.[864] The shareholder value approach simply proposes that the company should ultimately be run in the interest of the shareholders.[865] The CLRSG's criticism to such an approach centred on the failure of the law to sufficiently recognise that the wealth of firms will generally be maximised if all participants in the enterprise (not only shareholders) work harmoniously as groups, and that directors should act according to 'the wider interests of the community'.[866]

In its deliberations on for whose benefit a company should be managed, the CLRSG considered whether it was feasible to adopt a pluralist approach[867] (also known as the *stakeholder theory*),[868] which basically holds that directors should run the company for the benefit of all stakeholders (including non-shareholder constituencies), giving priority to

[856] See section 172(1)(a) of the CA 2006.
[857] See section 172(1)(b) of the CA 2006.
[858] Section 172(2) of the CA 2006.
[859] See para 330 of the Explanatory Notes to the CA 2006.
[860] For further discussion on section 172(3) and how it relates to section 172(1), see generally A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (London, Routledge 2013) 218–230.
[861] Ibid 67.
[862] See CLRSG, Modern Company Law for a Competitive Economy: *The Strategic Framework* (February 1999) para 5.1.1.
[863] See, for example, S Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50 Washington and Lee Law Review 1423, 1423–1425.
[864] *The Strategic Framework* (n 862) para 5.1.3.
[865] See, for example, Bainbridge (n 863).
[866] *The Strategic Framework* (n 862) para 5.1.9.
[867] Ibid paras 5.1.11 and 5.1.24–5.1.33.
[868] See, for example, A Keay, 'Stakeholder Theory In Corporate Law: Has It Got What It Takes?' (2010) 9 Richmond Journal of Global Law and Business 249.

none.[869] Put differently, it is the ultimate aim of directors to operate the company for the benefit of all stakeholders by striking a balance between their interests.[870]

In the view of the CLRSG, the adoption of the pluralist approach was not the best way forward.[871] Given the fact that not many respondents to the CLRSG's report supported the pluralist approach,[872] for such a model to apply would require a substantial reform of the law on directors' duties.[873] To be specific, the CLRSG was not in favour of extending the current concept of loyalty to cover broader interests, as required by the pluralist model.[874] In addition, the application of the pluralist model would require a major change to the institutional structure of UK corporate governance and such a change did not receive any support and was not favoured by the CLRSG.[875] In fact, the pluralist approach was viewed as unworkable and undesirable in the UK.[876]

The CLRSG was in favour of the adoption of what is called the 'enlightened shareholder value'[877] approach, to guide directors running the company.[878] This approach was explained by saying that in order to promote the success of the company for the benefit of all shareholders, company directors are expected to have regard for 'all the relevant considerations for that purpose' such as 'the need to sustain effective ongoing relationships with employees . . . and others', and the necessity to 'consider the impact of [the company's] operations on the community and the environment'.[879] This means that the consideration of a wider range of factors (e.g., employees and customers) is a means towards the success of the company for the benefit of all shareholders. Indeed, section 172(1) of the CA 2006 can be seen as an application of the enlightened shareholder value approach.[880]

---

[869] Ibid. 256.
[870] Ibid. 257
[871] CLRSG, Modern Company Law For a Competitive Economy, *Developing the Framework*, (March 2000) para 3.20.
[872] Ibid para 3.22.
[873] *The Strategic Framework* (n 862) para 5.1.30.
[874] *Developing the Framework* (n 871) para 3.27.
[875] Particularly, a radical change in the director–shareholder relationship (e.g., board composition and rules of dismissal and appointment of directors), see ibid para 3.29; *The Strategic Framework* (n 862) paras 5.1.31 and 5.1.32.
[876] CLRSG, Modern Company Law For a Competitive Economy, *Completing the Structure* (November 2000) para 3.5.
[877] See *The Strategic Framework* (n 862) para 5.1.12 where the CLRSG refers to it in such a way.
[878] *Developing the Framework* (n 871) paras 2.19, 2.21, 2.22, 3.21; *Final Report* (n 686) para 3.8.
[879] *Developing the Framework* (n 871) para 2.19.
[880] See the Explanatory Notes to the CA 2006, para 325.

It is worth saying that the duty contained in section 172 was introduced as a replacement of the classic duty to act *bona fide* in the interests of the company,[881] which had been an element of UK company law prior to codification and was set out by Lord Greene in *Re Smith & Fawcett Ltd.* case.[882] Whether or not the duty in section 172(1) merely reflects the pre-existing duty is an important issue in determining the extent to which the previous case law is relevant to the interpretation of section 172(1). It seems that this statutory duty reflects the previous one at least from the judicial perspective. In *Cobden Investments Ltd v RWM Langport Ltd*,[883] Warren stated that the common law duty to act *bona fide* in the interests of the company was 'reflected' in the terms of section 172.[884] He also added that the previous duty and the one found in section 172 came 'to the same thing with modern formulation giving a more readily understood definition of the scope of the duty'.[885] Notably, although the wording of section 172 suggests that it is somewhat different from the common law duty, the good faith requirement is embedded in both old and new versions of the duty. It should be noted further that the previous case law was referred to in relation to the interpretation of section 172[886] and will perhaps remain relevant to the consideration of how to apply the section in practice.[887]

4.2.2 The absence of a clear formulation of directors' duty to act in good faith in Saudi law

In some common law jurisdictions, directors' duty of loyalty is intended to oblige directors to act in the general interest of the company.[888] Within its structure, the duty of good faith has been viewed as an integral component of the duty of loyalty.[889] To illustrate this point: the affirmative duty of loyalty is traditionally formulated in UK company law to reflect two components: (i) the duty to act in good faith *and* (ii) in the interest of the company.[890]

---

[881] Kershaw (n 310) 381.
[882] His Lordship ruled that company directors were under an obligation to act 'bona fide in what they consider – not what a court may consider – is in the interests of a company'; see *Re Smith and Fawcett Ltd. (1942)* Ch 304, 306.
[883] *Cobden Investments Limited v RWM Langport Ltd* (2008) EWHC 2810 .
[884] Ibid para [52]. This position was recently affirmed by Popplewell in the *Madoff Securities International Ltd* case; see *Madoff Securities International Limited (In Liq.) v Raven* (2013) EWHC 3147, para [188].
[885] *Cobden Investments Limited v RWM Langport Ltd* (n 883) para [52].
[886] See, for example, *Madoff Securities International Limited (In Liq.) v Raven* (n 884) paras. [188]–[194].
[887] Keay (n 6) 125.
[888] R Langford, 'The Duty of Directors to Act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared' (2011) 11 Journal of Corporate Law Studies 215, 215 – 218.
[889] Ibid.
[890] Ibid; see also R Grantham, 'The Content of the Director's Duty of Loyalty' (1993) Journal of Business Law 149, 154 who asserted that there was no such distinction between the two elements in the UK company law.

This remains the case even following the enactment of section 172(1) of the CA 2006.[891] In this regard, the question that might be raised here concerns whether the Saudi law expressly or implicitly recognises the affirmative duty of loyalty, as a formulated in the UK law.

This area of Saudi law suffers from ambiguity. Arguably, directors' need to act in the company's interests and the good faith requirement can be, in an implicit way, established separately in Saudi law, but this does not necessarily mean that they can be brought together into a single duty, as formulated in the UK. The absence of a legislative statement clarifying the content of the duty of loyalty, coupled with the lack of judicial guidance, has raised questions as to whether the duty of good faith is a freestanding duty, distinct from the duty of loyalty.[892] Given the fact that the standard to meet the requirement of loyalty is not legislatively or judicially defined, the identification of such a standard depends upon whether or not the duty of good faith is part of the broad duty of loyalty directors have to the company. In general, as in other legal systems influenced by the civil law tradition,[893] there is no clear formulation of the affirmative duty of loyalty in the Saudi corporate statute.

In terms of the requirement to act in the interest of the company or its shareholders, neither the CL 1965 nor the new CL 2015 contains an explicit provision obliging directors to exercise their authority to achieve such a goal. Unlike the common law jurisdictions where judges have established and developed the duty of loyalty prior to codification,[894] Saudi judges have contributed very little to filling the legislative gap, creating a state of uncertainty in the area of law governing the affirmative duty of loyalty.

Nonetheless, from the position that directors hold and powers conferred on them, it can be argued that the duty to act in the general interest of the company is presumed to be one of their obligations. The starting point in establishing such a duty is to emphasise that the granting of discretionary powers to a person in order to act on behalf of another is an

---

[891] See footnotes 883–887 and accompanying texts in this Chapter.

[892] This issue has been the subject of considerable debate among US academics and legal specialists. For the argument of a freestanding duty of good faith, see, for example, M Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Delaware Journal of Corporate Law 1; for the view supporting the idea that the duty of good faith is not separate duty, see, for example L Strine et al., 'Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law' (2010) 98 Geo LJ 629.

[893] C Gerner-Beuerle and E Schuster, 'The Evolving Structure of Directors' Duties in Europe' (2014) 15 European Business Organization Law Review 191, 206.

[894] See footnote 882 and accompanying text in this Chapter.

important element in determining the existence of a loyal relationship.[895] In terms of joint stock companies in Saudi Arabia, the management of such companies is vested in a board of directors with broad delegated powers,[896] which can be used both for good and bad ends;[897] in other words, the way in which managerial powers are exercised is likely to affect the company's interest. Therefore, to ensure that such powers are employed to advance the company's interests rather than pursuing their own interests, directors should owe a fiduciary duty of loyalty towards the company requiring them to run the company solely for its interest.[898] This analysis is consistent with the judicial view that regards a company manager as one who is entrusted with the management of the company's affairs.[899] Since directors can be considered to occupy a position of trust and confidence in relation to the exercising of their managerial powers, they are expected to conduct themselves in a manner that promotes the general interest of the company. Furthermore, the Saudi corporate legislation, as will be explored later, recognises an important aspect of loyalty, namely the avoidance of conflicts of interest,[900] which is expected to preclude directors from advancing their own interests at the expense of those of the company.[901] Since the Saudi law has recognised, to some extent, the aspect of loyalty, it follows that there should be an indirect recognition of the affirmative duty of loyalty, which must be observed in every decision, including situations where there is a conflict of interests. This is because the focus of this duty is to ensure that directors use their managerial powers for the benefit of the company rather than for another's benefit.[902]

In terms of the good faith requirement, it is clear that CL 2015 imposes no such obligation upon directors. Yet, if a director has been seen as standing in an agency relationship with the company (i.e., shareholders as a class), it can be said that this director perhaps owes a duty of good faith, which can be derived from Sharia principles governing contracts.[903] It is generally believed that Sharia law recognises the principle of good faith in the contractual

[895] See, for example, R Grantham (n 890) 150–151.
[896] See particularly footnotes 315–317 and accompanying text, Chapter 2 in this thesis.
[897] Hart (n 854) 303.
[898] Ibid. It is worth noting that Hart views the fiduciary duty of loyalty as one that should be owed towards shareholders.
[899] See Saudi Case No. 1129/3/Q (n 639) 661.
[900] See the discussion in section (4.3) in this Chapter.
[901] This is what the common law literature submits and it also tends to be valid in the Saudi context; see Langford (n 888) 217.
[902] Ibid.
[903] As argued in relation to the recognition of the director's duty of care, the statutory joint stock company is set up by a contract and this could justify drawing on contract law principles as an acceptable mode of analogy, see section (3.2.2), Chapter 3 in this thesis.

context.[904] This view is based on some *Qur'anic* verses[905] and the Sunnah,[906] which signifies that contracting parties must act towards one another with good faith, honesty, and trust.[907] In practice, from one of few cases reported in the area of contracts, the Saudi court affirmed that the principle of good faith, which is well established in Sharia, must be observed in all contracts and dealings.[908] Presumably, since directors are in an agency relationship with the company, they are expected to observe the principle of good faith in their managerial conduct.

In this regard, it should be noted here that the reference to contract law in establishing directors' duty of good faith is not very helpful. It might be true to say that the application of good faith in the contractual context differs from its application in the fiduciary context, an observation that can be found in Anglo-American legal literature and could be equally valid in Saudi Arabia and elsewhere.[909] The main difference is that good faith requires more of those in a fiduciary relationship (in this case directors) than it does of those in a contractual context.[910] Unlike other areas of law, good faith is 'more goal-specific' in the fiduciary context, as it requires directors to act in the best interest of the company.[911] To illustrate this point, Coffee explains this difference by saying that while a contracting party is allowed to advance its own interest in good faith; this is not the case with respect to a fiduciary duty[912] because the latter, as a principle, should be a selfless act.[913]

The main issue here is that the duty of good faith based upon contract law is not consistent with the good faith expected from a person in a director's position, namely acting in the best interests of the company. This problem would be better dealt with if the Saudi corporate legislation clearly recognised the directors' duty to act in the company's interests, to which the good faith requirement is tied. The absence of legislative recognition, by implication, creates a state of uncertainty as to whether the good faith is a

[904] Rayner (n 156) 80; S Al-Theabi, 'The Principle Of Good Faith In Saudi Law Compared with Other Laws' - in Arabic (2014) 23 Journal of Sharia, Law and Islamic Studies 15, 22–23.
[905] See, for example, *Qur'an* 4:58.
[906] The Prophet Mohammed (PBUH) says 'the truthful, trustworthy merchant is with the Prophets, the truthful, and the martyrs', see *Jami*' *At-Tirmidhi* (Book of Business, Hadith 1209).
[907] Al-theabi (n 904) 22–23.
[908] The Board of Grievances, Case No. 6504/1/Q, Appeal Division Decision No. 1/AS/331, 2010 (1431H), 1875.
[909] See, for example, E Nowicki, 'A Director's Good Faith' (2007) 55 Buffalo Law Review 457.
[910] Ibid 484–485 and 508–512.
[911] Ibid 484–485.
[912] J Coffee, 'The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role' (1989) 89 Columbia Law Review 1618, 1658.
[913] Ibid.

freestanding duty distinct from the broad duty of loyalty. The effects of such an issue are considered in section (4.2.3.2).

While the Saudi CL 2015 does not contain any mention of duties to promote the company's interests and to act in good faith, the situation is noticeably different with regard to companies listed in the Saudi stock market. The CGRs 2017, as did their predecessor of 2006,[914] clearly recognise the director's obligation to act for the benefit of the company.[915] This is also the case in relation to the good faith requirement, where article 30(17) requires a director to act in good faith. It should be asserted, however, that provisions of the CGRs 2017 are only applicable to listed companies and do not rule on matters concerning the governance of unlisted companies. This may raise a question about whether fiduciary duties, in the first place, were designed and introduced in company law to address issues exclusively related to the securities market. The answer to this question is definitely not. This is because the duty of loyalty, as explained above, is one of the elements of fiduciary obligation owed by a person who is in a fiduciary relationship with another; it should be observed by directors in every decision made, regardless of the nature of company (private or public, listed or unlisted). This suggests that it is inappropriate to establish the duty of loyalty independent of legislation.

4.2.3 Main components of the duty to act in good faith: Interpretation and application

As has been discussed, essential elements of the affirmative duty of loyalty (the duty to act in good faith and in the company's interests) can be established implicitly in Saudi CL 2015, whereas the position of the UK CA 2006 is much clearer with regard to the formulation of the elements of the duty. The implied recognition of the duty has limits and inevitably makes room for uncertainty as to the interpretation of the duty of loyalty, including the legal standard for judicial review of decisions. Through comparison with the UK law, the following sub-sections will examine some areas of deficiency in the Saudi law governing the duty of loyalty.

---

[914] Article 11(c) and (d) of the CGRs 2006.
[915] Article 30(17) of the CGRs 2017.

4.2.3.1 Good faith: A standard for assessing directors' behaviour in the United Kingdom law

Legally speaking, the concept of good faith or *bona fides* can be understood either as performing 'honestly, with the best of intentions' or as a 'genuine' act.[916] While the former is likely to be subjectively applied, the latter requires a consideration of objective factors.[917]As far as the UK judicial approach is concerned, the traditional statement as to the affirmative duty of loyalty was delivered in *Re Smith & Fawcett Ltd* by Lord Greene who ruled that it was a matter for directors' *bona fides*, not the court, to decide which decisions serve the company's interests.[918] The test applied here is a subjective one, namely the directors' state of mind.[919] Many judicial rulings have been in favour of subjective good faith such as the one found in *Regentcrest Plc (in liq.)*.[920] In this case Lord Jonathan explained that the good faith standard was not about whether a director's action, after being objectively reviewed by the court, 'was in fact in the interests of the company' or 'whether the court, had it been in the position of the director at a relevant time, might have acted differently'.[921] More precisely, the directors' duty to act *bona fide*ly in the company's interest is 'a subjective one' in which if the director 'honestly believed that he[/she] was acting in the best interests of the company he[/she] was not in breach'.[922]

In line with the common law duty, section 172(1) of the CA 2006 expressly places directors under the obligation to act in good faith. Given the similarity between the statement of the pre-2006 duty and the wording of section 172(1), the subjective approach is likely to be the one taken by the court in determining compliance with section 172(1).[923] In practice, just as the common law duty was regarded as subjective, so the duty found in section 172(1) is a subjective one, as affirmed by the case of *Cobden Investments Ltd,*[924] and seemingly by the case of *Madoff Securities International Ltd. (in liq.)*.[925] Hence, it

---

[916] L Sealy, 'Bona Fide and Proper Purpose in Corporate Decisions' (1989) 15 Monash U L Rev 265, 269.
[917] Ibid.
[918] *Re Smith and Fawcett Ltd.* (n 882) 306.
[919] R Langford And I Ramsay, 'Directors' Duty to Act in the Interests of the Company: Subjective or Objective?' (2015) 2 Journal Of Business Law 173, 175–176.
[920] *Regentcrest plc (in liq.) v Cohen & Anor* (2001) BCC 494 .
[921] Ibid 513.
[922] Ibid.
[923] See A Keay, 'Good Faith and Directors' Duty to Promote the Success of their Company' (2011) 32 Company Lawyer 138, 139 – 140.
[924] *Cobden Investments Limited v RWM Langport Ltd* (n 883) para [53].
[925] *Madoff Securities International Limited (In Liq.) v Raven* (n 884) paras [188]–[190]. Although this case did not discuss section 172 in details, it clearly states that the section codified the common law.

might be true to say that directors are in breach of their duty to promote the success of the company if they were to fail to satisfy the subjective standard of good faith.[926]

Nonetheless, it seems that there are instances where the court can take objective factors into consideration. For example, in the case of *Charterbridge Corp Ltd*,[927] it was said that where a director fails to consider whether an action is in the company's interest, the court, in such an instance, can question whether 'an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that [the actions] were for the benefit of the company'.[928] The test applied in such an instance is an objective one and has been adopted in some cases[929] and appears to be a part of the UK law governing directors' affirmative duty of loyalty.[930] It is noteworthy that even in situations where the court applies the subjective test, it seems difficult for directors to convince the court that they honestly considered that they were acting for the benefits of the company, if the directors' act results in a serious harm to the company.[931]

To sum up, it is clear that the duty found in section 172(1) is a standard of good faith concerned with the directors' intention,[932] in which the concept of good faith has traditionally been defined as the directors' 'state of mind' that needs to be observed while exercising managerial discretion.[933] Without the good faith requirement, the core duty of loyalty will be left without a definition[934] and, more importantly, without an appropriate standard of liability. Indeed, it is broadly accepted in the UK that the need to act in good faith is part of the directors' duty of loyalty to work for the company's benefit, as illustrated by section 172 of the CA 2006 and its predecessor (the common law duty to act in good faith in the interests of the company).[935]

[926] Keay (n 6) 128.
[927] *Charterbridge Corporation Ltd. v Lloyds Bank Ltd* (1970) Ch 62 .
[928] Ibid 74.
[929] See Keay (n 923) 141; Langford and Ramsay (n 919) 179.
[930] See *Madoff Securities International Limited (In Liq.) v Raven* (n 884) para [194].
[931] See *Regentcrest plc (in liq.) v Cohen & Anor* (n 920) 513 & 514.
[932] Keay (n 6) 131, 132.
[933] This argument is made in relation to the US Delaware corporate law and it also pertains to other common law jurisdictions (e.g., the UK and Canada), see Strine et al. (n 892) 633 and 663–665. For the UK, see Grantham (n 890) 151, 154, 156.
[934] Strine et al. (n 892) 644.
[935] See, for example, Keay (n 860) 98.

4.2.3.2 The standard of liability: Does the Saudi law make it right and clear?

While the position of the UK law is quite clear, that is, that compliance with the statutory duty found in section 172(1) is determined by referring to directors' good faith, the Saudi law is not as clear in relation to the standard of liability for the breach of duty of loyalty. As has been argued above,[936] the necessity to act in the company's interests and the good faith requirement can be, in an implicit way, established individually in Saudi law, particularly the CL 2015, but this does not necessarily combine them into a single duty. It is difficult to conclude that compliance with the duty of loyalty is determined by meeting the standard of good faith in Saudi law without a clear legislative or judicial grounding for such a statement. Further, even with the clear reference to the duty of good faith and the need to act in the company's interests in both the CGRs 2017 and their predecessors of 2006,[937] there is nothing in the wording of the both Regulations suggesting that the good faith requirement is a part of the broader duty of loyalty to act for the benefit of the company. This legal uncertainty supports the argument for the freestanding duty of good faith. It is indeed one of deficiencies in the law governing the duty of loyalty if the good faith requirement is separated from the loyalty obligation. The following points explain the reasons behind such an argument:

First, the close linguistic relationship between the principle of good faith and the duty of loyalty, as some argue, supports the argument that good faith should not be separate from the broad duty of loyalty.[938] According to the *Oxford English Dictionary*, the terms of 'fidelity', 'loyalty' and 'faithfulness' are linguistic synonyms for 'faith'.[939] The concept of good faith, which comes from the Latin *bona fides*, is defined as meaning: 'loyalty', 'truthfulness' and specifically 'honesty or sincerity of intention'.[940] This broadly means that action taken in good faith or *bona fides* is often understood as one taken with faithful and loyal intention and purpose.[941] Similarly, in Arabic, the term 'faith' or 'fides' (*niyah*)[942] is described in the leading Arabic dictionary of *Le-san AL-Arab*, as 'intention', 'purpose' and 'determination towards something'.[943] Putting 'good' and 'faith' together, the phrase 'good faith' (*husn al-niyah* in Arabic) can be defined as the intention of honesty and

---

[936] See generally the discussion in section (4.2.2) in this Chapter.
[937] See particularly footnotes 914–915 and accompanying text in this Chapter.
[938] Strine et al. (n 892) 644–648.
[939] *Oxford English Dictionary*, 'faith, n. and int.' (OED 3rd edn, Oxford University Press June 2014) <http://www.oed.com/view/Entry/67760> accessed 12 October 2017.
[940] *Oxford English Dictionary*, 'good faith, n., int., and adj.' (OED 3rd edn, Oxford University Press June 2014) <http://www.oed.com/view/Entry/363783> accessed 12 October 2017.
[941] Strine et al. (n 892) 646, 647.
[942] H Faruqi, *Faruqi's Law Dictionary* (5th edn, Beirut, Librairie du liban 2006) 279, 289.
[943] A Kabeer et al. (eds), *The Arabic Tongue for I'bn Mandoor* (Cairo, Dar Al-Ma'ref).

integrity in which the lack of good faith in Sharia is evidenced by acting dishonestly, unfaithfully and disloyally.[944] Thus, from such a linguistic argument, there is no sense to divorce the term 'good faith' from its synonymous concepts of loyalty and trustfulness. In other words, in linguistic terms, there is no justification for divorcing the good faith requirement from the directors duty of loyalty in the corporate context.

Second, one of effects of separating the principle of good faith from the duty of loyalty is to leave the latter with an *inappropriate and rigid* standard of liability. As has been shown in the UK, good faith is used to define the state of mind that must be adhered to by loyal directors; otherwise directors would be liable for the breach of the duty mentioned in section 172(1) of the CA 2006. To clarify this point, regardless of the nature of the standard used, the UK courts' analysis is apparently limited to a consideration of whether directors acted in good faith and does not involve the question of whether a decision made advanced the company's success.[945] As a result, the UK court is prevented from examining directors' judgement in relation to the company's success.[946] Returning to the Saudi law, neither the CL of 2015 and of 1965 nor the case law specifies the standard of liability for the breach of duty to act in the company's interests. A closer look at the nature of Sharia law uncovers the tendency of Sharia towards objectivity in which standards of assessing behaviour in Islamic jurisprudence are likely to be objective, not subjective.[947] Having borne in mind that if the good faith requirement is separate from the loyalty duty, the court, by implication, would be permitted to engage in the objective consideration of whether the directors in fact acted in the general interests of the company. Directors' state of mind, as a consequence, is completely irrelevant in deciding where the interests of the company lie. This suggests that the court would be allowed to place itself in the directors' position, deciding what is good and bad for the company.[948] With this approach, directors tend to be subject to a high possibility of being liable for the breach of their duty of loyalty. Indeed, in a situation where the court follows a strict approach to assessing directors' business decisions, it is likely, as some argue, to reduce the shareholders' wealth[949] because directors would inevitably make low risk decisions in order to avoid personal liability.[950] With a greater concern for personal liability, gifted persons might also avoid accepting a

[944] Al-theabi (n 904) 21–23.
[945] See generally Keay (n 923); Grantham (n 890) 156–158.
[946] Keay (n 923) 143.
[947] Al-Sanhuri (n 653) 105.
[948] This is the most likely scenario of objectiveness in the context of the duty to act in the company's interests where the good faith principle is distinct from the duty of loyalty, see Langford and Ramsay (n 919) 174.
[949] Easterbrook and Fischel (n 301) 93–94.
[950] Ibid 94.

directorship.[951] This issue will likely be worsened by the fact that the court's *ex post* view about whether a decision had in fact served the interests of the company will be reached with the benefit of hindsight. The problem with hindsight bias[952] is that the court reviews the business decision with the knowledge of the result of the decision that was taken by the directors with *uncertain* knowledge of the outcome.[953] This would increase the possibility of failure at the time of making the decision, on the one hand, and decrease the probability of decisions' validity, on the other hand, making directors liable for the breach when they were not.[954] While some business decisions will, in fact, lead to a successful outcome, others will appear wrong with hindsight.[955] If directors can be held liable for decisions that look wrong with hindsight, they will, as a result, be reluctant to take high-risk decisions due to the greater possibility of being held legally liable.[956] Thus, the directors' state of mind, rather than whether a decision in fact serves the general interests of the company, should be the subject of the court's analysis when determining compliance with the affirmative duty of loyalty. This cannot be accomplished by treating good faith as a freestanding obligation, distinct from the broad duty of loyalty.

4.2.3.3 Interests that directors are required to consider: An area of uncertainty in Saudi law

For the court to determine whether there has been a breach of the duty of loyalty, it is expected to engage in the question of whose interests directors should serve. The answer to such a question is necessary in order for directors to discharge their loyalty obligation successfully. Considering the Saudi law first, the CL 2015 lacks a general statement establishing the duty of loyalty and therefore it is hard to ascertain the exact position of the CL 2015. For listed companies, the need for directors to act in the general interests of the company was expressly included in article 11(d) of the previous CGRs 2006. Although such a sub-article occupied the realm of 'soft law' in that it was not enforceable under the general law, it was assumed that it was followed in practice because investors expected this from the company's management. With the new CGRs 2017, the duty to act for the benefit of the company is also recognised, as set forth in article 30(17). As with many legal provisions found in the Saudi company law, both provisions have been drafted in an

[951] Ibid.
[952] *Regentcrest plc (in liq.) v Cohen & Anor* (n 920) 515, where the court expressed its awareness of the danger of hindsight bias.
[953] Kershaw (n 310) 345.
[954] Ibid.
[955] G Avilov et al., 'General Principles of Company Law for Transition Economies'(1999) 24 Journal of Corporate Law Studies 190, 284.
[956] Ibid.

obscure fashion, providing wide room for interpretation. This is because in both Regulations the reference was made to the concept of the company's interests, which is an elusive one.

It is true to assert that directors' duty is owed to the company that solely has, by implication, the right to decide whether or not an errant director should be sued for a breach of his duty.[957] However, in relation to the content of the duty of loyalty (i.e., the requirement to act in the general interests of the company), it is reasonable to argue that the company should be understood as recognising various interest groups who are invested in the success of the company, such as shareholders, creditors and employees.[958] Hence, it might be correct to describe the company, in the context of whose interests should be served, as 'different things in different contexts'.[959]

On the one hand, the phrase 'the interests of the company' can be interpreted as being synonymous with the interests of its shareholders. This is consistent with the narrow meaning of the duty of loyalty to the firm as referring to the interests of shareholders.[960] In spite of the lack of judicial guidance, it can be argued from some legal provisions of the company law system that the board of directors is likely to use its powers in furthering the shareholders' interests; for example, the idea that statutory companies exist solely to maximise profits for shareholders can be said to be the basis of company law in Saudi Arabia.[961] Company directors are primarily accountable to shareholders who, through the general meeting, can initiate a company's legal proceeding against directors.[962] Furthermore, shareholders, who are only entitled to have a say on directors' appointments and removals, may influence directors' decisions.[963] Moreover, in some cases, directors are under a legal obligation to act in the interests of shareholders.[964] Such factors would therefore place directors under pressure to consider the interests of shareholders while making decisions.

On the other hand, an understanding of the company's interests may include the need to take into account the interests of non-shareholder constituencies. For example, a proposed

---

957 See article 79 of the CL 2015. The issue of enforcement of breaches of directors' duties by way of private action are discussed in detail in Chapter 5 in this thesis.
958 E Ferran, *Company Law and Corporate Finance* (Oxford, OUP 1999) 124.
959 Sealy (n 916) 269.
960 Hart (n 854) 302.
961 See the definition of *statutory company* set out in article 2 of the CL 2015.
962 Article 79 of the CL 2015.
963 See footnotes 436–448 and accompanying text, Chapter 2 in this thesis.
964 Article 3(a) of the MARs 2007.

decision to reduce the equity capital may adversely affect the interests of creditors, and that should be, in some circumstances, taken into consideration when making the decision.[965] For listed companies, it is clear that the purpose of CGRs 2017 is to protect the interests of shareholders and non-shareholder constituencies,[966] and put a general framework for the rights of non-shareholder constituencies in place.[967] In addition, in a takeover, the board of directors of both companies is required to consider the interests of employees and creditors.[968]

It appears from the discussion above that the phrase 'the interests of the company' is an open-ended one that can embrace the interests of many corporate constituencies. The main point to make is that while there can be decisions where the interests of various groups coincide with one another, this is not the case in other decisions made by directors. An example of conflict between the interests of different constituencies might be the decision to relocate production to a country with cheaper labour costs; this may be beneficial for shareholders and creditors but not for employees who would become redundant.[969] Even if the company's interests are viewed as separate from those of its constituencies,[970] there is a possibility of conflicts between the interests of the company as an entity and the interests of shareholders.[971] This is also the case even with a certain category of corporate constituency, for example, a proposed decision to change the company's capital structure, which may not have the same effect on all classes of shareholder.[972] Having acknowledged the possibility of conflicting interests, while it is crucial to design a duty for directors that protects them, it is more important to define the extent to which potentially competing interests are to be considered. As Ferran suggests, it is a matter of 'prioritising' various conflicting interests.[973] Indeed, the reference to 'the interests of the company' within the legal formulation of the duty of loyalty is likely to confer on directors a very wide discretion to determine what the interests of the company are. Therefore, in the absence of clear rules governing the priority of relevant interests, it might be true to say that company

---

965 Article 145 of CL 2015.
966 Article 2(a) of the CGRs 2017.
967 Article 3(7) of the CGRs 2017.
968 Article 3(k) of the MARs 2007.
969 Ferran (n 958) 125.
970 A perception that is generally accepted more in continental Europe (e.g., France) compared with the common law jurisdictions; see The Boards of Directors of Listed Companies in France, *Vienot I Report*, (CNPF and AFEP, July 1995) 7 <http://www.ecgi.org/codes/documents/vienot1_en.pdf> accessed 1 December 2016.
971 For example, the takeover bid may benefit present shareholders if they have been offered a high price, but may not serve the company's interests if the bidder is intending to terminate the business; see Ferran (n 958) 125.
972 Ibid.
973 Ibid.

directors would be given the opportunity to 'play off competing interests against each other and to use them to mask [their] own failings'.[974] This would arguably render the shareholders' monitoring of the director's conduct challenging and, consequently, weaken the accountability of the directors (who could be controlling shareholders).

4.2.3.4 The priority for shareholder constituency in section 172(1) of the CA 2006

The UK company law has departed from any potential ambiguity connected to the phrase 'company's interests' and has formulated a more precise meaning of interests that is to benefit the shareholder constituency.[975] Before section172 was enacted, there had been no legislative compulsion for directors to act in the best interests of shareholders. This is compounded by the fact that the judicial rulings, as has been noticed,[976] have been divided between those suggesting directors should be guided by the shareholder value approach,[977] and others that emphasise the interests of company entity, which involves more than the interests of the shareholders.[978] From the legal perspective, the phrase 'the interests of the company', articulated as part of the old common law duty of loyalty, did not indicate preference for shareholders over other corporate constituencies[979] in which it appears that it was left to the discretion of directors to determine the company's interests.[980]

Therefore, it can be said that section 172(1) in part upholds the shareholder-centred approach.[981] However, the section includes a reservation on the shareholder value principle, which is the need for due consideration to be paid to a number of factors including non-shareholder interests.[982] Notably, what makes section 172(1) different from the previous case law is not allowing directors to consider the interests of non-shareholders,[983] but

---

974 Ibid.
975 A Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' (2011) 22 EBLR 1, 22 and 26.
976 See, for example, A Keay, 'Enlightened Shareholder Value, The Reform of the Duties of Company Directors and the Corporate Objective' (2006) Lloyds Maritime and Commercial Law Quarterly 335, 341–346.
977 See, for example, *Parke v Daily News Ltd.* (1961) Ch 927, 963; *Greenhalgh v Arderne Cinemas* (1951) Ch 286, 291.
978 See, for example, *Fulham Football Club Ltd & Ors v Cabra Estates plc* (1992) BCC 836 , 876 where the court said that directors owe their duties to the company and the latter 'is more than just the sum total of its members'.
979 Keay (n 975) 26.
980 J Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' (2009) 68 Cambridge Law Journal 607, 614.
981 See section (4.2.1) in this Chapter.
982 Section 172(1)(a)–(f) of the CA 2006.
983 This is because the UK law prior to the CA 2006 had not prevented directors from considering the interests of stakeholders while acting for the benefit of the company. This is exemplified by the lack of any restriction on directors' discretion with regard to the employees' interests. See, for example, *Hutton v West Cork Railway Co* (1883) 23 ChD 654, 672, 673.

obliging directors to consider stakeholder interests when promoting the company's success for *the benefit of all shareholders.*[984] As explained above in the discussion on the background to section 172, the enlightened shareholder value adopted by the section includes the idea that the consideration of stakeholders' interests is a means of achieving the success of the company for the benefit of all shareholders.[985] This clearly means that the duty to promote the company's success for the benefit of all shareholders is prioritised over the due consideration for the interests of non-shareholder constituencies.[986]

While the enlightened shareholder value embedded in section 172 has perhaps put an end to any uncertainty concerning what the interests of the company are,[987] the new legislative provision has brought to the UK legal landscape a number of unresolved questions. The main problem minimising the effectiveness of section 172 in practice is that non-shareholder constituencies mentioned in the section are left without legal remedy[988] and indeed 'a right without a remedy is worthless'.[989] Although directors are required to have regard to the interests of non-shareholder constituencies, there is no right for any stakeholder, other than a shareholder,[990] to bring a derivative action against directors in the case of the latter's failure to consider their interests.[991] This means that one can envisage legal action being brought by a shareholder on the basis of directors' failure to consider the long-term matters while making decisions[992] or to act fairly between company's shareholders.[993] However, in relation to the directors' duty towards non-shareholders, the

---

984 Keay (n 975) 26.
985 See footnotes 877–880 and accompanying text in this Chapter.
986 Keay (n 976) 350.
987 See the statement of Lord Goldsmith before the Grand Committee, the House of Lords (6 February 2006 col GC255) <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060206/text/60206-29.htm> accessed 13 December 2016.
988 This section has attracted a negative response from the beginning in relation to many issues, including the lack of legal remedy for non-shareholder constituencies in company law; see, for instance, D Arsalidou, 'Shareholder Primacy in Cl.173 of the Company Law Bill 2006' (2007) 28 Company Lawyer 67, 68; A Keay, 'Section 172(1) of the Companies Act 2006: An Interpretation and Assessment' (2007) 28 Company Lawyer 106, 109.
989 See M McDaniel, 'Bondholders and Stockholders' (1988) 13 Journal of Corporation Law 205, 309.
990 Shareholders are the only stakeholders who are entitled to sue directors for breach of their duty found in section 172 through the initiation of a derivative proceeding. For more details, see section (5.5), Chapter 5 in this thesis.
991 E Lynch, 'Section 172: A Ground-breaking Reform f Director's Duties, or the Emperor's New Clothes?' (2012) 33 Company Lawyer 196, 200.
992 See section 172(1)(a) of the CA 2006. However, according to an empirical study that examined how lawyers' advice may affect directors' and shareholders' response to section 172, it seems that lawyers perhaps advise their shareholder clients that there are a very few situations where derivative actions could be brought successfully against directors based upon section 172(1)(a); see J Loughrey, A Keay and L Cerioni, 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 Journal of Corporate Law Studies 79, 106–107.
993 See section 172(1)(f) of the CA 2006. As one commentator opined, it is, however, 'unlikely for individual members to bring an action based upon sub-section (f), unless he could demonstrate that unfairness caused by the director's breach of his duty had damaged the company itself'; see A Alcock, 'An Accidental Change to Directors' Duties?' (2009) 30 Company Lawyer 362, 367.

section is left ineffectual in a practical sense. On the one hand, directors might generally utilise section 172 to protect themselves against any legal actions brought by shareholders if they have regard to one of factors (a)–(f) listed in the statutory provision.[994] On the other hand, directors fail to do so, there is nothing in the CA 2006 that suggests any real threat of legal consequence at the hand of non-shareholder groups.[995] Hence, whether the wording of section 172 enhances the accountability of directors is doubtful.[996]

To sum up the UK company law position in relation to non-shareholder rights, it appears that the legal protection of stakeholders, other than shareholders 'is left not to any specific rights . . . but wholly to the discretion of directors'.[997] To be precise, the legal protection of non-shareholder constituencies seemingly falls beyond the scope of company law.[998] Shareholder constituency is the only stakeholder that can enforce the statutory duty found in s 172(1). Therefore, it can be said that the questionable element of section 172(1) is that the due consideration to non-shareholders' interests is practically ineffective, a perception that leads some commentators to opine that section 172(1) is no more than a codification of the shareholder value approach.[999] Given the above discussions, it is appropriate to suggest that section 172(1), by implication, does not go further than a tool for educating directors as to the need to have regard to non-shareholder interests and is unlikely to expose directors to an increased level of legal liability than under the previous law.[1000]

---

[994] Lynch (n 991) 200.
[995] Ibid.
[996] Ibid.
[997] Keay (n 6) 169.
[998] Lynch (n 991) 202–203.
[999] See, for example, ibid 201.
[1000] Alcock (n 993) 368, referring to J Bird's statement in A Alcock, The Rt Hon the Lord Millett, M Todd QC, *Gore-Browne on Companies* (45th edn, Bristol Jordans 2009) Ch 15 [10A]. It is noteworthy that the UK CA 2006 was reformed in 2013 to include a strategic report (Chapter 4A of the CA 2006), which *inter alia* intends to promote non-shareholders' interests through the disclosure requirement. The objective of the strategic report, as section 414C (1) provides, is 'to inform members of the company and help them to assess how the directors have performed their duty under section 172'. According to sections 414C (2) and (3), the report needs to include a fair and balanced analysis of the development, performance and status of the company in addition to an account of the main risks the company faces. What is relevant to our discussion here is that section 414C (4) requires directors to incorporate in the review, where appropriate, non-financial key performance indictors including data on environmental and employee issues. For quoted companies, the report should, as section 414C (7) (b) provides, contain information about environmental and social matters, 'the company's employees' and 'the community and human rights issues'. The CA 2006 makes it clear in section 414C (7) that a report that omits any of the non-financial information mentioned in sub-section (7) (b) must declare which of them has been omitted. It is worth mentioning that there has been a reform proposal suggested by the UK government for strengthening, among other things, the engagement of non-shareholder constituencies and for requiring companies to explain how directors can effectively discharge their duty with regard to stakeholders' interests under section 172. For more detailed background on the strategic report and the recent reform proposal by the UK government , see K Chalaczkiewicz-Ladna, I Esser and I MacNeil, 'Engaging Stakeholders in The UK in Corporate Decision-making Through Strategic Reporting: An Empirical Study' (October 2017) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049203> accessed 17 January 2018.

4.3 The duty to avoid conflicts of interest: The underlying principles that shape the framework of the duty

One of the fundamental aspects of the duty of loyalty is to prevent directors from engaging in self-interest activities. In common law jurisdictions such as the UK, the law imposes a widely understood requirement upon directors to avoid any form of conflict of interests.[1001] This is illustrated, as will be shown below, by the development of equity rules of no-conflict and no-profit that govern the relationship between a director as a fiduciary and a person in a position of trust, and the company. This introductory section will highlight the two rules of no-conflict and no-profit in the UK with examining the extent to which the Saudi corporate statute has recognised the rules in the corporate context.

4.3.1 No-conflict rule

In the UK, the duty to prevent conflicts of interest is the critical essence of the fiduciary relationship.[1002] If directors do not conform to this obligation, they might be regarded as performing their fiduciary duties disloyally and unfaithfully.[1003] The no-conflict rule in the context of conflicts involving directors was clearly stated in the case law before the CA 2006; for example, in the case of *Aberdeen Rly Co v Blaikie Bros*,[1004] the House of Lords ruled that a director cannot 'enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect'.[1005] Following the introduction of the CA 2006, it is one of directors' obligation, under section 175, to 'avoid a situation in which he has, or can have, direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company'.[1006]The scope of section 175 is wide enough to include all conflicts between the company's interests and directors' interests,[1007] such as those arising from the directors' exploitation of any company's 'property, information, or opportunity'.[1008] Section 175 does not, however, apply to a conflict of interests resulting from a situation where a director

[1001] Gerner-Beuerle and Schuster (n 893) 212.
[1002] *Bristol & West Building Society v Mothew* (n 624) 18.
[1003] Ibid.
[1004] *Aberdeen Rail Co v Blaikie Brothers* (1843-1860) All ER Rep 249. This case is about a self-dealing transaction, but the no-conflict rule applies to self-dealing and to corporate opportunities.
[1005] Ibid 252.
[1006] Section 175(1) of the CA 2006.
[1007] See Explanatory Notes to the CA 2006, para 339.
[1008] Section 175(2) of the CA 2006.

enters into a contract with the company (self-dealing transactions),[1009] because such a situation is governed by section 177 or section 182 of the CA 2006.

With regard to the Saudi law, there is no statutory provision placing directors under a general obligation to avoid conflict of interests. Instead, the statutory approach is to regulate a particular director's conduct involving a conflict of interests in a separate article. Hence, it can be asserted that the no-conflict rule is recognised in both the 1965 version and the 2015 version of the CL. The rule underlies more specific provisions governing directors, such as the regulation of self-dealing transactions set out in article 71(1) of the CL 2015 (article 69 of the CL 1965), and the regulation of directors' competition with the company in article 72 of the CL 2015 (article 70 of the CL 1965). Recently, Saudi law has recognised the obligation imposed upon directors to avoid exploiting the company's secrets for their own benefit;[1010] the no-conflict rule underlies such an obligation.

4.3.2 No-profit rule

In addition to the no-conflict rule, the UK law includes another principle in regulating the issue of conflicts of interest that prevents a fiduciary from making a profit.[1011] In the context of company law, the no-profit principle is mentioned in *Regal (Hasting) v Gulliver*.[1012] In this case Regal (Hastings) Ltd (Regal) owned a cinema and was interested in obtaining long-term leases on two cinemas. Regal formed a subsidiary company, Amalgamated Ltd, to buy the two cinema leases. However, Regal did not have adequate funds to provide Amalgamated Ltd with £5,000 of equity capital and was only able to raise £2,000. The company's directors and its solicitor agreed to provide £2,500 of equity capital (£500 each), and the chairman found outside subscribers to provide £500; thus, the capital required by Amalgamated Ltd. was met. The directors made a profit on the subsequent sale of the whole company including Amalgamated Ltd. The new owners of Regal appointed a new board which brought legal action against the former directors to recover the profit they received from purchasing and selling their shares in Amalgamated Ltd.[1013] The House of Lords held that the directors were liable to the company for the profit that had been made from the exploitation of an opportunity that had become available 'by reason' and 'in the

[1009] Section 175(3) of the CA 2006.
[1010] Article 74 of the CL 2015.
[1011] *George Bray v John Rawlinson Ford* (1896) AC 44 , 51.
[1012] *Regal (Hastings) Ltd. v Gulliver* (1967) 2 AC 134. This case sits in the context of corporate opportunities.
[1013] Ibid 135–137. The facts of this case are written down as mentioned by Viscount Sankey.

course' of their directorship.[1014] It is important to say that the *Regal (Hastings)* case, as has been noted,[1015] is an example of a case decided on the no-profit rule without reference to the no-conflict rule.[1016] This supported the view that believes that the no-profit rule is stand-alone and independent from the no-conflict rule.[1017] As Koh claims, it may be more accurate to treat the rules as separate as it is probable in certain circumstances that it will only be possible to hold directors accountable for the breach of his fiduciary duty in accordance with one of these rules.[1018]

Interestingly, there is disagreement as to whether the CA 2006 clearly recognises the no-profit rule or not. While some assume that the no-profit rule is codified in section 176,[1019] others suggest that the CA 2006 lacks clear mention of the no-profit rule.[1020] It appears that the no-profit rule is not directly stated in the CA 2006 and section 176 cannot be viewed as codifying the no-profit rule. While section 176 concerns benefit received by a director from a third party because of his/her being a director or doing something as a director,[1021] this is different from the no-profit rule. As one commentator correctly explains, it is true that the directors in the *Regal (Hastings)* case, for instance, made a profit by reason of their directorship, the benefit resulted from selling the shares to a third party. However, the directors did not receive this benefit because of their position in the company, but because they owned shares.[1022] Kershaw perceives that s 176 was simply introduced to ban the receipt of benefits such as bribes that result from their occupying the position of director.[1023] Nevertheless, this does not mean that the position of common law will be overruled, enabling directors to keep the profit made because of and in the course of their directorship.[1024] It rather means that the obligation to avoid conflict of interests requires directors, as a general rule, not to make a profit as a result of their directorship.[1025] Put differently, the director is only accountable under the no-profit principle once the breach of the no-conflict rule has been established.

1014 Ibid 147–149.
1015 See A McClean, 'The Theoretical Basis of the Trustee's Duty of Loyalty' (1969) 7 Alta L Rev 218, 224.
1016 See *Regal (Hastings) Ltd. v Gulliver* (n 1012) 139.
1017 See *Quarter Master UK Ltd v Pyke* (2004) EWHC 1815, para [55]. For recent cases viewing the no-profit rule as an application of no-conflict rule, see *Towers v Premier Waster Management Ltd* (2012) BCC 72 ,73.
1018 P Koh 'Once a Director, Always a Fiduciary' (2003) 62 Cambridge Law Journal 403, 406.
1019 See, for example, J Lowry, 'Codifying the Corporate Opportunity Doctrine: The (UK) Companies Act 2006' (2012) 5 International Review of Law 1,7.
1020 See, for example, Davies and Worthington (n 2) 543.
1021 See section 176(1) of the CA 2006.
1022 D Kershaw (n 310) 574.
1023 Ibid.
1024 Ibid.
1025 See Explanatory Notes to the CA 2006, para 338.

Under Saudi law, neither the CL 1965 nor the CL 2015 involves any provision requiring directors to avoid making profit because of and in the course of their tenure. The effect of this non-recognition is evident when the issue of exploitation of corporate opportunities is discussed below.[1026] Further, the CL 2015, as its predecessor of 1965, remains silent about whether the disgorging of profits is available for the company as a remedy for the breach in situations involving conflicts of interest. The only exception to this is found in article 71(2) of the CL 2015. It clearly states that the directors' engagement in self-dealing transactions without meeting the disclosure/approval requirement could trigger their liability to account to the company for profits made, as one of remedies for the breach of no-self-dealing rule.[1027] The wording of article 71(2) suggests that the fact that a director has made a profit is not sufficient to impose a liability as the company needs to establish first that the director has engaged in an unauthorised self-dealing transaction.

Having considered the underlying rules shaping the framework of the duty to avoid conflict of interests, the subsequent task is to discuss the application of the two rules in practice. The following two sections will analyse directors' exploitation and self-dealing transactions under the UK and Saudi laws respectively.

4.4 Conflict of Interests: Exploitation of Corporate Opportunity

One of the forms of the breach of the duty of loyalty is directors' exploitation of an investment opportunity or information for their personal benefit at the expense of the company's benefit because such behaviour would constitute a breach of the no-conflict rule. In this regard, in order to determine the liability of directors, the question of how the law identifies an opportunity or information that then gives rise to a conflict situation must be answered.[1028] The regulatory approach to the determination of liability should ensure that the company and its shareholders are adequately protected from the directors' self-interest behaviour. It is also important to specify mechanisms that allow the company to authorise any exploitation of business opportunities, such as a regulatory strategy (i.e., authorisation) that strikes the balance between control and discretion.[1029] The regulation of corporate opportunity, which comprises the elements of liability determination and of the authorisation mechanisms, is poorly developed in Saudi law. Even with the new

[1026] See section (4.4.2) in this Chapter.
[1027] Article 71(2) of the CL 2015.
[1028] The exploitation of an opportunity and information will hereafter simply be referred to as 'opportunity', unless otherwise stated.
[1029] A Keay, 'The Authorising of Directors' Conflicts of Interest: Getting a Balance?' (2012) 12 Journal of Corporate Law Studies 129, 136.

development brought by the CGRs 2017,[1030] there is still room for improvement in terms of legal uncertainty and deficiency in this area of law. The following sub-sections will discuss the issue of appropriation of corporate opportunities in order to demonstrate the absence of sufficient restrictions on directors to engage in such actions in the Saudi law as compared to the UK law.

4.4.1 The United Kingdom approach to regulating directors' exploitation

Section 175(2) of the CA 2006 clearly provides that the directors' duty to avoid conflict of interests applies to the exploitation of corporate opportunities and information. This indicates that if directors have personally exploited a corporate opportunity or information that would be of interest to the company, they may be held liable for breach of the statutory duty found in section 175, due to a conflict between the personal interests of directors and those of the company.[1031] Usually, such exploitation involves the making of a profit by the directors; therefore, the company is entitled to require directors to account for any profit made out of unlawful exploitation.[1032]

The no-conflicts approach to corporate opportunities places its focus on the extent to which and the ways in which directors' personal and company interests conflict.[1033] In order to determine whether or not there is conflict of interests in connection with corporate opportunities depends upon whether the following factors have been taken into consideration: does the scope of the company's interest include any profit-making opportunity or only an opportunity that falls within the company's area of business? Does the no-conflict rule only cover the actual conflicts or also possible conflicts?[1034] Is it relevant for determining the directors' liability to examine the facts of a case that led to the alleged breach of duty to avoid possible conflicts or to consider the equity of the situation? The response to these questions may depend on whether the no-conflict rule in its application is *strict* or *flexible* in regulating corporate opportunities. To explain this point, the strict approach assumes the law adopts a broad definition of company's interests, with

---

[1030] The Saudi law through the CGRs 2017 for the first time treats the director's exploitation of a business opportunity as a form of conflict of interest.

[1031] The UK law's understanding of this issue of directors' exploitation of corporate opportunities is known as the 'no-conflicts approach', see D Kershaw, 'Lost in Translation: Corporate Opportunities in Comparative Perspective' (2005) 25 Oxford Journal of Legal Studies 603, 605.

[1032] See *Cook v Deeks* (1916) 1 AC 554, 554, 564, where three directors were found liable because they obtained contracts for themselves to the exclusion of the company and had made profit from their position as directors.

[1033] D Kershaw, 'Does It Matter How the Law Thinks About Corporate Opportunities?' (2005) 25 Legal Stud 533, 537.

[1034] Ibid.

the rule involving the possibility of conflicts irrespective of the reality of those conflicts; whereas the flexible approach assumes a limited definition of the company's interests and the allowance of personal exploitation of corporate opportunities so long as there is not actual conflict.[1035]

On the whole, the case law as it developed before codification is seemingly relevant to the question of how section 175 of the CA 2006 will be interpreted and applied in practice.[1036] The no-conflicts approach to the directors' exploitation has been viewed as a strict and inflexible one[1037] and this is clear from the case law dealing with such opportunistic conduct. In *Boardman v Phipps*,[1038] the House of Lords ruled that it was sufficient to prove the possibility of conflicts to require a trustee to account for profit even when there was no actual conflict.[1039] Lord Cohen stated 'whether or not the trust or the beneficiaries in their stead could have taken advantage of the information is immaterial'.[1040] As has been pointed out,[1041] the strict no-conflicts approach was also affirmed in *Re Bhullar Bros Ltd*,[1042] where the court found that directors, by personally taking a commercial opportunity to purchase real estate that would have been 'worthwhile' and 'commercially attractive' to the company, had placed themselves in 'a real possibility of conflict' situation[1043] even though the directors had obtained the information in their spare time[1044] and the company lacked the commercial ability to exploit the opportunity.[1045]

The case of *Regal (Hasting)*,[1046] the facts of which were set out earlier,[1047] might be considered as a clear instance of a case where the strict approach was implemented. In this case, directors were held liable for the breach of their fiduciary duty and accountable for the profit made, regardless of the fact that the directors were considered to have performed *bona fide*;[1048] the company (Regal) was not in a position to take up the opportunity because it lacked the financial capability to capitalise on the subsidiary company

[1035] Ibid.
[1036] Section 170 (4) of the CA 2006.
[1037] See, for example, Davies and Worthington (n 2) 541, 551.
[1038] *Boardman v Phipps* (1967) 2 AC 46 . This is a trust law case which also applies to fiduciaries such as directors.
[1039] Ibid 69, 94, 103,112, 124.
[1040] Ibid 111. This was the view of the majority in the House of Lords, see ibid 94.
[1041] D Prentice and J Payne, 'The Corporate Opportunity Doctrine' (2004) 120 Law Quarterly Review 198, 200–201.
[1042] *Re Bhullar Bros Ltd* (2003) BCC 711 .
[1043] Ibid 712.
[1044] Ibid 723.
[1045] Ibid.
[1046] *Regal (Hastings) Ltd v Gulliver* (n 1012).
[1047] See footnotes 1012–1013 and accompanying text in this Chapter.
[1048] *Regal (Hastings) Ltd. v Gulliver* (n 1012) 136.

(Amalgamated Ltd);[1049] the company would not have acquired the lease of cinemas without the directors' assistance,[1050] and the company had not suffered any loss, but it rather received a profit from the directors' engagement in making profit for their own benefit.[1051]

Another instance of inflexibility can be seen in the judgment of the Court of Appeal in *O'Donnell v Shanahan,*[1052] which rejected the idea that the director's liability was reduced when exploiting opportunities that fall within the company's scope of business.[1053] Rimer stated that directors were subject to the duty of 'undivided loyalty' to their company and one aspect of that duty was to disclose all opportunities to the company, and it was not for directors to decide whether or not the company would be interested in a particular opportunity.[1054]

The strict approach followed by the case law in relation to the regulation of corporate opportunities is reaffirmed by section 175(1) of the CA 2006, where the directors' obligation covers not only the actual conflict but also the possibility of conflicts.[1055] Section 175(1) goes further – unlike the common law no-conflict rule – broadening the scope of the obligation to cover the avoidance of indirect interest as well as direct ones.[1056] Looking to section 175(2), the CA 2006 also follows the strict approach by adopting the majority view in *Boardman v Phipps*;[1057] the sub-section provides that 'it is immaterial whether the company could take advantage of the property, information or opportunity'. This means that a director would be liable for the breach even in the case of the company's inability to exploit a business opportunity.

Importantly, the UK company legislation has, however, contained an important strategy that intends to circumvent the inflexibility of the regulation of corporate opportunities, that is, the authorisation strategy set forth in sub-section 175(4)(b) of the CA 2006. It provides that there is no breach of the duty found in section 175 if the conflict has been authorised by the board of directors. In its deliberations on whether the authorisation of directors'

[1049] Ibid 142.
[1050] Ibid 139.
[1051] Ibid 144–145.
[1052] *O'Donnell v Shanahan* (2009) BCC 822; for the analysis of this case, see D Ahernn, 'Guiding Principles for Directorial Conflicts of Interest: Re Allied Business and Financial Consultants Ltd; O'Donnell v Shanahan' (2011) 74 The Modern Law Review 596.
[1053] *O'Donnell v Shanahan* (n 1052) 824 and 843.
[1054] Ibid.
[1055] See *Richmond Pharmacology Ltd v Chester Overseas Ltd* (n 689) 1124.
[1056] An example of indirect interest would perhaps be where a director represents a controlling shareholder in a company whose interests conflict with those of the company, see Keay (n 1029) 133.
[1057] See footnote 1040 and accompanying text in this Chapter.

exploitation should be granted by the general meeting of shareholders or the board of directors, the CLRSG was in favour of the requirement of board approval because of impracticability and high costs associated with the authorisation by shareholders.[1058] The CLRSG adds that independent board approval is more effective in dealing with the issue of the general meeting being dominated by a few directors (who are also controlling shareholders), particularly in private companies.[1059] Thus, the Act, in setting the mechanism for board approval, differentiates between the public and private company. For the former the constitution must expressly provide the board with the power to authorise the exploitation of an opportunity[1060] and for the private company the board may give the approval unless the constitution expressly involves a provision 'invalidating' such approval.[1061] It should be borne in mind that the company's articles of association may specify a certain requirement for approval, such as the need to obtain authorisation from shareholders.[1062] The CA 2006 also preserves the current ability of shareholders to approve conflicts that would otherwise be a violation of section 175.[1063] One point to consider is that for the board approval to produce its effects of releasing directors from liability, the required quorum in the meeting must be satisfied[1064] and such approval must be given by the votes of disinterested directors without counting the votes of interested directors.[1065] Section 175 remains silent about what is meant by 'interested directors' and whether persons connected to directors (e.g., family members) are also captured by the statutory provision. Thus, it is the court's task to decide which of the directors are categorised as interested directors.[1066]

4.4.2 The directors' exploitation in Saudi law: An area of deficiency

As has been shown, the UK law has reacted appropriately to the issue of directors' exploitation and developed a regulation protecting the rights of companies and, accordingly, its shareholders from opportunistic conduct by directors. This is not seemingly the case under Saudi law where both the CL 1965 and its successor the CL of 2015 lack any provision expressly preventing directors from exploiting corporate opportunities. Though there was a concern about diluting the strict approach to directors'

[1058] *Final Report* (n 686) para 3.23.
[1059] Ibid.
[1060] Section 175(5)(b) of the CA 2006.
[1061] Section 175(5)(a) of the CA 2006.
[1062] Section 180(1) of the CA 2006.
[1063] Section 180(4) of the CA 2006; the Explanatory Notes to the CA 2006, para 340.
[1064] Section 175(6)(a) of the CA 2006.
[1065] Section 175(6)(a) and (b) of the CA 2006.
[1066] Davies and Worthington (n 2) 556.

exploitation of opportunities in the UK, as this may tempt directors to benefit themselves at the expense of the company by taking up an opportunity,[1067] equally, if not more, concerning is the situation where the corporate statute (such as in the case of Saudi Arabia) does not expressly regulate the issue at all. It is clear that the absence of sufficient and well-defined regulation in the corporate statute could undermine directors' accountability, and leave the company and its shareholders unprotected. The main problem is that in the absence of legislative intervention, the court is unlikely to fill the legislative vacuum and develops effective regulation controlling the directors' discretion to exploit an opportunity or information. Equally, if the shareholders' protection against the directors' exploitation is left to the company's articles of association, this would not provide them with sufficient legal protection, increasing the incentives of directors to utilise their position to benefit themselves at the expense of shareholders. The following case concerning the limited liability of companies illustrates this point:

In the reported case number 725/1/Q,[1068] the action was brought by a member of company (A) against a former director (who was also a member of the company) to recover sums of money amounting to more than USD 8 million, which were profits made by him following the conclusion of some agreements with the third party in the course of his directorship, which were not disclosed to the board of company (A), as was required by the articles of association. The action was based upon the allegation that the director of company (A), in his negotiations with company (B) to hire a ship with an option to purchase it during the term of the lease, and after it had come to his knowledge that the company would purchase the ship, secretly made an agreement with company (B), whereby the latter was to sell to him a part of the ship at cost price, after the director had ensured that company (A) would sign the lease. The director, by using information obtained in his capacity of a director for his benefit, made a profit of about USD 3 million as a result of the company's purchase of the ship. As a representative of company (A) empowered to conclude other agreements with third party companies, the director also made profits (i.e., commissions) amounting to (more than USD 5 million).[1069] As a matter of fact, the articles of association of company (A) permitted directors to contract with the company and to make profit by reason and in the course of their directorship without any legal consequences.[1070] The court ruled that the director was not liable to account to the

[1067] Keay (n 6) 323.
[1068] The Board of Grievances, Case No. 725/1/Q, Appeal Division Decision No. 4/T/85, 1996 (1415H).
[1069] Ibid 54–55, 58.
[1070] Ibid 62.

company for the profits made during the course of his tenure.[1071] The court based its judgments on the following: the articles of association allow directors to obtain profits from agreements made for the company or by reason of their directorship; there is nothing in Sharia law or the corporate legislation preventing directors from making profits; the company did not suffer any losses as a result of unauthorised profits made from the director's agreements with third party companies.[1072]

The effect of an absence of a legislative ban on directors' exploitation of information to make unauthorised profits is made clear in the above case. Furthermore, if there were at least a recognition of the no-profit rule under the Saudi law, the director would not have evaded the liability to pay back unauthorised profits to the company. The court was unwilling to consider the director's personal gain as constituting a conflict of interests, thereby implicitly refusing the company's argument based on the director's breach of his fiduciary and trust duty.[1073] The contractual term set forth in the articles of association protected the director from any liability resulting from making profits and of failing to disclose his interest.[1074] Importantly, the court would perhaps have reached the same conclusion even in the absence of such a contractual term because the court clearly said that there was nothing in the law preventing directors from making profits during the course of their directorship.[1075] In the context of joint stock companies, it can be submitted that since the CL is devoid of a clear statutory provision addressing the issue of exploitation, the court is unlikely to develop the corporate opportunity rule. This diminishes restrictions on the directors' capability personally to taking up a business opportunity. If this case were brought under UK law, the defendant would most probably be found liable for the breach of the duty to avoid conflicts of interest.

While it is true that the Saudi law through the corporate statute does not expressly regulate the exploitation of corporate opportunities, one may think that the law indirectly addresses the issue through the no-compete rule and the new article 74 of the CL 2015. This argument will be discussed below in the context of Saudi law, demonstrating that the deficiency and uncertainty of the law places very limited, or no, restrictions on the extent to which a director can personally exploit an opportunity encountered during the course of his directorship.

[1071] Ibid 64.
[1072] Ibid 63.
[1073] Ibid 55, 60.
[1074] Ibid 63–64.
[1075] Ibid 63.

4.4.2.1 The no-compete rule

Some jurisdictions adopt the narrow approach, which relies upon the duty not to compete with the company and prevents directors from engaging in economic opportunities that fall within the company's scope of business.[1076] In the context of Saudi law the 'no-competing rule' set out in article 72 of the CL 2015 (article 70 of its predecessor of 1965) requires directors not to 'participate in any business *competitive* with that of the company or *compete* in any commercial activities carried on by the company' [emphasis added].[1077] However, whether or not this article will be broadly interpreted by the court to include the exploitation of corporate opportunities is a difficult question to answer due to the lack of any judicial guidance. Given the fact that the wording of article 72 does not suggest extending its application beyond the issue of competition with companies, makes it appear unlikely that the court will go further in its interpretation and widen the scope of the no-compete rule to include directors' exploitation of corporate opportunities.

Importantly, from the legal perspective, the approach that relies on the no-compete rule to address the issue of exploitation is flawed. Although the exploitation of corporate opportunity and competition with companies sometimes overlaps,[1078] each focuses on a different aspect of the duty of loyalty and therefore should be dealt with separately. According to article 72 of the CL 2015, directors are expected not to compete in activities similar to those carried out by their company. The court inquiry into whether or not there is a breach of the no-compete rule tends to focus on whether or not actions taken by directors placed them in competition with the company; in other words, for the purpose of article 72, the court analyses competition as a basis of liability. This means that the court's use of competition inquiry confines the appropriation of corporate opportunity as a basis of liability where the exploitation only amounts to competition with the company.[1079] The corollary of that approach is that directors might not be liable for a breach of article 72 in a situation where they take up an opportunity in keeping with the company's business that does not involve competitive actions.

[1076] Gerner-Beuerle, Paech and Schuster (n 613) 21.

[1077] However, with prior authorisation from shareholders, directors may compete with their company.

[1078] For example, directors may be aware of information or commercial opportunity and then use it to compete with their company.

[1079] In US law, competition with the company is usually viewed as involving questions of the exploitation of corporate opportunities, see J Popofsky, 'Corporate Opportunity and Corporate Competition: A Double-barreled Theory of Fiduciary Liability' (1982) 10 Hofstra Law Review 1193, 1205

To clarify this point, consider the following hypothetical example: suppose that a director of company (A) selling fashion clothes for women in a particular city or region (e.g., Riyadh) had, by virtue of his directorship, learnt of a business opportunity to join and establish company (B), which is the same kind of business as company (A), but in another city or region (e.g. Makkah). Since the business of companies (A) and (B) cover *different* geographic areas, the director's use of the business opportunity might not amount to competition with his company (A), from the viewpoint of competition analysis and therefore the director would not be in breach of article 72 (no-compete rule). However, applying the corporate opportunity inquiry which should focus on the relationship between the opportunity and the company's commercial activity, it is likely that the director would be liable for exploiting an opportunity that falls within company A's line of business, regardless of whether or not the exploitation leads him to be in competition with the company. Furthermore, another drawback of the approach that relies upon the no-compete rule is that the scope of a company's interest does not cover every profit-making opportunity[1080] in which directors are subject to very limited restrictions on their ability to personally exploit an opportunity encountered while serving as directors.

Another problem associated with the application of article 72 of the CL 2015 to the conflict of interests is what remedy is available for the company. The company is statutorily entitled to seek compensation for losses caused by directors' competition with the company.[1081] It is incumbent upon the company claimant to prove losses in order for the compensation to be awarded.[1082] While this remedy might be appropriate for the breach of the no-compete rule, this is not the case in connection with cases of corporate opportunities. In the UK and elsewhere, the law of corporate opportunities 'has developed as a specific application of the no-profit rule' because the main rationale for taking an opportunity is to make profit.[1083] This means that once a director has been found liable for usurping an opportunity, the company should be entitled to recover any profit from the director without the need to prove the loss.[1084] Indeed, if the remedy available for the company is compensation, as set forth in article 72 of the CL 2015, the burden of proof of loss would be the main challenge faced by the company claimant, and this tends to make it difficult to hold a director defendant to account for the exploitation of corporate opportunities.

[1080] For example, profit-making information exploited by the director in the case mentioned above, see footnotes 1068–1072 and the accompanying text in this Chapter.
[1081] See article 72 of the CL 2015.
[1082] See, for example, Case No. 725/1/Q (n 1068) 60.
[1083] Keay (n 6) 312–313.
[1084] See, for example, *Regal (Hastings) Ltd. v Gulliver* (n 1012).

To sum up, it can be suggested that the reliance upon article 72 of the CL 2015 (no-competing rule) to prevent directors from taking corporate opportunities is, in legal terms, wrong and does not provide the company and its shareholders with sufficient protection against directors' exploitation of business opportunities.

4.4.2.2 Article 74 of the Company Law 2015: The company's secrets

One of the elements presented by the new CL 2015 is to state clearly in article 74 that directors must refrain from exploiting the company's trade secrets obtained by reason of their directorship to benefit themselves or others.[1085] This category of information can be regarded as confidential information that belongs to, or is about, the company itself.[1086] It is clear from article 74 that the restriction is only limited to information that can be characterised as company secrets.[1087] It is therefore *beyond* the scope of the application of article 74 to cover both information that is not confidential (a trade secret) and information about an opportunity; in other words, the legal protection given to the company and its shareholders under article 74 is inadequate as the ban on exploiting trade secrets only applies to a very small category of information.

It should also be noted that article 74 of the CL 2015 adopts a total prohibition strategy in relation to the exploitation of confidential information. Such a conflict situation cannot be subject to authorisation by shareholders or the board of directors. This overly strict approach could be accepted in the context of confidential information, but not in relation to information about an opportunity.[1088]

4.4.2.3 The new development brought by the CGRs 2017 for listed companies

One of the main contributions of the new CGRs 2017 is to deal with the issue of the directors' exploitation of an investment opportunity or information. According to article 44(b)(2), directors are prohibited from personally taking up an opportunity or information presented to them in their capacity as director or to the company. The sub-article also adds that directors are required to avoid exploiting opportunities that 'are

[1085] It should be noted that the old version of article 74 of the CL 2015 (article 72 of the CL 1965) only prohibited disclosure of the company's secrets and did not provide a ban on exploitation.
[1086] Jobran (n 632) 288.
[1087] Ibid 278.
[1088] The disadvantages of a total prohibition strategy without an authorisation process will be highlighted in the section (4.4.2.3) in this Chapter.

within the activities of the company, or which the company wishes to make use of'. From the wording of article 44(b)(2), some critical remarks can be made concerning the regulation of corporate opportunities in the CGRs 2017.

First, it is clear that the CGRs 2017 have adopted the total prohibition approach to the issue of corporate opportunities without the adoption of authorisation process. While this approach has the benefit of being easy to apply and of creating a sufficient degree of clarity,[1089] it is simultaneously associated with some drawbacks. The total prohibition will produce a total state of inflexibility in which it broadly biases the balance between the control/accountability and discretion/authority towards the former.[1090] By contrast, the authorisation process under article 175 of the CA 2006, as has been noted, is expected to move the balance towards authority/discretion[1091] and to lessen the inflexibility of the regulation of corporate opportunities, by permitting directors' exploitation after obtaining the company's approval. Given the fact that the CGRs 2017 do not expressly involve a disclosure requirement in relation to the issue of corporate opportunities, the total prohibition strategy might largely encourage directors to divert investment opportunities secretly to themselves, a practice that 'is not good for board transparency and accountability'.[1092]

Second, the scope of what constitutes a corporate opportunity, under article 44(b)(2) of the CGRs 2017, lacks clarity and sufficient control over directors' exploitation, which could undermine the deterrent effect of the prohibition rule. Although it is hard to give conclusive answers due to the vague drafting of the article and the absence of judicial guidance, the wording of article 44(b)(2) may suggest that the prohibition includes only investment opportunities that fall within the business activities of the company and, if so, the question remains unresolved about whether the line of business test is limited to the present activities or allow for future development or expansion of the company. If this was the case, this means that the prohibition rule may not capture a wide range of profit-making opportunities and there is therefore a large possibility for directors to take an opportunity for themselves rather than for the company without being liable for the breach. Furthermore, it is unclear whether the incapability of the company or other considerations (e.g., the directors' good faith) are relevant to the court's inquiry about the directors'

[1089] Keay (n 1029) 154.
[1090] Ibid 136.
[1091] Ibid.
[1092] A similar argument has been presented in relation to the use of a prohibition strategy in a conflict situation, see ibid 154.

liability for breach of their duty. This lack of detailed rules and guidance has an undesirable effect that is widening the scope for judicial discretion, which would largely expand the legal uncertainty in this area of law.[1093]

Third, it is clear that directors can take up an opportunity where the company does not wish to exploit it. However, the CGRs 2017 do not specify which company organ (the board of directors or the general meeting of shareholders) should have the power to express the company's wish. The fourth point to consider is that, as has been said earlier, the CMA is responsible for ensuring compliance with the CGRs 2017 and is expected to enforce mandatory provisions on the basis of comply or be penalised.[1094] The question is what if the company or the minority shareholder decided to sue directors for the breach of their duty set forth in article 44(b)(2). The role of private enforcement action in relation to provisions of the CGRs 2017 is still unclear, although it might be available for the company, especially that the company is required to prepare its own corporate governance in accordance with the CGRs 2017.[1095] The problem with article 44(b)(2) is that it does not involve a legal remedy for the company, the party that is directly affected by the appropriation of corporate opportunities.[1096] To be specific, doubts could be cast on whether the company is entitled to disgorge profits made out of the exploitation without the need to prove loss. Indeed, the company will be left with inappropriate remedy (i.e., compensation) if the disgorgement of profits, as a remedy for breach, is not available to the company.[1097]

4.5 Conflict of Interest: Self-dealing Transactions

The concept of self-dealing in the context of company law may be described as a situation where a director, who might be also a controlling shareholder, is on both sides of an agreement with the company;[1098] for example, in the purchase or sale of company property. This type of transaction clearly involves a conflict of interests. In this regard, it might be true to say that mandatory disclosure, board approval and/or shareholder approval are legal strategies employed to control directors' exercise of powers. Failure to comply with those

---

[1093] The appropriate approach to the issue of corporate opportunities for Saudi jurisdiction will be further discussed while examining the transplantability of the UK model to the Saudi context; see section (6.4.2.3.1), Chapter 6 in this thesis.
[1094] See section (1.4.3), Chapter 1 in this thesis.
[1095] Article 94 of the CGRs 2017.
[1096] In fact, this is related to a wider problem that is associated with the public enforcement of breaches of directors' duties; see generally section (5.2), Chapter 5 in this thesis.
[1097] See the discussion in section (4.4.2.1) in this Chapter.
[1098] Pacces (n 361) 233–234. This definition also applies to the situation where the corporate controller is a shareholder. However, this type of self-dealing transaction is beyond the scope of this study.

strategies then constitutes a breach of the duty of loyalty.[1099] This seems to be the case, as will be shown, in the company legislation of both the UK and Saudi Arabia. The main concern of the following sub-sections is to evaluate rules governing disclosure and authorisation mechanisms found primarily in the Saudi CL 2015 as compared with the UK CA 2006 in relation to corporate self-dealing.

4.5.1 The development of the law of self-dealing in the United Kingdom

When discussing the law's response to the issue of corporate self-dealing, it should be borne in mind that in developed jurisdictions such as the UK, the law had gone through a process of evolution until it reached its current form expressed in the CA 2006. Before the recent Act was passed, in the self-dealing case of *Aberdeen Rly Co v Blaikie Bros*, the House of Lords emphasised the strictness of a judicial approach to conflict of interest transactions (including self-dealings) by saying that it was irrelevant to review whether or not the terms of the directors' contract were fair in determining a breach of the no-conflict rule.[1100] The rejection of the fairness test was rationalised on the basis that wat is 'impossible', at least in most cases, for the court to undertake a fairness review to decide whether the directors' contracts represented 'the best' agreement for the company.[1101] While the purpose of the fairness approach is to make sure that terms of the self-dealing transaction were fair for the company, the focus of the 'self-dealing rule' is to ensure the directors' adherence to the duty of loyalty,[1102] of which the avoidance of conflicts is an essential element. As one commentator further explained, if the fairness review approach to regulating self-dealing transactions were adopted, this would place directors under a lower standard of loyalty.[1103]

The judgment in the case of *Aberdeen Railway* tends to be read as following the total prohibition approach to self-dealing transactions.[1104] This regulatory strategy has been criticised on the basis that it prevents the company from entering into self-dealing transactions that are efficient,[1105] and involve 'more favourable terms' than those with a

---

[1099] Enriques, Hertige and Kanda (n 364) 155.
[1100] *Aberdeen Rail Co v Blaikie Brothers* (n 1004) 252 (*per* lord Cranworth LC).
[1101] Ibid. 252–253 (*per* lord Cranworth LC).
[1102] J Farrar and S Watson, 'Self-Dealing, Fair Dealing and Related Party Transactions: History, Policy and Reform' (2011) 11 Journal of Corporate Law Studies 495, 505.
[1103] Kershaw (n 310) 482.
[1104] D Kershaw, 'The Path of Fiduciary Law' (LSE Law, Society and Economy Working Papers, 6/2011) 28 <http://www.lse.ac.uk/collections/law/wps/WPS2011-06_Kershaw.pdf> accessed 10 January 2017.
[1105] L Enriques, 'The Law on Company's Directors' Self-Dealing: A Comparative Analysis' (2000) 2 International And Comparative Corporate Law Journal 297, 303.

third party.[1106] This argument goes on to say that self-dealing transactions perhaps have positive effects on the company since they are likely to lower transaction costs and might provide the company with the only available way to access necessary products.[1107]

As a result, the strictness of no-conflict can be minimised in the context of corporate self-dealings by resorting to two methods. First, the shareholders' approval could be sought to allow or ratify the interested directors' agreement with the company.[1108] Second, the equitable rule of no-conflict was to be treated as a default one, which is subject to contractual alterations through the company's articles of association.[1109] The second method was adopted by the court in *Imperial Mercantile Credit Association v Coleman*, [1110] when it allowed a director to keep the profit made from a self-dealing contract, because he had complied with the authorisation process set out in the company's articles of association.[1111] As the court asserted, it was left to shareholders to determine whether or not the permission for directors to enter into self-dealing transactions was useful to the company and the role of the court was limited to enforcing the process set out in the articles.[1112] Therefore, under the common law, it seems that the company is free to stipulate through its articles any mechanism of authorisation, such as disclosure to the board with disinterested directors' approval,[1113] or simple disclosure.[1114] This freedom for the company to derogate from the equity rules reached its height under the common law, where articles of association could allow interested directors to engage in self-dealing contracts without even declaring their interest.[1115]

The combination of fiduciary law rules and contractual alteration can be regarded as a reasonable reaction to the commercial need to make the equitable rule less strict.[1116] Nevertheless, this flexible approach to corporate self-dealings was not without critics. As Kershaw said, the flexible approach based upon contractibility does not provide shareholders with sufficient protection and undermines the accountability of directors.[1117] Therefore, it might be important to shift towards making substantive rules governing self-

---

[1106] Enriques, Hertige and Kanda (n 364) 154.
[1107] Enriques (n 1105) 305 referring to R C Clark, *Corporate Law* (Little Brown & Co., 1986) 184–187.
[1108] Kershaw (n 1104) 28.
[1109] Ibid 30.
[1110] *Imperial Mercantile Credit Association v Coleman* (1871) L.R. 6 Ch App 558.
[1111] Ibid. 558, 569–570.
[1112] Ibid. 568.
[1113] Ibid. 560.
[1114] *Boulting v Association of Cinematograph, Television and Allied Technicians* (1963) 2 QB 606 , 636.
[1115] Davies and Worthington (n 2) 518.
[1116] Kershaw (n 1104) 31.
[1117] Ibid.

dealings mandatory.[1118] The necessity of mandatory rules is illustrated by legislative intervention where directors are obliged to disclose their interest to the board regardless of any provision in the company's bylaw.[1119]

The CA 2006 affirms the adoption of this approach to corporate self-dealings, which are mainly regulated under two provisions. While section 177 is concerned with directors' duty to disclose interest in proposed transactions, section 182 relates to the disclosure of interest in the case of any current dealings. According to the CA 2006, in principle, directors are only obliged to disclose their interest to the board[1120] without statutory requirement for any approval, except in certain situations set out in Chapter (4) of Part (10) of the CA 2006 where the approval of shareholders is required. It should be noted that section 177, as other statutory general duties of directors, are mandatory provisions that cannot be departed from.[1121] This means that the company's bylaw can adjust the mandatory rule upwards (by demanding approval by shareholders), but cannot adjust it downwards (by derogating the disclosure requirement in section 177).[1122]

4.5.2 Article 71 of the Company Law 2015: Important changes in the law

In Saudi law directors' engagement in self-dealing is currently regulated under article 71 of the CL 2015 (article 69 of its predecessor of 1965). Sub-article (1), states as follows:

> A Board member shall not have any direct or indirect interest in the businesses and contracts that are made for the company's account, except with a *prior* authorisation from the Ordinary General Assembly to be renewed each year. A Board member shall inform the Board of Directors of any personal interest he may have in businesses and contracts made for the account of the company. Such declaration shall be recorded in the minutes of the meeting. The interested member shall not participate in voting on the resolution to be adopted in relation to this matter in *the board of directors or shareholders' assemblies*. The chairman of the board of directors shall inform the Ordinary General Assembly, when it convenes, of the activities and contracts in which any member has a direct or indirect and shall attach to such notification a special report prepared by the external company's auditor. [Emphasis added.]

[1118] Ibid.
[1119] See Davies and Worthington (n 2) 518, who give an example of a provision presented in 1929 that became section 317 of the CA 1985.
[1120] Sections 177 and 182 of the CA 2006. Note the scope of section 177 of the CA2006 is subject to statutory limitations in which certain interests are excluded from the obligation of declaration, see section 177(5) and (6) of the CA 2006.
[1121] Section 232(1) and (2) of the CA 2006.
[1122] Section 180(1) of the CA 2006.

It is clear that director are not absolutely banned from entering into transactions or business with the company. Instead, they are expected to follow the authorisation procedures set out in article 71(1) if they wished to avoid liability for breach of the self-dealing regulation.

At the outset, it is important to highlight some important contributions made by article 71 of the CL 2015 in terms of certainty and the reform of law. Compared with the CL 1965, directors are no longer exempted from disclosure in relation to self-dealing transactions entered into via general biddings where they are 'the best bidder'.[1123] This new legislative change has been a response to justifiable criticisms directed at the old version of the statutory provision.[1124] It therefore seems that the new provision offers more protection to the company and its shareholders against any attempt to derogate from the disclosure requirement. In addition, the new statutory provision has brought an end to the uncertainty concerning whether or not an interested director (who is also shareholder) is able to vote on self-dealing transactions at the general meeting. It is now expressly stated in article 71(1) of the CL 2015 that the interested director is not allowed to vote at the general meeting. Another development brought by the new provision is the requirement to seek shareholders' authorisation before engaging in any transaction or business with the company, an issue that will be discussed more fully later.[1125] Furthermore, unlike the CL 1965, the new legislation provides remedies for the company in the case of the directors' failure to disclose their interest; that is, the right to file suit for the rescission of contract or for giving up any profit made from corporate self-dealings.[1126]

Having considered the main developments in the regulation of self-dealing, the extent to which the new CL 2015 makes any improvement in terms of certainty and directors' accountability will be examined in the following sub-sections in comparison with the UK CA 2006. The analysis below will also consider, where necessary, the development brought by the new CGRs 2017 in the area of directors' engagement in self-dealing transactions.

4.5.3 The duty of disclosure to the board of directors

Disclosure is one of the most crucial tools to legally constrain the diversion of corporate assets at the expense of the company. The importance of this legal strategy lies in its role to

[1123] See article 69 of the CL 1965.
[1124] See, for example, Jobran (n 632) 276.
[1125] See section (4.5.5) in this thesis.
[1126] See article 71(2) of the CL 2015.

caution market participants against corporate self-dealing[1127] in order to deter the occurrence of unfair self-dealing transactions.[1128] It is important at this stage to bear in mind that the disclosure of self-dealing transactions, as Enriques notes, is included in the law in two ways. [1129] Generally, the first approach of disclosure does not have an impact on 'the validity of the transaction or on directors' liability for [the] unfair [transaction]'[1130] because the disclosure here is required for the purpose of giving the market necessary information to keep the stock 'efficiently' valued.[1131] This manner of disclosure is beyond the scope of this research. The second type, which is dealt with here, is where the law places directors under the obligation to disclose their interest as a 'procedural' condition for the validity of self-dealing transactions.[1132] This disclosure requirement is the one that relates to section 177 and 182 of the UK CA 2006 and article 71 of the Saudi CL 2015.

In both jurisdictions, directors are not only required to disclose their direct interest, but also their indirect interest in a proposed transaction with the company.[1133] The phrase 'indirect interest' embraces situations where directors are shareholders in a business who are proposing to enter into a contract with the company.[1134] In the Saudi market where the majority of companies, including those listed in Tadawul are controlled by blockholders,[1135] the statutory requirement to declare an 'indirect interest' is highly necessary if the court interprets it as including transactions between the company and persons connected to members of the board. As Al-Jaber argues, the statutory rule of self-dealing should include dealings between the company and the third party in which the latter is either a family member of the director[1136] (e.g., spouse and parents) or any person who enters into a contract with a company on the directors' behalf.[1137] Furthermore, the phrase 'indirect interest' could additionally include circumstances where the controlling shareholder has an interest in the corporate transaction and the directors are linked to them.[1138] Nevertheless, it must be noted that while it might be possible to apply article 71(1) of the CL 2015 to a transaction between the company and a third party connected to

[1127] Enriques, Hertige and Kanda (n 364) 155.
[1128] Pacces (n 361) 241–242.
[1129] Enriques (n 1105) 307.
[1130] Ibid.
[1131] Pacces (n 361) 243.
[1132] Enriques (n 1105) 307, 311.
[1133] See section 177(1) of the UK CA 2006 and article 71(1) of the Saudi CL 2015.
[1134] For the UK, see Kershaw (n 310) 493; for Saudi Arabia, see Al-Jaber (n 71) 331.
[1135] See generally section (2.5.2), Chapter 2 in this thesis.
[1136] Al-Jaber (n 71) 331.
[1137] Ibid.
[1138] For listed companies, this scenario could be captured by the definition of 'related parties' in article 1 of the CGRs 2017.

the director, the text of article 71(1) from the legal viewpoint explicitly imposes the obligation of disclosure upon directors and only they are subject to the statutory provision.

In respect of the scope of disclosure, directors under section 177 of the UK CA 2006 are obliged to disclose the nature and the extent of interest, whereas article 71 of the Saudi CL 2015 lacks the detailed regulation that one would expect from the director in relation to the disclosure requirement. This issue has been addressed by the CGRs 2017 through article 30(14), which requires an interested director to disclose 'the nature and the extent of [the] interest, the names of concerned persons, and the expected benefit to be obtained directly or indirectly from interest whether financial or non-financial'. Another point to consider is that the CA 2006, through s 182(1), makes it clear that if the interest has not already been disclosed in accordance with s 177, directors[1139] are obliged to disclose personal interest in existing transactions or arrangements. The *ex post* disclosure mentioned in s 182 will be made, for instance, in relation to 'interests of a newly appointed director' in the company's current transaction or in situations where directors have become interested after a transaction has been entered into.[1140] Mechanisms governing the declaration in existing transactions (section 182) are identical to those applying to proposed transactions (section 177) with a few exceptions,[1141] such as that regarding the consequences of a director's failure to disclose properly.[1142] In Saudi CL 2015, no such distinction has been made between a proposed or exiting transaction in terms of the disclosure requirement. Nevertheless, the duty found in article 71(1) of the CL 2015 should be seen as a continuing duty in which directors are always required to disclose their interest once they have become aware of a conflict situation; and this should at least be expected from a director of a listed company.[1143]

4.5.4 Approval by disinterested directors

As explained above, the CA 2006 only requires interested directors to disclose their personal interests with regard to self-dealing transactions. On top of that requirement, it is left to a company through its articles of association to stipulate that the approval by the

---

1139 As secion 187(1) of the CA 2006 provides, section 182 applies to a shadow director, but with certain adaptations stated in subsections 187(2)(3) and (4).
1140 Davies and Worthington (n 2) 523.
1141 See generally ibid 524.
1142 Non-compliance with the duty mentioned in section 182 only gives rise to criminal sanctions, whereas civil remedies are available for the breach of duty found in section 177; see section 183 of the CA 2006. See also section 178(1), which provides that civil sanctions are available for the breach of directors' duties in sections 171 to 177.
1143 See article 43(4) of the CGRs 2017.

board of directors is required as a condition in the case of a self-dealing transaction.[1144] Once the company's bylaw demands such an authorisation mechanism, directors need to comply with it since adherence to provisions of the company's bylaw is a statutory duty imposed upon directors by section 171 of the CA 2006. It should be noted that the directors' failure to follow the approval mechanism mentioned in the bylaw would result in a breach of section 171(a), not section 177 because only the failure to disclose will constitute a breach of the duty found in section 177. In Saudi Arabia the law does not explicitly state that the board must approve a self-dealing transaction; in other words, the board's approval is not mandatory as a procedural requirement for the validity of the transaction unless otherwise stipulated. Nevertheless, it can be implied from the wording of article 71(1)[1145] that the board's recommendation can be sought by the interested director prior to notifying the general meeting of a self-dealing transaction.

When the discussion focuses on the approval of the board of directors, it becomes important to address the issue of impartiality on the part of directors who approve a self-dealing transaction. In the UK, it is a matter for the company's articles of association to determine whether or not there must be approval by only disinterested directors. For instance, companies that still apply Table A articles, or that are shaped by Model Articles issued pursuant to the CA 2006 will include in their articles of association a provision that disallows approval by interested directors.[1146] Unlike the UK, the Saudi legislation makes it clear that an interested director is not allowed to vote on a transaction in which he/she has a personal interest.[1147]

The central problem resulting from the approval by the board members is that disinterested directors may not have the genuine capacity to act as 'disinterested trustees'.[1148] For example, the CL 2015 does not explicitly prevent members of directors' families (who are also board members) from voting on self-dealing transactions. Nevertheless, given the concept of indirect interest, the rule requiring approval by disinterested directors should be narrowly interpreted to exclude members of directors' families although they may have no specific interest in the conflict situation. More importantly, the broader the concept of 'family member' is interpreted, the more legal protection for shareholders (especially

[1144] See above texts accompanying footnotes 1120–1122 in this Chapter.
[1145] See the text of article 71(1) in section (4.5.2) in this Chapter.
[1146] See section 94 of the Table A articles issues according to the CA 1985. Under the CA 2006, see section 16 of the Model Articles for Public Companies. Note that section 16(3) provides an exception to this general rule.
[1147] Article 71(1) of the CL 2015.
[1148] Enriques, Hertige and Kanda (n 364) 162.

minority shareholders) is provided. In Saudi law neither the CL 2015 nor the CGRs 2017 involve a provision disallowing a friend or a family member of directors to be seated on the board or on one of its committees. Given the fact that the Saudi society is characterised by strong family and tribal ties,[1149] the ability of a person connected to an interested director to make an independent judgement will be questionable in respect of challenging unfair self-dealings.[1150] Another problem is that article 71(1) discounts the possible influence of interested directors in decisions concerning the approval of self-dealing transactions, since the statutory provision does not preclude directors from participating in discussions relating to authorisation.[1151]

As has been noted, the Saudi corporate statute and the UK Model Articles focus on the approval of disinterested directors. Apparently, the identity of disinterested directors cannot be determined until a transaction is brought to the table for authorisation; in other words, disinterested directors will not always be the same person.[1152] It should be noted here that the corporate governance literature always hinges upon independent directors playing a fundamental role in challenging conflicts of interest transactions.[1153] This is because those elected as independent directors are more likely to be 'less conflicted' than executive directors when 'representing shareholder interests'.[1154] However, as discussed earlier in Chapter 2,[1155] the ability of independent directors to make truly independent judgements is in doubt because they may be influenced by family connections or long-standing friendships with other directors and controlling shareholders, coupled with the fact that the mechanism of their nomination and appointment under Saudi law, would lead them to act in the interest of those who select them.

4.5.5 Approval by general meeting of shareholders

Under the CA 2006, Chapter (4) of Part (10) of the Act highlights situations where shareholders' approval is obligatory in cases of a company's transactions with directors. Without going into details, it suffices to mention that the CA 2006 in sections 188–225

[1149] Falgi (n 208)128–129.
[1150] It is common to find in some companies (especially family companies) more than one family member sitting on the board of directors. See, for example, the profiles of the following companies: Zamil Industrial (building and construction sector) and Dar Al Arkan (real estate development sector) on the Tadawul website at <http://www.tadawul.com.sa> accessed 21 January 2017.
[1151] Keay (n 1029) 140. It should be noted that the Saudi CGRs 2017 prevent interested director from taking part in its deliberations at the board meeting and the general meeting, see article 44(2) of the CGRs 2017.
[1152] See Clarke (n 532) 105 who describe it as a transaction-by-transaction approach.
[1153] See particularly footnotes 531– 538 and accompanying text, Chapter 2 in this thesis.
[1154] D Clarke (n 532) 106.
[1155] See footnotes 565–573 and accompanying text, Chapter 2 in this thesis.

specifies and regulates four categories of transactions that require the consent of company members; they are: (i) substantial property transactions,[1156] (ii) loans to directors and similar transactions, (iii) matters related to directors' service of contracts, and (iv) matters related to payments to directors for loss of their office.

In Saudi law article 71(1) of CL 2015, unlike the CL 1965,[1157] makes it clear that company directors shall not have an interest in the company's transactions except with *prior* authorisation from the general meeting of shareholders to be renewed each year. The disclosure process provides that the board's chairman is responsible for declaring to the general meeting of proposed transactions in which a director may be personally interested. Such notification has to be accompanied by a report of the company's external auditor.[1158] To ensure the proper investigation of a situation involving conflicts of interest, each self-dealing transaction should be listed in the agenda of general meeting 'as an independent item' without combining them under a single item for the purpose of voting.[1159]

It should be considered that the approval by shareholders might be associated with some problems. First, for jurisdictions where their laws require the prior approval for corporate self-dealings, the convening of general meeting could be costly and impractical.[1160] Second, it should be more concerned with those who receive the information.[1161] Doubts can be cast on the incentives, skills and knowledge of shareholders, especially minority shareholders, who are expected to inspect self-dealing transactions.[1162] Third and more importantly, it has been said that unless the law effectively prevents interested shareholders from taking part in voting, this strategy will be 'tainted by conflict of interest'.[1163] In Saudi law interested directors, who are also a shareholder, are excluded from voting on a transaction in which they have personal interest.[1164] However, the Saudi corporate statute overlooks the need to prevent interested shareholders (other than interested directors) or persons connected to

[1156] This category of transaction refers to arrangements in which a director acquires from the company, or vice versa, a substantial non-cash asset that is valued at more than either GBP 100,000 or 10% of the company's net assets, on the condition that the latter price exceeds GBP 5,000, see sections 190(1) and 191 of the CA 2006.
[1157] The previous legislation of 1965 through article 69 provides that a director shall not have interest in a contract with the company 'except with authorisation from the Ordinary General Assembly'. It did not specify whether it must be obtained *ex ante* or *ex post* entering into the contract. In the legal sense, the timing of approval might be insignificant as it often carries 'the same legal effects', see Enriques, Hertige and Kanda (n 364) 168–169.
[1158] Article 71(1) of the CL 2015.
[1159] Article 14(b) of the CGRs 2017.
[1160] See the CLRSG's reasoning for being in favour of the board's approval in relation to the authorisation process in the context of corporate opportunities; see footnote 1058 and accompanying text in this thesis.
[1161] Pacces (n 361) 246.
[1162] Ibid.
[1163] Enriques (n 1105) 325.
[1164] Articles 71(1) and 95(1) of the CL 2015.

interested directors from voting. There is nothing in the CL 2015 or the CGRs 2017 excluding, for instance, the directors' family members from participating in the voting at the general meeting. By contrast, although the UK CA 2006 remains silent on this issue, for companies with premium listing, directors' associates are expected not to participate in a vote at the general meeting.[1165] Indeed, since the Saudi law does not expressly prevent interested shareholders, especially interested directors' family members from voting, the obtaining of shareholders' approval, for the directors, is unlikely to be a significant issue. In spite of the absence of empirical studies, there are two compelling instances that illustrate this point. First, it is very rare to find a resolution by the general meeting of companies listed in Tadawul disapproving a self-dealing transaction.[1166] This low possibility of disapproval by shareholders increases self-dealers' incentives to enter self-dealing transactions. Second, the approval rates of the proposed resolutions in relation to self-dealing transactions were often not less than 98%;[1167] in other words, the opposition of shareholders was very modest when they are asked to authorise a transaction at general meeting.

4.6 Concluding Remarks

The main research activity in this chapter was to evaluate the effectiveness of the Saudi law on the following forms of the directors' duty of loyalty: the obligation to act in good faith in the company's interests and the obligation to avoid conflicts of interest, with particular focus on the application of this duty in the area of corporate opportunities and self-dealing transactions. The comparative analysis with the UK law reveals significant aspects of uncertainty and deficiency in the duties of loyalty in Saudi Arabia.

There are two main issues associated with the affirmative duty of loyalty in Saudi law. First, the components of the obligation (the duty to act in good faith and in the interest of the company) are not understood as a single obligation. This means that there is no duty to act in the company's interests to which the good faith requirement is tied. The corollary of

1165 See LR 11.1.8 <https://www.handbook.fca.org.uk/handbook/LR.pdf> accessed 30 July 2017.
1166 See the results of the general meeting of Saudi Industrial Services Co (02 May 2016) where the general meeting refused authorisation for most self-dealing transactions. Other than a very few cases, the large number of requests for the authorisation of self-dealing transactions were granted; see, for example, the results of the general meetings of the following companies: Jouf Cement Co. (14 June 2016), National Petrochemical Co. (05 April 2016) and Untied Wire Factories Co. (30 Marc 2016). The above information was found on the Tadawul website at <https://www.tadawul.com.sa>.
1167 See, for example, the minutes of the general meeting of Herfy Food Services Co. (28 April 2015, <http://www.herfy.com/mubasher/run_con/GenAssemblyMinutes28042015.pdf> accessed 12 January 2017. See, for example, the minutes of the general meeting of Zamil Industrial Co., 09 April 2015, <http://www.zamilindustrial.com/pdf/ZI-OGA-09Apr2015.pdf> accessed 12 January 2017.

the absence of legislative and judicial recognition is that the duty of loyalty is left with an *inappropriate* standard of liability, which exposes directors to a high risk of accountability. Unlike the UK law, the Saudi law seemingly treats good faith as a freestanding obligation distinct from the broad duty of loyalty, with the effect that the court will be permitted to engage in an objective consideration of whether directors, in fact, acted in the general interests of the company. Second, when it comes to the question of in whose interests the company is to be managed, the Saudi law has failed to introduce clear rules governing the priority of competing interests. With reference to the elusive concept of 'the interests of the company', directors have been given wide discretion to determine what the interests of the company are and this weakens the shareholders' monitoring capability.

With regard to the requirement of avoiding the exploitation of corporate opportunities, the boundaries of the duty to avoid conflicts of interest are not clearly defined, and the law governing directors' exploitation is uncertain. In comparison with the UK law, the regulation of corporate opportunity, which comprises the clearly defining elements of liability determination and the authorisation mechanisms, is not sufficiently developed in the Saudi jurisdiction. This legislative and judicial vacuum would provide fertile ground for directors to divert the company's wealth to themselves. The chapter has shown that even with the new regulation of corporate opportunities under article 44(b)(2) of the CGRs 2017, some drawbacks and limits were identified above that could raise valid doubts about the effectiveness and clarity of the current state of law.

It is clear from the analysis of the law governing self-dealing transactions that the legal strategy of disclosure and/or approval is employed in both jurisdictions to control such self-interest activities. In this regard it should be acknowledged that the recent reform introduced by the CL 2015 and the new CGRs 2017 has put an end to some areas of uncertainty and deficiency. The comparative analysis reveals that the Saudi law places more constraints on the directors' engagement in self-dealing transactions than the UK law in the sense that both disclosure to the board[1168] and the prior approval by shareholders are mandatory in every transaction in which directors have a direct and indirect interest. While the UK CA 2006 contains more detailed rules governing the disclosure strategy than the CL 2015, the new Saudi CGRs 2017 have filled in the statutory gaps in relation to the disclosure strategy for listed companies. Nevertheless, there is still concern about the

[1168] It should be borne in mind that the board's approval can also be sought prior to the authorisation process at the general meeting.

effectiveness of approval by shareholders in the absence of express rules excluding interested shareholders other than board members from participating in the voting process.

Chapter 5: An Evaluation of Private Formal Enforcement of Breaches of Directors' Duties

5.1 Introduction

The importance of enforcement in the context of corporate governance has been stressed by saying that besides the role of laws and regulations, the effectiveness of enforcement is the major factor in the degree of protection given to corporate investors;[1169] in other words, good law and effective enforcement are prerequisites to the enhancement of investor protection.[1170] An improvement in this regard would, in turn, increase the motivation of outside investors to finance firms[1171] and minimise the expropriation of corporate wealth by insiders.[1172] In the context of directors' duties, the law of enforcement is expected to be a crucial element in the regulation of directors' duties. This is simply because the general obligations of care and loyalty are functionally meaningless without enabling those to whom directorial obligations are owed to 'hold' directors liable for violations of their obligations.[1173] Indeed, it has been rightly noted that the deterrent effects of directors' duties on their behaviour depend on the availability of an effective enforcement mechanism.[1174]

Generally speaking, the concept of enforcement can be divided into two broad categories: (i) formal and (ii) informal enforcement according to whether or not there is judicial intervention in the process of enforcement of directors' duties.[1175] While the formal enforcement takes the form of legal action brought before the court,[1176] non-judicial mechanisms of enforcement are known as 'informal enforcement'.[1177]Within each category the distinction can generally be recognised between private and public enforcement on the basis of whether the judicial and non-judicial intervention is made by a private party or

[1169] La Porta et al. (n 13) 15.
[1170] Ibid 15, 20.
[1171] Ibid 15.
[1172] Ibid 16.
[1173] Millstein et al. (n 373) 6.
[1174] Keay (n 7) 76.
[1175] J Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' (2008) ECGI Law Working Paper 106, 3 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1133542&rec=1&srcabs=1105355&alg=1&pos=3> accessed 22 September 2017.
[1176] Ibid.
[1177] Ibid.

government body;[1178] for instance, private formal enforcement involves a situation where a derivative suit is filed by a shareholder on behalf of the company against members of the board of directors.[1179]

In this regard, as has been shown in Chapter 2, *ex post* private non-judicial mechanisms such as the removal of directors at the general meeting and markets suffers from flaws and limits, which suggest that such mechanisms cannot substitute the need to put sound private judicial mechanisms for enforcement of breaches of duties in place. Indeed, the private enforcement action, of which a derivative claim is an important component, is one of the corporate governance mechanisms introduced to ensure the accountability of directors to the company and its shareholders.[1180] It is therefore indisputable that inaccessibility, deficiency and vagueness of the mechanisms of formal private enforcement in the context of directors' duties weaken the accountability of directors. This need for dealing with failings in the law governing the private enforcement action, particularly a derivative suit in Saudi Arabia, will be further supported by the limits to the role of formal public enforcement, as will be discussed below.

As far as the effectiveness of private formal enforcement is concerned, key questions have to be addressed in connection with which of the company's organs has the right to make the decision to litigate against directors, whether there are issues resulting from giving the board or the general meeting such right and, if so, which regulatory strategy is appropriate for addressing such problems. What if the company decides not to commence the litigation, on what conditions does the law entitle the shareholder to initiate the derivative action? Arguably, the inaccessible and vague mechanism of derivative litigation would undermine the legal accountability of directors for the breach of their duties. In addition, the costs of litigation could be a disincentive for the minority to rely on the judicial mechanism of accountability, a valid consideration while assessing the effectiveness of private enforcement action by a shareholder.

This chapter evaluates the Saudi law of private enforcement action with special consideration given to the issues raised above. The UK and Saudi laws will be critically analysed, exploring some areas of inaccessibility and deficiency in their private formal enforcement of breaches of directors' duties. As regards the structure, this chapter is

[1178] Ibid 3–5.
[1179] Reisberg (n 8) 18.
[1180] Keay (n 304) 219.

divided into five main sections. First, the extent to which public enforcement can play a role in the enforcement of directors' duties and whether there is a role for private enforcement action to play in complementing the public enforcement are considered. This is followed by a discussion of the different regulatory approaches to the question of who should have the power to initiate the litigation against directors, followed by a consideration of the UK and Saudi laws as far as the power of private litigation decisions is concerned. The focus then shifts to an analytical review of the UK derivative action system. The question of whether the derivative action is in fact clearly regulated in Saudi law is also explored. In the final part, the problem of funding in the context of derivative actions is considered, examining the position of the law in both jurisdictions.

5.2 The Respective Roles of Public and Private Enforcement

The public formal enforcement of breaches of directors' duties can either take the form of criminal sanctions (e.g., fines and imprisonment) or civil penalties (e.g., disqualifications and pecuniary penalties). Compared with private enforcement, public enforcement is expected to have greater deterrent effect on wrongdoing directors as it involves harsher penalties.[1181] In Saudi law one of main contributions of the new CL 2015 has been to introduce harsher penalties for violating its legislative provisions, compared with the CL 1965;[1182] for example, a director commits a criminal offence if he/she benefits himself/herself or any third party by intentionally using corporate assets, his/her managerial powers, or voting against the company's interests.[1183] These contraventions would give rise to the imposition of a sanction in the form of maximum five years' imprisonment and/or a fine not exceeding SAR 5 million (over USD 1.3 million).[1184] In the UK, unless the misconduct is clearly criminal activity (i.e., theft or fraud),[1185] the law does not allow criminal liability[1186] and the breaches of directors' duties are usually enforced by means of private enforcement.[1187]

While the criminal prosecution of individual directors would lead to greater deterrence compared with other enforcement mechanisms, its effectiveness does not only rely on the

[1181] A Keay And M Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' (2015) 15 Journal of Corporate Law Studies 255 , 260.
[1182] See articles 211–213 of the CL 2015.
[1183] Article 211(b) and (c) of the CL 2015.
[1184] Article 211 of the CL 2015. The regulator is required to refer to the public prosecutor who will have the right to initiate a legal action against those who are suspected of committing one of the contraventions set out in articles 211 and 212 of the CL 2015, see article 215 of the CL 2015.
[1185] See, for example, section 993 of the CA 2006 (fraudulent trading).
[1186] See Keay and Welsh (n 1181) 269.
[1187] Ibid 256.

harshness of the penalty, but it does also on the extent to which the wrongdoers would be detected and convicted;[1188] in other words, the effectiveness of the criminal enforcement regime will be undermined if the cost of finding wrongdoers guilty is too high.[1189] One of the issues associated with public formal enforcement is that a criminal conviction would be more difficult to obtain compared with proving the breach of a director's duties under the private enforcement system.[1190] The bar for evidence is also much higher in criminal cases than in civil cases, and courts in criminal proceedings are expected to be stricter in excluding evidence obtained unlawfully.[1191] The high costs of detecting, investigating and convicting wrongdoing directors under the criminal enforcement regime could be one of underlying reasons for the lax attitude of the Saudi MOCI towards enforcing criminal offences under corporate legislation.[1192] Indeed, the severity of penalties mentioned in the CL 2015 will have little effect on deterring directors if the statutory penalties are not enforced in practice.[1193] In the Saudi market there are some instances where harsh sanctions have been imposed for directorial misconduct, especially in relation to criminal activity that is deemed to be extremely serious and harmful to the market.[1194]

As a result of the above difficulties associated with criminal sanctions, one may rightly argue that the imposition of civil penalties by the public body can be a good alternative to criminal sanctions.[1195] In the Saudi CL 2015, although the public regulator is empowered to impose a fine without referral to the public prosecutor on those guilty of any violations set out in article 213,[1196] the scope of civil penalty provisions does not include the basic duties of directors.[1197] Similarly, UK law does not allow for criminal liability following the breach of general directors' duties, except for non-compliance with the disclosure duty mentioned

---

[1188] G Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 Journal of Political Economy 169, 170.
[1189] Ibid.
[1190] As a principle, an accused is considered innocent until proven guilty (the presumption of innocence principle); thus, judgments of criminal conviction must be based only on conclusive and clear evidence that convince the judge that a suspect is certainly guilty beyond doubt; see, generally, M Hosni, *Jurisdiction and Proof in the Criminal Procedure Law* (Arabic), (Cairo, Dar Al Nahda 1992) 58–73.
[1191] Ibid 54, 77.
[1192] M Albrahim, 'The Enforcement of Directors' Duties in the Context of Shareholders' Rights Protection: A Comparative Study Between UK and Saudi Law' (PhD thesis, Lancaster University 2016) 274; here the absence of reported prosecution against directors under the previous CL 1965 is noted.
[1193] Ibid.
[1194] For example, for cases related to insider trading violations, see the CRSD's resolution on insider trading in shares of the Bishah Agriculture Development Company reported in *Alriyadh* Newspaper (15031 edn 19 August 2009) (Arabic) <http://www.alriyadh.com/453290> accessed 25 July 2017.
[1195] See Keay and Welsh (n 1181) 263.
[1196] See article 216 of the CL 2015 which, in turn, allows those on whom the fine has been imposed to challenge the regulator's decision before the court.
[1197] For example, the duties to act in good faith, to act with reasonable care or to avoid directors' exploitation of corporate opportunities or engagement in unauthorised self-dealing transactions.

in section 182 of the CA 2006.[1198] For companies listed in the Saudi market, the CMA, unlike MOCI, is more active in ensuring compliance with the securities law and regulations by, for example, imposing fines on wrongdoers.[1199] This is illustrated by the CMA's imposition of a financial penalty of SAR 50,000 (USD 13,000) on each board member of the Saudi Chemical Company, following the board's failure to comply with the approval requirement in relation to the engagement in self-dealing transactions.[1200] It is noteworthy that the CMA's imposition of such fines was based on the violation of the Listing Rules 2004 and not on a violation of the previous CGRs 2006. There are also some cases where errant directors have been fined and disqualified as a result of judicial decisions following legal actions brought by the CMA because of their breaches of securities law and regulations.[1201]Another point to consider is that under the new CGRs 2017, directors are obligated to act with reasonable care and in good faith, to advance the company's interests[1202] and to avoid exploiting investment opportunities.[1203] It is indisputable that the company has no option other than to include the mandatory rules of the CGRs 2017 into its own corporate governance code.[1204] Given the CMA's approach to enforcing mandatory rules in the previous CGRs 2006, it is presumed that sanctions will be imposed on directors in the case of their breaches of directors' duties. However, at this stage, it is too early to determine whether or not the CMA will effectively discharge its duties in terms of ensuring compliance with the CGRs 2017 not only by the companies, but also by directors and managers.

In any event, when assessing the characteristics of the public enforcement regime, some additional difficulties and issues arise. For public enforcement to be effective, the public regulator needs to be armed with sufficient resources and expertise to detect, investigate and penalise wrongdoing directors; a logical consideration that may affect the effectiveness of public enforcement.[1205] Even if a regulator is well funded, the resources of the regulator

[1198] Section 183 of the CA 2006.
[1199] Compared with its counterparts in the region, the CMA is regarded as one of most active regulators in ensuring compliance with securities laws, see A Amico, *Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities* (OECD, OECD Corporate Governance Working Papers No. 15 2014) 27 <http://dx.doi.org/10.1787/5jxws6scxg7c-en> accessed 25 July 2017.
[1200] The penalty was imposed because of a violation of the LRs 2004; see the CMA's announcement published on its website on 18 October 2009 <https://www.cma.org.sa/market/news/pages/cma_n536.aspx> accessed 20 July 2016.
[1201] See the announcement of the CMA regarding the decision made by the CRSD (AC) in relation to a violation on the part of former board members of the Saudi Transport and Investment Co. <https://cma.org.sa/en/market/news/pages/cma_n_1966.aspx> accessed 26 August 2017.
[1202] Article 30(17) of the CGRs 2017.
[1203] Article 44(b)(2) of the CGRs 2017.
[1204] See article 94 of the CGRs 2017.
[1205] See A Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry' (2014) 43 Common Law World Review 89, 101–102.

responsible for the enforcement tend be limited in the sense that it is difficult to discover and investigate every contravention that comes to its attention.[1206] Under such a condition, the regulator would have to select carefully which breaches can be pursued.[1207] Ramsay correctly notes that the enforcement priorities chosen by the regulator might not be appropriate and effective, and this underlines the important role of private enforcement within the overall system of enforcement.[1208] Given the austerity policy pursued by the Saudi government as a means of reducing the fiscal deficit,[1209] public enforcement of directors' duties could be indirectly affected.[1210] In the same line of analysis, the role of MOCI in enforcing breaches of company law, as mentioned above, is questionable and there have been no reported penalties imposed to date. Even regarding the CMA's approach, some argue that there has been a failing in imposing adequate sanctions and penalties upon wrongdoers[1211] and there is still much work to be done in terms of monitoring the companies and encouraging investment in the market.[1212]

Importantly, as a matter of policy, the enforcement of directors' duties should strike a balance between two competing goals: encouraging legitimate risk-taking, on the one hand, and increasing the level of liability, on the other hand. The law that provides especially criminal penalties for the breach of directors' duties of care and loyalty would tilt the balance too far in favour of increasing the level of liability. The scope of liability should not be greatly expanded as directors will be under increased threat from actions from the public regulator.[1213] Furthermore, one of the drawbacks of public enforcement is that any financial relief will flow to the public regulator rather than the company and its shareholders, whereas this is not the case in relation to private enforcement actions.

[1206] Reisberg (n 8) 31.
[1207] Keay (n 1205) 102.
[1208] I Ramsay, 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 UNSW Law Journal 149, 152.
[1209] This has mainly been because of the reduction in oil prices from USD 110 a barrel in 2014 to below USD 50 a barrel. According to the Saudi Ministry of Finance, the deficit for the 2017 national budget was projected to be (SAR 198 billion), about USD 53 billion, see the Ministry's statement for the 2017 national budget <https://www.mof.gov.sa/docslibrary/Budget/Documents/2017.pdf> accessed 22 July 2017.
[1210] Albrahim (n 1192) 307.
[1211] See A Alkahtani, 'The Influence of Corporate Governance on Protecting Minority Shareholders' Rights in the Saudi Stock Market: A Comparative Study' (PhD thesis, University of Westminster 2015) 89–90.
[1212] See A Jammal, *Al-Madina* Newspaper (23 July 2017) <http://www.al-madina.com/article/533239/> accessed 2 August 2017.
[1213] See Bernard S. Black et al., Report to Russian Center for Capital Market Development: Comparative Analysis on Legal Regulation of the Liability of Members of the Board of Directors and Executive Organs of Companies (English Language Version) (ECGI Law Working Paper Series 103/2008 University of Texas Law, Law and Econ Research Paper No. 110, February 2008) 287 <http://ssrn.com/abstract=1001990> accessed 1 August 2017.

What can be taken from the above discussion is that there are some limits to the role of formal public enforcement. This highlights the necessity for the private enforcement action to complement enforcement by the public regulator. In any legal framework of directors' duties, both enforcement regimes should be effectively present as neither regime can adequately deter mismanagement by directors.

5.3 The Theoretical Viewpoint: Which Corporate Organ Should Make the Decision to Litigate Privately?

At the outset, it is important to say that the company's decision to initiate proceedings can be seen as a 'commercial judgement' involving an evaluation of all viewpoints related to the commencement of legal action through a consideration of factors such as 'risks', 'expenses' and potential gains from the litigation.[1214] This means that although directors have breached their duties towards the company, there are situations where bringing legal proceedings against the director is not in the best interests of the company, for example, when there is a *low* possibility of success,[1215] or of a good financial return[1216] when compared with the incurrence of *high* legal fees,[1217] and the expense of management time and effort.[1218] Having said that, it can be argued from the theoretical perspective that the board of directors would be the most appropriate organ to bring a lawsuit because the board, compared to the general meeting, is expected to 'have a more informed understanding' of potential impacts of litigation on the company's business and managerial resources.[1219] However, when the board has the power to take legal action against errant directors, it is more likely to give rise to the issue of conflict of interests within the board of directors.[1220]

This heightened possibility of conflicts of interests results from wrongdoing directors engaging in the voting process at the board meeting in relation to the litigation decision against them.[1221] Even if erring directors are not part of the decision-making process, doubt could be cast upon the independence of disinterested directors from the influence of

---

[1214] H Hirt, 'The company's Decision to Litigate Against Its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest' (2005) JBL 159, 165–166.
[1215] S Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps Towards a Possible Harmonisation by Means of a European Model Code' (2009) 2–3 European Company and Financial Law Review 324, 331.
[1216] Hirt (n 1214) 165.
[1217] Kalss (n 1215) 331.
[1218] Hirt (n 1214)165.
[1219] Kershaw (n 310) 590.
[1220] Hirt (n 1214) 162.
[1221] Ibid.

directors who have purportedly infringed their duties;[1222] for example, the close friendship and family and social ties between disinterested members of the board and wrongdoing directors could influence the independent judgment of the former in this regard. Furthermore, disinterested directors may feel that if they decide not to bring an action against other directors because of the breach of their duties, in return those errant directors will not sue them if they fail to comply with their obligations in future.[1223] In the scenario that the entire board has breached their duties, it is extremely unlikely that it will decide to litigate.[1224] This means that the board's decision to sue one of its members is fraught with difficulties, making the commencement of litigation unlikely.

One potential response to leaving the litigation decision making exclusively to the board is to enable the general meeting of shareholders to initiate the proceeding or instruct the board to do so.[1225] Nevertheless, this approach, which leaves the litigation decision to a vote of shareholders as a whole, may suffer from a practical drawback, that is, the presence of 'wrongdoer control',[1226] which is mainly found in small or medium companies with a low number of shareholders,[1227] or in companies with concentrated share ownership. The 'wrongdoer control' occurs in circumstances where, for example, directors who do wrong hold the majority of shares and use their vote at the general meeting to disallow the proceeding, or where they have 'influence' over the majority of shareholders, persuading them to reject litigation.[1228] The meaning of 'wrongdoer control' not only captures the de jure control over the company but also the de facto control that can be gained without holding the majority of the company's shares.[1229] This problem is exacerbated when interested shareholders are not precluded from voting on the general meeting's decision to litigate.[1230]

The second issue associated with decision making at the general meeting is known as the 'collective action' problem, which is seen at its most extreme in companies with widely dispersed share ownership.[1231] The source of this dilemma is that the decision-making by

---

[1222] Ibid.
[1223] Keay (n 6) 412.
[1224] Ibid.
[1225] See, for example, F A Gevurtz, 'Who Represent the Corporation? In Search of a Better Method for Determining the Corporate Interest in Derivative Suits' (1985) 46 U Pitt L Rev 265, 268.
[1226] Hirt (n 1214) 169 and 171.
[1227] Ibid 171.
[1228] Ibid.
[1229] Gevurtz (n 1225) 313;
[1230] Hirt (n 1214) 171.
[1231] Ibid 170.

the shareholder body tends to be ill informed.[1232] As Gevurtz explains, shareholders at the general meeting will face difficulty in making an 'intelligent decision', determining whether or not taking a legal action serves the interests of the company because such a decision requires the assessment of potential losses and benefits from the litigation; such an assessment requires information that is likely not to be automatically available for shareholders.[1233] Even if such information was made available to shareholders, they are likely to lack the necessary time and effort to make an informed decision.[1234]

As a result of problems associated with both the decision-making at the board meeting and at the general meeting of shareholders, the law may respond by enabling an individual shareholder or a group of shareholders to bring an action against wrongdoing directors on behalf of the company in order to enforce the company's rights.[1235] This action, as mentioned earlier, is referred to as a *derivative claim* because the shareholder's right to initiate litigation 'is derived from the right of the company'.[1236] Concerns over the independence of a subset of shareholders from an errant directors' influence seems not to come up in this regulatory approach.[1237] While the availability of derivative action is likely to tackle the problem of 'wrongdoer control', the individual shareholder or a group of shareholders will, to some degree, continue to face the collective action problem.[1238] The minority shareholder will perhaps lack the necessary 'time, effort and resources' to make an informed decision in relation to initiating derivative litigation, or to examine the company's possible costs and gains from litigation against directors who have purportedly breached their duties.[1239] It should be pointed out that derivative action litigation is associated with serious challenges on the part of the individual shareholder (particularly the non-controlling shareholder) in terms of having access to necessary information and acquiring financial aid.[1240]

To address the problems resulting from the mechanism of derivative litigation, the 'external trusteeship strategy' could be seen as an alternative solution.[1241] This refers to situations where bodies or persons 'external to the [company] may be called upon to serve

[1232] Gevurtz (n 1225) 315.
[1233] Ibid 317.
[1234] Ibid.
[1235] Ibid 267 and 287. This action, as mentioned earlier, is referred to as a *derivative claim*; see Reisberg (n 8) 18.
[1236] Keay (n 6) 413.
[1237] Kershaw (n 310) 593.
[1238] Hirt (n 1214) 173.
[1239] Ibid 174.
[1240] Reisberg (n 8) 85–88.
[1241] Hirt (n 1214) 179.

as trustees' (e.g., court and government body);[1242] in other words, the determination of whether a derivative claim serves the best interest of the company will be left to the judicial or government body. Although the option of external trustees, such as courts, can be regarded as the best approach 'for a neutral judgment' regarding the litigation decision,[1243] doubt could be cast on the court's ability to make a 'commercial judgment'.[1244] This difficulty probably results from the fact that the court lacks the necessary experience and knowledge of the company's policies and objectives.[1245]

To sum up, as regards the question of who should have the power to initiate litigation, it has been shown that each regulatory approach has benefits and problems, and the selection of one without the other seemingly differs between jurisdictions according to the legislator's considerations concerning which problems resulting from the regulatory strategies are less important;[1246] for example, the significance of derivative actions as an enforcement mechanism will be noticeable in jurisdictions where the legislators regard the wrongdoer control problem resulting from giving the decision to litigate to shareholders, and the problem of independence in disinterested directors' decisions, as important and serious issues that must be avoided.[1247]

5.4 Litigation Decisions and the Position of Company Law

The primary issue that will be focused on here concerns the position of company law in relation to the question of who has the power to make the decision to litigate in the name of the company. To be specific, does such power fall within the remit of the board of directors or the general meeting of shareholders? And if one of the corporate organs was given the exclusive power to litigate, to what extent would the other organ have the power to intervene? To answers such questions, the laws of the UK and Saudi Arabia will be referred to in the following sub-sections.

[1242] Armour, Hansmann and Kraakman (n 227) 44.
[1243] Gevurtz (n 1225) 268.
[1244] Hirt (n 1214) 180.
[1245] Ibid.
[1246] A similar observation has presented in relation to the possible important role of derivative actions among available regulatory options; see Kershaw (n 310) 594.
[1247] Ibid.

5.4.1 The state of the law in the United Kingdom

As a stated earlier,[1248] the UK law provides a default rule on the general division of decision-making powers between the board of directors and the shareholder body, and it is left to a company's articles of association to determine the matter. Most companies' articles of association vest all powers of management in directors[1249] and the decision to bring legal action falls within their general authority in managing the company's affairs.[1250] This means that in the UK the board is granted the power to initiate litigation against directors who do wrong and enforce the company's rights. However, as stated above,[1251] it would be a flawed policy to leave the litigation decision totally in the hands of the board of directors; a policy that would undermine the accountability of directors and offer very limited protection to the company and its shareholders.

In the UK it appears that there is no dispute over the right of shareholders to initiate litigation where the company's bylaw explicitly reserves such power for the general meeting of shareholders. In a company with Model Articles, shareholders at the general meeting by special resolution may direct the board to bring legal action or to cease litigation that has already been initiated against a director. [1252] This is also the case in relation to a company with the 1985 version of Table A.[1253] This is in line with the mainstream body of authorities, of which *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame*[1254] is a clear example.[1255] In this case, the Court of Appeal held the view that when the powers of management are conferred on directors, the general meeting does not have the power to intervene in the company's management or to compel directors to obey its instruction by simply passing an ordinary resolution.[1256] In the context of the commencement of litigation, the court, in the case of *Breckland Group Holdings Ltd v London & Suffolk Properties Ltd*,[1257] adopted the *Automatic Self-Cleansing* line of authorities.[1258] In this case, the court addressed the question of whether the general meeting had the power to instigate 'a material litigation' where the company's articles of

---

[1248] See particularly footnotes 307 and 314, Chapter 2 in this thesis.
[1249] See, for example, section 70 of Table A and article 3 of the Model Articles.
[1250] K. Wedderburn, 'Control of Corporate Litigation' (1976) 39 Modern Law Review 327, 327.
[1251] See footnotes 1220–1224 and accompanying text in this Chapter.
[1252] Article 4 of the Models Articles on public companies.
[1253] Article 70 of Table A issued pursuant to the CA 1985.
[1254] *Automatic Self-Cleansing Filter Syndicate Co. Ltd v Cuninghame* (n 314).
[1255] See C Z Qu, 'Some Reflections on the General Meeting's Power to Control Corporate Proceedings' (2007) 36 Common Law World Review 231, 242.
[1256] See *Automatic Self-Cleansing Filter Syndicate Co. Ltd. v Cuninghame* (n 314) 38, 40, 43, 44.
[1257] *Breckland Group Holdings Ltd. v London & Suffolk Properties Ltd* (1988) 4 BCC 542.
[1258] See Qu (n 1255) 242; Wedderburn (n 1250) 406.

association (article 80 of the 1948 version of Table A) provided that 'such a matter is within the remit of the board'.[1259] In the view of Harman, the law stipulates that as long as the company's articles have given directors the power to manage the company's business 'it is not a matter where the general meeting can intervene'.[1260] The hallmark of this approach is to comply with the literal construction of the company's articles, which vest the decision-making power in the board, and the general meeting does not have the power to initiate legal proceedings by an ordinary resolution even if the board cannot or does not act.[1261]

It is also important to bear in mind that the directors' accountability would not be substantially enhanced if the UK law *only* relied on the involvement of the general meeting in the litigation decision, as a response to the conflicts of interest of the board. This is because the role of the general meeting of shareholders in jurisdictions such as the UK, where the share ownership of most public companies is highly diffused,[1262] would be reduced due to the collective action problem.[1263] This requires a legislative intervention to find an alternative means to facilitate access to the judiciary, and so enable an individual shareholder to bring a legal action on behalf of the company against wrongdoing directors.[1264]

5.4.2 The state of Saudi law

A company's right to sue errant directors is clearly articulated in article 79 of the CL 2015 (article 77 of its predecessor of 1965), which literally states that 'the company may initiate a liability proceeding against the members of the board of directors for wrongful acts that cause harms to all shareholders'. In this regard, some key observations need to be made. As can be seen from the wording of article 79, the scope of the statutory company proceeding is rather vague regarding the question of against whom the legal action can be brought because it is unclear whether or not this statutory provision includes a situation

[1259] *Breckland Group Holdings Ltd v London & Suffolk Properties Ltd* (n 1257) 545.
[1260] Ibid 546. It is worth mentioning that there was also a shareholder agreement in effect requiring the board nominations of two shareholders to support the initiation of material proceedings, see pp. 542, 547.
[1261] A Dignam, *Hicks & Goo's Cases and Materials on Company Law* (7th edn, Oxford, Oxford University Press 2011) 240. It is worth mentioning that there was a line of authority in the UK case law that reserved for the general meeting the power to bring the action against directors by an ordinary resolution in certain circumstances (i.e., 'non-functioning board'), regardless of what the company's articles said about directors having general powers of management, see Wedderburn (n 1250) 404–405. For more discussion on the position of UK case law, see Qu (n 1255).
[1262] See footnotes 413–415 and accompanying texts, Chapter 2 in this thesis.
[1263] See footnotes 1231–1234 and accompanying texts in this Chapter.
[1264] The derivative action under the UK law will be discussed in section (5.5) in this Chapter.

where the breach is committed by a person such as a senior manager who is not a member of the board. It seems that the statutory action set out in article 79 can only be initiated when a board member has breached one of his/her duties towards the company; in other words, the company can sue those responsible for the company's management apart from board members, but without the necessity to commence such proceeding in accordance with the statutory requirement set out in article 79 of the CL 2015.[1265]

It is also important to stress that the company should only bring legal action against miscreant directors in relation to a wrongful act leading to an injury to the shareholders as a group (i.e., the company).[1266] There are various types of misconduct that cause harm to the company; for example, the corporate injury could result from directors' violations of the company's rights set out in the CL 2015 and in the company's articles of association; breaches of their loyalty duties; negligence; or any misconduct causing harm to the company's interests while managing the company.[1267] In this regard, a wrongful act committed against an individual shareholder causing personal loss is not considered a cause of action under article 79 of the CL 2015; for example, the direct injury to shareholder rights, such as the right to inspect the corporate records and books,[1268] is not a cause of action against the board members under article 79 of the CL 2015.[1269]

The final observation is that even if the general meeting discharges members of the board of directors from liability concerning occurrences from the previous fiscal year, this does not prevent the hearing of a company action against board members.[1270] It is noteworthy that proposals to release board members of liabilities routinely appear on the agendas of annual shareholders meetings in Saudi Arabia,[1271] and since a granted discharge will not bar any claim made by the company against board members, it appears that this can be

[1265] This action could be probably brought by the board of directors on behalf of the company without prior approval of the general meeting of shareholders.
[1266] The phrase 'harms to all shareholders' set forth in article 79 of the CL 2015 (article 77 of its predecessor of 1965) will be interpreted as 'harms suffered by the company', see Al-Jaber (n 71) 341.
[1267] Indeed, any conduct that minimises the value of the company and damages its general interests can be a cause of action under article 79 of the CL 2015 because directors are responsible for maximising the company's wealth; see article 21(a) of the CGRs 2017. See generally article 78 of the CL 2015.
[1268] This group of rights attached to shareholders' ownership of shares is recognised by the Saudi law; see article 88(1)(a) of the CL 2015.
[1269] It should be noted that injured shareholders have, however, the right to sue the company to compel its directors to permit them to exercise their right; see article 88(1)(a)(5) of the CL 2015; Jobran (n 632) 392–393.
[1270] See article 78(2) of the CL 2015.
[1271] See, for example, the announcements of the following companies listed on Tadawul: The agenda of the general meeting of Tourism Enterprise Co. (held on 04 May 2016) and the agenda of the general meeting of Saudi Industrial Services Co. (held on 02 May 2016). The above information was taken from the website of Tadawul at <https://www.tadawul.com.sa accessed> accessed 22 June 2016.

regarded as a declaration of trust and is unlikely to carry legal implications. In Saudi Arabia, failure to obtain such a pardon does not appear to have an immediate effect on directors' liability, but simply leaves the door open for being sued by the company. Under the Saudi law, company directors, appearing as shareholders in the general meeting, shall be precluded from voting on the resolution regarding their discharge of liability for occurrences from the previous fiscal year.[1272] However, there is nothing in the CL 2015 suggesting that at least wrongdoing directors (who are also shareholders) must abstain from voting on the resolution regarding the brining of legal action under article 79 of the CL 2015.

Saudi company law clearly reserves the power to bring legal action against wrongdoing directors to the general meeting of shareholders.[1273] It might be true to say that the Saudi legislator, by giving shareholders the power to make the decision to litigate, intends to avoid problems associated with this decision being exclusively in the remit of the board of directors.[1274] However, the Saudi approach could give rise to the possibility of wrongdoer control, which results from the fact that interested shareholders at the general meeting have not been barred from voting on the resolution regarding the commencement of litigation.[1275] In the Saudi market, the issue of wrongdoer control could be considered as one of the main deficiencies in the enforcement of directors' duties for the following reasons: First, since concentrated ownership is the norm in most companies listed in the Saudi stock market,[1276] this offers sufficient explanation as to why the issue of wrongdoer control is present within the general meeting of shareholders.[1277] The involvement in the general meeting of shareholders in the litigation decision may give a shareholder (who could be a member of the board)[1278] sufficient control to abuse his/her voting power by

[1272] See article 95(2) of the CL 2015.
[1273] It is worth noting that the decision to bring a legal action against the third party falls exclusively within the board's general power to manage the company's affairs because the Saudi corporate statute remains silent on this issue, leaving the matter entirely to a company's articles of association to determine whether or not the board is required to seek the approval of shareholders *ex ante* in order to bring a legal action against the third-party.
[1274] See footnotes 1220–1224 and accompanying text in this Chapter.
[1275] See footnotes 1226–1230 and accompanying text in this Chapter. In this regard, interested shareholders could be directors acting as shareholders at the general meeting or other shareholders who are under the directors' influence; H Hirt (n 1214) 171.
[1276] See generally section (2.5.2), Chapter 2 in this thesis.
[1277] As could be argued, the structure of corporate ownership 'determines what decisions are and how these decisions are brought about in a given organization', see M Sáez and D Riaño, 'Corporate Governance and the Shareholders' Meeting: Voting and Litigation' (2013) 14 European Business Organization Law Review 343, 350.
[1278] See, for example, the composition of the board of directors for the following listed companies: Al-Rajhi Company for Cooperative Insurance and Anaam International Holding Group. This information was taken from the company's overview page on the Tadawul website at <https://www.tadawul.com.sa accessed> 22 June 2016.

disallowing the lawsuit, the main reason for which will be the protection of minority shareholders.[1279] It should be further noted that the presence of multiple blockholders (who are perhaps directors) at the general meeting may lead to the problem of conflicts of interest,[1280] similar to those discussed in the context of the board of directors. Second, the Saudi corporate statute is also devoid of a provision to ban persons connected to, or under the influence of, wrongdoing directors from engaging in the voting process at the general meeting in relation to the litigation decision. Accordingly, the issue of wrongdoer control could minimise the possibility of a company action against directors. This could be one of primary reasons for what it is noticed as the limited number of such lawsuits in the Saudi legal system.[1281]

Another issue to consider is that shareholders can only bring the legal action through the general meeting and the process of convening the general meeting tends to be costly and difficult; for example, as Reisberg noted in relation to the UK law and equally valid in Saudi Arabia, not every shareholder meets the statutory requirement for summoning a meeting of the shareholders.[1282] Under the Saudi law, shareholders (representing at least 5% of equity capital) are eligible for calling a general meeting and such call should be addressed to the company's board of directors.[1283] The threshold of 5% may represent thousands or even millions of Saudi riyals in market value of shareholding, especially for companies listed in the market.[1284] This is a significant limit to the minority shareholders' right to summon a general meeting, which consequently weaken the ability of disinterested shareholders to litigate against directors who do wrong through the general meeting.

What can be inferred from the above analysis is that legal proceedings under article 79 of the CL 2015, which cannot be initiated without the approval by the general meeting, appears to be an inadequate mechanism for private formal enforcement of directors' duties.

1279 Sáez and Riaño (n 1277) 351.

1280 See footnote 460 and accompanying text, Chapter 2 in this thesis.

1281 As has been reported, no lawsuit had been brought against directors under the corporate statute until 2009; see Report on the Observance of Standards and Codes (ROSC), 'Corporate Governance Country Assessment: Kingdom of Saudi Arabia' (February 2009) 32 <http://documents.worldbank.org/curated/en/838731468106752813/Kingdom-of-Saudi-Arabia-Report-on-the-Observance-of-Standards-and-Codes-ROSC-corporate-governance-country-assessment> accessed 12 March 2016.

1282 Reisberg (n 8) 81.

1283 Article 90(1) of the CL 2015.

1284 Among companies listed on Tadawul until the end of December 2015, consider, for example the listed company of Al-Baha which had the lowest market capitalisation (SAR 202,500,000.00), whereas the listed company of STC had the largest market capitalisation (SAR 136,860,000,000.00). The aforementioned values were reported as at 31 December 2015; see Annual Statistical Report 2015 on Saudi Stock Market (Tadawul), available on the Tadawul website at <https://www.tadawul.com.sa/wps/wcm/connect/a24165eb-08f8-4988-a8ec-6ee48eba6c6b/Yearly_2015_1.pdf?MOD=AJPERES&CONVERT_TO=url&CACHEID=a24165eb-08f8-4988-a8ec-6ee48eba6c6b> accessed 22 September 2017.

This leads one to examine whether the Saudi law introduces an alternative mode to enforce the rights of the company in cases of a breach of directors' obligations through the commencement of litigation. The derivative action, under the Saudi law, will be considered later in section (5.6).

5.5 Conferring a Right on a Shareholder to Litigate: A Statutory Derivative Action in the United Kingdom

Before the CA 2006, it appears that the initiation of derivative litigation posed a significant challenge for a minority shareholder. This is because the common law rule, known alternatively as the rule in *Foss v Harbottle*, essentially provided that the proper claimant to bring an action against wrongdoing directors was not the minority shareholder, but the company itself.[1285] Since the absolute application of the rule in *Foss* might damage the minority's interests due to an abuse by the controlling majority who may ratify the wrongdoing[1286] or the board's reluctance to bring the action, the common law allowed a derivative claim to be made in very limited circumstances, as exceptions[1287] to the rule in *Foss*. It was ruled that once the appropriate majority had ratified the wrong done to a company, a minority shareholder would be bound by the decision of the majority and cannot sue in relation to this wrongdoing[1288] unless the claimant could prove the wrongdoer was in control of the company.[1289] In addition, a minority shareholder had to demonstrate that there was a 'fraud on the minority'[1290] or 'self-serving negligence'[1291] on the part of directors.[1292] In principle, mere negligence, under the common law, was not sufficient to allow the claim under the fraud exception.[1293] Furthermore, not all breaches of directors' duties fall within the meaning of 'fraud' for the purpose of starting derivative litigation.[1294] A claimant also had to prove, for example, that a derivative action had been brought in

---

[1285] *Foss v Harbottle* (n 19) 202; see *K Wedderburn, 'Shareholders' Rights and the Rule in Foss v Harbottle*' (1957) Cambridge LJ 194, 196 who pointed out that this 'proper plaintiff rule' originated from the company law principle which considers the company as a separate 'person' from its members.
[1286] E Mujih, 'The New Statutory Derivative Claim: A Delicate Balancing Act: Part 1' (2012) 33 Company Lawyer 76, 76.
[1287] Ibid 76–77.
[1288] *Foss v Harbottle* (n19) 203–204; see also *Edwards and Another v Halliwell* (1950) 2 All ER 1064 , 1066.
[1289] *Edwards and Another v Halliwell* (n 1288) 1067.
[1290] Ibid 1067.
[1291] E Mujih (n 1286) 77.
[1292] This occurs where directors have considerable benefits at the expense of the company; see *Daniels v Daniels* (1978) Ch 406 , 406.
[1293] K. Wedderburn, 'Derivative Actions and *Foss v. Harbottle*' (1981) 44 Modern Law Review 202, 205.
[1294] Ibid. 206.

good faith for the benefit of the company[1295] and the ratification of wrongdoing was consequently not possible.[1296]

In its deliberation on the state of the derivative claim, the Law Commission described the law as ‘rigid [and] complex’,[1297] ‘outmoded’[1298] and ‘inaccessible’.[1299] Most of the difficulties and complexities faced by claimants in bringing derivative proceedings had been recognised by the Law Commission in its report,[1300] which proposed the replacement of common law rules with a statutory derivative mechanism.[1301] Many of recommendations presented by the Law Commission and reaffirmed by the CLRSG in their Final Report[1302] were eventually enacted in Part 11 of the CA2006, sections 260–264 for England, Wales and Northern Ireland and sections 265–269 for Scotland.[1303]

5.5.1 Main reforms under the statutory derivative action

Lord Goldsmith, speaking in the debates in the House of Lords, asserted that the requirements for bringing derivative claims should be ‘more modern, flexible and accessible’, arguing that the Act would provide ‘greater clarity’ concerning how the minority can make a derivative claim.[1304] A closer look at the statutory provisions governing derivative litigation reveals distinct characteristics of legal action under the CA 2006 of which the following are the most important:

First, the CA 2006 introduced judicial control of a derivative action in which the court is granted the power to decide whether such litigation should be able to continue.[1305] While a claimant in Scotland must obtain the permission (leave) of the court before initiating

---

1295 *Barrett v Duckett* (1995) 1 BCLC 243, 243.
1296 *Smith v Croft (No.2)* (1988) Ch 144, 122.
1297 The Law Commission, *Shareholders Remedies: Consultation Paper* (No.142, 1995) para 1.6 <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/cp142_Shareholder_Remedies_Consultation.pdf> accessed 20 February 2017.
1298 Ibid para 14.1.
1299 Ibid para 4.35.
1300 See The Law Commission, *Shareholders Remedies: Report* (1997) Part 6, <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc246_Shareholder_Remedies.pdf> accessed 20 February 2017.
1301 Ibid paras 8.10 and 8.11.
1302 See *Final Report* (686) para 7.46.
1303 See, for example, M Almadani, ‘Derivative Actions: Does the Companies Act 2006 Offer a Way Forward?’ (2009) 30 Comp Law 131, 140–141. It is worth noting that provisions for Scotland largely replicate those applying elsewhere in the UK. For the purpose of this thesis, the reference will be made to provisions applying to England, Wales and Northern Ireland, expect when discussing Scottish cases.
1304 See the statement of Lord Goldsmith before the Grand Committee, the House of Lords (27 February 2006, col. GC4–5) <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060227/text/60227-36.htm> accessed 25 February 2017.
1305 Section 261(1) of the CA 2006, which is equivalent to section 266(1) for Scotland.

derivative litigation, this is not the case elsewhere in the UK as the permission must be sought once a claimant has brought the derivative proceeding.[1306] The CA 2006 provides a two-stage procedure for obtaining the court's permission to continue with the action.[1307] In the first stage, the court must dismiss the application if the applicant fails to establish a '*prima facie* case' 'for giving permission'.[1308] In the second stage, the court in exercising its discretion to grant the permission takes into considerations a set of factors, including those mentioned in section 263(3) and (4).[1309] The UK approach to controlling derivative actions, which is based on placing the litigation decision power in the hands of a body external to the company (i.e., courts) might be criticised by questioning whether the court should be allowed to get involved in the company's internal management since the litigation decision involves a commercial judgment determining whether the derivative action is in the company's interests.[1310] On the other hand, the introduction of judicial control of derivative actions indicates how problematic the UK legislator considers the problems associated with placing the litigation decision in the hands of the board of directors or the shareholder body; in other words, it might be true to say that the law assumes that an independent decision is more likely to be reached with judicial intervention in the derivative litigation process.[1311] Furthermore, Reisberg believes that the judicial control of derivative actions tends to 'provide an important check that should contribute positively to the view of the derivative action being seen as an important social mechanism'.[1312] This argument goes on to say that the higher the public support the derivative action, the higher 'its deterrent value' will be.[1313] In the view of Reisberg, the court's early examination of allegations and facts supporting the derivative claim is basically a beneficial 'pre-trial screening mechanism', which should result in the early 'dismissal of baseless suits', allowing only meritorious actions to progress through the pre-trial procedures.[1314]

Second, it is clear that the scope of the provision, which constitutes a derivative claim, is wider than previously seen under the common law. The statutory derivative claim might be made in respect of a director's 'actual and proposed act or omission involving negligence,

[1306] *Re Wishart* (2009) CSOH 20 , at [25] (*per Lord Glennie*, at first instance).
[1307] Section 261 of the CA 2006.
[1308] Section 261(2) of the CA 2006.
[1309] The judicial approach will be considered in section (5.5.2) in this Chapter.
[1310] Hirt (n 1214) 180.
[1311] Ibid 179.
[1312] A Reisberg, 'Judicial Control of Derivative Actions' (2005) 16 ICCLR 335, 338.
[1313] Ibid referring to J. Cox, 'The Social Meaning of Shareholder Suits' (1999) 65 Brooklyn Law Review 3, 4.
[1314] Reisberg (n 1312) 338.

default, breach of duty, or breach of trust'.[1315] Thus, one of the main differences between the common law and the CA 2006 is that under the former negligence on its own could not be considered as a cause of action because a claimant had to show the presence of fraud to bring the claim,[1316] whereas under the CA 2006 proving the existence of mere negligence would be sufficient grounds to establish a derivative claim. Mujih observes that a claimant's burden to prove breach or negligence is easier than demonstrating fraud, and this probably gives greater protection for company's interests compared with the situation under the common law.[1317]

Third, what constitutes wrongdoer control of the general meeting was not clear under the common law.[1318] With the advent of the CA 2006, there is a general belief among many scholars,[1319] and even judges,[1320] that the claimant's proof of wrongdoer control is no longer a requirement for bringing a derivative claim. Instead, the court, as mentioned above, is given the discretionary power to decide whether or not the applicant has met the criteria set forth in the CA 2006. This general view as to the abolition of the wrongdoer control requirement is borne out by that fact that the CA 2006 does not mention wrongdoer control as a consideration or a prerequisite for the initiation of a derivative action.[1321]

Fourth, the scope of derivative claims under the CA 2006 has become wider in relation to the questions of against whom a derivative action can be brought. Section 260(3) provides that derivative litigation can be initiated against a 'director or another person or (both)'. Regarding the phrase 'another person', it seems to refer to any third party. The court in *Iesini v Westrip Holdings Ltd* stressed that when the derivative action is brought against the third party, it must rely on a cause of action linked to wrongdoing or omission by a director.[1322] Another point to consider is that the CA 2006, in section 260(4), widens the scope of the statutory derivative claim by providing a broader category of possible

1315 Section 260(3) of the CA 2006.
1316 See footnotes 1290–1294 and accompanying text in this Chapter.
1317 Mujih (n 1286) 79.
1318 *Shareholders Remedies: Report* (n 1300) para 6.4.
1319 See, for example A Keay and J Loughrey, 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 Law Quarterly Review 469, 477; J P Sykes, 'The Continuing Paradox: A Critique of Minority Shareholder and Derivative Claims Under The Companies Act 2006' (2010) 29 CJQ 205, 215.
1320 See, for example, *Bamford v Harvey* (2013) Bus LR 589, 597 where the court agreed that 'wrongdoer control is not an absolute condition for a derivative claim'.
1321 See D Kershaw, 'The Rule in *Foss v Harbottle* is Dead; Long Live the Rule in *Foss v Harbottle*' (LSE Law, Society and Economy Working Papers, 5/2013) 13, <https://www.lse.ac.uk/collections/law/wps/WPS2013-05_Kershaw.pdf> accessed 22 February 2017. In this article, Kershaw argued that one of possible readings of Part 11 of the CA 2006 suggests that the wrongdoer control requirement could be relevant in determining the continuation of a derivative claim.
1322 *Iesini v Westrip Holdings Ltd* (2010) BCC 420 , 439.

claimants than the common law.[1323] The shareholder can make a claim in relation to a cause of action that occurred before he/she became a member of the company.[1324] It should, however, be borne in mind that the UK law limits the initiation of derivative actions to the company's members, disallowing a broader range of persons from bringing the action (e.g., directors).[1325]

It appears that some legal uncertainties and difficulties in the previous common law of derivative actions have been resolved with the introduction of the CA 2006. The removal of the requirement of fraud and of wrongdoer's control, and the broadening of the scope of the claim by including new conducts and providing additional categories of possible claimants are regarded as steps forward in giving more protection to the minority and making the law clearer. However, some concerns were raised before the statutory system of derivative action came into force; for example, there was a fear that Part 11 of the CA 2006 might result in an increase in litigation against directors, and that such an increase might deter people from becoming directors in a company.[1326] As Lord Hodgson during the Grand Committee Stage described, directors could be subject to a 'double whammy'.[1327] His lordship went on to say that while the scope of directors' duties set forth in Part 10 of the CA 2006 was widened, the statutory scheme of derivative actions makes it easier for shareholders to bring legal action against directors.[1328] Loughrey et al. in their empirical study, reported that lawyers predicted an increase in derivative litigation following the enactment of the CA 2006.[1329] The source of the concern comes from the wide scope of the derivative claim and the expected simplicity to meet the requirement for bringing the claim.[1330]

However, as a matter of fact, any worry that Part 11 of the CA 2006 would lead to an increase in derivative litigation has not yet been shown to be correct. This is because only 22 derivative actions, as Keay notes, have been initiated since the CA 2006 took effect up

[1323] Mujih (n 1286) 80.
[1324] Section 260(4) of the CA 2006.
[1325] The UK approach is more limited in terms of the range of applicants compared with other common law jurisdictions such as Australia and Canada. See A Keay, 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 Journal of Corporate Law Studies 39, 45.
[1326] D Arsalidou, 'Litigation Culture and the New Statutory Derivative Claim' (2009) 30 Company Lawyer 205, 207.
[1327] See the statement of Lord Hodgson before the Grand Committee, the House of Lords (27 February 2006, col. GC2) <https://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060227/text/60227-35.htm> accessed 28 February 2017.
[1328] Ibid.
[1329] Loughrey, Keay and Cerioni (n 992) 96–97.
[1330] Arsalidou (n 1326) 206–207, 209.

to 1 September 2015.[1331] The small numbers of cases are clear evidence that any concern that had been raised following the enactment of the CA 2006 about a possible increase in derivative litigation is unjustifiable. The curious paradox is that although the statutory provisions seemingly facilitate a shareholder starting derivative litigation, fewer actions have been reported under the umbrella of the CA 2006. This may give rise to a question about whether statutory provisions coupled with the judicial approach to grant permission to continue the derivative action have played a significant role in controlling the flood of activist shareholder actions. In the section that follows the judicial approach to the application for permission will be discussed.

5.5.2 The judicial approach to grant permission (leave): the two-stage procedure

As stated above,[1332] the CA 2006 provides a two-stage process for obtaining permission to continue a derivative claim. With the legislative guidance, it is, however, left to the court's discretion to control the derivative claim and determine whether or not the claim should be allowed. The section will review the judicial approach to the application for permission, identifying some areas of deficiencies as well as areas of strength.

5.5.2.1 The first stage: *Prima facie* question

In the first stage, the court has to be satisfied that an application and evidence submitted by the claimant discloses a '*prima facie* case'.[1333] If the court concludes that no *prima facie* case has been established, the application for permission will be dismissed.[1334] In common law, there was not much guidance as to the meaning of *prima facie* and how to establish such a case.[1335] It has been noted that an applicant, at this stage, is required to show that there is 'a substantial chance of success at the final hearing',[1336] and this implies that there will inevitably be some considerations of the basic merits of the case.[1337] A closer look at the case law reveals that the court has taken different approaches to the *prima facie* question.

1331 See Keay (n 1325) 41. It is worth mentioning here that the research conducted by Keay was aimed at detecting applications for permission (leave) to continue with derivative claims.
1332 See footnotes 1307–1309 and accompanying text in this Chapter.
1333 See section 261(2) of the CA 2006.
1334 See section 261(2) (a) of the CA 2006.
1335 A Keay and J Loughrey, 'Derivative Proceedings in a Brave New World for Company Management and Shareholders' (2010) 3 Journal of Business Law 151, 154.
1336 Ibid 154, referring to J Heydon and P Loughlan, *Cases and Materials on Equity and Trusts* (5th edn, 1997) 978.
1337 Keay and Loughrey (n 1335) 154.

For example, in the Scottish case of *Wishart v Castlecroft Securities Ltd*,[1338] the court asserted that at this stage it should only consider the application and the supporting evidence presented by an applicant and 'no onus is placed on the applicant to satisfy the court that there is a *prima facie* case; rather, the court is to refuse the application if it is satisfied that there is no *prima facie* case'.[1339] While the court's opinion is arguably seen as placing a low threshold on the applicant,[1340] doubts might arise about what this would, in fact, mean for the applicant.[1341] As one commentator opines, since the refusal of an application will be based on the absence of a *prima facie* case regardless of whether there is an initial burden of proof on the applicant, this ultimately implies that the applicant is, in fact, expected to satisfy the court that there is a *prima facie* case in order to obtain permission to continue, as the court was unclear whether or not proving a *prima facie* case is part of an initial burden.[1342] In order to determine the presence of a *prima facie* case, it was said in the *Wishart* case that the court should check compliance with basic requirements such as whether or not the applicant is a shareholder and whether or not the application relates to an act or omission falling within the meaning of section 265(3) of the CA 2006 (equivalent to section 260(3) applying elsewhere in the UK).[1343] The court also added that a set of considerations set forth in sections 268(1), (2) and (3)[1344] will be relevant in exercising its discretion to grant leave (permission in elsewhere in the UK) at this stage.[1345] Keay and Loughery, in their comment on the *Wishart* case, believed that the court, by considering factors mentioned in section 268 in the first stage, 'set a far higher bar' than the CA 2006 seems to provide, and that it will be more difficult for the applicant to prove that he/she has a *prima facie* case.[1346] At the very least, this could lead to shareholders being discouraged from initiating derivative litigation.[1347]

In contrast to the case of *Wishart*, another line of authorities, of which *Iesini*[1348] is a clear example, follows a different approach to the *prima facie* question. In this case, it was said that the application would be dismissed if the applicant failed to establish a *prima facie* case;[1349] in other words, the initial burden of proof was on the applicant to satisfy the court

[1338] *Wishart v Castlecroft Securities Ltd* (2009) CSIH 65 (on appeal).
[1339] Ibid [31].
[1340] Keay and Loughrey (n 1335) 155.
[1341] Mujih (n 1286) 80.
[1342] Ibid.
[1343] *Wishart v Castlecroft Securities Ltd* (n 1338) [31].
[1344] Section 263(2), (3) and (4) of the CA 2006 for the rest of the UK.
[1345] *Wishart v Castlecroft Securities Ltd* (n 1338) [31].
[1346] Keay and Loughrey (n 1335) 155–156.
[1347] Ibid 157.
[1348] *Iesini v Westrip Holdings Ltd* (n 1322).
[1349] Ibid 440.

of the existence of *prima facie* case. The court, in the *Iesini* case, stated that in order to meet the *prima facie* requirement, the applicant had to show that the company had a 'good' cause of action that involved any wrongful conduct mentioned in section 260(3) of the CA 2006.[1350] Unlike the *Wishart* case, the court in *Iesini* did not need to take the statutory factors set forth in section 263 (section 268 in the Scottish provisions) into consideration in the first stage. It is important to say that while *Iesini*, for instance, followed the prescribed two-stage procedure,[1351] this is not always the case since the practical reality reveals that the court in some cases has decided to conflate the two-stage process into one. For example, in the case of *Stimpson v Southern Private Landlords Association*,[1352] the court skipped the first stage involving the *prima facie* inquiry and preferred to start with section 263 of the CA 2006, as the judge believed that it would be 'unduly elaborate' to address the *prima facie* question.[1353]

Although the courts have taken different approaches to applications for permission at the initial stage, the test for proving the *prima facie* case, as one commentator illustrates, seems to be low and the court approach is to ease the shareholders' task to obtain the court's permission to reach the second stage[1354] where applications can always be dismissed.[1355] With this in mind, it might be true to say that the first stage is likely to result in increased costs and time-wasting since the second stage could itself achieve the purpose of judicial control of derivative claims.[1356]

5.5.2.2 The second stage: Section 263 of the CA 2006[1357]

If the court reaches the conclusion that a *prima facie* case has been established, the application will then continue as a full hearing and the court may order the company to submit evidence.[1358] In the second stage, the CA 2006 enumerates specific situations where the court must deny permission and where the court does not have discretion to permit the

[1350] Ibid 440.
[1351] Ibid 437.
[1352] *Stimpson v Southern Private Landlords Association* (2010) BCC 387 .
[1353] Ibid 391.
[1354] D Gibbs, 'Has the Statutory Derivative Claim Fulfilled Its Objectives? A Prima Facie Case and the Mandatory Bar: Part 1' (2011) 32 Company Lawyer 41, 43. Since the first stage under the CA 2006 is decided upon the supporting evidence submitted by the applicant only, this could explain the lenient approach adopted by the court regarding the *prima facie* question, see Keay (n 6) 428.
[1355] Keay (n 6) 432.
[1356] Ibid 432; see also Gibbs (n 1354) 44–45 who supports skipping the stage requiring the proof of a *prima facie* case.
[1357] Section 268 of the CA 2006 for Scotland.
[1358] Section 261(3) (a) of the CA 2006.

claim to continue if it is satisfied that any one of the followings applies.[1359] The mandatory refusal of permission will be made where 'a person acting in accordance with section 172' would decide that continuing the claim would not promote the success of the company[1360] and where the actual or proposed wrongdoing (e.g., breach of the directors' duty of care or of loyalty) has been authorised or ratified.[1361]

If none of the above situations applies, the court is given the discretionary power under sections 263(3) and (4) to determine whether or not permission to continue the claim should be granted. To enhance the certainty of the law,[1362] the CA 2006 requires the court to take a set of specific factors into account while exercising its discretion. The non-exhaustive considerations include[1363] whether a shareholder is acting in good faith; the importance that a person in performing the duty found in s 172 'would attach to continuing the action'; whether the wrongdoing could be ratified or authorised; whether the company has decided not to bring a claim; the availability of an alternative remedy;[1364] and the viewpoints of the independent shareholders of the company.[1365] It should be borne in mind that depending on the facts of the case, some of the above factors may not be relevant to the case in question.[1366] In addition, when considering sections 263(3) and (4) of the CA 2006, there should not be a particular test that has to be satisfied; but rather, the court is expected to reach an overall decision at its discretion about whether to grant the permission based upon a set of considerations.[1367] Following the court's assessment of relevant factors, if the court decides to permit the derivative claim to continue, the shareholder will then be able to continue the litigation on behalf of the company[1368] on the possible condition that the claim will not be discontinued, settled or compromised without the court's permission.[1369]

1359 Section 263(2) of the CA 2006.
1360 Section 263(2)(a) of the CA 2006.
1361 Section 263(2), (b) and (c) of the CA 2006.
1362 Prior to the introduction of the CA 2006, R.19.9 (3) of the Civil Procedure Rules, the claimant was allowed to apply to the court for permission to continue the derivative claim, but there was no two-stage process or certain factors that needed to be considered by the court in its decision; for details see Reisberg (n 1312).
1363 See, for example, *Wishart v Castlecroft Securities Ltd* (n 1338) [36]; *Iesini v Westrip Holdings Ltd* (n 1322) 436.
1364 Section 263(3) (a)–(f) of the CA 2006.
1365 Section 263(4) of the CA 2006.
1366 See, for example, *Franbar Holdings Ltd v Patel* (2008) BCC 885, 894 where factors mentioned in subsections 263(3)(c) and (4) are irrelevant to the case.
1367 See *Stainer v Lee* (2011) BCC 134 , 142
1368 G Pendell, 'Derivative Claims: A Practical Guide' (2007) 20 Company Law Newsletter 1,4.
1369 Rule 19.9F of the Civil Procedure Rules, <https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part19#Back-to-top> accessed 1 March 2017.

It is important in the following subsections to consider, albeit briefly due to space constraints, the judicial approach for assessing relevant factors in determining whether to grant permission in the second stage. This task is necessary to reveal a clear picture of how the court can control a derivative action. More importantly, the identification of problems and concerns associated with the judicial approach is crucial so as to avoid them in the legal reform proposed for the Saudi law.

5.5.2.2.1 *The view of the hypothetical person under section 172 to which the court must have regard*

UK corporate legislation instructs the court in sections 263(2)(a) and 263(3)(b) to take into account the view of 'a person acting in accordance with section 172' when considering whether continuing to seek the court's permission would promote the company's success. In the second stage, the court is required to have regard to this hypothetical person's view in two sub-stages: (i) at the mandatory dismissal stage and (ii) again at the permissive stage. The question here is about how the court interprets sections 263(2)(a) and 263(3)(b), and whether the court follows a different approach for each statutory provision.

As stated above, if the court is satisfied that section 263(2)(a) should apply, it has no option other than to refuse permission to continue the derivative claim. The CA 2006 does not explain what is meant by this hypothetical person. Nonetheless, the case law does offer guidance that reduces uncertainty about how section 263(2)(a) will be assessed; for example, in the *Iesini* case, it was ruled that the statutory provision would only apply where '*no* director acting in accordance with section 172 would seek to continue the claim'.[1370] In determining whether the hypothetical director would seek to continue the claim, the court acknowledged that there may be a set of commercial factors (e.g., the size, strength, cost of the claim and the impact of litigation on the company's activities) to take into consideration.[1371] Yet, the court refused to engage with this because it was 'ill-equipped' to make commercial decisions, 'except in a clear case'.[1372] As Gibbs points out, this judicial approach followed in the *Iesini* case was in favour of staying within the limits of the law to determine whether a director would seek to continue the claim.[1373] The test used by the court in *Iesini* to determine whether the application should be dismissed pursuant to section 263(2)(a) has also been adopted by other courts such as in the case of

---

[1370] *Iesini v Westrip Holdings Ltd* (n 1322) 441.
[1371] Ibid.
[1372] Ibid.
[1373] Gibbs (n 1354) 45. The court in *Iesini* concluded that the legal basis for the claim was so weak and therefore the claim should be discontinued; see *Iesini v Westrip Holdings Ltd* (n 1322) 445.

Singh v Singh,[1374] and of *Cullen Investment Ltd v Brown*.[1375] It has been noted that this is a relatively low threshold suggested by the mainstream judicial line of authorities in which it appears fairly easy for a shareholder applicant to prove that no hypothetical director would refuse the bringing of the claim.[1376] It is worth mentioning that the court, besides assessing the legal basis for the claim, may take into account other considerations, such as the modest value of the claim compared with its costs, to determine whether or not section 263(2)(a) should apply to the case in question.[1377]

With regard to section 263(3)(b), the court, in the permissive stage, is also expected to take into account whether a hypothetical director acting under the duty found in section 172 would attach importance to pursuing the derivative claim.[1378] In this regard, the court will determine 'how important it is to continue the claim' in the view of a hypothetical director who would take into account under section 172 whether the commencement of litigation would be likely to promote the company's success for the benefit of all shareholders, with possible reference to matters set forth in sub-sections 172(1), (a)–(f), where relevant.[1379] To explain this point, if the hypothetical director were to attach little importance to the continuation of the derivative action, this could result in the refusal of permission, and the converse is true if he/she were to attach considerable importance to the continuation of the action.[1380]

While section 263(2)(a) has been seen as an undemanding test that is relatively easy to pass, the applicant is likely to face more challenges when the duty found in section 172 is assessed by the court under the requirement set down in section 263(3)(b).[1381] Unlike section 263(2)(a) where the court resisted engagement with business considerations, this, as has been submitted, should not be the case in relation to section 263(3)(b).[1382] As one commentator suggested, in section 263(2)(a) the court's business judgment involving the weighing of commercial factors could result in the mandatory refusal of permission and the court's engagement in the consideration of commercial factors would be the reason for dismissal.[1383] However, in the context of section 263(3)(b), the court's business judgment

1374 *Singh v Singh* (2013) EWHC 2138 , at [18].
1375 *Cullen Investments Ltd v Brown* (2015) BCC 539, 540.
1376 Keay (n 6) 435.
1377 *Stimpson v Southern Private Landlords Association* (n 1352) 403.
1378 *Franbar Holdings Ltd v Patel* (n 1366) 895.
1379 *Cullen Investments Ltd v Brown* (n 1375) 551.
1380 *Franbar Holdings Ltd v Patel* (n 1366) 895.
1381 Keay (n 6) 447.
1382 Kershaw (n 310) 621.
1383 Ibid.

court and the consideration of commercial matters is ‘a part of a discretionary mix of factors’ that enables the court to prioritise other factors mentioned in section 263 over the court’s commercial judgment.[1384] Hence, while a literal reading of section 263(2)(a) suggests that judges will be led to make a definitive commercial decision, the wording of section 263(3)(b) indicates that the judicial assessment will focus on ‘the importance’ that a director would attach to that decision.[1385]

A close look at the case law reveals that the court in some cases, for instance, in *Franbar Holdings Ltd v Patel,*[1386] believed that a hypothetical director would take into consideration a set of business factors such as the prospects of success of the claim; the ability of the company to make a recovery on any award of damages; the disruption that would be caused to the development of the company's business by having to concentrate on the proceedings; the costs of the proceedings; and any damage to the company’s reputation and business if the proceedings were to fail.[1387] Other matters, such as keeping experienced directors within the company,[1388] ‘the amount at stake’,[1389] and whether the applicant will entirely incur the cost of a claim and be liable for adverse costs that result in the case of failure,[1390] might be relevant to assessing section 263(3)(b).

Nevertheless, there are some indications that the court would resist engaging in the business judgment, preferring to rely on the decisions of those responsible for the company’s management; for instance, in *Franbar Holdings Ltd*, although the court enumerated a set of business considerations that should be taken into account in relation to section 263(3)(b), as Kershaw noted, the court did not consider any business concerns,[1391] and the same was true in the *Iesini* case.[1392] In the view of Keay, the general approach of the court can be seen as a strict one in the sense that when considering the application for permission under the derivative claim scheme, the court usually relies on the view of directors when it comes to the question of where the company’s interests lie because the court, as Keay points out, thinks that directors are in a better position to determine what is in the best interests of the company.[1393] It might be true to say that the approach of the

---

[1384] Ibid.
[1385] Ibid.
[1386] *Franbar Holdings Ltd v Patel* (n 1366).
[1387] Ibid 895.
[1388] *Kleanthous v Paphitis* (2012) BCC 676, 696.
[1389] *Wishart v Castlecroft Securities Ltd* (n 1338) at [37].
[1390] *Cullen Investments Ltd v Brown* (n 1375) 551–552.
[1391] Kershaw (n 310) 622.
[1392] *Iesini v Westrip Holdings Ltd* (n 1322) 441.
[1393] See Keay (n 1325) 53 where the author comments on the case of *Kleanthous v Paphitis*, referring to it as an example of the court’s resistance to engage in assessing commercial considerations.

court usually tends to step back from the objective assessment of commercial factors, being in favour of staying within the limits of the law.[1394] In his comments on whether or not the statutory system of derivative claims would result in significant numbers of derivative litigation, Reisberg seems to be right when he asserted that the traditional suspicion of courts towards derivative actions would continue, especially following the introduction of CA 2006 because they were currently' 'armed' with a very restrictive legislation to 'justify' their attitudes'.[1395]

5.5.2.2.2 Ratification (authorisation)

In the second stage, the ratification of wrongdoing is still relevant to the question of whether permission will be granted to continue the derivative action. The court has no option other than to dismiss the claim if the act complained of was ratified or authorised by the company (mandatory dismissal stage).[1396] If the ratification or authorisation did not occur, the court proceeds to the permissive stage where it, at its discretion, decides whether the act is likely to be ratified or authorised.[1397] It is noteworthy that while ratification simply refers to the 'retrospective approval' of acts (breaches), authorisation (via the board or the general meeting) is a 'requisite approval' obtained prior to the act.[1398]

When examining the issue of ratification,[1399] it seems true to say that ratification under the common law is still relevant to the regulation of this area of law because the CA 2006 does not change many rules on ratification of breaches of directors' duties that were developed by the case law.[1400] In the context of derivative claims, the central question encountered by the court concerns whether or not a purported ratification of wrongdoing is effective. In this regard, the common law rule that allows the wrongdoer to vote as a shareholder in

---

[1394] See D Gibbs, 'Has the Statutory Derivative Claim Fulfilled Its Objectives? The Hypothetical Director And CSR: Part 2' (2011) 32 Company Lawyer 76, 79.
[1395] A Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 2–3 European Company and Financial Law Review 219, 225.
[1396] Section 263 (2)(c) of the CA 2006. In relation to authorisation, the court must also dismiss the claim if an act has not yet occurred, but has been authorised by the company, see section 263(2)(b) of the CA 2006.
[1397] See section 263(3)(c) of the CA 2006 which relates to the cause of action resulting from an act yet to occur, whereas section 263(3)(d) is concerned with that an act that has occurred and is likely to ratified.
[1398] See Kershaw (n 310) 612–613.
[1399] Because of limited space within which to discuss the authorisation, which is certainly relevant to the discussion of this section, reference will be made here to the issue of ratification, assuming that statutory rules in the context of derivative claims applying to ratification largely apply to authorisation. However, any discrepancy between rules will be highlighted.
[1400] C Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34 Legal Studies 582, 583.

relation to the ratification resolution[1401] is no longer valid under the CA 2006.[1402] Section 239(4) clearly excludes the votes of an errant director, or any person 'connected with him[/her]'[1403] from being counted in relation to any ratification resolution at the general meeting. Furthermore, a wrongdoer or any connected person, as section 239(3) provides, will not count as a member for the purposes of written resolutions.[1404]

Nevertheless, the law on ratification has been seen by many as involving areas of complexity and ambiguity.[1405] In cases where the wrongdoing in question has been ratified, the court, as required by section 239, is expected to ensure the effectiveness of purported ratification by analysing the nature of the votes of shareholders at the general meeting and whether a voter could be regarded as being connected to the defendant, thereby invalidating their vote.[1406] This would result in hearings becoming dominated by arguments over whether or not the ratification is effective and therefore no change is likely to occur in favour of a wide judicial discretion.[1407] Since the validity of the ratification requires excluding the votes of those connected with wrongdoers, this implicitly means that the court will take into account wrongdoer control over the voting process. Accordingly, the uncertainty associated with what amounts to wrongdoer control of the general meeting might continue to be used to determine whether or not particular shareholders are connected.[1408] This task, namely to identify the purported wrongdoer control, is likely to be a difficult one in companies with large numbers of shareholders.[1409] Furthermore, the Act has been criticised for opening up more possibility for the ratification to be relied on to undermine the accessibility to derivative actions, because not only will the fact that the wrongdoing has been ratified be considered as a ground for the denial of a derivative action, but the likelihood of ratification might also be taken into account to dismiss the application for the continuation of a claim.[1410] The case of *Franbar Holdings Ltd* is an

---

[1401] See *North-west Transportation v Beatty* (1887) 12 AppCas 589 , 589, 591–592, 596 and 600, where it was held that the director who was in breach of his duty 'was entitled to exercise his voting powers as a shareholder in general meeting to ratify'; his wrong was done to the company because shareholders, unlike directors, do not owe fiduciary duties and their votes were considered proprietary rights; shareholders are entitled to use them to serve their own interests even if these conflicted with the company's interests.
[1402] See *Franbar Holdings Ltd v Patel* (n 1366) 897.
[1403] The definition of 'connected person' is set out in section 252 of the CA 2006.
[1404] It is worth noting that requirements set forth in section 239 of the CA 2006 are seemingly limited to ratification and do not apply to authorisation; D Kershaw (n 310) 613.
[1405] See generally Riley (n 1400); Reisberg (n 1395) 230; Keay (n 1325) 51–53.
[1406] This is called a *voting-based approach* and is designed to determine the validity of ratification; see Riley (n 1400) 583.
[1407] Reisberg (n 1395) 230–231.
[1408] Riley (n 1400) 608.
[1409] *Shareholders Remedies: Consultation Paper* (n 1297) para 4.13.
[1410] Keay (n 1325) 52.

example of an application being refused, *inter alia*, because of the likelihood of ratification taking place in future.[1411]

Further problems might exist in relation to section 239(7), which provides that 'any rule of law as to acts that are incapable of being ratified by the company' and remains unaltered by the statutory framework for ratification. Riley points out that the CA 2006 in section 239(7) preserves the common law position as to certain wrongs (e.g., acts amounting to fraud) that cannot be ratified and that also unsurprisingly preserves 'all the uncertainties' associated with the law on what constitutes an unratifiable wrong.[1412] The lack of clarity in the law could undermine the accessibility of derivative claims, forcing a minority shareholder to ponder whether the derivative litigation is a remedy worth pursuing. The importance of the problem associated with section 239(7) is best illustrated by the judgment delivered by William Trower QC in the case of *Franbar Holdings Ltd*. In brief, this was an application for permission brought by a minority shareholder to continue an action on behalf of Medicentres (UK) Ltd against the defendants who were two directors appointed by the majority shareholder (Casualty Plus Ltd) and Casualty Plus Ltd itself. The applicant, *inter alia*, alleged that the directors, by diverting businesses from Medicentres Ltd to Casualty Plus Ltd, had breached their fiduciary duties.[1413] The court, in deciding whether to grant the permission, took into its account the likelihood of ratification,[1414] especially as it was indicated to the court that Casualty Plus Ltd (which owned 75% of the company's shares) was likely to ratify the wrongdoing.[1415] Since Casualty Plus Ltd was a shareholder, the court had to consider whether Casualty Plus Ltd was a connected person within the meaning of section 254 of the CA 2006.[1416] The court found no evidence supporting the idea that Casualty Plus Ltd was a person connected to the wrongdoers within the meaning of the statutory provisions and therefore the vote of Casualty Plus Ltd could not be excluded in relation to the ratification resolution.[1417] One of the allegations the applicant submitted was that the wrongs in question could be ratified in the common law.[1418] While the deputy judge confirmed in interpreting section 239(7) that the CA 2006 did not change the common law position that specific wrongdoings were not

[1411] *Franbar Holdings Ltd v Patel* (n 1366) 898.
[1412] Riley (n 1400) 603.
[1413] *Franbar Holdings Ltd v Patel* (n 1366) 885–886.
[1414] Section 263 (3)(c) (ii) of the CA 2006.
[1415] *Franbar Holdings Ltd v Patel* (n 1366) 895.
[1416] What is relevant to the facts of this case is section 252(2)(b), which is concerned with 'a body corporate with which the director is connected', which is defined in section 254 of the CA 2006.
[1417] *Franbar Holdings Ltd v Patel* (n 1366) 896–897.
[1418] Ibid 897.

ratifiable,[1419] such unratifiable wrongs could effectively be ratified on condition that the vote to ratify did not involve the wrongdoers using their control of the company to 'improperly' prevent the applicant from initiating a derivative claim, which would be the case 'where the new connected person provisions are not satisfied but there is still actual wrongdoer control' of the company.[1420] The court here required more than a merely unconnected vote to ratify effectively unratifiable acts (e.g., fraud); in other words, the ratification could only be valid without the vote of Casualty Plus Ltd. If Casualty Plus Ltd were to vote, this would constitute an actual wrongdoer control.[1421]

It might be true to say that this judicial approach involves some aspects of uncertainty; for example, the law on what could be considered as a ratifiable wrong, as some argue, is still unclear.[1422] In addition, it is obvious that breaches that are categorised as unratifiable wrongs (e.g., fraud) cannot be ratified by merely an unconnected vote, as 'beyond that uncertainty prevails'.[1423] Indeed, given the fact that a ratification is only one (and perhaps not the weightiest)[1424] factor considered by the court in its discretion to grant permission, arguments over what amounts to a valid ratification would in many instances dominate the permission hearing,[1425] and this is regarded as a complex and contentious issue.[1426]

5.5.2.2.3 Applicant's good faith

Under section 263(3)(a) the court is required to take into account whether an applicant 'is acting in good faith in seeking to continue the claim'. To ensure that the good faith requirement is met, the court tends to question whether the shareholder applicant has a collateral purpose or motive for bringing the derivative action.[1427] In this regard, the case law seems to suggest that the court is unlikely to refuse permission based upon the absence of good faith simply because the applicant has other secondary motives for bringing the claim, provided the claim has also been brought in the interests of the company.[1428] This is expressed, for instance, by Lord Glennie in the case of *Wishart*, saying, in his own words, that 'why should an applicant be prevented from bringing the action simply because it may be asserted against him that he has other less creditable motives than a desire to see the

[1419] Ibid.
[1420] Ibid 897–898.
[1421] Riley (n 1400) 606.
[1422] Ibid 603 and 606.
[1423] Ibid 607.
[1424] Ibid 606.
[1425] Keay (n 1325) 52.
[1426] Reisberg (n 1395) 230.
[1427] See, for example, *Singh v Singh* (n 1374) [22]; *Hook v Sumner* (2016) BCC 220 , 235.
[1428] Keay and Loughrey (n 1335) 165–166.

company put back into funds?'.[1429] Furthermore, the court, in the *Iesini* case, disregarded allegations that shareholder applicants had brought the claim for the benefit of a third party and not the company,[1430] asserting that since the claim was initiated for the benefit of the company, the application for permission could not be refused because 'there are other benefits which [the claimant] will derive from the claim'.[1431] It seems clear that as long as the company will benefit from the bringing of derivative actions, the lack of good faith on the part of a shareholder claimant is likely to be disregarded.[1432]

In considering section 263(3)(a) the question of whether the claimant 'has clean hands' can be addressed by the court.[1433] In the common law the court would not allow the minority shareholder to bring a derivative action, as an exception to the rule in *Foss v Harbottle*, if the shareholder's behaviour, from the standpoint of equity, disqualified him/her from being a plaintiff on behalf of the company. This would be the case, for instance, 'if he[/she] participated in the wrong of which he[/she] complains'.[1434] The judicial approach to ensuring compliance with the equitable doctrine of clean hands has remained even after the introduction of the statutory derivative scheme, as illustrated in the *Iesini* case[1435] where the claimant's prior involvement in the company's management had contributed to the losses in the company, which would have constituted bad faith for the purposes of section 263(3)(a) of the CA 2006.[1436]

5.5.2.2.4 The availability of alternative remedies

It should be borne in mind that a derivative action is brought in relation to directors' breach of their duty towards the company and not individual shareholders.[1437] However, in some situations directors' conduct may amount to a breach of their duty towards the company and simultaneously a violation of shareholders' personal rights.[1438] Thus, in exercising its discretion as to whether to allow the continuation of derivative claim, the court is expected under section 263(3)(f) to consider whether the shareholder claimant can pursue the action in his/her own name instead of on the company's behalf. A petition for unfair prejudice

---

1429 *Re Wishart* (n 1338) [33].
1430 *Iesini v Westrip Holdings Ltd* (n 1322)114 120
1431 Ibid 448.
1432 Keay and Loughrey (n 1335) 167.
1433 E Mujih, 'The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2' (2012) 33 Company Lawyer 99, 101–102.
1434 *Nurcombe v Nurcombe* (1985) 1 WLR 370 , 376. The court cited the quoted statement, with approval from L Gower, *Principles of Modern Company Law* (4th edn, 1979) 652.
1435 See *Iesini v Westrip Holdings Ltd* (n 1322) 448–449.
1436 Ibid 448.
1437 Section 260(1) of the CA 2006.
1438 For example, a breach of the company's articles of association, see Kershaw (n 310) 625.

under section 994 of the CA 2006 is an example of an alternative remedy that can be brought by shareholders in their own name and the availability of the petition is usually considered by the court to determine whether or not section 263(3)(f) applies.[1439]

In brief, the petition under section 994 is typically ‘a personal action potentially producing personal benefits for the petitioning shareholder’, whereas the derivative action is brought to seek a corporate relief.[1440] The unfair prejudice petition is wider in scope than the derivative action.[1441] While a derivative action can only be brought in respect of a wrong done to the company within the meaning of section 260(3) of the CA 2006 (e.g., breaches of directors’ duties),[1442] the unfair prejudice petition can be submitted in respect of any act of the company to protect not only the rights of shareholders, but also their interests.[1443] Having said that, section 994 petitions can be founded on a wrongful act perpetrated against the company by directors because this remedy intends to protect members’ interests.[1444] In such situations, where unfair prejudice petitions are based on grounds such as breaches of directors’ duties, if the shareholder petitions successfully under section 994, the court may grant relief under section 996, under which it can ‘authorise civil proceedings to be brought in the name and on behalf of the company’.[1445] It should be noted that unlike the derivative action, there is no requirement to submit an application for permission under the unfair prejudice remedy.[1446]

Turning to the court’s consideration of section 263(3)(f), the court in the *Iesini* case makes it clear that the availability of an alternative remedy is not considered as a compelling reason for the discontinuation of derivative action because ‘if it were then it would have been a mandatory ground for refusing permission under s. 263(2) rather than a discretionary consideration under s. 263(3)(f)’.[1447] Indeed, the availability of alternative remedies is one among many factors that the court should take onto account to reach its overall decision. Whether or not the court will permit the application is fact-sensitive. The few cases heard since the CA 2006 do offer some guidance; for example, in a situation where a shareholder brings a derivative claim and has also initiated an unfair prejudice petition, the court is likely to refuse the continuation of the derivative claim, as illustrated

[1439] See, for example, *Franbar Holdings Ltd v Patel* (n 1366) 898–900.
[1440] Keay (n 1325) 60.
[1441] Reisberg (n 8) 278.
[1442] See *Iesini v Westrip Holdings Ltd* (n 1322) 441.
[1443] Reisberg (n 8) 278.
[1444] Ibid 278.
[1445] Section 996(2)(c) of the CA 2006.
[1446] Reisberg (n 8) 274.
[1447] *Iesini v Westrip Holdings Ltd* (n 1322) 449.

by the judgment of William Trower QC in the case of *Franbar Holdings Ltd*.[1448] However, the mere availability of unfair prejudice proceedings does not necessarily lead to the dismissal of the application for permission from the viewpoint of the court in *Stainer v Lee*.[1449] In addition, the more favourable claimant costs applying to derivative claims compared to unfair prejudice petitions[1450] could, as in *Kleanthous v Paphitis*, be a relevant consideration for dismissing the permission because of the availability of a more appropriate remedy in the form of a section 994 petition.[1451] However, the claimant's motivations to benefit from the indemnity costs should not prevent the court from permitting the claim if other considerations, especially the nature of wrongdoing purported and the relief pursued, indicate that the derivative action was the suitable remedy.[1452]

5.5.2.2.5 Other statutory factors that the court must consider

Under section 263(3)(e) the court must take into consideration 'whether the company has decided not to pursue the claim'. This discretionary factor was one of the grounds for refusing permission in the *Kleanthous* case.[1453] In *Kleanthous* the court attached considerable importance to the viewpoint of a committee of two disinterested directors who were empowered to offer professional advice and to make decisions on litigation. The court rationalised its position by saying that the committee concerned was better placed to determine what served the commercial interests of the company.[1454]

Under section 263(4), judges are required to take into account the evidence before them concerning 'the views of members of the company who have no personal interest, direct or indirect, in the matter'. The relevance of subsection (4) might be questionable because it is hard to imagine a shareholder of a company that does not have a personal interest in the derivative action that is brought to seek relief for the benefit of the company and not for a shareholder claimant.[1455] Indeed, as long as the wrong is perpetrated against the company, it is logical that every shareholder will at least be affected by the outcome of the claim and therefore have an interest in the claim.[1456] The court, in *Iesini*, acknowledged the difficulty

---

[1448] *Franbar Holdings Ltd v Patel* (n 1366) 899.
[1449] *Stainer v Lee* (n 1367) 135.
[1450] Keay (n 6) 454.
[1451] See *Kleanthous v Paphitis* (n 1388) 678 where the court, *inter alia*, refused the permission on suspicion that the claimant had decided to bring only a derivative action 'in the hope that he would be able to obtain a costs indemnity'.
[1452] Keay (n 6) 454.
[1453] *Kleanthous v Paphitis* (n 1388) 678.
[1454] Ibid 696.
[1455] Mujih (n 1433) 105.
[1456] Ibid.

in understanding subsection (4), suggesting that it might be better interpreted to require the court to consider the view of shareholders who were not involved in the alleged wrong and who were not in a position to benefit otherwise than in their capacity as shareholders.[1457] Even with this interpretation, the court will face some difficulties in resolving any dispute in relation to such matters.[1458]

5.6 The Right of Shareholders to Litigate: Areas of Uncertainty in Saudi Law

As explained above,[1459] the general meeting of shareholders is entitled to make litigation decisions against directors and the wrongdoer control of the general meeting is one main stumbling block to commencing the company's proceedings. In response to this issue, the law would usually confer the right on an individual shareholder to bring a derivative action. As far as the Saudi company law is concerned, one may question whether an individual shareholder can litigate, enforcing the breaches of directors' duties owed to the company. As will be argued below, neither the CL 1965 nor the new CL 2015 has successfully introduced an alternative judicial mechanism of enforcement for breaches of directors' duties in the form of derivative actions. Failure on the part of the legislation to adopt a clear regime of derivative actions does not sufficiently protect the company's interests and, consequently, undermines directors' accountability.

In respect of shareholders' right to commence derivative litigation under Saudi law, the only statutory provision relevant to this matter is article 80 of the CL 2015 (article 78 of its predecessor of 1965). According to article 80, a shareholder is entitled to bring a legal action 'against the members of the board of directors *on behalf of the company* if the wrongful act committed by them is of *a nature to cause him personal prejudice*' [emphasis added]. Significantly, the statutory provision adds that the shareholder claimant 'shall be adjudged compensation only to the extent of the prejudice caused him'.[1460] As a condition to initiate such litigation, the shareholder cannot bring a case unless the company's right to litigate is still valid and after he has given notice of his intention of bringing a lawsuit to the company.[1461] Article 80 of the CL 2015 is drafted the same as its immediate predecessor article 78 of the CL 1965. The statutory provision in the CL 1965 was the

[1457] *Iesini v Westrip Holdings Ltd* (n 1322) 350–451.
[1458] Ibid 451.
[1459] See footnotes 1273–1281 and accompanying text in this Chapter.
[1460] Article 80 of the CL 2015.
[1461] Ibid.

subject of criticism by some legal writers.[1462] The main shortcomings of article 80 will be examined below.

5.6.1 Uncertainty in the nature of article 80 action: Is it, in fact, a derivative action?

One of the sources of confusion stems from the fact that while the corporate statute permits shareholders to bring a lawsuit on behalf of the company, it clearly requires such a claim to be legally based on misconduct that has caused harm to the shareholders' interests, with any compensation flowing to the shareholders.[1463] The wording of article 78 (article 80 of the CL 2015) has posed a dilemma concerning whether or not the shareholders' action falls within the domain of derivative actions.

The argument put forward here is that although it is stated in article 80 of the CL 2015 that the claim is brought on behalf of the company, this is not sufficient to categorise it as a derivative action since the primary elements of a derivative action cannot be found in the article 80 claim. Legally speaking, whether the potential to instigate a legal action belongs to the company or to shareholders will be determined by determining whose rights are primarily breached by the wrongful act. If shareholders' personal rights are directly affected by the director's misconduct, they can bring a direct claim in their own name, and such litigation falls outside the domain of derivative action.[1464] However, in some instances where the wrongful act primarily amounts to the violation of the company's rights, such as breaches of duties of loyalty and care owed to the company, it is the company to which the claim belongs. In this case an injured shareholder should be only allowed to initiate the litigation derivatively so as to enforce the company's rights.[1465]

Another hallmark of derivative actions is that the shareholder claimant seeks a corporate relief (e.g., in the form of damages or disgorgement of profit) where any potential recovery, as a rule, belongs to the company and only benefits the derivative claimant indirectly.[1466] Based on this, the claim is understood to be derivative when a person (i.e., a director) who owes a duty to the company wrongs the company and when any relief

[1462] See, for example, Y Al-Zahrani, 'Rights of Shareholders under Saudi Company Law 1965' (Phd Thesis, Brunel University 2013) 195.
[1463] Ibid.
[1464] H Baum and D Puchniak, 'The Derivative Action: An Economic, Historical and Practice-oriented Approach' in D Puchniak, H Baum and M Ewing-Chow (eds), *The Derivative Action in Asia: A Comparative and Functional Approach* (Cambridge, Cambridge University Press 2012) 10–11.
[1465] Ibid 7, 8.
[1466] Ibid 9.

received from a successful derivative claim 'flows directly' to the company, not to the derivative shareholder claimant.[1467]

From the language of article 80, it appears that a claim is only permitted when a wrongful act has resulted in a personal prejudice to a shareholder. Importantly, the company would not receive relief for the wrong taken against it even though such claim was brought on its behalf. This suggests that the legal basis for 80 article claims cannot be a purely personal cause of action belonging to the shareholder, but it appears to be triggered by a wrong done to the company in which the interests of an individual shareholder have been indirectly prejudiced.[1468] In this regard, the shareholder can only seek a personal relief, not a corporate relief. A probable exception to that is in relation to self-dealing transactions where the shareholder under article 80 can seek a remedy either in the form of the rescission of a contract or the disgorgement of unauthorised profit.[1469] Still, the shareholder has to prove that the directors' failure to disclose their interest caused personal prejudice to him/her and that is not always easily accomplished.

Apart from that, a successful claim under article 80 is likely to result in a personal remedy for shareholders rather than a corporate remedy. As the wording of article 80 suggests, the claim is introduced to redress harm done to shareholders personally rather than harm done to the company. From the theoretical perspective, shareholders' right to bring legal action on behalf of the company is seen as deriving from the right of the company.[1470] As a result, the law should only allow the initiation of such rights as long as the wrong is done to the company and the remedy sought is for the benefit of the company.[1471] This means that both the direct claim by the company and the derivative claim by a shareholder should only be brought to protect the company's rights. Therefore, it is theoretically improper to allow a legal action by shareholders on behalf of the company in order to seek a personal relief for the wrong originally perpetrated against the company. In the strict sense it seems that an article 80 claim is not a derivative action[1472] and tends to be more a personal claim, which would legally be based upon the wrong done to the company.

[1467] Ibid 7.
[1468] Jobran (n 632) 388.
[1469] Article 71(2) of the CL 2015.
[1470] Baum and Puchniak (n 1464) 8.
[1471] A similar view is also expressed in the UK in relation to the debate concerning the interrelationship between a derivative claim and an unfair prejudice petition, see Reisberg (n 8) 282.
[1472] This has similarly been claimed regarding the old article 78 of the CL 1965, see Al-Zahrani (n 1462) 19.

Shareholders' use of an article 80 claim may come with some problems and concerns of which the following are the most important: first, as long as the remedy sought under an article 80 claim will flow to a shareholder claimant, the implication is that the company, including shareholders other than the shareholder claimant, will not benefit from any remedy granted by the court. As a result, non-shareholder constituencies also do not receive benefits. Indeed, creditors, for instance, tend to be well positioned and 'treated equally' if the wrongful act done to the company is redressed by corporate relief rather than a personal relief under article 80.[1473] Second, the permission for an individual shareholder to obtain personal relief for a wrong done to the company is likely to 'lead to a multiplicity of proceedings' in connection with the one wrongful act.[1474] Consequently, this could cause 'inefficiencies and inconvenience', and more specifically the incurring of greater costs than if there were a claim leading to relief for the company.[1475] Third, for an article 80 claim to be successful, it appears that shareholders would not only bear the burden to prove the breach of directors' duties, but also that the relevant misconduct on the part of a director(s) would have caused them personal prejudice, which could be difficult to establish; for example, in terms of self-dealing transactions, if a given director does not meet the disclosure requirement under article 71(1) and the company is unable to sue him/her, a shareholder may do so on behalf of the company under article 80, Here, he/she is likely to have the burden of not only establishing the breach of article 71, but also that the breach caused a personal prejudice. In relation to directors' breach of the duty of care, which is regarded as a wrong done to the company, not every instance of negligence amounts to shareholders' personal harm (e.g., reduction in dividends), unless the director has been grossly negligent in the company's management.

5.6.2 Other examples of deficiency

According to article 80 of the CL 2015, shareholders can derivatively sue directors who do wrong as long as the company entitlement to file the liability lawsuit is outstanding. The main problem with such a requirement is that the company's decision through the general meeting not to initiate litigation against directors would be regarded as a bar to the action under article 80 of the CL 2015. Given the issue of wrongdoer control over the general

[1473] See *Shareholders Remedies: Consultation Paper* (n 1297) para 16.4. Although this remark is made by the UK Law Commission when rationalising the need for derivative claims, it can also be valid in other jurisdictions in which the derivative action is not channelled into unfair prejudice petition.
[1474] Keay (n 1325) 65.
[1475] Ibid.

meeting, the law has indeed introduced an inaccessible mechanism available for the minority shareholders to enforce the company's rights.

Another point to consider is that the law *ex ante* requires shareholders to notify a company of their intention to sue directors on their behalf. The rationale behind this rule is to provide the company with an opportunity to determine whether to litigate against directors since the shareholders' right to litigation is originally derived from the right of the company. To be specific, the notice requirement intends to give the company a chance 'to vindicate its own rights'.[1476] In some jurisdictions the demand requirement will be submitted to the company's competent organs, which need to respond to such demand within a certain period.[1477] With such an arrangement, the law ensures that the company is informed and, more importantly, that its view is heard. In this regard, the Saudi law lacks certainty, making the demand requirement virtually meaningless. The CL 2015 is unclear about the nature of such notice to the company: is the purpose of such notification only to inform the company or to offer the company the chance to remedy the wrong before resorting to the court? What if the company refuses to take action against a director, will the company's refusal be regarded as a bar to the bringing of derivative litigation? This confusion results from the fact that the CL 2015 does not require the company to respond to the shareholders' notice and, equally, it does not oblige the shareholder to wait with proceeding with the action until receipt of the company's response.

From the discussion above it can be said that Saudi law has lacked clarity in designing a derivative claim intended to protect companies' interests. Indeed, the failure by Saudi law to introduce a clear system of derivative action undermines the effectiveness of derivative actions as a mechanism of accountability, impeding the shareholder's initiation of legal action on behalf of the company as a remedy of last resort.

5.7 The Problem of Funding and the Shareholder's Incentive to Initiate Derivative Actions

In order to determine whether or not the law provides an effective mechanism for enforcement in relation to derivative actions, it is not sufficient to evaluate the degree of accessibility and certainty of rules allowing for derivative actions to be brought, but it is

[1476] Reisberg (n 8) 219.
[1477] Baum and Puchniak (n 1464) 47; see also Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe' (2011) 37 Brooklyn Journal of International Law 843, 858–859, who reported the German law's adoption of the demand requirement as a procedural rule of derivative action.

also important to take into consideration the issue of funding derivative actions. This is because the legal costs of derivative actions could be a disincentive for minority shareholders.[1478] Thus, it can be reasoned that directors' duties would rarely be enforced by derivative actions.[1479] As Reisberg explains, if the lawsuit against a wrongdoing director failed and an individual shareholder is obliged to incur the costs of the lawsuit, this would make the commencement of derivative action uneconomical for the individual shareholder.[1480] In addition, even in the case of success, an individual shareholder will not directly receive any financial benefits, as any award made must be paid to the company as a compensation for the damage suffered, and the shareholder will obtain 'only' a financial benefit equal to 'a pro rata share' of the award of total damages.[1481] Indeed, the shareholder decision to initiate litigation is likely to be significantly affected by the above factors as the potential losses suffered from the action, in some instances, could exceed the possible potential benefits.[1482]

5.7.1 Costs rules of derivative actions

In Saudi law, the CL 2015 does not mention that the costs of litigation brought by a shareholder on behalf of the company must be incurred or indemnified by the company itself. This means that the shareholder plaintiff pursuing an article 80 action is, in the first instance, responsible for the financial coats of the litigation, regardless of the outcome of the legal proceeding. The absence of legislative arrangements for the issue of funding does not come as a surprise since an article 80 claim can only be brought if the shareholder claimants have been personally prejudiced and, more importantly, the compensation sought will directly flow to them. If shareholders sought corporate relief in the form of disgorgement of unauthorised profit, as they are perhaps entitled to do so under article 71(2) of the CL 2015, it is unclear whether the costs of litigation would be incurred by the company due to the absence of certainty in this area of law. The uncertainty faced by shareholders is exacerbated by the fact that the Sharia Procedure Law 2013 (SPL 2013) makes no provision for dealing with the issue of the financial costs of proceedings. For the Saudi law to encourage a shareholder to bring a derivative action, there must be some legislative rules dealing with the issue of funding, because if costs of litigation are not paid

---

[1478] A Reisberg, 'Funding Derivative Actions: A Re-examination of Costs and Fees as Incentive to Commence Litigation' (2004) 4 J Corp L Stud 345, 345 and 347.
[1479] Ibid 34, 347.
[1480] Ibid 345.
[1481] A Reisberg, 'Derivative Actions and the Funding Problem: The Way Forward' (2006) JBL 445, 446.
[1482] Reisberg (n 1478) 347 referring to J D Wilson, 'Attorney Fees and the Decision to Commence Litigation: Analysis, Comparison and an Application to the Shareholder's Derivative Action' (1985) 5 Windsor Y B Access Just 142, 171.

by the company, this may hinder a valid claim and allow those who have caused the company's losses to evade liability.

In contrast to the Saudi jurisdiction, the UK law has dealt with the issue of funding of derivative actions by leaving the power to issue indemnity cost orders to the court's discretion.[1483] This is illustrated by Civil Procedure Rule 19.9E, which states that the 'court may order the company [. . .] to indemnify the claimant against liability for costs incurred in the permission application or in the derivative claim or both'. In the UK there is always a general concern about the issue of costs in most legal proceedings because unsuccessful litigants, as a general principle, will be obliged by the court to incur the costs of their lawsuit in addition to the legal costs of the successful party.[1484] This principle is called 'a loser pays costs rule'[1485] and since it applies to the derivative claim, it is likely to be a disincentive for the minority to initiate litigation unless the chances of winning are very strong.[1486]

Therefore, whether the court has adopted a strict or lenient approach to the granting of indemnity costs orders is vital as far as the minority shareholders' incentive to bring derivative actions is concerned. In the common law, the judgment of *Wallersteiner v Moir*[1487] is an example of a case where the shareholder could obtain the indemnity costs orders at an *ex parte* preliminary hearing.[1488] In this case, Moir, a shareholder in the company, in the course of a continuing action against Wallersteiner for misconduct in the management of the company's affairs applied to the court for an indemnification order in relation to the future costs of litigation against Wallersteiner.[1489] The Court of Appeal held that, based on principles of equity, a derivative plaintiff had to be indemnified by the company against all costs he/she paid on behalf of the company as the company was the direct recipient of all benefits from such litigation.[1490] Lord Denning asserted that if the litigation was successful, the losing party (wrongdoing director) had to incur the costs; if he/she could not do so, the court would order the company to indemnify the derivative claimant.[1491] The Court of Appeal also made it clear that even in the case of failed litigation

1483 Reisberg (n 1481) 445.
1484 Rule 44.2 (a) of the Civil Procedure Rules (General Rules about costs), <https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part-44-general-rules-about-costs> accessed 1 April 2017.
1485 Reisberg (n 1481) 446, footnote 4.
1486 Kershaw (n 310) 632 and 633.
1487 *Wallersteiner v Moir (No. 2)* (1975) QB 373 .
1488 Keay (n 1325) 55.
1489 *Wallersteiner v Moir (No. 2)* (n 1489) 374.
1490 Ibid 391–392.
1491 Ibid 392.

so long as a shareholder's commencement of the derivative proceeding was based on 'reasonable grounds' which are meant to be 'a reasonable and prudent course to take in the interests of the company', the shareholder was entitled to be indemnified by the company for the costs.[1492]

Under the statutory regime of derivative claims, there are indications from the judiciary that the granting of indemnity costs orders is not a significant issue for an applicant seeking permission; for example, in *Iesini* the court asserted that once, through its discretion, it was satisfied that the claim should continue in the interest of the company, 'it ought normally to order the company to indemnify the claimant against his costs' in the context of derivative actions.[1493] The same view was also expressed in the case of *Stainer v Lee* where the court opined that the shareholder claimant being 'indemnified as to his reasonable costs by the company' is a normal outcome of the successful application for permission.[1494]

However, there have been a number of cases, under both the common law and the statutory scheme, which tend to follow a more cautious approach to the indemnity of costs in relation to derivative claims. Under the statutory system, in only two out of eight successful applications for permission has the court ordered the company to indemnify the applicant for the costs incurred.[1495] According to Keay, there is uncertainty revolving around the question of when the indemnity costs orders will be granted and this may undermine shareholders' confidence and negatively impact on their incentive to bring a derivative claim.[1496] The court's reluctance to award costs for a successful applicant is seen as unfair and 'harsh' as this approach may hinder a valid action, undermining the accountability of directors.[1497]

5.8 Concluding Remarks

The comparative analysis conducted in this chapter has shown that rules governing private litigation, as a mechanism of directors' accountability towards the company and its shareholders, are more certain and accessible in the UK compared with Saudi Arabia, despite the fact that there are some aspects of uncertainty in the UK law. In theory, whether

[1492] Ibid.
[1493] *Iesini v Westrip Holdings Ltd* (n 1322) 450.
[1494] *Stainer v Lee* (n 1367) 148.
[1495] See Keay (n 1325) 57.
[1496] Ibid.
[1497] Ibid 57–58.

the litigation decision is vested in the board of directors (e.g., the UK) or in the general meeting of shareholders (e.g., Saudi Arabia) comes with problems and concerns that make the enforcement of breaches of directors' duties difficult. As a matter of policy, this chapter has shown that the law should not exclusively rely on the board or the general meeting to bring the legal action. Alternatively, an accessible and clear mechanism of enforcing directors' duties in the form of derivative action should be established within the system of legal accountability. This is simply because even in the presence of public enforcement of breaches of directors' duties, some limits, as have been identified above, to the role of public enforcement give room for the private enforcement action, particularly derivative action to complement enforcement by the public regulator.

In the UK the statutory derivative scheme has been introduced to address some issues relating to the derivative claim under the common law. It is now for the court through two-stage hearings to determine whether or not the commencement of derivative litigation is in the interests of the company. The main observations identified in the UK system of derivative actions can be summarised as follows: it seems that it is an easy task for shareholders to establish a *prima face* case that does not reflect whether or not the chance of success in the final stage is substantial. Having said that, doubts could be raised about whether the court should go through the first stage involving the *prima facie* enquiry because of increased costs and time wasting associated with such an inquiry. In addition, within the second stage, while the court's resistance to engage with the business judgment is understandable at the mandatory refusal stage when assessing section 263(2)(a), such continued resistance in relation to section 263(3)(b) is not justifiable because this strict approach adopted by the court has, to some extent, contributed to the limited accessibility to derivative actions.[1498] Furthermore, it has been shown that some areas of the law on ratifications are complex and vague, and this could lead a minority shareholder to question whether the derivative litigation is a remedy worth seeking.

Nevertheless, the UK law tends to be well positioned compared with the Saudi law as far as the enforcement of breaches of directors' duties are concerned. The chapter has shown that if the company was incapable of pursuing the legal action because of the wrongdoer's control of the general meeting, the law has not, in fact, introduced a statutory derivative action to enforce the company's rights. The Saudi law, unlike the situation in UK, has

[1498] Ibid 67–68.

failed to formulate the claim under article 80 of the CL 2015 in such a way that protects the company's interests and ensures the accountability of directors to its company.

With respect to the role of funding in incentivising minority shareholders to bring a derivative action, the Saudi law lacks statutory provisions dealing with the issue of funding in the context of derivative actions. Since an article 80 claim is more likely to be a personal action rather than a derivative action, the absence of rules governing costs of litigation cannot be seen as highly desirable. However, in the presence of a derivative action regime, there must be rules governing the costs of derivative litigation, as there are in jurisdictions such as the UK.

Chapter 6: To What Extent Can Saudi Law Benefit from the United Kingdom? Considering a Reform Agenda and Its Implications

6.1 Introduction

By using the UK law as a benchmark to evaluate the Saudi law, previous chapters[1499] have located significant areas of uncertainty and deficiency in the legal system of directors' duties, particularly the duty of care; the duty to act in good faith in the general interests of the company; and the duty to avoid conflict of interests with particular focus on the corporate opportunities and self-dealing transactions, and the private formal mechanism of enforcement. Despite the enactment of the new CL 2015 and the new Saudi CGRs 2017, the comparison with UK law has shown that there is still room for improvement. Indeed, the law should be designed in a way that creates incentives for directors to behave honestly and effectively by imposing legal liability on those who do not. This cannot be properly achieved without legal reform that ensures that well-formulated directors' duties are included in the corporate law. This must be combined with an effective private formal mechanism, namely a derivative action to enforce breaches of the obligations. Arguably, it is believed that resolving this important area of corporate law would enhance the accountability of directors, and provide greater protection for the company and its shareholders, including the minority.

This chapter, by resorting to legal change through legal transplantation, examines the extent to which the Saudi legislature can benefit and learn from the experience of the UK in order to correct deficiencies identified in the aforementioned areas of the legal system of directors' duties. The comparative law literature suggests that law reform through the transfer of legal ideas and rules from one country to another cannot be accomplished without taking into account the legal environment and institutional structure in the host country (in the present case, Saudi Arabia).[1500] The analysis conducted below will have particular regard to the fact that new imported rules do not contradict Sharia, the paramount law of Saudi Arabia.[1501] The effectiveness and the capability of courts will also be taken into account to ensure that rules imported from the UK concerning duties of directors and the enforcement of their breach through litigation are likely to fit within the

[1499] Particularly, see Chapters 3, 4 and 5 in this thesis.
[1500] See for example Kanda and Milhaupt (n 41) 891.
[1501] See section (1.2), Chapter 1.

legal infrastructure.[1502] Furthermore, while examining the feasibility of legal transplantation, cognisance will be taken of factors such as the limited role of markets as a non-legal mechanism of accountability in the Saudi context, as well as the need to ensure greater protection for non-controlling shareholders from abusive practices by directors, who may also be blockholders. The primary argument submitted here is that the transfer of some selective legal ideas and notions from UK law to Saudi law is necessary, and seems to be feasible with some adaptions to take account of local circumstances. When considering legal reform for Saudi law of directors' duties and enforcement, it should be kept in mind that corporate governance regulation must always attempt to strike a proper balance between accountability (reducing agency costs) and authority (directors' freedom to exercise its discretion).[1503]

Concerning its structure, Chapter 6 is divided into four main sections. The first section contains reasons that support the reform by way of legal transplantation in Saudi Arabia (6.2) followed by a consideration of the debate over the competing values of accountability and authority (6.3). In sections (6.4) and (6.5), the feasibility of transplantation of some legal ideas from the UK are examined and a reform agenda for the Saudi law of directors' duties and derivative actions is proposed.

6.2 Legal Transplants As a Strategy of Legal Reform in Saudi Arabia: The Necessity and Possible Success

Legal transplantation, an approach adopted in this chapter to remedy deficiencies in Saudi law, might be considered as the most productive source of legal development.[1504] The central question addressed in this section is whether the importation of legal norms from Western legal systems, such as the UK, is necessary, and if it is, how legal transplants can be effective or successful in the Saudi context.

6.2.1 Justifications for legal transplantation in Saudi Arabia

As has been emphasised earlier in this thesis, the movement of legal ideas and rules across national borders is at least possible from the theoretical point of view.[1505] In the Saudi

[1502] See Pistor and Xu (n 226) who emphasise the important role of courts by arguing that they should be given the power to define and enforce fiduciary duties.
[1503] See generally Keay (n 304) 259 –276.
[1504] Watson (n 30) 95.
[1505] See footnotes 29–49 and accompanying text, Introduction of this thesis.

context, it can be argued that there is a convincing rationale for legal transplantation in relation to company law. What follows are some of the most significant arguments supporting the idea that legal transplant is largely possible and necessary to reforming the law of directors' duties.

First, as stated earlier,[1506] the long historical practice of voluntary adoption of foreign laws by the Saudi legislature, at least in the areas of commercial and business law, demonstrates the important role of legal transplant as a process of legal change.[1507] This suggests that by using the legal transplant approach to improve the law of directors' duties, this thesis is in line with the government policy on modernising the law of business organisations.

Second, with the growth of globalisation and the pressure exerted by competition, it may be argued that countries have no option other than to move towards legal convergence by means of the voluntary adoption of efficient corporate rules and institutions.[1508] This is because companies operating with a sound corporate governance system will have an advantage in this global competition.[1509] In Saudi Arabia, as in other countries in the region, the development of corporate governance has been mainly attributable to the state's intervention through legislating legal ideas and concepts.[1510] As Amico correctly noted, the competition among Middle Eastern countries to establish themselves as regional financial centres, was one of the main motivations behind the government's desire to develop a good corporate governance culture.[1511] Similarly, as some areas of uncertainty and deficiency identified in the legal system of directors' duties, would undermine the accountability of directors and, more generally, the availability of good practices of corporate governance, the decision to draw on legal ideas found in well-developed legal systems such as the UK tends to be necessary for establishing the sound company law needed to survive in such constant competition. It should further be noted that the new Saudi 2030 Vision, along with its implementing and transformative programmes, which are intended to help Saudi Arabia to increase the non-oil government revenues, will put the Kingdom's economy on the threshold of a new era. It is a significant part of the 2030 Vision to support the private

[1506] See section (1.3), Chapter 1 in this thesis.
[1507] See Sfeir (n 124) 733–734.
[1508] F A Gevurtz, 'The Globalization of Corporate Law: The End of History or a Never-Ending Story?' (2011) 86 Wash L Rev 475, 494. This argument can be linked to the economic efficiency explanation for legal change proposed by Mattei, who opined that the race to adopt efficient rules would lead to the legal transplants of foreign ideas, see U Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 14 International Review of Law and Economics 3.
[1509] Gevurtz (n 1508) 494.
[1510] See A Amico, 'Towards 'Shareholder Spring' in the Middle East?' in S Boubaker and D Nguyen (eds), *Corporate Governance in Emerging Markets* (Berlin Heidelberg Springer 2014).
[1511] Ibid 534.

sector through increased involvement and investment, and create a comprehensive privatisation programme.[1512] In order to help the government achieve the aims of the 2030 Vision, it has been clearly said that there is a need to update and review the laws and regulations.[1513] One of main reforms should be directed at reducing the serious levels of uncertainty in the legal system of directors' duties. Indeed, the design of a sound company law system where the directors' accountability towards shareholders, including minority shareholders, is promoted, will assist the Saudi government in achieving its goal to make investment in the stock market more attractive to domestic and foreign investors. In this regard, seeking to benefit from the experience of well-developed legal systems would seem to be an effective and efficient strategy.[1514]

Third, the voluntary adoption of foreign company laws and institutions to meet the economic demands of Saudi Arabia is likely to encounter much less cultural resistance from the host country, at least from the theoretical perspective.[1515] As Cotterrell explains, a distinction can be drawn between 'instrumental law' and 'culturally based law'; while the former is 'more loosely connected' with culture, this is not the case in relation to the latter.[1516] In developing his theory about the interaction between comparative law and legal sociology, Cotterrell categorises the law into four basic kinds of 'community': the 'instrumental community, traditional community, community of belief and affective community'.[1517] Commercial law, of which company law is a main element, falls within the instrumental community, which involves laws that are not strongly linked with culture, compared with, for example, family law.[1518] As Cotterrell explains, legal rules (e.g., company law) in the instrumental community are tied to 'economic interests rather than national customs and sentiments'.[1519] Given the fact that the nature of company law is, to a large extent, culturally neutral, the flexible nature of Sharia involving the general guiding principle that 'all things not specifically prohibited are allowed',[1520] will continue to facilitate the legal importation of some foreign ideas into the Saudi legal landscape if it is both not clearly prohibited and is unlikely to face cultural resistance.

[1512] For more details as to the Saudi 2030 vision, see the website of the Saudi 2030 Vision, <http://vision2030.gov.sa/en>.
[1513] 'The Regulation Review Program' is one of the transformative programmes designed to achieve the aims of the 2030 Vision; see the website of Saudi 2030 Vision <http://vision2030.gov.sa/en>.
[1514] See Fedtke (n 14) 550.
[1515] Cotterrell (n 49) 80.
[1516] Ibid.
[1517] Ibid 82.
[1518] Ibid 81–82.
[1519] Ibid
[1520] M Hanson (n 52) 289.

Fourth, as has been shown in Chapter 2, although the predominant structure of most companies in the Saudi stock market (Tadawul) is one of concentrated share ownership, the reliance on monitoring by blockholders is unlikely to ensure that directors are subject to an adequate level of control and accountability.[1521] Similarly, the role of markets, when it comes to the issue of directors' accountability and governance, tends to be ineffective.[1522] Therefore, a detailed system of legal liability (i.e., well-formulated directors' duties, coupled with effective legal mechanisms available for shareholders) is necessary for ensuring greater legal protection for shareholders, including minority shareholders, against directors' misconduct. By imposing a sound system of legal liability, the law would also create incentives for directors to behave honestly and diligently. With the support from other legal jurisdictions such as the UK which has a long-established system of directors' duties and derivative actions,[1523] new legal ideas and concepts can, therefore, be borrowed to address legal deficiencies and promote legal certainty in the application of the law.

While the above-mentioned points explain why the approach of legal transplants to address deficiencies in the law of directors' duties is necessary and beneficial, it should be borne in mind that this study does not recommend the blind copying of the law from the UK to Saudi Arabia without having regard to the appropriateness of imported rules in the Saudi context. According to Berkowitz et al., the effectiveness of transplanted law in the host country depends upon whether or not the latter is receptive to the foreign transplanted law.[1524] This argument goes on to reason that the receptivity of the imported law would increase if the law is adapted to suit local conditions *and/or* is transferred to a legal system that is familiar with the law of the donor country.[1525] Indeed, by making changes to the law to ensure that it fits within the legal environment of the host country, it would appear that the appropriateness of the imported law has already been taken into account and, therefore, the law is likely to be employed in practice.[1526] The receptivity of Saudi Arabia to legal rules and standards that are recommended for transplantation from the UK to reform the Saudi legal system of directors' duties will be taken into consideration throughout the remainder of this chapter.

[1521] See generally sections (2.5.2) and (2.5.3), Chapter 2 in this thesis.
[1522] See section (2.8), Chapter 2 in this thesis.
[1523] In terms of company law, see for example, the case of Re Cameron's Coalbrook Railway Co (n 18) concerning fiduciary duties of directors, and the case of Foss v Harbottle (n 19) concerning the derivative action. These cases date back to the 19th century.
[1524] Berkowitz, Pistor and Richard (n 46) 174. The authors describe the term 'receptivity' as 'the country's ability' to give meaning to the imported law'.
[1525] Ibid 174, 180.
[1526] Ibid 174.

Before discussing the feasibility of legal transplantation, the following section will pay attention to an important aspect of the regulation of corporate governance, namely the need to strike the proper balance between accountability and authority:

6.3 The Policy Issue: Accountability Versus Authority

When drawing up a reform agenda for a corporate governance provision dealing with the board of directors, it is generally accepted that there has to be some balance between the authority given to directors and the accountability of directors.[1527] As many assume, there would be a tension between these two important values (i.e., authority and accountability).[1528] The conflict, as has been noted, starts with the assumption that accountability mechanisms (e.g., directors' duties and the law of their enforcement) could limit the exercise of authority.[1529] One of the leading opponents of increasing accountability of directors is Bainbridge who opines that if the board of directors is subject to greater accountability, this will usually result in an inefficient decision-making process because it is necessary for efficient decision-making to expose the board to less risk of external review.[1530] According to Bainbridge, the increase of accountability comes at a price, namely shifting the decision-making power to shareholders or the court,[1531] which perhaps lacks the necessary expertise to make business judgments.[1532] It is also claimed that 'accountability unease will etherize necessary and desirable board discretion'.[1533] This argument goes on to say that accountability and authority are 'competing values', and, consequently, 'are ultimately irreconcilable' because it is impossible to hold directors accountable without constraining the directors' exercise of discretionary powers.[1534] Therefore, when it comes to the question of how to attain a proper balance between accountability and authority, scholars such as Bainbridge tend to be in support of granting directors significant authority, while placing less emphasis on accountability.[1535]

[1527] See for instance McDonnell (n 580) 140, 142; Arrow (n 303) 65–67, 77–79.
[1528] Bainbridge (n 325) 605.
[1529] See Gevurtz (n 1508) 515. The author gives examples of such tension by saying that the need to seek *ex ante* approval, as an accountability mechanism, which may only contain after-the-fact consequences, would undermine the motivation to use the authority.
[1530] S Bainbridge, *Director Primacy*, (UCLA School of Law Law-Econ Research Paper No. 10-06, May 2010) 11 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1615838> accessed 1 May 2017.
[1531] Ibid.
[1532] Bainbridge (n 323) 114, 120–121. According to Bainbridge, the US business judgment rule is a clear example of the US Delaware corporate law tilting the balance towards the authority of directors; see Bainbridge (n 1530) 11. For more details about the argument that the business judgment rule provides some indications that the US Delaware law does focus on the board's authority, see Bainbridge (n 323) 106-129.
[1533] Hutchinson (n 349) 1202.
[1534] Bainbridge (n 1530) 16.
[1535] See Bainbridge (n 325) 605.

Nevertheless, it seems right to say that there has been a general agreement that directors should be subject to an adequate volume of accountability while exercising their managerial discretion.[1536] While one may agree with Bainbridge when he states that it would be more efficient to design a corporate law that emphasises authority, Keay asserted that one should not overlook other significant principles such as 'fairness, respect and justice', which justify the imposition of accountability on the board of directors.[1537] Even proponents of shifting the balance towards authority do not deny the necessity of holding directors accountable for irresponsible use of authority, because the survival of any organisation requires a balance between accountability and authority within its governance system.[1538] It should always be borne in mind that the board's accountability is needed to reduce agency costs that result from self-interested conduct.[1539] Furthermore, not only do most scholars recognise the inevitable importance of board accountability within the legal system of corporate governance, there is a line of argument that challenges the irreconcilability of accountability and authority; for example, as Moore contends, accountability and authority in corporate governance, contrary to common assumption, are not 'mutually offsetting . . . phenomena, such that a gain in one can only be achieved at the corresponding loss of the other'.[1540] The two concepts are, in fact, 'mutually sustaining' phenomena;[1541] in other words, authority is not sustainable if it is not supplemented with effective accountability mechanisms.[1542] Similarly, Keay claims that if the law is in favour of greater accountability, this approach 'will just lead to less unaccountable authority, with the level of authority remaining the same'.[1543] Keay further suggests that increased board accountability simply consists of 'a check on how' the board of directors uses its discretionary powers.[1544]

It should be noted, however, that it will go against the will of legal reformers to introduce an effective corporate governance provision if the reform proposal that imposes greater accountability on directors leads to ineffective management and promotion of the

[1536] See, for example, Keay (n 304) 264, 276; see McDonnell (n 580) 168, 186; Arrow (n 303) 76.
[1537] Keay (n 304) 264.
[1538] Dooley (n 303) 468–471; Bainbridge (n 325) 573.
[1539] See footnotes 360 – 370 and accompanying text in Chapter 2 in this thesis.
[1540] M Moore, 'The (Neglected) Value of Board Accountability in Corporate Governance' (University of Cambridge Faculty of Law Research Paper No. 9/2015, February 2015) 3, <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2566335> accessed 4 May 2017.
[1541] Ibid 20.
[1542] Ibid 4.
[1543] Keay (n 304) 268. See also McDonnell (n 580) 144, who is in favour of adopting greater mechanisms of board accountability in the US corporate governance system.
[1544] Keay (n 304) 727–737; Moore (n 330) 39.

company's business.[1545] It seems true to say that in designing any corporate governance provision, accountability and authority should be reconciled in a manner that provides sufficient accountability in order to correct errors, while not 'destroy[ing] the genuine values of authority'.[1546] This indicates that any new corporate governance provision must not reduce accountability totally in favour of authority, or vice versa.[1547]

Having said that, as the current balance between accountability and authority in Saudi Arabia is not optimal in relation to the law of directors' duties and enforcement, it seems necessary to reform this area of law in a way that results in enhancing the legal accountability of directors, but without reducing directors' willingness to use their powers to efficiently manage the company's business.

6.4 The Reform of the Duties of Care and Loyalty by Way of Legal Transplantation

This section focuses on the feasibility of transferring selective rules and standards from the UK law to its Saudi counterpart to correct deficiencies identified in Chapters 3 and 4 of this thesis. The section starts with an examination of whether the duties of care and loyalty can be transferable.

6.4.1 Why can directors' duties be transplanted?

One of the important factors to take into consideration is the compatibility of any legal reform with Sharia instructions, because the codification of foreign legal ideas is permissible only if it produces laws that fall within the Sharia framework.[1548] It appears credible that recourse to the importation of some legal ideas and concepts from foreign legal systems can be justified on the basis that Sharia does not include precise details relating to how the corporate form of organisation should be governed and controlled.[1549] In many areas of law Sharia tends to provide only general guidelines, leaving the details to be filled in by the society concerned according to the level of development it has achieved; for example, from the primary sources (*Qur'an* and the Sunnah), Muslim jurists had developed

---

1545 Keay (n 304) 273.
1546 Arrow (n 303) 77–78.
1547 McDonnell (n 580) 143 and 168.
1548 See generally section (1.3), Chapter 1 in this thesis.
1549 It is worth mentioning here that there was no recognition of the Western legal notions of corporation, legal personality and limited liability in the classical Islamic law literature in which Muslim jurists were familiar with a partnership with unlimited liability and with interdependent legal personality; see generally Kuran (n 151) 786–787; Foster (n 145) 29–33.

the concept of *ta'adi* to cover negligent acts.[1550] While it is generally accepted that the failure to act diligently falls within the concept of *ta'adi* (negligence in a narrow sense), the criterion on which the *ta'adi* is established is not defined in the traditional Islamic jurisprudence, leaving this issue to the state concerned to deal with. In this regard, to define the negligence standard, Sharia leaves it open as to whether recourse should be made to custom,[1551] or state legislation introduced in accordance with the Islamic principle of public interest.[1552] This argument is also valid in relation to some aspects of the duty of loyalty as Sharia recognises several general legal principles that can be employed as a theoretical basis of the duty of loyalty in the corporate context; for example, Sharia law explicitly requires Muslims to comply with the general principles of fairness, honesty, trustworthiness and justice in their business activities.[1553] Yet, Sharia does not provide detailed rules of how the general principles should be applied in specific contexts, leaving room for jurists to develop a body of law that can effectively apply to a particular context. Having said that, Sharia tends to have a large degree of flexibility and capability for development in which it is possible to introduce new rules that were not previously recognised in response to varying needs, as long as they are not in conflict with the general instructions found in the *Qur'an* and the Sunnah.[1554]

This argument is borne out by the fact that although there are still some areas of uncertainty and ineffectiveness in the legal standards of directors' conduct and liability, Saudi corporate law has already looked to developed legal systems to improve the law governing directors' duties; for example, self-dealing transactions by directors have been regulated since the first corporate legislation in Saudi Arabia in 1965 and were reregulated by the recent CL 2015, with further rules introduced by the CGRs 2017 for companies listed on Tadawul. With new developments introduced by the CGRs 2017, this is also the case in relation to the obligation to act in good faith and to advance the company's interests. The need to prevent directors exploiting corporate opportunities has finally been recognised by the CGRs 2017. In this regard, it is fair to say that the aforementioned provisions governing directors conduct and liability are clear examples of the use of Islamic principles of public interest being employed to protect the welfare of those involved in the market. The main point to take from this is that while Sharia provides general guidelines in relation to the area of corporate law, the practice of legal

---

[1550] See footnotes 649–655 and accompanying text, Chapter 3 in this thesis.
[1551] See footnotes 691–693 and accompanying text, Chapter 3 in this thesis.
[1552] See footnotes 101 and 133–137 and accompanying text, Chapter 1 in this thesis.
[1553] See footnotes 88– 90, Chapter 1 in this thesis.
[1554] See footnotes 128–137 and accompanying text, Chapter 1 in this thesis.

transplantation is not only permissible, but also necessary for supplying specifics and ensuring the most effective application of general Islamic instructions. It therefore seems that it is unlikely that Sharia will present a barrier to legal transplantation of standards of directors' duties in Saudi Arabia, given the fact that the recognition of directors' duties of care and loyalty are already in place within the legal structure of corporate governance.

Another important point to consider is that the proper application and enforcement of the Anglo-American version of directors' duties require the presence of a highly developed court regime. According to Pistor and Xu, it is optimal to empower courts with law-making and law enforcement powers to deal successfully with open-ended standards (e.g., duties of care and loyalty),[1555] which is an example of an incomplete law.[1556] As to law-making powers, the duty of care and of loyalty is inherently an area of law in which written legal provisions are often incomplete,[1557] and the standardisation of directors' actions is usually impossible.[1558] Hence, there should be a heavy reliance on the role of courts in making the incomplete law effective (i.e., more complete) through the allocation of *ex post* extensive law-making powers.[1559] This includes the power of interpretation of statutes, of adapting to varying conditions and the extension of its application to other cases.[1560]

In the common law tradition it is not unusual to see judges not only applying the law, but also making the law, and the exercise of such a task is more familiar to common law courts than civil courts.[1561] To clarify this point, for example, the interdoctrinal legal transplant of the fiduciary duty of loyalty from trust law to company law within the UK legal system should be considered.[1562] Although the fiduciary duties are rooted in UK law of equity,[1563] the law of fiduciary duties has been adapted to the needs of those involved in the field of companies. As Kershaw points out regarding the law of self-dealing transactions, the importation of some equitable principles from trust law was justified to fill in the gaps left

[1555] Pistor and Xu (n 226) 6-17.
[1556] Ibid 14. As developed by Pistor and Xu, the idea that the law is inherently incomplete means that when the lawmakers enact statutes, it is impossible to design legislation that would cover all future contingencies. The incompleteness of law can result from either a situation where the law 'broadly circumscribes outcomes' while specifying no or only a few actions (Type I incomplete law) or a situation where the law identifies certain prohibited actions 'but fails to capture all relevant actions' (Type II incomplete law). As far as the directors' duties are concerned, such obligations fall within the domain of type I incomplete law; see generally Pistor and Xu (n 398) .
[1557] Pistor and Xu (n 226) 14.
[1558] Ibid 6, 14.
[1559] Ibid 17.
[1560] Pistor and Xu (n 398) 4.
[1561] See J Coffee, 'Privatization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 J Corp L Stud 1, 27.
[1562] Davies and Worthington (n 2) 478.
[1563] See L Sealy, 'The Director as Trustee' (1967) Cambridge LJ 83.

by the company legislation, but the case law promptly diverged to introduce 'different fiduciary standards for directors'.[1564] Arguably, the development of fiduciary duties is largely attributable to the significant role played by the court when adapting the fiduciary law to fit within the corporate context. Indeed, until the introduction of the CA 2006, the law defining the scope of directors' duties of loyalty was made by judges and the case law was the predominant source of law.[1565]

By contrast, the situation in jurisdictions such as Saudi Arabia is substantially different regarding the court's exercise of law-making power. As the analysis conducted throughout Chapters 3 and 4 shows,[1566] Saudi courts have not been sufficiently active in filling in the legislative vacuum and that is one of main contributing factors to the underdeveloped regulation of directors' duties. It is perhaps true to say that Saudi judges are not willing to exercise law-making powers in areas that fall beyond context of Sharia because they may not have sufficient expertise in corporate matters.[1567] This is illustrated by the court's reluctance, when the legislative vacuum exists, to shape clear boundaries for the duty of loyalty in a way that reduces agency costs that result, for example, from the appropriation of corporate opportunities. Indeed, in the absence of a legislative provision, a director could be allowed to make profits by engaging in a conflict situation.[1568] In this regard, Saudi Arabia does not differ much from neighbouring jurisdictions that suffer from the underdevelopment of fiduciary duties because of the court's failure to define the limits of the concept of the fiduciary relationships and the basis of legal liability adequately.[1569] More generally, Saudi Arabia is similar to other civil law jurisdictions where judges usually tend to apply, but not make the law;[1570] in other words, the power of law-making is primarily allocated to the legislature and the court has very limited discretion to make the law.[1571]

It seems that the blind copying of UK directors' duties standards into the Saudi company law may not be effective as Saudi judges tend to be reluctant to play an active role in developing clear guidelines that delineate directors' liability. This means that Saudi judges

[1564] Kershaw (n 1104) 4.
[1565] See the analysis in Chapter 4 in this thesis. This is also the case in relation to the duty of care, see Chapter 3 in this thesis.
[1566] See the analysis in Chapters 3 and 4 in this thesis.
[1567] This is seemingly a common problem in civil law jurisdictions, See Pistor and Xu (n 226) 7.
[1568] See the discussion concerning Case No. 725/1/Q (n 1068) in section (4.4.2), Chapter 4 in this thesis.
[1569] L Al-Rimawi, 'Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation' (1999) 7 Journal of Financial Regulation and Compliance 149, 159.
[1570] See, for example, J Coffee (n 1561) 27.
[1571] See section (1.5), Chapter 1 in this thesis.

with their current training and experience would not be able to deal with broadly open-ended standards as effectively as UK judges, who are usually granted wide discretion to make the law *ex post* and are more comfortable with dealing with open-ended concepts. Therefore, the transplantation of UK directors' duties can only be feasible if they are adapted to fit properly within the Saudi legal environment.[1572] To be specific, the UK version of duties of care and loyalty can be successfully transferred into Saudi law (i.e., a legal system influenced by, or similar to, the civil law court tradition) only with support of detailed legislation, which will help to ensure the effective enforcement of the imported rules by Saudi courts.[1573]

6.4.2 Selecting the legal concepts and ideas to transfer

The comparison made between the UK and Saudi company laws in Chapters 3 and 4 revealed that there are four main areas of the law of directors' duties that need to be reformed in the Saudi context: (i) the duty to manage the company with diligence; (ii) the duty to act in good faith in the general interests of the company; (iii) the duty not to appropriate corporate opportunities; and (iv) the duty not to engage in self-dealing transactions. In this section the focus will be on examining the extent to which Saudi law can benefit from UK law, addressing the question of which UK rules and standards can be transferred and what adaption needs to be carried out in order to ensure proper enforcement by Saudi courts.

Before examining the feasibility of reforming directors' duties by way of legal transplantation, it is important to note that any proposed reform agenda resulting from such an examination should take the form of mandatory rules to be included in the Saudi CL 2015,[1574] either as an amendment to an existing provision or as a new provision. This should also be the case in relation to the proposed reform agenda in the context of a derivative action, which is considered later.[1575] The presentation of the proposed reform as mandatory rules in the CL 2015, can be justified on the basis that unlike the UK, mandatory corporate rules are needed in jurisdictions like Saudi Arabia where there are incomplete and immature non-legal mechanisms of markets.[1576] Hence, the mandatory nature of corporate rules would play a central role in providing shareholders (especially

[1572] See Berkowitz, Pistor and Richard (n 46) 167, 174.
[1573] See Pistor and Xu (n 226) 7 – 8.
[1574] This is subject to one exception in relation to self-dealing transactions where the proposed reform should be part of the CGRs 2017.
[1575] See section (6.5.2), Chapter 6 in this thesis.
[1576] See section (2.8), Chapter 2 in this thesis; see generally Paredes (n 608).

minority shareholders) with necessary protection against abusive practices by directors, filling the vacuum left by the absence of accountability mechanisms of markets.[1577] In addition, by rendering the law of directors' duties mandatory, company participants (in our case directors) will be bound to comply with them; therefore, such law would provide the minimum necessary protection for shareholders because mandatory rules can be adjusted upwards, but cannot be adjusted downwards. Furthermore, a mandatory model of company law will guarantee that all companies are subject to the proposed reforms, ensuring greater accountability of directors and more legal protection for the company and shareholders in the Saudi market. Finally, increased legal certainty can be accomplished via a mandatory law drafted with intelligible rules and standards,[1578] that can be understood by the corporate community, which, in turn, can rely on the judiciary to it apply in consistent fashion.

6.4.2.1 The duty of care

Although the CL 2015 does not expressly oblige directors to act diligently, this can be implicitly derived from the director–company relationship and from some statutory provisions under which the courts can expect directors to act with care to avoid legal liability.[1579] However, it is not enough simply implicitly to recognise the directors' need to act with diligence. Given the modest role of courts in developing an accessible and effective model of the duty of care, there should be legislative intervention to introduce clear and authoritative guidance for directors, judges and lawyers to ensure legal accountability of directors for negligence. Therefore, under Saudi law, the standard for compliance with the diligence requirement should not only be based upon objective consideration,[1580] but also on subjective factors (i.e., a dual subjective/objective standard) drafted in clear terms.

With regard to the formulation of the objective standard for the duty of care, given the legislative and judicial vacuum, it is not sufficient to presume that directors' behaviour will be assessed according to an 'imaginary ordinary careful director test'.[1581] Like the UK CA 2006,[1582] the Saudi legislation should expressly refer, within the design of an objective standard, to the need for the court to take into consideration different roles and functions of

[1577] Ibid 407.
[1578] Paredes (n 587) 1133–1134.
[1579] For more details on the issue of recognition of director's duty of care, see section (3.2.2), Chapter 3 in this thesis.
[1580] See section (3.3.2), Chapter 3 in this thesis.
[1581] See particularly footnotes 694–696 and accompanying text, Chapter 3 in this thesis.
[1582] See section 174(2)(a) of the CA 2006.

the directors concerned. For considerations of fairness and justice, it is important for the Saudi law to recognise that the extent of the care obligation varies depending upon the role assigned to the respective directors; for example, the performance of non-executive directors with less access to information compared with executive directors would be assessed pursuant to what can be reasonably expected of non-executive directors.[1583] The failure to adopt such a model is likely to expose non-executives, including independent directors, to a high risk of liability for the breach of duty of care because of the application of an over-demanding standard, and this could deter truly independent directors from accepting directorships.[1584]

In addition to the use of an objective standard, the court should take the skill, experience and knowledge of the different directors into its consideration (i.e., a subjective standard) when determining compliance with the requirement of due care.[1585] The adoption of a subjective standard would ensure that highly skilled and experienced directors would not evade legal liability when they fail to act as a reasonably diligent person with their skills and experience. This means that the more expertise directors have, the more care will be expected of them. The inclusion of subjective considerations in determining compliance with the obligation of due care will perhaps receive a broad welcome from the corporate community, especially as far as companies listed on Tadawul are concerned. As has been mentioned, listed company usually require certain qualifications and experiences from those nominated as board members.[1586] Indeed, it is generally expected that directors of a listed company will have the appropriate level of qualifications, training, financial knowledge and practical experience relevant to the company's business.[1587] Therefore, given the fact that directors are usually selected for certain skills and experience, it seems fair to accept that they should be judged against the degree of skill and experience reasonably expected of a person with their expertise and knowledge.[1588]

[1583] See generally section (3.4), Chapter 3 in this thesis.
[1584] See Hoffmann (n 715) 196. Regarding the composition of the board and its committees for listed companies, see footnotes 540–544 and accompanying text, Chapter 2 in this thesis.
[1585] This recommendation is based upon the UK standard for the statutory duty found in section 174(2)(b) of the CA 2006.
[1586] See footnote 699 and accompanying text, Chapter 3 in this thesis.
[1587] See article 18 of the CGRs 2017 which specifies a set of *recommendations* regarding conditions for board membership; article 39 of the CGRs 2017 which *recommends* that the company should provide directors and senior managers with necessary training.
[1588] A similar argument is put forward in relation to the UK law, see Reed (n 700) 172.

Within the legal regime of the duty of care, provisions for best practice in the decision-making process[1589] can be referred to, where appropriate, for the assessment of directors' compliance. It is, therefore, vital to specify a (non-exhaustive) set of statutory factors that constitute the breach of such an obligation. Not only will these factors largely guide the court, but directors will also be guided to discharge the duty of care successfully. It seems that in determining whether or not directors have conducted themselves reasonably, the Saudi law should refer to the need for the court, where appropriate, to examine the extent of reasonableness in a monitoring role,[1590] the extent to which directors have kept themselves informed of the company's affairs,[1591] and the extent of reliance upon information and advice given by other directors and professionals.[1592]

6.4.2.1.1 The issue of a high standard of care: Relief granted by the court

As mentioned in Chapter 3, concerns have been raised concerning the high possibility of the courts' review of business decisions when a single high standard of care is adopted. Neither jurisdiction (the UK and Saudi Arabia) has recognised the divergence between the standard of conduct and the standard of review, and have introduced a single standard to perform the two functions: (i) the establishment of a standard of behavioural expectation and (ii) a standard of determining the directors' liability for a breach.[1593] One of the UK's responses to this issue is to grant the court a discretionary power, under section 1157 of the CA 2006, to release directors from liability for the breach of their duty towards the company.[1594] Although the scope of section 1157 is wide enough to include cases other than negligence, it has been noted that this provision will usually be taken into account in the case of a breach of the duty of care.[1595] The question that will be addressed here is about the feasible transferability of the same legal idea into the Saudi legal context in order to deal with the issue of a single high standard of care.

In this regard, it might be true to say that judicial relief of liability is unlikely to fit within the Saudi legal conditions for the following reasons: First, the empowerment of judges to release wrongdoers (directors) from liability is not in line with Sharia philosophical

[1589] The new CGRs 2017 involves some provisions that need to be observed by directors and managers while managing the company; see, for instance, articles 30 and 31 of the CGRs 2017. It is worth saying that there is a draft CGRs that is intended to apply to unlisted joint stock companies, but it will be introduced as a set of non-binding rules.
[1590] See section (3.4.1), Chapter 3 in this thesis.
[1591] See section (3.4.2), Chapter 3 in this thesis.
[1592] See section (3.4.3), Chapter 3 in this thesis.
[1593] See footnotes 793–808 and accompanying text, Chapter 3 in this thesis.
[1594] See section (3.5.2), Chapter 3 in this thesis.
[1595] Keay (n 6) 529.

considerations. From the perspective of Sharia, rights can be broadly categorised into two groups: (i) the rights of God (Allah) and (ii) the rights of people. Directors' failure to take care or act in good faith falls within the latter. While the rights of Allah belong to Allah*,* who alone has the right to forgive any violation via an act of repentance, the acts of people can be only forgiven by the people;[1596] for example, the right to compensation is retained individually by an injured person and only he/she may forgo that right; the state (e.g., through the judiciary) does not have the right to forgo such a right and release the wrongdoer from the liability on behalf of the person concerned.[1597] Having said that, it can be argued that the judicial relief of liability is not an Islamic idea in the sense that it contradicts Sharia doctrines.[1598]

Second, the application of a judicial relief rule would be characterised by a large degree of confusion and uncertainty within the Saudi legal environment. There is nothing in the Saudi company law literature suggesting that care (or diligence) and reasonableness are different concepts in which the standard of care and diligence is higher than the standard of reasonableness for the purpose of determining directors' liability for the breach of their duty of care. As one commentator asserts, Sharia jurists do not even recognise a difference between diligence and reasonableness, and a reasonable act cannot be considered negligent.[1599] By contrast, the UK law, as explained in Chapter 3 of this thesis, has attempted to draw a distinction between what amounts to negligence under section 174 and what constitutes unreasonableness for the purpose of section 1157; in other words, although directors would be found liable for a breach of section 174 under the standard of negligence, they could be released from liability under section 1157 according to the standard of reasonableness.[1600] Nevertheless, even UK judges such as Hoffmann LJ have acknowledged that it appears 'odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably'.[1601]

In addition, as far as the UK court's exercise of fairness discretion is concerned, it has been noted that it is difficult to extract any fixed guidelines underlying the exercise of

[1596] K El-Fadl, 'The Centrality of Shari'ah to Government and Constitutionalism in Islam' in R Grote and T J Röder (eds), *Constitutionalism in Islamic Countries: Between Upheaval and Continuity* (Oxford OUP 2012) 53.
[1597] Ibid 53–54.
[1598] A similar view is expressed by another scholar, see Albrahim (n 1192)102.
[1599] Ibid 102–103.
[1600] See particularly footnotes 833–839 and accompanying text, Chapter 3 in this thesis.
[1601] *Re D'Jan of London Ltd* (n 665) 649.

fairness.[1602] As Edmunds and Lowry remark, 'it is not possible to define clear categories of breach that will always be excused', and for those who need to know whether relief is available in their case, it is impossible to give a definite, consistent answer in practice.[1603] The high level of legal unpredictability associated with the judicial relief rule is illustrated by the fact that even after the conditions of reasonableness and honesty have been met by the director, the UK court is given a very wide discretion to determine whether the liability relief ought to be granted or not.[1604] The difficulty with the UK judicial relief rule as applied in practice is the uncertainty and ambiguity, which are likely to persist in the Saudi context.

From the two reasons mentioned above, the transferability of a similar rule that allows the court to grant judicial relief for directors' breach of duty is unlikely to be feasible and it would be more appropriate to retain the present system of legal relief (remedies) without any significant change. One point to consider is that the potential impact of the absence of judicial relief should not be overstated in Saudi Arabia. As long as the basic rules of liability are well established, there is no clear need for the adoption of judicial relief. With the understanding of the duty of care as providing a legal standard of conduct and review of the decision-making process,[1605] the court should only assess whether directors have taken reasonable steps in reaching their decision, regardless of the outcome of the decision. Even if directors could not satisfy the high standard of care, this does not automatically give rise to the directors' legal liability. The court would question whether there is damage to the company and whether directors are liable for that damage. In this regard, it is the plaintiff's task to prove the presence of damage and the causal link between directors' breach and the damage. While it is true that judges are not businesspeople, they are expected to be experienced in legal affairs, and they can hear and make their decision based upon the evidence presented by both parties.

6.4.2.1.2 A proposed reform by way of legal transplantation

As a result of the examination of the feasibility of transplanting the UK duty of care found in section 174 of the CA 2006 into the Saudi law, the research suggests that since the CL 2015 lacks a provision requiring directors of joint stock companies to act diligently, a new statutory article should be inserted in the CL 2015 that:

[1602] Kershaw (n 310) 454.
[1603] Edmunds and Lowry (n 840) 213.
[1604] Keay (n 6) 527.
[1605] See Kershaw (n 310) 455.

- Establishes an overriding principle under which an individual director should act with reasonable care and skill.

- Specifies the standard for compliance with the statutory requirement of care in which a dual subjective/objective standard for the duty of care must be satisfied. This should also state that a reasonable director must perform as a reasonable person acting to fulfil the functions of a director and as a reasonable person with his/her skill, experience and knowledge.

- Specifies a non-exhaustive set of factors that constitute the breach of the proposed statutory duty of care. This shall particularly include the directors' failure to exercise the required reasonableness in monitoring the conduct of co-directors and managers, in keeping themselves informed of the company's business, and in their reliance on the conduct, information and advice given by other directors and professionals.

6.4.2.2 The affirmative duty to act in good faith in the general interest of the company

As discussed in Chapter 4,[1606] Saudi law suffers from the problem that the affirmative duty of loyalty, which specifies the legal standard of conduct and for a review of a decision itself,[1607] is left with an improper and rigid standard of liability. It appears that the duty is not formulated to reflect two integral components, namely (i) good faith and (ii) acting in the company's interests; in other words, it is unclear whether the law ties the good faith requirement to the duty to act in the company's interests. This, by implication, means that directors' state of mind is completely irrelevant when deciding where the interests of the company lie, allowing the court, at least in theory, to place itself in the directors' position to determine what is good or bad for the company. Having said that, there would be a high possibility of holding directors personally liable for a breach and the concern of increased liability would have a negative impact on the company's success.[1608]

A more appropriate test for assessing compliance with the affirmative duty of loyalty can be found in section 172(1) of the CA 2006, where good faith, which is used to define the

[1606] See section (4.2), Chapter 4 in this thesis.
[1607] See Kershaw (n 310) 455.
[1608] See footnotes 949–956 and accompanying text, Chapter 4 in this thesis

state of mind that must be complied with by loyal directors, precludes the court from second-guessing directors' judgement.[1609] The test applied by UK courts is a subjective one in which it is a 'director's honest belief' that will be taken into account when determining compliance with the obligation found in section 172(1).[1610] While considering the feasibility of transplanting the UK standard for the duty of good faith, it should be borne in mind that with a purely subjective test, it might be difficult to demonstrate directors' breach of duty under section 172(1) because it is for the directors, not the court, to determine where the company's interests lie. This is further complicated by the difficulty of challenging directors' assertion that what was done was what they honestly believed was in the interest of the company.[1611] However, it should be noted that having said that the duty of good faith is a subjective one (i.e., the directors' state of mind), this does not mean that the court is compelled to accept without question the directors' assertion that they acted in good faith, especially if the evidence contradicts the directors' statement.[1612]

Since good faith is the sole standard for the duty found in section 172(1), coupled with the fact that the court's recourse is to the subjective test, it can be argued that the standard for such a statutory duty protects directors' exercise of business powers rather than exposing them to greater legal accountability. Yet, for Saudi Arabia, the focus should be on ensuring directors' accountability for their own misconduct, despite the fact that the protection of their authority remains important and should be present in any corporate governance provision. The preferred approach should, therefore, combine both subjective and objective tests to determine whether directors have breached their duty to act in good faith in the general interest of the company.[1613] Put differently, the duty is subjective in the sense that it is for directors to decide where the company's interests lie. It is also objective in the sense that objective considerations and surrounding circumstances can be taken into account when determining whether directors honestly believed that what they had done was for the company's benefit. It is useful to note that the objective consideration focuses on the 'honest belief of directors' and should not assess the quality of the directors' judgement itself.

[1609] See footnotes 932–933 and 945–946 and accompanying text, Chapter 4 in this thesis.
[1610] For more details, see section (4.2.3.1), Chapter 4 in this thesis.
[1611] This concern has been raised by many in the UK company law literature; see, for example, Keay (n 6) 128–129.
[1612] For more details, see ibid 134–136.
[1613] A similar argument has been presented by scholars in the UK and Australian law literature, supporting the combination of two tests; see Langford and Ramsay (n 919).

The proposed approach can be justified by saying that the use of a purely subjective standard does not really correspond with the nature of Sharia law, which tends to prefer objectivity rather than subjectivity in assessing an individual's conduct.[1614] More importantly, it seems that a combination of subjective and objective tests would strike a balance between authority and accountability. On the one hand, the focus on the subjective belief of directors signifies that their business discretion is appropriately respected and they are the ones who are best placed to decide what is in the company's commercial interest. Indeed, the subjectivity of this approach tends to give directors the freedom to exercise discretion without being subject to strict judicial review of their business decisions.[1615] On the other hand, the reference to objective considerations can help to evaluate whether the belief is honestly held; this would promote the directors' accountability and ensure that directors will not easily escape legal liability.

When discussing the duty of loyalty to act in the general interest of the company under Saudi company law, the question of in whose interests the company should be managed is vital in determining whether directors have breached their loyalty obligation. As discussed in Chapter 4,[1616] Saudi company law, in the relevant legal provision,[1617] has used the elusive and open-ended phrase of the 'interests of the company', which can include the conflicting interests of many corporate constituencies. Given the ambiguity and uncertainty revolving around what is precisely meant by such a phrase, Ferran seems right when she suggests that it is a matter of 'prioritising' variously conflicting interests.[1618] In the absence of clear rules governing the priority of relevant interests, directors are given the opportunity to 'play off competing interests against each other and to use them to mask [their] own failings'.[1619]

As in the UK,[1620] Saudi law should abandon the reference to the 'interests of the company' within the legal formulation of the duty of loyalty, in favour of a more precise meaning of interests that should be served. To be specific, it should be stated that directors should predominantly manage joint stock companies for the benefit of the shareholder constituency who should have a priority for due consideration over non-shareholders. This view can be justified on the basis that since shareholders are the residual claimants to the

[1614] See Al-Sanhuri (n 653) 105.
[1615] See, for example Langford and Ramsay (n 919) 181.
[1616] For details on this issue, see section 4.2.3.3, Chapter 4 in this thesis.
[1617] See article 30 (17) of the CGRs 2017.
[1618] Ferran (n 958) 125.
[1619] Ibid.
[1620] See generally section 4.2.3.4, Chapter 4 in this thesis.

company's income, and they bear the most 'marginal risks of the [company]',[1621] the company has to be run mainly in the interests of shareholders.[1622] In addition, the formulation of the duty of loyalty in a way that requires directors to act for the benefit of all shareholders is in line with the basic feature of Saudi corporate governance, which is 'shareholder wealth maximisation', as the statutory definition of a company is to 'participate in enterprise for profit'. [1623]

A closer look at the content of the CL 2015 reveals that while rules governing the shareholder–management relationship are mentioned in detail, the CL 2015 lacks a single statutory provision requiring the board of directors to take into account the interests of non-shareholder constituencies. This does not mean that the interests of these groups are not protected; it merely means that those interests are beyond the scope of protection under current company law.[1624] Furthermore, if the law were to adopt a pluralist approach, it could lead to the same failing identified in the phrase 'interests of the company', [1625] that is, giving directors wide discretion to balance competing interests, which makes it difficult for shareholders to monitor directors and, consequently, weakens director's accountability.[1626]

In the view of Hansmann and Kraakman, the attainment of aggregate social wealth requires making directors 'strongly accountable to shareholder interests and, at least in direct terms, only to those interests'.[1627] Given the aforementioned arguments, it also seems unnecessary for the Saudi CL 2015 to adopt the UK CA 2006's approach when section 172(1) expressly requires directors to have regard for non-shareholder interests within the formulation of the affirmative duty of loyalty. As explained earlier,[1628] section 172(1) does not, in practice, give non-shareholder constituencies a legal remedy in the case of a director's failure to consider their interests, and the section goes no further than educating directors on the need to have regard for non-shareholder interests.[1629] The Saudi law, similar to the UK law, does not give any stakeholder, other than shareholders, the right to bring a 'liability proceeding'

[1621] Easterbrook and Fischel (n 301) 91.
[1622] Ibid 37–91.
[1623] See article 2 of the CL 2015.
[1624] See H Hansmann and R Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439, 442, 449, who say that the interests of non-shareholder constituencies, unlike shareholders, might be protected by contracts or other regulations. It should be noted that the Saudi CL 2015 does not require corporate constituents, other than shareholders, to select their representatives on the board of directors; this is a clear example of the tendency of Saudi law towards the protection of shareholder wealth.
[1625] See particularly footnotes 969–974 and accompanying text, Chapter 4 in this thesis.
[1626] See Keay (n 975) 31.
[1627] Hansmann and Kraakman (n 1624) 441.
[1628] See footnotes 988–1000 and accompanying text, Chapter 4 in this thesis.
[1629] See Alcock (n 993) 368, referring to J Bird's statement in A Alcock, The Rt Hon the Lord Millett, M Todd QC, *Gore-Browne on Companies* (45th edn, Bristol Jordans 2009) Ch 15 [10A].

against directors for wrong done to the company.[1630] This means that if the proposed legislative provision were designed to extend the notion of loyalty to cover non-shareholders' interests, this change would be ineffective in practice within the current institutional structure of Saudi corporate governance, and would introduce further ambiguity into the legal statement on directors' duties.[1631] With all this in mind, it can be said that since the need for due consideration to non-shareholder interests has already been referred to in the Saudi CGRs 2017 as a guiding rule,[1632] such a statement would be sufficient for serving the educational purpose of section 172 of the UK CA 2006.

6.4.2.2.1 A proposed reform by way of legal transplantation

As a result of the above examination of the feasibility of transplanting the UK duty of good faith found in section 172(1) of the CA 2006 into the Saudi law, the research suggests that since the CL 2015 lacks a provision requiring directors of joint stock companies to act in good faith, a new statutory article must be inserted into the CL 2015 that:

- Establishes an overriding principle under which an individual director is required to act in good faith in the general interests of the company (the formulation of the duty to act in the company's interests, to which the good faith is tied).

- Specifies the standard for compliance with the proposed statutory duty of good faith in which a dual subjective/objective standard for the duty of good faith must be met. The duty should be formulated to require an individual director to act in a way that he/she honestly believes is in the company's interests in which objective considerations and surrounding circumstances should be considered to determine the reasonableness of his/her honest belief.

- Refers to the need to manage the company predominately for the benefit of shareholders as whole, abandoning the reference to the interests of the company. The proposed article shall therefore require a director to manage the company in a way that he/she honestly believes is in the interests of shareholders as whole and in which the reasonableness of his/her honest belief must be taken into account.

[1630] See article 79 and 80 of the CL 2015.
[1631] It seems that the core problems of the Saudi corporate governance still revolve around such issues as transparency, accountability, board of directors' function, directors' duties and responsibilities, shareholders' rights, and the protection of minority shareholders.
[1632] See particularly articles 83 and 87 of the CGRs 2017.

6.4.2.3 Corporate opportunities

As shown earlier, the Saudi regulation on corporate opportunity is underdeveloped, placing very limited restrictions on the extent to which directors can personally exploit an opportunity during the course of their directorship.[1633] As matter of fact, the regulation of such a situation had been almost absent in Saudi Arabia until the introduction of the CGRs 2017, in which the law now requires directors to avoid the appropriation of corporate opportunities. Even with this new legal development, the law of corporate opportunities is at a nascent stage and there have been no reported judicial cases to analyse. This is coupled with the fact that article 44(b)(2) of the CGRs 2017 suffers from serious deficiencies, which may pose concerns about whether such a provision signifies an effective and appropriate law in practice.[1634]

While the new regulation, as a starting point, establishes the prohibition of appropriation of corporate opportunities, it does not properly and clearly define the scope of the corporate opportunities, raising a question about whether it is sufficient to confine the prohibition to 'investment opportunities which are within the activities of the company'.[1635] It lacks the design of an appropriate and workable standard capable of assisting the court in determining whether a breach of the corporate opportunities rule has taken place. In addition, it does not attempt to establish a procedural mechanism placing directors under the obligation of disclosure, or even allow authorisation by the company. Furthermore, if the company or a shareholder were to rely on article 44(b)(2) of the CGRs 2017 to sue directors for the exploitation of a corporate opportunity, it is not clear whether the directors would only be liable for the company's losses or would also be bound to disgorge the profit they have made. Moreover, since the application of such a mandatory provision is only limited to companies listed on the Saudi stock exchange, the vast majority of joint stock companies are left with uncertain and inadequate regulation to control directors' exploitation of corporate opportunities.[1636]

Indeed, with the Saudi economic policy being based upon principles of a free-market economy,[1637] and with government grants and funding options available for small

[1633] See the discussion, in section (4.4.2), Chapter 4 in this thesis.
[1634] See section (4.4.2.3), Chapter 4 in this thesis.
[1635] See article 44(b)(2) of the CGRs 2017.
[1636] See the statistics reported by I Abdullah, *Aleqtisadiah* Newspaper (22 June 2017) (Arabic) <http://www.aleqt.com/2017/06/22/article_1208011.html> accessed 20 July 2017.
[1637] See an outline of the Saudi economy published on MOCI's website at <http://mci.gov.sa/en/AboutKingdom/Pages/SaudiEconomy.aspx> accessed 10 July 2017.

business,[1638] the company's investment opportunities can be regarded as one of the main sources of financial gain for any businessperson. Under such circumstances, it is highly possible that directors would take up corporate opportunities for their personal benefit, especially when the law is characterised by a lack of clarity and underdevelopment, leaving the company and its shareholders insufficiently protected.[1639]

In the following sub-sections, with reference to the experience of the UK, some important changes to the current regulation of corporate opportunities are suggested that are aimed at designing workable and effective legislation that could be part of legislative amendments to the CL 2015.

6.4.2.3.1 The appropriateness of the no-conflict framework: Designing the scope for the directors' exploitation

As stated in Chapter 4, the UK law adopts the no-conflict approach to corporate opportunities in which, if there is a possible conflict, the director may not appropriate corporate opportunities without authorisation by the board of directors. The UK law is generally viewed as strict because once a conflict situation has arisen, it is *irrelevant* for determining the directors' liability to investigate *bona fides* or other relevant circumstances (e.g., the financial incapability of the company).[1640] The question addressed here is whether the UK no-conflict approach can be transferred to the Saudi legal context.

Given the Saudi legal conditions, the UK approach to corporate opportunities is likely to be the most appropriate choice for reforming the Saudi legislation for the following two reasons. First, the adoption of a strict non-conflict approach would be characterised by increased legal certainty around the application of the law and more consistent enforcement by the court. To clarify this point it might be important to compare the position of the UK with an alternative approach, namely the US 'corporate opportunities doctrine'.[1641] 'The defining feature of' the US approach to corporate opportunities is to focus on answering the question of who is entitled to exploit the corporate opportunities –

[1638] See an outline of the investments in Saudi Arabia published on the website of MOCI, <http://www.mci.gov.sa/en/AboutKingdom/Pages/InvestmentInKingdom.aspx> accessed 10 July 2017.
[1639] For the effects of absence of legislative intervention in protecting shareholders from insiders' abuse, see the discussion concerning Case No. 725/1/Q (n 1068) in section (4.4.2), Chapter 4 in this thesis.
[1640] See particularly footnotes 208–229 and accompanying text, Chapter 4 in this thesis.
[1641] The US approach is generally known as 'corporate opportunities doctrine'; see Koh (n 1018) 410. It should be noted that US cases are numerous and each state has its own approach. Therefore, it is intended here to give a broad outline of the US approach rather than an exhaustive and detailed analysis.

is it the director or the company?[1642] If the opportunity 'belongs' to the company, directors should not be allowed to exploit it and if they have done so, they would be in breach of their duty of loyalty.[1643] For the court to determine to whom the corporate opportunity belongs, the US case law (e.g., US Delaware law) has applied a number of different approaches; for example, the court may focus on whether the opportunity falls within the company's line of business;[1644] whether the company had a prior interest or expectancy in the opportunity;[1645] whether the company was financially capable of exploiting the opportunity;[1646] and/or whether the director has treated the company fairly.[1647]The US regulation of corporate opportunities is generally viewed as a more flexible approach compared with the UK no-conflict rule because the former basically widens the ambit for directors to exploit opportunities without pre-authorisation by the company.[1648] In practice, this means that a larger number of possible opportunities would be allocated to directors under the US approach.[1649]

Importantly, the effective application of US law requires an active judicial role to determine whether or not directors' exploitation of an opportunity amounts to a breach of their duty of loyalty;[1650] in others words, the effectiveness of such an approach depends on whether or not the court has broad judicial discretion, and on the level of expertise and commercial knowledge of the judges.[1651] By contrast, the application of the UK no-conflict approach does not require an active judicial role since, as stated above, it does not involve judicial engagement in an investigation of the facts of the case to determine, for example, whether or not the company is financially capable of taking an opportunity.[1652] This is simply because such an investigation is irrelevant to the inquiry concerning compliance with the duty to avoid conflict of interests. The strict judicial approach, as Kershaw notes, is borne out by the reality that the facts and evidence in corporate opportunities cases tend

[1642] Kershaw (n 1031) 608.
[1643] S Bainbridge, 'Rethinking Delaware's Corporate Opportunity Doctrine' (UCLA School of Law, Law-Econ Research Paper No. 08-17 November 2008) 1 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1296962> accessed 10 July 2017.
[1644] Ibid 5–6.
[1645] Ibid 6–7.
[1646] Ibid. 7–9.
[1647] See, for example, C Chadien, 'The Law on Corporate Opportunity Transactions by Directors: A Comparative Analysis of Delaware Law and Australian Law' (2016) 5 GSTF Journal of Law and Social Sciences 28, 33.
[1648] See Kershaw (n 1031) 608–609.
[1649] Ibid.
[1650] Ibid.
[1651] According to Kershaw, the scope of judicial discretion will be expanded as a logical result of judicial engagement in examining the detailed facts of a case under the US flexible approach; see ibid 625.
[1652] In many cases, there would be real difficulties in verifying the company's financial capability to take up an investment opportunity, see Koh (n 1018) 424; Kershaw (n 1031) 621–622.

to be largely inaccessible.[1653] Unlike the strict rule applied under UK law, the US corporate opportunities doctrine has been found by many commentators to involve a greater degree of legal uncertainty and ambiguity;[1654] for example, the difficulty in ascertaining the company's line of business is that the company's business is 'dynamic' and constantly changing,[1655] and so it is challenging to determine what the company's business is.[1656] This is also the case in relation to the fairness test, which suffers from ambiguity and lack of clear criteria for assessing what constitutes fairness.[1657]

With all this in mind, the UK no-conflict rule is a more straightforward option for Saudi judges to apply effectively, compared with the US corporate opportunities doctrine. To explain this point: the application of the no-conflict rule does not expand the scope of judicial discretion and does not require the presence of a highly experienced judge who can deal successfully with broadly open-ended standards in the corporate context. Given the Saudi judicial tradition, and the experience of commercial law that Saudi judges have,[1658] it appears that Saudi courts would face serious difficulties in managing and developing the US open-ended standards. This will not, however, be the case in relation to the application of the UK no-conflict rule, which is characterised by more certainty and determinacy.[1659] With the strict no-conflict rule, since directors place themselves in a conflict situation, the investigation of detailed circumstances and facts of a corporate opportunity case is irrelevant when determining directors' liability. Indeed, the strict rule would relieve the Saudi court of having to engage in such an investigation and therefore the length of litigation will be significantly reduced.

Second, when the inflexible no-conflict approach is adopted, the integrity of the fiduciary duty of loyalty would *necessarily* be defended against the directors' capability to benefit personally from an investment opportunity that should be exploited by the company.[1660] For scholars such as Koh, who prefers the UK approach to that of the US, any standard regarding directors' duty to avoid conflict of interests (and in particular the exploitation of corporate opportunities) that is not totally rigid will produce a state of ambiguity,[1661] and

[1653] Kershaw (n 1031) 616–617, 621.
[1654] See, for example, Koh (n 1018) ; Bainbridge (n 1643); G Bean, 'Corporate Governance and Corporate Opportunities' (1994) 15 Company Lawyer 266, 272.
[1655] Kershaw (n 1031) 614; Davies and Worthington (n 2) 548, footnote (351).
[1656] Davies and Worthington (n 2) 548.
[1657] See Bean (n 1654) 271.
[1658] See footnotes 1555–1573 and accompanying text in this Chapter.
[1659] Kershaw (n 1031) 625.
[1660] Ibid 603–604; see also Koh (n 1018) 409.
[1661] Koh (n 1018) 413.

‘will do no good, to say the least, to commercial morality’.[1662] The Saudi adoption of a strict no-conflict approach, which maintains the integrity of the director–company relationship, would ensure that the ability of directors to take an opportunity is subject to the utmost degree of control, and a greater percentage of opportunities would be allocated to the company.[1663]

In a situation where corporate opportunities regulation has been and remains largely under-developed, it is highly likely that directors with wide discretionary powers would engage in self-interest activities. The argument for a strict application of the standard against directors is borne out by recent corporate scandals and fraud in the Saudi market,[1664] which give a clear indication of the lack of commercial morality among market participants (including directors and managers) when the company law system is weak. Seemingly, the need to promote responsible directorial behaviour will perhaps be achieved by the application of a no-conflict rule that narrows the ability of directors to exploit an investment opportunity.[1665]

From the above discussion, the UK’s strict no-conflict approach is based upon promoting legal certainty, as well as protecting the integrity of directors’ duty of loyalty to the company; the two primary features that would justify the adoption of such an approach to deal with the problem in Saudi Arabia. Indeed, the wording of article 44(b)(2) of the Saudi CGRs 2017 suffers from ambiguity, and there is a lack of certainty concerning how directors’ liability can be triggered.[1666]

In this regard, when considering the transferability of the UK no-conflict approach into the Saudi legal environment, there is an important issue that needs to be considered to ensure the proper reception of such an approach. In UK law, directors will be liable under section 175(1) of the UK CA 2006, to account for the profit made if the circumstances surrounding their exploitation of an opportunity have given rise to an actual or possible conflict between their personal interests and the company’s interests.[1667] With the UK no-conflict

[1662] Ibid 413, quoting from F Pollock, ‘*Derry v. Peek* in the House of Lords’ (1889) 5 LQR , 422.
[1663] This is in contrast to the flexible approach to corporate opportunities; see footnotes 1648–1649 and accompanying text in this Chapter.
[1664] This can be best illustrated by the recent corporate scandals of Etihad Etisalat Co. and Al Mojil Group Co., which arguably raise questions about the commercial morality of market participants. Furthermore, it might be said that the new mandatory CGRs was introduced in 2017 with the purpose of enhancing the investors’ confidence in the Saudi stock market following the recent corporate corruption scandals.
[1665] See Kershaw (n 1033) 553.
[1666] See section (4.4.2.3), Chapter 4 in this thesis.
[1667] For more details, see section (4.4.1), Chapter 4 in this thesis.

approach, there would be large scope for judicial discretion to determine what amounts to actual or possible conflicts.[1668]

In the context of the Saudi regulation of corporate opportunities, it seems that conflicts of interest should be understood as arising from unauthorised exploitation of any profit-making opportunity during the course of being a director.[1669] Put differently, for directors' liability to be established under the no-conflict approach, it is sufficient to prove that the directors' profit came from the unauthorised exploitation during the course of their tenure.[1670] It should be added to the legislation that it is *irrelevant* for determining directors' liability to investigate, for example, whether the company could or would exploit the opportunity, whether the directors had acted in good faith, whether the opportunity came to the directors in their private capacity, whether the opportunity was within the company's line of business, or whether the company had, in fact, benefited from the directors' exploitation.[1671]

Although such a proposed threshold of liability is high, several reasons can be put forward in support of the adoption of the no-profit rule. First, a claimant will be relieved of establishing the actual or possible presence of a conflict of interests. Similarly, judges will be relieved of close analysis of the facts of a case to decide what constituted a real or possible conflict. Second, the strictness of the no-profit rule would effectively disincentivise directors from exploiting an opportunity for their own benefit and therefore provide the company and its shareholders (including the minority) with sufficient legal protection. Third, while those who are against the strict approach to corporate opportunities would say that it would perhaps discourage entrepreneurial activities in the economy,[1672] the validity of such an argument can be challenged in the Saudi context. One of the main aspects of the entrepreneurial argument is that the strict approach leads to investment opportunities being unused.[1673] Such an impact should not be exaggerated. In an environment where there is high competition, if the strictness of the approach deters

---

[1668] See Kershaw (n 1033) 537; for a different explanation for the standard of liability under the no-conflict approach; see footnotes 204–206 and accompanying text, Chapter 4 in this thesis.
[1669] This is an application of the UK no-profit rule which is a part of the UK common law regulating the issue of corporate opportunities; see particularly section (4.3.2), Chapter 4 in this thesis.
[1670] This view is similar to the position of the UK court in the *Regal* case where the directors were found liable due to the no-profit rule only, without reference to the no-conflict rule, see footnotes 1015 – 1018 and accompanying text, Chapter 4 in this thesis.
[1671] Those are examples of circumstances surrounding a conflict situation in which the UK case law has determined their irrelevance to the inquiry concerning compliance with the director's duty to avoid conflict of interests, see footnotes 1038–1053 and accompanying text, Chapter 4 in this thesis.
[1672] See Kershaw (n 1031) 616–617.
[1673] Ibid 617.

directors from exploiting an opportunity, this would not *usually* result in the opportunity remaining unexploited; this is because the opportunity is likely to be taken up by a competitor.[1674] Furthermore, as will be proposed in the next section, the prohibition here will be limited to *unauthorised* exploitation of an opportunity by directors, and does not cover the exploitation by a third party or by the directors following the company's authorisation.[1675]

It appears from the above analysis that the UK's strict no-conflict approach, in which the company's interests are understood as any profit-making opportunity, would be the best and most appropriate choice for adoption into the Saudi legislation, given the Saudi legal conditions.

6.4.2.3.2 Devising an authorisation process

As a stated in Chapter 4 of this thesis, article 44(b)(2) of the CGRs 2017 lacks an authorisation procedure that allows directors to exploit an opportunity following the receipt of approval either from shareholders or from the board of directors.[1676] With the total prohibition of any conflicts, there would be an emphasis on control at the expense of discretion exercised by the competent body (i.e., the general meeting or the board of directors).[1677] If the law adopts an authorisation process, it will, along with moving the balance towards more discretion,[1678] relax the strictness of the no-conflict approach by allowing directors to exploit an opportunity when the company gives its approval. Furthermore, a rule prohibiting the engagement in a conflict situation, while introducing an authorisation process, would arguably be a compromise between fairness and efficiency; two important values that should be considered in any corporate governance provision.[1679]Accordingly, the suggestion could be that the Saudi law should not adopt an absolute prohibition strategy, but rather allow directors' exploitation of an opportunity, only after obtaining the company's consent.

In this regard, as a default rule, the UK CA 2006 clearly provides that with respect to public companies, unless the company's articles of association permit authorisation by the

[1674] A similar argument is put forward by Kershaw who challenges the claim that the strict approach dampens entrepreneurial activities, see ibid 618.
[1675] See the next section (6.4.2.3.2) which proposes an authorisation mechanism to allow a director to exploit an investment opportunity.
[1676] See section (4.4.2.3), Chapter 4 in this thesis.
[1677] Keay (n 1029) 136.
[1678] Ibid.
[1679] See ibid 137.

board, a conflict involving a business opportunity must be authorised by the company's members.[1680] As far as the reform of Saudi law is concerned, there should be a mandatory rule obliging directors who wish to exploit an opportunity personally to seek authorisation from the shareholders. In addition to the attainment of greater legal certainty through the mandatory corporate rules,[1681] in developing markets such as Saudi Arabia a mandatory rule on the issue of conflict of interests, rather than a default rule, would be more desirable. In Saudi Arabia where there are immature and incomplete non-legal mechanisms of markets, there is more need for mandatory corporate rules offering more legal protection that would shield shareholders, especially minority shareholders from the risk of expropriation and opportunism.[1682] The enabling version of rules may not always work effectively in Saudi Arabia in the absence of markets that complement the law in protecting shareholders from abusive practices by insiders (e.g., directors who could be controlling shareholders).[1683] With the default requirement of approval by shareholders, the company that might be controlled by insiders will be given the chance to shift to approval by the board; an authorisation process that does not sufficiently protect shareholders, as will be seen below.[1684] Further, as the interested directors (who could be majority shareholders) will be excluded from voting at the general meeting,[1685] the approval by shareholders, compared with the approval by directors, will offer more transparency and better legal protection for minority shareholders.

Within the regulation of corporate opportunities, it should be expressly stated in the legislation that if directors have exploited a profit-making opportunity without obtaining the approval of the general meeting, the company is entitled to require that these directors account for any profit made out of unlawful exploitation in addition to its right to seek compensation for losses caused by the directors' exploitation.

6.4.2.3.3 A proposed reform by way of legal transplantation

When considering the possibility of transferring the UK approach to corporate opportunities to the Saudi law, the research submits that there are a substantial number of UK rules that can be transplanted. Some important improvements could be made to the

[1680] See section 175(5)(b) of the CA 2006.
[1681] Paredes (n 587) 1133–1134.
[1682] See section (2.8), Chapter 2 in this thesis; see generally Paredes (n 608).
[1683] This seems to be the case in emerging markets; see ibid 405–408.
[1684] The appropriateness of board approval will be considered when the discussion focuses on the transferability of the UK model of approval in relation to self-dealing transactions, see section (6.4.2.4) in this Chapter.
[1685] Article 95(2) of the CL 2015; see also article 44(a)(2) of the CGRs 2017.

current regulation of corporate opportunities under the CGRs 2017, and these should be part of legislative amendments to the CL 2015.[1686] Indeed, it is inappropriate to establish the duty to avoid conflicts of interests in the context of corporate opportunities independent of the CL 2015. This is because the avoidance of conflicts of interests is one of the significant elements of fiduciary obligation owed by directors towards the company, regardless of the nature of the company (listed or unlisted). Since the CL 2015 lacks a provision requiring directors of joint stock companies to avoid the exploitation of corporate opportunities, a new statutory article must be inserted into the CL 2015 and to regulate this issue under the following terms:

- As an application of the director's duty to avoid conflicts of interests, a director shall not personally exploit an investment opportunity or information that would be of interest to the company during the course of his/her tenure.

- It is immaterial for determining directors' liability to investigate whether the company could or would exploit the opportunity, whether the directors had acted in good faith, whether the opportunity came to the directors in a private capacity, whether the opportunity was within the company's line of business, or whether the company had, in fact, benefited from the directors' exploitation.

- The company's interests should be understood as referring to any profit-making opportunity.

- As a mandatory rule, a director may exploit an opportunity following the receipt of approval by the general meeting of shareholders, at which interested directors will be excluded from voting at the general meeting.

- The remedy for the breach of this proposed article is to hold a director accountable for any profit made out of unauthorised exploitation.

6.4.2.4 Self-dealing transactions

As the comparative study in Chapter 4 revealed, both jurisdictions (i.e., the UK and Saudi Arabia) have relied upon the disclosure and approval requirement as a legal strategy to control directors' engagement in corporate self-dealings, in which the failure to comply

[1686] The CGRs 2017 is only applicable to companies listed in the Saudi market, see section (1.4.3), Chapter 1 in this thesis.

with those strategies would constitute a breach of the duty of loyalty.[1687] The regulation of self-dealing transactions is one of the major areas in Saudi law that has benefitted from legal development in the new CL 2015 and the CGRs 2017. The change has promoted legal certainty in the application of the law and, consequently, enhanced directors' accountability towards the company and its shareholders. Nevertheless, there is still room for improvement to ensure greater legal protection for shareholders, including minority shareholders.

It is necessary to begin with considering whether the UK model for authorising self-dealing transactions can be transferred into the Saudi context. As explained in Chapter 4,[1688] directors, in principle, are *only* obliged to disclose their interests to the board with a default requirement of approval by directors; for only in certain situations set out in the CA 2006 is it mandatory for directors to seek authorisation from the general meeting. By contrast, the Saudi law requires directors, as a mandatory rule, to disclose their interest to the board and seek *ex ante* approval from the general meeting. Such authorisation process could be accompanied by the board's recommendation. On top of that, directors are required to seek the general meeting's approval for renewing the authorisation each year. In the present researcher's view, the transplantation of the UK model for approving self-dealing transactions is unlikely to be transferred into the Saudi legal environment. One of the reasons for such an argument is that the UK law tends to place less constraints on directors' discretion compared with the Saudi law and such lenient approach to self-dealing transactions is not appropriate for the Saudi settings. Unlike in the UK, Saudi law should focus more on ensuring the integrity of transactions even if this came at the expense of efficiency because the minority shareholders incur more severe risks from the insiders' control over the company's affairs. As explained above, stronger legal protection for shareholders against insiders' abuses is more desirable in the Saudi context.[1689] It appears that a law that only requires directors to disclose their interest to the board with the default requirement of the board's approval in Saudi Arabia is likely to give a good opportunity for directors (who could be blockholders) to engage in more self-dealing transactions that may not benefit the company. Furthermore, doubts could be cast on whether disinterested directors can be trusted to make independent judgements regarding the authorisation of a transaction in which one of their colleagues has an interest. One of the main concerns related to approval by the board is its possible contribution to the directors' adoption of 'a

[1687] See section (4.5), Chapter 4 in this thesis.
[1688] See generally sections (4.5.3), (4.5.4) and (4.5.5), Chapter 4 in this thesis.
[1689] See footnotes 1681–1683 and accompanying text in this Chapter.

culture based upon reciprocity'.[1690] Davies and Worthington note that such unlawful practice 'you scratch my back and I'll scratch yours' is not easy to discover and establish in court.[1691] Even with the Saudi adoption of the institution of independent directors, it is questionable whether or not independent directors, as was stressed earlier, are able to make independent judgments that are free from social connections and from the influence of those who selected them.[1692] Moreover, it seems inappropriate to switch from a mandatory system requiring approval by shareholders that has been in place for a long time in relation to self-dealing transactions and around which practices have developed. Thus, the present authorisation process for self-dealing transactions under article 71 of the CL 2015 should be retained.

While the discussion above suggests maintaining the present Saudi model of approval, this should be done with modification. The primary concern identified in Chapter 4 in this thesis relates to the action of approval of self-dealing transactions. While Saudi law makes it clear that conflicted directors are not permitted to vote,[1693] it is unclear whether persons related to directors (particularly family members) must abstain from voting on self-dealing transactions, especially at the general meeting of shareholders.[1694] Neither the CL 2015 nor the CGRs 2017 contain a single provision to that effect. As highlighted earlier, since the votes of interested shareholders (i.e., persons connected to interested directors who are not members of the board) will be, at least in theory, counted when determining whether approval should be granted, this would weaken the effectiveness of the shareholders' approval mechanism as a means of protecting shareholders (especially minority shareholders) against self-dealing transactions that have little or no benefit to the company.[1695] It might also lead to unnecessary judicial involvement in deciding whether or not the votes of persons connected to directors should be counted. This could consume more judicial time and resources, especially when directors claim that they honestly thought that the transaction served the general interests of the company.

Thus, when reforming Saudi law, there should be as a starting point a legal rule requiring the approval of self-dealing transactions at the general meeting to be made *without* counting the votes of persons related to interested directors, especially for listed

[1690] Keay (n 1029) 142.
[1691] Davies and Worthington (n 2) 556.
[1692] See footnotes 564–576 and accompanying text, Chapter 2 in this thesis.
[1693] See articles 71(1) and 95(2) of the CL 2015.
[1694] This is because the rule requiring approval by disinterested directors should be narrowly interpreted to exclude members of the directors' family who are also board members although they may have no specific interest in the conflict situation.
[1695] See section (4.5.5), Chapter 4 in this thesis.

companies. As explained earlier, within the meaning of indirect interest in a transaction with the company, it seems indisputable that directors should be subject to the disclosure and approval requirement set forth in article 71(1) of the CL 2015 as far as related-party transactions are concerned.[1696] The CGRs 2017 specify 11 categories of related parties of which the following are examples relevant to the discussion in this section: (i) entities, other than companies, owned by directors or their relatives; (ii) companies, other than joint stock companies, in which directors or their relatives are a partner or member of the companies' board; (iii) or joint stock companies in which director or their relatives own at least 5% of the share capital.[1697]

For the purpose of the right to participate in the vote at the general meeting, the question that may be asked concerns the appropriate understanding of the concept of 'relatives' or 'family members' in the Saudi context. In UK law the concept of family members connected to a director under section 253 of the CA 2006 is limited to directors' spouse (or civil partner), child(ren) and parents.[1698] In relation to companies with premium listing, directors' associates, who are expected not to participate in a vote at the general meeting,[1699] can be defined as directors' spouse or child(ren).[1700] It is notable that the UK law definition of a family relationship, especially under section 253, is almost the same as the definition adopted by the previous Saudi CGRs 2006.[1701] However, the new CGRs 2017 have rightly expanded the meaning of family relationship to include, in addition to first-degree relatives, grandparents, grandchildren, siblings, nephews and nieces.[1702] Thus, it seems that the family relationship, unlike in the UK, should be broadly defined and the present definition of 'relatives' in the CGRs 2017 should be retained, if not further expanded, for the purpose of abstention from the vote at the general meeting. This view is justified on the basis that in a culture such as Saudi Arabia the family and tribe play a significant role in shaping people's behaviour in addition to their role in supporting its members in doing business.[1703] Given the feeling among family members that each owes a moral obligation towards the other to support him/her and serves his/her interests, the ability of a director's family member to make an impartial decision will be

[1696] See section (4.5.3), Chapter 4 in this thesis.
[1697] See the definition of 'related party' in article 1(e), (f), (g), (h) of the CGRs 2017.
[1698] See section 253 of the CA 2006.
[1699] LR 11.1.8 <https://www.handbook.fca.org.uk/handbook/LR.pdf> accessed 30 July 2017.
[1700] See LR Appendix, relevant definitions (App 1.1.1).
[1701] According to the CGRs 2006, relatives is defined to include only 'first-degree relatives' (i.e., 'father, mother, spouse and children').
[1702] See the definition of 'relatives' in article 1 of the CGRs 2017.
[1703] Saudi society is characterised by strong family and tribal ties, see Falgi (n 208) 128–129.

questionable.[1704] Thus, the broad definition of relatives in the context of self-dealing transactions is crucial to ensuring that this type of transaction is approved only for commercial reasons rather than family considerations. It may also contribute to ending the culture of easy conflict approvals.[1705]

In the researcher's opinion, the proposed legal rule that requires the approval of self-dealing transactions at the general meeting to be made *without* counting the votes of family members of interested directors should only be applicable to listed companies. The rationale behind this view is that the general meetings of some unlisted companies are formed exclusively of family members. Therefore, if the proposed rule was applied to unlisted companies, it would be impossible to obtain approval by the general meeting because all shareholders would be disqualified from voting on self-dealing transactions.

6.4.2.4.1 A proposed reform by way of legal transplantation

When addressing the question of legal transferability, it seems possible that the Saudi law of self-dealing transactions would partially benefit from the UK in relation to the mechanism of approval by shareholders. Since the research is in favour of applying the proposed legal rule to listed companies only, a new article should be inserted in the CGRs 2017 rather than the CL 2015 to establish the following rules:

- Family members of interested directors (who are not members of the board of directors) must abstain from voting on self-dealing transactions at the general meeting of shareholders.

- Family members should be understood in accordance with the definition of 'relatives' set forth in article 1 of the CGRs 2017.

6.5 The reform of the private enforcement action: The transplantation of derivative actions

As has been mentioned in Chapter 5, the enforcement of breaches of directors' duties by means of litigation initiated by shareholders has been largely inoperative and ineffective in Saudi Arabia because of legislative shortcomings. The Saudi law confers the power to

[1704] See footnote 1150, Chapter 4 in this thesis.
[1705] See footnotes 1166–1167 and accompanying text, Chapter 4 in this thesis.

initiate the litigation against wrongdoing directors to the general meeting of shareholders. The core problem is that if the company was incapable of pursuing the legal action because of, *inter alia*, the wrongdoer's control of the general meeting, the law has failed to introduce an alternative judicial remedy that enables a shareholder to enforce the company's rights. The Saudi law of derivative actions, set forth in article 80 of the CL 2015,[1706] can be described as vague and outmoded.[1707]

Given that *ex post* private non-judicial mechanisms such as the removal of directors at the general meeting and markets,[1708]and the public enforcement[1709] might suffer from flaws and limits, which suggest that such mechanisms cannot substitute the need to put a sound system of derivative actions in place within the entire system of enforcement for breaches of directors' duties. It might be true to say that the derivative action, as other mechanisms of accountability, may come with costs. There is a potential risk of abuse by a shareholder who might bring a legal action to serve his personal interests rather the company's interests.[1710] There might be concerns that the derivative action would expose directors to a high risk of liability, which may result in reducing risk-taking.[1711]Nevertheless, the introduction of an accessible derivative action in Saudi Arabia can be justified for several reasons. Where legal certainty in this area of law is promoted, the reasonable expectation is that the company and shareholders will be adequately aware of their legal rights and how to use them, and shareholders may become more active in filing litigation against directors for the breach of their duties. The court will, in return, have more chances to develop their professional knowledge as well as the standards for assessing compliance with. Furthermore, unlike with article 80, the derivative action would directly relieve the company whilst providing indirect relief to shareholders and non-shareholder constituencies.[1712] If the law permits a shareholder to commence a derivative claim this can be regarded as 'a powerful *ex post* mechanism for recovering corporate losses'.[1713]When directors (who could be or be connected to a blockholder) believe they will be the target of legal action for their breach, the derivative action is also regarded as a good deterrent as well as a way to mitigate agency costs even in companies with a dominant shareholder.[1714] Indeed, the derivative action may be used by the minority shareholder to effectuate the

[1706] It is an exact copy of article 78 of the CL 1965.
[1707] See sections (5.6), Chapter 5 in this thesis.
[1708] See sections (2.6.1) and (2.8), Chapter 2 in this thesis.
[1709] See section (5.2), Chapter 5 in this thesis.
[1710] Reisberg (n 8) 83.
[1711] Ibid 49.
[1712] See section (5.6.1), Chapter 5 in this thesis.
[1713] Baum and Puchniak (n 1464) 14.
[1714] Ibid.

director's obligation to act in the general interests of the company rather than the interests of a certain group of shareholders.[1715]

6.5.1 Considerations in support of the feasible transplantation of derivative actions

As mentioned earlier in this chapter, it is important to ensure the proper reception of any imported rule by the host country.[1716] To be specific, it should be questioned whether the Saudi jurisdiction has the key factors to ensure a successful transplantation of the derivative action. There are two encouraging considerations that will be taken into account below:

First, the derivative action is a mechanism that requires shareholders who are sufficiently motivated to commence the litigation.[1717] In this regard, it should be stressed from the outset that it is a fundamental right of any citizen and resident in Saudi Arabia to litigate before the court. This is a constitutional right that is safeguarded by the state.[1718] It is noteworthy that the right to litigation is one that Sharia also recognises and the necessity of the judiciary in Muslim society is illustrated by the fact that the Prophet Muhammad (PBUH) acted as a judge in Al-Madinah and dispatched others as judges in territories such as Makkah and Yemen.[1719] This implies that there is nothing in Islamic culture discouraging the right holder from resorting to the judiciary to seek a remedy and defence.

Another matter to consider is that Saudis' recourse to the court to resolve disputes is an inevitable result of the economic and social changes witnessed by Saudi Arabia over the past few decades. This social and economic development has established a very wide range of commercial relationships among individuals in Saudi society. It is generally accepted that a party to any commercial relationship should fulfil his/her obligations towards the other party and bear responsibility for the failure to do so. In the business community it is common practice for the injured party to bring a lawsuit before the court against the negligent party. This is borne out by the fact that government statistics have indicated a rise in the rate of civil or commercial litigation. Consider, for example, financial disputes heard by ordinary courts. The judicial sources indicate that there was an increase in the

---

[1715] Ibid.

[1716] See footnotes 1524–1526 and accompanying text in this Chapter.

[1717] See, for example, Q Quach, 'Transplantation of Derivative Actions to Vietnam: Tip-offs from Absence of Academic Debate' (2012) 7 Asian Journal of Comparative Law 1.

[1718] See article 47 of the BLG 1992.

[1719] A Zidan, *The Judicial System in Islamic* Sharia (Arabic), (Amman, Al-Bashaer Library 1989) 7.

number of financial cases filed in the courts between 1435 and 1437 AH,[1720] and a total of 156,498 cases was registered by the end of 1437 AH; a rise of 20.6% compared with the same period for 1435 AH.[1721] Looking at the rate of commercial lawsuits, statistics published by the Board of Grievances also show an increase in the numbers registered with the Board; for example, 3,488 commercial cases were filed in the first quarter of 1437 AH (corresponding with the period between 14 October 2015 and 10 January 2016); the figure gradually rose each quarter, reaching 5,167 commercial cases by the end of the first quarter of the following year (corresponding with the period between 2 October 2016 and 29 December 2016).[1722] It should also be borne in mind that no court fees or the 'loser pays costs rule' are imposed on litigants[1723] in the Saudi civil procedures.[1724] Arguably, these two factors have also contributed to the rising rates of civil litigation.

In Saudi Arabia the increasing amount of litigation perhaps suggests a growing willingness among individuals to bring legal proceedings against others to enforce their legal rights. This might be seen as an important indicator to assume the active use of derivative actions by non-controlling shareholders to protect the interests of the company against directors.

Second, while considering the reform of derivative actions, one may doubt the capability of the Saudi judiciary to handle the possible increase in derivative litigation following the adoption of the proposed reform. This argument tends to be based upon three elements: (i) the lack of sufficient skill and competence of Saudi judges, (ii) the long duration of litigation, and (iii) the inconsistency of judicial decisions. While such concerns might be true to some extent, they should not be overstated as there are several significant indications of a shift in the judicial system towards greater efficiency. With the recent judicial reform establishing specialised commercial courts, the government has undertaken to ensure that specialised courts are staffed with well-trained judges with long-standing expertise in commercial matters.[1725] In general, a candidate for judge must possess an

---

[1720] *AH* stands for 'After Hijra' which denotes the Islamic calendar system. The period from 1435 to 1437 AH corresponds to the period between 4 November 2013 and 1 October 2016).

[1721] See official statistics released by the Ministry of Justice and made available to the public in Arabic on the Ministry's website at <https://www.moj.gov.sa/en/Pages/default.aspx#> accessed 6 August 2017.

[1722] See official statistics released by the Board of Grievances and made available to the public on the Board's website at <https://www.bog.gov.sa/MediaCenter/Statistics/Pages/default.aspx> accessed 6 August 2017. It is worth remembering that this statistic does not yet include other civil or commercial cases heard by quasi-judicial committees. Note that there are no published statistics covering the period before the year 1437 AH.

[1723] This is a civil procedural rule adopted in the UK; see footnotes 1484–1485 and accompanying text, Chapter 5 in this thesis.

[1724] There is nothing in the SPL 2013 suggesting the application of such a rule within the civil procedural system.

[1725] See the Implementation Mechanism 2007 (n 237) para 1/8/9.

academic degree, among other requirements that need to be met depending on the position and the type of court.[1726] For specialised courts, the allocation of judges is likely to be made according to the competence, academic specialisation and experience, which are the most important criteria.[1727] A number of courses and workshops have been held to train judges for specialised courts dealing with commercial disputes.[1728] Furthermore, the creation of specialised courts (in the present case commercial courts)[1729] is expected to contribute significantly to developing the judges' expertise in adjudicating disputes arising from a particular area of law because judges in these courts frequently deal with such legal issues.[1730] With all this in mind, it can be assumed that judges in commercial courts tend to have a reasonable level of expertise that enables them to deal with the complexities of corporate matters.

Concerning the issue of the long duration of litigation, the Board of Grievances had taken important steps towards reducing the period of commercial litigation; for example, any commercial case should be heard within 20 days from the date of registration. The maximum limit for adjournment of the case should not be more than three hearings. In any event, a good reason should be presented to secure the postponement of hearings.[1731] In order to speed up the resolution of cases, judges' administrative commitments are significantly reduced so that they will not be preoccupied with anything other than the case.[1732] It is worth mentioning here that recent statistics have suggested a growth in the performance of commercial divisions of the Board. For example, in the first quarter of 1438 AH, the number of completed cases was 5,751, an increase of 53% compared with the same period in 1437 AH.[1733] With the recent transfer of commercial cases to specialised courts, it is envisaged that the duration of litigation will be more reduced.

In terms of the inconsistency of judicial decisions, since there is no system of binding judicial precedent in Saudi Arabia,[1734] the possibility of inconsistency among judgments on derivative action cases with similar facts will always exist. Nevertheless, the severity of

[1726] See Part 4 of Chapter 1 of the JL 2007 and Rules for Selection of Judges.
[1727] See Part 4 of Chapter 1 of the JL 2007; see also Draft Rules for Selection of Judges of Specialised Courts and Divisions <https://www.scj.gov.sa/newsdesc?ItemID=170> accessed 13 August 2017.
[1728] For example, the Closing Ceremony of the Second Training Program for Judges of Commercial Courts on 16 October 2012, see O Aljamaan and M Hamzani, *Alriyadh* Newspaper (edn 16186, 17 October 2012) <http://www.alriyadh.com/776934> accessed 22 December 2016.
[1729] See section 1.5.2, Chapter 1 in this thesis.
[1730] Zimmer (n 267) 1 and 2.
[1731] See the decision of the president of the Board of Grievances, <https://www.bog.gov.sa/MediaCenter/news/Pages/455.aspx> accessed 13 August 2017.
[1732] Ibid.
[1733] See official statistics released by the Board of Grievances (n 1722).
[1734] See footnotes 228–232 and accompanying text, Chapter 1 in this thesis.

such an issue will be largely reduced due to the founding of specialised commercial courts at the first instance and at appeal. When the legislature decides to establish specialised courts at the first instance, it will be with the intention of improving the quality of judicial decisions.[1735] Yet, if the legislature wishes to achieve greater uniformity and predictability in the interpretation of a certain area of law, the appeal courts should be staffed by specialised, not generalist, judges.[1736] With regard to Saudi law, it seems that the Saudi legislature intends to accomplish both objectives: an enhancement of the quality of judicial rulings, and a high degree of uniformity and predictability in interpreting commercial legislation. Furthermore, if the Saudi judiciary expanded its policy on the publication of judicial decisions, this would also contribute to greater uniformity and predictability in the application of the law.

From the above discussion regarding concerns about the capability of the Saudi judiciary, it can be argued that such concerns tend to be exaggerated. The reform that the judicial system has been witnessing should be seen as a stepping-stone to an efficient and sound system. Put differently, the above analysis demonstrates that concerns about the capability of Saudi judiciary tend not to be sufficient justification for discouraging the design of an effective derivative action system. Moreover, it should be borne in mind that the initiation of derivative litigation will go through procedural rules intended to reduce the flow of malicious claims.

6.5.2 What legal concepts and ideas will be adopted?

This section intends to specify requirements and conditions for a shareholder to bring a derivative action. By examining the extent to which Saudi law can benefit from UK law, the elements of a derivative action remedy will be designed, correcting deficiencies identified in Chapter 5 of this thesis. It should be borne in mind that although it is important to ensure that an effective mechanism of derivative action is in place, this does not mean it is necessary to design a derivative action that exposes directors to high risk of legal liability and damages the company's interests. It should also be recalled that any proposed reform agenda resulting from the examination of the feasibility of legal transplant should take the form of mandatory rules to be included in the CL 2015.[1737]

[1735] See Zimmer (n 267) 1– 2 and 6.
[1736] Ibid 7.
[1737] See the accompanying text to footnotes 1575 – 1578, Chapter 6 in this thesis.

6.5.2.1 The nature of wrongs and the relief to be sought

It has been argued that there is technically no derivative action in Saudi law, as understood in other jurisdictions such as the UK. One of the key problems of article 80 of the CL 2015 is that a shareholder can only bring a legal action on behalf of the company in relation to a wrongful act that causes harm to his/her personal interests, with the result that any relief will flow directly to the shareholder. By contrast, UK law makes it clear that derivative litigation has to be initiated as a result of wrong done to the company and any financial gain from it should be given to the company.[1738] For reasons put forward in Chapter 5 of this thesis,[1739] one of the important elements of the proposed reform is to recommend derivative action where the cause of action belongs to the company and it is brought to seek corporate relief.

The proposed derivative action should be brought in relation to a cause of action that can be the subject of the company's action under article 79 of the CL 2015. This, as explained earlier, will include any misconduct causing harm to the company's interests while managing the company.[1740] Under UK law, directors might be exposed to the risk of being defendants in derivative claims because of wrongs that have been perpetrated.[1741] While this could be seen as a positive step towards the promotion of directors' accountability; a reform that broadens the scope of causes of actions is, no doubt, undesirable as far as Saudi law is concerned. This is because such reform would increase the already high possibility of bringing litigation against directors. This, by implication, could deter talented individuals from accepting directorships. Furthermore, the design of a derivative action system should be guided by the need to achieve the right balance between safeguarding the interests of the company and shareholders, and showing appropriate reverence to the directors' exercise of managerial authority.

Since derivative litigation is initiated in relation to wrongs done to the company, the claimant should only be allowed to seek corporate relief. This could, for example, be in the form of compensation,[1742] disgorgement of profit or the rescission of the self-dealing transaction.[1743] This change would bring article 80 actions in line with the law of other

---

[1738] See footnotes 1440–1443 and accompanying text, Chapter 5 in this thesis.
[1739] See section (5.6.1), Chapter 5 in this thesis.
[1740] See footnotes 1266–1267 and accompanying text, Chapter 5 in this thesis.
[1741] See section 260(3) of the CA 2006.
[1742] See, for example, article 78 of the CL 2015.
[1743] See article 71(2) of the CL 2015.

jurisdictions, such as the UK. It would also, as a matter of policy, draw a clear distinction between personal and representative actions.

6.5.2.2 Should the claimant be required to obtain the court's permission to continue the claim?

In the UK shareholders may sue wrongdoing directors derivatively. However, they are required to obtain the court's permission to continue the claim. As explained earlier, the UK's adoption of this approach indicates how serious the UK legislator regards the problems associated with placing the decision to litigate in the hands of the board of directors or the shareholder body to be. Indeed, among other benefits, independent decision-making is more likely to be reached with judicial intervention in the derivative litigation process.[1744] Theoretically, this approach could be seen as a solution for problems associated with giving the general meeting or the board of directors the power to make this decision. Nevertheless, this does not mean that judicial intervention in the derivative litigation decision would fit perfectly within the Saudi legal environment. The UK permission procedure has problems and uncertainties that cast doubts upon the feasibility of such an approach in Saudi Arabia.

In the UK, although the court is expected in the first stage to consider the probability of a claim succeeding, there is some uncertainty about how to establish the *prima facie* case as the court has taken different approaches to the *prima facie* question and in some cases even skipped the *prima facie* stage and moved straight to the second stage.[1745] As stated earlier,[1746] it is an easy task for a shareholder to establish a *prima face* case but this does not reflect whether or not the chance of success in the final stage is substantial. Therefore, doubts have been raised as to whether the court should go through the first stage involving the *prima facie* inquiry because of the increased costs and time wasting associated with such an inquiry.

Another source of uncertainty stems from the very wide discretion given to the court at the permissive stage to determine whether to permit the application for permission. Although the CA 2006 specifies a set of factors that the court can take into consideration while exercising its discretion, ambiguity remains concerning how the court will reach its decision as the Act does not provide guidance on how the court should weigh various

[1744] See section (5.3) and footnotes 1311–1314 and accompanying text, Chapter 5 in this thesis.
[1745] See section (5.5.2.1), Chapter 5 in this thesis.
[1746] See footnotes 1354–1356 and accompanying text, Chapter 5 in this thesis.

statutory factors set out in section 263(3) and (4).[1747] Put differently, there is no specific test that has to be satisfied. A related issue that may be of great concern to parties in the litigation is the court's decision to determine whether to pursue the derivative claim is basically an 'investment decision'[1748] that the court (in the present case the Saudi court) may not always be able to make.[1749] Therefore, it has been argued that the court should not be empowered to intervene in the internal affairs of the company.[1750] This argument may not be sufficiently convincing because it might be true to say that a judge does not need to be an expert on the company's business to make an independent judgment based upon evidence submitted about whether the litigation would bring benefits to the company.[1751] Nevertheless, it is a strong argument that should not be discounted while studying the adoption of the court approval requirement because judges may differ in terms of their understanding of the company's affairs, and this may require them to spend more time and effort to reach a sound decision.

A further problem may be raised concerning the procedure involving the granting of permission. In assessing whether the claim would benefit the company, the court cannot make a sound judgment without some review of the legal merits of the case.[1752] However, it has been pointed out that the permission stage in some UK cases has turned to mini-trials;[1753] a matter that should be avoided according to the recommendation of the Law Commission.[1754] With all this in mind, in Saudi Arabia, if the requirement that the court's permission needs to be obtained were adopted, there would be a high risk that this procedure would escalate into mini-trials and a detailed investigation of evidence, resulting in lengthy hearings. This is a valid concern that might discourage a shareholder from bringing a genuine derivative claim due to the costly and lengthy permission procedure associated with the court approval requirement.

6.5.2.3 The standing requirement for the plaintiff

Like in the UK,[1755] the bringing of actions on behalf of the company is limited to shareholders under article 80 of the Saudi CL 2015. Seemingly, it is generally accepted

[1747] See footnotes 1366 and 1367 and accompanying text, Chapter 5 in this thesis.
[1748] See Hirt (n 1214) 165–166.
[1749] Ibid 195.
[1750] Ibid.
[1751] See Keay and Loughrey (n 1335) 161–162; Gevurtz (n 1225) 297–298.
[1752] See *Shareholders Remedies: Consultation Paper* (n 1297) para 16.22.
[1753] Keay and Loughrey (n 1335) 177.
[1754] *Shareholders Remedies: Consultation Paper* (n 1297) para 16.22.
[1755] See section 260(1) of the CA 2006.

that as long as the Saudi legislation allows a shareholder to sue directors on behalf of the company without giving further details, it is a standing requirement for a plaintiff in derivative actions to be a shareholder at the time of bringing the action.[1756] It seems that the Saudi law, as with its UK counterpart,[1757] does not prevent shareholders from bringing a lawsuit on behalf of the company in relation to an action that occurred before they became shareholders. Neither the UK CA 2006, nor the Saudi CL 2015 requires a plaintiff to have been holding stock at the time of the wrongdoing. The law should not allow directors to escape liability simply because the plaintiff had not been a shareholder at the time when the wrongdoing occurred.

The question that may arise is whether Saudi law should impose a threshold requirement on shareholders when bringing derivative actions. While the UK CA 2006 does not contain such a requirement, the laws of other jurisdictions only permit the initiation of derivative actions following the fulfilment of a minimum ownership requirement.[1758] One of the main justifications for a shareholding threshold is to prevent malicious lawsuits.[1759] Put differently, since substantial shareholders have sufficient interests in bringing derivative litigation compared with those with smaller shareholding ownership, they are unlikely to bring frivolous lawsuits.[1760] However, by requiring a minimum shareholding ownership (e.g., a 5% or 10% threshold),[1761] it might be said that derivative actions will only be available for a wealthy minority of shareholders as far as listed companies are concerned. In Saudi Arabia, although it is common to find a listed company with a blockholder owning at least 5% of the company's equity,[1762] the number of blockholders in each company, in an extreme scenario, can be counted on the fingers of one hand. This means that tens of thousands of shareholders will practically be excluded from brining a claim. For unlisted companies, if the law introduced a shareholding threshold as high as, for example, 5% or 10%, this requirement could also make it difficult for minority shareholders – who do not have access to a liquid market compared with shareholders of listed companies – to protect themselves when directors have breached their duties,

[1756] See Jobran (n 632) 387.
[1757] Section 260(4) of the CA 2006.
[1758] See Gelter (n 1477) 859 who provides examples of some European company laws imposing the minimum shareholding ownership requirement for bringing derivative actions.
[1759] H Hirt, 'The Enforcement of Directors' Duties in Large Companies: Reassessment of the Rule in *Foss v Harbottle* and Analysis of Reform Proposals with Particular Reference to German Company Law' (PhD thesis, University of London 2002) 251.
[1760] See Gelter (n 1477) 856.
[1761] Ibid 859, indicting that the shareholding thresholds are 5% in Spain and 10% in Austria.
[1762] Approximately 91% of listed companies have a shareholder with ownership of at least 5%, see Table 2.1, Chapter 2 in this thesis.

causing harm to the company's interests. The danger with the high threshold requirement is that it may block the initiation of desirable lawsuits.[1763]

Nevertheless, while it may be said that each shareholder should be entitled to equal protection regardless of the size of his/her shareholding, the inclusion of a threshold condition in the Saudi law of derivative actions might be necessary for several reasons. First, if every individual shareholder were entitled to sue derivatively without any standing requirements (e.g., a shareholding threshold) stated in the legislation, there would be a very large number of shareholders who could be potential plaintiffs initiating derivative claims, some of which may not serve the interests of the company. Indeed, the shareholding threshold is needed, especially given that neither the current Saudi law nor the proposed reform[1764] include the UK model of judicial procedure for permission to sue derivatively. The threshold requirement might also be necessary as a means of controlling the flow of derivative actions in the absence of the 'loser pays costs rule' in Saudi law.[1765] Furthermore, reducing the threshold to 1% or even lower[1766] would reduce the negative effect of a minimum ownership requirement on the effectiveness of derivative actions, as an important mechanism of corporate governance. Finally, the law should expressly allow shareholders to aggregate their shares to meet the minimum shareholding requirement.

6.5.2.4 The requirement to provide the company with notice

The need to notify the company of their intention to sue directors on its behalf is one of conditions placed upon shareholders under article 80 of the CL 2015.[1767] However, as explained in Chapter 5 of this thesis, the CL 2015 remains silent on the nature of such notification, whether the company should respond to the shareholder's statement and the legal implications of the company's response.[1768] The question that would be posed here concerns whether there is a need to retain such a requirement in Saudi law.

In the researcher's opinion, the law should retain the notice condition for the bringing of derivative actions, but with more clarification. It should be made clear from the outset that

[1763] Hirt (n 1759) 252.
[1764] See section (6.5.2.2), Chapter 6 in this thesis.
[1765] See footnote 1724 in this Chapter.
[1766] Such reductions have occurred in some European countries such as Germany and Italy. Regarding the former, the German law traditionally used to require a qualified minority of 10% and reduced the threshold in 2005 to 1% or Euro 100,000. It is worth mentioning that the German law also requires the court's approval, see Gelter (n 1477) 858–860.
[1767] In the UK CA 2006 the statutory derivative claim does not demand a shareholder applicant to provide the company with such a notice.
[1768] See section (5.6.2), Chapter 5 in this thesis.

the notice should take the form of a procedural rule of derivative actions.[1769] The rationale for the demand requirement is to give the company the opportunity to determine whether to litigate against directors, since the shareholders' right to litigation is originally derived from the right of the company. This requirement would control the flow of undesirable litigation to the court,[1770] prevent the 'multiplicity of proceedings' and encourage plainer communication between the company and its shareholders.[1771] Indeed, it is undoubtedly unwise to allow every case to reach courts and the demand requirement may resolve disputes before they reach the courts.[1772]

As in some other jurisdictions, companies should be required to respond within a specific period following receipt of the shareholders' demand.[1773] The question that arises is whether a shareholder should be allowed to sue derivatively if the demand has been refused or the company fails to act within the specific period.[1774] It seems that the company's refusal to sue should not prevent a shareholder from bringing derivative actions. This is because the independence of the company's decision can be questionable, especially in the presence of the possible influence of the wrongdoer over the company's affairs;[1775] for example, if the board of directors was the body responsible for responding to the shareholders' demand, the board may face the problem of a conflict of interests regarding the litigation decision.[1776] Even if the audit committee, which is formed separately from the board, responded, the independence of such a committee would also be the subject of concern. This is because the committee's members[1777] will usually be nominated by the board and perhaps be appointed by interested persons at the general meeting.[1778] Indeed, if shareholders were deprived of their right to bring their action due to the refusal of their demand to sue, it could be asserted that the role of the derivative action as a mechanism of accountability would largely be diminished and its effectiveness to deter directors would be significantly undermined.

[1769] The demand requirement has been adopted by other jurisdictions such as Germany, as a prerequisite to the initiation of derivative litigation, see Gelter (n 1477) 860.
[1770] S Jobran (n 632) 388.
[1771] G Zouridakis, 'Introducing Derivative Actions to the Greek Law on Public Limited Companies: Issues of Legal Standing and Lessons from the German and UK Experience' (2015) 26 International Company and Commercial Law Review 271, 282.
[1772] Jobran (n 632) 389.
[1773] Gelter (n 1477).
[1774] This question is closely related to section 263(3)(e) of the CA 2006 regarding the consideration of the company's decision.
[1775] The wrongdoer's control is a common problem in companies with concentrated ownership structure; see footnotes 1226–1230 and accompanying text, Chapter 5 in this thesis.
[1776] For more details, see footnotes 1220–1224 and accompanying text, Chapter 5 in this thesis.
[1777] A board member other than an executive director could be a member of the audit committee.
[1778] Article 101 of the CL 2015.

Thus, based upon the discussion above, the notice (demand) requirement should be mandatory, but the company's refusal to sue should not be accepted as a bar to the bringing of derivative actions. Nevertheless, if the derivative litigation was initiated after being refused earlier by the company, the court should be informed of the grounds for refusal, and take them into consideration.

6.5.2.5 Should authorisation, ratification and the availability of alternative remedies bar derivative litigation?

In the UK the court is required to refuse the application for permission to bring an action if the act complained of has been authorised by the company;[1779] in other words, if a director had exploited an opportunity or had engaged in a self-dealing transaction *after* obtaining the required approval, a shareholder applicant cannot bring a derivative action in relation to an authorised exploitation or self-dealing. This is a logical bar to initiating derivative litigation, which is no doubt expected to be a part of the Saudi law. Under an authorised act by a director, there is no breach of duties and, consequently, there should be no legal basis for a derivative lawsuit.

The ratification of wrongdoing has been regarded as one of the main legal problems within the current UK derivative action system. It seems accurate to suggest that many derivative actions could be dismissed because of the ratification of wrongdoing. As pointed out earlier, not only can the fact that the wrongdoing has been ratified be grounds for the denial of a derivative action, but also the likelihood of ratification could prevent a shareholder from bringing a derivative claim.[1780] As a result, reform proposals invariably suggest the exclusion of any reference to ratification from the UK derivative action scheme.[1781] With all this in mind, it seems that the Saudi law should be keener than the UK law to avoid reference to ratification as far as the derivative action scheme is concerned. In jurisdictions such as Saudi Arabia where share ownership tends to be more concentrated than in the UK[1782] the wrongdoer's control over the general meeting is more likely to occur and the inclusion of ratification in the law may significantly undermine an important mechanism of accountability. If the Saudi law adopted ratification as a bar to derivative litigation, this could result in a serious problem concerning what constitutes a valid

---

[1779] See section 263(2)(b) and (c) of the CA 2006.
[1780] See footnotes 1410–1411 and accompanying text, Chapter 5 in this thesis.
[1781] See Keay (n 1325) 53.
[1782] The patterns of corporate ownership in the UK and Saudi Arabia was considered in sections (2.5.1) and (2.5.2) respectively, Chapter 2 in this thesis.

ratification.[1783] Given the problems and uncertainties associated with the concept of ratification, it would seem inappropriate for Saudi law to provide ratification as a means of preventing shareholders from suing wrongdoing directors derivatively.

Regarding the availability of alternative remedies, in some situations directors' conduct may amount to a breach of their duty towards the company and, simultaneously, to a violation of shareholders' personal rights. In this regard, the Saudi law, similar to the UK law,[1784] should not regard the availability of alternative remedies, such the shareholder's personal action, as a condition that prevents the initiation of derivative litigation. Indeed, this should be the positon of Saudi law, as long as the nature of the purported wrongdoing and the relief pursued are suitable for a derivative action.

6.5.2.6 The shareholder's good faith: A proposed approach

A derivative action is one that is brought by a shareholder to seek corporate relief because of a wrong done to the company. This means that derivative litigation is initiated for the purpose of benefiting the company. In the UK the claimant's good faith is one of discretionary factors set out in the UK CA 2006 that the court needs to consider when reaching its decision to permit the continuation of derivative actions.[1785] As stated in Chapter 5 of this thesis, as long as the company will benefit from the bringing of a derivative action, the applicant will be regarded as acting in good faith and the court is likely to disregard other minor associated benefits that he/she will gain from the action.[1786] For Saudi Arabia, since there is no cases on this subject. The question here is how the Saudi court should address the allegations of a lack of good faith on the part of shareholder plaintiffs.

In the hearings of derivative action cases, a lack of good faith on the part of a plaintiff shareholder could be one of the defences that defendant directors might raise. It should always be born in mind that it depends on the particular circumstances and facts of the relevant case in order to determine whether or not good faith is present. In the context of derivative actions, the motive and intention of the shareholder in bringing the derivative

[1783] The UK law on ratification is a clear example of the complexity of what constitutes an effective ratification, see section (5.5.2.2.2), Chapter 5 in this thesis.
[1784] See section (5.5.2.2.4), Chapter 5 in this thesis.
[1785] Section 263(3)(a) of the CA 2006.
[1786] See section (5.5.2.2.3), Chapter 5 in this thesis.

action is the subject of an inquiry in relation to the good faith issue.[1787] In the UK ulterior motives and collateral purposes are clearly relevant in considering the good faith test under section 263(3)(a) of the CA 2006.[1788] For Saudi courts, there are two possible scenarios: First, good faith can only be established in situations where there is *no* ulterior motive.[1789] In this case derivative actions 'would be few and far between'.[1790] The second scenario is to overlook the presence of collateral purpose and focus on the main purpose of the claim; in other words, as long as the claim brought by shareholders benefit the company, the allegations concerning the shareholders' good faith should be rejected even if there are other collateral benefits, which the shareholders will gain as a result of the claim.[1791] The main rationale for the adoption of such an approach is not to allow a defendant director to evade the liability for the wrong done to the company. Indeed, if the lack of good faith in the context of a derivative action is interpreted broadly, this might prevent the initiation of legitimate litigation. It is also worth noting that it is the defendant director who bears the burden of proving the shareholders' lack of good faith.[1792] In order to deter speculative allegations and to avoid hearings being dominated by questions of the shareholders' good faith, it is recommended that the allegations be based upon strong and persuasive evidence that is clearly relevant to the issue of good faith.[1793]

6.5.2.7 A proposed reform by way of legal transplantation

In addressing the question of how Saudi law can benefit from the UK law in designing requirements and conditions for a shareholder to bring a derivative action, it seems that significant reform by way of legal transplantation is feasible. Consequently, amendments to the CL 2015, particularly article 80, should be made in order to regulate the initiation of derivative actions as follows:

- The right to initiate a derivative action should only be exercised to remedy the company for a wrong done to the company.

[1787] For the meaning of good faith, see footnotes 938–943 and accompanying text, Chapter 4 in this thesis.
[1788] See, for example, *Singh v Singh* (n 1374) [22]; Hook v Sumner (n 1427) 235. For further details, see J Tang, 'Shareholder Remedies: Demise of the Derivative Claim?' (2012) 1 UCL Journal of Law and Jurisprudenc 178, 192–193.
[1789] Tang (n 1788) 193.
[1790] Ibid.
[1791] It should be acknowledged that the distinction between prime motive and collateral motive is a complex one; see ibid 196.
[1792] This is according to the well-established Sharia rule of 'onus of proof lies with the plaintiff', see N Hamad, 'Transfer of Burden of Proof in T'adi Cases in Mudarabah and Agency to Trustees' (2010) 1 Journal of Judiciary 22, 28.
[1793] The same proposal is made in the UK company law literature, see Keay and Loughrey (n 1335) 169; J Tang (n 1788) 195.

- A derivative action should only be brought by a qualified shareholder (one owns a minimum of 1% of the company's equity). The aggregation of shares to meet the minimum shareholding requirement shall be allowed.
- The qualified shareholder should notify the company of his/her intention to sue directors derivatively and the company should respond within a specified period. The company's refusal to sue should not bar derivative litigation, but the court should be informed of the reasons for its refusal and take these reasons into consideration.
- An authorisation of the act complained of shall be considered as a bar to a derivative action.
- A ratification of the wrongdoing shall not be regarded as a bar to suing directors derivatively.
- The availability of an alternative remedy shall not disbar the initiation of a derivative action as long as the nature of the wrongdoing purported and the relief pursued are suitable for a derivative action.
- The potential of other collateral benefits that may be gained by a shareholder plaintiff is irrelevant in determining the validity of allegations concerning the shareholder's good faith, as long as the claim brought by the shareholder will benefit the company and there is no strong and persuasive evidence to support the allegations regarding the lack of good faith.

6.5.3 Funding of derivative actions

As stated in Chapter 5 of this thesis, shareholders' decisions to initiate litigation is likely to be largely affected by the funding of the action and whether or not the law involves rules dealing with the issue.[1794] This could be a serious issue and a major barrier to the bringing of derivative actions when the law is devoid of any mention of the issue of funding. Saudi company law is a case in point.[1795] Before considering the extent to which the Saudi law can benefit from the UK law, it is important first to establish the theoretical basis of indemnification of the plaintiff shareholder in a derivative action. As long as the

[1794] See footnotes 1478–1482 and accompanying text, Chapter 5 in this thesis.
[1795] See section (5.7.1), Chapter 5 in this thesis.

shareholder is entitled to initiate the litigation against the wrongdoing directors on behalf of the company, he/she should be indemnified by the company for all costs, since the company is the direct recipient of all benefits from such litigation.[1796] This view is borne out by a well-established Sharia rule of *al-ghurm bil al-ghunm* (liability accompanies gain).[1797] This general principle can suggests that the costs and losses that result from something shall be incurred by the person who benefits from them.[1798] As far as the funding of derivative actions is concerned, it can be said that the incurrence of litigation costs by the company finds its theoretical legal basis in the Sharia principle of *al-ghurm bil al-ghunm*.

As regards how to reform Saudi law in terms of funding derivative actions, the discussion of the UK funding rule[1799] has shown that the granting of indemnity costs lies within the discretionary power of the court, and it is generally unclear under what circumstances the orders will be granted. The broad discretion given to the court is illustrated by the fact that the granting of indemnity costs is not an inevitable result of a successful application for the continuation of a derivative action. Further, the UK case law seems unresolved in relation to whether or not the financial position of the claimant is relevant to the court's discretion. On the one hand, the court in *Smith v Croft* went with the view that if the plaintiff has enough money to incur the costs of litigation, there is no need to grant an indemnification order so as not to put financial strain on the company.[1800] On the other hand, the court, in *Jaybird v Greenwood*, disagreed with the argument, saying that the court should take the financial position of the derivative claimant into account.[1801] As one commentator believes, if the financial capability of the claimant has a role to play in the court's discretion, this will discourage even wealthy claimants from bringing a derivative action due to the fact that the financial benefits of the action, if successful, go directly to the company and the claimant's benefit might be 'minimal'.[1802]

Therefore, for Saudi law, the uncertainty associated with the UK courts' approach to the granting of indemnification orders may prevent the feasibility of transferring the UK

[1796] See Jobran (n 632) 390.
[1797] Ibid.
[1798] See W Waemustafa and S Suriani, 'Theory of Gharar and Its Interpretation of Risk and Uncertainty from the Perspectives of Authentic Hadith and the Holy Quran: A Qualitative Analysis' (MPRA Paper No. 78316, July 2015) 5 <https://mpra.ub.uni-muenchen.de/78316/1/MPRA_paper_78316.pdf> accessed 26 August 2017.
[1799] See footnotes 1493–1497 and accompanying text, Chapter 5 in this thesis.
[1800] *Smith v Croft* (1986) 1 WLR 580 , 597.
[1801] *Jaybird Group Ltd v Greenwood* (1986) BCLC 319 , 327
[1802] D D Prentice, '*Wallersteiner v Moir*: A Decade Later' (1987) Conv 167.

funding rule into the Saudi jurisdiction. Put differently, if the UK approach were to be adopted, it is essential to clarify the boundaries of the court's discretion in granting the order of indemnity costs. In this regard, it should be mandatory for the company to pay the costs of the derivative litigation following the fulfilment of the conditions for the bringing of the derivative action.[1803] The Saudi court must ensure that the claim is based upon the subject of the derivative litigation, the relief sought is for the company, the standing requirement for the plaintiff is satisfied, the demand (notice) requirement to the company was made before the lawsuit was filed, the act complained of was not authorised, and any allegations about the lack of good faith have been disapproved. Indeed, as long as the conditions for filling derivative lawsuits are satisfied, the court should show no reluctance in requiring that the company pay the costs of litigation.

With the mandatory requirement of the company incurring the costs of litigation, the uncertainty associated with the discretionary power of the court to grant indemnity costs orders would be substantially reduced and this would provide 'a shareholder with more certainty and confidence'.[1804] In the researcher's view, this approach could succeed in encouraging shareholders to commence derivative litigation given the absence of other financial disincentives. In Saudi Arabia, the shareholder is unlikely to be at risk of paying the legal expenses of the defendant if the action is unsuccessful; in other words, the 'loser pays costs rule', which is regarded by many as being an impediment to the bringing of derivative actions,[1805] is not present in Saudi law.[1806] Furthermore, there is no requirement to pay the court to commence litigation; an element of litigation costs that might discourage derivative claims, especially where the court fees are high.[1807] Having said that, the payment of lawyers' costs and perhaps the cost of expert evidence, if needed,[1808] are usually the elements that would make a shareholder think before initiating derivative litigation. With the mandatory requirement for the company to indemnify a shareholder for costs incurred, this would give the shareholder more confidence and incentives to bring derivative litigation.

[1803] This is one of the options considered by Reisberg for dealing with the economic impediment to derivative actions, see Reisberg (1478) 371–372.
[1804] Ibid 372.
[1805] See, for example, ibid 348–349 (stating that 'the American treatment of fees in such actions provides significantly lower disincentives to prospective plaintiffs than does the English rule'); Keay (n 1325) 55.
[1806] See footnote 1724, Chapter 6 in this thesis.
[1807] Gelter (n 1477) 869.
[1808] See particularly articles 128 and 129 of the SPL 2013 regarding the expert evidence.

6.5.3.1 A proposed reform by way of legal transplantation

When considering the possibility of transferring the UK approach to the funding of derivative actions to the Saudi law, the research submits that since the CL 2015 lacks a provision dealing with this issue, a new statutory article must be inserted into the CL 2015 and regulates this issue as follows:

- It is the court that is entitled to grant the indemnification orders requiring the company to incur the costs of the derivative litigation
- It is mandatory for the court to grant the indemnification orders as long as the court is convinced that the proposed conditions for filing the derivative lawsuit are satisfied.
- The court must ensure that the claim is based upon the subject of the derivative litigation, that the relief sought is for the benefit of the company, that the standing requirement for the plaintiff is satisfied that the demand (notice) requirement to the company was made before the lawsuit was filed, that the act complained of was not authorised, and that any allegations concerning the lack of good faith have been disapproved.

6.6 Concluding Remarks

This Chapter has revealed that the reform of the Saudi law of directors' duties by way of legal transplantation from the UK is necessary and, to a large extent, feasible as long as the imported rules and legal ideas have been adapted to fit properly within the Saudi legal context. Given the institutional structure and legal environment of Saudi Arabia, this chapter has examined which legal ideas can be transferred from the UK and designed a reform agenda for the law of directors' duties in the light of the need to enhance the accountability of directors without damaging the significant value of authority. Table 6.1 below is a summary of the proposed transplantation together with an indication of any current relevant provision in Saudi law. In some situations, there is no relevant Saudi law and therefore the transplantation serves as a gap-filing function.

With regard to the reform of directors' duties, the chapter has ensured that the proposed foreign legal standards and rules for directors' duty of care and of loyalty[1809]fall within the Sharia framework, are formulated where possible with legislative detail to ensure the effective enforcement by Saudi courts, and provide greater legal protection for shareholders including the minority; for example, while the transplantation of standards and tests for the duty of care and for the duty to act in good faith in the general interest of the company can be done, the UK model for the approval of self-dealing transactions and the judicial relief of liability are not recommended for transplantation into Saudi company law. In relation to corporate opportunity, the analysis carried out in this chapter has suggested that the UK's strict no-conflict approach to corporate opportunity is the most appropriate choice for Saudi law as directors would be liable for the breach in cases of unauthorised exploitation of any profit-making opportunity during the course of their tenure.

Table 6. 2: A summary of proposed provisions for reforming the relevant legal issues in Saudi law by way of legal transplantation

Legal issues	Relevant Saudi law	Proposed transplantations
The duty of care	▪ No express provision in the CL 2015 ▪ Article 30 (17) of the CGRs 2017	A new article to be inserted in the CL 2015 based upon section 174 of the UK CA 2006 with adaptations
The duty to act in good faith in the general interests of the company	▪ No express provision in the CL 2015 ▪ Article 30 (17) of the CGRs 2017	A new article to be inserted in the CL 2015 based upon section 172 (1) of the UK CA 2006 with adaptations
The avoidance of conflicts of interests in the context of corporate opportunities	▪ No express provision in the CL 2015 ▪ Article 44 (b)(2) of the CGRs 2017	A new article to be inserted in the CL 2015 based upon section 175 of the UK CA 2006 with adaptations
A Rule on preventing family members of directors from voting on self-dealing transactions at the general meeting	No express provision	A new article to be inserted in the CGRs 2017 based upon the UK LR 11.1.8, while retaining the definition of 'relatives' set forth in article 1 of the CGRs 2017
Requirements for the initiation of derivative actions	Article 80 of the CL 2015	Amendments to article 80 based upon sections 260 (1) and 263 of the UK CA 2006 with adaptations
Funding of derivative actions	No express provision	A new article to be inserted in the CL 2015 based upon the Rule 44.2 (a) of the UK Civil Procedures Rules with adaptations

[1809] It refers to the following sub-duties: the duty to act in good faith in the general interests of the company, the duty to avoid exploiting an opportunity and the duty to disclose a self-dealing transaction.

In terms of the reform of derivative actions, It has been argued that the design of an effective derivative action system is supported by the possible willingness of non-controlling shareholders to resort to such mechanisms of enforcement, as well as the fact that concerns about the capability of Saudi judiciary to deal with such actions is largely unfounded. With a view to striking the right balance between the enhancement of accountability and the deference of the director's authority, this chapter has examined which conditions should be adopted from the UK statutory derivative action system. It has been recommended that derivative actions should be brought by qualified shareholders to remedy the company for a wrong done to the company (e.g., a breach of directors' duties of loyalty and care) following the submission of a demand requirement to sue wrongdoing directors, and the authorisation of the act complained of should be regarded as a bar to derivative litigation. The transplantation of the court's permission requirement into the Saudi legal environment is not feasible. The ratification of wrongdoing and the availability of an alternative remedy should also not deprive shareholders from initiating derivative litigation. To make derivative actions work effectively in Saudi Arabia, a *redeveloped* form of the UK indemnity costs orders has been recommended to deal with the issue of the funding of this form of litigation.

Conclusion

The primary objective of this research was to propose a reform of Saudi law of directors' duties and of derivative actions in order to offer greater legal protection for the company and its shareholders (including minority shareholders) against abusive practices by directors. The proposed reform, in the researcher's opinion, would contribute to the promotion of good corporate governance and, more generally, the development of the commercial environment in Saudi Arabia. This study, which sought to benefit from the experience of well-developed law such as that in the UK, designed a novel framework that involved clearer, well-defined duties of care and loyalty, reinforced by a more accessible derivative action, compared with the current Saudi law. With the proposal that remedies the problems of uncertainty and deficiency identified throughout the analysis of Saudi law, this study intended to ensure that directors were subject to a sufficient level of accountability and control in which the law retained a pivotal role in creating incentives for directors to act diligently and loyally by imposing liability on those who failed to do so.

This research put forward the argument that legal uncertainty and deficiency in the current Saudi law on the duty of care, the duties of loyalty,[1810] and the derivative action, were the main reasons that prompted the researcher to propose the reform by way of legal transplantation. The argument for such reform is further supported by demonstrating the inadequacy of other monitoring and discipline mechanisms that operate within the Saudi corporate governance system. While examining the feasibility of transferring selective legal models and rules from the UK law to its Saudi counterpart, the research took into account the appropriateness of imported rules in the Saudi context; a consideration that involves making some adaptations to the foreign rules, if necessary, to fit properly within the new legal and institutional environment. This is a vital prerequisite for proper receptivity of imported rules and models by Saudi Arabia.

A. Summary

In order to achieve the aims of this study, the researcher structured the study to necessarily begin with a general overview of the Saudi legal system in which joint stock companies operate (**Chapter 1**). The purpose of this introductory chapter was to bring out the primary features of the Saudi legal system and provide an accurate understanding of Saudi law that

[1810] For the purpose of this thesis, two main forms of duties of loyalty have been discussed, namely (i) the duty to act in good faith in the company's general interests and (ii) the duty to avoid conflict of interests with particular focus on the corporate opportunities and self-dealing transactions.

would be discussed in the rest of the study. The unique nature of the Saudi legal system involving rules of Islamic origin and rules of foreign origin was highlighted. It was necessary to point out that the drafting of legislation, which may involve the importation of rules of non-Islamic origin, was only legitimate when it produced laws that did not conflict with Sharia, which enjoys primacy over the general legal context. It was equally important to emphasise the flexible nature of Sharia from two aspects. First, Sharia, in some areas of law such as corporate matters, tends to provide general guidelines rather than detailed rules, leaving room for the society concerned to develop detailed rules according to its social and economic needs. Second, the principle that 'all things not specifically prohibited are allowed'[1811] in Sharia is an important basis that clears the way for introducing new legal ideas that were not previously recognised in Sharia as long as they do not conflict with the general principles of *Quran* and the Sunnah. The overview also involved a description of the current legal framework for corporate governance that is the main legislation and public enforcers (i.e., judicial institutions and regulators). Importantly, the chapter referenced aspects of the Saudi judicial system that are relevant to the discussion in the chapters that follow. It was stressed that there is no system of binding judicial precedent in Saudi Arabia. Saudi judges also tend to apply, not make, the law, adhering to the formal application of written rules without deviation.

In **Chapter 2** the discussion narrowly focused on the assessment of the main problems prevailing in the current accountability framework for directors in Saudi Arabia with the purpose of defining where directors' duties and the enforcement by public enforcers (e.g., courts) sit within the entire framework. The main theme of this chapter was to explain why there was a need for legal reform of directors' duties and private enforcement through derivative actions as mechanisms to ensure directors' accountability for misuse of their powers. This area of law, as highlighted, suffers from legal uncertainty and deficiency caused either by the absence of legislative recognition or unclear legislative statement in addition to the inactive role of courts in filling in the legislative vacuum. This, by implication, undermines the effectiveness of the legal liability system as an essential mode of accountability. It is also believed that the legal liability regime has been well recognised as a last resort when other mechanisms and market forces fall short in ensuring the board accountability. Accordingly, a significant part of this chapter was devoted to arguing that the need to remedy deficiencies found in the law of directors' duties and derivative actions

[1811] See Hanson (n 52) 289.

was further supported by the limits and drawbacks associated with other mechanisms of monitoring and accountability in the Saudi context.

In this regard, the chapter assessed four mechanisms of accountability, namely (i) monitoring by blockholders, (ii) shareholders' internal mechanisms at the general meeting, (iii) the role of independent non-executive directors and (iv) the markets. The study argued that although the concentrated ownership structure prevails in most companies listed in on Tadawul, this does not underestimate the importance of sound company law in ensuring the accountability of directors towards shareholders or even towards non-controlling shareholders in the case where directors are under the control of blockholders. The study further claimed that blockholders' incentives to monitor in the Saudi context may be affected by a relatively small block of shares,[1812] the presence of multiple blockholders or the identity of blockholders, as illustrated by the state as a blockholder. Similarly, internal mechanisms of accountability that are available to shareholders at the general meeting (e.g., removal of directors) and the independent director institution operate within limits and so this cannot mask the need for an effective system of legal liability. This was also the case in relation to the markets, which tend to be immature in the Saudi context, in addition to some significant flaws associated with such a mechanism.

The argument of legal uncertainty and deficiency was developed in **Chapters 3**, **4** and **5** by using the UK law as a benchmark for the evaluation of the Saudi law of directors' duties and private enforcement by derivative action. In **Chapter 3** the study examined the extent of clarity and strength in the current Saudi law governing directors' duty of care. The comparative analysis found that this area of law was more certain and settled in the UK compared with Saudi Arabia, especially following the UK codification of the duty in the CA 2006. In Saudi Arabia the lack of detailed legislative statement on this duty, coupled with the almost absent role of the courts in filling the legislative vacuum, creates aspects of uncertainty regarding the substantive content of such duty. As regards the standard of liability, the UK law follows the objective/subjective standard, whereas the Saudi law tends to adopt the purely objective standard. In Saudi Arabia the standard by which directors' actions are reviewed is not clear: Is it ordinary negligence or gross negligence? The core problem exists in the absence of a clear line between what constitutes gross negligence and what is considered ordinary negligence. There is also uncertainty about

[1812] See Table 2.1, Chapter 2 in this thesis.

whether the court will consider directors' experience and skill while assessing their compliance with their duty. Failure to do so means that the law does not create incentives for highly skilled directors to act in a way that is expected from a reasonable person with his or her equivalent experience and skill. In the absence of legislative and judicial guidance, it also remains unclear whether the Saudi court recognises that the extent of the obligation of care varies, depending upon the role and function assigned to the directors concerned. Furthermore, the study found that unlike the CL 2015, the new CGRs 2017, to some extent, have established the directors' need to monitor, to keep themselves informed, and not rely completely on the conduct of others (e.g., directors). This chapter ended by investigating the effects of a single high standard of care, and how the UK and Saudi laws respond to such an issue. Importantly, the analysis showed that the UK law, unlike Saudi law, introduces a mechanism (i.e., judicial relief of liability) to address directors' concern about a single high standard of care. Nevertheless, the study questioned the UK judicial approach to relief of liability in terms of legal certainty; a consideration that was taken into account while examining the feasibility of Saudi reform by legal transplantation.

In **Chapter 4** the comparative analysis focused on the duties of loyalty, particularly the obligation to act in good faith in the company's interests, and the obligation to avoid conflicts of interest, with particular focus on their application in the area of corporate opportunities and self-dealing transactions. This chapter revealed a number of findings of which the following are the most central: First, unlike the UK, it appears that the components of the loyalty obligation (i.e., the duty to act in good faith and in the interest of the company) are not understood as a single obligation. This means that there is no duty to act in the company's interests, to which the good faith requirement is tied. As a result, the duty of loyalty is left with an *inappropriate* standard of liability, which at least permits the court to engage in an objective consideration of whether directors, in fact, acted in the general interests of the company. Second, when it comes to the question of in whose interests the company is to be managed, the Saudi law, unlike in the UK, does not provide clear rules governing the priority of competing interests. With reference to the elusive concept of 'the interests of the company', directors have been given wide discretion to determine what the interests of the company are and this weakens the shareholders' monitoring capability. Third, regarding the duty to avoid the exploitation of corporate opportunities, the study argued that in comparison with the UK law, this area of directors' duties is poorly developed in the Saudi jurisdiction. Under such conditions, the law, as has been submitted, does not sufficiently ensure directors' accountability for misconduct, leaving the company and its shareholders unprotected. Even with the new regulation of corporate opportunities under the CGRs 2017, questions were raised about whether the new regulation represented sound law in terms of legal certainty and the striking of the right balance between discretion and control. Fourth, concerning directors' engagement in self-dealing transactions, the research found that the recent reform introduced by the CL 2015 and the new CGRs 2017 has developed the law to a model that approximates to the UK CA 2006. However, the comparative analysis revealed that the Saudi law places more constraints on directors' engagement in self-dealing transactions than the UK law by placing directors under a mandatory requirement to disclose their conflicting interest to the board and seek shareholders' prior approval. In the Saudi context, the research raised concern about the effectiveness of approval by shareholders in the absence of an express rule in the CL 2015 on the exclusion of interested shareholders other than board members from participating in the voting process.

Following the discussion of directors' duties of care and loyalty, the research evaluated the accessibility of Saudi law of private formal enforcement (**Chapter 5**). The chapter began with an assessment of the role of public enforcement of breaches of directors' duties, especially following the recent reform brought about by the CL 2015 and the CGRs 2017. The study argued that the role of public enforcement by regulators tended to suffer from significant limits that underlie the important role of private enforcement, including an accessible derivative action regime within the overall system of enforcement. Regarding the private enforcement action, it is believed, as a matter of policy, that the law should not exclusively rely on the board or the general meeting to bring the legal action. The law, which does not provide an alternative judicial remedy that enables a shareholder to enforce the company's rights, does not ensure sufficient accountability of directors. It further undermines the efficacy of directors' duties. In the Saudi context, throughout the analysis, the main problem was that if the company was incapable of pursuing the legal action because of, *inter alia*, the wrongdoer's control of the general meeting, the law did not formulate an effective mechanism of enforcement in the form of derivative actions, which promoted the legal protection of the company and its shareholders especially minority shareholders. Although the comparative analysis suggested that he UK law was more certain and accessible than its Saudi counterpart, significant problems and uncertainties were discussed and highlighted in relation to the UK derivative action regime and rules governing the funding of derivative actions. The study highlighted the fact that the UK court had wide discretion to control the derivative claim, determine whether or not the claim should be allowed, and grant indemnity cost orders. It was necessary to establish this in order for it to be taken into account when examining the feasibility of reforming the

Saudi law of derivative actions by way of legal transplantation. This is because the wider the discretion given to the court, the more uncertain the law is, especially in jurisdictions where the court may not have the necessary capability to develop the law without detailed legislative guidance.

The study ended, in **Chapter 6**, with a consideration of the extent to which the Saudi law could benefit from the experience of the UK in order to reform the law of directors' duties and derivative actions in Saudi Arabia. To be specific, the extent to which the reform of Saudi law by way of legal transplantation was feasible was examined. The research approach to this enquiry was that the feasibility of legal transplantation depended on whether the imported rules and legal ideas had been adapted to fit properly within the Saudi institutional and legal context. The study principally took into account the following factors while examining which legal ideas could be transferable: the lack of conflict between Sharia and a proposed model; the Saudi court tradition along with the limited capability of its judges to deal with broadly open-ended principles; the need to enhance legal certainty at the expense of flexibility; the possibility that a director was under the control of a blockholder and therefore there was a need to protect non-controlling shareholders; the centrality of sound company law in the presence of the limited role of the markets as a mechanism of accountability in Saudi Arabia; and concerns over the independence of disinterested directors in the Saudi context. The design of a reform agenda was guided by the need to enhance the directors' accountability, but without damaging the significant value of their authority.

With all this in mind, the examination of the feasibility of transplanting selective UK rules and models into Saudi law concluded with the following recommendations and suggestions in relation to the legislation reform:

A.1 Recommendations concerning the duties of care and loyalty

As regards the duty of care, the study recommends that a new statutory provision should be included in the CL 2015, codifying it in a way that reflects the adoption of dual objective/subjective standards for the duty of care. Within the design of the objective standard, there should be express mention of the need for the court to consider various roles and functions assigned to the directors concerned. The company statute should involve a (non-exhaustive) set of statutory factors that will be taken into account for the assessment of directors' compliance; this shall include the need to consider the extent of directors' care in monitoring, keeping themselves informed and relying on others. The study does not recommend the adoption of the UK model for the judicial relief of liability.

Regarding the affirmative duty to act in good faith in the company's general interests, a new statutory provision should be included in the CL 2015 that requires directors to act in a way that they honestly believe is in the interests of shareholders as a whole. The standard for the duty should be the directors' honest belief, which would be judged according to subjective/objective considerations. It is recommended that the reference to the interests of the company should be abandoned in favour of more specific objective, that is, the interest of shareholders as a whole. Directors should *predominantly* manage companies for the benefit of the shareholder constituency who should have priority for due consideration over non-shareholders. The present research does not support the express reference to the due consideration of the non-shareholder constituency within the statutory formulation of the duty.

In terms of the duty to avoid conflicts of interest, the research recommends the introduction of a new statutory provision in the CL 2015, codifying the duty in the area of exploitation of a corporate opportunity in a way that reflects the adoption of the strict no-conflict approach. It should be additionally stated that the circumstances surrounding the conflict situation be regarded as irrelevant to the inquiry concerning compliance with the duty to avoid conflict of interests.[1813] The company's interests should be understood as referring to any profit-making opportunity for the purpose of corporate opportunities. There should be an authorisation process in the form of a mandatory pre-approval by the general meeting, allowing a director to exploit an opportunity following the receipt of shareholders' consent. There should also be a statutory rule entitling the company to disgorgement of unauthorised profits.

With regard to the issue of self-dealing transactions, the study does not recommend the adoption of the UK model for authorising self-dealing transactions. For listed companies, there should be a new provision included in the CGRs 2017 that prevents interested shareholders (persons connected to interested directors who are not members of the board) from voting on self-dealing transactions at general meetings. The study is not in favour of adopting the UK definition of *family relationship* in the context of self-dealing transactions

[1813] See the accompanying text to footnote 1671, Chapter 6 in this thesis.

and prefers retaining the current Saudi definition of family members, as a described by the CGRs 2017.

A.2 Recommendations concerning the regime of derivative actions

It is submitted that the recommended conditions for a shareholder to bring a derivative action should be part of proposed amendments to article 80 of the CL 2015. The study suggests that the initiation of derivative litigation should only be permitted to remedy the company for a wrong done to the company. It does not recommend the adoption of the UK model which requires the plaintiff to obtain the court's permission to continue the action. As a requirement for bringing the action, it should be brought by qualified shareholders (who own a minimum of 1% of the company's equity) and who are allowed to aggregate their shares to meet the minimum shareholding requirement. Qualified shareholders should notify the company of their intention to sue directors derivatively and the latter should respond within a specific period. The company's refusal to sue should not bar the derivative litigation, but the court should be informed of the reasons for its refusal to take them into consideration.

The research proposes that a derivative action should not be brought if the act complained of is authorised. By contrast, the ratification of wrongdoing should not be regarded as a bar to derivative litigation. This should also be the case in relation to the availability of an alternative remedy as long as the nature of the wrongdoing purported and the relief pursued are suitable for a derivative action. The court's approach to allegations concerning the shareholder's good faith should be more flexible in the sense that it should reject allegations concerning good faith as long as there is no persuasive and strong evidence to support such allegations and the claim brought by the shareholder will benefit the company irrespective of the presence of other collateral benefits to be gained by a shareholder plaintiff.

Regarding the issue of the funding of derivative litigation, the study recommends the introduction of a new statutory provision in the CL 2015, requiring the court to order the company to pay the costs of litigation as long as the court is convinced that conditions for filling the derivative lawsuit are satisfied. In this regard, the Saudi court must ensure that the claim is based upon the subject of the derivative litigation; the relief sought is for the benefit of the company; the standing requirement for the plaintiff is satisfied; the demand (notice) requirement to the company was made before the lawsuit was filed; the act complained of was not authorised; and any allegations about the lack of good faith have been disapproved.

B. Contribution to Knowledge

More generally, the research provides an assessment of current Saudi mechanisms of directors' accountability and governance, emphasising the centrality of a sound legal liability regime that establishes well-designed duties of care and loyalty, reinforced by accessible derivative litigation, in relation to the reform of corporate governance in Saudi Arabia. By conducting a comparative study with the UK law, the research has evaluated the current Saudi law of directors' duties and private formal enforcement in depth, taking into consideration the recent development brought by the CL 2015 and the CGRs 2017. In comparison with the UK, the research shows that Saudi law suffers from serious areas of deficiency and uncertainty that undermine the effectiveness of directors' duties and private formal enforcement, as mechanisms introduced to ensure that directors are subject to sufficient levels of accountability and control. Importantly, the research adopts the legal transplantation approach to improve the effectiveness of Saudi company law in the area of directors' duties and private formal enforcement. To the best of the researcher's knowledge, it is the first study to examine the feasibility of reforming Saudi law by way of legal transplantation from the UK in the areas of directors' duty of care; duty to act in good faith in the company's general interests; the duty to avoid conflict of interests with particular focus on the corporate opportunities and self-dealing transactions; and derivative actions. Indeed, the research can be seen as an important contribution to the body of literature on the feasibility of legal transplants, as a method to reform corporate governance in Saudi Arabia.

When examining the feasibility of legal transplantation in the Saudi context, some practical contributions can be highlighted. First, the proper reception of foreign rules requires the consideration of institutional structure and legal environment of the host country. As a result, the research has concluded that the transferability of some UK legal models is not feasible, while others can be transferred with adaptations to fit within the Saudi legal and institutional settings. Second, it is important to take the limited capability of public enforcers (e.g., courts) into consideration. Under such conditions, the law should contain, when possible, more detailed and practicable legal rules rather than ambiguous principles. Third, in jurisdictions such as Saudi Arabia where there is a limited role for the market in the promotion of good corporate governance, the law is expected to play a more central role in filling in this gap and provide investors with sufficient legal protection against abusive practices by directors.

Finally, this research submits recommendations that are intended to reform the Saudi company law system in a way that enhances the directors' accountability in particular and the good corporate governance system in general. The findings of the study are relevant for various legal participants such as judges, lawyers and legislators. Since the proposed reform agenda can be introduced as a bill to amend the current law of directors' duties and derivative actions, this comparative research may significantly contribute to legal development in Saudi Arabia. Furthermore, by employing legal transplant as a strategy for reform, this research intended to develop a legal model that approximated the UK law but remained appropriate to Saudi characteristics. This would consequently contribute towards producing understandable Saudi law, especially for foreign investors and business people.

C. Limitations and Avenues for Future Research

Corporate governance is a wide topic. In this research a specific area within the general framework of directors' accountability and governance in Saudi Arabia was studied, namely the law of directors' duties of care, and loyalty and private formal enforcement. The focus was on specific problems and an argument was put forward for the reform of the current position of Saudi law by way of legal transplantation from the UK law. This means that the study is not comprehensive in that it does not cover all elements in the framework of directors' accountability and governance, but rather attempts to tackle certain deficiencies in specific forms of directors' duties and in the derivative action system.

Therefore, further research could be conducted to examine the effectiveness of other forms of directors' duties (e.g., those owed towards the company or towards specific corporate constituencies) and possible solutions for reform. Similarly, while the derivative action is expected to be brought against directors in relation to breaches of duties owed to the company, an area of research may include the study of personal actions brought by a shareholder against directors and other shareholders, and the consideration of the feasibility of reform by way of legal transplantation. Within the derivative action system, the research only concerns the issue of when a shareholder is allowed to bring a derivative action. A further avenue for research may include the discussion of detailed procedural rules that govern derivative actions such as the issue of access to information; potential defendants; which organ of the company should be responsible for responding to the demand requirement; within which period the company should respond to a shareholder; and under which circumstances the notice period can be waived.

The study also limits its scope by focusing on the Saudi and UK laws. On the one hand, this means that the findings and recommendations for reforming Saudi law cannot be regarded as necessarily applicable to other jurisdictions, such as those in the Middle East and North Africa. On the other hand, further research might consider how jurisdictions other than the UK may help to develop reforms to the directors' duties and derivative actions through legal transplantation.

Bibliography

A Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles' (2009) 20 Critical Perspectives on Accounting 556

A Al-Ghadyan, 'The Judiciary in Saudi Arabia' (1998) 13 Arab Law Quarterly 235

A Al-Jarbou, 'Judicial Independence: Case Study of Saudi Arabia' (2004) 19 Arab Law Quarterly 5

A Al-Kyat, *Companies in Islamic Sharia and Positive Law*, vol 2 (4th edn, Beirut, Al-Ressalh Publishers 1994)

A Al-Qasem, 'The Injurious Acts under the Jordanian Civil Code' (1989) 4 Arab Law Quarterly 183

A Al-Sanhuri, *Al-Wasit: Commentary on the New Civil Code: Sources of Obligation (Arabic)*, vol 1 (Beirut, Dar Alturah Arabi)

A Al-Sanhuri, *Sources of Right under the Law and Islamic Jurisprudence (Arabic)*, vol 6 (Beirut, Dar Alturah Arabi 1954)

A Al-Shalhoub, *The Constitutional System in the Kingdom of Saudi Arabia between Islamic Sharia and Comparative law (Arabic),* (Riyadh, King Fahd National Library 1999)

A Alcock, 'An Accidental Change to Directors' Duties?' (2009) 30 Company Lawyer 362

A Alkahtani, 'The Influence of Corporate Governance on Protecting Minority Shareholders' Rights in the Saudi Stock Market: a Comparative Study' (PhD thesis, University of Westminster 2015)

A Amico, 'Towards "Shareholder Spring" in the Middle East?' in S Boubaker and D Nguyen (eds), *Corporate Governance in Emerging Markets* Springer Berlin Heidelberg 2014)

A Amkhan, 'The Concept of Fault in Arab Law of Contract' (1994) 9 Arab Law Quarterly 171

A Awwad, 'Legal Regulation of the Saudi Stock Market: Evaluation, and Prospects For Reforms' (PhD thesis, University of Warwick 2000)

A Berle and G C Means, *The Modern Corporation and Private Property* (New York, Macmillan Company 1933)

A Dignam, *Hicks & Goo's Cases and Materials on Company law* (7th edn, Oxford, Oxford University Press 2011)

A Edmans, 'Blockholders and Corporate Governance' (2014) 6 Annual Review of Financial Economics 23

A Hicks, 'Directors' liabilities for Management Errors' (1994) 110 LQR 390

A Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Cambridge, Harvard Univ. Press 1970)

A Kabeer et.al. (ed.), *The Arabic Tongue for I'bn Mandoor* (Cairo, Dar Al-Ma'ref)

A Keay and J Loughrey, 'Derivative Proceedings in a Brave New World for Company Management and Shareholders' (2010) 3 Journal of Business Law 151

A Keay and J Loughrey, 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action under the Companies Act 2006' (2008) 124 Law Quarterly Review 469

A Keay and J Loughrey, 'The Framework for Board Accountability in Corporate Governance' (2015) 35 Legal Studies 252

A Keay and M Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' (2015) 15 Journal of Corporate Law Studies 255

A Keay, 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33 Civil Justice Quarterly 76

A Keay, 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 Journal of Corporate Law Studies 39

A Keay, 'Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective' (2006) Lloyds Maritime and Commercial Law Quarterly 335

A Keay, 'Good Faith and Directors' Duty to Promote the Success of their Company' (2011) 32 Company Lawyer 138

A Keay, 'Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado About Little?' (2011) 22 EBLR 1

A Keay, 'Section 172(1) of the Companies Act 2006: An Interpretation and Assessment' (2007) 28 Company Lawyer 106

A Keay, 'Stakeholder Theory in Corporate Law: Has it Got What it Takes?' (2010) 9 Richmond Journal of Global Law and Business 249

A Keay, 'The Authorising of Directors' Conflicts of Interest: Getting a Balance?' (2012) 12 Journal of Corporate Law Studies 129

A Keay, 'The Public Enforcement of Directors' Duties: A Normative Inquiry' (2014) 43 Common Law World Review 89

A Keay, *Board Accountability in Corporate Governance* (London, Routledge 2015)

A Keay, *Directors' Duties* (2nd edn, Bristol, Jordans 2014)

A Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (London, Routledge 2013)

A McClean, 'The Theoretical Basis of the Trustee's Duty of Loyalty' (1969) 7 Alta L Rev 218

A Pacces, *Rethinking Corporate Governance: The Law and Economics of Control Powers* (Routledge 2012)

A Reisberg, 'Derivative Actions and the Funding problem: the Way Forward' (2006) JBL 445

A Reisberg, 'Funding Derivative Actions: A Re-examination of Costs and Fees as Incentive to Commence Litigation' (2004) 4 J Corp L Stud 345

A Reisberg, 'Judicial Control of Derivative Actions' (2005) 16 ICCLR 335

A Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)Action' (2009) 2-3 European Company and Financial Law Review 219

A Reisberg, *Derivative Actions and Corporate Governance* (Oxford, OUP 2007)

A Shleifer and R Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737

A Shleifer and R Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461

A Walters, 'Directors' Duties: The Impact of the Company Directors Disqualification Act 1986' (2000) Company Lawyer 110

A Watson, 'Comparative Law and Legal Change' (1978) 37 Cambridge Law Journal 313

A Watson, *Legal Transplants: An Approach to Comparative law* (2nd edn, Athens, University of Georgia Press 1993)

A Yunus, *Commercial Companies (Arabic)* (Cairo, 1991)

A Zidan, *The Judicial System in Islamic Sharia (Arabic)* (Amman, Al-Bashaer Library 1989)

B Al-Haboob, 'The Contractual Liability (Arabic)' (2011) 3 Al-Qadhaiyah Journal 278

B Black and R Kraakman, 'A Self-Enforcing Model of Corporate Law' (1995) 109 Harv L Rev 1911

B Black, 'Shareholder Passivity Reexamined' (1990) 89 Michigan Law Review 520

B Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2000) 48 UCLA L Rev 781

B Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 The Journal of Legal Studies 459

B Cheffins, *Company Law: Theory, Structure and Operation* (Oxford, Clarendon Press 1997)

B Clark, 'The Director's Duty of Skill and Care: Subjective, Objective or Both?' (1999) 27 SLT 239

B Grossfeld, *The Strength and Weakness of Comparative Law* (T Weir tr, Clarendon Press 1990)

B McDonnell, 'Professor Bainbridge and The Arrowian Moment: A Review of The New Corporate Governance in Theory and Practice' (2009) 34 Del J Corp L 139

B Seaman, 'Islamic Law and Modern Government: Saudi Arabia Supplements the Shari'a to Regulate Development' (1979) 18 Columbia Journal of Transnational Law 413

B Sharfman, 'What's Wrong with Shareholder Empowerment?' (2012) 37 The Journal of Corporation Law 903

B Weiss, 'Interpretation in Islamic Law: The Theory of Ijtihad' (1978) 26 The American Journal of Comparative Law 199

C Baxter, 'Demystifying D&O Insurance' (1995) 15 Oxford J Legal Stud 537

C Chadien, 'The Law on Corporate Opportunity Transactions by Directors: A Comparative Analysis of Delaware Law and Australian Law' (2016) 5 GSTF Journal of Law and Social Sciences 28

C Childress, 'Saudi Arabian Contract Law: A comparative Perspective' (1990) 2 St Thomas Law Forum 69

C Gerner-Beuerle and E Schuster, 'The Evolving Structure of Directors' Duties in Europe' (2014) 15 European Business Organization Law Review 191

C Hurt, 'The Duty to Manage Risk' (2014) 39 Journal of Corporation Law 253

C Jungmann, 'The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems:Evidence from the UK and Germany' (2006) 4 ECFR 426

C Parsons, 'Directors' and Officers' liability Insurance: A Target or a Shield?' (2000) 21 Company Lawyer 77

C Qu, 'Some Reflections on the General Meeting's Power to Control Corporate Proceedings' (2007) 36 Common Law World Review 231

C Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34 Legal Studies 582

C Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999) 62 Mod L Rev 697

CLRSG, Modern Company Law For a Competitive Economy, Completing the Structure, (November 2000)

CLRSG, Modern Company Law For a Competitive Economy, Developing the Framework, (March 2000)

CLRSG, Modern Company Law For a Competitive Economy, Final Report (vol 1, June 2001)

CLRSG, Modern Company Law For a Competitive Economy, The Strategic Framework, (February 1999)

D Ahernn, 'Guiding Principles for Directorial Conflicts of Interest: Re Allied Business and Financial Consultants Ltd; O'Donnell v Shanahan' (2011) 74 The Modern Law Review 596

D Arsalidou, 'Litigation Culture and the New Statutory Derivative Claim' (2009) 30 Company Lawyer 205

D Arsalidou, 'Shareholder Primacy in cl.173 of the Company Law Bill 2006' (2007) 28 Company Lawyer 67

D Arsalidou, 'The Impact of Section 214(4) of the Insolvency Act 1986 on Directors' Duties' (2000) 22 Company Lawyer 19

D Berkowitz, K Pistor and J Richard, 'Economic Development, legality, and the Transplant Effect' (2003) 47 European Economic Review 165

D Chen, *Corporate Governance, Enforcement and Financial Development : The Chinese Experience* (Cheltenham, Edward Elgar 2013)

D Clarke, 'Corporate Governance in China: An Overview' (2003) 14 China Economic Review 494

D Clarke, 'Three Concepts of Independent Directors' (2007) 32 Delaware Journal of Corporate Law 73

D Donald, 'Approaching Comparative Company Law' (2008) 14 Fordham Journal Corporate and Financial Law 83

D Gibbs, 'Has the Statutory Derivative Claim Fulfilled its Objectives? A Prima Facie Case and the Mandatory Bar: Part 1' (2011) 32 Company Lawyer 41

D Gibbs, 'Has the Statutory Derivative Claim Fulfilled its Objectives? The Hypothetical Director and CSR: Part 2' (2011) 32 Company Lawyer 76

D Karl, 'Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know' (1991) 25 George Washington Journal of International Law and Economics 131

D Kershaw, 'Does it Matter How the Law Thinks About Corporate Opportunities?' (2005) 25 Legal Stud 533

D Kershaw, 'Lost in Translation: Corporate Opportunities in Comparative Perspective' (2005) 25 Oxford Journal of Legal Studies 603

D Kershaw, *Company Law in Context : Text and Materials* (2nd edn, Oxford, Oxford University Press 2012)

D North, 'Institutions' (1991) 5 Journal of Economic Perspectives 97

D Prentice and J Payne, 'The Corporate Opportunity Dctrine' (2004) 120 Law Quarterly Review 198

D Prentice, 'Wallersteiner v Moir: A Decade Later' (1987) Conv 167

E Ferran, *Company Law and Corporate Finance* (Oxford, OUP 1999)

E Lynch, 'Section 172: A Ground-Breaking Reform of Director's Duties, or the Emperor's new Clothes?' (2012) 33 Company Lawyer 196

E Maug, 'Large Shareholders as Monitors: Is There a Tarde-off between Liquidity and Control?' (1998) 53 The Journal of Finance 65

E Mujih, 'The New Statutory Derivative Caim: A Delicate Balancing Act: Part 1' (2012) 33 Company Lawyer 76

E Mujih, 'The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2' (2012) 33 Company Lawyer 99

E Nowicki, 'A Director's Good Faith' (2007) 55 Buffalo Law Review 457

E. Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 Journal of Finance 383

F Al-Saud, 'Political Development in the kingdom of Saudi Arabia: An Assessment of the Majlis Ash-Shura' (PhD Thesis, University of Durham 2000)

F Almajid, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective' (PhD Thesis, University of Manchester 2008)

F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Cambridge, Harvard University Press 1996)

F Gevurtz, 'The Globalization of Corporate Law: The End of History or a Never-Ending Story?' (2011) 86 Wash L Rev 475

F Gevurtz, 'Who Represent the Corporation? In Search of a Better Method for Determining the Corporate Interest in Derivative Suits' (1985) 46 U Pitt L Rev 265

F Hassan, 'The Sources of Islam Law' (1982) 76 American Society of International Law Proceedings 65

F Pollock, ' Derry v. Peek in the House of Lords' (1889) 5 LQR

F Vogel, 'Islamic Governance in the Gulf: A Framework for Analysis, Comparison, and Prediction' in G Sick and L Potter (ed) *The Persian Gulf at the Millennium: Essays in Politics, Economy, Security, and Religion* Macmillan Press Ltd 1997)

F Vogel, *Islamic law and legal system : Studies of Saudi Arabia* (Leiden, Brill 2000)

G Avilov and Others, 'General Principles of Company Law For Transition Economies' (1999) 24 Journal of Corporate Law Studies 190

G Bean, 'Corporate Governance and Corporate Opportunities' (1994) 15 Company Lawyer 266

G Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 Journal of Political Economy 169

G Bermann and E Picard, *Introduction to French law* (Alphen on the Rhine, Kluwer Law International 2008)

G Hagel, ' A Practitioner's Introduction to Saudi Arabian Law' (1983) 16 Vand J Transnat'l L 113

G Pendell, 'Derivative Claims: A Practical Guide' (2007) 20 Company Law Newsletter 1

G Sfeir, 'The Saudi Approach to Law Reform' (1988) 36 Am J Comp L 729

G Zouridakis, 'Introducing Derivative Actions to the Greek Law on Public limited Companies: Issues of Legal Standing and Lessons from the German and UK Experience' (2015) 26 International Company and Commercial Law Review 271

H Baum and D Puchniak, 'The Derivative Action: An Economic, Historical and Practice-Oriented Approach' in D Puchniak and Others (eds), *The Derivative Action in Asia: A Comparative and Functional Approach* Cambridge, Cambridge University Press 2012)

H Faruqi, *Faruqi's Law Dictionary* (5th edn, Beirut, Librairie du liban 2006)

H Hansmann and R Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439

H Hirt, 'The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest' (2005) JBL 159

H Hirt, 'The Enforcement of Directors' Duties in Large Companies: Reassessment of the Rule in Foss v Harbottle and Analysis of Reform Proposals with Particular Reference to German Company Law' (PhD Thesis, University of London 2002)

H Hutchinson, 'Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm' (2004) 36 Loy U Chi LJ 1111

H Kanda and C Milhaupt, 'Re-examining Legal Transplants: the Director's Fiduciary Duty in Japanese Corporate law' (2003) 51 The American Journal of Comparative Law 887

I Abdal-Haqq, 'Islamic Law: An Overview of its Origin and Elements' (1996) 1 The Journal of Islamic Law 1

I MacNeil and X Li, '"Comply or Explain": Market Discipline and Non-compliance with the Combined Code' (2006) 14 Corporate Governance: An International Review 486

I MacNeil, 'Uncertainty in Commercial Law' (2009) 13 Edinburgh Law Review 68

I MacNeil, *An Introduction to the Law on Financial investment* (2nd edn, Oxford, Hart Publishing 2012)

I Ramsay, 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 UNSW Law Journal 149

I Shihata, 'The Role of Law in Business Development' (1996) 20 Fordham Int'l LJ 1577

J Armour, H Hansmann and R Kraakman, 'Agency Problems and Legal Strategies' in R. Kraakman et.al. (ed) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009)

J Armour, H Hansmann and R Kraakman, 'What is Corporate Law?' in R Kraakman et al. (eds) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009)

J Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 Stanford Journal of International Law 307

J Birds and Others, *Boyle & Birds' Company Law* (8th edn, Bristol, Jordans 2011)

J Birds, B Lynch and S Milnes, *MacGillivray on Insurance Law : Relating to All Risks Other than Marine* (13th edn, London, Sweet & Maxwell/Thomson Reuters 2015)

J Braithwaite, 'Rules and Principles: A Theory of Legal Certainty' (2002) 27 Austl J Leg Phil 47

J Brand, 'Aspects of Saudi Arabian Law and Practice' (1986) 9 B C Int'l & Comp L Rev 1

J Coffee, 'Privatization and Corporate Governance: The Lessons from Securities Market Failure' (1999) 25 J Corp L Stud 1

J Coffee, 'Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145

J Coffee, 'The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role' (1989) 89 Columbia Law Review 1618

J Cox, 'The Social Meaning of Shareholder Suits' (1999) 65 Brooklyn Law Review 3

J Farrar and S Watson, 'Self-Dealing, Fair Dealing and Related Party Transactions—History, Policy and Reform' (2011) 11 Journal of Corporate Law Studies 495

J Fedtke, 'Legal transplants' in J Smits (ed) *Elgar Encyclopedia of Comparative Law* (2nd edn, Edward Elgar Publishing 2012)

J Franks and C Mayer, 'Hostile takeovers and the correction of managerial failure' (1996) 40 Journal of Financiai Economics 163

J Franks, C Mayer and L Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 Journal of Financial Intermediation 209

J Heydon and P. Loughlan, *Cases and Materials on Equity and Trusts* (5th edn, 1997)

J Ipp, 'The Diligent Director' (1997) 18 Co Law 162

J Kechichian, *Legal and Political Reforms in Saudi Arabia* (Abingdon, Routledge 2013)

J Loughrey, 'The Directors' Duty of Care and Skill and the Financial Crisis' in J Loughrey (ed) *Directors' duties and shareholder litigation in the wake of the financial crisis* Cheltenham, Edward Elgar Publishing Limited 2013)

J Loughrey, A Keay and L Cerioni, 'Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance' (2008) 8 Journal of Corporate Law Studies 79

J Lowry, 'Codifying the corporate opportunity doctrine: The (UK) Companies Act 2006' (2012) 5 International Review of Law 1

J Lowry, 'The duty of loyalty of company directors: bridging the accountability gap through efficient disclosure' (2009) 68 Cambridge Law Journal 607

J Piesse, R Strange and F Toonsi, 'Is there a distinctive MENA model of corporate governance?' (2012) 16 J Manag Gov 645

J Popofsky, 'Corporate Opportunity and Corporate Competition: A Double-Barreled Theory of Fiduciary Liability' (1982) 10 Hofstra Law Review 1193

J Raz, 'Legal Principles and the Limits of Law' (1972) 81 The Yale Law Journal 823

J Schacht, 'Islamic Law in Contemporary States' (1959) 8 The American Journal of Comparative Law 133

J Solomon, *Corporate Governance and Accountability* (3rd edn, Chichester, John Wiley & Sons 2010)

J Sykes, 'The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006' (2010) 29 CJQ 205

J Tang, 'Shareholder Remedies: Demise of the Derivative Claim?' (2012) 1 UCL Journal of Law and Jurisprudenc 178

Jami At-Tirmidhi (Book of Business, Hadith 1209)

K Al-Abdulqader, G Hannah and D Power, 'A Test of the Weak-form of the Efficient Markets Hypothesis for the Saudi Stock Market' (2007) 6 Journal of Emerging Market Finance 167

K Arrow, *The Limits of Organization* (New York, W.W. Norton 1974)

K El-Fadl, 'The Centrality of Shari'ah to Government and Constitutionalism in Islam' in R Grote and T J. Röder (eds), *Constitutionalism in Islamic Countries: Between Upheaval and Continuity* OUP 2012)

K Falgi, 'Corporate Governance in Saudi Arabia: A Stakeholder Perspective' (Phd Thesis, University Of Dundee 2009)

K Pistor et al., 'Evolution of Corporate Law and the Transplant Effect: Lessons from Six Countries' (2003) 18 The World Bank Research Observer 89

K Wedderburn, 'Control of Corporate Actions' (1989) 52 Modern Law Review 401

K Wedderburn, 'Control of Corporate Litigation' (1976) 39 Modern Law Review 327

K Wedderburn, 'Derivative Actions and Foss v. Harbottle' (1981) 44 Modern Law Review 202

K Wedderburn, 'Shareholders' Rights and the Rule in Foss v Harbottle' (1957) Cambridge LJ 194

K Zweigert and H Kotz, *An Introduction to Comparative Law* (T Weir tr, 3rd edn, Clarendon Press 1998)

L Al-Rimawi, 'Emerging markets of the Middle East: a critique of selected issues in Arab securities regulation' (1999) 7 Journal of Financial Regulation and Compliance 149

L Enriques, 'The Law on Company's directors' self-dealing: A comparative Analysis' (2000) 2 International and Comparative Corporate Law Journal 297

L Enriques, G Hertige and H Kanda, 'Related-Party Transactions' in R. Kraakman et.al. (ed) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, Oxford, OUP 2009)

L Enriques, H Hansmann and R Kraakman, 'The Basic Governance Structure: The Interests of Shareholders as a Class' in R. Kraakman et.al. (ed) *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2nd edn, (Oxford, OUP 2009)

L Gower, *Principles of Modern Company Law* (3rd edn, Stevens and Sons 1969)

L Hoffmann, 'The fourth annual Leonard Sainer lecture: the Rt Hon Lord Hoffmann' (1997) 18 Company Lawyer 194

L Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 42 Duke LJ 557

L Miles and S Goulding, 'Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?' (2010) 2 Journal of Business Law 126

L Sealy and R Hooley, *Commercial law : text, cases, and materials* (4th edn, Oxford, Oxford University Press 2009)

L Sealy, 'Bona Fide and Proper Purpose in corporate Decisions' (1989) 15 Monash U L Rev 265

L Sealy, 'The Director as Trustee' (1967) Cambridge LJ 83

L Strine et al., 'Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law' (2010) 98 Geo LJ 629.

M Al-Jaber, *Saudi Commercial Law (Arabic)* (5th edn, Riyadh, 2000)

M Al-Uthaymeen, *A System of Roots of Jurisprudence and its principles (Arabic)* (3rd edn, Riyadh, Dar Ibn Al-Jawzi 2012)

M Alamri, 'Corporate Governance and the Board of Directors in Saudi-listed Companies' (PhD Thesis, University of Dundee 2014)

M AlBahuti, *Explanation of Muntaha al-Iradat* (A Al-Turki ed, 3rd vol, Al-Resalah, 2000)

M Albrahim, 'The enforcement of directors' duties in the context of shareholders' rights protection: A comparative study between UK and Saudi law' (PhD Thesis, Lancaster University 2016)

M Almadani, 'Derivative actions: does the companies Act 2006 offer a way forward?' (2009) 30 Comp Law 131

M Bassiouni and G Badr, 'The Shari'ah: Sources, Interpretation, and Rule-Making' (2001) 1 UCLA J Islamic & Near E L 135

M Becht and C Mayer, 'Introduction' in F Barca and M Becht (eds), *The Control of Corporate Europe* Oxford, Oxford University Press 2002)

M Bukhari, 'The Impact of Institutions on the Development of Corporate Governance in Saudi Arabia' (PhD thesis, University of Nottingham 2014)

M Dooley, 'Two Models of Corporate Governance' (1992) 47 The Business Lawyer 461

M Eisenberg, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62 Fordham L Rev 437

M Eisenberg, 'The Duty of Good Faith in Corporate Law' (2006) 31 Delaware Journal of Corporate Law 1

M Faccio and L Lang, 'The ultimate ownership of Western European corporations' (2002) 65 Journal of Financial Economics 365

M Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe' (2011) 37 Brooklyn Journal of International Law 843

M Goergen and L Renneboog, 'Strong Managers and Passive Institutional Investors in the UK' in F Barca and M Becht (eds), *The Control of Corporate Europe* Oxford, Oxford University Press 2002)

M Gutierrez and M Saez, 'Deconstructing Independent Directors' (2013) 13 Journal of Corporate Law Studies 63

M Hanson, 'The Influence of French Law on the Legal Development of Saudi Arabia' (1987) 2 Arab LQ 272

M Hosni, *Jurisdiction and Proof in the Criminal Procedure Law (Arabic)* (Cairo, Dar Al Nahda 1992)

M Jensen and W Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305

M McDaniel, 'Bondholders and Stockholders' (1988) 13 Journal of Corporation Law 205

M Moore, *Corporate Governance in the Shadow of the State* (Oxford, Hart Publishing 2013)

M Roe, 'Corporate Law's Limits' (2002) 31 The Journal of Legal Studies 233

M Sáez and D Riaño, 'Corporate Governance and the Shareholders' Meeting: Voting and Litigation' (2013) 14 European Business Organization Law Review 343

M Saleem, *Islamic Commercial Law* (Singapore, Wiley 2013)

M Siems, *Comparative Law* (Cambridge, Cambridge University Press 2014)

M Urban, *The Influence of Blockholders on Agency Costs and Firm Value: An Empirical Examination of Blockholder Characteristics and Interrelationships for German Listed Firms* (Springer 2015)

M Zimmer, 'Overview of Specialized Courts' (2009) 8 International Journal for Court Administration 1

N Brennan and J Solomon, 'Corporate governance, accountability and mechanisms of accountability: an overview' (2008) 21 Accounting, Auditing & Accountability Journal 885

N Foster, 'Islamic perspectives on the law of business organisations: Part 1: an overview of the classical Sharia and a brief comparison of the Sharia regimes with Western-style law' (2010) 11 European Business Organization Law Review 3

N Hamad, 'Transfer of burden of proof in t'adi cases in mudarabah and agency to trustees' (2010) 1 Journal of Judiciary 22

O Hart, 'An Economist's View of Fiduciary Duty' (1993) 43 The University of Toronto Law Journal 299

O Hart, 'Corporate Governance: Some Theory and Implications' (1995) 105 The Economic Journal 678

O Kahn-Freund, 'On Use and Misuse of Comparative Law' (1974) 37 Modern Law Review 1

P Beleya and others, 'Independent Directors and Stakeholders Protection: A Case of Sime Darby' (2012) 2 International Journal of Academic Research in Business and Social Sciences 422

P Davies and K Hopt, 'Corporate Boards in Europe-Accountability and Convergencet' (2013) 61 Am J Comp L 301

P Davies and S Worthington, *Gower Principles of Modern Company Law* (10th edn, London, Sweet & Maxwell 2016)

P Koh 'Once a Director, Always a Fiduciary' (2003) 62 Cambridge Law Journal 403

P Legrand, 'The Impossibility of Legal Transplants' (1997) 4 Maastricht J Eur & Comp L 111

P Mitchell, 'Patterns of Legal Change' (2012) 65 Current Legal Problems 177

Q Quach, 'Transplantation of Derivative Actions to Vietnam - Tip-offs from Absence of Academic Debate' (2012) 7 Asian Journal of Comparative Law 1

R Aba-Namay, 'The New Saudi Representative Assembly' (1998) 5 Islamic L & Soc'y 235

R Al-Shoronbassy, *The Introduction to Islamic Jurisprudence: development, Schools, Sources, Doctrines and Theories (Arabic)* (2nd edn, Alexandria, 1983)

R Cotterrell, 'Is there a logic of legal transplants' in D Nelken and J Feest (eds), *Adapting legal cultures* Hart Publishing 2001)

R Edmunds and J Lowry, 'The Continuing Value of Relief for Directors' Breach of Duty' (2003) 66 Mod L Rev 195

R Esen, 'Managing and Monitoring: the dual role of non-executive directors on U.K. and U.S. boards' (2000) 11 International Company and Commercial Law Review 202

R Grantham, 'The content of the director's duty of loyalty' (1993) Journal of Business Law 149

R Hay, A Shleifer and R Vishny, 'Toward a Theory of Legal Reform' (1996) 40 European Economic Review 559

R Jones, 'Law, Norms, and the Breakdown of the Board: Promoting Accountability in Corporate Governance' (2006) 92 Iowa Law Review 105

R Khnayn, 'A viewpoint about the compilation of preponderant views of jurists (Arabic)' (1991) 33 Journal of Islamic Research 26

R la Porta et al., 'Investor Protection and Corporate Governance' (2000) 58(3) Journal of Financial Economics 3

R la Porta et al., 'Law and Finance' (1998) 106 Journal of Political Economy 1113

R la Porta, F Lopez-de-Silanes and A Shleifer, 'Corporate Ownership around the World' (1999) 54 The Journal of Finance 471

R Langford and I Ramsay, 'Directors' duty to act in the interests of the company - subjective or objective?' (2015) 2 Journal of Business Law 173

R Langford, 'The Duty of Directors to act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared' (2011) 11 Journal of Corporate Law Studies 215

R Nolan, 'The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report' (2005) 6 Theoretical Inquiries in Law 413

R Peters, 'From Jurists' Law to Statute Law or What Happens When the Shari'a is Codified' (2002) 7 Mediterranean Politics 82

R Reed, 'Company directors - collective or functional responsibility' (2006) 27 Company Lawyer 170

S Al-theabi, 'The principle of good faith in Saudi law compared with other laws - in Arabic' (2014) 23 Journal of Sharia, Law and Islamic Studies 15

S Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 Northwestern University Law Review 547

S Bainbridge, 'In Defense Of The Shareholder Wealth Maximization Norm: A Reply To Professor Green' (1993) 50 Washington and Lee Law Review 1423

S Bainbridge, *Corporate Law* (2nd edn, New York, Foundation Press 2009)

S Bainbridge, *The new corporate governance in theory and practice* (Oxford, Oxford University Press 2008)

S Bottomley, *The constitutional corporation : rethinking corporate governance* (Aldershot, Ashgate 2007)

S Claessens, S Djankov and L Lang, 'The separation of ownership and control in East Asian Corporations' (2000) 58 Journal of Financial Economics 81

S Jobran, *The Board of Directors of Joint Stoke Company in Saudi law (Arabic)* (Beirut, Librairie Juridique Al-Halabi 2006)

S Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' (2009) 2-3 European Company and Financial Law Review 324

S Mahmassani, *Falsafat Al-Tashri Fi Al-Islam - The Philosophy of Jurisprudence in Islam (English)* (Brill, Leiden 1961)

S Ramadan, *Islamic law : its scope and equity* (London, P.R. Macmillan 1961)

S Rayner, *The theory of contracts in Islamic law* (Arab and Islamic laws series, London, Graham & Trotman 1991)

S Turnbull, 'Corporate Governance: Its scope, concerns and theories' (1997) 5 Corporate Governance: An International Review 180

S Watson, 'The significance of the source of the powers of boards of directors in UK company law' (2011) 6 Journal of Business Law 597

S Wrbka, 'Comments on Legal Certainty from the Perspective of European, Austrian and Japanese Private Law' in M Fenwick and S Wrbka (eds), *Legal Certainty in a Contemporary Context Private and Criminal Law Perspectives* Springer 2016)

S Yahea, *The Brief in Saudi Commercial Law (Arabic)* (6th edn, Arabian Modern Office 2010)

Sahih Muslim (Book 21, Hadith No. 1531)

T Baker and S Griffith, 'The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer' (2007) 95 Geo LJ 1795

T Bingham, *The rule of law* (London, Allen Lane 2010)

T Kuran, 'The Absence of the Corporation in Islamic Law: Origins and Persistence' (2005) 53 The American Journal of Comparative Law 785

T Paredes, 'A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer' (2004) 45 William & Mary Law Review 1055

T Paredes, 'Importance of Corporate Law: Some Thoughts on Developing Equity Markets in Developing Economies' (2006) 19 Pac McGeorge Global Bus & Dev LJ 401

U Mattei, 'Efficiency in legal transplants: an essay in comparative law and economics' (1994) 14 International Review of Law and Economics 3

V Finch, 'Company Directors: Who Cares About Skill and Care?' (1992) 55 The Modern Law Review 179

W A-Zuhayli, *Theory of Reparation* (9th edn, Damascus, Dar Al-Fikr 2012)

W Allen, J B Jacobs and L E Strine, 'Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of Van Gorkom and its Progeny as a Standard of Review Problem' (2002) 96 North Western University Review 449

W Ringe, 'Independent Directors: After the Crisis' (2013) 14 European Business Organization Law Review 401

Y Al-Zahrani, 'Rights of Shareholders under Saudi Company Law 1965' (Phd Thesis, Brunel University 2013)

Y Alzahrani, 'Critical Evaluation of Minority Shareholders' Rights in General Shareholders Meeting Underthe Saudi Company Law No.1965' (2014) 14 Global Journal of Human Social Science 37

Web References

A Amico, *Corporate Governance Enforcement in the Middle East and North Africa: Evidence and Priorities* (OECD, OECD Corporate Governance Working Papers No.15 2014) <http://dx.doi.org/10.1787/5jxws6scxg7c-en> accessed 25 July 2017

A Ansary, 'A Brief Overview of the Saudi Arabian Legal System' (Hauser Global Law School Program, July 2008) 10 <http://www.nyulawglobal.org/globalex/saudi_arabia.htm#_Toc200894559> accessed 26 August 2017

A Arrobbio, *Corporate Governance of State-Owned Enterprises : A Toolkit* (Washington, DC, World Bank Group 2014) <http://documents.worldbank.org/curated/en/2014/10/20286791/corporate-governance-state-owned-enterprises-toolkit> accessed 23 March 2016

A Blom, I Shah and R Wynn, 'Personal Risks Facing Board Members in the Middle East' *Financier Worldwide* (November 2011) <http://www.financierworldwide.com/personal-risks-facing-board-members-in-the-middle-east/#.V_Ds0mO9h0c> 28 September 2016

A Felsted, 'The Danger of Being an Executive', *Financial Times* (16 October 2006), <https://www.ft.com/content/2fc9618a-5d13-11db-9d15-0000779e2340> accessed 23 September 2016

A Jammal, *Al-Madina* Newspaper (23 July 2017) <http://www.al-madina.com/article/533239/> accessed 2 August 2017

A Licht, 'Accountability and Corporate Governance' (September 2002) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=328401 > accessed 1 April 2016

A Singh, A Singh and B Weisse, 'Corporate Governance, Competition, the New International Financial Architecture and Large Corporations in Emerging Markets' (MPRA Paper No 53665, August/ 2002) <https://mpra.ub.uni-muenchen.de/53665/1/MPRA_paper_53665.pdf> accessed 21 September 2017

Alriyadh Newspaper (edn 15031, 19 August 2009) (Arabic) *<http://www.alriyadh.com/453290> accessed 25 July 2017*

Annual Statistical Report 2015 (Saudi Stock Exchange, 31 December 2015) < https://www.tadawul.com.sa/wps/portal/tadawul/markets/reports-%26-publications/periodical-publications > accessed 15 September 2017

C Garham, R Litan and S Sukhtanker, 'Cooking the Books: The Costs to the Economy' (Brookings Policy Brief Series, Brookings Institution, August 2002) <https://www.brookings.edu/research/cooking-the-books-the-cost-to-the-economy/> accessed 11 May 2017

C Gerner-Beuerle, P Paech and E Schuster, 'Study on Directors' Duties and Liability' (A paper prepared by LSE for the EC, Apirl 2013) <http://ec.europa.eu/internal_market/company/docs/board/2013-study-analysis_en.pdf> accessed 16 July 2016

C Paz-Ares, *Directors' Duties and Directors' Liabilities: A framework for the law Reform in Latin America* (OECD, The Third Meeting of the Latin American Corporate Governance Roundtable, April 2002) <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/2085788.> accessed 22 September 2016)

D Kershaw, 'The Path of Fiduciary Law' (LSE Law, Society and Economy Working Papers, 6/2011) <http://www.lse.ac.uk/collections/law/wps/WPS2011-06_Kershaw.pdf> accessed 10 January 2017.

D Kershaw, 'The Rule in Foss v Harbottle is Dead; Long Live the Rule in Foss v Harbottle' (LSE Law, Society and Economy Working Papers, 5/2013) <https://www.lse.ac.uk/collections/law/wps/WPS2013-05_Kershaw.pdf> accessed 22 February 2017

D Kershaw, 'Web Chapter A: The Market for Corporate Control' in D Kershaw (ed) *Company Law in Context: Text and Materials* OUP 2010) <http://global.oup.com/uk/orc/law/company/> accessed 14 October 2014

G Dari-Mattiacci and B Deffains, 'Uncertainty of Law and the Legal Process' (Amsterdam Center for Law & Economics Working Paper No 2005/10, 2005) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=869368> accessed 2 June 2016

I Abdullah, *Aleqtisadiah* Newspaper (22 June 2017) (Arabic) <http://www.aleqt.com/2017/06/22/article_1208011.html> accessed 20 July 2017

I Millstein, 'Non-Traditional Modes of Enforcement' *Enforcement and Corporate Governance: Three Views* Focus 3 Global Corporate Governance Forum, 2005) <http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGo%20v3.pdf?MOD=AJPERES> accessed 28 February 2017

I Ramsay, *Corporate Governance and the Duties of Company Directors* (Centre For Corporate Law and Securities Regulation, University of Melbourne 1997) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=924312> accessed 27 Febraury 2017

J Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' (ECGI Law Working Paper No106, 2008) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1133542&rec=1&srcabs=1105355&alg=1&pos=3> accessed 22 September 2017

J Coles, N Daniel and L Naveen, 'Co-opted Boards' (September 2013) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1699272> accessed 7 September 2017

K Chalaczkiewicz-Ladna, I Esser and I MacNeil, 'Engaging Stakeholders in The UK in Corporate Decision-making Through Strategic Reporting: An Empirical Study' (October 2017) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049203> accessed 17 January 2018

K Pistor and C Xu, 'Fiduciary Duty in Transitional Civil Law Jurisdictions Lessons from the Incomplete Law Theory' (ECGI - Law Working Paper No. 01/2002) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=343480> accessed 1 June 2017.

K Pistor and C Xu, 'Incomplete Law: A Conceptual and Analytical Framework And its Application to the Evolution of Financial Market Regulation' (Working Paper No 204, 2002) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=310588> accessed 2 June 2016

Law Commission and the Scottish Law Commission, Company Directors: Regulating Conflicts of Interests and Formulating and Statement of Duties, (Law Com No 261 and Scot Law Com No 173, September 1999) <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc261_Company_Directors.pdf> accessed 23 July 2016.

Law Commission, Shareholders Remedies: Consultation Paper, (No.142, 1995) <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/cp142_Shareholder_Remedies_Consultation.pdf> accessed 20 February 2017.

Law Commission, Shareholders Remedies: Report, (1997) <http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc246_Shareholder_Remedies.pdf> accessed 20 February 2017

M Alghamdi, 'Family Business Agency Problems, Ownership Concentration and Corporate Performance: Theory and Evidence from Saudi Arabia'(Proceedings of 26th International Business Research Conference, 7 - 8 April 2014, Imperial College) <https://wbiworldconpro.com/uploads/london-conference-2014/finance/1396842795_322-Al-Ghamdi.pdf > accessed 11 March 2017

M Iskander and N Chamlou, *Corporate Governance: A Framework for Implementation* (World Bank Publication,Washington, May 2000) <http://www-wds.worldbank.org/servlet/WDSContentServer/ WDSP/IB/2000/09/08/000094946_00082605593465/Rendered/PDF/multi_page.pdf > accessed 1 May 2015.

M Moore, 'The (Neglected) Value of the Board Accountability in Corporate Governance'(University of Cambridge, Faculty of Law Research Paper No. 9/2015, February 2015) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2566335> accessed 4 May 2017

M Roe, 'The Institutions of Corporate Governance'(The Harvard John M Olin Discussion Paper Series No 488, 8/2004) <http://www.law.harvard.edu/programs/olin_center/papers/pdf/Roe_488.pdf> accessed 22 September 2017

M Shirley and P Walsh, 'Public versus Private Ownership: The Current State of the Debate'(Policy Reserch Working Paper 2420, The World Bank, August 2000) <http://documents.worldbank.org/curated/en/2000/08/693336/public-versus-private-ownership-current-state-debate> accessed 2 May 2016

O Aljamaan and M Hamzani, *Alriyadh* Newspaper (edn 16186, 17 October 2012) <http://www.alriyadh.com/776934> accessed 22 December 2016

OECD Proceedings, *Corporate Governance, State-owned Enterprises and Privatisation* (Paris, OECD Publishing 1997) < http://www.keepeek.com/Digital-Asset-Management/oecd/governance/ corporate-governance-state-owned-enterprises-and-privatisation_9789264162730-en#page39> accessed 11 May 2016

OECD, *State-Owned Enterprises in the Middle East and North Africa* (Paris, OECD Publishing 2013) <http://www.oicexchanges.org/docs/third-meeting-istanbul/mena-soes-eng.pdf> accessed 22 September 2017

OECD, *Towards New Arrangements for State Ownership in the Middle East and North Africa* (Paris, OECD Publishing 2012) <http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/50087769.pdf > accessed 22 September 2017

Oxford English Dictionary, 'faith, n. and int.' (OED 3rd edn, Oxford University Press June 2014) <http://www.oed.com/view/Entry/67760> accessed 12 October 2017

Oxford English Dictionary, 'good faith, n., int., and adj.' (OED 3rd edn, Oxford University Press June 2014) <http://www.oed.com/view/Entry/363783> accessed 12 October 2017

P Davies, *Corporate Governance* (Acts of the Conference on Company Law and the Single Market: European Comission, 15 and 16 December 1997) <http://ec.europa.eu/internal_market/company/docs/otherdocs/actes_en.pdf> accessed 3 January 2016

P Davies, *The Board of Directors: Composition, Structure, Duties and Powers* (Paper on Company Law Reform in OECD Countries, OECD 2000) <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf> accessed 15 September 2017

R Al-fozan, 'Board Member: From where did you get this?'*Alriyadh* Newspaper (edn 15519, 20 December 2010) <http://www.alriyadh.com/587034> accessed 20 May 2016

R Al-fozan, 'The State Is Investor, and a Seller'*Alriyadh* Newspaper (edn 17226, 23 August 2015)<http://www.alriyadh.com/1075718> accessed 22 May 2016

R B Khnayn, 'A Viewpoint About the Compilation of Preponderant Views of Jurists'(Arabic) (1991) 33 Journal of Islamic Research 26, 26 <http://www.alifta.net/Fatawa/FatawaDetails.aspx?languagename=ar&View=Page&PageID=4602&PageNo=1&BookID=2> accessed 1 February 2015.

Report of the Committee on the Financial Aspects of Corporate Governance, The Cadbury Report (UK, December 1992) <http://www.ecgi.org/codes/documents/cadbury.pdf> accessed 1 September 2017

Report on the Development of Private Sector and the Privatisation Policy, Achievements of The Development Plans: Facts and Figures (2013) <http://www.mep.gov.sa> accessed 12 April 2015

Report on the Observance of Standards and Codes (ROSC), 'Corporate Governance Country Assessment: Kingdom of Saudi Arabia'(February 2009) <http://documents.worldbank.org/curated/en/838731468106752813/Kingdom-of-Saudi-Arabia-Report-on-the-Observance-of-Standards-and-Codes-ROSC-corporate-governance-country-assessment> accessed 12 March 2016

Report to Russian Center for Capital Market Development, Comparative Analysis on Legal Regulation of the Liability of Members of the Management Organs of Companies, (Law Working Paper No. 103/2008, February 2008) <http://ssrn.com/abstract=1001990> accessed 1 August 2017

S Bainbridge, 'Smith v Van Gorkom'(Law-Econ Research Paper No 08-13, May 2008) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1130972#%23> accessed 23 September 2016

S Bainbridge, *Director Primacy* (UCLA School of Law Law-Econ Research Paper No. 10-06, May 2010) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1615838> accessed 1 May 2017

S Bainbridge, *Rethinking Delaware's Corporate Opportunity Doctrine* (UCLA School of Law, Law-Econ Research Paper No. 08-17 November 2008) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1296962> accessed 10 July 2017

S Galletti, 'The Existing Division of Corporate Decision-Making Power in the UK, USA and Europe: A Comparative Perspective'(2015) Corporate Governance Journal, Bond University <http://epublications.bond.edu.au/cgej/36> accessed 22 April 2016

Statistical Report, published in *Alarabiya* (9 March 2017) (Arabic) <https://www.alarabiya.net/ar/aswaq/2017/03/09/110--ارتفاعا-بعدد-الشركات-المدرجة-في-تداول-بـ10-سنوات > accessed 26 August 2017

Statistical Report, published in *CNBC Arabiya* (23 May 2015) (Arabic) <http://www.cnbcarabia.com/?p=226299> accessed 29 February 2016

T Al-Sayah ,*Aleqtisadiah* Newspaper (edn 7983, 20 August 2015) (Arabic) <http://www.aleqt.com/2015/08/20/article_983393.html> accessed 7 March 2016

T Al-Sayah, *Aleqtisadiah* Newspaper (edn 7577, 10 July 2014) (Arabic) <http://www.aleqt.com/2014/07/10/article_865848.html> accessed 7 March 2016.

The Boards of Directors of Listed Companies in France, *Vienot I Report*, (CNPF and AFEP, July 1995)<http://www.ecgi.org/codes/documents/vienot1_en.pdf> accessed 1 December 2016

The Statement of Lord Goldsmith before the Grand Committee, the House of Lords (6 February 2006 col GC255) <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060206/text/60206-29.htm> accessed 13 December 2016.

The Statement of Lord Goldsmith before the Grand Committee, the House of Lords (27 February 2006, col. GC4–5) <http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060227/text/60227-36.htm> accessed 25 February 2017

The Statement of Lord Hodgson before the Grand Committee, the House of Lords (27 February 2006, col. GC2) <https://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060227/text/60227-35.htm> accessed 28 February 2017

The website of Board of Grievances at https://www.bog.gov.sa/en

The website of Bureau of Experts at the Council of Ministers at https://www.boe.gov.sa

The website of CHUBB Arabia Cooperative Insurance Co. at https://www2.chubb.com/sa

The website of General Presidency of Scholarly Research and Ift at http://www.alifta.net

The website of Herfy Food Services Co. at http://www.herfy.com

The website of Jarir Marketing Co. at http://www.jarir.com

The website of Saudi Arabia Public Transport CO. at https://www.saptco.com.sa

The website of Saudi British Bank at http://www.sabb.com/en

The website of Saudi Capital Market Authority at https://cma.org.sa/en/

The website of Saudi Electricity Company at https://www.se.com.sa

The website of Saudi Industrial Development Co. at http://sidc.com.sa

The website of Saudi Ministry of Commerce and Investment at https://mci.gov.sa/en

The website of Saudi Ministry of Justice at https://www.moj.gov.sa

The website of Saudi Press Agency at http://www.spa.gov.sa/home.php?lang=en

The website of Saudi Vision 2030 at http://vision2030.gov.sa/en

The website of Tadawul at https://www.tadawul.com.sa

The website of Taiba Co. at http://www.taiba.com.sa

The website of UK Financial Conduct Authority at https://www.fca.org.uk

The website of Zamil Industrial Investment at http://www.zamilindustrial.com

U Awan and M Subayyal, 'Weak Form Efficient Market Hypothesis Study: Evidence from Gulf Stock Markets'(June 2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2787816> accessed 21 September 2017

W Waemustafa and S Suriani, *Theory of Gharar and its interpretation of Risk and Uncertainty from the perspectives of Authentic Hadith and the Holy Quran: A Qualitative Analysis* (MPRA Paper No. 78316, July 2015) <https://mpra.ub.uni-muenchen.de/78316/1/MPRA_paper_78316.pdf> accessed 26 August 2017