The New Saudi Corporate Governance Framework: A Comparative Legal Study with the UK and Delaware

Abdulaziz Farraj Bin Hagshah

Submitted in fulfilment of the requirements of the Degree of Doctor of Philosophy in Law

School of Law
College of Social Sciences
University of Glasgow

February 2022

Abstract

In 2017 the Capital Market Authority in Saudi Arabia issued long-awaited new Corporate Governance Regulations which brought significant changes to the previous corporate governance framework of 2006. The CMA stressed that the new framework provides appropriate solutions to domestic governance challenges and that it is consistent with the best international practices. However, to date, the framework has not been subject to any detailed and comprehensive study seeking to ascertain its suitability and alignment with best international practices. Therefore, this thesis evaluates the appropriateness of the new Saudi framework through comparative study and critical analysis supported by the available empirical evidence. In doing so, the thesis uses the legal models of the UK and Delaware to evaluate the Saudi framework in respect to 1) the design and approach of the framework; 2) the structure and operations of the board of directors; and 3) the role and representation of shareholders. The thesis evaluates the Saudi approach towards such aspects from two perspectives: the regulatory mode of the framework (i.e., either mandatory or voluntary), and the substance of the rules. As to the regulatory mode of the Saudi framework, the thesis concludes that despite the global popularity of the voluntary approach and notwithstanding the typical challenges associated with the mandatory approach, the current conditions and market-specific characteristics in Saudi Arabia justify the preservation of the existing mandatory regime, and mean that replacing it with a voluntary one would be a futile endeavour as such a shift would be likely to do more harm than good. These local conditions and market characteristics comprise highly concentrated ownership of the Saudi capital market, the absence of stewardship obligations, an inactive market for corporate control, modest shareholder activism, a strong influence of informal relationships, and the absence of an independent investigative financial media.

As to the substance of the rules, the thesis concludes that while the new framework is in line with the best international practices in many respects, the framework suffers from significant deficiencies in several fundamental areas best exemplified by the excessive regulations, undefined role of NEDs, the notably low level of representation of independent directors, and the uncertainty surrounding both the content and scope of directors’ duties, and shareholders’ proposal right. The thesis therefore proposes legal reforms for these specific areas which, if adopted, would bring greater clarity and certainty to the framework, reconcile it with the empirical evidence, and bring it into closer alignment with the best international practices, all of which would significantly enhance its effectiveness.

Contents

Tables

Acknowledgement

First and foremost, all praise and thanks be to Allah Almighty for enabling me to complete this thesis, and for His countless blessings.

I would like to extend my deepest thanks to Professor MacNeil and Professor Esser for their continuous support, valuable advice, and helpful feedback. This thesis would not have been possible without the tremendous guidance which they provided throughout this journey.

I am very grateful to my parents and family for their constant encouragement and prayers.

Special thanks are due to the Saudi Capital Market Authority for sponsoring this research.

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: Abdulaziz Bin Hagshah

Signature: AFH

Abbreviations

ADS 2018	Admission and Disclosure Standards 2018 (United Kingdom)
BLG 1992	Basic Law of Governance 1992
CA 2006	Companies Act 2006 (United Kingdom)
CEO	Chief Executive Officer
CGC 2018	Corporate Governance Code 2018 (United Kingdom)
CGRs 2006	Corporate Governance Regulations 2006 (Saudi Arabia)
CGRs 2017	Corporate Governance Regulations 2017 (Saudi Arabia)
CL 1965	Companies Law 1965 (Saudi Arabia)
CL 2015	Companies Law 2015 (Saudi Arabia)
CLRSG	Company Law Review Steering Group (United Kingdom)
CMA	Capital Market Authority (Saudi Arabia)
CML 2003	Capital Market Law 2003
DTRs	Disclosure Guidance and Transparency Rules (United Kingdom)
DWSRCPA 2010	Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 (United States)
FCA	Financial Conduct Authority (United Kingdom)
FRC	Financial Reporting Council (United Kingdom)
FSMA 2000	Financial Services and Markets Act 2000 (United Kingdom)
GCLSD	General Corporation Law of the State of Delaware (United States)
GOSI	General Organization for Social Insurance (Saudi Arabia)
IPO	Initial Public Offering
LR	Listing Rules (United Kingdom)
LRs 2017	Listing Rules 2017 (Saudi Arabia)
LSE	London Stock Exchange (United Kingdom)
M&A	Mergers and acquisitions
Manual	New York Stock Exchange Listed Company’s Manual (United States)
MARs 2018	Mergers and Acquisitions Regulations 2018 (Saudi Arabia)
Model Articles	Schedule 3 of the Companies (Model Articles) Regulations 2008 (United Kingdom)
NEDs	Non-executive Directors
NYSE	New York Stock Exchange (United States)

PBUH	Peace Be Upon Him
PIF	Public Investment Fund (Saudi Arabia)
PPA	Public Pension Agency (Saudi Arabia)
ROSCOs 2017	Rules on the Offer of Securities and Continuing Obligations 2017 (Saudi Arabia)
RRPs 2016	Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016 (Saudi Arabia)
SA 1933	Securities Act 1933 (United States)
SAR	Saudi Riyal
SC 2020	Stewardship Code 2020 (United Kingdom)
SEA 1934	Securities Exchange Act 1934 (United States)
SEC	Securities and Exchange Commission (United States)
SOX 2002	Sarbanes-Oxley Act 2002 (United States)
Tadawul	Saudi Exchange (Saudi Arabia)
USD	United States Dollar

CHAPTER 1: INTRODUCTION

1.1 Introduction

Corporate governance refers to those sets of arrangements that regulate companies' behaviours and balance the position of their various stakeholders, ultimately enhancing companies' efficiency and profitability.[1] It relies on legal tools such as legislation and codes in addition to non-legal tools such as self-regulatory arrangements and business practises that vary from a country to another depending on each country's particular needs.[2] Corporate governance is important because on a company level, not only does it help in monitoring performance and accomplishing goals, but it also guides the company by providing it with the structure through which its objectives are determined in the first place.[3] It also assists in enhancing a company's reputation through arrangements that safeguard the decision-making process from opportunistic behaviours. Accordingly, the probability of winning the trust of investors and the support of business is higher in companies that adopt the highest standards of corporate governance.[4] On a country level, strong corporate governance enhances a country's business climate and instils confidence in its capital market, which on the one hand promotes it for both domestic and foreign investors, and on the other hand helps to protect the national economy from poorly managed companies. Such virtues emphasise the need for a solid and effective corporate governance framework, as this is one way of ensuring the orderly operations of a country's capital market.[5]

Such a need appears to be acknowledged by regulators worldwide, as demonstrated by the fact that many countries are regularly updating their corporate governance frameworks.[6] Among these countries is Saudi Arabia - the focus of this thesis - which has revised its framework[7] multiple times since its first issuance.[8] This constant review is part of the

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[1] Jean Jacques Du Plessis, Anil Hargovan and Jason Harris, *Principles of Contemporary Corporate Governance* (Cambridge University Press 2018) 13.
[2] OECD, *G20/OECD Principles of Corporate Governance* (2015) 13 <https://www.oecd-ilibrary.org/content/publication/9789264236882-en>.
[3] Marc Moore and Martin Petrin, *Corporate Governance: Law, Regulation and Theory* (Macmillan International Higher Education 2017) 3.
[4] Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance*, vol 1 (Gee 1992) para 1.6.
[5] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 13.
[6] OECD, *OECD Corporate Governance Factbook* (2017) 16.
[7] The various components comprising the Saudi framework are explored in detail in Section 3.1 of this thesis.
[8] The Saudi Corporate Governance Regulations have undergone several issuances and amendments, most notably in 2006, 2010, 2012, 2017, and 2018.

country’s efforts to enhance its investment environment and to promote its fairness and competitiveness.[9] It is also consistent with the country’s objective of keeping pace with worldwide developments of corporate governance practises,[10] especially in the United Kingdom and the US State of Delaware,[11] whose corporate governance frameworks are both highly regarded[12] and frequently updated. In the UK, the corporate governance framework has been revised at various times during the last three decades as a result of several reviews undertaken since the publication of Cadbury’s report, the first report on corporate governance in the UK.[13] This is also true for Delaware, whose framework is revised annually by the Delaware legislature in accordance with the recommendations of the Council of Corporation Law Section of the Delaware State Bar Association.[14]

1.2 Research Importance

To demonstrate the importance of this research, it is essential first to briefly explore the corporate governance developments in Saudi Arabia. For more than five decades, legislators in Saudi Arabia have been interested in corporate governance by regulating some aspects of it in the old Companies Law issued in 1965 (CL 1965).[15] However, such regulations were limited to selected parts of corporate governance, adopting general and loose language when it came to several important issues such as independence of the board, conflicts of interest, and remedies available for shareholders. In 2003, the Capital Market Authority (CMA) was established, which bridged some of the gaps by issuing the Corporate Governance Regulations in 2006 (CGRs 2006). This regulation was a tentative attempt to close some loopholes in a limited and cautious manner, and most of its provisions were of a voluntary nature, operating on a *Comply or Explain* basis.[16]

The CGRs 2006 remained in place until drastic changes were made to Saudi corporate law by the new Companies Law in 2015 (CL 2015). Among other corporate matters, this new

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[9] ‘Approving and Issuing The New Corporate Law Provides An Incubator Environment That Stimulates The Investment In The Kingdom’ <https://www.MOCI.gov.sa/en/MediaCenter/News/Pages/09-11-15-01.aspx> accessed 30 April 2019.
[10] ‘The Capital Market Authority Approves the Amendments Of the Corporate Governance Regulations’ <https://cma.org.sa/en/MediaCenter/PR/Pages/CGRAmendments.aspx> accessed 20 May 2019.
[11] The various components comprising the UK and Delaware frameworks are explored in detail in Section 3.1 of this thesis.
[12] Willem JL Calkoen, *The Corporate Governance Review* (Law Business Research Limited, 2014) 398, 409.
[13] Christine Mallin, *Corporate Governance* (Oxford University Press 2013) 27–36.
[14] Calkoen (n 12) 422.
[15] Chapter 1 of Part 3 of the Companies Law 1965.
[16] Article 1 (B) of the Corporate Governance Regulations 2006.

law contains more profound, detailed, and modern regulations of corporate governance than the previous law, taking advantage of several advanced international practices in this regard.[17] Additionally, the new law empowered the relevant regulators, namely the CMA and the Ministry of Commerce (MOC) to issue further regulations related to corporate governance as needed.[18] Accordingly, the new Corporate Governance Regulations (CGRs 2017) were issued by the CMA in 2017,[19] as a response to several corporate scandals in the Saudi capital market along with the legislative developments that had taken place, particularly the issuance of the CL 2015, in addition to the launch of the Saudi Vision 2030.[20] The importance accorded by the CMA to corporate governance is evident in the ninety-eight articles included in the new regulations (mostly mandatory in nature)[21] compared to the eighteen articles of the old one, most of which were voluntary.[22]

That all being said, the importance of this research stems from the facts that while the Saudi framework was set up after extensive consultations with public and interested parties, and that the relevant regulators stress that best international practices were considered,[23] to date this framework has not been the subject of any detailed and focused study which has aimed to properly evaluate it and ascertain its appropriateness and alignment with best international practices. The need for such a study is particularly evident following the launch of Saudi Vision 2030, the admission of the Saudi Exchange (Tadawul) to prominent international indices, and the relaxation of restrictions concerning foreign portfolio investments.[24] As will be discussed in Chapter 2 of this thesis, such developments have significantly increased, and will cause listings in the Saudi capital market to continue to increase, attracting more investors, both domestic and foreign. With that in mind, it is imperative now more than ever to subject the framework to critical analysis to ensure its reliability and readiness to tackle the increasing challenges faced by companies and investors alike, and to cope with the rapid developments the Saudi capital market has been experiencing. The ultimate objective of this research is to propose reforms to the Saudi framework and benefit from the different approaches and solutions offered by

[17] 'Approving and Issuing The New Corporate Law Provides An Incubator Environment That Stimulates The Investment In The Kingdom' (n 9).
[18] Articles 219 and 225 of the Companies Law 2015.
[19] 'The Capital Market Authority Approves the Corporate Governance Regulations' <https://cma.org.sa/en/MediaCenter/PR/Pages/NewCGR.aspx> accessed 30 April 2019.
[20] ibid. This refers to the Saudi government's Vision that was launched in 2016 in the form of a strategy for the future, and which aims at, inter alia, promoting national companies and ensuring their stability and strength. The Vision is discussed in detail in Section 2.2 of this thesis.
[21] See generally the Corporate Governance Regulations 2017.
[22] See generally the Corporate Governance Regulations 2006.
[23] 'The Capital Market Authority Approves the Corporate Governance Regulations' (n 19).
[24] These developments are explored in detail in Sections 2.2, 2.4, and 2.5 of this thesis.

the UK and Delaware, and by doing so the research seeks to become a valuable reference for Saudi legislators. It particularly aims at providing a road map for them to follow when assessing the current regulations and determining appropriate legislative reforms, all of which signifies the importance of this research.

1.3 Research Objectives and Questions

The main objective of this research is to evaluate the appropriateness of the new Saudi corporate governance framework through comparative study and critical analysis supported by the relevant available empirical studies. This entails identifying any deficiencies, shortcomings, uncertainties, or inconsistencies from which this framework suffers. The research will identify prominent issues of corporate governance in Saudi Arabia, the UK, and Delaware and analyse the approach of each jurisdiction in addressing these issues in order to draw a solid conclusion about how appropriate the Saudi framework is, and which approach is most optimal to overcome domestic challenges. Ultimately, this research will propose reforms to the Saudi corporate governance framework in light of the comparative and critical analysis to allow it to better regulate Saudi corporate governance and to bring it closer to international practices, taking into account the unique characteristics of the country's legal system and capital market, and other relevant factors.

That being the case, the main research question addressed in this thesis is how appropriate the new Saudi corporate governance framework is in comparison with its counterparts in the UK and Delaware. In answering the main question, the research will also seek to answer several other sub-questions, which are as follows: 1) Whether the current mandatory nature of the Saudi framework is suitable for the governance of Saudi listed companies; 2) Whether the Saudi framework provides for the proper, balanced and independent composition of boards and committees enabling them to act independently and effectively; 3) Whether the Saudi framework provides a clear and robust accountability framework within which directors operate where the scope, nature, and content of their duties are sufficiently defined; 4) Whether the Saudi framework empowers shareholders to reasonably engage in the company's decision-making process and adequately participate in the monitoring and disciplining tasks; and finally 5) What lessons the Saudi framework can learn from its counterparts in the UK and Delaware.

Addressing these questions will eventually lead to an overall assessment of the new Saudi framework's quality, and assist in identifying the reforms necessary to enhance this framework.

1.4 Research Structure and Issues

Corporate governance covers a very wide spectrum of topics and issues, each of them deserving of dedicated academic research. It is not the intention of this research to cover all of these topics, as this would be an impractical and even an impossible undertaking. However, this research is most concerned with three fundamental aspects: The design and approach of the framework; the structure and operations of the board of directors; and the role and representation of shareholders. The rationale behind selecting these aspects is that they constitute the core of any corporate governance framework[25] as many corporate governance issues revolve around them; thus, the way in which such aspects are constructed has a great impact on the functionality and effectiveness of other corporate governance arrangements.[26] In other words, the functionality of many corporate governance mechanisms are dependent on how solidly such aspects are built.[27] That being the case, upon a proper evaluation of the abovementioned aspects, this research will be able to determine the appropriateness of the Saudi corporate governance framework as a whole.

This thesis comprises six chapters, each of which will present an in-depth analysis involving primary sources as well as secondary sources. The current chapter presents the research plan and direction, demonstrates the importance of the research, and sets out its objectives, main questions, structure and issues, methodologies, and justifications for selecting the UK and Delaware as legal models. Chapter 2 will provide an overview of Saudi Arabia from different perspectives so that the historic, economic, political, and legal contexts of the country are understood. It will also discuss many of the prominent factors affecting the operations of the corporate governance framework, namely the Saudi capital market ownership structure, the role of government, institutions, and foreign investors, along with the reality of the country's market for corporate control and financial media.

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[25] See generally OECD, *G20/OECD Principles of Corporate Governance* (n 2) 14, 27, 37.
[26] See generally ibid.
[27] See generally ibid.

Chapter 3 will focus on several elements relating to the design and approach of the Saudi framework, namely the regulatory mode of the framework, its level of flexibility and distribution of rules across it, and lastly the enforcement of the framework's rules. As the regulatory approach of corporate governance frameworks varies among jurisdictions, with some adopting a voluntary based framework to others adopting a mandatory one, a significant part of the discussion in this chapter will be devoted to the regulatory approaches employed in each jurisdiction. This is important for the thesis's overall discussion, as the effectiveness of any framework is directly affected by the chosen regulatory approach in addition to its impact on the flexibility and enforcement that follows.[28] Turning to flexibility, companies are different in size, complexities of operations, and business needs; thus, what is found to work for one company may not work well for other companies.[29] This, in turn, gives rise to the argument that corporate governance frameworks should manifest flexibility so that companies are able to comply in appropriate ways which accommodate their individualistic needs. With that in mind, the research will ascertain the flexibility of the Saudi framework and the appropriateness of its enforcement mechanism, by discussing whether the mandatory approach serves any particular interests, or whether adopting a voluntary approach would be more appropriate for the Saudi capital market.

Chapter 4 will address the prominent issues related to the structure and operations of boards of directors. The importance of evaluating this aspect lies in the fact that the board is the highest authority within any company, in which many of the key functions and major decisions are vested. It is therefore of paramount importance to evaluate the structure and operations of the board under the Saudi framework to ensure that such a powerful body is adequately regulated, and that it is properly composed, and thus able to exercise its functions effectively. The focus here will be on several topics, namely: the duality of chairman and chief executive officer (CEO) roles, board composition, board independence, board committees, and directors' duties.

Chapter 5 will evaluate shareholders' role and representation as approached under the Saudi framework, focusing on the issues deemed central to the protection of shareholders. In this respect, the research will assess the availability and quality of shareholders' control rights to ascertain whether shareholders are able to reasonably intervene in the decision-

[28] E Wymeersch, 'The Enforcement of Corporate Governance Codes' (2006) Journal of Corporate Law Studies 113, 114.
[29] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 13, 14.

making process and to effectively participate in the monitoring of companies' management and disciplining thereof. Such an assessment is necessary for the overall evaluation of the Saudi framework, as the ability of any capital market to continuously attract and retain investors is highly dependent on the strength of shareholders' protection rights and the balanced allocation of control rights.[30] The topics covered in this chapter include the allocation of decision-making powers, shareholders' appointment rights, shareholders' meeting and voting rights, and shareholders' decision rights.

Chapter 6 will provide the conclusion of this thesis. It will start with a summary of the thesis's main discussion points followed by the key findings on the overall status of the new Saudi corporate governance framework. Building on these findings, the chapter will then identify the areas where the Saudi approach is appropriate, and those where it could benefit from moving closer to the models of the UK and Delaware. Consequently, this chapter will present the proposed reforms that are needed to overhaul the Saudi corporate governance framework.

1.5 Research Methodologies

As was explained earlier in this chapter,[31] the main questions of this research revolve around the evaluation of the new corporate governance regulatory framework in Saudi Arabia and identifying its appropriateness in comparison with its counterparts in the UK and Delaware. Therefore, this research will employ a comparative approach in a descriptive and analytical manner. Furthermore, in order to construct a comprehensive understanding of the frameworks of the selected jurisdictions, the research will engage in doctrinal and critical analysis of the relevant legislation and case law where needed. The doctrinal and critical analysis in this context means that the relevant rules, principles, and court decisions which comprise the corporate governance framework in each jurisdiction will be explored and clarified in order to reveal the statement of the law relevant to the matters being investigated. The goal is that when embarking on the comparative journey, the journey will be based on an accurate comprehension of the frameworks under investigation. Importantly, the discussion presented in this thesis will largely be built around the agency theory[32] and the shareholder/director primacy theories,[33] as they have

[30] ibid 37.
[31] See Section 1.3 of this thesis.
[32] Agency theory and its main considerations are discussed in detail in Section 4.1.1 of this thesis.
[33] Shareholder and director primacy theories and their main considerations are discussed in detail in Sections 5.1.1 and 5.1.2 of this thesis.

been regarded as among the most influential theories driving contemporary corporate governance practices. The importance of these theories lies in the fact that they assist in understanding the regulatory approaches towards corporate governance including the allocation of control rights within companies and other mechanisms that are employed to balance the relationship between the board of directors and shareholders.

Moreover, the comparative analysis in this research will employ the functional comparative method where the focus will be on the practical effects of rules and legal and non-legal institutions. Accordingly, rules and institutions are analysed by reference to their function and operation rather than their formal legal framing.[34] That being the case, the research will take into account - to a certain extent and subject to the considerations explained below - the insights offered by the theory of *Legal Transplants* which deals with the idea of legal borrowing across national frontiers. The research aims to benefit from the discussion around this theory regarding the primary considerations and challenges of comparative study and legal development. This is particularly important as using a foreign law as a model for the reform of local laws typically brings practical issues that should be considered to avoid negative effects. Lastly, where the context permits, this research will occasionally refer to the relevant available empirical research to shed light on the practical side of the issue being analysed and to support or debunk an argument.

Turning again to legal reforms based on foreign models, the research notes that when convergence with best international practices is an objective for countries whose legal systems are still developing, comparative law has typically manifested itself as helpful tool.[35] However, the practice of using foreign law as a model to reform another country's law has been associated with practical difficulties that arise not only from random borrowing, but also from selective borrowing.[36] Therefore, given that the ultimate objective of this research is to propose reforms to the Saudi framework of corporate governance through mainly comparative study, it is important to discuss the concept of *Legal Transplants* which is closely related to the field of legal comparative study. The importance of discussing this concept lies in the fact that it, and the subsequent opinions

[34] For more on the functional method and other comparative law methods see: Mathias Reimann and Reinhard Zimmermann, *The Oxford Handbook of Comparative Law* (Oxford University Press 2019); Mathias Siems, *Comparative Law* (2nd edn, Cambridge University Press 2018); Geoffrey Samuel, *An Introduction to Comparative Law Theory and Method*, vol 11 (Bloomsbury Publishing 2014); Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (3rd edn, Oxford University Press 1998).
[35] Jaakko Husa, 'Developing Legal System, Legal Transplants, and Path Dependence: Reflections on the Rule of Law' (2018) 6 The Chinese Journal of Comparative Law 129, 129.
[36] ibid 129.

triggered by it, have contributed to the studies of legal development throughout history. Such views have helped in understanding the process of legal development, as well as its motives and practical challenges.

Legal Transplants refers to the process of transferring legal rules across nations.[37] Watson was the first to introduce this concept, arguing that legal development is attributed to it, and that the process is socially easy.[38] He maintains that law operates independently and could survive anywhere without dependency on a particular society[39] and that a successful borrowing of legal rules is possible even if both the borrowing and the borrowed systems are not equally complex and developed.[40] What a law reformer should be most concerned with when considering foreign legal systems is the existence of an idea that his own country could make use of within its own law.[41] In the face of criticisms of his theory, Watson has always relied on what he believes to be successful examples of legal borrowing throughout history, where environmental factors such as society, culture, and religion were irrelevant.[42] His strong opinion on the feasibility of legal transplants across nations stems *inter alia* from his belief that humans typically face the same problems, and that these same problems should be solved using the same solutions. In other words, if one legal rule is found to meet the needs of one nation, then this same rule should also meet the same needs in any other nation.

Watson’s strong view has provoked some strong opposition from other scholars, who have expressed both extreme and moderate views. The most notable extreme opposition was given by Pierre Legrand, who strongly criticized Watson's view by arguing that law is not an independent entity, that it embodies a range of complex components which are only relevant to the social environment within which it was created in the first place, and that for this uniquely created law to transfer outside of its environment unchanged is an impossible task.[43] Legrand’s extreme view is consistent with his views on law and comparative legal studies which in essence builds on the belief that law can only be

[37] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (University of Georgia Press 1993) 21.
[38] ibid 95.
[39] ibid 100.
[40] Alan Watson, ‘Legal Transplants and Law Reform’ (1976) 92 Law Quarterly Review 79.
[41] ibid 79.
[42] For example, he opines that the fact that most legal systems in Western countries are influenced either by Roman Civil Law or English Common Law is not disputed. See: Watson, *Legal Transplants: An Approach to Comparative Law* (n 37) 22.
[43] Pierre Legrand, ‘The Impossibility of Legal Transplants’ Maastricht Journal of European and Comparative Law 111, 114.

understood as part of a wider cultural context, and that law is deeply connected and linked with the community it operates within.[44] Legrand responded to some of Watson's historical examples that he used to prove the concept of legal transplants, specifically the example of the Roman rules on transfer of ownership and risk in sale which were generally accepted in France and Prussia. In his response, Legrand maintained that the mere fact that the same written words "rules" exist in different jurisdictions does not imply that those same actual "rules" were interpreted and applied in the same way. Despite the apparent similarity of the rules, there could have been unique characteristics in each jurisdiction which were culture-specific and situated around each community that distinguished the way each jurisdiction interpreted and applied the same rule.[45]

On the other hand, a more moderate opposition to the concept of legal transplants was provided in the influential opinion presented by Sir Otto Kahn-Freund. In summary, Kahn-Freund argued that legal transplants should not be taken for granted, and that the process of transferring legal rules across nations is a risky process that might result in the borrowing country rejecting the borrowed rules.[46] In his view, understanding the context of the law in the borrowed country is paramount for any comparative study and legal transplants. He supports his argument by drawing several historic examples where, in his opinion, attempted legal transplants failed.[47] He clearly differentiates between the mere act of copying foreign laws, and forcing such laws onto the borrowing country regardless of how they function in reality, on the one hand, and on the other hand, successful legal transplants where the transplanted law continues to function properly in the borrowing country.[48] It is worthwhile mentioning that while Kahn-Freund acknowledges the existence of legal reforms based on comparative law and legal transplants, and that this process could produce desirable effects,[49] he is very cautious about it. In this regard, he maintains that while legal transferability is possible, not all legal rules are capable of being borrowed, adding that while some of them are relatively easy to transfer (i.e., those which are

[44] ibid 124.
[45] ibid 119.
[46] O Kahn-Freund, 'On Uses and Misuses of Comparative Law' Modern Law Review 1, 27.
[47] To illustrate his view Kahn-Freund uses the example of Turkey, which adopted the complete Swiss Civil Code, and in relation to which studies have found that Western family law was rejected in the rural areas. See: ibid 16, 17.
[48] Kahn-Freund notes that while it would have been impossible for the British rulers to adopt the English law of marriage in India and other colonies, they managed to adopt the English law of contract, criminal law, and law of civil procedure and evidence. See: ibid.
[49] ibid 2.

mechanical in nature), others are very difficult to transfer due to being organically attached to the society they were developed within.[50]

In light of the views expressed by Legnard and Kahn-Freund that there is a strong relationship between law and the society it was firstly developed within, the question becomes whether such a relationship is so close that it entirely prevents legal borrowing. Hoeflich argues that it is not, and that the process of borrowing foreign rules becomes possible if legislators and lawyers in the borrowing country are fully aware of their legal environment and absorb the borrowed law in a way that is compatible with that environment.[51] This is consistent with the theory of *Legal Hybridity,* which essentially argues that the feasibility of legal borrowing is a result of the interaction that takes place between the borrowed rules and the legal traditions in the reception country.[52] Put differently, when legal rules are transferred from one country to another, an interaction takes place between the borrowed rules and the legal traditions in the reception country to reach a level of adjustment and integration between the two different systems. The result of this interaction is a set of adjusted legal rules that are suitable for the reception country.[53] Solinas studied some examples of legal changes that had occurred in England and European countries in order to better understand the phenomena of legal development. The study's results suggest that the process of moving laws from one country to another is not as straightforward as had been portrayed by Watson,[54] and that the many successful examples of legal development that had taken place across nations were not a direct result of legal transplants, as some claim.[55]

To conclude the present discussion about legal reforms based on foreign models, having considered the above views it can be said that historically and theoretically speaking, legal reforms based on foreign laws is possible when carefully approached, and when both the borrowed and the borrowing legal systems are well understood. In fact, legal borrowing has to an extent become inevitable in the light of globalisation, especially in areas where convergence with best international rules is encouraged, such as capital markets. However,

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[50] ibid 12.
[51] Michael H Hoeflich, 'Law, Society, and Reception: The Vision of Alan Watson' 1089.
[52] Matteo Solinas, *Legal Evolution and Hybridisation: The Law of Shares Transfer in England*, vol 126 (Intersentia 2014) 217, 222.
[53] ibid 106, 107.
[54] ibid 222.
[55] Rather, they were the results of complex processes that involved many multifaceted aspects that contributed to the enhancement of the transfer process and paved the way for the borrowed laws to function smoothly and properly in the host countries. These aspects included several contextual factors, foremost among them the culture, language, and legal structure of the host countries. See: ibid.

it is essential for any researcher when embarking on a legal comparative study to take into account the aspects highlighted by Kahn-Freund and Solinas to avoid any negative consequences for the borrowing legal system. Building on this conclusion, this research does not intend to merely propose reforms based on foreign models, neither does it suggest accepting those foreign models at face value. Rather, it intends to examine the solutions provided under the frameworks of the UK and Delaware to determine whether they are suitable for the Saudi context. When navigating the comparative path, this research will seek to identify the existence of any factors in the UK and Delaware rules that may preclude such rules from being adopted in Saudi Arabia. Furthermore, it will identify shortcomings in the Saudi framework and potential benefits from the UK and Delaware examples only when such examples are regarded as compatible with the legal system in Saudi Arabia and suitable for the Saudi capital market's nature.

Furthermore, an important aspect to consider when determining the appropriateness of adopting foreign models to enhance the Saudi model is to fully understand the Saudi context and all the relevant internal factors,[56] most importantly: 1) The difference between the legal system in Saudi Arabia and its counterparts in the UK and Delaware, especially in light of Saudi legal system being Sharia-based,[57] which means that all laws and regulations must be compatible with the principles of Islamic law. 2) The disparities between the judicial systems in the three jurisdictions, particularly that unlike the UK and Delaware, judicial precedent (*stare decisis*) does not apply in Saudi Arabia. 3) The differences between the ownership structure in the three jurisdictions, as the ownership structure of the Saudi capital market is highly concentrated, whereas ownership in the UK and US markets is fragmented. 4) The dominant role of the institutional investors in the UK and US markets,[58] which is notably different to that of the Saudi market.[59]

The abovementioned factors will be discussed in detail in Chapter 2 of this thesis. The purpose of taking all these aspects into account is to build an accurate understanding of the Saudi context and the way its legal framework functions, as the UK and Delaware models should only be used when they can help in designing a Saudi corporate governance model that is both effective and relevant to the Saudi capital market.

[56] These factors are discussed in detail in Chapter 2 of this thesis.
[57] Articles 7 and 17 of the Basic Law of Governance 1992.
[58] Mallin (n 13) 26.
[59] 'السوق السعودي: 4.6 مليون عدد المستثمرين الأفراد بنهاية عام 2016.. يمتلكون أسهما قيمتها 483 مليار ريال' <https://www.argaam.com/ar/article/articledetail/id/474179> accessed 20 June 2019.

1.6 Legal Models of the United Kingdom and Delaware

For the purpose of this comparative research, the legal models of the UK and Delaware are selected.[60] The reasons behind selecting these two models are grounded in how far both jurisdictions have gone in developing corporate governance rules and practises. They now have some of the most robust systems for corporate law generally and corporate governance particularly.[61] Specifically, on the one hand, the UK offers an innovative model of corporate governance regulation.[62] Unlike many countries that adopt a mandatory approach, the UK has adopted a voluntary model that is primarily based on the *Comply or Explain* approach.[63] This model is flexibly designed to encourage companies to adopt the best principles of good governance, taking into account their different circumstances.[64] This different approach arguably offers a balance between government intervention in controlling all aspects of companies' operations, and the use of other tools that contribute to the promotion of good governance within such companies, such as market participants.[65] Accordingly, the UK is highly regarded as a leader in corporate governance regulations,[66] and its approach has influenced the development of corporate governance frameworks worldwide.[67] Therefore, studying the UK approach will be beneficial for the Saudi framework, as shortcomings can be found not only in the substance of Saudi framework's rules but also in the way such rules are enforced. On the other hand, and similar to Saudi Arabia, Delaware is one of the many jurisdictions that follows a mandatory approach to corporate governance, relying heavily on binding provisions to deal with corporate governance issues.[68] This similarity makes Delaware's framework a suitable model for comparative study, especially as its framework is reviewed annually by knowledgeable experts of the Delaware bar.[69]

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[60] An overview of the development of UK corporate governance is provided in Section 3.2.1.1 of this thesis.

[61] Calkoen (n 12) 398, 409.
[62] Marc T Moore, 'The End of Comply or Explain in UK Corporate Governance Special Issue on Corporate Governance' (2009) Northern Ireland Legal Quarterly 85, 86.
[63] ibid. It is worthwhile noting to note that while the UK is generally moving to Apply or Explain especially regarding listed companies and that it is generally becoming more mandatory than before with disclosure requirements, the prominent feature of its framework is still its emphasis on flexibility.
[64] ibid; Financial Reporting Council, 'The UK Approach To Corporate Governance' (2006) 3 <https://www.frc.org.uk/getattachment/8cd9bbbb-9c3f-46ae-83f1-f915b9cfb028/UK-approach-to-corporate-governance-2006.pdf> accessed 30 April 2019.
[65] Moore, 'The End of Comply or Explain in UK Corporate Governance Special Issue on Corporate Governance' (n 62) 86.
[66] ibid.
[67] Mallin (n 13) 28.
[68] OECD, *OECD Corporate Governance Factbook* (n 6) 15.
[69] Calkoen (n 12) 472.

Furthermore, the capital markets in these two jurisdictions have existed for a long period and attracted a large number of companies and investors, which means that their frameworks have been heavily tested, making them great models to study and benefit from.[70] To illustrate, the London Stock Exchange (LSE) is one of the world's oldest stock exchanges and has been home to more than a thousand companies from over sixty countries, across forty business sectors.[71] Similarly, Delaware has been the legal home of many of the largest companies in the US and the world. More than one million business entities are incorporated in Delaware, including more than 66% of Fortune 500 companies.[72] The internal affairs of these companies are governed by Delaware's state laws.[73] This demonstrates how influential the UK and Delaware models have been on the way corporate governance practices are applied around the world. These considerations, coupled with the fact that their capital markets, similar to the Saudi one, respond to a diverse base of investors which include both institutional and individual investors,[74] makes the selection of their models not only relevant to this research but also of paramount importance, as the Saudi framework will greatly benefit from the insights offered by the laws and rules of these two jurisdictions.

Another important factor in selecting these two jurisdictions for this comparative study is the fact that their courts have dealt with corporate governance issues for a very long time.[75] This has provided their judicial bodies with cumulative experience that continues to enrich the field. Their case law has clarified some uncertainties in their respective legal frameworks and provided guidance going beyond the regulatory texts.

Lastly, the amount and quality of publications devoted to the field of corporate governance in the UK and Delaware is invaluable. Such publications greatly contribute to the understanding of the issues investigated in this research, shed light on the relationship between legal rules and court decisions, and help in ascertaining the applicability of such frameworks in real life.

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[70] The London Stock Exchange was founded in 1801. The New York Stock Exchange and the NASDAQ Stock Exchange were founded in 1817 and 1971 respectively.
[71] 'An Overview of London Stock Exchange' (25 May 2020) <https://www.londonstockexchange.com/personal-investing/overview-london-stock-exchange-markets-lse>.
[72] Calkoen (n 12) 422.
[73] ibid.
[74] Mallin (n 13) 27, 49.
[75] See, for example, *Foss v Harbottle (1843)*, one of the UK's oldest cases in corporate law.

It should be mentioned that when considering which jurisdictions to select for this comparative study, other jurisdictions whose capital markets are, similar to Saudi Arabia, concentrated were deemed unsuitable due to some prominent differences that make their frameworks less comparable.[76] For example, Germany where the corporate governance framework is advanced and the capital market is developed and concentrated, was deemed unsuitable given *inter alia* its two-tier system which means that its framework is constructed fundamentally different than the Saudi's one-tier system making the former less comparable, less relevant, and consequently less useful for the Saudi framework.[77] Moreover, other Islamic countries such as Egypt and United Arab Emirates where Islam is the state's official religion and *Sharia* is a relevant source of law were also deemed unsuitable for this study given that the extent of *Sharia* influence over their legal systems and institutions is largely uncertain particularly in relation to business and commercial matters. This is due to, among other factors, the absence of any constitutional obligation in those countries that oblige their legal institutions and legislations to strictly adhere to *Sharia* law. Such position is remarkably different from the position in Saudi Arabia where, unlike the former countries, the constitution explicitly recognises *Sharia* as the primary source of law and *further* explicitly obliges all legal institutions and legislations to strictly adhere to *Sharia* provisions.[78] Therefore, none of those jurisdictions could be considered prominent examples of Sharia-based systems especially in areas related to corporate and business laws making them less relevant and useful for this study.

Bearing the above considerations in mind, building on the experiences of the UK and Delaware will enrich this thesis and widen its perspective so that an informed evaluation of the Saudi framework can be performed, with the objective of adequately regulating corporate governance in Saudi Arabia, bringing it into a closer alignment with best international practices.

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[76] See Section 2.5 of this thesis for a detailed discussion of the ownership structure of the Saudi capital market.

[77] See Section 4.2 of this thesis for more on the structure of the Saudi corporate governance framework.

[78] See Article 2 of the Egyptian Constitution and Article 7 of the United Arab Emirates Constitution. See Section 2.3 of this thesis for a detailed discussion of *Sharia* law and the way it is implemented in Saudi Arabia.

CHAPTER 2: OVERVIEW OF SAUDI ARABIA

2.1 Introduction

The purpose of this chapter is to provide an overview of Saudi Arabia so that the historic, economic, political, and legal context of the country can be understood. This will help in evaluating the corporate governance framework in the country and build understanding of the nature of the environment within which that framework operates. The following sections will cover the political history of Saudi Arabia; its legal system and the role of Sharia and state laws within that system; the development of its stock exchange, and the ownership structure of listed companies; and then provide a brief description of some of the more relevant external factors, mainly the Saudi market for corporate control and the financial media therein. These two factors play a sizable role in the advocation and enforcement of corporate governance practices, which is why establishing their presence in Saudi Arabia is required for the thesis's subsequent analysis.

2.2 Overview of Saudi Arabia

Saudi Arabia is situated in Western Asia and is considered the largest Middle Eastern country and the second largest Arabic country, which occupies the vast majority of the Arabian Peninsula.[79] The modern state of Saudi Arabia was born in 1932 when[80] the political system was confirmed as an absolute monarchy, and Islam was reaffirmed to be the country's official religion.[81] Accordingly, the *Quran* (the Holy Book of Allah), the *Sunnah* (the Prophet Mohammed's Teachings) and *Al-Fiqh* (Islamic Jurisprudence) are the primary sources of Saudi law and the basis of its legal institutions.[82]

Vast reserves of petroleum were discovered in the country in 1938, followed by many further discoveries over the subsequent decades.[83] Consequently, Saudi Arabia became the world's second largest oil producer (behind the US) and the world's largest oil exporter, putting the government in control of the world's second largest oil reserves and the sixth

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[79] See generally the Saudi Geological Survey Authority, *Kingdom of Saudi Arabia: Facts and Numbers* (First Issuance, 2012).
[80] 'Official Website of the Saudi Ministry of Foreign Affairs' <https://www.mofa.gov.sa/aboutKingDom/Pages/CountryDevelopment36.aspx> accessed 27 July 2021. The King's Announcement was published in the Official Gazette of Umm Al-Qura on 23/09/1932.
[81] The King's Announcement published in the Official Gazette of Umm Al-Qura in December 1924
[82] See generally the Basic Law of Governance 1992.
[83] See generally the Saudi Geological Survey Authority (n 79).

largest gas reserves.[84] Ever since, Saudi Arabia has made ongoing efforts and implemented ambitious development programs to transform what was previously a barren desert into one of the most economically prosperous countries in the world. These efforts have contributed to the stable political and economic position that Saudi Arabia has enjoyed over the last century,[85] with the country being classified as a World Bank high-income economy,[86] and the only Arabic country to be one of the G20 group of major economies.[87] In addition, Saudi Arabia has been evaluated as the largest economy in the Middle East and the 19th largest in the world.[88]

In 2016, in order to further develop the country and efficiently utilise its wealth and resources, the government launched its Vision 2030 which aims *inter alia* at reforming the economy and driving its growth and diversification through several strategies and programs such as privatisation and the development of the financial sector in general and the capital market in particular.[89] To this end, and among other programs which all operate to fulfil the vision's various economic and non-economic objectives, the Financial Sector Development Program was launched in 2017 to ensure that the financial industry would be sufficiently well developed and robust to be able to contribute fully to economic growth.[90] Among the objectives of these state programs are increasing the market value of the stock market as a percentage of GDP by 2025, to reach SAR 3,515 billion (around USD 1 trillion) in banking assets by 2025,[91] raising the private sector's contribution of GDP from 40% to 65%, increasing foreign investment from 3.8% to the international level of 5.7% of

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[84] 'Official Website of the Organization of Petroleum Exporting Countries: Saudi Arabia, Facts and Figures' <https://www.opec.org/opec_web/en/about_us/169.htm> accessed 13 July 2021; See generally Thomas Wilson and Dara Sahab, *Saudi Arabia* (De Gruyter 2021); Mohammad Nurunnabi, 'Transformation from an Oil-Based Economy to a Knowledge-Based Economy in Saudi Arabia: The Direction of Saudi Vision 2030' (2017) 8 Journal of the Knowledge Economy 536.

[85] Nurunnabi (n 84); Wilson and Sahab (n 84); 'World Bank's Statistics and Classification of Saudi Arabia' <https://www.data.worldbank.org/country/SA> accessed 28 July 2021.

[86] 'World Bank's Statistics and Classification of Saudi Arabia' (n 85).

[87] 'Official Website of G20 Countries' <https://www.g20.org/about-the-g20.html> accessed 28 July 2021.

[88] ibid; 'Official Website of Vision 2030: Overview of the Vision's Aspirations in Relation to Investment' <https://www.vision2030.gov.sa/thekingdom/invest/> accessed 15 July 2021; 'Official Website of the Organization of Petroleum Exporting Countries: Saudi Arabia, Facts and Figures' (n 84).

[89] 'Council of Ministers Approves the Kingdom's Vision 2030' <https://www.spa.gov.sa/1493540) (https://www.vision2030.gov.sa/v2030/overview/> accessed 15 July 2021.

[90] 'Official Website of Vision 2030' <https://www.vision2030.gov.sa/v2030/vrps/fsdp/> accessed 15 July 2021.

[91] 'Official Website of Vision 2030: The Financial Sector Development Program' <https://www.vision2030.gov.sa/v2030/vrps/fsdp> accessed 15 July 2021.

GDP, and ultimately moving from the current position as the 19th largest economy in the world into the top 15.[92]

Having provided this brief overview of the strong political and economic position of Saudi Arabia, it is appropriate now to shift the discussion to the legal system of the country and its most prominent features.

2.3 Legal System in Saudi Arabia

Turning to the legal basis upon which Saudi Arabia operates, the first thing to highlight is that for over fourteen centuries, specifically since the time of Prophet Mohammed (peace be upon him (PBUH)), Sharia law has been the foundation of the many ruling regimes that have ruled over the Arabian Peninsula and its residents.[93] Saudi Arabia continued to apply Sharia law under the reign of King Abdulaziz, the modern state's founder, and his successor's sons[94] until the enactment of the first written constitution, the Basic Law of Governance in 1992 (BLG 1992), in which the state's commitment to apply Sharia Law was explicitly stipulated.[95] In this constitution, Islam was once again confirmed as the state's religion, and the *Quran* and *Sunnah* were stated as the primary constitution of the state,[96] with their provisions prevailing over every other legislation enacted by the state.[97] With that in mind, it is appropriate now to briefly describe Sharia law and the way in which it interacts with state laws in Saudi Arabia.

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[92] 'Official Website of Vision 2030: Overview of the Vision's Aspirations in Relation to Investment' (n 88). Notably, although Saudi Arabia is an oil-based economy and its 2030 Vision is an ambitious and comprehensive plan covering many goals including some related to managing climate change, neither the Vision and its various programs nor the Saudi corporate governance framework specifically refer to a Net Zero target. Such a target refers to the processes, strategies, and actions that would decrease the emissions associated with the production of greenhouse gases so that by 2050 the amount of carbon dioxide absorbed from the atmosphere is not less than the amount of greenhouse gas produced in order to ensure that the global temperature rise is lower than 2° by 2050. The relevance of Net Zero to corporate governance lies inthe fact that it has become a major feature of the evolution of corporate governance in recent years in the West, and it has gained increasing attention from investors following the Paris Agreement because corporate governance is one mechanism through which the agreement's targets could be achieved, by ensuring that corporations focus on reducing emissions. From a governance perspective, investors are encouraged to exert pressure on management to ensure that corporate strategies and actions are aligned with the objectives of the Paris Agreement through adequate disclosures of climate change risks and mitigating strategies, among other things. Saudi Arabia, as one of the world's largest oil producers, could play a significant role in the fight against global warming and in tackling the challenges associated with climate change.

[93] See generally: Joseph Schacht, 'Islamic Law in Contemporary States' (1959) The American Journal of Comparative Law 133; See generally: Frank E Vogel, *Islamic Law and the Legal System of Saudi: Studies of Saudi Arabia*, vol 8 (Brill 2000).

[94] Vogel (n 93) xiv.

[95] See generally the Basic Law of Governance 1992.

[96] Article 1 of ibid.

[97] Articles 7 and 23 of ibid.

2.3.1 Sharia law and state laws in Saudi Arabia

The *Quran* and *Sunnah* are the primary sources of Islamic law, which in turn governs Saudi law. The *Quran* ranks first in terms of bindingness, being the exact words spoken by Allah and conveyed to Prophet Mohammed (PBUH), while *Sunnah* ranks second and derives its bindingness from many of the *Quran's* verses.[98] It serves as another religious source which further details some of the *Quran's* provisions, in addition to interpreting the topics addressed in the *Quran* either concisely or generally, and it also addresses other issues on which the *Quran* is silent.[99] The *Sunnah* is defined as the Prophet Mohammed's (PBUH) sayings, deeds, and any other action or practice that was approved by him in the form of silence and tacit approval.[100] Both sources contain religious provisions covering the obligations, rights, and duties that govern all aspects of Muslims' lives, including in the political, economic, social, moral, behavioral, and spiritual fields.[101] Some of these provisions are explicitly stipulated and detailed in the *Quran*, while others are concisely provided for in it and further detailed in the *Sunnah*, and some others are left mostly to the *Sunnah* to address. A guiding principle of Sharia law is that every action that is in line with these two fundamental sources or at least does not contradict their provisions, is considered permissible in Islam.[102]

As was mentioned earlier, there are aspects that are either not addressed or not precisely regulated in either source. This is the area where *Al-Fiqh* becomes relevant in regulating them in a way consistent with Sharia principles and satisfies the needs of Islamic societies.[103] As was stated above, the *Quran* and *Sunnah* deal with all aspects of Muslims' lives, including the many issues arising in association with business transactions. In this regard, many detailed provisions set out in the *Quran* and *Sunnah* are explicitly and directly concerned with Muslims' conducts in such contexts. For example, both sources oblige Muslims to honour their contractual obligations,[104] to base their business dealings on

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[98] An example is: *Quran 4:80.*
[99] A Al-Shalhoub, 'The Constitutional System in the Kingdom of Saudi Arabia between Islamic Sharia and Comparative Law' 92.
[100] Subhi Mahmasani, *Falsafat Al-Tashri Fi al-Islam* (Brill Archive 1961) 71.
[101] Al-Shalhoub (n 99) 90–91.
[102] Said Ramadan, 'Islamic Law: Its Scope and Equity' 31–33.
[103] See generally Bernard Weiss, 'Interpretation in Islamic Law: The Theory of Ijtihād' (1978) 26 The American Journal of Comparative Law 199.
[104] An example is: *Quran 5:1.*

trust and honesty,[105] to abstain from terms that are vague and uncertain,[106] and to always observe the principles of justice in every business transaction undertaken.[107]

Al-Fiqh is the secondary source of Sharia law and is comprised of legal opinions and reasoning contributed by Muslim jurists who have endeavoured to interpret the general provisions of the *Quran* and *Sunnah,* especially on issues where no particular guidance is available in those sources to create new and suitable provisions that deal with such issues. They therefore offer interpretations which can be deemed consistent with the *Quran* and *Sunnah* through recourse to several methods that while not equally binding, are still accepted as a proper ways of reasoning. The main methods are *Al-Ijmaa* (the consensus of all Islamic scholars on a given matter at a given time after the death of Prophet Mohammed (PBUH))[108] and *Al-Qiyas* (analogical reasoning),[109] both of which are respectively binding sources of Sharia law that rank third and fourth below the *Quran* and *Sunnah* themselves.[110] Other methods include the less binding method of *Al-Masaleh Al-Morsalah* (public interest), *Al-Istehsan* (preference),[111] *Al-Istedlal and Al-Isteshab* (ratiocination and presumption of continuity),[112] *Al-Urf* (custom),[113] and *Saad Al-Thara'e* (the prohibition of means that amount to undesirable ends).[114] The combination of these methods has contributed significantly to Islamic Jurisprudence over past centuries, enabling Muslims since the death of Prophet Mohammed (PBUH) to deal with the new issues of their time, especially in cases where authentic and authoritative relevant texts are unavailable in the *Quran* and *Sunnah*.[115]

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[105] Some examples include *Quran 83:1–3; Quran 55:9; Quran 4:58.*

[106] An example is the saying of Prophet Mohammed (PBUH) which was narrated by his companion Abu Hurairah, that "The Messenger of Allah prohibited the *Hasah* sale and the *Gharar* sale.". *Gharar* in Islam refers to any transaction that involves a great deal of vagueness and uncertainty. See: *Sahih Muslim, Book 21, Hadith No. 1513.*

[107] Lilian Miles and Simon Goulding, 'Corporate Governance in Western (Anglo American) and Islamic Communities: Prospects for Convergence?' (2009) Journal of Business Law; Abdussalam Mahmoud Abu-Tapanjeh, 'Corporate Governance from the Islamic Perspective: A Comparative Analysis with OECD Principles' (2009) 20 Critical Perspectives on accounting 556.

[108] M Al-Uthaymeen, *A System of Roots of Jurisprudence and Its Principles (Arabic)* (3rd edn, Dar Ibn Al-Jawzi 2012) 208.

[109] Mahmasani (n 100) 79.

[110] Al-Uthaymeen (n 108) 208.

[111] Mahmasani (n 100) 83–84.

[112] ibid 85–91.

[113] Ramadan Al-Shoronbassy, *The Introduction to Islamic Jurisprudence: Development, Schools, Sources, Doctrines and Theories (Arabic)* (2nd edn, 1983) 240.

[114] ibid.

[115] ibid 253; Weiss (n 103).

Importantly, such secondary sources and methods, particularly *Al-Masaleh Al-Morsalah*, have been the basis upon which the majority of detailed rules in Saudi law are based.[116] In other words, detailed rules including those imported from non-Islamic states, and especially those forming part of modern Saudi commercial regulations, cover areas that are not necessarily referred to in the *Quran* and *Sunnah,* but they are presumed to be consistent with what legislators and regulators believe, based on guidance by Muslim jurists, to be in line with Sharia principles.

It should be emphasised that describing Saudi law as a Sharia-based law does not mean that Saudi law and Sharia law are exactly the same thing. Rather, it means that modern Saudi laws and regulations, which comprise many rules of Islamic origin in addition to rules that have been imported from Western jurisdictions, do not conflict with Sharia principles. In this regard, rules that are of foreign origin are transplanted into Saudi law on the basis that they do not contradict Sharia principles, and that they are deemed to be suitable for the local legal environment.[117] That being established, and as will be explored in greater detail in the following chapters, the Saudi corporate statute has remained the primary source of rules pertaining to listed companies, including corporate governance. It should, however, be noted that Sharia law in its pure form is still relevant to corporate governance in Saudi Arabia, most notably in regard to directors' duties.[118] As will be discussed in detail later, this area of corporate governance has not been adequately codified in the Saudi framework, as the current level of regulatory vagueness surrounding such area shows, implying that Sharia principles and rules on contracts and agency are the primary source of directors' duties and that the recourse to Sharia law is inevitable.

The utilisation of these various methods to interpret the provisions of the *Quran* and *Sunnah* or to produce new legal rules in response to the modern needs of society in the absence of particular reference in the *Quran* and *Sunnah* is called *Al-Ijtihad.*[119] This concept refers to the independent reasoning resulting from the exhaustive and systematic exertion of a qualified jurist's intellectual ability in interpreting the religious texts and employing the abovementioned methods to explore solutions to the questions at hand.[120]

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[116] See generally Vogel (n 93).
[117] ibid.
[118] The relevance of Sharia law to directors' duties in Saudi Arabia is discussed in detail in Section 4.4 4.4.1of this thesis.
[119] See generally Weiss (n 103); See generally Al-Shoronbassy (n 113); See generally Al-Uthaymeen (n 108).
[120] See generally Weiss (n 103); See generally Al-Shoronbassy (n 113); See generally Al-Uthaymeen (n 108); Irshad Abdal-Haqq, 'Islamic Law: An Overview of Its Origin and Elements' (1996) 1 The Journal of Islamic Law 1.

Al-Ijtihad is not accepted in the presence of authentic and authoritative texts from the *Quran* and *Sunnah* or in the presence of *Al-Ijmaa,* where Muslim jurists have reached a consensus on the given issue.[121]

Given that *Al-Ijtihad* requires independent reasoning from independent jurists, the opinions of jurists have, in many cases, differed on what Sharia's stance should be towards a given issue, thus leading to the emergence of different scholarly schools within Islamic jurisprudence.[122] In this respect, the Islamic *Sunni* jurisprudence, which is prevalent in most Islamic states including Saudi Arabia, has four main orthodox scholarly schools, namely: 1) the *Hanafi* school, 2) the *Maleki* school, 3) the *Shaf'ei* school, and 4) the *Hanbali* school.[123] The opinions of jurists on certain legal issues under Sharia law can sometimes differ depending on which school the jurists belong to. Such differences sometimes also arise among jurists from the same school due to the independent judgements exercised by each jurist.[124]

Moving on, in relation to trade and business, Sharia law tends to be principle-based[125] thus enabling Muslim jurists to produce detailed rules on the issues at stake in a way that meets the new needs of society as it develops, provided that such rules do not contradict the established Sharia provisions. Accordingly, the Sharia-based legislations in Islamic states such as Saudi Arabia are the result of efforts undertaken by the state and legislators to address the issues Muslim society faces, which means that any deficient rule, ambiguous language, or errors in Saudi law should not be attributed to Sharia itself, but to the failure of the state and legislators to provide appropriate and unambiguous legal rules.

2.3.2 Enforcement of Sharia and state laws in Saudi Arabia

As to the enforcement of Sharia and state laws in Saudi Arabia, the BLG 1992 states that the judiciary has independent authority, that judges are not bound in their judgement by any authority except that of Sharia,[126] and that courts must apply Sharia provisions when

[121] See generally Weiss (n 103); See generally Al-Shoronbassy (n 113); See generally Al-Uthaymeen (n 108); Abdal-Haqq (n 43).
[122] Abdal-Haqq (n 120).
[123] ibid.
[124] Rudolph Peters, 'From Jurists' Law to Statute Law or What Happens When the Shari'a Is Codified' (2002) 7 Mediterranean Politics 82.
[125] See generally Gali Hagel, 'A Practitioner's Introduction to Saudi Arabian Law' (1983) 16 Vand. J. Transnat'l L. 113.
[126] Article 46 of the Basic Law of Governance 1992.

deciding cases brought before them in accordance with the provisions of the *Quran* and *Sunnah* and the provisions of the state's laws that do not contradict them.[127] The implication of such articles is that, theoretically speaking, judges are empowered to use their independent judgement when deciding the disputes brought before them. Taking into consideration that while Saudi Arabia largely follows the *Hanbali* school it still deviates on some issues and sometimes applies opinions from other *Sunni* schools, and that many Sharia rules have not been codified, including in the areas of contracts law and agency law, the challenge here is that judges in such cases have wide discretionary power in formulating their own understanding and views of what they believe to be the truth and consistent with Sharia principles. This means that judicial decisions can vary even in cases of similar facts and legal questions due to the different approach that individual judges can take. The extent of this challenge is made greater given that Saudi Arabia is a jurisdiction where judicial precedent (*stare decisis*) does not apply, and the legal system in the country does not recognise judicial precedent as a source of law.[128] As a result, a high level of uncertainty and judicial inconsistency may be expected in the application of Sharia law. Nevertheless, the discretionary power of judges in deciding cases is limited when it comes to enforcing the state's codified laws and rules as judges in Saudi Arabia tend to enforce all codified rules provided they do not contradict Sharia law, which implies in turn that judges are not a source of Saudi law.[129]

It should be mentioned here that unlike other types of disputes (i.e., civil, criminal, commercial, labour, etc.) that are decided by the relevant court within the country's ordinary judiciary system,[130] disputes pertaining to listed companies and shareholders in matters governed by the CML 2003 and CL 2015 and their implementing regulations such as the CGRs 2017 fall exclusively within the jurisdiction of the Committee for Resolution of Securities Disputes.[131] This is a quasi-judicial specialised committee which is not part of the country's ordinary judiciary system, and which comprises two levels; a preliminary level and an appeal level.[132] Its powers include investigating and settling claims, issuing

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[127] Article 48 of ibid.
[128] David J Karl, 'Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know' (1991) 25 Geo. Wash. J. Int'l L. & Econ. 131.
[129] Ayoub M Al-Jarbou, 'Judicial Independence: Case Study of Saudi Arabia' (2004) 19 Arab Law Quarterly 5.
[130] See the Implementation Mechanism of the Judiciary Law and the Board of Grievances Law 2007. It was Issued by the Royal Decree No. M/78 dated 01 October 2007. Available in Arabic at <https://www.laws.boe.gov.sa/BoeLaws/Laws/LawDetails/8b59b6e9-94ff-4d7c-90df-acc60000e5ee/1> accessed 11 May 2019.
[131] Article 30 (a) of the Capital Market Law 2003; Article 223 of the Companies Law 2015.
[132] Articles 30 (a) and 30 (i) of the Capital Market Law 2003.

subpoenas to witnesses, ordering the production of evidence and documents, issuing decisions, and imposing sanctions.[133] Although this committee is not part of the ordinary judiciary system in Saudi Arabia, and is considered a fully independent quasi-judicial committee, it and its judges are bound by the same constitutional provisions that apply to all types of judicial institutions, which in essence obliges them to strictly observe and apply Sharia principles and rules along with the state's laws that are consistent with them. Furthermore, this committee and its judges enjoy the same discretionary power granted to other judges under the ordinary judiciary system, which indicates that the same challenges concerning the uncertainty and unpredictability of judicial rulings discussed above are also relevant in relation to the rulings of this committee.

Now that an overview of the country's legal system including the role of Sharia law and Saudi law has been provided, the chapter turns to the Saudi Exchange's development followed by exploration of the ownership structure of the Saudi capital market and other relevant and influential external factors including the country's market for corporate control and financial media.

2.4 Development of the Saudi Exchange (Tadawul)

The unofficial public trading of shares started in 1954 with only 14 listed companies, and the number of listed companies remained the same until 1975.[134] An ambitious plan to drive the growth of the Saudi economy led to the establishment of the official stock exchange in 1984.[135] The responsibility for regulating and maintaining the new stock exchange was given to the Saudi Arabian Monetary Authority (SAMA) before later being assigned to the newly created the CMA upon the enactment of the Capital Market Law in 2003 (CML 2003).[136] The same law provided for a separate and an independent stock exchange to be established in the form of a joint stock company. Thus, Tadawul was created in 2007 and it has been responsible for operating the capital market ever since.[137]

Tadawul is the largest stock market in the Middle East, the 3rd largest market among emerging market peers, and the 9th largest stock market among the 67 members of the

[133] See generally Article 30 of ibid.
[134] 'The Saudi Exchange's Annual Report' (2020) 9 <shorturl.at/aeyOS> accessed 15 July 2021.
[135] ibid.
[136] ibid; See generally the Capital Market Law 2003.
[137] 'The Saudi Exchange's Annual Report' (n 134) 9; See Chapter 3 of the Capital Market Law 2003.

World Federation of Exchanges.[138] The number of publicly listed companies in Saudi Arabia increased from 14 in 1975 to 203 by 2020.[139] As of 2020, the market capitalisation of Tadawul is USD 2.42 trillion, making it the world's 9th largest market in terms of capitalisation value.[140] The Saudi capital market represents 77.66% of the total capitalisation value of all capital markets in the Middle East and North Africa.[141] Furthermore, the trading volume of Tadawul in 2020 was SAR 2.09 trillion (over USD 555 billion), and a total of 33.4 billion shares were traded,[142] making the significance of the market clear. In 2019, Aramco, the world's largest oil producer, was listed in Tadawul, taking it to become one of the ten largest exchanges in the world.[143] In the same year Tadawul was fully admitted to the Morgan Stanley Capital International (MSCI) and Standard and Poors (S&P) indices, and partially admitted to the Financial Times Stock Exchange Russell (FTSE Russell) index ahead of its full admission in 2020.[144]

With the history and development of Tadawul sketched here, and its position among global exchanges established, the following sections will address the ownership structure of the Saudi capital market along with its most influential external factors, namely the country's market for corporate control and financial media.

2.5 Ownership Structure of the Saudi Capital Market

Agency theorists highlight a connection between the ownership structure of a company and the level of its corporate governance. Government ownership, institutional ownership, and the level of ownership concentration are all believed to be influential regarding the governance of listed companies.[145] Therefore, the following section will briefly describe

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[138] 'Official Website of the Saudi Stock Exchange: About Saudi Exchange' <https://www.saudiexchange.sa/wps/portal/tadawul/about?locale=en> accessed 15 July 2021.
[139] 'The Saudi Exchange's Annual Report' (n 134) 9 and 12.
[140] ibid 10–11.
[141] ibid.
[142] 'The Saudi Exchange in 2020: Fluctuations, Challenges, and a Positive End' (2020) <shorturl.at/auFKQ> accessed 17 July 2021.
[143] 'The Saudi Exchange's Annual Report' (n 134) 9.
[144] ibid.
[145] John E Core, 'A Review of the Empirical Disclosure Literature: Discussion' (2001) 31 Journal of accounting and economics 441; Scott Fung and Shih-Chuan Tsai, 'Institutional Ownership and Corporate Investment Performance' (2012) 29 Canadian Journal of Administrative Sciences/Revue Canadienne des Sciences de l'Administration 348; Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305; Christine A Botosan, 'Disclosure Level and the Cost of Equity Capital' (1997) Accounting review 323; Michael C Jensen, 'The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems' (1993) 48 the Journal of Finance 831; Li Li Eng and Yuen Teen Mak, 'Corporate Governance and Voluntary

the ownership structure in the Saudi capital market so that the main considerations affecting corporate governance in it can be introduced, setting the scene for the subsequent analysis in the next chapters.[146]

2.5.1 Government ownership

Corporate ownership in Saudi Arabia has historically been classified as concentrated, in that the dominant players in the form of the government, institutions, families, and individual block holders are in control of Saudi listed companies.[147] Of these forms of ownership, government ownership is very important in understanding the context of corporate governance, as despite limited prior evidence on the link between government ownership and enhanced corporate governance practices, several studies have identified a positive association between government ownership and enhanced corporate governance in terms of voluntary disclosure, voluntary corporate social responsibility, and risk disclosures.[148] This is of particular relevance in the Saudi market given that the Saudi government, through a number of its institutions namely its investment arm the Public Investment Fund (PIF), the General Organization for Social Insurance (GOSI), and the Public Pension Agency (PPA), has long been a key shareholder in the largest Saudi listed companies such as Aramco, SABIC, and the majority of Saudi banks.[149] In fact, the value of shares owned by the state's various arms increased to SAR 7.48 trillion (around USD 2 trillion) in 2019, and as of 2020, the state's ownership stakes represent around 82% of the

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Disclosure' (2003) 22 Journal of accounting and public policy 325; Yves Bozec and Richard Bozec, 'Ownership Concentration and Corporate Governance Practices: Substitution or Expropriation Effects?' (2007) 24 Canadian Journal of Administrative Sciences/Revue Canadienne des Sciences de l'Administration 182; Collins G Ntim and Teerooven Soobaroyen, 'Corporate Governance and Performance in Socially Responsible Corporations: New Empirical Insights from a Neo-Institutional Framework' (2013) 21 Corporate Governance: An International Review 468.

[146] A more detailed account of ownership structure and agency theory will be given in Chapters 4 and 5 of this thesis.

[147] Abdulrahman Al-Razeen and Yusuf Karbhari, 'Interaction Between Compulsory and Voluntary Disclosure in Saudi Arabian Corporate Annual Reports' (2004) Managerial Auditing Journal; Jenifer Piesse, Roger Strange and Fahad Toonsi, 'Is There a Distinctive MENA Model of Corporate Governance?' (2012) 16 Journal of Management & Governance 645; Waleed M Al-Bassam and others, 'Corporate Boards and Ownership Structure as Antecedents of Corporate Governance Disclosure in Saudi Arabian Publicly Listed Corporations' (2018) 57 Business & Society 335.

[148] Eng and Mak (n 145); Yaseen Al-Janadi, Rashidah Abdul Rahman and Normah Haj Omar, 'Corporate Governance Mechanisms and Voluntary Disclosure in Saudi Arabia' (2013) 4 Research Journal of Finance and Accounting; Ntim and Soobaroyen (n 145).

[149] 'The Public Investment Fund's Stake in Listed Companies' (2020) <shorturl.at/uNWX8> accessed 17 August 2021; 'The Saudi Sovereign Fund Owns Shares in the Value of 90 Billion Saudi Riyal in Banking Industry' (2018) <shorturl.at/bouEQ> accessed 13 August 2021.

market total capitalisation value, jumping significantly from 34.3% in 2019.[150] This reality of heavy state ownership has implications for the development and enforcement of corporate governance in listed companies, and also affects the extent of the agency problem such companies face.[151]

2.5.2 Institutional ownership

In discussing institutional ownership, agency theory suggests that because of institutional investors' large shareholdings, such investors are incentivised to play a greater role in corporate governance to safeguard their sizable investments and shield them from board exploitation.[152] Additionally, boards are expected to behave sensibly not only to satisfy the informational needs of powerful institutional investors,[153] but also to stabilise their positions in the company and gain those investors' support to legitimise their stewardship of the company.[154] With that in mind, the Saudi capital market could benefit from the presence of institutional investors, especially as the level of institutional ownership has continued to grow considerably over the past few years, reaching a level of 96.35% of the market's total capitalisation value in the first financial quarter of 2021.[155] The CMA had undertaken different steps to facilitate such an increase, chief among them its decision to increase the allocation percentage devoted to institutions in initial public offerings to 90%, and allowing strategic foreign investors to enter the market and own considerable shareholdings, along with the admission of Tadawul to the MSCI, S&P, and FTSE Russell indices.[156]

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[150] 'Press Report: 7.5 Trillion Saudi Riyal Is the Value of the State's Ownership in TASI Representing 82% of the Market Total Capitalization Value' (2020) <https://maaal.com/archives/20201118/164245/> accessed 17 August 2021.
[151] Agency theory and its various considerations are discussed in detail in Chapter 4 of this thesis.
[152] Core (n 145); Fung and Tsai (n 145); Jensen and Meckling (n 145).
[153] Craig Deegan, 'Introduction: The Legitimising Effect of Social and Environmental Disclosures–a Theoretical Foundation' (2002) Accounting, Auditing & Accountability Journal.
[154] Manuel Castelo Branco and Lucia Lima Rodrigues, 'Factors Influencing Social Responsibility Disclosure by Portuguese Companies' (2008) 83 Journal of Business Ethics 685.
[155] 'Report on the Level of Institutional Investment in the Saudi Capital Market' (2021) <shorturl.at/irIP0> accessed 17 August 2021. This figure includes the 82% owned by the state both directly and indirectly which may indicate that the true institutional ownership is low. However, it should be noted that this very high level of state ownership is due to the state's ownership of the state oil company Aramco, the value of which alone represents around 75% of the market total capitalisation. Prior to Aramco's listing, the state ownership of listed companies represented just above 34% of the Saudi market's total capitalisation.
[156] ibid.

2.5.3 Block ownership

From an agency theory perspective, block ownership could play a positive role in reducing agency problems, improving a company's practices, and enhancing corporate performance, all of which are the results of the closer monitoring of management that block owners exercise.[157] Some even argue that block ownership can serve as an alternative for good corporate governance practices, as the latter are less needed in the presence of powerful block owners, who are naturally highly incentivised to pay close attention to management.[158] However, as will be discussed later in detail in Chapters 4 and 5, a block ownership structure raises an issue from the minority shareholder perspective, by giving rise to what is known as the principal-principal problem where tension increases between large and minority shareholders rather than between shareholders as a group and management.[159] This occurs when block shareholders, who have strong voting power, abuse their position to exploit the company's assets at the expense of the more vulnerable minority shareholders with weak voting power.[160] This dilemma is even more worrying in markets where block ownership is the norm, such as Saudi Arabia.[161]

This concern will be discussed later in more detail as part of the substantive analysis of the thesis's various chapters. For now, it is sufficient to mention that concentrated ownership is a prominent feature of the Saudi capital market[162] as evidenced by the fact that as of June 2021, 84.5% of the market's total capitalisation value was owned by 286 large shareholders to the value of SAR 8.2 trillion (around USD 2.2 trillion).[163] These large shareholders range from the state's various investment arms such as the PIF, the GOSI, and the PPA, to six senior members of the royal family, as well as several other organisations and a long list of families and wealthy individuals.[164] As will be shown later in this research, this reality has many implications in the context of corporate governance. Therefore, to ensure the suitability of importing any foreign rule into the local market, an abundance of caution

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157 Botosan (n 145); Jensen (n 145); Jensen and Meckling (n 145).
158 Bozec and Bozec (n 145).
159 Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26 The journal of law and Economics 301; John Armour, Henry Hansmann and Reinier Kraakman, 'Agency Problems and Legal Strategies' (2017) The Anatomy of Corporate Law: A Comparative and Functional Approach.
160 Fama and Jensen (n 159); Armour, Hansmann and Kraakman (n 159).
161 Al-Bassam and others (n 147).
162 Abdulaziz Mohammed Alsahlawi and Mohammed Abdullah Ammer, 'Corporate Governance, Ownership Structure and Stock Market Liquidity in Saudi Arabia: A Conceptual Research Framework' (2017) 6 Accounting and Finance Research.
163 'Report on the Presence of Large Shareholders in the Saudi Capital Market' (2021) <shorturl.at/mwxK8> accessed 17 August 2021.
164 ibid.

should be exercised prior to any attempt to align the Saudi corporate governance framework with frameworks in other developed markets where the ownership structure is fundamentally different.

2.5.4 Foreign ownership

In recent years the CMA has been keen on paving the way for the injection of foreign capital into the Saudi capital market, which had previously been highly restricted. As a result, the CMA implemented a new policy aiming at increasing the Saudi capital market's appeal for foreign investors and facilitating the direct and indirect entry of such investors. To this end, foreign investors were offered several paths into the market, including investing through swap agreements, permitting *qualified* foreign investors to invest in listed securities, allowing foreign *strategic* investors to own strategic and sizable stakes in listed companies, and allowing foreign investors to directly invest in debt instruments.[165] This opening up of the market gained more global attention following the launch of Vision 2030 which, as was explained earlier, aims (among many other targets) at increasing foreign direct investment from 3.8% to the international average level of 5.7% of GDP.[166] Among the effects desired by attaining this objective is to stimulate investment in the financial market and improve its role in capital formation, in addition to enhancing market efficiency, transferring knowledge and expertise, and increasing the level of corporate governance in listed companies.[167]

With these goals in mind, the CMA has implemented several measures to ensure that the capital market is ready and attractive for foreign investors, including the issuance of new regulations that regulate foreign investment in the market and working closely with Tadawul to facilitate its admission to the MSCI, S&P, and FTSE Russell indices. These efforts were largely successful, as Tadawul was indeed admitted to the MSCI and S&P indices in 2019, and was partially admitted to the FTSE Russell index in 2019 too, prior to its full admission in 2020. [168] The significance of these admissions is that they facilitate the entry of foreign investors into the Saudi capital market, as the indices are used by international investors to benchmark a given market against other global markets and to

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[165] 'Official Website of the Capital Market Authority: Foreign Investors' <https://cma.org.sa/en/Market/QFI/Pages/default.aspx> accessed 18 July 2021.
[166] 'Official Website of Vision 2030: Economic Objectives' <https://www.vision2030.gov.sa/v2030/overview/thriving-economy/> accessed 15 July 2021.
[167] 'Official Website of the Capital Market Authority: Foreign Investors' (n 165).
[168] 'The Saudi Exchange's Annual Report' (n 134).

evaluate its risks and the trends for investment diversification in it, thus providing an overall analysis of the given market. Following the admission to the international indices, the level of foreign portfolio investment significantly increased to 9% of the Saudi market's total capitalisation value as of 2020[169] and it is expected to increase further.

2.6 External Factors Affecting Corporate Governance in Saudi Arabia

Lastly in this chapter, it is relevant to touch upon some of the external factors which affect the quality of corporate governance practices in any given capital market and play a significant role in the advocation and enforcement of corporate governance rules, especially in jurisdictions where voluntary compliance is the norm. Among these factors are the presence of an active market for corporate control, and an independent and active financial media.

2.6.1 Presence of a market for corporate control

The concept of a market for corporate control refers to the existence of a market where control rights can be secured through mergers and acquisitions and proxy fights.[170] This is a factor that is argued to be able to reduce the agency cost associated with the separation of ownership and control in companies, thus aligning the interests of both management and shareholders.[171] Securing control rights can take different forms, among which is through external pressure as the result of mergers and acquisitions, in which a poorly-managed company is acquired so that changes to the way it is managed can be brought and its corporate governance practices improved. The level of impact of this factor is dependent, among other things, on the level of mergers and acquisitions (M&A) activity in a given capital market, with the implication that whenever M&A level in a given market is low, the effect of this factor is also low.[172] In Saudi Arabia, despite the official launch of the Saudi capital market in 1985 and its developments since, and notwithstanding the regulatory framework surrounding mergers and acquisitions activity provided by the CL 2015 and the Mergers and Acquisitions Regulations 2018 (MARs 2018), M&A activity has remained

[169] 'The Annual Report of the Capital Market Authority' (2020).
[170] Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110, 114.
[171] ibid 119.
[172] Omesh Kini, William Kracaw and Shehzad Mian, 'The Nature of Discipline by Corporate Takeovers' (2004) 59 The Journal of Finance 1511; Mark L Mitchell and J Harold Mulherin, 'The Impact of Industry Shocks on Takeover and Restructuring Activity' (1996) 41 Journal of Financial Economics 193.

very limited.[173] Nevertheless, the new regulatory framework has contributed to a relative increase in such activity, as evidenced by the high-profile mergers and acquisitions transactions that took place in the Saudi market in 2018 onwards. For example, the high-profile acquisition which saw Aramco taking control of 70% of SABIC in 2019 with a value of USD 69 billion,[174] and the two other mega-acquisition transactions in the banking industry which led to the merger between SABB Bank and Al-Awal Bank in 2019,[175] and Al-Ahli Bank acquiring 100% of SAMBA Bank in 2020.[176] Other instances include the SIPCHEM acquisition of Sahara in 2019,[177] and the Gulf Union acquisition of the Alahlia Company in 2020.[178] However, based on these examples it is difficult to describe the market for corporate control within the Saudi listed companies as active in the sense that it contributes towards an effective market-led enforcement of corporate governance practices, given that none of these transactions were driven by corporate governance considerations such as wanting to affect change in the targeted company's direction or to replace an underperforming board, nor were they outcomes of shareholder activism. On the contrary, these transactions were mainly driven by government-led initiatives that appeared to be aimed at either restructuring the state’s assets held by its investment arms, or strengthening the country’s financial and banking institutions to enhance their global market competitiveness. This is especially true as the government is a major shareholder in most leading Saudi listed companies, such as Aramco, SABIC, Saudi Electricity Company, and most of the banks operating in the country.[179] Moreover, while some other transactions were officially led by the private sector, they were still initiated and encouraged by the relevant regulatory authorities to rescue declining companies due to market stability and consumer protection considerations with the insurance industry a good example.[180] Overall,

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[173] The market for corporate control is relatively more active in relation to unlisted companies, but this area falls outside the present research's scope as it is irrelevant to listed companies.

[174] ‘Saudi Aramco Completes $69 Billion SABIC Stake Deal, Extends Schedule’ (2020) <https://www.reuters.com/article/us-sabic-m-a-saudi-aramco-idUSKBN23O0VK> accessed 5 August 2021.

[175] ‘SABB Says Merger with Alawwal Bank Complete, All Services Integrated’ (2021) <https://www.argaam.com/en/article/articledetail/id/1450636> accessed 5 August 2021.

[176] ‘NCB-Samba to Merge into Saudi Banking Heavyweight’ (2020) <https://www.reuters.com/article/us-saudi-ncb-samba-m-a-idUKKBN26W0KX> accessed 5 August 2021.

[177] ‘Sipchem-Sahara Merger Completes; Firm Changes Name’ (2019) <https://www.argaam.com/en/article/articledetail/id/610646> accessed 5 August 2021.

[178] ‘Al-Ahlia Insurance Shareholders Approve Merger with Gulf Union’ (2020) <https://www.argaam.com/en/article/articledetail/id/1418401> accessed 5 August 2021.

[179] ‘The Public Investment Fund’s Stake in Listed Companies’ (n 149); ‘The Saudi Sovereign Fund Owns Shares in the Value of 90 Billion Saudi Riyal in Banking Industry’ (n 149).

[180] ‘The Governor of the Saudi Central Bank Honours Merged Companies in the Insurance Sector’ (2021) <https://www.sama.gov.sa/en-us/news/pages/news-644.aspx> accessed 13 August 2021; ‘SAMA: Preliminary Negotiations to Merge Four Companies in the Insurance Industry’ (2020) <shorturl.at/nGIW7> accessed 13 August 2021.

it is difficult to establish the existence of an *active* market for corporate control in Saudi Arabia in the context of private and market enforcement of corporate governance practices.

2.6.2 Presence of active and independent financial media

Another external factor which affects the quality of corporate governance practices in listed companies is the presence of an active and independent financial media. The relevance of financial media to corporate governance is that it is capable of positively impacting companies' levels of conformity with corporate governance rules by shedding light on companies' practices and on the actions of boards and managers, a scrutiny which can shape their behaviours.[181] Generally speaking, the media investigations conducted into the practices of companies and the behaviours of their boards and management can serve as a pressure force that exposes wrongdoers and deters potential ones.[182]

Saudi Arabia is home to many media outlets, ranging from television channels and radio stations to newspapers and magazines, with various specialisms including politics, economics, finance, society, sports, and entertainment.[183] In fact, most of the largest and most influential media outlets in the Middle East are owned or controlled by Saudi companies.[184] In terms of the financial media sector, while there are several dedicated financial media outlets that cover issues related to economics and finance which monitor and analyse capital market performance, one evident problem is that most, if not all, of these focus on the traditional technical analysis of listed companies' share performance and coverage of those companies' announcements and shareholders' meetings. In other words, the Saudi financial media tends not to engage in investigations of the environment within which listed companies operate. If this was done, then the reality of what happens behind the scenes could be revealed and corporate governance practices ascertained, exposing any existing or potential financial scandals and corporate exploitation.

With this absence of a genuinely independent investigative financial media, doubts arise as to whether the sector is capable of enhancing the quality of corporate governance in Saudi

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[181] Erik Berglöf and Stijn Claessens, *Enforcement and Good Corporate Governance in Developing Countries and Transition Economies*, vol 21 (2006) 143.
[182] ibid.
[183] Mohamed Zayani, 'Transnational Media, Regional Politics and State Security: Saudi Arabia between Tradition and Modernity' (2012) 39 British Journal of Middle Eastern Studies 307; 'Saudi Arabia Focuses on Reshaping Media Landscape' <https://oxfordbusinessgroup.com/overview/switched-authorities-focus-reshaping-media-landscape> accessed 12 August 2021.
[184] Zayani (n 183); 'Saudi Arabia Focuses on Reshaping Media Landscape' (n 183).

listed companies, or serving as a source of pressure to deter any potential manipulation in such companies. Exploring the structural and historical reasons for this absence falls outside the scope of this research, but it is worth mentioning that the reality of the financial media in Saudi Arabia is consistent with the reality of the Saudi media's performance in general, in that it has largely remained silent and indifferent towards issues that are of great importance to society, focusing primarily on issues that are crowd-oriented and more profitable such as politics, entertainment, and sports journalism.

2.7 Summary and Conclusion

The purpose of this chapter was to provide an overview of different aspects of Saudi Arabia to understand the environment within which the Saudi corporate governance framework operates. In doing so, the chapter highlighted the country's advanced economic position globally which led it to be a G20 member and a high-income economy. The chapter then summarised the country's legal system establishing the prominent role of Sharia law and concluding that it in its purest form remains relevant to the modern corporate governance regulations particularly in respect to directors' duties. It also discussed the enforcement of Sharia and state laws in Saudi Arabia arguing that the courts' wide discretionary and inapplicability of judicial precedent in the country is a cause for concern, as such position is likely to affect the predictability of the Saudi laws.

The chapter subsequently overviewed the development of the Saudi Exchange over the last few decades demonstrating that the exchange's large size, admission to international indices, and significant increase of foreign and institutional investment indicate a constant need for the country's corporate governance framework to be as robust and developed as possible to build confidence in the integrity of the Saudi capital market. The discussion then progressed on to the main characteristics of the Saudi capital market establishing it as a highly concentrated market, and concluding that block holders, regardless of whether they are government, institutions, or individuals, dominate the market. This dominance was argued to be a double-edged sword. On the one hand, such a structure allows shareholders (particularly large ones) to directly influence management actions and reduce reliance on corporate governance arrangements. On the other hand, the structure poses different challenges than those facing dispersed markets, chief among which is the emergence of principal-principal conflict where the tension becomes more about majority and minority shareholders and less about directors and shareholders as a whole.

Lastly, the chapter discussed the country's market for corporate control and financial media concluding that the former is not active within listed companies, and the latter's role in corporate governance is absent; thus, these two factors, which are viewed as influential factors in other developed countries, cannot be relied upon to positively and significantly enhance corporate governance practices in the Saudi capital market.

The implication from the chapter's conclusions particularly in respect of the country's market characteristics is that corporate governance solutions may need to differ across jurisdictions as what works in one jurisdiction may not necessarily work in another. Accordingly, adequate evaluation and consideration of the various characteristics of a given market is crucial prior to any attempt to align a national framework's rules with those of other international frameworks.

Now that the main considerations concerning the political, legal, and economic contexts of Saudi Arabia have been established, and the prominent characteristics of the Saudi capital market along with the external factors affecting it have been discussed, it is time for the thesis's substantive discussions regarding the Saudi corporate governance framework to be presented, starting with the design and approach of the framework, which forms the focus of the next chapter.

CHAPTER 3: DESIGN AND APPROACH OF THE FRAMEWORK

3.1 Introduction

As was discussed in the first chapter, the design and approach of any corporate governance framework is a vital factor in determining how appropriate it is. Therefore, the focus of this chapter will be on comparatively exploring these elements by discussing the regulatory mode of the framework, covering the topics of corporate rule types and common regulatory approaches; the level of its flexibility; and lastly, the enforcement of the framework's rules covering public enforcement, private enforcement, and market discipline.

This chapter aims at introducing and discussing the main theoretical aspects of the design and approach of any framework so that the main theories underpinning the discussions in Chapters 4 and 5 are established. Ultimately, the chapter will assess whether the regulatory mode of the Saudi framework is suitable for the national context, whether it is flexible enough to meet the various needs of companies, and lastly, whether it provides appropriate public and private enforcement mechanisms.

Prior to evaluating the three jurisdictions' positions, it is essential first to explore the various components that together comprise the corporate governance framework in each jurisdiction, in order to set the scene for the subsequent discussion.

To begin with, the corporate governance frameworks in Saudi Arabia, the UK, and Delaware all derive their components from several legal and regulatory sources that together constitute the overall regulatory framework for the governance of public companies listed on the relevant capital market. These sources vary in form, content, and purpose, and also in their enforceability. However, they all intersect with each other in order to regulate corporate governance issues both directly and indirectly.

In Saudi Arabia, the framework consists mainly of the CL 2015, the CGRs 2017, and the Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016 (RRPs 2016). Some other provisions and references related to corporate governance are sporadically found in a number of regulations issued under the CML 2003, such as the MARs 2018 and the Rules on the Offer of Securities and Continuing Obligations 2017 (ROSCOs 2017). The Listing Rules of the Saudi Exchange (LRs 2017) also include an indirect and embedded reference to corporate governance by requiring the issuer to comply with the regulations issued by the CMA, which implicitly includes the CGRs 2017.[185]

As in Saudi Arabia, the corporate governance framework in the UK draws upon several different sources. The main sources are the UK Companies Act 2006 (CA 2006), the UK Corporate Governance Code 2018 (CGC 2018), the UK Listing Rules (LR), and the UK Stewardship Code 2020 (SC 2020). While the Financial Services and Markets Act 2000 (FSMA 2000) is also relevant to corporate governance, it is mostly concerned with aspects related to disclosure. Other sources include the Disclosure Guidance and Transparency Rules (DTRs) and the Admission and Disclosure Standards (ADS 2018).

In Delaware, the framework is affected by different federal and state laws and regulations.[186] At the federal level, the most relevant laws are the Securities Act of 1933 (SA 1933), the Securities Exchange Act of 1934 (SEA 1934), the Sarbanes-Oxley Act of 2002 (SOX 2002), the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DWSRCPA 2010), and the regulations thereunder issued by the Securities and Exchange Commission (SEC).[187] At the state level, two bodies contribute to the corporate governance framework; the first of these is the General Corporation Law of the State of Delaware (GCLSD)[188], and the second are the state's past judicial decisions.[189] In addition, exchange rules regulate several aspects of corporate governance within companies listed on national exchanges, most notably the New York Stock Exchange (NYSE) which regulates corporate governance within its Listed Company's Manual (Manual).[190]

Having set out the main components from which the framework in each jurisdiction is made up, it is possible to embark on a discussion of the first issue addressed by this chapter, the regulatory mode of the framework.

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[185] See Article 3 (A) and Article 36 (2) of the Saudi Listing Rules 2017.
[186] Adam O Emmerich and others, 'The Corporate Governance Review: United States' (2018) Law Business Research, London, 409; Ellisa O Habbart and Michael S Swoyer, 'The Corporate Governance Review: United States: Delaware' (2018) Law Business Research, London, 422–423.
[187] See generally the Securities Exchange Act of 1934; the Sarbanes-Oxley Act of 2002; the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
[188] See generally the Delaware General Corporation Law.
[189] Habbart and Swoyer (n 186) 422.
[190] See generally the New York Stock Exchange Listed Company Manual.

3.2 Regulatory Mode of the Corporate Governance Framework

The approaches countries take to regulating corporate governance vary.[191] In fact, various states have employed a mix of binding and voluntary provisions to tackle aspects of corporate governance, and in doing so have utilised multiple regulatory techniques, many through corporate law. Such variation has led to the emergence of distinct regulatory approaches, with the most notable distinction being between the voluntary approach and the mandatory approach. Each approach deals with corporate governance issues in its own way, thus the impact each has is different. With that in mind, the following discussion will shed light on the role of corporate law in corporate governance, followed by an exploration of the most common regulatory approaches to corporate governance in order that ultimately, the regulatory mode of the Saudi framework can be established and evaluated.

The role of corporate law in the context of corporate governance is of fundamental importance, as it is typically the primary legal source from which many corporate governance obligations are derived. Corporate law regulates the relationship between a company's various constituencies (mainly between its management and shareholders) to facilitate the company's ongoing affairs and reduce the degree of conflict between its various corporate actors.[192] In doing so, corporate law provides the necessary protection to all parties involved within the company and upholds the regulatory framework through which such parties can reach agreement on many aspects of corporate operations.[193] That being said, it is crucial to bear in mind that the structure of corporate law, that is the type of rules it utilises, varies in nature across jurisdictions, thus affecting the legal outcomes of the given rule. Rules typically take one of three forms: mandatory rules where parties have no option but to abide by the given rule; default rules where the prescribed rule applies unless parties agree otherwise; and enabling rules where the law prescribe rules whose legal effects are given if parties choose to adopt them in a specified manner.

Among the objectives of mandatory rules is to establish minimum standards that market participants must abide by, especially in areas of universal importance and where no possible individualistic circumstances of a company can justify deviation. This, in turn, provides a large degree of protection to shareholders as a result of companies and directors

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[191] OECD, *OECD Corporate Governance Factbook* (n 6) 15.
[192] See generally Henry Hansmann and Reinier Kraakman, 'What Is Corporate Law?' (2004) Yale Law & Economics Research Paper.
[193] See generally ibid.

fearing the imposition of sanctions in the event of non-compliance. An example of mandatory rules is the requirement to establish an audit committee within listed companies, which is a mandatory requirement for listed companies in Saudi Arabia, the UK, and the US.[194]

On the other hand, default rules provide a company's actors with ready-made rules that address many matters related to governance in the manner which such actors would have negotiated effortlessly had they been given the opportunity to do so, and had both parties had roughly the same level of information. Default rules mitigate some of the risks associated with one party, usually shareholders, having lower bargaining power as a result of having less access to information.[195] Put another way, because default rules should apply unless parties agree otherwise, when parties negotiate alternative terms then the superior party would then be encouraged to reveal any relevant information so that the weaker party could be better informed.[196] One of the examples of default rule found in all three jurisdictions is the rule regarding the board's power which provides that unless agreed otherwise, the board should have the widest power to manage the affairs of the company.[197]

Next, enabling rules could be described as those which are prescribed by the law without being self-functional unless adopted by the company's parties. The legal effect of such rules is only granted once parties choose to apply them. Examples include Article 86 (3) of the CL 2015, which stipulates that shareholders may use electronic means to convene general assemblies. This rule is neither mandatory nor default if none of the company's actors chooses to apply it to make it functional. Should any of them wish to do so then the rule enables them to convene the assembly using electronic means, and the legal outcome that the given law specifies for violating this rule then becomes applicable.

Now that the different corporate rule types have been discussed, it is possible to explore the most common regulatory approaches to corporate governance, most of which are the result of different utilisations of the abovementioned rule types.

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[194] For Saudi Arabia, see Article 101 of the Companies Law 2015; For the UK see generally from Rule 7.1.1 to Rule 7.1.7 of the Disclosure Guidance and Transparency Rules Sourcebook; For the US see Section 303A.06 of the New York Stock Exchange Listed Company Manual.

[195] John Armour, Henry Hansmann and Reinier Kraakman, 'The Essential Elements of Corporate Law' (2009) Working Paper Series in Law, European Corporate Governance Institute, 21 < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1436551> accessed 5 March 2019.

[196] Hansmann and Kraakman (n 192) 18.

[197] Article 75 (1) of the Companies Law 2015; Article 3 of Schedule 3 of the Companies (Model Articles) Regulations 2008; Section 141 (a) of the Delaware General Corporation Law.

3.2.1 Voluntary approach

A voluntary framework is one that regulates corporate governance primarily through reliance on principles and recommendations to manage the internal affairs of companies.[198] There are different forms of voluntary approaches and although each functions slightly differently from the others, they are similar in that compliance is voluntary in the sense that companies should follow the prescribed rules, and if they do not then they need to provide sufficient justifications for non-compliance.[199] The most common voluntary form is the *Comply or Explain* approach, which is the basis for the UK's corporate governance framework. However, other voluntary forms have emerged in recent years - most notably *Apply or Explain, Apply and Explain,* and *If not Why not?.* The following paragraphs will briefly provide an overview of these forms and their main considerations.

3.2.1.1 Comply or Explain approach

Comply or Explain can be defined as a method of regulation in which regulators prescribe high level principles and detailed provisions that are deemed to be appropriate for companies most of the time.[200] The regulator expects companies to assess their needs and ideally observe the principles and comply with those provisions, unless a company decides that a given recommendation is unsuitable due to the company's circumstances,[201] in which case it is permitted to deviate from it and follow a path which it deems suitable, provided that it adequately explains to its shareholders its justifications for non-compliance.[202] The company's disclosure statement regarding its compliance with the recommendations along with adequate justifications are required to be published in the company's annual report.[203] Then, it is up to shareholders to assess the company's governance choices and determine whether they are well-grounded. If shareholders disagree, they can choose to escalate the matter further and take action accordingly.[204] Therefore, disclosure is a central part of this

[198] Wymeersch (n 28) 114.
[199] ibid.
[200] See Pages 1-2 of the Corporate Governance Code 2018; See Section 2 titled 'What is Comply or Explain?' David Seidl, Paul Sanderson and John Roberts, 'Applying" Comply-or-Explain": Conformance with Codes of Corporate Governance in the UK and Germany'.
[201] See Section 2 entitled 'What is Comply or Explain?' Seidl, Sanderson and Roberts (n 200).
[202] Wymeersch (n 28) 114; Mallin (n 13).
[203] Sridhar Arcot and Valentina Bruno, 'One Size Does Not Fit All, After All: Evidence from Corporate Governance' (2007) 1; Pages 1-2 of the Corporate Governance Code 2018.
[204] Wymeersch (n 28) 121.

approach, as it is the means through which the regulatory objectives are achieved.[205] In other words, the "compliance" part is voluntary, but the "explanation" part is mandatory.[206] The importance of this approach is evident in the fact that the OECD endorses it within its principles,[207] and in that the majority of countries, including all EU member states, have adopted it as the basis for their corporate governance frameworks.[208]

The concept of C*omply or Explain* was pioneered by the UK in the 1990s as a response to the failures witnessed in the UK's corporate governance landscape at the time (e.g., Maxwell Communication, Polly Peck, and BCCI), and since then this approach has continued to underpin its corporate governance code.[209] It was believed that dealing with companies' failures of corporate governance would be meaningful if the approach to doing so emphasised the importance of giving companies sufficient flexibility to draw up their own governance standards in accordance with their needs.[210] The idea is that the cost of complying with the code should not be higher than the intended benefits, and that the desired flexibility might disappear if a mandatory framework was adopted.[211] The promise of the C*omply or Explain* approach is that it can ensure high governance standards while keeping the cost of compliance at a minimum.[212] In fact, some empirical research suggests that the performance of companies which opted not to comply with some of the provisions of the UK's code due to their specific needs was strong as compared to others which were considered to be fully adhering with the code's provisions.[213] This may indicate that a flexible approach - when implemented properly - may play a role in companies achieving success. This approach is praised for the freedom and flexibility it grants to the board in choosing the best corporate governance structure to suit its own circumstances.[214] It is also hailed for its encouragement of adopting a self-evaluation approach towards governance

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[205] The role of disclosure in the monitoring and enforcement of the rules of a given framework is discussed further in Section 3.4.2.1.2 of this thesis.
[206] Iain MacNeil and Xiao Li, '"Comply or Explain": Market Discipline and Non-compliance with the Combined Code' (2006) 14 Corporate Governance: An International Review 486, 486.
[207] OECD, *OECD Corporate Governance Factbook* (n 6) 15.
[208] ibid.
[209] Arcot and Bruno (n 203) 1.
[210] Cadbury (n 4) para 1.1 and 1.10.
[211] ibid 1.10.
[212] Financial Reporting Council (n 64) 3.
[213] Arcot and Bruno (n 203) 1.
[214] Andrew Keay, 'Comply or Explain in Corporate Governance Codes: In Need of Greater Regulatory Oversight?' (2014) 34 Legal Studies 279, 280.

obligations, as opposed to the box-ticking approach that is thought to be an effect of a mandatory framework.[215]

It is generally assumed that a voluntary approach encourages better and more sustainable corporate governance practices, thus facilitating investors' engagement in corporate governance decisions and enabling them to influence companies' behaviours either by taking actions internally or redirecting their investments to other better-governed companies.[216] Therefore, such an approach will only serve its purpose if market forces (particularly investors) take a prominent role in the monitoring and enforcement processes, and pay great attention to companies' behaviours and disclosures. This assumption is critical to the effectiveness and survival of the voluntary approach given that, as will be discussed below, in the absence of monitoring and enforcement by market forces, a voluntary approach would be likely to fail to prevent corporate crises, especially as judging from the past this absence was, among other reasons, behind the global financial crisis.[217]

The popularity of the *Comply or Explain* approach across jurisdictions is driven by several assumptions. Most of those assumptions build on the idea that capital markets can achieve effective corporate governance without regulatory interference[218] and that companies have sufficient self-motivation to follow good corporate governance practices as a way of increasing their attractiveness to potential investors and to generate rewarding returns through adopting appropriate governance principles,[219] negating the need for regulatory intervention in the form of mandatory rules that may turn out to be counterproductive.[220]

Furthermore, among the prominent assumptions presented by advocates of the *Comply or Explain* approach is that companies and shareholders are in a much better position than a regulator to determine which corporate governance arrangements best suit their individual needs.[221] The idea here is that shareholders are the ones affected by the board's choices in regard to governance, and they are the beneficiaries of those choices, so they should be the ones responsible for monitoring and enforcing the governance standards they deem

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[215] Sridhar Arcot, Valentina Bruno and Antoine Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) 30 International Review of Law and Economics 193, 1.
[216] Ruth Jebe, 'Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure' (2014) 23 Cardozo J. Int'l & Comp. L. 233, 275.
[217] ibid.
[218] See generally Anita Indira Anand, 'An Analysis of Enabling vs. Mandatory Corporate Governance Structures Post-Sarbanes-Oxley' (2006) 31 Del. J. Corp. L. 229.
[219] ibid 230–237.
[220] ibid 233–235.
[221] Keay (n 214) 279.

appropriate.[222] On the other hand, a board should be vested with the power to determine whatever governance arrangements are appropriate for the company and should then be held accountable to shareholders on its choices. In this regard, the *Comply or Explain* approach is similar to corporate law's utilisation of default rules in that legislators prescribe what they deem to be optimal and provide parties with the option to follow other paths and be responsible for their own choices and enforcement thereafter. The framework's duty is thus to guide companies towards optimal corporate governance practices while at the same time facilitating the role of shareholders in the monitoring and enforcement processes through *inter alia* obliging companies to make appropriate disclosures. Consequently, unless companies' disclosures violate the disclosure requirements, it is the shareholders' task to assess the company's governance and justifications.

Among the other assumptions associated with the *Comply or Explain* approach is that it is adaptable by companies regardless of their various circumstances, which corresponds with the idea that "one size does not fit all".[223] To clarify this point further, companies typically differ in many respects such as their ownership structure, size, the industry sector(s) in which they operate, and the complexity of their operations.[224] Such differences imply that the appropriate form of governance will vary from one company to another depending on the circumstances of each. It is therefore inappropriate for the corporate governance framework to oblige all companies to follow the same governance practices without regard to their differences.[225] With that in mind, a *Comply or Explain* approach is presumed to be advantageous as it provides this sought-after flexibility that is, arguably, of paramount importance for companies' prosperity.[226]

Furthermore, a *Comply or Explain* approach is arguably cost effective from a regulator's perspective,[227] as a framework based on mandatory rules implies that regulator intervention is constantly required, putting pressure on the regulator to monitor the governance of every single company, evaluate their compliance, and assess their conduct to determine if a given rule has been violated.[228] The amount of time required in addition to financial and human

[222] Financial Reporting Council (n 64) 3.
[223] Cadbury (n 4) para 1.10.
[224] Page 1 of the Corporate Governance Code 2018; Cadbury (n 4) para 1.10.
[225] Mallin (n 13) 36.
[226] Cadbury (n 4) para 1.10; Mallin (n 13) 36.
[227] Ian Bartle and Peter Vass, 'Self-Regulation and the Regulatory State' 2.
[228] Keay (n 214) 300.

resources constraints make it difficult for regulators to fulfil such functions.[229] Therefore, it can be said that under a voluntary framework which operates on a *Comply or Explain* basis, the expected roles of shareholders and market forces in monitoring and enforcement are more far-reaching than what is expected from the regulator.[230] Similarly, given that the level of prescription regarding how companies should fulfil their duties is relatively low,[231] this approach places a lower regulatory burden on businesses[232] and reduces the compliance cost as they do not have to automatically abide by a long list of generic mandatory provisions.

Advocates of a *Comply or Explain* approach further opine that the approach can positively affect corporate performance; indeed, one empirical study found that companies that did not comply with some of the UK's corporate governance code for genuine reasons (as could be judged based on their corporate governance statements) outperformed other companies, including those in full compliance with the code.[233] The study's authors proposed that a possible reason for this positive performance was that those companies which deviated from the code's recommendations made efforts to explain in a detailed and informative manner why they had chosen to deviate from the given provision and why they believed that the non-compliance was in the best interests of the company.[234] The implication is therefore that it is likely that companies which provide well-grounded justifications for non-compliance will be governed well, while companies that fully comply with the code or deviate without providing informative and genuine reasons for compliance and non-compliance may not. The former, judged by their well-grounded reasons, are more likely to have been carefully making rational decisions in respect of how their companies operate, all of which explain how they outperform their peers.[235]

Another presumed advantage of a *Comply or Explain* approach is that since it permits companies to draw up their own governance structures as they deem appropriate, this flexibility encourages companies to engage in a healthy competition to adopt good

[229] ibid; Ana Carvajal and Jennifer A Elliott, *The Challenge of Enforcement in Securities Markets: Mission Impossible?* (International Monetary Fund 2009) 18.
[230] The challenges facing public enforcement are discussed in detail in Section 3.4.1 of this thesis.
[231] Financial Reporting Council (n 64) 3.
[232] Bartle and Vass (n 227) 2.
[233] Arcot and Bruno (n 203) 3, 25.
[234] ibid 9.
[235] ibid.

governance that is attractive to potential investors.[236] An example is Brazil, in which Novo Mercado, a new segment market of the Sao Paulo Stock Exchange, was established in 2000 to allow companies to follow corporate governance standards higher than those required by law.[237]

3.2.1.2 Other forms of voluntary approach

Among other forms of voluntary approach is the *Apply or Explain* approach which could be viewed as a slightly improved version of *Comply or Explain.* The usage of the term *Apply* instead of *Comply* is arguably more appropriate as it aligns with the regulatory expectations, considering that a company which chooses to deviate from a recommended standard and provides adequate justification for doing so is still compliant.[238] Moreover, this approach slightly differs from *Comply or Explain* in the level of expectations it imposes on companies when dealing with the principles and provisions of corporate governance codes.[239] While the *Comply or Explain* approach is understood to grant companies the freedom to formulate their own governance structure, whether by complying with the code or by drawing up their own structure provided they make relevant disclosure, the *Apply or Explain* approach assumes that all governance recommendations in the code are appropriate in essence for all types of companies, and that applying them is expected to be the norm.[240] However, if after careful consideration a company believes that any of these recommendations are unsuitable, it can follow other alternatives, but only if it provides sufficient explanation to the shareholders.[241] It is then the shareholders' responsibility to assess the given justifications and determine if the non-application is acceptable. The emphasis on *Apply* as opposed to *Comply* is considered necessary because many companies are not as thoughtful as might be expected in their governance choices, and many comply only with what they view to be the lowest cost option, without consideration of the company's real needs or the ultimate outcomes of their governance practices.[242] In other words, when utilising an *Apply or Explain* approach the presumption

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[236] Anita Anand, Frank Milne and Lynnette D Purda, 'Voluntary Adoption of Corporate Governance Mechanisms' 26; Arcot and Bruno (n 203) 4.
[237] Maria Helena Santana and others, 'Novo Mercado and Its Followers: Case Studies in Corporate Governance Reform' (2008) 1.
[238] Antoine Faure-Grimaud, Sridhar Arcot and Valentina G Bruno, 'Corporate Governance in the UK: Is the Comply-or-Explain Approach Working?' (2010) 30 International Review of Law and Economics 193, 19.
[239] Mallin (n 13) 58.
[240] Jebe (n 216) 275.
[241] ibid.
[242] Mallin (n 13) 59.

is that the “apply” part will be stronger than the “explain” part, leading companies to adopt more of the recommended standards rather than blindly deviating and providing perfunctory justifications. Therefore, it could be argued that because *Apply or Explain* sets defined expectations, the extra value it brings as compared to a *Comply or Explain* approach is that it shifts boards’ focus from cherry-picking which standards to comply with to how the standard or an alternative could be applied to ultimately produce better outcomes. Given that *Apply or Explain* is to a great extent an improved version of the *Comply or Explain* approach, the previously discussed assumptions and challenges of a *Comply or Explain* approach are largely similar to those of *Apply or Explain*, as both build on the ideas that companies should have liberty in drawing up their own governance structure, that they should justify deviations, and that market forces should take the greater role in monitoring and (where necessary) sanctioning the board.

Apply and Explain is another approach followed in the context of corporate governance. This approach is the basis for the corporate governance code in South Africa,[243] and forms the basis for the SC 2020 in the UK.[244] The basic idea behind this approach is that companies are required to apply the principles prescribed under the given code, explain how they did so, and disclose how their application of governance practices contributes towards achieving ultimate governance objectives. The difference between this approach and the *Apply or Explain* approach is that the former assumes that the provided provisions will be applied regardless of individual corporate circumstances, whereas the latter allows for deviation from the provisions should the company decide that deviation is more appropriate, and an explanation is disclosed.[245] The utilisation of *Apply and Explain* builds on the idea that the prescribed provisions are believed to be of a fundamental and critical importance that companies, regardless of their circumstances, should all be expected to apply.[246]

Lastly, the *If not Why not?* approach is the basis for the corporate governance code in Australia.[247] Under this approach, companies are required to disclose their governance choices rather than to comply with the practices specified by the regulator.[248] Therefore, it

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[243] See generally King Committee on Corporate Governance and Mervyn E King, *King IV Report on Corporate Governance for South Africa 2016* (Institute of Directors in Southern Africa 2016).
[244] See generally the Stewardship Code 2020.
[245] Jebe (n 216) 275.
[246] Page 4 of the Stewardship Code 2020.
[247] See generally the ASX Corporate governance principles and recommendations 2019.
[248] ibid 2–3.

could be said that the focus of such an approach is on the disclosures of companies regarding their governance practices, their reasons for following such practices, identification of the code's recommendations that have not been implemented, and the reasons for non-implementation. As part of the required disclosure, companies should demonstrate how the alternative practices they chose to pursue are in line with the spirit of the code so that shareholders can be satisfied that the company made a sensible decision in choosing an alternative path.[249]

3.2.2 Mandatory approach

The second common approach in regulating corporate governance is the mandatory approach. It regulates corporate governance through reliance on binding rules that explicitly recognise the power of the given regulator in mandatorily compelling companies to comply with the framework, and attaches legal consequences for non-compliance.[250] It is mandatory in the sense that companies have no option but to abide by the framework's rules unless otherwise stated.[251] This approach is adopted in several countries around the world, including the US, China, India, Turkey, and Saudi Arabia.[252] This approach is the classical method typically pursued by governments to regulate activities and achieve regulatory objectives where they prescribe sets of rules, describe the relevant procedures which must be followed, and specify the sanctions which will be imposed in the event of non-compliance.[253] Therefore, it is fair to assume that companies in complying with the mandatory framework's rules are normally driven by fear of those sanctions. A significant example employing a mandatory approach is the US where, as will be further detailed below,[254] the majority of aspects of corporate governance, such as those concerning the structure of the board and composition of its committees are all mandatory in nature.[255] It is worthwhile noting that while mandatory rules are mostly found forming part of a mandatory framework, they also can be found in a voluntary framework. An example of the latter is the UK, where although the framework is largely of a voluntary nature, a few

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[249] Ray da Silva Rosa, Dane Etheridge and HY Izan, 'One Size Does Not Fit All: Small Companies and ASX Corporate Governance Compliance' (2007) 5 Corporate Ownership & Control 66; See generally the ASX Corporate governance principles and recommendations.
[250] Wymeersch (n 28) 114.
[251] The enforcement of the mandatory approach is further discussed in Section 3.4.1 of this thesis.
[252] OECD, *OECD Corporate Governance Factbook* (n 6) 22, 23.
[253] Darren Sinclair, 'Self-regulation versus Command and Control? Beyond False Dichotomies' (1997) 19 Law & Policy 529, 534.
[254] Delaware's position towards various aspects of corporate governance are discussed below in the present chapter and also in Chapters 4 and 5.
[255] See generally the New York Stock Exchange Listed Company Manual.

aspects are mandatorily regulated such as the presence of an audit committee[256] and rules regarding related party transactions.[257]

The survival, and in fact the increasing adoption of the mandatory approach can be attributed to several factors. From a capital market prosperity perspective, it is believed that a mandatory framework has a positive impact on capital market prosperity and investor protection, and that capital markets cannot flourish if they entirely rely on market forces.[258] In this regard, the mandatory approach is advantageous in that it enables the regulator to set minimum governance standards that companies must abide by, which helps the regulator in achieving its regulatory objectives, guides companies towards proper corporate governance practices, and enhances shareholders' protection. The role played by governments in the enforcement process can contribute towards the development of these markets and the enhancement of their integrity, both of which increase the appeal of the markets in question for existing and prospective investors.[259] The assumption is that this advantage is not strongly present in a voluntary framework where companies are free to adopt any governance practice they deem appropriate, and the daunting monitoring and enforcement tasks are delegated mostly to market forces.

In addition, from a compliance perspective, the fact that a mandatory framework is backed by the regulator enhances the enforceability of its rules in the event of non-compliance, in turn significantly increasing the compliance rate. This is because in a mandatory approach the regulator is equipped with monitoring and sanctioning powers that are typically missing in a voluntary approach. Consequently, the level of compliance with the framework's rules, especially when the penalties are harsh, is often much higher than in a voluntary framework. This high compliance rate leads over time to a high degree of consistency in the application of the framework's rules, further demonstrating how advantageous the mandatory approach is.[260]

Moreover, the regulator's power to enforce compliance is advantageous in that it compensates for a lack of shareholder activism and interest in monitoring and enforcement.

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[256] See generally from Rule 7.1.1 to Rule 7.1.7 of the Disclosure Guidance and Transparency Rules Sourcebook.
[257] From Rule 7.3.1 to Rule 7.3.13 of ibid; Rule 11.1.7 of the UK Listing Rules.
[258] Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'What Works in Securities Laws?' (2006) 61 The Journal of Finance 1, 27–28.
[259] ibid.
[260] Sinclair (n 253) 534.

As a result, investors' confidence in the integrity of a given market is likely to significantly improve when the regulator takes part in the monitoring and enforcement process and exercises its powers sensibly. The need for the regulator to engage in the monitoring and enforcement process is advocated by the OECD which encourages jurisdictions to equip regulators with effective enforcement mechanisms and sanctioning powers.[261]

Furthermore, the mandatory approach is advantageous as it reduces the cost associated with the need for investors to evaluate the appropriateness of a company's governance practices in order to become informed investors.[262] This is of particular importance given that many investors are unsophisticated and are not as informed as expected; thus, mandatory rules serve to standardise conduct, in turn contributing towards protecting investors against the risks associated with disclosures and information such as the risk of misleading disclosures.[263] In other words, in a voluntary framework shareholders are expected to separately evaluate the governance practices of each company and assess the suitability of those practices to the particular circumstances of the given company. In contrast, in a framework based on mandatory rules, shareholders do not have to bear the same costs and burden. To illustrate, investors do not need to incur the cost of comparing the practices of company (A) against the practices of company (B) to determine which are more appropriate. That being the case, the mere non-compliance of a company with any mandatory rule would raise a red flag from an investor's perspective, prompting him to take actions. This kind of cost is typically incurred under a voluntary framework, as investors are expected to evaluate the practices of each company individually given that companies have the freedom to draw their own unique governance practices. This, in turn, makes the process of assessing such individual practices costlier and more difficult as companies' governance practices are not necessarily comparable.[264]

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[261] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 15.
[262] Anita I Anand, 'Voluntary vs Mandatory Corporate Governance: Towards an Optimal Regulatory Framework' (bepress 2005) 11.
[263] Jeffrey N Gordon, 'Mandatory Structure of Corporate Law, The' (1989) 89 Colum. L. Rev. 1549, 1556–1557.
[264] See generally Anand (n 262); The process of all investors adopting the same approach towards the assessment of companies' practices is termed the 'Network effect'. For more on this topic see Marcel Kahan and Michael Klausner, 'Standardization and Innovation in Corporate Contracting (or" The Economics of Boilerplate")' (1997) Virginia Law Review 713.

3.2.3 Legal position of the jurisdictions

Now that the main concepts and prominent regulatory approaches relevant to corporate governance have been discussed, it is possible to compare and evaluate the regulatory mode of the relevant frameworks in Saudi Arabia, the UK, and Delaware. On the regulatory mode of the framework in the three jurisdictions, it can be said that both Saudi Arabia and Delaware operate a mandatory framework where full compliance is required and non-compliance may trigger legal consequences. This position is strikingly different to that of the UK which operates a voluntary framework on a *Comply or Explain* basis, where non-compliance is permitted provided sufficient justifications are disclosed.[265]

To elaborate, and beginning with Saudi Arabia, the corporate governance framework is based on legislative instruments and regulations that are mandatory in nature.[266] Companies listed on the Saudi Main Market must adhere to the mandatory provisions of the framework or suffer the legal consequences.[267] Although most of this framework's provisions are binding, a few allow voluntary compliance[268] provided that the given company discloses such non-compliance and explains its reasons.[269]

The Saudi framework makes it clear that its provisions are binding and that legal consequences will follow in the event of non-compliance. Article 213 of the CL 2015 provides for a monetary sanction of an amount not exceeding 500,000 SAR for several violations of the law, such as the obstruction of the general assemblies, preventing shareholders from exercising their voting rights, and non-compliance with the laws and regulations that regulate listed companies. This article, especially the part related to non-compliance with the laws and regulations, demonstrates the mandatory nature of the framework.

Moreover, Article 211 of the CL 2015 specifies the criminal offenses for which wrongdoers can be punished by a fine not exceeding 5,000,000 SAR and imprisonment not exceeding five years. The offenses include knowingly exercising the power or voting right

[265] Page 1 of the Corporate Governance Code 2018. It is worthwhile noting that the three jurisdictions recognise the idea that corporate governance rules apply to a specific class of listed companies as is illustrated in this section.
[266] OECD, *OECD Corporate Governance Factbook* (n 6) 23.
[267] Article 2 (B) of the Corporate Governance Regulations 2017.
[268] Article 2 (B) of ibid.
[269] Article 90 (1) of ibid.

enjoyed by any director or manager in a way that is against the interests of the company and for personal gain. Furthermore, Article 2 (B) of the CGRs 2017 explicitly clarifies the mandatory nature of the provisions of the CGRs 2017 confirming that listed companies have no choice but to comply with them, except for the (very few) voluntary provisions.

Turning to the UK, a review of its framework indicates that it is voluntary in nature, with no serious legal consequences for non-compliance.[270] The UK Code operates on two levels, *Apply and Explain* in relation to the code's principles, and *Comply or Explain* in relation to its provisions. What this means is that companies should apply the principles of the code, and comply with its provisions.[271] However, if it deviates from any of the code's provisions then it should explain the rationale behind the deviation to its shareholders. The explanation provided should be sufficient to enable the shareholders to assess the extent to which the company has complied with the code, and whether that deviation is suitable in light of the company's needs.[272] It is worthwhile noting that the Code applies to all companies with a premium listing in the LSE regardless of where they are incorporated.[273]

Recognition of the voluntary nature of the UK's framework is evident in several places in the various regulatory sources. For example, the preamble of the CGC 2018 notes that the code is voluntary in nature and that its rules should not be seen as a set of mandatory rules that must be applied, but rather as a set of principles and recommendations that are to be evaluated in accordance with the circumstances of each company.[274] Furthermore, the UK Listing Rules stipulate that a listed company must provide a statement explaining how the main principles of the code have been applied, whether the company is in compliance with the code's provisions, and if not, the reasons for non-compliance.[275] Similar rules are set out in the DTRs which requires the issuer to include in its board report a similar statement.[276]

Unlike the UK and similar to Saudi Arabia, the framework in Delaware is based on laws and regulations which operate on a mandatory basis. The mandatory nature of Delaware's framework is evident in the fact that many aspects of its corporate governance are

[270] Page 1 of the Corporate Governance Code 2018.
[271] Pages 1-3 of ibid.
[272] Page 2 of ibid.
[273] Page 3 of ibid.
[274] Pages 1-3 of ibid.
[275] Rule 9.8.6 (5, 6) of the UK Listing Rules.
[276] Rule 7.2.1, Rule 7.2.2 and Rule 7.2.3 of the Disclosure Guidance and Transparency Rules Sourcebook.

statutorily regulated either in the GCLSD or in the relevant federal laws that stipulate the relevant rules, and further specify the relevant sanctions to impose in the event of violations.[277] The NYSE's corporate governance standards apply in full to all companies listing common equity securities, with certain exceptions as provided under the rules. Different types of enforcement actions and sanctions can be imposed depending on which regulatory source has been violated. The SEC is responsible for enforcing rules that are found in the above-mentioned federal laws and regulations issued thereunder,[278] while the exchange in question, for example the NYSE, is responsible for enforcing its own rules.[279] Given that many corporate governance rules are found in federal laws and regulations, the violators of such rules could be subject to sanctions that include fines, imprisonment, and prohibition from serving as a director or officer.[280]

3.2.4 Assessment of the regulatory mode of the Saudi framework

Now that the regulatory mode of the Saudi framework has been established in comparison to its counterparts in the UK and Delaware, the question to be addressed is whether the current Saudi mandatory regime is appropriate for the national context, taking into account the previously discussed considerations regarding the advantages and challenges of both mandatory and voluntary approaches. This question will be addressed throughout the thesis, with a particular focus in Chapters 4 and 5, but in this chapter there now follows a discussion of this aspect with the aim of summarizing the high level views on the suitability of the mandatory approach in comparison to the voluntary one in principle, thus paving the way for the detailed critical analysis that will follow in Chapters 4 and 5. In those later chapters, a substantive critical discussion of the prominent corporate governance arrangements as provided under the framework (i.e., the rules concerning the structure and operations of the board along with those concerning shareholders' role and representation) will be presented so that an informed evaluation of how suitable the mandatory approach is will be made.

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[277] Section 21 of the Securities Exchange Act of 1934; Section 303A.13 of the New York Stock Exchange Listed Company Manual provides that a public reprimand will be issued to any listed company that violates the prescribed governance standards. The Manual also provides that the NYSE will deploy other severe sanctions to deter non-compliance with the standards such as suspension of trading and delisting the company in certain conditions as stated under the Manual.

[278] Section 21 of the Securities Exchange Act of 1934.

[279] Section 303A.13 of the New York Stock Exchange Listed Company Manual.

[280] See Section 21 of the Securities Exchange Act of 1934; Sections 807 and 1105 of the Sarbanes-Oxley Act of 2002.

Returning to the question posed above concerning the differences between the voluntary and mandatory approaches, it should be reiterated that both approaches carry their own benefits and drawbacks, and both deal with some corporate governance issues better than others depending on the issue at stake, suggesting that one regulatory approach may not necessarily be appropriate to transfer across jurisdictions, and that a thorough consideration of the distinct characteristics of a given country is crucial before deciding which approach to implement. Among those considerations are the various internal and external factors within which each corporate governance framework operates, such as the legal system, the market infrastructure, the ownership structure, the level of shareholder activism, the market for corporate control, market discipline, cultural influences, and several other factors.

Starting with the voluntary approach, while this approach is associated with several positive assumptions which have driven its popularity across prominent jurisdictions including the UK and European countries, there are several challenges to the assumption that the voluntary approach presents an optimal solution for corporate governance issues. These challenges not only hinder the feasibility of applying the approach in a jurisdiction like Saudi Arabia where the legal infrastructure and market characteristics differ significantly from those of the UK and the EU, but also cast doubts on its effectiveness even in the UK where it was born and in European countries where capital markets are in a better position to implement a voluntary approach. Those unresolved challenges may explain why some countries which primarily rely on a voluntary approach have started to gradually introduce some mandatory provisions which companies must comply with.[281]

Among the prominent challenges facing the voluntary approach is that because compliance is largely based on self-disclosure by companies, the quality of corporate disclosure is concerning to the extent that a question arises as to whether the regulatory objectives behind the approach can be properly achieved. In this regard, the European Commission notes that disclosures made and justifications provided by companies regarding non-compliance with the corporate governance codes in European countries are in most cases inadequate and unsatisfactory, especially that the code itself is insufficiently monitored.[282] These issues also apply to the UK, where it has been reported that identical justifications

[281] The OECD has observed that due to the evolving activities and behaviours of companies and investors, the balance between a Comply or Explain approach and formal regulations is changing. It cites Turkey as an example, where several provisions of the Corporate Governance Principles have adopted a more mandatory nature for large listed companies. OECD, *OECD Corporate Governance Factbook* (n 6) 15.
[282] EC–European Commission, 'Green Paper on the EU Corporate Governance Framework' (2011) European Commission Communication 3.

have been used repeatedly by many companies over recent years in ways that do not show that the companies involved had thought carefully about their governance choices and the disclosures and justifications presented.[283] While this reality could largely be attributed to the lack of interest of companies in governance codes, it could also be viewed as a natural and predictable outcome of the voluntary approach which builds on self-disclosure as the primary tool for enforcement. In other words, the self-disclosure element of this approach places a significant burden on companies which causes excessive disclosure pressure and pushes companies over time to fulfill their disclosure obligations in a perfunctory manner that lacks authenticity.

The inadequate disclosure is further complicated by another challenge associated with the voluntary approach, which is the high level of subjectivity involved in complying with the code.[284] This means that given the lack of guidelines as to what constitutes a satisfactory compliance and a sufficient justification, boards are free to comply with the provisions they want, and ignore the provisions they do not. While this should not be a problem in itself - provided that the unique needs of the company in question necessitate such non-compliance, and adequate justifications are presented for shareholders to evaluate - there is evidence that companies are not complying in the way they should, and that many instances of non-compliance occur without sufficient justifications; indeed, many lack any justifications at all.[285] Even when companies provide justifications, sometimes they do not make clear the rationale behind the non-compliance in an informative way that will enable shareholders to make sense of how corporate governance in their companies is approached[286] and to take action accordingly.

Another challenge that limits the effectiveness of the voluntary approach in achieving its objectives is that shareholders, the group which the voluntary framework relies upon to monitor compliance and sanction non-compliers, do not seem to be as involved and incentivised to do so as might have been expected.[287] In fact, a relevant empirical study analysing the justifications provided by companies with a recognised history of non-compliance with the UK corporate governance code and the role of market discipline in

[283] Moore, 'The End of Comply or Explain in UK Corporate Governance Special Issue on Corporate Governance' (n 62) 101.
[284] Keay (n 214) 291.
[285] ibid; For more on 'boilerplate statements' see Marc T Moore, '"Whispering Sweet Nothings": The Limitations of Informal Conformance in UK Corporate Governance' (2009) 9 Journal of Corporate Law Studies 95.
[286] Keay (n 214) 291.
[287] Arcot and Bruno (n 203) 4.

allowing such non-compliance found that shareholders are mostly driven by share price in determining their attitudes towards a company's governance practices.[288] The study's authors suggest that when shareholders (regardless of whether they are institutional or not) assess the company's governance structure and the justifications provided for non-compliance, they will be more likely to accept the justifications if the company's financial performance is good.[289] On the other hand, they are likely to challenge the company's justifications if the performance is bad.[290] Interestingly, even when shareholders assume such tasks, it is believed that the effectiveness of the voluntary framework could be limited in companies where large shareholders are prevalent and are taking over the board. In such cases, minority shareholders' rights might be affected, and their efforts to monitor compliance with the code and influence the company's governance choices could be undermined by larger shareholders who are typically in a better position to influence the board and secure their own interests.[291]

The extent of this issue is further extended by the lack of external enforcement mechanisms that compensate for the modest internal enforcement mechanism. In this regard, many companies in countries adopting a voluntary approach violate corporate governance provisions on a large scale without being subject to any punitive measures, which is arguably an outcome of not establishing clear and effective enforcement mechanisms to back up the voluntary framework.[292] Thus, the absence of external mechanisms to support the enforcement of a soft approach and the lack of sanctions for non-compliers may cause the voluntary approach to fail to fulfil its objectives.[293]

These concerns, especially that of shareholders' low participation, are worrying as the survival of any framework depends greatly on the level and quality of monitoring and enforcement, and if the role of shareholders is modest, then the premise of the voluntary approach in effectively regulating corporate governance can be called into question. As will be further discussed below,[294] several factors influence shareholders' willingness to participate in monitoring and enforcement processes that go beyond corporate

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[288] MacNeil and Li (n 206) 490.
[289] ibid 492.
[290] ibid.
[291] EC–European Commission (n 282) 16.
[292] Tshepo Mongalo, 'Self-Regulation versus Statutory Codification: Should the New Regime of Corporate Governance Be Accorded Statutory Backing' (2004) 67 Tydskrif vir Hedendaagse Romeins-Hollandse Reg (Journal for Contemporary Roman-Dutch Law), 264, 276.
[293] Keay (n 214) 301.
[294] Market discipline is discussed in detail in Section 3.4.2 of this thesis.

performance. Such factors include the free rider problem, information asymmetry, principal-principal conflict, the cost of monitoring and enforcement, lack of incentives, and excessive reporting.

Interestingly, even some of the other arguments put forward by advocates of the voluntary approach that were mentioned above in highlighting the positive impact of the approach on corporate performance and the relationship between its flexibility and companies' prosperity should not go unchallenged. Importantly, the extent of the causal relationship between the flexibility in designing a governance structure and the financial performance of a company is uncertain. In this regard, several studies have noted that while there is a strong correlation between companies adhering to governance standards and financial performance, they could not confirm a clear causal relationship between adhering to the code and high performance.[295] The suggestion is that in the absence of strong evidence that directly links compliance with the code to better performance, the correlation between compliance with governance standards and stock returns could be attributed to the influence of unobservable corporate characteristics.[296] As to the latter argument which basically views flexibility as a virtue of the voluntary approach, the relevance of flexibility in the context of corporate governance can be questioned given that, as indicated earlier, a causal relationship between corporate governance and financial performance has not been clearly established.[297]

It is worthwhile highlighting that many of the challenges associated with the voluntary approach are acknowledged by the European Commission, which notes that improving the quality of disclosure related to non-compliance, investing monitoring bodies such as securities regulators and stock exchanges with more powers should enhance the functionality and effectiveness of this approach.[298] Therefore, if the quality of disclosure in countries applying a voluntary approach is unsatisfactory, compliance with the codes is largely perfunctory, and shareholders and market forces, upon which the framework relies on for monitoring and enforcement, are not as involved in such tasks as they were expected to be, then the virtues and premises of the voluntary approach in resolving corporate

[295] MacNeil and Li (n 206) 487; Elisabeth Dedman, 'The Cadbury Committee Recommendations on Corporate Governance–A Review of Compliance and Performance Impacts' (2002) 4 International Journal of Management Reviews 335, 345–349; Paul Gompers, Joy Ishii and Andrew Metrick, 'Corporate Governance and Equity Prices' (2003) 118 The Quarterly Journal of Economics 107, 144–145.
[296] Gompers, Ishii and Metrick (n 295) 144–145.
[297] MacNeil and Li (n 206) 486–487.
[298] EC–European Commission (n 282) 18–19.

governance issues are indeed questionable. Interestingly, if the reality of corporate governance is concerning in the UK where the voluntary approach was first pioneered and where many of the pillars upon which the approach was built already exist (i.e., fragmented ownership, the strong presence of institutional investors, the availability of a stewardship code, an active market for corporate control, and a free financial press), the question that should be posed: what would the reality be if Saudi Arabia, where these pillars are mostly still absent, adopted a voluntary approach? This question is among the primary questions that will be addressed throughout this thesis.

Notwithstanding the flaws pointed out above with the voluntary approach, the mandatory approach also faces several challenges and can be associated with several drawbacks that may limit its effectiveness in regulating the corporate governance issues. However, it is crucial to put these challenges into perspective so that their validity is properly weighted. This is particularly true given that the assumptions of the voluntary approach, as demonstrated above, do not appear to act in practice as they do in theory.

Shifting the focus of discussion now to the challenges of the mandatory approach, its opponents have put forward several arguments upon which they rely to defend the adoption of voluntary approach. To begin with, lack of flexibility in addressing corporate governance issues is typically argued to be a notable disadvantage of the mandatory approach.[299] Mandatory frameworks are criticized for following a general approach to regulation that does not differentiate between different sizes and types of companies, always adopting a *one-size-fits-all* approach.[300] The regulator specifies the ultimate governance outcomes that should be sought by companies and prescribes the means which companies must follow to achieve those outcomes.[301] Therefore, little, if any, room for manoeuvre is given to companies to draw up their governance practices in accordance with their specific needs. The importance of providing companies with flexibility in dealing with governance matters lies in the idea that companies are different in size, operations, and circumstances, and therefore an ideal framework should take such differences in mind. This is not believed to be possible with the mandatory approach, which normally requires compliance by all companies with the same set of rules.[302] The perceived inflexibility of the mandatory approach is arguably not only detrimental to companies, but is also

[299] Mongalo (n 292) 274.
[300] Anand (n 262) 16–17.
[301] ibid.
[302] Anand (n 218) 245; Mongalo (n 292) 274.

detrimental to the governance rules themselves. Furthermore, opponents of the mandatory approach argue that reliance on mandatory rules forces regulators to compromise when prescribing rules in the first place, in order for the rules to accommodate as many circumstances as possible. As a result, regulators may bring in rules which represent minimum standards, and which may not foster corporate governance best practices.[303] Put differently, under a mandatory framework the governance standards that companies are required to abide by might be lower than those companies may otherwise have adopted were they given the opportunity to draw up their own standards.

This view (that the mandatory approach should be disregarded due to its inflexibility) is the most prominent argument that advocates of voluntary approach use. While the validity of the argument at first glance seems undeniable, it is important to put it into perspective so that the extent of its validity can be assessed. In this regard, it is true that companies do indeed differ in terms of their size, operations, and circumstances; however it is not yet clear how relevant flexibility is for companies in real life, and whether such business differences imply that corporate governance arrangements should materially differ across companies. In other words, the extent to which the flexibility of the corporate governance framework is vital for companies to survive and thrive should be questioned, for several reasons.

Firstly, as was discussed and demonstrated earlier,[304] many companies are complying with the UK's voluntary code in a perfunctory manner, providing few if any justifications for doing so. This situation does not demonstrate that the code's flexibility was put to use in a way that reflects positively in such companies. Secondly, the mandatory framework is capable of manifesting flexibility in areas of corporate governance where flexibility is convincingly needed; thus, some positive effects associated with flexibility which are often linked with a voluntary framework could still be produced.[305] This absorption could occur via the mandatory framework's utilisation of default rules. As was discussed earlier,[306] such default rules prescribe the best governance principles, and unless a company agrees otherwise, it must adopt the governance standards as prescribed under the default rules.[307] The difference this utilisation makes, which is a remarkable one, is that if such default

[303] See generally John T Scholz, 'Voluntary Compliance and Regulatory Enforcement' (1984) Law & Policy 385; Mongalo (n 292) 275.
[304] See Section 3.2.4 of this thesis.
[305] MacNeil and Li (n 206) 486–493.
[306] See Section 3.2 of this thesis.
[307] MacNeil and Li (n 206) 486–493.

rules were part of corporate law, shareholders would be in a better position to enforce them in the event of a company's non-compliance.[308] This is in contrast to the shareholders' position when a company does not comply with a code's principles, as their ability to enforce these is much weaker.[309]

Turning to the argument that a mandatory approach brings governance standards to a minimum level which may force companies to apply governance standards that are lower than those they would have applied under a voluntary approach, it could be said that while this argument may hold some element of truth in theory, it is not true in practice. Firstly, as was discussed earlier,[310] despite the fact that the voluntary approach enables companies to draw up their own governance arrangements, many companies in the UK comply with the relevant code’s provisions as they stand without deviation, and use the same disclosure statements for year after year, demonstrating that their compliance is to a great extent perfunctory. Secondly, as will be ascertained in Chapters 4 and 5, generally speaking the content and substance of corporate governance rules in Saudi Arabia, the UK, and Delaware are largely similar, despite the fact that Saudi Arabia and Delaware, unlike the UK, follow a mandatory approach. This means that the fact that the regulatory mode of the framework differs across these jurisdictions is less relevant when it comes to the quality of rules provided under the given framework.

The mandatory approach is also arguably disadvantageous in that it negatively affects shareholder activism by discouraging shareholders from playing the role they should play in the monitoring and enforcement process. The presumption here is that shareholders are likely to be silent about their companies’ governance practices, instead waiting for regulators to intervene and take enforcement action, especially as there are costs associated with monitoring and enforcement which shareholders are reluctant to incur. This lack of activism is inconsistent with the role they are encouraged to play in the monitoring and enforcement of the framework’s rules.[311] It is also inconsistent with regulators’ limited capacity and resources,[312] as regulators supervise hundreds if not thousands of listed companies; thus, they would be unable to monitor and assess the appropriateness of the governance practices in every single company.[313] In this regard, while it is true that under a

[308] ibid 493.
[309] ibid.
[310] See Section 3.2.4 of this thesis.
[311] Keay (n 214).
[312] See Sections 3.2.4 and 3.4.1of this thesis.
[313] Keay (n 214) 299–300.

mandatory framework the public authority will have a significant role in the monitoring and enforcement process, and that shareholders in such a case will be less incentivised to intervene, this is not a disadvantage in itself - on the contrary, it is an advantage of the mandatory approach for at least two good reasons. First, as was stated above,[314] in reality it has been observed that shareholders do not engage in the monitoring and enforcement process as might have been expected, meaning that public enforcement compensates for modest shareholders' enforcement. Second, even when shareholders participate in the enforcement process, their participation can occur at the expense of other shareholders, especially in capital markets in which the ownership structure is concentrated, such as the Saudi market.[315] In such instances, larger shareholders can pursue enforcement for their own benefits without regard for their fellow minority shareholders, and may even undermine enforcement efforts pursued by minority shareholders. The level of shareholder activism can also be negatively affected by factors such as the free ride problem, information asymmetry, the cost of monitoring and enforcement, and excessive reporting, meaning that public monitoring and enforcement is still needed. This view is endorsed by the OECD, which calls for regulators to be equipped with enforcement mechanisms and sanctioning powers to ensure that the regulatory objectives of the given framework are achieved, and to strike a balance between public enforcement and market forces enforcement.[316]

Among other drawbacks of the mandatory framework as put forward by its opponents is that given that it is based on legislative instruments, the framework is not revised as frequently as it should be,[317] because legislation takes a long time to pass[318] and legislators have many items on their agenda; thus, corporate governance might not always be top priority.[319] The delay in revising such a framework is inconsistent with the recognised need for frequently developing corporate governance principles to keep pace with the best international practices.[320] Thus, while the need to frequently revise corporate governance rules is indisputable, in reality this is highly unlikely to happen with mandatory rules. This is because corporate governance rules do not necessarily exist in statutes, and while major

[314] See Section 3.2.4 of this thesis.
[315] This is known as the principal-principal conflict which is discussed in detail in Section 4.1.1 of this thesis.
[316] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 15.
[317] Mongalo (n 292) 274. Unlike some frameworks that are based on legislative instruments, the UK Corporate Governance Code has been revised many times since the inception of the Cadbury report in 1992. The most recent revision took place in 2018.
[318] For example the Saudi Companies Law of 1965 has been revised only once, in 2015.
[319] See generally Gordon (n 263); Mongalo (n 292) 274.
[320] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 13.

aspects of corporate governance are typically regulated in statutes even in countries where the voluntary approach is endorsed such as the UK, some jurisdictions such as Saudi Arabia and the US regulate many aspects of corporate governance either in the implementing regulations issued by the executive agency, as is the case in Saudi Arabia, or in the exchange listing rules, as is the case in the US. These regulatory sources are easier to revise given the powers of the regulator and exchange to issue and update such rules as they deem appropriate from time to time. In fact, this has been the case in Saudi Arabia, as the CGRs 2017 has been amended several times since its first issuance in 2017.

From a regulator's perspective, the mandatory approach is also disadvantageous in that the monitoring and enforcement of the framework places a heavy burden on regulators and puts enormous pressure on their human and financial resources, all of which may hinder their enforcement efforts.[321] The regulator incurs the cost of building the framework, monitoring its implementation, conducting inspections and investigations to detect violations, litigation, imposing sanctions on non-compliers, and collecting fines.[322] These types of costs are typically much lower under a voluntary framework, within which shareholders are responsible for the framework's monitoring and enforcement.

Moreover, the mandatory approach is also criticised for increasing the costs of compliance incurred by companies as they bear costs of, for example, establishing certain committees, internal controls, and risk management systems, in addition to the preparation of various reports as prescribed under the framework. These types of costs would not necessarily be incurred under a voluntary framework as companies are allowed to determine which governance practice to follow and to choose what costs they are willing to incur. This argument is probably the most concerning one for regulators, and it is indeed challenging for regulators to monitor and enforce a mandatory framework; however, two counter points should be mentioned which can be balanced against the criticism concerning high costs.

First, the costs incurred by regulators in monitoring and enforcing corporate governance frameworks can be justified by the major benefits associated with strengthening the national economy, supporting the capital market through increasing confidence and transparency in it, protecting shareholders, and what all of these factors achieve in terms of facilitating access to finance and fostering innovation. Moreover, costs can be mitigated

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[321] Anand (n 262) 13–14.
[322] ibid.

through the adoption of various reasonable enforcement strategies such as identifying the types of violations that most require monitoring and enforcement, since not all governance arrangements are of equal importance. Mandatory laws rarely mandate regulators to take enforcement actions, which means that regulators have discretionary powers that allow them to choose what and when to monitor and enforce.

Second, the mere existence of rules for which violations are punishable could deter companies from non-compliance and encourage them to comply regardless of whether the regulator would be able to detect the non-compliance and take action accordingly. Costs can also be mitigated by encouraging shareholders to participate in the monitoring and enforcement process and take advantage of the binding nature of mandatory corporate governance rules which makes it easier for shareholders to legally enforce them in the event of non-compliance. Raising awareness of the values which good corporate governance brings to companies and the roles of various parties (e.g., shareholders, creditors, auditors, investment groups, and the financial press) in encouraging better practices is also a strategy which can assist in relieving the pressure on regulators and reducing the typical costs. All in all, the challenges facing enforcement are not confined to the public enforcement of mandatory frameworks, as the enforcement by shareholders of voluntary framework rules also faces several challenges. These challenges and possible mitigating measures will be the focus of the chapter's last section, below, which is concerned with the issue of enforcement.[323]

In light of the above discussion, the voluntary and mandatory approaches each seem to provide unique solutions for corporate governance issues while at the same time posing several challenges, and despite the disadvantages of both approaches, especially the voluntary one, neither approach can be viewed as clearly superior to the other. This means that the choice between them has to be made largely based on the circumstances of the country in question and the characteristics of its capital market. This is a case-by-case issue where, as will be demonstrated later in Chapters 4 and 5, the regulatory approach may need to be varied depending on the governance issue at stake, so that a hybrid framework (where various regulatory techniques are utilised depending on the nature of the issue and its complexity) may be more appropriate than a one-form approach.

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[323] The challenges facing public and private enforcement are discussed in Section 3.4 of this thesis.

3.3 Flexibility of the Corporate Governance Framework

As Chapter 1 of this thesis suggested, flexibility is arguably a factor of fundamental importance in the effectiveness of a corporate governance regulatory framework. The significance of flexibility in a governance structure builds on the view that companies vary in their needs, circumstances, and characteristics such as ownership structure, industry, and operations.[324] Therefore, the governance structure of a company is said to be influenced by individual circumstances meaning that what works for one company may not work for another, and that the optimal solution for investors also varies from company to company, all depending on the uniqueness of a company's situation.[325] For instance, a requirement to establish a nomination committee whose members are independent might not be optimal for a small company whose board, shareholder base, and operations are small. However, the same requirement would be more suitable for a larger company with a larger board, shareholder base, and operational scope.[326]

Building on this idea, many believe that a given framework is likely to be more effective when it addresses aspects of corporate governance in a flexible way that allows companies to draw up their own governance structures in a way which will suit them best, while still guided by the principles and best practices endorsed by the framework.[327] That being said, this section will discuss the concept of flexibility in this context in order to assess how flexible the Saudi framework is as compared with that of the UK and Delaware. In doing so, the discussion below will also deal with rules distribution across the given framework, and will explore the rule types utilised under each framework. The rationale for this review is that the extent of a given framework's flexibility is directly affected by the way rules are distributed across the various regulatory sources, and by what each source entails in terms of bindingness, in addition to being affected by the rule type employed to address a given issue, such as mandatory rules, default rules, enabling rules, and voluntary rules.

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[324] Anand (n 262) 15.
[325] Sir David Walker, 'A Review of Corporate Governance in UK Banks and Other Financial Industry Entities: Final Recommendations' (2009) 7 <https://webarchive.nationalarchives.gov.uk/+/www.hm-treasury.gov.uk/d/walker_review_261109.pdf> accessed 30 April 2019.
[326] Anand (n 262) 15, 16.
[327] Walker (n 325) 7.

3.3.1 Relevance of Flexibility to Corporate Governance Framework

Prior to exploring the positions of the three jurisdictions, it is appropriate to briefly discuss some of the assumptions associated with flexibility in order to fully appreciate its relevance to corporate governance. One of the presumptions associated with a framework which embraces flexibility is that it incentivises companies to compete in capital markets through the adoption of better governance practices.[328] Rather than being driven by fear of public sanctions, companies' activities related to their governance obligations are driven by investors' demands and companies’ desire to increase their attractiveness to potential capital providers. This builds on the notion that the better governed a company is, the more attractive it becomes for potential investments.[329] Therefore, recognising this idea may shift the regulator's focus from protecting investors through setting up a single form of rigid rules to focusing on encouraging companies’ voluntary adoption of better governance practices through the establishment of a framework that helps companies to adopt governance standards that will actually enable them to operate more efficiently.[330] What this means from a regulator’s perspective is that if companies already have incentives to follow better governance practices, why not take advantage of this situation by refraining from introducing mandatory rules that might not be necessary, but which may be costly to monitor and enforce? This is especially relevant as both regulators and companies have strong interest in adopting a cost-effective framework.[331]

Another presumed incentive is that a company’s board is likely to adopt a better governance structure to prevent the possible devaluation of the company by shareholders. In other words, a board will adopt a better governance structure due to the fear that if it does not, shareholders may be dissatisfied and see no value in continuing to hold the company's shares, and might then take their money to another company which is better governed.[332] Therefore, from a board perspective, the cost of adopting better governance practices is potentially lower than the cost it would bear if shareholders dispose of their shares as a result of the company following bad governance practices. This presumption is supported by a study that surveyed 1500 companies in the US, concluding that companies

[328] Anand (n 262) 16.
[329] ibid.
[330] ibid.
[331] ibid.
[332] ibid 19; Sidney J Gray and Clare B Roberts, ‘Voluntary Information Disclosure and the British Multinationals: Corporate Perceptions of Costs and Benefits’ (1989) International Pressures for Accounting Change, Prentice Hall, Hertfordshire 116, 118.

where the rights of shareholders were strong had much more value, more profit, and higher sales compared to other companies with weaker shareholder rights.[333]

Another incentive for boards to follow better governance practices is to prevent any aggressive regulatory response that might occur as a result of patterns of adopting weak governance practices.[334] The presumption here is that the regulator's response typically comes in the form of mandatory and rigid rules that provide little, if any, space for companies in terms of compliance with their corporate governance obligations, thus the cost of compliance will typically be higher for such companies, and their freedom in drawing up their own governance structure will be severely restricted.[335] When such a fear exists, companies are incentivised to show the regulators goodwill by voluntarily adopting better governance standards. This presumption is supported by a relevant study which observed that in terms of environmental concerns, companies usually tend to follow some form of self-regulation prior to the introduction of regulatory rules, in an attempt to convince the regulator that its imminent regulatory interference is not necessary.[336]

It should be noted that although there are incentives for companies to voluntarily adopt better governance practices when they are given flexibility, the quality of governance choices made by a company depends on each company's circumstances, and is still influenced by its overall objectives, and more importantly by what governance standard it can afford to adopt in light of its financial performance.[337] For example, an underperforming company might decide that adopting a certain governance standard would be costly for the time being in light of its financial performance, and thus that it may need to allocate its funds to other urgent aspects of its operations in order to improve its position so that when things improve in the future it can afford to adopt the abandoned standard.[338] This is where a framework’s flexibility shines through, as flexible rules are more capable than mandatory rules of enabling companies to act in accordance with their individual needs.

[333] See generally Gompers, Ishii and Metrick (n 295).
[334] John W Maxwell, Thomas P Lyon and Steven C Hackett, ‘Self-Regulation and Social Welfare: The Political Economy of Corporate Environmentalism’ (2000) 43 The Journal of Law and Economics 583, 613.
[335] Anand (n 262) 20.
[336] Madhu Khanna and Lisa A Damon, ‘EPA’s Voluntary 33/50 Program: Impact on Toxic Releases and Economic Performance of Firms’ (1999) 37 Journal of Environmental Economics and Management 1, 2.
[337] Anand (n 262) 21.
[338] ibid.

It is also worthwhile mentioning that flexibility does not exclusively exist as part of a voluntary corporate governance code.[339] In fact, and as was discussed earlier,[340] a mandatory approach is also capable of manifesting some forms of flexibility towards corporate governance.[341] This manifestation takes place by making use of default rules that set out what the regulator deems suitable as a default option in relation to a given matter, while at the same time permit companies to deviate if they decide otherwise in their constitutional documents.[342] Mandatory rules can also have exceptions and conditions to improve their flexibility.

Importantly, and as was established earlier, the view that flexibility encourages shareholders to play their role in monitoring the framework and taking a greater part in its enforcement does not go unchallenged. For example, in the UK where the framework is widely hailed for providing such a flexible framework operating on a *Comply or Explain* basis, concerns have been expressed regarding the ways in which some companies comply and the sufficiency of the disclosures and justifications provided.[343] What is more concerning is that, as highlighted in some studies,[344] shareholders are not doing what they are supposed to do in monitoring and enforcement; instead, it is suggested that shareholders typically are not concerned with companies' governance choices and compliance as long as the companies' financial performance is satisfactory.[345]

These observations on shareholder vigilance can be understood by distinguishing between two types of investors: on the one hand, there are active investors who are engaged in monitoring the company and act accordingly; and on the other there are passive investors who are not as concerned with the company's affairs but are simply seeking good returns. The importance of this distinction lies in the fact that corporate governance practices within a given company are affected by the dominant type of investors. This is due to the belief that the quality of a given company's governance practices depends to a large extent on the level of investor activism within the company,[346] and whether such investors are

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[339] MacNeil and Li (n 206) 493.
[340] See the prior discussion in Section 3.2 of this thesis.
[341] MacNeil and Li (n 206) 486–493.
[342] ibid.
[343] See generally Moore, 'The End of Comply or Explain in UK Corporate Governance Special Issue on Corporate Governance' (n 62); Keay (n 214); Arcot and Bruno (n 203); MacNeil and Li (n 206).
[344] These studies are discussed in detail in Section 3.2.4 of this thesis.
[345] MacNeil and Li (n 206) 494.
[346] See Sections 3.4.2 and 4.1.1 of this thesis for more discussion on market discipline and shareholder activism.

systemically and conscientiously involved in the process of monitoring the company, voting on its decisions, attending its general assemblies, and discussing its affairs with the board and executive management.[347]

Lastly in this regard, the benefits of flexibility, particularly under a voluntary framework, are to a great extent dependent on the goodwill of companies and boards.[348] This is because a voluntary framework is a form of soft law.[349] The expectation in soft law is that while regulatees have the option either to comply or not, they tend to comply as part of their willingness to meet social norms.[350] The challenge is that due to voluntary rules being greatly dependent on regulatees' goodwill, an absence of goodwill in companies and a reluctance of shareholders to monitor and enforce the rules can undermine the benefits of flexibility.[351] That all being said, and in light of the abovementioned considerations regarding patterns of companies compliance and modest shareholder engagement in monitoring and enforcement in countries applying voluntary codes, the benefits associated with flexibility offered under a voluntary framework can be challenged, in turn raising the question of how much weight a regulator should place on flexibility when designing a corporate governance framework.

3.3.2 Legal position of the jurisdictions

After establishing the importance of flexibility in the context of corporate governance and discussing some of its prominent assumptions and challenges, the next task of this study is to assess the extent of the Saudi framework's flexibility. In doing so, rules distribution across the framework and the rule types[352] utilised will be used as a basis for ascertaining the level of flexibility of the Saudi framework in comparison with those of the UK and Delaware.

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[347] Lucian A Bebchuk and Scott Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (National Bureau of Economic Research 2019) 0898–2937.

[348] Paul Sanderson and others, *Flexible Or Not?: The Comply-or-Explain Principle in UK and German Corporate Governance* (University of Cambridge, Centre for Business Research 2010) 1.

[349] Francis Snyder, 'Soft Law and Institutional Practice in the European Community (EUI Working Paper LAW No. 93/5)' 2.

[350] Sanderson and others (n 348) 1.

[351] Michelle Cini, 'The Soft Law Approach: Commission Rule-Making in the EU's State Aid Regime' (2001) 8 Journal of European Public Policy 192, 194.

[352] The various rule types employed in regulating corporate governance issues were discussed in detail in Section 3.2 of this thesis.

To begin with, in relation to rules distribution across the framework and the type of rules utilised, it can be observed that the rules in each of the three jurisdictions are not entirely contained within a single regulatory source, and no single rule type is dominantly employed. Rather, rules related to corporate governance are scattered among several different regulatory sources, and the usage of different rule types is common. More specifically, corporate governance rules can be found in each of the given jurisdictions' company law, securities laws, and corporate governance code/regulations (with the exception of the US which lacks a national code), and listing rules.

Furthermore, corporate law plays a similar role in the three jurisdictions, addressing aspects such as board formation, the minimum number of directors, the election and removal of directors, shareholders' rights, general assembly rules, and related party transactions.[353] However, a significant difference observed among the three jurisdictions is that while directors' duties are to great extent codified in the relevant corporate law implicitly[354] in Saudi Arabia and explicitly[355] in the UK, they are to be found in Delaware's case law rather than its statutory laws.[356]

Additionally, the role played by securities laws varies across the jurisdictions, but generally their role is more concerned with the disclosure aspects of corporate governance, with the exception of Delaware where the federal securities laws affect the substance of corporate governance practices. Moreover, both Saudi Arabia and the UK have a separate national set of rules that address aspects of corporate governance - the mandatory CGRs 2017 in Saudi Arabia[357] and the voluntary CGC 2018 in the UK.[358] These two sources, despite being different in terms of bindingness, cover the same topics of corporate governance including the composition of the board, the role of the chairman and other board members, the duties and responsibilities of board committees, and the independence of directors. This important component (i.e., a national corporate governance regulations) is missing in Delaware. This may explain the other observation of this research in regard to the different roles played by listing rules in the three jurisdictions. To illustrate, in both

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[353] For Saudi Arabia, see Articles 70 (1), 75 (1,2), 81 (4), 83 (4), 93 (1), and 93 (3) of the Companies Law 2015; For the UK, see Schedule 3 of Schedule 3 of the Companies (Model Articles) Regulations 2008; See Sections 18 and 19 of the Companies Act 2006; See also the Explanatory Note found in The Companies (Model Articles) Regulations 2008; For Delaware, see Sections 141 (b), 141 (c/3), 141 (f), 212 (a), and 216 of the Delaware General Corporation Law.
[354] See Section 4.4 of this thesis for a detailed discussion of directors' duties in Saudi Arabia.
[355] See Sections 171, 173, 174, and 175 of the Companies Act 2006.
[356] Habbart and Swoyer (n 186) 475–476.
[357] See the Corporate Governance Regulations 2017.
[358] See the Corporate Governance Code 2018.

Saudi Arabia and the UK, listing rules are mostly concerned with disclosure requirements pertaining to corporate governance without dealing with the substance of governance practices within listed companies,[359] but this is not the case in Delaware. In Delaware, the role of the NYSE's listing rules seems to compensate for the absence of national corporate governance regulations as the national exchanges took it upon themselves, as required by the relevant securities laws, to address governance aspects of companies listed on US exchanges.

However, the central issues of corporate governance such as the role of the chairman, board committees, and directors' independence are not approached in the same manner. For example, while the CL 2015 explicitly recognises the audit committee and prescribes several rules governing its responsibilities and the qualifications of its members,[360] other committees such as the nomination and compensation committees are recognised by the CGRs 2017.[361] This approach is different to that taken in the UK and Delaware. In the UK, recognition of the audit committee is to be found in DTRs[362] while recognition of nomination[363] and remuneration[364] committees is located in the UK's code. For Delaware, rules relevant to the audit and compensation committee are to be found in the SEA 1934 and the DWSRCPA 2010, whereas rules related to the nomination committee are provided under the NYSE's listing rules.[365]

As to the utilisation of rule types, it could be observed that all frameworks in the three jurisdictions utilise multiple types of rules, in the form of mandatory rules, default rules, enabling rules, and voluntary rules. A key difference across the jurisdictions, however, lies in the extent of use of each type. The general observation to make is that both Saudi Arabia and Delaware heavily rely on mandatory rules in regulating various aspects of corporate governance, while voluntary rules are dominant in the UK. For instance, in Saudi Arabia the aspects addressed by the CL 2015 and which are mandatory in nature include the formation and size of the board,[366] the appointment and removal of directors,[367]the duality

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[359] In the UK, the Listing Rules provide provisions relevant to related party transactions and controlling shareholder agreements. They also require premium listed companies to conform with the CGC.
[360] Articles 101,102,103, and 104 of the Companies Law 2015.
[361] See generally Articles 60, 61, 64, 65 of the Corporate Governance Regulations 2017.
[362] See generally from Rule 7.1.1 to Rule 7.1.7 of the Disclosure Guidance and Transparency Rules Sourcebook.
[363] See Principles J-L of the Corporate Governance Code 2018.
[364] See Principles P-R of ibid.
[365] Sections 303A.04, 303A.05, and 303A.06 of the New York Stock Exchange Listed Company Manual.
[366] Article 68 of the Companies Law 2015.
[367] Article 68 (3) of ibid.

of CEO and chairman positions,[368] the decision-making process,[369] the rights of shareholders,[370] and the rules surrounding the general assemblies.[371] Other closely related corporate governance matters such as the board's independence and board's committees are regulated in the CGRs 2017 on mandatory basis.[372]

In the UK, several aspects of corporate governance are regulated using mandatory rules, such as directors' duties[373], the appointment and removal of board members,[374] directors' liabilities,[375] and periodic disclosures including board reports, auditor reports, and financial statements.[376] Moreover, the DTRs contain mandatory rules related to corporate governance, most notably in regard to the procedures the company must follow in relation to related party transactions.[377]

In Delaware, the situation is similar to that in Saudi Arabia, as many aspects of corporate governance are regulated through mandatory rules including the board's powers, board's size, removal of directors,[378] and board independence.[379] Furthermore, the establishment of an audit committee,[380] compensation committee[381] and nomination committee,[382] and related party transactions[383] are all based on mandatory rules.

As to the utilisation of default rules, all three jurisdictions in the present comparison use such rule type to address certain matters of corporate governance, most of which are associated with the framework's references to articles of association. For example, in all three jurisdictions, aspects related to the powers of the board, the election of directors, the quorum required to hold board and general assembly meetings, and the quorum required for board and general assembly decisions to pass are all regulated through default rules

[368] Article 81 (1) of ibid.
[369] Article 83 (4) of ibid.
[370] Article 110 of ibid.
[371] Article 93 (3) of ibid.
[372] See generally Articles 20, 31, 60, 61, 64, and 65 of the Corporate Governance Regulations 2017.
[373] UK directors' duties are formulated as minimum standards and so can be considered as a special form of mandatory rule, as other mandatory rules are generally uniform in their application. This approach is derived from the common law approach to fiduciary duties, which can be adjusted by contract.
[374] Sections 157-161 and Section 168 of the Companies Act 2006.
[375] Chapter 7 of Part 10 of ibid.
[376] Examples include Chapters 4-8 of Part 15 of ibid.
[377] See generally Rule 7.3.1 to Rule 7.3.13 of the Disclosure Guidance and Transparency Rules Sourcebook.
[378] Section 141 of the Delaware General Corporation Law.
[379] Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[380] Section 301 of the Sarbanes-Oxley Act of 2002.
[381] Section 303A.05 of the New York Stock Exchange Listed Company Manual.
[382] Section 303A.04 of ibid.
[383] Section 144 of the Delaware General Corporation Law.

contained in the relevant corporate law, with companies having the ability to agree to different rules in their articles of association or by-laws (as in Delaware).[384]

Turning to the presence of voluntary rules, it can be observed that the UK relies primarily on this type of rule, while both Saudi Arabia and Delaware employ them in very few instances. For example, in the UK's CGC 2018 which operates on a voluntary basis,[385] many corporate governance areas are addressed through this code including the board's composition,[386] the independence of directors[387], and other matters related to audit, risk management, internal control,[388] and remuneration.[389] Furthermore, this code covers areas related to the role of chairman[390] and the CEO,[391] as well as the functions of the board's various committees.[392] The situation in Saudi Arabia is different in that the framework only uses voluntary rules in relation to a few aspects with which companies have the option not to comply provided they discloses the non-compliance incident and the reasons for doing so. Examples of such aspects are the establishment of a risk committee, a corporate governance committee, and corporate social responsibility.[393]

In Delaware, however, the utilisation of voluntary rules rarely happens, as there are only a few instances where a *Comply or Explain* approach is employed. One example is the requirement to appoint a financial expert in the company's audit committee.[394] Another example is the rule surrounding duality of CEO and chairman positions which in effect leaves this matter for the company to decide provided that it discloses to its shareholders its rationale behind its approach of either combining or separating the two positions.[395]

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[384] For Saudi Arabia, see Articles 70 (1), 75 (1,2), 81 (4), 83 (4), 93 (1), and 93 (3) of the Companies Law 2015; For the UK, see Schedule 3 of Schedule 3 of the Companies (Model Articles) Regulations 2008; See Sections 18 and 19 of the Companies Act 2006; See also the Explanatory Note found in the Companies (Model Articles) Regulations 2008; For Delaware, see Sections 141 (b), 141 (c/3), 141 (f), 212 (a), and 216 of the Delaware General Corporation Law.
[385] The UK Corporate Governance Code operates on two levels, *Apply and Explain* for the code's principles, and *Comply or Explain* for the code's provisions.
[386] See Principles J-L of the Corporate Governance Code 2018.
[387] See Principles F-I of ibid.
[388] See Principles M-O of ibid.
[389] See Principles P-R of ibid.
[390] See Principles A-E and F of ibid.
[391] See Principles F-I of ibid.
[392] See Principles M-O of ibid.
[393] See generally Articles 70, 73, 74, 83, 87, and 95 of the Corporate Governance Regulations 2017.
[394] Section 407 of the Sarbanes-Oxley Act of 2002.
[395] Section 14B of the Securities Exchange Act of 1934.

3.3.3 Assessment of Flexibility under the Saudi Framework

Now that the rules distribution across the frameworks in the three jurisdictions along with the rule types utilised within them have been established, and an exploration of the frameworks' rules and various components has taken place, several observations can be summarised. The facts that the frameworks in both Saudi Arabia and Delaware operate on a mandatory basis, and that the vast majority of corporate governance aspects are regulated either via statutory corporate law or binding corporate governance regulations and listing rules indicate a lack of flexibility. This is contrary to the UK, where the framework is largely flexible as it operates on a voluntary basis and the substantive regulation of corporate governance issues are part of its voluntary code, while mandatory rules are only utilised in a few instances.

Despite the level of inflexibility demonstrated above, there are a few areas where the Saudi framework allows an element of flexibility. The manifestation of flexibility is mostly associated with the CL 2015 utilisation of default rules to deal with certain corporate governance issues in which the prescribed rules will apply unless otherwise agreed in a company's articles of association. The areas covered by these default rules and in which companies therefore have flexibility in determining what they deem suitable include the possibility of re-electing the chairman and vice chairman,[396] the quorum required to approve the board's decisions,[397] and the validity of an ordinary general assembly's decisions if they have been approved by an absolute majority.[398] Furthermore, flexibility in the Saudi framework is manifested through the CL 2015 recognition of shareholders' power to determine certain matters as part of the articles of associations such as the board's remuneration,[399] the voting mechanisms in shareholder assemblies,[400] the basis for terminating a director's membership,[401] and the responsibilities of the chairman.[402] Furthermore, the voluntary rules found in the CGRs 2017, which operates on a *Comply or Explain* basis, also offer flexibility in several aspects such as those related to the

[396] Article 81 (4) of the Companies Law 2015.
[397] Article 83 (4) of ibid.
[398] Article 93 (3) of ibid.
[399] Articles 76 (1, 2, 3) and 81 (1, 2) of ibid.
[400] Article 95 (1) of ibid.
[401] Article 68 (3) of ibid.
[402] Article 81 (1) of ibid.

establishment of a risk committee, a corporate governance committee, internal controls, and corporate social responsibility.[403]

In light of the above discussion, it could be argued that much of the liberty enjoyed by UK companies in drawing up their own governance structures to suit their specific needs is absent in both Saudi Arabia and Delaware, where many prominent governance aspects are prescribed within the framework. Indeed, compliance with the framework's rules in Saudi Arabia and Delaware is mostly a matter of substance, while in the UK it is mostly a matter of disclosure. The framework's inflexibility in the first two jurisdictions is further indicated by the presence of harsh penalties at the regulators' disposal to use when the framework's rules are violated. This is not the case in the UK, as in line with the voluntary nature of its framework, the role of the Financial Reporting Council (FRC) is very limited as its monitoring activities are disclosure-related.[404]

Furthermore, it could be said that from among the three frameworks, the Saudi framework is the most rigorous, the least flexible, and the most detailed. Although both Saudi Arabia and Delaware operate a mandatory framework, the extensiveness of the rules is remarkably different in each, as evidenced by the presence of 98 articles in the CGRs 2017[405] and 60 articles in the RRPs 2016, both of which are additional to the rules already found in the CL 2015. Many of those rules go beyond providing high-level standards specifying the procedures that companies must follow when fulfilling their obligations. Such detailed procedures could be restricting companies' freedom and limiting their choices. Many of these procedural rules should be part of a separate guideline or practice notes that are educational in nature.

3.4 Enforcement of the Corporate Governance Framework

Central to the design and approach of any corporate governance framework is its enforcement. The enforcement element is one of the prominent factors in determining whether a soft law or a hard law approach is preferred.[406] Enforcement in this context refers to the ability of the given framework to compel companies to adhere to its provisions. It deals with critical questions such as what legal consequences follow when

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[403] See generally Articles 70, 73, 74, 83, 87, and 95 of the Corporate Governance Regulations 2017.
[404] Section 3.4 of this thesis presents a detailed discussion of the public enforcement of the framework's rules in each of the three jurisdictions
[405] Of these 98 Articles, 22 are of a voluntary nature in that companies can either apply them or deviate and explain their reasons for deviation to their shareholders.
[406] Keay (n 214) 288.

companies fail to comply with the framework's provisions, what role the regulator assumes in such an event, what measures are at shareholders' disposal to enforce such provisions, and what sanctions are put at the disposal of the regulator to impose on wrongdoers. The concept of enforcement is crucial because the enforcement of the rules is more important than the rules themselves in the context of the regulatory instruments aiming at the enhancement of the business environment within which companies operate and improvement of corporate governance practices.[407] This is emphasised by the OECD, which states:

> Enforcement mechanisms [of corporate governance rules], will help improve the confidence of domestic investors, reduce the cost of capital, underpin the good functioning of financial markets, and ultimately induce more stable sources of financing.[408]

To be clear, the suggestion here is not that the rules themselves are not important, but that they should be written with enforcement in mind, in order to ensure they are reliable, and that the parties in whom enforcement is vested are defined in addition to having proper enforcement mechanisms in place.[409] This is because negative consequences often result from an environment which lacks enforceable laws. For example, in the absence of enforceable laws, companies may find themselves in a difficult position when they seek to attract external finance given that the extent of companies' success in securing that finance is highly dependent on the ability of the finance providers to get their money back, which is boosted by the assurance that the company's management will deal with their money in a productive and honest way.[410] With that in mind, the existence of strong enforceable rules (e.g., rules concerning shareholder protection) is fundamental if investors are to have confidence in capital markets. This also explains why the cost of equity is typically higher in countries where the enforcement environment is perceived to be weak.[411]

Another negative consequence is that when finance providers have concerns as to the enforceability of legal rules, they will make special arrangements to protect their own investments.[412] These arrangements include working towards controlling shareholdings so that when successfully secured, they can employ their controlling stake as a protective

[407] Berglöf and Claessens (n 181) 123.
[408] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 10.
[409] Berglöf and Claessens (n 181) 124.
[410] ibid.
[411] Utpal Bhattacharya and Hazem Daouk, 'The World Price of Insider Trading' (2002) 57 The Journal of Finance 75, 23.
[412] See Section 4.1.1 of this thesis for more discussion of the principal-principal problem.

mechanism through which they can intervene in the company's affairs and directly influence the decision-making process.[413] The problem with this approach is that it sometimes occurs at the expense of other shareholders, especially the minority, thus undermining the corporate governance objectives. This in turn leads to another consequence, which is the loss of minority investors' confidence in the capital market due to the absence or weakness of the enforcement mechanisms that would ideally enable them to enforce the framework's rules if their rights are violated.[414] Therefore, these challenges and consequences linked with a weak enforcement environment could ultimately reduce the attractiveness of the capital market in question.

Importantly, while it is self-evident that rules should naturally be enforceable when they are violated, the reality is that many rules are not enforced for a number of reasons that must be taken into account when designing any regulatory framework to ensure efficient enforcement.[415] To better understand the challenges associated with enforcement, it is necessary first to differentiate between two modes of law enforcement; public enforcement and private enforcement. Each of these two modes poses certain issues and challenges which, if neglected, will hinder the regulatory framework in question in achieving its objectives. The next sub-sections explore these two modes and shed light on their main considerations.

3.4.1 Public enforcement

Public enforcement of the law occurs when government agencies are involved in the oversight and enforcement of the law.[416] They monitor compliance with the law, inspect parties governed by the law, and impose sanctions on violators.[417] Those roles exercised by them are typically based on statutory rules that explicitly recognise the powers of relevant government agencies. This approach is typically the main element of the so called "hard law approach" where the framework is of a mandatory nature and relies heavily on the regulator in relation to monitoring and oversight responsibilities. In turn, the regulator employs several tools to supervise compliance with the framework, such as reviewing the

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[413] Erik Berglöf and Anete Pajuste, 'What Do Firms Disclose and Why? Enforcing Corporate Governance and Transparency in Central and Eastern Europe' (2005) 21 Oxford Review of Economic Policy 178, 182.
[414] OECD, *G20/OECD Principles of Corporate Governance* (n 2) 20.
[415] Iain MacNeil, 'Enforcement and Sanctioning' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *Oxford Handbook of Financial Regulation* (OUP Oxford 2015) 281–282.
[416] A Mitchell Polinsky and Steven Shavell, 'The Theory of Public Enforcement of Law' (2007) 1 Handbook of Law and Economics 403, 405.
[417] ibid.

companies' disclosure to detect any violations, random inspections of companies, press reports that expose corporate scandals, and shareholders' complaints. In this approach, the expected role of private parties in the monitoring and enforcement is significantly less than the expectations of them in a voluntary approach. This is among the main distinctions which can be drawn between enforcement under a mandatory framework and enforcement under a voluntary framework.

However, having explicit monitoring and enforcement powers does not necessarily mean that public enforcement is convenient. On the contrary, several challenges are associated with public enforcement which offer a hint as to why the public enforcement of rules does not always take place. In fact, when it comes to enforcement in securities markets in particular, it is often found that large numbers of regulators worldwide do not have reliable enforcement systems for several reasons, chief among them the limited resources of the relevant regulators.[418] The pressure becomes greater on such resources when the gains resulting from non-compliance are vast, meaning that companies are more likely to be tempted to violate the rules.[419]

The extent of the challenges associated with public enforcement is affected by several factors. For example, inconsistency in enforcing the rules is among the key challenges facing public enforcement. Laws rarely mandate regulators to enforce them, which in turn gives regulators discretion to decide which rules to enforce, which form of enforcement to follow, and when enforcement action should take place.[420] The exercise of this discretionary power is influenced by several considerations, chief among them the uncertainty of the rules, the seriousness of the violation, and the harm it has caused.[421] Enforcement is easier when the rules in question deal with straightforward regulatory obligations having prescribed some form of simple conduct that can easily be monitored, thus enforcement in the event of violation should be easier.[422] However, enforcement of obligations that are complex in nature can be challenging[423] given that the rules may in the first place be ambiguous, making monitoring and enforcement more difficult. This in turn forces the regulator to discharge its enforcement power on a case-by-case basis in the event

[418] Carvajal and Elliott (n 229) 11.
[419] ibid.
[420] MacNeil, 'Enforcement and Sanctioning' (n 415) 283.
[421] ibid.
[422] Scholz (n 303) 387.
[423] Examples of these complex obligations are those concerning the role and responsibilities of NEDs, which are discussed in detail in Section 4.2.2 of this thesis.

of violations as regulators in such cases may be reluctant to enforce a rule that is not clearly defined.

The harm caused by a violation is another factor that influences the regulator's decision towards enforcement. This factor is however difficult to assess, as determining the actual harm involves several variables such as the financial loss caused by the violation, the cost of the punishment, and the cost of the enforcement activities, all of which are difficult to measure.[424]

Furthermore, the general pattern of compliance with the rules manifested by regulated persons is a factor that regulators take into account when deciding which enforcement action to pursue.[425] Put differently, regulators may adopt different styles of enforcement, with one style applied to those with a good history of compliance, and a different style for those with a bad history of compliance.[426] The idea of establishing different modes of enforcement depending on the general pattern of compliance builds on the argument that better compliance is fostered when the relationship between the regulator and regulated people and organisations is based on mutual trust and cooperation.[427]

Among the prominent factors that influence regulators' enforcement decisions is the availability of the legal powers and tools needed to ensure that regulators can exercise their enforcement role properly.[428] These include the power to supervise, monitor, investigate, request information, and impose sanctions. The absence of such powers limit regulators' ability to respond effectively to breaches of rules.[429] In this regard, sanctions are of fundamental importance to the quality of public enforcement, because equipping regulators with diverse and appropriate punitive tools helps them to achieve the objectives of the regulatory framework and to lower the incentive to violate the law. Therefore, a framework that recognises various sanctions such as license suspension or cancellation, public censure, fines, the prohibition of certain activities and imprisonment is likely to be more effective than a framework where sanctions are milder and more limited.[430]

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[424] Gary S Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 Journal of Political Economy 169, 180.
[425] MacNeil, 'Enforcement and Sanctioning' (n 415) 303.
[426] Scholz (n 303) 390.
[427] ibid 390–393.
[428] MacNeil, 'Enforcement and Sanctioning' (n 415) 286–287.
[429] ibid.
[430] ibid 296–298.

Lastly, it should be borne in mind that the fact that the regulator plays a crucial part in the enforcement of the mandatory framework does not mean that shareholders do not have a role in this regard. Shareholders are normally entitled to take action against the board when the latter does not comply with the framework's rules, especially if such non-compliance amounts to damage to shareholders. For example, shareholders may invite the general assembly to vote either on the removal of a given director or replacement of the entire board, to have a certain board's decision nullified, or to instruct the board to take (or refrain from taking) certain actions.[431] Furthermore, shareholders may use the mandatory rules to their benefit during their private enforcement efforts by demonstrating that the board's failure to adopt best governance standards (as evidenced by their failure to observe the prescribed rules) has been detrimental to their interests. The presumption here is that it should be less challenging for shareholders to win their case against the board when what they need to prove is the simple fact that the prescribed rules have been violated.

3.4.2 Private enforcement and market discipline

The other possible mode of enforcement is private enforcement of law and market discipline. Private enforcement occurs when private parties rely on the regulatory framework to punish wrongdoers and to seek redress when their rights or interests have been violated.[432] In the corporate governance context, private parties, particularly shareholders, can use the framework's rules to hold companies or boards liable for their corporate governance choices, and to oblige them to adopt the corporate governance practices set out within the given framework. On other hand, market discipline could be defined as the ability of market forces, particularly shareholders, to monitor corporate governance practices within a given company in order to evaluate how appropriate they are for the given company, and to influence the board's actions when shareholders are dissatisfied through market-led strategies.[433] Therefore, one could observe two presumptions, one is that market forces would monitor, and the other is that they would act accordingly if they disapprove of certain governance practices. Such presumptions build on the idea that shareholders have incentives to participate in the monitoring and disciplinary process as a way of ensuring that good governance practices are in place, so that they can

[431] See Chapter 5 of this thesis for a detailed discussion of shareholders' control rights.
[432] Berglöf and Claessens (n 181) 125.
[433] Robert R Bliss and Mark J Flannery, 'Market Discipline in the Governance of US Bank Holding Companies: Monitoring vs. Influencing' (2002) 6 Review of Finance 361, 361.

be assured that their investments are protected.[434] The importance of this idea stems from the wide belief that the 2008 global financial crisis which saw the failures of large companies were the result of, *inter alia*, failures of corporate governance regimes in general and market discipline in particular.[435] That being the case, many countries begun focusing on strengthening their corporate governance regimes through advocating market-led mechanisms that aim at engaging private parties in the monitoring and disciplining of companies' management.[436]

Although private enforcement and market discipline are relevant parts of a mandatory framework, they are more relevant in a voluntary one.[437] In fact, one of the main features of the voluntary approach is that in it, enforcement is not generally the task of the regulator, but is instead typically vested in market forces such as shareholders, investment banks, rating agencies, and the press.[438] The effect and decisions of these forces - which typically influence companies' share prices and management reputations - are presumed to encourage companies to conform with the framework's rules and follow best governance standards.[439]

The above being the case, the premise upon which private enforcement is based is that a company's shareholders scrutinise its governance practices through the mandatory disclosures made, and examine them to ascertain whether the company is making rational choices in relation to its governance. If they believe it is not, then shareholders can act depending on the severity of the non-compliance.[440] In doing so, and apart from the market for corporate control that will be discussed below, when shareholders are dissatisfied with a company's governance practices, the disciplinary actions at their disposal can take different forms. As part of market discipline, they can escalate the issue internally discussing the matter with the board and pressuring it into making positive changes. If the board does not respond well to this approach, shareholders can then use their voting power to either decide to adopt a certain form of governance, or even to replace the board with another board that more closely shares the shareholders' vision. An alternative path that

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[434] Section 3.2.4 of this thesis challenged this idea and concluded that monitoring and enforcement by shareholders do not always take place, for the several reasons discussed in that section.
[435] Emilios Avgouleas and Jay Cullen, 'Market Discipline and EU Corporate Governance Reform in the Banking Sector: Merits, Fallacies, and Cognitive Boundaries' (2014) 41 Journal of Law and Society 28, 29.
[436] ibid 28.
[437] See generally Keay (n 214); Berglöf and Claessens (n 181); Wymeersch (n 28) 114.
[438] Wymeersch (n 28) 117.
[439] Moore, 'The End of Comply or Explain in UK Corporate Governance Special Issue on Corporate Governance' (n 62) 98; MacNeil and Li (n 206) 487; Keay (n 214) 280; Wymeersch (n 28) 121.
[440] Keay (n 214) 280.

can be followed by shareholders is simply to dispose of their shares, which could reflect negatively on the share price of the company, thus deterring the board from pursuing bad governance practices.[441]As a last resort, shareholders have recourse to the private enforcement of rules as discussed earlier and can choose to sue the board on the basis that it has breached its duties towards the company and its shareholders. Such action does not normally take place until shareholders have fully exhausted all other options.

Worthy to mention that a strong relationship exists between public and private enforcement, as the two strengthen and reinforce each other. For private enforcement to be effective, it requires the support of the public law, meaning that private parties are in a better position to lead enforcement actions when the law in question recognises their role and facilitates it.[442] Part of this facilitation is the establishment of clear rules that define the responsibilities and obligations required from regulated persons. Other factors that influence the pattern of private enforcement include the roles played by other institutions, such as regulators and the courts, in relation to enforcement.[443] For instance, the position of the capital market's regulator towards disclosure requirements, the exchange's monitoring of continuous obligations, and the courts' attitude towards the enforceability and certainty of the framework's rules and the nature of the directors' duties all have a considerable influence on the willingness of private parties to pursue private enforcement.

3.4.2.1 Factors affecting the quality of private enforcement and market discipline

For the private enforcement of rules and market discipline mechanisms to function effectively, several factors must come into play, all of which can affect the extent of their success. Such factors include the consistency and legal certainty of the rules, efficient disclosure,[444] stronger rights for shareholders, active institutional investors, the presence of a market for corporate control, and the presence of a strong and independent investigative financial media.[445]

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[441] See generally Wymeersch (n 28); See generally Keay (n 214).
[442] MacNeil, 'Enforcement and Sanctioning' (n 415) 281–282.
[443] Polinsky and Shavell (n 416) 435–436; See generally MacNeil, 'Enforcement and Sanctioning' (n 415).
[444] Mongalo (n 292) 271.
[445] Gregory F Maassen, Frans AJ van den Bosch and Henk Volberda, 'The Importance of Disclosure in Corporate Governance Self-Regulation across Europe: A Review of the Winter Report and the EU Action Plan' (2004) 1 International Journal of Disclosure and Governance 146, 151.

3.4.2.1.1 Consistency and legal certainty

The consistency and legal certainty of rules are relevant factors in corporate governance as a lack of consistency and certainty hinder the regulatory objectives and undermine the private enforcement efforts.

Consistency in terms of defined rules is crucial for effective private enforcement because it increase the level of market prediction of how the rules should be applied, and which form of enforcement will take place in the event of non-compliance.[446] This is the result of the legal certainty which defined rules bring.[447] A high degree of predictability can contribute to raising the degree of compliance with the rules given that regulated persons would then be informed as to what the regulatory objectives and public policy are,[448] especially when dealing with cases of a similar nature.[449] A lack of legal certainty about the purpose of a legal rule and how it is fulfilled adversely affects the legitimacy of the given rule, and more importantly the legitimacy of any judicial decisions based on this rule.[450]

As judges are responsible for serving justice and adjudicating legal disputes in light of the legislative and regulatory purposes provided by the written rules,[451] if the legal rule is inconsistent with the legal framework within which it operates then the task of the courts in interpreting the given rule and determining how it should apply will be made more difficult.[452] Therefore, there is a likelihood that the court's decision will be predicated on an inaccurate understanding of the rule that is not in line with the original legislative purpose, which would render that judicial decision illegitimate, at least from a theoretical point of view.[453] Furthermore, any lack of legal certainty and consistency in the framework can mean higher litigation and enforcement costs because the burden of proving a failure to abide by the rule will be greater if the rule is not as defined and precise as it should be in the first place.[454] This in turn complicates, and may frustrate, the hoped-for public and

[446] Iain MacNeil, ‘Uncertainty in Commercial Law’ (2009) 13 Edinburgh Law Review 68, 72.
[447] ibid.
[448] Victor J Tremblay, ‘Consistency between the Law and Its Enforcement: The Case of Mergers’ (1993) 38 The Antitrust Bulletin 327, 329.
[449] MacNeil, ‘Uncertainty in Commercial Law’ (n 446) 69.
[450] ibid 71.
[451] ibid.
[452] ibid.
[453] ibid.
[454] ibid 72.

private enforcement pursued by shareholders as they are likely to have a much harder time determining and proving that a given rule has been violated.

3.4.2.1.2 Disclosure

In addition to the consistency of the rules as discussed above, the disclosure of accurate and sufficient information coupled with regulators and shareholders' ability to review and process such information is also considered to be among the most critical factors that facilitate public and private enforcement and market discipline efforts.[455] In fact, it is believed that corporate governance regimes would be unable to achieve their objectives if shareholders' knowledge of what happens in their companies are restricted.[456] It is also believed that there is generally a lack of transparency in relation to corporate actions and transactions.[457] Therefore, the importance of disclosure lies in the fact that it is the lens through which market participants monitor companies, and upon which investment decisions are based. Disclosure presents the company's risks to its shareholders, enabling them to predict future performance and thus to act accordingly.[458] Furthermore, high quality disclosure provides the market with the signals it needs to determine if the management is good or bad, and which interests are being pursued, so that market participants can act in a way that prevents corporate failures and ultimately leads companies towards much better decisions.[459]

For disclosures to be effective, several characteristics must be present, which include accuracy, completeness, materiality, and timelessness.[460] Information which is disclosed should be accurate in that it provides true statements of the circumstances of the company, and complete in that it sufficiently informs shareholders, and that it does not leave out critical information. Disclosures should also be timely so that shareholders can act in a timely manner before the information becomes irrelevant. Indeed, high quality disclosure

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[455] Disclosure is important for reducing the information asymmetry that increases agency cost. See Section 4.1.1 of this thesis for more on this aspect.
[456] Avgouleas and Cullen (n 435) 29.
[457] ibid.
[458] 'Corporate Governance Disclosure in Emerging Markets: Statistical Analysis of Legal Requirements and Company Practices' (UNITED NATIONS 2011) ix.
[459] Bliss and Flannery (n 433) 362.
[460] Benjamin Fung, 'The Demand and Need for Transparency and Disclosure in Corporate Governance' (2014) 2 Universal Journal of Management 72, 75–76.

is the basis for informed decision-making by investors whose absence is likely to undermine the overall role of investors in maintaining market discipline.[461]

The challenges facing disclosures about corporate governance practices are twofold. One problem is that it is not uncommon for companies to provide insufficient information that does not help investors to make informed decisions, and the other main issue is that even when a disclosure is provided, shareholders are not typically enthusiastic about acting accordingly.[462]

3.4.2.1.3 Institutional investors

Institutional investors represent another factor relevant to effective market discipline. The powerful influence they are capable of exerting is illustrated by the fact that the global size of assets under their management reached USD 103 trillion by the of 2020, and is expected to reach USD 145.4 trillion by 2025.[463] That being the case, the efficiency of a given corporate governance framework relies to a great extent on the willingness of institutional investors to utilise their voting powers to lead companies towards better governance practices.[464] The presumption here is that large investors, unlike small investors, are in a better position to closely watch the company and bring changes to its operations given that the size of their holdings incentivises them to do so.[465] With that in mind, it is no surprise that countries such as the UK recognise the powerful impact of these investors, as evidenced by the issuance of the SC 2020, which was introduced to encourage institutional investors to play a greater role in monitoring the companies they invest in to ensure sustainable values for their clients and beneficiaries.[466]

Importantly, it is observed that although institutional shareholders are believed to have influential powers which enable them to discipline companies' management and lead them to better governance practices, such shareholders do not in fact exercise their powers as

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[461] See generally Maassen, van den Bosch and Volberda (n 445); See generally Berglöf and Pajuste (n 413).
[462] See Section 3.2.4 of this thesis for more on this issue and for relevant empirical evidence.
[463] 'The $100 Trillion Machine: Global Asset Management 2021' (8 July 2021) <https://www.bcg.com/publications/2021/global-asset-management-industry-report> accessed 2 October 2021; 'Global Assets under Management Set to Rise to $145.4 Trillion by 2025' <https://www.pwc.com/ng/en/press-room/global-assets-under-management-set-to-rise.html> accessed 2 October 2021.
[464] OECD, 'Corporate Governance: The Role of Institutional Investors in Promoting Good Corporate Governance' (2011) 20.
[465] See Sanford J Grossman and Oliver D Hart, 'Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation' (1980] The Bell Journal of Economics 42.
[466] See Page 4 of the Stewardship Code 2020.

might be hoped.[467] Possible reasons for their low engagement include the fact that taking disciplinary actions such as contemplating a takeover bid, replacing the board, or restructuring a company's governance are usually costly and time-consuming, and they are therefore more likely to dispose of their shares when they are dissatisfied with a company's management.[468] This is especially true as institutional investors are typically required to provide their clients with the highest return possible on investments under management.[469] This costs-benefits analysis may lead institutional investors such as fund managers towards selling their shares[470] instead of getting involved in costly battles that might also reduce the profitability of their funds.[471] Another challenge is that when evaluating governance practices within a given company and assessing its compliance, institutional investors, just like other shareholders, are driven mainly by the company' performance.[472] This means that to a certain extent, provided that the performance of the company in question is satisfactory, little attention is paid to a company's governance practices.[473]

To enhance monitoring and enforcement by institutional investors, several possibilities should be considered. One is to oblige investors with fiduciary duties to disclose their voting policy and views on corporate governance arrangements[474] so that their clients are able to understand what strategies are being pursued by them to safeguard their assets, and what mechanisms they have in place to monitor companies' compliance with corporate governance rules. Another possibility is to facilitate cooperation between institutional and non-institutional investors to overcome the free rider problem, where one active shareholder bears all the costs and burdens of monitoring and enforcement actions while the benefits go to other shareholders who do not take part.[475] This is especially true considering that initiating actions and disciplining bad management can be costly; thus, institutional investors are not incentivised enough to play their role.[476] This issue becomes

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[467] Avgouleas and Cullen (n 435) 40–41.
[468] Gregory Jackson, 'Comment: A New Financial Capitalism? Explaining the Persistence of Exit over Voice in Contemporary Corporate Governance' (2008) 5 European Management Review 23, 23.
[469] See generally Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of political economy 288.
[470] It should be noted however that selling shares as a disciplinary action is increasingly becoming a less valid option for some institutional investors, particularly index funds. This is due to stewardship considerations, as is explained in Section 5.4.1 of this thesis.
[471] Avgouleas and Cullen (n 435) 40–41.
[472] See Section 3.2.4 of this thesis for relevant empirical evidence.
[473] MacNeil and Li (n 206) 492.
[474] OECD, 'Corporate Governance: The Role of Institutional Investors in Promoting Good Corporate Governance' (n 464) 23.
[475] ibid 38.
[476] See generally Moshe Pinto, 'The Role of Institutional Investors in the Corporate Governance' (2006) German Working Papers in Law and Economics 1.

more problematic when considering that the business model of institutional investors does not encourage them to bear any extra cost, as due to high competition in the financial industry and market pressure, these investors must closely guard their income.[477]

3.4.2.1.4 Market for corporate control

Among the factors most relevant to market discipline is the market for corporate control. This topic will be discussed in further detail in Chapter 4 as part of the discussion of agency theory, but it is appropriate to briefly introduce it here. The market for corporate control refers to the market in which parties seek to secure control rights, mainly through M&A and proxy fights.[478] This factor is arguably capable of reducing the agency cost associated with the separation of ownership and control in companies, thus aligning the interests of management and shareholders.[479]

Securing control rights can take different forms, among which is through the external pressure resulting from M&A, in which a poorly-managed company is acquired so that changes to the way it is managed can be brought.[480] Another form is the application of internal pressure by coordinating voting shares through proxy fights so that shareholders are in a better position to influence the company's practices.[481] As found in an analysis of 1064 companies[482], the pressure caused by M&A positively affects governance practice in companies subject to M&A activity and other companies that tend, for fear of the threat of M&A, to adopt better governance standards. That being said, the probability of a takeover is highly dependent on two factors: firstly, that the company's share price has been negatively influenced by the company's poor practices,[483] as a positive share price reflects positively on a company's management,[484] and secondly, that there is a strong relationship between poor practices and the company's management justifying the occurrence of a takeover and the subsequent removal of the management.[485]

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[477] OECD, 'Corporate Governance: The Role of Institutional Investors in Promoting Good Corporate Governance' (n 464) 41.
[478] Manne (n 170) 114.
[479] ibid 119.
[480] See generally Manne (n 170).
[481] See generally ibid.
[482] Mitchell and Mulherin (n 172).
[483] See Section 3.2.4 of this thesis for relevant empirical evidence.
[484] Manne (n 170) 112–114.
[485] ibid.

3.4.2.1.5 Financial media

The financial media is among the influential factors that play a considerable role in facilitating private enforcement and market discipline. It is believed that independent and investigative media can positively impact upon conformity with the corporate governance framework by shedding light on the practices of certain companies and the actions of certain boards and managers, which in turn assists in shaping the behaviours of boards and the discipline of managers.[486] The type of pressure exercised by the media result in companies producing higher quality disclosures, providing easier access to information, and making more sensible governance choices.[487] Press reports and financial journalists who expose poor corporate governance practices could enhance the enforcement of corporate governance principles in two ways. The first is that media pressure could in itself be motivation for boards to adopt best governance standards, to avoid reputational risk; and the second is that media reports can highlight examples of inappropriate governance practices which may get shareholders' attention and prompt them to investigate the matter internally and take action accordingly.[488]

Lastly, in light of the above discussion, it could be said that the enforcement of corporate governance rules is usually a complex matter, as it is influenced by the various factors set out earlier. Nevertheless, it is particularly relevant in the context of corporate governance to stress that, as was shown earlier in this chapter,[489] the regulatory mode of the corporate governance framework varies across jurisdictions, from those adopting a voluntary framework to others adopting a mandatory framework. That being the case, the effectiveness of enforcement under any framework is directly affected by the adopted mode.

Now that the main considerations surrounding enforcement approaches have been established and discussed, the remaining task in this chapter is to explore the three chosen jurisdictions in order to establish and discuss their respective enforcement positions.

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[486] Berglöf and Claessens (n 181) 143.
[487] ibid.
[488] Section 2.6.2 of this thesis discussed the reality of the financial media in Saudi Arabia and concluded that it is too weak to have any meaningful impact on corporate governance in the Saudi capital market.
[489] See Section 3.2 of this thesis.

3.4.3 Legal position of the jurisdictions

In Saudi Arabia, the CMA plays a crucial role in the monitoring and enforcement of the framework's rules. The CL 2015 grants the CMA the powers to regulate and supervise listed companies, monitor their compliance with the framework's rules, and impose sanctions on violators.[490]

The CL 2015 equipped the CMA with tools to assist it in fulfilling its tasks, such as the rights to inspect listed companies,[491] request information, attend the general assemblies, along with other supervisory tools. In order to exercise its monitoring and enforcement powers, the CMA follows several methods to detect any breaches of the framework's rules, including random inspection of companies, attending general assemblies, requesting periodic disclosures, and reviewing shareholders' complaints.[492] As was presented earlier, the framework sets out the sanctions that are to be imposed on violators[493] in the form of monetary and criminal penalties to be imposed by the CMA, either directly or through the Public Prosecution if the violation is a criminal offense.[494] It is worthy to note that the role played by the exchange in the enforcement process is minor, as all the exchange can do in the event of non-compliance with the framework's rules is to propose to the CMA to suspend or cancel the listing of a company found to be in violation of the exchange's rules.[495]

Based on the above, it can be said that the CMA has wide powers in relation to corporate governance practices in listed companies. Nevertheless, it is important to note that enforcement under the Saudi framework depends not only on the regulator, as the

[490] Articles 219 and 225 (2) of the Companies Law 2015.
[491] The power of the CMA to inspect listed companies and require the submission of any document or information it deems necessary for the monitoring of the framework is clear under Articles 220 and 221 of the CL 2015. These articles together reinforce the CMA's right to monitor the implementation of the framework, and can be considered to comprise a mechanism for the CMA to detect non-compliance.
[492] Article 86 (4) of the Companies Law 2015; Articles 89, 90, 91, 92, and 93 of the Corporate Governance Regulations 2017.
[493] The CMA, as per Article 213 of the CL 2015, can impose a fine not exceeding 500,000 SAR for any violation of the regulations issued by the CMA pursuant to the CL 2015, so this includes the CGRs 2017 as issued under the CL 2015. Moreover, the CMA, through the Public Prosecution and the Committee, could build a case for imposing a fine not exceeding 5,000,000 SAR and imprisonment for a term not exceeding five years for more serious offenses stated in Article 211 of the CL 2015.
[494] See generally Articles 211, 213 of the Companies Law 2015.
[495] Article 36 (d) of the Saudi Listing Rules provides that the exchange may at any time propose to the CMA to suspend or cancel a company's listing if it considers that company to be in violation of the exchange's rules. While the Listing Rules themselves do not contain any corporate governance related provision, they do however include an indirect and embedded reference to corporate governance by requiring the issuer to comply with the regulations issued by the CMA, which implicitly includes the Corporate Governance Regulations.

framework enables shareholders to enforce its rules in a number of cases. Indeed, a number of provisions can only be enforced at the initiative of the shareholders themselves.[496]

Turning to Delaware, it can be observed that its position is similar to that of Saudi Arabia in that the SEC is a key player in the monitoring and enforcement of the framework's rules. Consistent with its mandatory nature, the various sources that together constitute the framework provide three types of enforcement actions. The first are the enforcement activities undertaken by the SEC;[497] the second are the enforcement activities undertaken by the NYSE;[498] and the third are the enforcement activities undertaken by shareholders.[499] The SEC's monitoring and enforcement activities are concerned with corporate governance aspects that are part of the federal laws and regulations, mainly the SA 1933, the SEA 1934, the SOX 2002, the DWSRCPA 2010, and the regulations issued thereunder.[500] The SEC is equipped with several monitoring and sanctioning powers that enable it to play its role as envisioned under the relevant laws.[501]

The SEC can bring an action against the violator by applying to the court to either impose civil penalties[502], enjoin the complained about action[503], prohibit any violator of Section 10 (b), which deals with audit committees, from serving as an officer or director at an issuer.[504] The sanctions provided under the SEA 1934 are harsh, as it stipulates that any natural person who violates the act or any of the regulations issued thereunder shall upon conviction be fined not more than $5,000,000 or imprisoned for not more than 20 years, or both.[505] The exception is a non-natural person, who could be punished by a fine not exceeding $25,000,000.[506] Lastly, private investors may also initiate actions under several parts of the securities laws to recover damages from misstatements or omissions in public disclosures.[507]

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[496] For examples see Articles 79 and 80 of the Companies Law 2015.
[497] See generally the Securities Exchange Act of 1934.
[498] See generally the New York Stock Exchange Listed Company Manual.
[499] See generally the Delaware General Corporation Law.
[500] Emmerich and others (n 186) 409–410.
[501] Section 21 (a/1) of the Securities Exchange Act of 1934.
[502] Sections 21 (3/a) and (3/b) of ibid; This section also provides that the penalty may include the gross amount of pecuniary gain which is the result of the violation.
[503] See generally Section 21 of ibid.
[504] Section 21(2) of ibid; It should be noted that while the SEC is responsible for pursuing civil actions, criminal violations of federal securities laws and associated rules are prosecuted by the US Department of Justice. See Emmerich and others (n 186) 410.
[505] Section 32 of the Securities Exchange Act of 1934.
[506] Section 32 of ibid.
[507] Section 21 (d) of ibid.

In regard to the enforcement of the NYSE's listing rules, given that many aspects of corporate governance are regulated under those rules, the responsibility of enforcing them is vested in the exchange itself. The failure of a company to abide by the exchange's rules makes it subject to a public reprimand, the temporary suspension of trading, and/or permanent delisting.[508]

In relation to Delaware's General Corporations Law, the enforcement thereof is the responsibility of private parties, particularly shareholders.[509] In this context, shareholders are provided with three types of actions. The first type of action is derivative action, in which a shareholder, subject to certain requirements, sues the board on behalf of the company where the complained about act is allegedly causing harm to the company and its shareholders as a whole.[510] A shareholder can generally bring this action after demanding that the company take the action itself; however, there are circumstances where such a demand is waived, and shareholders can take the action directly.[511] The second type of action is a class action which is brought by a shareholder on behalf of a group of shareholders who share the same complaint and seek the same remedy.[512] The third type of action is a direct action where a shareholder sues the board due to the damage caused to him as an individual.[513]

In contrast, the enforcement approach of the UK is notably different than those of Saudi Arabia and Delaware as the largest part of enforcing the framework's rules is left to market forces, particularly shareholders.[514] Public enforcement rarely takes place, as the FRC's main supervisory and enforcement role is mostly concerned with aspects of disclosure.[515] In discharging its role, the FRC aims at enabling shareholders, through enforcing disclosures, to play a key role in assessing the company's governance choices and if necessary, holding the board liable for any violation which has been identified.[516] Apart from the internal actions that shareholders can take to pressure the company to adopt better

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[508] See generally the New York Stock Exchange Listed Company Manual.
[509] Emmerich and others (n 186) 410.
[510] Rule 23.1. of the Rules of the Court of Chancery of the State of Delaware; Ángel R Oquendo, 'Six Degrees of Separation: From Derivative Suits to Shareholder Class Actions' (2013) 48 Wake Forest L. Rev. 643; Emmerich and others (n 186).
[511] Emmerich and others (n 186) 410.
[512] Rule 23. of the Rules of the Court of Chancery of the State of Delaware; Oquendo (n 510).
[513] Oquendo (n 510).
[514] 'The FRC and Its Regulatory Approach' 3.
[515] ibid.
[516] ibid 3–4.

governance practices such as making a special resolution,[517] or replacing the board and selling their shares,[518] the CA 2006 empowers shareholders with two main enforcement mechanisms: a derivative action,[519] and through claiming unfair prejudice to shareholders' interests.[520] Turning again to the FRC's role, the FRC is not concerned with the governance choices each company makes, provided that it discloses how it has applied the code's principles and which provisions have been complied and which have not, and the reasons for any non-compliance.[521] Whether such choices are appropriate for the given company is left to shareholders to decide.[522]

When the FRC has concerns regarding a disclosure report of a given company, it will communicate its concerns to the company in question, and require it to correct and resolve the issues highlighted.[523] If a company is uncooperative with the FRC, then the case will be referred to the Conduct Committee of the FRC, which will be asked to review the case and apply to the court to oblige the company either to publish a revised report, or to take (or refrain from) specific action.[524] Regarding the enforcement of corporate governance requirements that are part of the listing rules, the Financial Conduct Authority (FCA), as the UK's listing authority, can take action if a listed company violates the relevant rules which are mainly concerned with disclosing the corporate governance statement mentioned earlier and related-party transactions.[525] The FCA's enforcement actions in this context include fines, public censure, suspending a company's listing or cancelling it altogether.[526] Similar enforcement actions can be taken by the exchange (i.e., LSE) when the relevant rules stipulated in its ADS 2018 are violated. Its rules are also mainly concerned with disclosure of corporate governance practices within a listed company.[527]

In summary, and in light of the overview set out here of the jurisdictions' legal positions, it can be said that the enforcement approach adopted by each jurisdiction is consistent with the regulatory mode of the given framework. The main observation to be made is that, as

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[517] Section 283 of the Companies Act 2006.
[518] Keay (n 214) 288.
[519] See generally Part 11 of the Companies Act 2006.
[520] Part 30 of ibid.
[521] Wymeersch (n 28) 132.
[522] ibid.
[523] 'How We Review Reports and Accounts' <https://www.frc.org.uk/accountants/corporate-reporting-review/how-we-review-reports-and-accounts> accessed 27 November 2019.
[524] ibid.
[525] 'The Enforcement Guide' 187 <https://www.handbook.fca.org.uk/handbook/document/eg/EG_20160101.pdf> accessed 27 November 2019.
[526] ibid.
[527] Item 1.8, Rules B7, B8, and B10 of the Admission and Disclosure Standards 2018.

will be explored in more detail below, when it comes to enforcement of the framework's rules, in both Saudi Arabia and the US the role of public regulators is far greater than that of their counterpart in the UK, where the regulators are not as concerned with the direct enforcement of the UK's rules. Both the CMA in Saudi Arabia, and the SEC in the US are explicitly empowered by the relevant laws to monitor, inspect, request information, investigate violations, and impose sanctions. The sanctions at their disposal vary in form, and include fines and imprisonment in certain cases. This is in marked contrast to the UK, where the FRC's role is solely limited to ensuring full corporate disclosure, in line with the voluntary nature of the framework. Furthermore, in all three jurisdictions, the exchange plays a role in corporate governance in that it can take enforcement actions when the relevant rules are violated - indirectly in Saudi Arabia, and directly in the UK and the US -. The biggest difference, however, is that in the UK the corporate governance rules that are part of the listing rules are mostly related to disclosure, while in Delaware the listing rules are the main regulatory vehicle through which most typical governance aspects are regulated. As a result, the exchange in the US assumes far greater responsibility for the substance of corporate governance practices within listed companies, while the exchanges in Saudi Arabia and the UK are theoretically concerned only with the disclosure element of corporate governance.

3.4.4 Assessment of enforcement under the Saudi framework

Now that the legal positions of the three jurisdictions in relation to enforcement of the framework have been established, several points can be made. The first is that the supervisory and sanctioning tools provided to regulators in Saudi Arabia and Delaware are consistent with the mandatory nature of their frameworks. Therefore, the availability of these tools reflects their necessity in enabling the regulators to monitor and enforce the framework's rules. Meanwhile, the relative lack of monitoring and sanctioning measures in the UK is consistent with the voluntary nature of the UK's framework, where shareholders are expected to assume the bulk of the monitoring and enforcement tasks.

The second observation is that despite the importance of facilitating the role of market forces and market discipline in the enforcement of the framework's rules and its effect of reducing the pressure on the regulator, the public enforcement of corporate governance rules is vital in a jurisdiction like Saudi Arabia to maintain the integrity of its capital market. This is because the extent to which companies are willing to comply with voluntary rules is open to question given that the Saudi capital market has distinct cultural characteristics wherein social status and relationships are strongly influential in corporate settings. In such settings, the role of informal relationships such as tribal or familial associations can sometimes be more influential than formal corporate governance arrangements and mechanisms such as boards and their committees. This means that in the absence of mandatory rules backed by the regulator and public enforcement of those rules, the rights and interests of shareholders, especially minority ones, are more likely to be ignored for the benefit of the more powerful shareholders and executives.

Furthermore, the Saudi capital market is characterised by its concentrated ownership,[528] with block holders (primarily government bodies and wealthy families) dominating listed companies.[529] This ownership structure could negatively affect companies' inclination to voluntarily comply with governance rules for the benefit of their powerful controlling shareholders. Moreover, the presence of institutional investors is relatively low, leading to inadequate shareholder activism and a limited ability to design and enforce governance rules. The low level of activism in Saudi Arabia coupled with the inactive market for corporate control and the absence of an independent financial media casts doubt on the promises of any potential voluntary approach towards being able to maintain an effective accountability mechanism.[530]

Lastly, it is important that the sanctions available to the CMA are suited to the nature of corporate governance in order to ensure their effectiveness. Although the CL 2015, as the relevant corporate law, grants the CMA the right to impose various sanctions on those who violate corporate governance rules including fines and imprisonment, it is not clear whether the sanctions of the CML 2003 as the relevant securities law are also applicable in the context of corporate governance enforcement. To explain this distinction further, the CML 2003 contains other forms of punishment measures that the CMA can impose on violators of its regulations, such as delisting a given company, suspending its listing, cancelling licenses, preventing wrongdoers from serving as directors, and public censure and reprimand, none of which are stipulated in the CL 2015 which governs the corporate governance rules and upon which the CGRs 2017 is issued. Accordingly, it is uncertain that the CMA would be able to impose any of those sanctions on violators of the CGRs

528 For more on the ownership structure of the Saudi capital market see Section 2.5 of this thesis.
529 Al-Bassam and others (n 147).
530 See the prior discussion of the Saudi capital market's ownership structure presented in Section 2.5 of this thesis.

2017 or the CL 2015, which means that such violators are only subject to either fines or imprisonment. This is especially true given that corporate governance rules are not all at the same level of importance and materiality, as many are procedural in nature and their non-compliance should not necessarily be punishable by a fine or imprisonment, as a public censure or a reprimand may be more appropriate and reasonable based on the seriousness and impact of the violation. In the absence of such light measures (i.e., public censure and reprimand), the CMA may find itself either reluctant to punish wrongdoers via a fine or imprisonment due to the severity of these punishments in cases where the rule being violated is not highly material. This may in turn encourage companies to continue to violate such rules and may therefore lead shareholders to gradually lose confidence in the regulator, or alternatively, it could impose such sanctions for every offense regardless of severity, which would undermine its enforcement efforts, hinder its effectiveness, and significantly increase the compliance costs incurred by companies.

3.5 Summary and Conclusion

The objective of this chapter was to evaluate the design and approach of the Saudi framework in comparison to its counterparts in the UK and Delaware by discussing the regulatory mode of each framework, its flexibility, and its enforcement mechanism. By doing so, the chapter aimed to establish the main context and key ideas underpinning the discussions in chapters 4 and 5. The chapter started by exploring the regulatory components that comprise each framework, establishing that corporate law, securities law, corporate governance regulations, and listing rules affect the content of corporate governance obligations in the three jurisdictions.

The chapter then explored the voluntary and mandatory approaches and critically discussed their main assumptions prior to establishing the mandatory mode of the Saudi framework and assessing its suitability. The chapter discussed whether this mode is appropriate for the Saudi capital market or whether a voluntary one would be more beneficial. Despite the popularity of the voluntary approach worldwide and challenges associated with mandatory approach, the research concluded that the conditions and characteristics of the Saudi capital market justify the preservation of the mandatory regime, and that replacing it with a voluntary one would be a futile endeavor.

In this regard, the research argued that the effectiveness of a voluntary approach is dependent on several prerequisites such as strong shareholder activism, shareholder coordination, the existence of a stewardship obligation, the presence of an active market for corporate control, and the existence of an independent investigative financial media. The research noted that these conditions are absent in Saudi Arabia, concluding that this absence, along with the concentrated ownership structure, necessitate that Saudi mandatory regime remains in place. Furthermore, the research argued that a voluntary framework is likely to struggle in Saudi Arabia given the role of informal relationships that are sometimes more influential than formal corporate governance arrangements, implying that in the absence of a mandatory framework backed by the regulator and public enforcement, the rights of shareholders, especially minority ones, are more likely to be abused.

Importantly, the chapter challenged many of the assumptions underpinning the voluntary approach, arguing that the reality of corporate governance in jurisdictions operating under a voluntary framework does not validate those assumptions. On the contrary, the chapter demonstrated with reference to the available empirical evidence that, for example, in the UK and European countries many companies comply with the rules in a perfunctory manner, while many others violate the rules on a large scale without any disciplinary action being taken. Moreover, the chapter exposed the weak role of market forces upon which the enforcement of the voluntary approach is based by establishing that shareholders do not participate in the monitoring and disciplining tasks as seems to be expected, and that they are mostly driven by share price, all of which calls into question the virtues of a voluntary approach, even in mature jurisdictions. While the research advocated for the preservation of the mandatory system in Saudi Arabia to increase the compliance rate, control the agency problem (both principal-agent and principal-principal), and compensate for the weak role of market forces and external factors, it did not entirely dismiss the value of a voluntary approach. Instead, it recommended that the Saudi framework should incorporate some forms of a voluntary approach by introducing voluntary guidance notes wherein many of the detailed rules and procedural aspects are dealt with. This recommendation is based on the observation that the Saudi framework, as opposed to those of the UK and Delaware, suffers from regulatory over-extensiveness.

As to flexibility, despite acknowledging the idea that companies' needs differ and that a mandatory approach is inherently less flexible than a voluntary one, the research did not support the argument that flexibility can only be offered in a voluntary framework. To the contrary, the mandatory approach was shown to be capable of manifesting flexibility through the utilisation of default rules and that such utilisation is advantageous in that it provides shareholders with statutory protection.

Furthermore, the research challenged the assumptions that flexibility enhances the effectiveness of corporate governance by allowing companies to determine their governance structures according to their needs. In this regard, the research argued that, as is empirically evidenced, many companies do not make use of the flexibility offered under voluntary framework, in that they fully comply with the relevant codes without material deviation. The research then moved to ascertain the level of flexibility of the Saudi framework, concluding that taking into account its heavy reliance on mandatory rules and the over-extensiveness thereof, it is the least flexible and the most detailed and over-extensive of the three frameworks. However, the research also argued that this is in itself does not necessarily indicate that the Saudi approach is deficient, questioning the virtues of flexibility in light of the empirically endorsed findings that many companies largely comply with the code in a mechanical manner without formulating their own governance structure, thus implying that the flexibility was not put to use. Therefore, the research established that flexibility becomes less relevant especially that many corporate governance arrangements are universally important across all companies, and that in many situations no alternative path can be justified.

The research also discussed enforcement and established its centrality to the effectiveness of corporate governance, and in doing so covered public enforcement and private enforcement, in addition to the concept of market discipline. The negative outcomes that result from weak enforcement were explored, and the main factors affecting public and private enforcement were highlighted. The research then progressed to establish the legal position of the three jurisdictions in relation to enforcement, concluding that the Saudi framework rightfully equips the regulator with the required monitoring and sanctioning tools to fulfil its supervisory role. This position is consistent with the framework's mandatory mode and recommendations of the OECD and the European Commission which call for enhancing the effectiveness of the corporate governance framework by investing regulators with appropriate monitoring and sanctioning powers.

Nevertheless, the research recognised an area of uncertainty on whether the CMA can take the disciplinary measures (e.g., delisting, public censure, and reprimand) stipulated in the CML 2003, which governs securities matters, against non-compliers with the framework's rules or that the CL 2015 is the only source of sanctions. This is critical to the effectiveness of public enforcement given that the CL 2015's sanctions are generally harsher than those stipulated in the CML 2003, and thus in some instances may not be proportionate to immaterial violations. The absence of diverse measures (including lighter ones) may either pressure the CMA to enforce harsh sanctions for every violation despite its materiality, thus exhausting its resources and placing an unreasonable burden on companies, or discourage it from taking action altogether in situations where the violation is immaterial, thus incentivising companies to violate the rules, both of which scenarios are detrimental to the capital market.

CHAPTER 4: STRUCTURE AND OPERATIONS OF THE BOARD

4.1 Introduction

The focus of the previous chapter was on analysing the design and approach of the framework in the three selected jurisdictions, in order to build understanding of how each framework functions.

Having done so, it is appropriate to comparatively explore the structure and operations of the board to ascertain whether the Saudi approach is suitable in this regard, and how the framework's design and approach (as discussed in Chapter 3) affects the regulatory approach towards the board's structural and operational arrangements. As will be explored below, the board is a fundamental organ that plays a vital role in the life of listed companies, thus there is a pressing need to evaluate the Saudi position towards it. The discussion of this chapter will focus on several board-related topics, all of which contribute to providing a clearer understanding of how each jurisdiction approaches the major aspects of the board. These topics are board's composition, board committees, and directors' duties.

Before the discussion of these three main topics begins, it is essential first to introduce the agency theory, which is an influential theory in the field of corporate governance. Its importance lies in the fact that it assists in understanding the regulatory approaches in regard to the board and the implementation of governance mechanisms to regulate it. It also helps to highlight the theoretical issues surrounding the relationship between the company's different constituencies, chief among which are its shareholders, board of directors, and senior management.

4.1.1 Agency theory

The agency theory is one of the oldest theories in the economics literature.[531] It discusses the problems arising within large business organisations, such as publicly-held companies, as a result of the separation of ownership and control, and seeks to reduce those

[531] Catherine M Daily, Dan R Dalton and Nandini Rajagopalan, 'Governance through Ownership: Centuries of Practice, Decades of Research' (2003) 46 Academy of Management Journal 151; Noam Wasserman, 'Stewards, Agents, and the Founder Discount: Executive Compensation in New Ventures' (2006) 49 Academy of Management Journal 960.

problems.[532] In publicly-held companies, the ownership of shares is in the hands of a large number of shareholders (principals) who delegate the decision-making authority to a group of managers (agents) with the expectation that managers will act in good faith and serve the best interests of shareholders.[533] The major concern, however, is that these managers may sometimes act in pursuit of their own benefit, putting the interests of shareholders second, a phenomenon known as the agency problem.[534]

The agency theory is an influential dogma in the context of corporate governance, as it is used to explain the relationship between the company's shareholders and managers, and to explore the various complexities associated with that relationship. Adam Smith was a prominent early figure who wrote about the existence of the agency problem, and since then his work has become a catalyst for researchers to further explore aspects of this theory. In his seminal book *The Wealth of Nations,* Smith opined that if an organisation is run by people who are not its owners, then there is a possibility that managers will not work for the owners but in their own interests.[535] Berle and Means later reinforced this concern by analysing the ownership structure of major companies in the US and concluding that the appointed agents control large companies, and that these agents may use corporate funds and assets for their personal benefit in a way that will create conflict between the owners (principals) and managers (agents).[536] Therefore, it could be said that the agency theory in the context of corporate governance has established its popularity by assisting in the creation and implementation of various governance mechanisms to control agents' behaviours in companies and ensure that shareholders' interests are always served.

4.1.1.1 Causes of the agency problem

In shareholders-managers relationships, many factors give rise to the agency problem, all of which can be attributed to the separation of ownership and control in publicly listed companies, at least in the three jurisdictions under study here, as evidenced by the fact that the corporate law in all three recognises such a separation, making it clear that the business

[532] Adolf Berle and Gardiner Means, 'The Modern Corporation and Private Property, 1932' (1968) McMillan, New York, NY.
[533] Jensen and Meckling (n 145); Stephen A Ross, 'The Economic Theory of Agency: The Principal's Problem' (1973) 63 The American Economic Review 134.
[534] Berle and Means (n 532); Ross (n 533); Jensen and Meckling (n 145).
[535] Adam Smith, *The Wealth of Nations: An Inquiry into the Nature and Causes of the Wealth of Nations* (Harriman House Limited 2010).
[536] Berle and Means (n 532).

and affairs of a company should be managed by an elected board of directors.[537] As noted in the influential work by Fama and Jensen on decision-making processes in large companies, agency problems emerge in companies where the people initiating and executing the decisions are different to those who suffer the economic effects of these decisions, with the authors concluding that controlling the agency problem is crucial to the survival of such companies.[538] This separation results in opposing risk-sharing attitudes among the company's different parties. The shareholders invest their money and bear the associated risk in order to obtain economic benefits from their investment, while the managers who run the company are inherently risk averse and their decisions are influenced by a desire to maximise their self-interest while keeping the risk level low so that their jobs remain stable and compensation is protected.[539] An example is when managers decide to avoid entering into a risky yet promising investment in the fear that while the investment may prove successful in the long term, the risks associated (despite being low) may cause it to fail, thus jeopardising their jobs security and impacting their compensation.

Another factor causing the agency problem is that contrary to shareholders, whose association with the company is relatively long rendering them an inseparable part of the company, the period during which managers are attached to the company is often much shorter, compelling them to get involved in self-enriching activities in order to maximise their own interests as much as possible during the short period they are there before leaving to work for another company.[540] This is especially true as labour markets for talented managers are highly developed in many countries, including the UK and the US; thus, executives tend to spend shorter periods in the same company before leaving for another company.[541]

Furthermore, the information asymmetry between shareholders and managers is a critical factor affecting the agency problem. The asymmetry occurs as managers run the company's day to day operations and therefore are fully informed of what is happening

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[537] Article 68 (1) of the Companies Law 2015; Article 17 (a) of the Corporate Governance Regulations 2017; Section 154 (2) of the Companies Act 2006; Principle (A) of the Corporate Governance Code 2018; Section 141 (a, b) of the Delaware General Corporation Law.
[538] Fama and Jensen (n 159).
[539] Kenneth Arrow, 'Essays in the Theory of Risk Bearing' (1970) Chicago: Markham Publishing; Robert Wilson, 'The Theory of Syndicates' (1968) Econometrica: Journal of the Econometric Society 119.
[540] Amir Barnea, Robert A Haugen and Lemma W Senbet, *Agency Problems and Financial Contracting* (Prentice Hall 1985).
[541] *OECD Corporate Governance Factbook* (2019) 127.

inside the company, with access to all the information necessary to evaluate and assess its position. This is not the case with shareholders, whose knowledge of the company's operations is highly dependent on managers, who in turn decide which information is released to shareholders and when. That being the case, the information obtained by shareholders is unlikely to be as complete and accurate as the information possessed by managers, leading to a situation where one party (managers) has an information advantage over the other party (shareholders).

Among the causes of the agency problem is the phenomenon known as moral hazard. The general principle of moral hazard is that the post-contract performance of one party may deviate from the norm. In the example of directors' activities, the discretionary power provided to them by the contract, the articles of association, may lead to a situation of moral hazard where the directors (as the agents) may be tempted to abuse their discretionary power by taking reckless decisions or failing to act in good faith, as they know that the possible economic losses resulting from their decisions will be suffered by the shareholders (as the principals).[542] The lack of monitoring and disciplining by shareholders increases the probability of moral hazard because the directors of the company can behave irrationally without adherence to a standard of reasonable care while performing their jobs,[543] prompting the need for effective arrangements to ensure that the performance of those agents is as appropriate as possible.

Lastly, the ownership structure could have a significant impact on the extent of the agency problem, given that shareholders could take a stronger part in monitoring and disciplining the management.[544] However, the rewards shareholders receive from monitoring is proportionate to their shareholding size,[545] meaning that a small shareholder may not be as incentivised as a large shareholder to take part in monitoring activities.[546] Therefore, it is fair to assume that as the size of shareholding increases, such as in companies with a strong

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[542] Robert A Burgelman, 'A Process Model of Internal Corporate Venturing in the Diversified Major Firm' (1983) Administrative Science Quarterly 223.

[543] Philip Stiles and Bernard Taylor, *Boards at Work: How Directors View Their Roles and Responsibilities: How Directors View Their Roles and Responsibilities* (OUP Oxford 2001); Gareth R Jones, 'Task Visibility, Free Riding, and Shirking: Explaining the Effect of Structure and Technology on Employee Behavior' (1984) 9 Academy of Management Review 684.

[544] Chrisostomos Florackis, 'Agency Costs and Corporate Governance Mechanisms: Evidence for UK Firms' (2008) International Journal of Managerial Finance.

[545] Oliver Hart and Sanford Grossman, 'One Share/One Vote and the Market for Corporate Control' (1988) Journal of Financial Economics.

[546] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737; Irwin Friend and Larry HP Lang, 'An Empirical Test of the Impact of Managerial Self-interest on Corporate Capital Structure' (1988) 43 The Journal of Finance 271; Florackis (n 544).

presence of active block holders, the incentive to monitor the management also increases and the agency problem could be reduced. Nevertheless, it should be borne in mind that any reduction of the agency problem associated with shareholders and managers in companies with concentrated ownership may be offset by a possible increase in the agency problem associated with major shareholders and minority shareholders.[547] This increase occurs because major shareholders driven by their own interests may make decisions without regard to the interests of minority shareholders, thus affecting the extent of the agency problem.[548]

4.1.1.2 Agency cost

An important element of agency theory is the agency cost,[549] which can be defined as the aggregated costs resulting from the opposing interests between principals and agents and the associated controlling mechanisms.[550] Agency costs can be categorised as either direct or indirect costs. One example of direct costs are the expenses incurred to monitor the management, such as hiring an external auditor to audit the company's accounts and financial statements. Another example are the expenses borne by the company to benefit management at the expense of shareholders, such as paying for unnecessary luxurious offices, private jets, unreasonable remuneration, and other perks. Examples of indirect costs, on the other hand, include the lost opportunity when managers avoid an investment opportunity due to the fear that although the opportunity may be promising, it might affect the managers' jobs or remuneration.

The agency cost begins with the cost of evaluating and selecting the agent, on top of which other costs are then added, such as the cost of training the agent and monitoring and controlling his actions, and the losses arising from the agent's ineffective decisions.[551] Furthermore, a cost known as the bonding cost is also accrued, which is the cost associated with the procedures through which agents continuously inform principals of the way they are managing the company so that principals can rest assured that their funds and assets are being managed according to the defined arrangements.[552] Such procedures include

[547] Shleifer and Vishny (n 546).
[548] Fama and Jensen (n 159); Armour, Hansmann and Kraakman (n 159).
[549] Jensen and Meckling (n 145).
[550] ibid.
[551] ibid; Fama and Jensen (n 159).
[552] Jensen and Meckling (n 145).

preparing periodic reports, the purpose of which is to shorten the information gap between agents and principals.[553]

The agency cost also encompasses the residual loss, which is incurred by principals despite the mechanisms they employ to reduce the agency cost and to align managers' interests with their own. This cost arises as it is impossible to completely align managers' actions with shareholders' interests. The residual loss is the primary component of agency cost that should be addressed by principals.[554] In an attempt to reduce this loss, shareholders increase monitoring, which in turn increases the monitoring and bonding costs[555] leading to a situation where the agency cost would be irreducible.

4.1.1.3 Solutions to the agency problem

Investigating the agency problem and ways to tackle it is an ongoing field of academic and corporate research. The different studies conducted on the agency problem in a company setting have proposed several mechanisms, many of which relate to a corporate governance system, as helpful in managing this problem and reducing its cost.[556] At the core of the relevant empirical research are several mechanisms, most notably managerial ownership,[557] executive compensation,[558] ownership structure,[559] the market for corporate control,[560] and corporate governance arrangements.[561] Each of these is now discussed in turn in terms of its effect on the agency problem.

First, a managerial ownership scheme through which the company's directors and managers are granted shares in the company increases their association with the company and helps to align their interests with those of the shareholders.[562] Because the directors

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[553] James S Ang, Rebel A Cole and James Wuh Lin, 'Agency Costs and Ownership Structure' (2000) 55 the Journal of Finance 81.
[554] Oliver Eaton Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (Free Press 1985).
[555] Edward A Dyl, 'Corporate Control and Management Compensation: Evidence on the Agency Problem' (1988) 9 Managerial and Decision Economics 21.
[556] Kathleen M Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14 Academy of management review 57; Stuart Rosenstein and Jeffrey G Wyatt, 'Outside Directors, Board Independence, and Shareholder Wealth' (1990) 26 Journal of Financial Economics 175.
[557] Jensen and Meckling (n 145).
[558] John E Core, Robert W Holthausen and David F Larcker, 'Corporate Governance, Chief Executive Officer Compensation, and Firm Performance' (1999) 51 Journal of Financial Economics 371.
[559] Mike Burkart, Denis Gromb and Fausto Panunzi, 'Large Shareholders, Monitoring, and the Value of the Firm' (1997) 112 The Quarterly Journal of Economics 693.
[560] Kini, Kracaw and Mian (n 172).
[561] Rosenstein and Wyatt (n 556).
[562] Jensen and Meckling (n 145).

and managers (i.e., the agents) own shares in the company, becoming owners themselves, they are more likely to act and behave with the same vigilance and diligence expected from the principals should they run the company themselves, thus focusing on increasing the company's value.[563] Compensation, on the other hand, is a critical factor when seeking to motivate managers to behave responsibly. That being said, it is no surprise that the frameworks of Saudi Arabia and the UK recognise the influence of managerial ownership and compensation on the agency cost, as they both explicitly provide for long term incentives for executives in the form of an employee share plan.[564]

Second, the market for corporate[565] control manifested by the presence of an active M&A market contributes to motivating managers to fulfil their responsibilities in an honest and effective way, and compels them to enhance the company's performance.[566] The assumption is that the poor management would frustrate shareholders compelling them to sell their shares as a response to the underperformance rather than engaging in a lengthy and costly attempt to replace the poor managers and hold them accountable. The continuous sale of shares reflects negatively on their price, lowering it to a level where market watchers believe it has become attractive enough for them to take over the company,[567] remove its poor management, and run the company more efficiently. The fear that the company could end up in such a vulnerable position should encourage managers to do the best they can in managing the company, maintain its growth, and put shareholders' interests above their own.[568] The relationship between the market for corporate control and agency cost is evidenced by the empirical evidence, among which one study analysed 1064 companies and found that the pressure caused by M&A positively affects corporate governance practice within companies, including both companies subject to M&A and other companies that tend, due to the fear of M&A threats, to adopt better governance standards and work towards maximising the wealth of their shareholders.[569]

Third, ownership structure, particularly in terms of concentrated ownership, can relieve the agency problem if it is utilised to place pressure on managers, thus inducing managers to

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[563] ibid.
[564] Articles 13 and 24 of the Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016; Provisions 36 and 37 of the Corporate Governance Code 2018.
[565] Section 3.4.2.1.4 of this thesis discussed this concept in more detail.
[566] Kini, Kracaw and Mian (n 172).
[567] Manne (n 170) 112–114.
[568] Mitchell and Mulherin (n 172); George Bittlingmayer, 'The Market for Corporate Control (Including Takeovers)' (1998) Available at SSRN 81808.
[569] Mitchell and Mulherin (n 172).

preserve shareholders' interests.[570] This is particular relevant to Saudi Arabia as the predominant ownership structure of its market is categorised as one of concentrated ownership,[571] contrary to its counterparts in the UK and Delaware where ownership is dispersed,[572] suggesting that the Saudi framework could benefit from such a structure and encourage block owners to play a larger role in monitoring companies to ensure that proper governance system is in place.

Now that the agency theory has been explored, the following discussion focuses on the relationship of agency theory with the board of directors.

4.1.2 Board of directors and agency theory

The board of directors has long been among the most prominent characteristics of joint stock companies, having been closely associated with them since the emergence of this type of company. The legal recognition of this corporate organ across the world[573] and the associated governance rules demonstrate the paramount role which boards play within companies,[574] to the point where a modern company without this fundamental element can hardly be imagined.[575] This critical role of the board is widely established, as it is the corporate organ in which ultimate decision-making authority is vested. As was established earlier, the frameworks of Saudi Arabia, the UK, and Delaware all recognise the board of directors as the legitimate body responsible for managing the affairs of joint stock companies to the extent specified in their articles of association.[576] In addition to setting the company's strategy, monitoring its management, and safeguarding the trustworthiness of the company's accounting and financial statements, many corporate laws around the world place many of the company's major decisions in the hands of the board. Examples of such decisions[577] include approval of M&A transactions, the distribution of dividends, approval

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[570] Burkart, Gromb and Panunzi (n 559).
[571] For more on the ownership structure of the Saudi capital market see Section 2.5 of this thesis.
[572] *OECD Corporate Governance Factbook* (n 541) 17.
[573] ibid 115–117.
[574] Stephen M Bainbridge, 'The Board of Directors', *The Oxford Handbook of Corporate Law and Governance* (2018).
[575] B Hermalin and M Weisbach, 'Board of Directors as an Endogenously Determined Illusion' (2003) 9 Federal Reserve Bank of New York. Economic Policy Review 1.
[576] Article 68 (1) of the Companies Law 2015; Article 17 (a) of the Corporate Governance Regulations 2017; Section 154 (2) of the Companies Act 2006; Principle (A) of the Corporate Governance Code 2018; Section 141 (a, b) of the Delaware General Corporation Law.
[577] It should be noted here that while many corporate laws around the world place many of the company's major decisions and transactions in the board's hands, the extent of its power varies from one jurisdiction to another. For example, in the UK, as opposed to the US, the shareholders play a more prominent role in

of financial statements, the sale of assets, and the appointment of senior management.[578] The potential value a board brings to the company adds to its importance as the different expertise, perspectives, analysis, and connections each member brings together form a highly powerful asset that a company can utilise to thrive and maximise its shareholder value.

The concept of a board of directors emerged as business organisations evolved over time and their size and operations expanded in a way that necessitated the separation of their ownership and control, particularly in publicly held companies where ownership is often diffused. In such companies, shareholders are normally unwilling to suffer the cost and trouble of coordinating efforts and monitoring company activities. The discrepancy between the interests of shareholders (the principals) and managers (the agents) along with the practical challenges facing monitoring by shareholders impose a need for an active board and strong corporate governance mechanisms to minimise shareholders' financial losses (the agency cost) and to prevent economic failure.

That being the case, it can be said that agency theory relates to the board in two ways. The first is that a strong and independent board can offer a solution to the agency problem as such a board is capable of managing the conflicts between shareholders and managers, thus reducing the agency costs. [579] In this regard, it is widely believed that the primary goal of corporate law and corporate governance is – among other things – to solve the agency problem.[580] The other way in which agency theory relates to the board is that the board itself can create an agency problem in that the directors, as agents themselves, may deviate from their presumed monitoring functions and act in pursuit of their own benefits without regard to the interests of shareholders, in addition to not making the necessary efforts to monitor the company's performance, resulting in an over-reliance on managers.[581] After all,

approving major decisions such as Class 1 transactions as defined in the Listing Rules and related party transactions, both of which are dealt with in Rules 10 and 11 of the UK Listing Rules.

[578] Bainbridge, 'The Board of Directors' (n 574) 3; OECD, *G20/OECD Principles of Corporate Governance* (n 2) 6.

[579] Praveen Kumar and K Sivaramakrishnan, 'Who Monitors the Monitor? The Effect of Board Independence on Executive Compensation and Firm Value' (2008) 21 The Review of Financial Studies 1371; Rosenstein and Wyatt (n 556).

[580] Hermalin and Weisbach (n 575); Bainbridge, 'The Board of Directors' (n 574).

[581] Renée B Adams, Benjamin E Hermalin and Michael S Weisbach, 'The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey' (2010) 48 Journal of Economic Literature 58.

a troubling company performance and bad governance are indicators of a board not doing its job properly.[582]

That being the case, maintaining proper governance rules for such a powerful organ is vital to the success of companies as doing so ensures that the board refrains from self-enriching activities and instead focuses on maximising shareholders wealth.

Now that the relationship between the agency problem and corporate governance has been established, and the relevance of the board has been explained, it is an appropriate point at which to begin the comparative evaluation of the structure and operations of the board. It is important to take into account that, consistent with the regulatory mode of each framework, responses to the agency problem can take two forms. The first of these is a regulatory response where the framework directly manages the conduct of the agents for the benefit of the principals, and the other is a governance-based response where the framework paves the way for principals to discharge their monitoring and enforcement role over the agents.[583] Therefore, the discussion below will explore the nature of the responses in each jurisdiction and which form is most suitable to the Saudi framework in light of the comparative analysis and the theoretical and empirical evidence. The discussion will begin first with the board's structural issues which are: board's composition and board's committees, then the discussion will shift to the board's operational issues namely: directors' duties.

4.2 Board's Composition

The board's capacity to lead the company well, monitor its management vigilantly, and represent shareholders fairly is affected by the board's ability to exercise independent judgement. As far as agency theorists are concerned, the challenge lies in appointing the right monitors and designing the proper board structure that enables it to play its role as envisioned.[584] This is where the question of what makes an effective board arises, a question which evolves to include who should be on the board, who should dominate the board, what role the CEO should play on the board, and ultimately, how to create an

[582] Carolina Azar and A Grimminger, 'Achieving Effective Boards: A Comparative Study of Corporate Governance Frameworks and Board Practices in Argentina, Brazil, Chile, Colombia, Mexico, Panama and Peru' 1.
[583] Armour, Hansmann and Kraakman (n 159).
[584] Gareth R Jones and John E Butler, 'Managing Internal Corporate Entrepreneurship: An Agency Theory Perspective' (1992) 18 Journal of Management 733.

independent and balanced board where no individual or group is dominating the decision-making.

To this end, many jurisdictions across the world have increasingly introduced regulations that aim to ensure the balanced design of a board and the independent judgement of its directors.[585] To achieve such a balance, the focus of jurisdictions' efforts have been on several issues, chiefly the major compositional aspects such as the duality of the CEO and chairman, the right combination of executive and non-executive directors (NEDs), and the independence of NEDs. These three topics will now be discussed in order to explore the position of the three jurisdictions towards each issue and to ultimately assess the suitability of the Saudi approach.

Before shifting to the specific discussions of each of the three issues identified above, it is important to present a comparative overview of the high-level rules surrounding the board's composition. To begin with, the choice between a one-tier and two-tier board structure have been settled in favour of the former structure,[586] with convergence evident in that the one-tier board structure combining both executives and NEDs is the only recognised board type in all three jurisdictions.[587] The size of the board, however, is a matter of divergence, as the Saudi framework requires a board of any size between three and eleven members, [588] whereas the UK and Delaware require at least two members and one member respectively, with neither stipulating a maximum number.[589] In relation to the board's composition, it is apparent that the chairman is a fundamental component of the board, a position that is recognised in all three jurisdictions, [590] while the position of a vice chairman is only legally recognised and required under the Saudi framework.[591] Moreover, the issue of the duality of the CEO and chairman is another area of divergence, as the Saudi framework prohibits the chairman from occupying any executive position at the

[585] *OECD Corporate Governance Factbook* (n 541) 115–127.
[586] It should be noted here that the corporate laws in the three jurisdictions do not explicitly prohibit a two-tier board structure, but it is implied that the existing board-related rules and recommendations such as rules on composition, NEDs, and the duality of CEO and chairman are designed with a one-tier board in mind, in a way that does not facilitate or encourage a two-tier board. In other words, any companies wishing to adopt a two-tier structure would find it difficult in practical terms to do so.
[587] Articles 16 and 24 (b) of the Corporate Governance Regulations 2017; Principles (G) and (F) of the Corporate Governance Code 2018; Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[588] Article 68 (1) of the Companies Law 2015; Article 17 (a) of the Corporate Governance Regulations 2017.
[589] Section 154 (2) of the Companies Act 2006; Section 141 (a, b) of the Delaware General Corporation Law.
[590] Article 81 of the Companies Law 2015; Principle (F) of the Corporate Governance Code 2018; Section 14B of the Securities Exchange Act of 1934.
[591] Article 81 of the Companies Law 2015.

company, including the CEO's position,[592] while Delaware is neutral as to whether the same person occupies the two positions. The UK seems to take a middle ground, as its code, through a voluntary rule, discourages the same individual from occupying the two positions.[593]

Turning to who should sit on the board, there is consensus across the three jurisdictions on the need for a balanced board combining executives and NEDs both independent and non-independent, with NEDs occupying more seats. The distinction between the three types of board membership is seen equally in Saudi Arabia, the UK, and Delaware, which all recognise and distinguish between executive directors, non-independent NEDs, and independent NEDs.[594]

The difference among the jurisdictions lies in the approach each framework takes towards the expected role and number of NEDs in addition to the legal nature of the approach, as will be discussed below in addressing NEDs and independence.

Now that the position of each jurisdiction in relation to board composition has been set out, evaluation of the Saudi approach to board composition, in comparison to the UK and Delaware, can begin, starting with its attitude towards CEO and chairman duality, followed by its approach towards NEDs and independence.

4.2.1 Duality of CEO and chairman

Among the important compositional issues often discussed within the corporate governance literature is whether the position of the company's chairman should be separated from the position of the CEO, which is referred to as the duality of CEO and chairman. Discussion of this matter has several dimensions, most of which relate to the relationship between duality and the agency problem, and the relationship between duality and the company's performance. The relevant theoretical and empirical studies are inconclusive and inconsistent on both relationships, which may explain the remarkable divergence to be found among the three jurisdictions on duality. As was explained above the Saudi framework prohibits a chairman from occupying any executive position at the

[592] Article 81 (1) of ibid.
[593] Provision 9 of the Corporate Governance Code 2018.
[594] Articles 1, 16 (2, 3), and 90 (3) of the Corporate Governance Regulations 2017; Principle (G) of the Corporate Governance Code 2018; Section 303A.03 of the New York Stock Exchange Listed Company Manual.

company, which includes that of CEO,[595] while Delaware is neutral on whether the same person occupies the two positions.[596] As per the SEA 1934,[597] all a company is required to do in this regard is to disclose why it has chosen the same person, or a different person, to occupy, or not to occupy, the positions of chairman and CEO.[598] On the other hand, the UK seems to take a middle ground, as the code discourages the same individual from occupying the two positions through a voluntary rule operating on a *Comply or Explain* basis.[599]

Despite the different and mixed findings of the prior theoretical and empirical studies on the relationship between agency cost and the duality of CEO and chairman, most of those studies indicate that the ability of the board to fulfil its monitoring functions will be negatively affected in companies where the CEO is also the chairman, leading to an increase in agency cost. Several ways to measure such relationship have been applied, including measuring the effect of the duality on succession planning, executive compensation, management misconduct, and the entrenchment of the CEO's powers.

For example, one empirical study examining the relationship between CEO duality and succession planning found that while a higher turnover of CEOs was seen in underperforming companies both with and without dual CEOs, the rate of turnover was lower by 50% in companies with dual CEOs.[600] In other words, companies with dual CEOs are less likely to fire the CEO when underperforming, something that raises a warning flag as to how dual CEOs may use their powers to stabilise their jobs even when the company's performance is troubling.

Another empirical study aiming to ascertain the effect of duality on CEO empowerment activities used the adoption of "poison pills" (the tactic often used by a company's management to reduce the possibility of a hostile takeover and their possible replacement by reducing the attractiveness of the company in various ways) as a measure when analysing 673 public US companies.[601] The findings reached by Mallette and Fowler

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[595] Article 81 (1) of the Companies Law 2015.
[596] Section 14B of the Securities Exchange Act of 1934.
[597] Section 14B of ibid.
[598] See page 71 of this thesis for a previous discussion on this aspect.
[599] Provision 9 of the Corporate Governance Code 2018.
[600] Vidhan K Goyal and Chul W Park, 'Board Leadership Structure and CEO Turnover' (2002) 8 Journal of Corporate finance 49.
[601] Paul Mallette and Karen L Fowler, 'Effects of Board Composition and Stock Ownership on the Adoption of "Poison Pills"' (1992) 35 Academy of Management Journal 1010.

indicate that the adoption of “poison pills” was more common in companies with dual CEOs,[602] supporting the argument that CEO duality could be used to enrich the CEO at the expense of the company and its shareholders, all which increases the agency cost.

Duality is also believed to be associated with corporate misconduct, as indicated by a study conducted by Kesner and Johnson who used the number of shareholders' lawsuits against boards to support the hypothesis that companies with dual CEOs are more prone to shareholders' lawsuits than those where the CEO and the chairman are separate people.[603] Based on an analysis of 112 companies, they found that lawsuits against boards are indeed much higher in companies with dual CEOs,[604] strengthening the argument that duality is more likely to lead to governance problems.

These studies and several other studies with similar findings support the Saudi approach of imposing an absolute prohibition on duality, a position that is mirrored by the UK except that it regulates duality through a voluntary rule, enabling companies to deviate as needed provided that they justify their reasons for doing so. However, before concluding whether or not the Saudi approach is optimal, it is first necessary to explore why Delaware’s approach differs from the Saudi approach although both operate a mandatory framework. The US is generally less flexible when it comes to regulations of corporate governance and yet it is apparently indifferent as to whether the same person should occupy the two positions.[605] The second question which needs to be investigated is whether the duality issue under the Saudi framework should continue to be regulated by a mandatory rule, or if it would be better to change to a voluntary rule like that of the UK.

Starting with the first question, the research argues that different board compositions and the different decision-making process in general explain the divergence in this matter, most clearly in Delaware and to a lesser extent in the UK. In other words, the influence of a dual CEO over the board’s decision-making process should be lower in Delaware and the UK than it is in Saudi Arabia as the Saudi framework requires independent directors to occupy

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[602] ibid.
[603] Idalene F Kesner and Roy B Johnson, ‘An Investigation of the Relationship between Board Composition and Stockholder Suits’ (1990) 11 Strategic Management Journal 327.
[604] ibid.
[605] This is evidenced by the fact that the US as compared with most other countries approaches corporate governance matters through binding legal provisions that in many instances do not leave room for companies to make their own choices; see *OECD Corporate Governance Factbook* (n 541); See generally the Sarbanes-Oxley Act of 2002; See generally the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

at least two seats or one-third of the board's seats, whichever is greater,[606] a number that is much lower than in the UK, which provides that apart from the chair, half of the board should be independent NEDs,[607] and in Delaware,[608] where the majority of board directors must be independent.[609]

Furthermore, the Saudi framework requires that a company's audit,[610] nomination[611] and compensation[612] committees each must have at least one independent director, and that the audit committee's chairman is independent,[613] while in Delaware the Manual requires the nomination, compensation, and audit committees to be composed entirely of independent directors.[614] In the UK, the CGC 2018 requires the chairman of the board[615] and a majority of the nomination committee to be independent directors,[616] and the remuneration and audit committees to have at least three independent directors.[617] It is therefore clear that the environment within which the board's chairman operates is different between Delaware and the UK on the one hand and Saudi Arabia on the other, in that in the former he mostly operates within a group of independent directors whose independence should theoretically shield them from the negative influence of a dual chairman. This is contrary to Saudi Arabia, where the chairman operates within a board on which independent directors are not adequately represented, thus he may be capable of exerting influence over the decision-making, thus jeopardising the independent judgement of the board. Furthermore, and as was indicated above, independent board members in the UK and Delaware are in charge of the decision-making on the three most influential board committees, so the likelihood of a dual CEO in either jurisdiction being able to abuse his powers should theoretically be lower than in Saudi Arabia due to adequate representation of independent directors on such committees. These committees have a direct and powerful influence over the board's

[606] Article 16 of the Corporate Governance Regulations 2017.
[607] Provision 11 of the Corporate Governance Code 2018.
[608] Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[609] The various aspects of board independence are discussed in detail in Section 4.2.3 of this thesis.
[610] Article 54 (a) of the Corporate Governance Regulations 2017.
[611] Article 64 of ibid.
[612] Article 60 of ibid.
[613] Article 54 (b) of ibid.
[614] The various aspects of board committees are discussed in detail in Section 4.2.34.3 of this thesis.
[615] Provision 9 of the Corporate Governance Code 2018.
[616] Provision 17 of ibid.
[617] Provisions 24 and 32 of ibid.

decision-making process, as many of the board's decisions are in fact decided outside the board itself, particularly at meetings of these specific committees.[618]

Now that the above discussion has established that many studies support separating the position of the CEO from that of the chairman, and that the different approaches of the UK and Delaware could be attributed to different board compositions and decision-making processes, the second issue to consider is whether duality under the Saudi framework should continue to be prohibited by a mandatory rule, or if it would be better to change it to a voluntary rule like that found in the UK. In defence of the Saudi approach, the research argues that at least for now, Saudi Arabia should continue the prohibition through a mandatory rule, for several reasons.

To begin with, the fact that the predominant ownership structure in the Saudi market is categorised as concentrated ownership suggests a pressing need for a strong and independent board that takes it upon itself to protect the interests of shareholders (especially minority ones) and to monitor the management and check their powers. This is something that would be more challenging if duality was present. It would be unrealistic to expect dual CEOs to wear two hats (the manager's hat and the monitor's hat) where they are expected to run the day-to-day operations while also monitoring their own actions. This is especially true given that the Saudi framework invests the board and its chairman with various monitoring and disciplining powers over senior management, including the power to appoint, remove, and evaluate managers and determine their compensation, in addition to making them accountable for their misconduct.[619] Many of the benefits which can be expected from an independent board would be lost if the individual responsible for running the company's day-to-day business is also the head of the supervisory body. From an agency theory perspective, it would be rational to expect that many dual CEOs would be tempted to cover up management misconduct and prevent information from reaching other directors, affecting their ability to hold management to account.

While it could be argued that regulating duality through a voluntary rule is advantageous as it provides companies with flexibility in determining which approach to follow (either to split or combine the two positions in light of their specific needs), the counter argument is that such specific needs do not exist in reality. As was discussed earlier in Sections 3.23.3

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[618] Douglas Michael Wright and others, 'Process Matters Understanding Board Behavior and Effectiveness'.
[619] Articles 27 and 30 of the Corporate Governance Regulations 2017.

of this thesis, the flexibility desired under a *Comply or Explain* approach can only be advantageous if there are individual real life circumstances which realistically necessitate an alternative approach, thus benefiting companies by enabling them to choose the governance structure that fits their needs; otherwise, it is better to hold all companies to the same standard especially that doing so will make it easier for shareholders and regulators to detect non-compliance and act accordingly. It is also difficult to find a valid justification necessitating a dual CEO. Even if such circumstances do occur, such as the need for a harmonised management system and quicker decision-making which are typically associated with duality and argued to be beneficial for companies during the entrepreneurial stage, and even if duality in some instances can moderate the agency cost,[620] the question that then arises is whether the benefits of combining the two positions outweigh the benefits of splitting them.

Therefore, the facts that mandatory rules are capable of increasing the compliance rate, that they are easier for shareholders and regulators to monitor and enforce in the event of non-compliance,[621] and that the individual circumstances that would justify deviation are arguable, along with the concentrated ownership of the Saudi market and the lack of independent board, are all factors that justify the current Saudi approach.

Having discussed the role of duality in forming a balanced board, this chapter can move on to the other board-related issue affecting the balance of the board, which is the role and representation of NEDs.

4.2.2 Role and representation of NEDs

The second compositional issue to be discussed is the representation of NEDs on the board. The discussion below will focus on the recognition of NEDs, the nature of such recognition, the optimal number on the board, and their role. But before starting the comparative analysis, it is essential to explore some of the most relevant considerations relating to NEDs.

[620] Brian K Boyd, 'CEO Duality and Firm Performance: A Contingency Model' (1995) 16 Strategic management journal 301; James A Brickley, Jeffrey L Coles and Gregg Jarrell, 'Leadership Structure: Separating the CEO and Chairman of the Board' (1997) 3 Journal of corporate Finance 189.
[621] See the prior discussion of the advantages of mandatory rules presented in Section 3.2.4 of this thesis.

In an ongoing attempt to enhance the board's effectiveness, many corporate governance reform efforts have focused on the role of NEDs, which are viewed as one of the fundamental pillars of corporate accountability.[622] After a series of corporate scandals and the failures of some of the largest companies around the world, legislators and regulators responded by putting in place a set of controls that aimed at mitigating conflicts of interest within companies and advocating for more independent boards, so that decision-making could be shielded from the negative influence of powerful insiders and outsiders.[623] As a result, recommendations on NEDs have been reinstated in regulations and codes, and the values they bring have been emphasised.[624] This constant pressure has led to a position where many jurisdictions such as Saudi Arabia, the UK, and Delaware all advocate for the greater presence of NEDs on boards. This is demonstrated by Saudi Arabia and Delaware's requirements that the majority of board members should be NEDs, and particularly independent NEDs in the case of Delaware.[625] The UK advocates a similar approach by encouraging boards to have an appropriate combination of NEDs, and recommending that half the board is composed of independent NEDs.[626]

The advocation of a greater presence of NEDs on boards builds largely on the presumed benefits that this group adds to the company, particularly in relation to monitoring and advisory tasks,[627] especially as shareholders typically face practical obstacles to the exercise of removal rights.[628] These practical difficulties prompted the need for more independent boards,[629] as executive directors are normally on the same page as the CEO which means that it is often unrealistic to expect them to monitor or challenge their boss.

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622 Catherine M Daily, Dan R Dalton and Albert A Cannella Jr, 'Corporate Governance: Decades of Dialogue and Data' (2003) 28 Academy of management review 371; Dan R Dalton and others, 'Meta-analytic Reviews of Board Composition, Leadership Structure, and Financial Performance' (1998) 19 Strategic Management Journal 269.

623 Ruth V Aguilera, 'Corporate Governance and Director Accountability: An Institutional Comparative Perspective' (2005) 16 British Journal of Management S39; Catherine M Dalton and Dan R Dalton, 'Boards of Directors: Utilizing Empirical Evidence in Developing Practical Prescriptions' (2005) 16 British Journal of management S91.

624 Alessandro Zattoni and Francesca Cuomo, 'How Independent, Competent and Incentivized Should Non-executive Directors Be? An Empirical Investigation of Good Governance Codes' (2010) 21 British Journal of Management 63.

625 Article 16 of the Corporate Governance Regulations 2017; Section 303A.01 of the New York Stock Exchange Listed Company Manual.

626 Principle (G) and Provision 11 of the Corporate Governance Code 2018.

627 Zattoni and Cuomo (n 624); Halpege Walter Gunetilleke, 'Role of Non-Executive Directors in Corporate Governance in the Context of the Codes on Corporate Governance' (2009) PhD Thesis, University of Greenwich; Mallin (n 13).

628 Paul L Davies, 'The Board of Directors: Composition, Structure, Duties and Powers' (2000) Paper on Company Law Reform in OECD Countries: A Comparative Outlook of Current Trends <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf> accessed 3 December 2019.

629 Gunetilleke (n 627).

Therefore, NEDs are argued to be capable of increasing accountability, ensuring appropriate deliberations and discussions at board meetings, and finding a balance between supporting management and challenging their views.[630] These roles are already acknowledged in the UK and Delaware frameworks, which provide that NEDs are expected to monitor executives and challenge them meaningfully,[631] something that is missing from the Saudi framework in which the roles of NEDs are not defined.

Furthermore, the injection of powerful NEDs into a board is advantageous in that they can communicate to the board the views of shareholders and other groups.[632] This means that the wider interests of stakeholders such as employees may be considered during board discussions, thus enabling companies to meet the expectations of the various stakeholders that influence their success. Moreover, the collective knowledge, skills, and viewpoints of NEDs should improve the quality of decision-making process and help in generating creative responses to the challenges facing the company.[633] NEDs may also be better positioned to define the strategic path which the company should follow given their isolation from the company's daily operation[634], and to oversee executives at the operational level to ensure that the strategic goals are being met.[635] Furthermore, by utilising their business relationships and reputations, NEDs should be capable of providing sound corporate advice, expanding the horizons of the company.[636]

Many of these presumed advantages are based on two main ideas; the first is that the occasions in which executives might be tempted to exploit the company's funds and assets for their benefits are not duplicated in the case of NEDs[637], putting the latter in a better position to provide unbiased judgements, which should improve the quality of the monitoring vested in the board. This presumed high integrity of NEDs is an element which both the Saudi and UK frameworks seem keen to protect, as indicated by them prohibiting NEDs from participating in the company's share options and employees' share plans, or

[630] John Roberts, Terry McNulty and Philip Stiles, 'Beyond Agency Conceptions of the Work of the Non-executive Director: Creating Accountability in the Boardroom' (2005) 16 British Journal of Management S5.
[631] Principle (H) and Provision 13 of the Corporate Governance Code 2018; Section 303A.03 of the New York Stock Exchange Listed Company Manual.
[632] Section 303A.03 of the New York Stock Exchange Listed Company Manual.
[633] Roberts, McNulty and Stiles (n 630).
[634] ibid.
[635] Stiles and Taylor (n 543).
[636] Gunetilleke (n 627).
[637] Davies (n 628).

linking their remuneration to the company's performance.[638] Second, NEDs are incentivised to do a better job in safeguarding the interests of shareholders, as doing so will protect their reputations and advance their careers further.[639] The motivation to excel in discharging their roles could be positively affected by the fact that the labour market is in a constant search for talent, and doing a good job is the number one strategy for gaining the attention of head-hunters. This is especially true as the labour market evaluates directors' capabilities based on their prior performance.[640] It is therefore unsurprising that all three jurisdictions further emphasise the critical contribution expected from NEDs, in that they all require NEDs, especially independent ones, to dominate the company's audit, nomination, and remuneration committees.[641]

It is worthwhile mentioning that the regulatory focus on increasing NEDs' presence and strengthening their role is consistent with the empirical evidence suggesting that NEDs are indeed an effective mechanism by which to increase corporate accountability and safeguard shareholders' interests. For example, several studies have found that (mostly independent) NEDs, especially those with financial expertise, are of great importance in monitoring a company's financial reporting practices.[642] One example is a study which analysed 75 companies in which fraud had been committed, and 75 non-fraud companies, concluding that the presence of NEDs, most of which were independent, on the boards of non-fraud companies was much higher than on the boards of fraudulent companies.[643] The findings of this study are consistent with those of another study which examined 159 public companies in the US to ascertain whether certain corporate governance mechanisms are associated with the likelihood of a company restating its earnings.[644] This latter research concluded that restatement of earnings is indeed lower in companies where boards

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[638] Article 24 (3) of the Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016; Provision 34 of the Corporate Governance Code 2018.

[639] Stephen P Ferris, Murali Jagannathan and Adam C Pritchard, 'Too Busy to Mind the Business? Monitoring by Directors with Multiple Board Appointments' (2003) 58 The Journal of Finance 1087; David Yermack, 'Remuneration, Retention, and Reputation Incentives for Outside Directors' (2004) 59 The Journal of Finance 2281; Davies (n 628).

[640] Fama (n 469).

[641] Articles 103 and 104 of the Companies Law 2015; Articles 54, 60, and 64 of the Corporate Governance Regulations 2017; Rule 7.1.1 to Rule 7.1.3 of the Disclosure Guidance and Transparency Rules Sourcebook; Provisions 17, 32, and 33 of the Corporate Governance Code 2018; Sections 303A.04, 303A.05, 303A.06, and 303A.07 of the New York Stock Exchange Listed Company Manual.

[642] Anup Agrawal and Sahiba Chadha, 'Corporate Governance and Accounting Scandals' (2005) 48 The Journal of Law and Economics 371; Mark S Beasley, 'An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement Fraud' (1996) Accounting review 443; Obeua S Persons, 'Corporate Governance and Non-Financial Reporting Fraud' (2006) 12 The Journal of Business and Economic Studies 27.

[643] Beasley (n 642).

[644] Agrawal and Chadha (n 642).

or audit committees have an independent director with a financial expertise.[645] Other empirical studies endorse similar results, concluding that NEDs are capable of safeguarding the interests of shareholders by influencing the board's attitude towards significant matters such as dealing with prospective takeovers, the implementation of anti-takeover tactics, executives' remuneration, and the replacement of the CEO.[646]

Now that some of the main concepts surrounding NEDs have been discussed and the relevant empirical evidence has been established, the Saudi approach to NEDs can be comparatively assessed.

All three jurisdictions recognise the importance of NEDs, as is evidenced by the fact that the Saudi framework mandatorily requires the majority of board members to be NEDs,[647] whereas the UK requires the board to have an appropriate representation of executives and NEDs, at least half of whom, excluding the chair, should be independent NEDs.[648] Delaware, on the other hand, does not refer to the number of non-independent NEDs required, except for the mandatory requirement that the majority of board seats must be occupied by independent directors.[649] Also, the Saudi framework mandatorily requires all a board's committees to be composed entirely of NEDs. While this is good practice that meets the approaches of the UK and Delaware, the Saudi approach is still a step behind with NEDs in committees as it does not advocate independent NEDs in the core committees (the audit, nomination and remuneration committees).

Overall, it can be argued based on the above that in relation to the regulatory recognition of NEDs representation, the Saudi framework is in line with the best international practices as advocated by the OECD[650] and as followed by the UK and Delaware. Furthermore, the Saudi approach is largely consistent with the overwhelming empirical evidence on the positive effects of NEDs, which were discussed above and which, in summary, support the relationship between the presence of NEDs and the reduction of agency costs. Therefore, building on the theoretical benefits, the empirical evidence, and the present comparative

[645] ibid.
[646] Benjamin E Hermalin and S Michael, 'E., and Weisbach, M, S., 2003. Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature' (2003) 9 Economic Policy Review 7; Rita D Kosnik, 'Greenmail: A Study of Board Performance in Corporate Governance' (1987) Administrative science quarterly 163; Michael S Weisbach, 'Outside Directors and CEO Turnover' (1988) 20 Journal of financial Economics 431.
[647] Article 16 (2) of the Corporate Governance Regulations 2017.
[648] Principle (G) and Provision 11 of the Corporate Governance Code 2018.
[649] Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[650] See generally OECD (n 2); See generally *OECD Corporate Governance Factbook* (n 541).

analysis, the Saudi approach can be regarded as appropriate in relation to the recognition and size of NEDs. With that in mind, the remaining question is whether the current mandatory approach towards issues of NEDs in the Saudi framework is appropriate. As with the case of the duality of CEOs, the research argues that the approach is justified, and that shifting to a voluntary approach is inappropriate, for several reasons.

First, in light of the theoretical and empirical evidence which strongly endorses the role of NEDs and finds that their presence protects shareholders and reduces agency costs, the arguments for regulating this matter through voluntary rules, allowing companies to deviate as needed, are unconvincing. This is because, as was discussed earlier, the flexibility desired under a voluntary approach is only advantageous if there are individual circumstances which realistically necessitate an alternative governance approach, thus benefiting companies by enabling them to choose the governance choice that fits their needs; otherwise, it is better to hold all companies to the same standards especially that doing so will make it easier for shareholders and regulators to detect and non-compliance and take action accordingly. Therefore, with the overwhelming evidence on NEDs' positive impact, it may be difficult to find a valid justification necessitating the need for an alternative approach to the optimal presence of NEDs.

Second, the extent to which companies in Saudi Arabia are willing to comply with voluntary rules is questionable given that the Saudi market has distinguishing cultural characteristics where social relationships are strongly influential in the corporate setting. As the previous chapter explained, the role of social relationships in Saudi Arabia can weaken formal corporate governance arrangements. This suggests that the voluntary approach can be undermined by these social relationships, making the mandatory approach a necessity.

Furthermore, the ownership structure of the Saudi capital market is characterised by predominantly concentrated ownership[651] with block holders dominating the listed companies primarily through shares held by the government and wealthy individuals.[652] This ownership structure could negatively affect companies' inclination to voluntarily comply with governance rules[653] in order to maximise the benefits of the powerful controlling shareholders. Moreover, the presence of institutional investors is relatively low,

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[651] For more on the ownership structure of the Saudi capital market see Section 2.5 of this thesis.
[652] Al-Bassam and others (n 147).
[653] ibid.

leading to inadequate shareholder activism and a limited ability to design and enforce governance rules.[654] This inadequate activism in Saudi Arabia should cast doubt on the promises of any potential voluntary approach.

Taking these concerns into account, enforcing a greater representation of NEDs on the board and its committees is a critically important endeavour to ensure the protection of shareholders and the survival of Saudi listed companies. In fact, it is now more important than ever, as the government is aspiring through its 2030 Vision[655] to attract more foreign investment and convince overseas investors that they can enter the Saudi capital market with confidence. Among the prerequisites of this pledge is the presence of strong mechanisms to protect shareholders and hold management to account, an objective that NEDs are believed to be capable of attaining.

The discussion now shifts to the roles of NEDs as envisioned in the Saudi framework, in order to assess the suitability of the framework in dealing with them. In this regard, it can be seen that unlike the UK and to a lesser extent Delaware, the Saudi framework does not address the specific roles of NEDs, particularly in relation to monitoring and challenging management. The framework makes no reference to what they are expected to do, apparently leaving this matter to the NEDs themselves to figure out.[656] The UK framework explicitly encourages NEDs to play a particular role within the board, which specifically relates to the appointment and removal of executive directors, monitoring the performance of executive directors along with top management,[657] purposefully challenging the company's management, providing strategic guidance, offering specialist advice, communicating the views of employees, and holding the management accountable for their decisions.[658]

A similar definition of NEDs' role can be found in Delaware, where the Manual makes brief reference to the role of non-independent NEDs, providing that their role is to serve as a check on management and to communicate to the board the concerns of interested parties

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[654] Abdulrahman Al-Razeen and Yusuf Karbhari, 'Annual Corporate Information: Importance and Use in Saudi Arabia' (2004) Managerial Auditing Journal; Piesse, Strange and Toonsi (n 147).
[655] The Vision and its objectives are discussed in Section 2.2 of this thesis.
[656] As per Article 41 (f) of Corporate Governance Regulations 2017, the only unique tasks assigned to non-independent NEDs under the Saudi framework is to evaluate the performance of the chairman, identifying his strengths and weaknesses and proposing suitable solutions. It should be noted that the Saudi framework as per Article 30 of Corporate Governance Regulations 2017 addresses the roles and duties of the general board of directors, without distinguishing between the roles of different categories of directors.
[657] Provision 13 of the Corporate Governance Code 2018.
[658] Principle (H) and Provisions 5 and 13 of ibid.

such as shareholders and other groups. To foster the latter role, the Manual requires listed companies to establish a method by which communication between NEDs and interested parties can be made easier.[659] The absence of these considerations in the Saudi framework, as explained above, casts the regulatory objectives behind requiring the majority of the board to be NEDs into doubt. Put another way, it leaves unclear what added value is to be gained if NEDs are to hold a significant portion of seats on the board, subjecting the board to their influence, without clarifying their responsibilities and how their obligations could be fulfilled, and how their role should differ from that of other directors. The presence of such clarification helps NEDs to understand their role, and thus to make meaningful efforts and take the necessary steps to carry out their tasks as envisioned. In the absence of such clarification, it is likely that the effectiveness of NEDs as a powerful corporate governance mechanism would be reduced. The need to address their role is even greater given the fact that as of 2019, NEDs in Saudi listed companies constitute more than 90% of board seats (among which 43.3% are held by non-independent NEDs and 47.1% are independent NEDs).[660] This means that more than a third of Saudi companies' NEDs today may be unaware of the unique nature of their tasks and what the expectations are of them from the perspective of shareholders, stakeholders, or regulators. This also implies that shareholders may confuse the roles of NEDs with those of other directors, affecting their ability to assess the performance of NEDs against the performance of other directors.

The role of NEDs is therefore an obvious area where the Saudi framework could benefit from the UK and Delaware, which both pay special attention to this area. To elaborate, the Saudi framework could benefit from the example of the UK framework by following the same approach of addressing the roles of NEDs through a voluntary rule functioning on a *Comply or Explain* basis. To achieve this, a voluntary article could be added to the CGRs 2017 which defines NEDs' roles in relation to appointing and dismissing senior managers, monitoring their performance, challenging their views, providing advice and strategic guidance, and holding management them to account, in addition to communicating the stakeholders' concerns.

An alternative path would be to deal with this area via separate guidance notes similar to the guidance notes published by the FRC in the UK such as the Guidance on Board Effectiveness. This would act to raise awareness among NEDs and educate them about

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[659] Section 303A.03 of the New York Stock Exchange Listed Company Manual.
[660] 'The Annual Report of the Capital Market Authority' (2019).

their roles. The research argues that utilising the voluntary approach in this area could be advantageous for at least three good reasons. First, as was discussed in Section 3.2.1 of this thesis, the voluntary approach provides a lower regulatory burden on companies[661] as they would not have to comply with generic statutory rules that might be rigid to deal with. Second, this approach places lower costs on the public authorities as they would not be hugely concerned with the monitoring of the substance of the compliance with the voluntary rule and its enforcement.[662] This is particularly important given that verifying whether a given rule has been applied to the letter is quite a challenging task[663] because of the amount of time and resources required to do so, especially if the given public authority aims at performing this task for every single company.[664] Third, mandatory rules pose another challenge, which is the use of undefined terms and loose language that later affects the monitoring and enforcement process.[665] This may not be an issue when the mandatory rule addresses straightforward and simple conducts that can easily be monitored and enforced given that the rule in the first place prescribes some form of simple conduct that could easily be measured. An example of this type of rule is that prescribing the proportion of NEDs, regarding which the research argued earlier in favour of maintaining as a mandatory rule. However, this is not the case with more complicated aspects such as the roles of NEDs, which are complex in nature as they deal with the interactions, behaviours and attitudes of humans, compelling regulators to use loose language to capture as many conducts as needed. That being the case, a voluntary approach allows regulators to enjoy some liberty in addressing certain complex matters using less defined terms in order to capture a broader range of conducts.

Now that the main considerations of the issues surrounding the role and representation of NEDs have been established, the remaining task is to discuss the most fundamental element affecting the effectiveness of NEDs, which is their independence.

4.2.3 Role and representation of independent directors

The corporate governance literature establishes that the effectiveness of NEDs is critically affected by several factors, chief among which is the extent of their independence.[666]

[661] Bartle and Vass (n 227) 2.
[662] ibid.
[663] Keay (n 214) 300.
[664] ibid.
[665] See Section 3.2.4 of this thesis for more on the challenges associated with mandatory rules.
[666] Fama (n 469); Fama and Jensen (n 159).

Therefore, it is pivotal for the purpose of this thesis to explore this aspect and establish its main theoretical and empirical considerations, so that an informed discussion can be conducted as to the appropriateness of the Saudi framework towards it.

The independence of directors is viewed as an essential precondition of directors' impartial monitoring, rendering independence a critical component of effective governance.[667] This builds on the assumption that independent NEDs who are not subject to the influence of top management are better positioned to discharge their monitoring duty effectively.[668]

This impartial monitoring expected from independent NEDs builds on the belief that they are able to look at matters from a different perspective that is not used by the executive directors as they are immersed in the company's day-to-day operations.[669] Other values associated with them include that they typically bring to the company various forms of expertise that can be of particular importance to the company, particularly if they possess knowledge in technical field that is relevant to the company's needs.[670] They could also employ their business connections to serve the company, and explore its potential.[671] Independent NEDs can also create a balance in the company by restraining the executive management, especially if it has a tendency to take high-risk decisions.[672] In doing so, a sufficient number of independents ensures that the company's decision-making process is not controlled by a person or group. In this regard, agency theorists note that independent NEDs are typically skilled monitors, as failure to discharge their monitoring task may put their professional reputation at risk.[673] The value of independent directors can also be observed in their pivotal role in the board's committees, especially in those concerned with making sensitive decisions, such as the audit, nomination, and remuneration committees.[674]

These values have encouraged legislators and regulators to push for a greater representation of independent directors on boards, especially following some high profile corporate scandals.[675] By doing so, it can be said that jurisdictions have advocated

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[667] See generally Colin B Carter and Jay W Lorsch, *Back to the Drawing Board: Designing Corporate Boards for a Complex World* (Harvard Business Press 2003).
[668] Davies (n 628).
[669] Roberts, McNulty and Stiles (n 630).
[670] Mallin (n 13) 179–182.
[671] Gunetilleke (n 627).
[672] Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster, 'Study on Directors' Duties and Liability, Prepared for the European Commission DG Market' (2013) LSE Enterprise, London.
[673] Fama (n 469); Fama and Jensen (n 159).
[674] Zattoni and Cuomo (n 624); See generally Mallin (n 13); Gunetilleke (n 627).
[675] Agrawal and Chadha (n 642).

independence as one of the most effective mechanisms for corporate accountability, perhaps best exemplified by the recognition of the role of independents found in Saudi Arabia, the UK, and Delaware. To illustrate, the Saudi framework requires independent directors to occupy at least two seats or one-third of the board's seats, whichever is greater.[676] In the UK, apart from the chair, half of the board should be independent NEDs,[677] and in Delaware the majority of board directors must be independent.[678] This strong cross-national regulatory focus on increasing the number of independent directors and strengthening their role is grounded in two main reasons; the first is that most other mechanisms of corporate accountability such as the market for corporate control and shareholder litigation are triggered post-crisis when malpractice has already occurred and the company has already suffered, whereas independent directors operate pre-crisis, meaning that they are capable of preventing the occurrence of malpractice in the first place.[679] The second reason is that by playing an active role and ensuring a constant flow of information and timely and accurate corporate disclosure, independent directors can pave the way for other corporate accountability mechanisms to function effectively, building on proper public disclosure.[680]

Despite presenting mixed findings on the contribution of independent NEDs, the available empirical studies largely support the existence of a positive relationship between independent NEDs and good governance, endorsing the assumptions that independent NEDs positively influence companies' operations and contribute towards reducing agency costs.[681] For example, a study examining the reaction of shareholders to the election of 1251 independent directors found that shareholders reacted positively, as reflected in remarkably positive share prices within two days from the election announcements.[682] Another study of shareholders' reaction to the announcement of independent directors' deaths found that shareholders reacted negatively to the death of independent directors, especially those who had served in critical positions such as the board chairman and audit

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[676] Article 16 of the Corporate Governance Regulations 2017.
[677] Provision 11 of the Corporate Governance Code 2018.
[678] Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[679] Irwin Borowski, 'Corporate Accountability: The Role of the Independent Director' (1983) 9 J. Corp. L. 455.
[680] Roberts, McNulty and Stiles (n 630).
[681] Afzalur Rashid, 'Revisiting Agency Theory: Evidence of Board Independence and Agency Cost from Bangladesh' (2015) 130 Journal of Business Ethics 181; Scott E Miller, 'Governance Mechanisms as Moderators of Agency Costs in a Pre-SOX Environment' (2009) 7 Journal of Business & Economics Research (JBER); Gul Sajid and others, 'Agency Cost, Corporate Governance and Ownership Structure: The Case of Pakistan'.
[682] Rosenstein and Wyatt (n 556).

committee members, or when the representation of independent directors on the board was relatively inadequate.[683] The findings of these two studies endorse the idea that independents are indeed viewed by investors as representing a critical corporate governance mechanism.

Further, the effect of independent directors can also be seen in relation to overall corporate performance. One example was provided by a study examining the relationship between independent directors and companies' performance in 900 companies in the S&P 1500 index from 1996-2006. In their findings, the authors of the study concluded that there is a positive relationship between independent directors and company value, as measured by the market-to-book ratio and operating performance.[684] Furthermore, the empirical evidence supports the belief that independent directors are good guardians of shareholders' interests. In this regard, a study examining the relationship between independent directors and takeover premiums based on 169 tender offers between 1989 and 1992 found that companies in which independent directors occupied the majority of board seats had higher takeover premiums by 20%.[685]

This particular relationship between independent directors and positive takeover outcomes is also endorsed by another study examining the relationship between independent directors and deal activities among acquiring companies, which concluded that, as demonstrated by 128 tender offers between 1980 and 1987, the acquiring company's stock price reaction to the acquisition announcement was remarkably less negative (-0.07% vs. -1.86%) when the acquiring company had an independent board, suggesting that independent directors advocate sensible acquisition activities.[686]

With these theoretical assumptions and empirical findings in mind, it is now appropriate to evaluate the Saudi approach towards independence, focusing on three main aspects: the role of independents, the proportion of independents, and the criteria of independence.

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[683] Bang Dang Nguyen and Kasper Meisner Nielsen, 'The Value of Independent Directors: Evidence from Sudden Deaths' (2010) 98 Journal of Financial Economics 550.
[684] Anzhela Knyazeva, Diana Knyazeva and Ronald W Masulis, 'The Supply of Corporate Directors and Board Independence' (2013) 26 The Review of Financial Studies 1561.
[685] James F Cotter, Anil Shivdasani and Marc Zenner, 'Do Independent Directors Enhance Target Shareholder Wealth during Tender Offers?' (1997) 43 Journal of financial economics 195.
[686] John W Byrd and Kent A Hickman, 'Do Outside Directors Monitor Managers?: Evidence from Tender Offer Bids' (1992) 32 Journal of Financial Economics 195.

All three jurisdictions seem to recognise the importance of independent directors' role on boards, with the Saudi framework putting more weight on their role inside the board itself as opposed to their role inside the board's committees. While the Saudi framework specifies the general duties of all directors under Article 30 of the CGRs 2017, Article 31 of the CGRs 2017 further assigns specific duties to independent directors which include expressing unbiased opinions on strategic issues and company policies, appointment of the executive management, handling conflicts of interest, overseeing the development of the company's corporate governance rules, and monitoring the implementation of the rules by the executive management.[687] While addressing the role of independents on the board is a good approach to ensuring that the board's discussions and decisions are not entirely dominated by non-independents directors, the Saudi framework still deviates from the approaches of the UK and Delaware in that the role of independents on board committees is not as strongly advocated. The Saudi framework requires that the audit,[688] nomination,[689] and compensation[690] committees have at least one independent director each, and that the audit committee's chairman is independent.[691] This is a notable difference from the UK approach, where the critical role the UK envisioned for independent directors is evidenced by the fact that the code requires the chairman of the board[692] and a majority of the members of the nomination committee to be independent directors,[693] and all members of the remuneration and audit committees to be independent.[694] It also differs from Delaware's approach, where the role of independent directors on board committees is strongly advocated, as the Manual requires that the nomination, compensation, and audit committees are composed entirely of independent directors.[695] This particular issue will be discussed in more detail below when exploring the topic of board's committees.

Based on the above, it can be observed that while the role and representation of independent directors within board committees is weak in Saudi Arabian corporate governance when compared to the UK and Delaware, the stipulated *role* of independent directors on the board itself is largely similar in the three jurisdictions. What the Saudi framework could improve in this area is to eliminate some forms of excessive language

[687] Article 31 of the Corporate Governance Regulations 2017.
[688] Article 54 (a) of ibid.
[689] Article 64 of ibid.
[690] Article 60 of ibid.
[691] Article 54 (b) of ibid.
[692] Provision 9 of the Corporate Governance Code 2018.
[693] Provision 17 of ibid.
[694] Provisions 24 and 32 of ibid.
[695] Sections 303A.04, 303A.05, and 303A.06 of the New York Stock Exchange Listed Company Manual.

found in some of the mandatory rules of the CGRs 2017 regarding the role and responsibilities of independents, and to make use of guidance notes. In such guidance notes the CMA could use more relaxed language and provide further clarification in order to improve independents' perceptions of their role without incurring the costs of monitoring and enforcement associated with mandatory rules.[696]

Turning to the required proportion of independent directors on the board, although the three jurisdictions recognise the importance of having more independent directors on the board, each differs in terms of the proper number of these directors. The Saudi framework requires independent directors to occupy at least two seats or one-third of the board's seats, whichever is greater,[697] a proportion that is much lower than its counterparts in the UK, which provides that apart from the chair, half of the board should be independent NEDs,[698] and Delaware, where the majority of board directors must be independent.[699]

Based on this notable divergence and the available empirical evidence supporting the need for a strong presence of independent directors on a company's board, the research argues that this is a clear area of concern, and therefore that the Saudi framework should reconsider its approach here. It is not clear how requiring a minimum of two independent directors or third can shield the board and decision-making process from the influence of powerful executives, even when NEDs are required to occupy the majority of the seats, given that non-independent NEDs are still in one way or another associated with the company and may be prone to conflicts of interest, in contrast to fully independent directors. The Saudi approach is particularly concerning as it is inconsistent with both the frameworks of the UK and Delaware, and with the theoretical and empirical evidence. Notably, the Saudi approach does not seem to take into account the theoretical benefits discussed above, most of which relate to protecting the interests of shareholders, serving as a check on management, resolving conflicts of interest, and providing fresh and impartial opinions on strategic matters.[700] Furthermore, this approach is inconsistent with many of the empirical studies discussed above which establish that a higher presence of independent directors contributes significantly towards protecting the integrity of the

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[696] See the discussions of the cost and practical difficulties associated with mandatory rules in Chapter 3, as well as in the present chapter.
[697] Article 16 of the Corporate Governance Regulations 2017.
[698] Provision 11 of the Corporate Governance Code 2018.
[699] Section 303A.01 of the New York Stock Exchange Listed Company Manual.
[700] See the discussion above in relation to the benefits of NEDs and independent directors.

company's accounts, positively affecting the company's operations, safeguarding the interests of shareholders, and reducing agency costs.[701]

That being said, the Saudi position in this regard should be reconsidered so that the representation of independent directors on the board is increased. The research argues that a reform based on the UK example, which advocates for half of the board being independent, would be suitable and that such a reform could benefit the Saudi frameworks in two ways. First, it increases the number of independents to at least half of the board, thus bringing the Saudi framework much closer to the best international practices, and reconciles it with the overwhelming empirical evidence on the value and benefits of the higher presence of independent directors. Second, it creates a balanced board in which three categories of members are represented: executive, non-executive, and independent directors. By not requiring the vast majority of the board to be independent, the framework could distance boards from the potential drawbacks which some associate with independent directors. Such drawbacks include information asymmetry as independent directors are often faced with challenges in accessing relevant information in a timely manner, and time-commitment issues because they work on a part-time basis, both of which are likely to affect their ability to monitor and discipline the management.[702] This is especially true as the dominant ownership structure of the Saudi capital market is categorised as one of concentrated ownership, with controlling shareholders better positioned to monitor executives.[703] This concentrated ownership implies that the need for a vast majority of independent directors is not as pressing as it is in markets with dispersed ownership, such as the US.

In addressing the question of whether stipulating the proportion of independent directors through a mandatory approach is appropriate, as is the case with CEO duality and NEDs, the characteristics of the Saudi market may not allow a voluntary system to function

[701] Rashid (n 681); Miller (n 681); Sajid and others (n 681); Rosenstein and Wyatt (n 556); Nguyen and Nielsen (n 683); Knyazeva, Knyazeva and Masulis (n 684); Cotter, Shivdasani and Zenner (n 685); Byrd and Hickman (n 686).

[702] Gregory Francesco Maassen, *An International Comparison of Corporate Governance Models: A Study on the Formal Independence and Convergence of One-Tier and Two-Tier Corporate Boards of Directors in the Unites States of America, the United Kingdom and the Netherlands* (Gregory Maassen 1999); Margaret J Nowak and Margaret McCabe, 'Information Costs and the Role of the Independent Corporate Director' (2003) 11 Corporate Governance: An International Review 300; Ying Cao and others, 'Are All Independent Directors Equally Informed? Evidence Based on Their Trading Returns and Social Networks' (2015) 61 Management Science 795.

[703] See Section 2.5 of this thesis for more on the characteristics of the Saudi capital market.

properly, casting doubt on the feasibility of such an approach.[704] In addition to the reasons discussed earlier relating to the advantages of the mandatory approach and the weak environment for voluntary compliance in Saudi Arabia,[705] it can be added that the effectiveness of the voluntary approach is contingent on the extent to which shareholders are practically able to discharge their monitoring and disciplining rights. This is something that shareholders typically find challenging and, as discussed earlier, it is a challenge that in the first place prompted regulators to advocate for the stronger presence of NEDs in the board. With this in mind, and with the established need for shareholder protection, especially in a capital market like Saudi Arabia which is dominated by block holders, and where the market for corporate control is very weak, it would be unrealistic to expect companies and large shareholders to voluntarily fill their boards with independent directors. Therefore, it is likely to be detrimental for shareholders (especially minority ones) to leave such shareholders subject to the mercy of powerful insiders and controlling shareholders. Even in highly developed markets such as the UK and the US where the ownership is dispersed and which feature stronger shareholder activism, active markets for corporate control, and influential institutional investors, shareholders still suffer from irrational boards, as has been found by several empirical studies which have ascertained that the affairs of those companies with lower independents representation on boards and committees are more likely to be mismanaged as opposed to those with a higher presence of independents.[706] Therefore, the case for mandatorily regulating the proportion of independents in Saudi Arabia is much stronger than for regulating it through a voluntary rule.

Turning now to the independence criteria, it can be seen that unlike the UK, where the board has a wide authority to determine the independence of a given director guided by the code's non-binding criteria,[707] the board under the Saudi and Delaware frameworks does not enjoy such liberty, as it must use the binding criteria provided under the relevant

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[704] See the above discussions above on the reasons justifying the retention of the mandatory approach towards CEO duality and NEDs.
[705] See Section 3.2.4 of this thesis.
[706] Mark L DeFond and James Jiambalvo, 'Incidence and Circumstances of Accounting Errors' (1991) Accounting review 643; April Klein, 'Firm Performance and Board Committee Structure' (1998) 41 The Journal of Law and Economics 275; Beasley (n 642); Lawrence J Abbott, Susan Parker and Gary F Peters, 'Audit Committee Characteristics and Restatements' (2004) 23 Auditing: A Journal of Practice & Theory 69; Jean Bédard, Sonda Marrakchi Chtourou and Lucie Courteau, 'The Effect of Audit Committee Expertise, Independence, and Activity on Aggressive Earnings Management' (2004) 23 Auditing: A Journal of Practice & Theory 13; Edward J Zajac and James D Westphal, 'Director Reputation, CEO/Board Power, and the Dynamics of Board Interlocks' (Academy of Management Briarcliff Manor, NY 10510 1996); Williamson (n 554).
[707] Provision 10 of the Corporate Governance Code 2018.

regulations to evaluate the independence of a given director.[708] The set criteria are largely similar in the three jurisdictions in that they mostly measure independence, to a varying degree, by the absence of any material relationship in relation to ownership, financial, familial, and employment factors. Therefore, based on the comparative analysis, there are no material issues with the substance of the independence criteria under the Saudi framework. Nevertheless, one way in which the Saudi framework could learn from the UK's approach to this aspect is to encourage the board to assume a greater role in determining the true independence of directors beyond the criteria already provided by the framework.[709] In doing so, the framework could encourage companies to look for genuine independence of judgement in potential directors rather than simply for those who meet the minimum generic conditions currently provided under the framework. This is because, as has been found in the US, many directors who are deemed independent when assessed against the framework criteria are ultimately found not to be truly independent when measured by their social ties with the CEO.[710] Such a situation would undermine the value of independence and gives shareholders the false impression of being fairly represented.

Now that the discussion has covered the first structural issue (i.e., board's composition), it is time to turn to the other structural issue affecting the effectiveness of the board's structure, which is the board's committees.

4.3 Board committees

Notwithstanding the fundamental role of boards of directors in corporate governance, there is modest understanding of the internal structure of boards, especially with regard to the structure and role of board committees.[711] These committees are important because most of

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[708] Article 20 (b) of the Corporate Governance Regulations 2017; Section 303A.02 of the New York Stock Exchange Listed Company Manual.
[709] Provision 10 of the Corporate Governance Code 2018.
[710] This is based on an empirical study which aimed at ascertaining whether the NYSE rules on independence measurement actually measure independence accurately. In doing so, the study distinguishes between directors who are classified as independent as per the NYSE criteria and directors who are genuinely socially independent from the CEO. It found that in the Fortune 100 companies between 1996 and 2005 87% of directors were NYSE independent, but only 62% were both NYSE and socially independent. It also found that such social dependence negatively affects executive compensation leading among other things to higher CEO pay. The results of this study suggest that even when certain directors are considered to be independent against the NYSE criteria, many are not substantively independent due to their social ties with executives, thus affecting the monitoring and disciplining tasks of independent directors. Byoung-Hyoun Hwang and Seoyoung Kim, 'It Pays to Have Friends' (2009) 93 Journal of Financial Economics 138; For more on independence, see: Harald Baum, 'The Rise of the Independent Director in the West. Understanding the Origins of Asia's Legal Transplants', *Independent Directors in Asia. A Historical, Contextual and Comparative Approach* (Cambridge University Press 2017).
[711] Kevin D Chen and Andy Wu, *The Structure of Board Committees* (Harvard Business School Boston, MA 2016).

the decisions taken by the board are engineered inside them, and most activities related to the board take place during their meetings rather than full board meetings.[712] This is supported by the empirical evidence, among which a study of S&P 1500 companies found that 52% of board activities are conducted at the committee level after implementing the SOX 2002.[713] That being the case, it is unsurprising to find that companies' committees, specifically the audit, nomination, and remuneration committees, have become major components of corporate governance worldwide,[714] as demonstrated by the fact that almost all jurisdictions recognise the audit committee and more than 80% of jurisdictions recognise the nomination and remuneration committees.[715]

Committees have several benefits that justify the increased recognition of their role in corporate governance. First, the committees can encourage knowledge specialisation through the decentralisation process,[716] in turn benefitting the company as the board's monitoring and advisory tasks are complex, thus requiring specific knowledge of the company to assist directors in effectively responding to the company's changing needs.[717] Second, specialisation through committees can allow the efficient distribution of tasks among board members, which in turn positively affects the decision-making process.[718] This efficient distribution of tasks facilitates the board's discussions and lessens the negative effects associated with coordination and communication.[719]

Third, committees are capable of increasing the board's accountability towards the company and its shareholders through lessening the free-riding problem[720] and protecting the integrity of the decision-making process.[721] To illustrate, independent directors in particular are enabled through separate committees composed mostly of them to monitor the company effectively, and away from the influence of the executives in the boardroom.[722] This is especially critical when independent directors are reviewing certain

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[712] Idalene F Kesner, 'Directors' Characteristics and Committee Membership: An Investigation of Type, Occupation, Tenure, and Gender' (1988) 31 Academy of Management journal 66; Klein (n 706).
[713] Renée B Adams, Vanitha Ragunathan and Robert Tumarkin, 'Death by Committee? An Analysis of Delegation in Corporate Boards' (Working Paper 2015).
[714] *OECD Corporate Governance Factbook* (n 541) 121.
[715] ibid.
[716] See generally Cornelis A De Kluyver, *A Primer on Corporate Governance* (Business Expert Press 2009).
[717] Kyonghee Kim, Elaine Mauldin and Sukesh Patro, 'Outside Directors and Board Advising and Monitoring Performance' (2014) 57 Journal of accounting and economics 110; Chen and Wu (n 711).
[718] David Reeb and Arun Upadhyay, 'Subordinate Board Structures' (2010) 16 Journal of Corporate Finance 469; Chen and Wu (n 711).
[719] Reeb and Upadhyay (n 718).
[720] For more on the free-riding problem see the discussion in Section 3.4.2.1.3 of this thesis.
[721] Chen and Wu (n 711).
[722] ibid.

matters such as conflicts of interest, during which isolation from executives is essential to ensure unbiased, honest, and tension-free discussions. Another aspect is that committees increase the individualistic contribution of a given director as they are assigned a specific task.[723] The result is that such a director is incentivised to do a better job, as their contribution becomes distinguishable from the collective contributions of other directors.[724] This is of particular relevance as collective contributions typically lead to some directors' over-dependence on others given that the incentive to shrink is stronger.[725]

The basic issues surrounding board committees being established, and guided by the comparative analysis and the available theoretical and empirical evidence, the following discussion will focus on the assessment of the Saudi framework in regard to how it approaches the board's three core committees; the audit, nomination, and remuneration committees. Three main aspects will be assessed; the recognition, composition, and the role of each of these three committees.

4.3.1 Recognition of the board's committees

Assessment of the suitability of any given framework towards the board's committees should start with a discussion of whether the committees are recognised by the framework in the first place, and if so, how that recognition takes place, including which regulatory mode is adopted. This is especially important given the differences across the three selected jurisdictions in this regard. That said, it could be observed that aspects related to the establishment, composition, and roles of the audit, nomination, and remuneration committees are recognised and mandatorily regulated in Saudi Arabia and Delaware,[726] whereas in the UK the audit committee is the only one to be mandatorily regulated, with the two remaining committees recognised and approached by the Code on a *Comply or Explain* basis.[727]

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[723] J Richard Harrison, 'The Strategic Use of Corporate Board Committees' (1987) 30 California Management Review 109.
[724] Armen A Alchian and Harold Demsetz, 'Production, Information Costs, and Economic Organization' (1972) 62 The American economic review 777.
[725] ibid.
[726] Articles 103 and 104 of the Companies Law 2015; Articles 54, 55, 60, 61, 64, and 65 of the Corporate Governance Regulations 2017; Sections 303A.04, 303A.05, 303A.06, and 303A.07 of the New York Stock Exchange Listed Company Manual.
[727] Rule 7.1.1 to Rule 7.1.3 of the Disclosure Guidance and Transparency Rules Sourcebook; Provisions 17, 32, and 33 of the Corporate Governance Code 2018.

On that basis, by recognising all three core committees the Saudi framework is consistent with the UK and Delaware, as well as with the empirical evidence which demonstrates that the presence of these three committees contributes towards a reduction in agency cost. The empirical evidence suggests, for example, that the audit committee is capable of mitigating agency cost by lowering information asymmetry between executive and NEDs and improving the quality of financial statements, confirming it as an effective corporate governance mechanism.[728] Other relevant empirical studies state similar findings in relation to nomination and remuneration committees. In a study examining 79 companies in New Zealand it was found that the presence of nomination and remuneration committees reduces agency cost,[729] while various further empirical studies have similar findings all of which confirm the three core committees' role in the reduction of agency cost, endorsing the adoption of such committees.[730]

Apart from the convergence in the recognition of such committees, a major difference can be seen in that both the Saudi and Delaware frameworks differ from that of the UK in that the nomination and remuneration committees are mandatorily required in the former, whereas the UK recommends these two committees on a *Comply or Explain* basis. The Saudi approach may be justified by the special circumstances of the Saudi capital market which affect its ability to adopt a voluntary system on a large scale. As was discussed earlier,[731] the concentrated ownership pattern of the Saudi capital market combined with the greater influence of social relationships over formal corporate accountability mechanisms and the weak market for corporate control activities calls for a greater enforcement of corporate governance mechanisms, something that a mandatory system is more capable of achieving. Furthermore, the fact that almost all jurisdictions recognise the audit committee and more than 80% of jurisdictions recognise the nomination and remuneration committees[732] indicates that companies may not have viable alternative mechanisms with which to replace these committees, therefore doubt may be cast on the feasibility of a voluntary approach in this matter. This becomes more concerning as even in

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[728] Klein (n 706); F Todd DeZoort, Dana R Hermanson and Richard W Houston, 'Audit Committees: How Good Are They?' (2002) 13 Journal of Corporate Accounting & Finance 53; Noriza Mohd Saad, 'Corporate Governance Compliance and the Effects to Capital Structure in Malaysia' (2010) 2 International journal of economics and finance 105; DeFond and Jiambalvo (n 706).
[729] Fitriya Fauzi and Stuart Locke, 'Do Agency Costs Really Matter? A Non-Linear Approach to Panel Data' (2012) 4 Asian Journal of Finance & Accounting.
[730] Charlie X Cai and others, 'Do Audit Committees Reduce the Agency Costs of Ownership Structure?' (2015) Pacific-Basin Finance Journal, 35 (Part A), 225-240.; Chen and Wu (n 707).
[731] See the discussion above in relation to the reasons justifying the retention of the mandatory approach towards ensuring the duality of the CEO, NEDs, and independence.
[732] *OECD Corporate Governance Factbook* (n 541) 121.

the UK, which is hailed for its voluntary framework, many companies are found either to be non-compliant with the recommendations of CGC 2018 in respect of nomination and remuneration committees or to be failing to comply in a proper and sensible manner.[733]

With the above considerations in mind, the current approach of the Saudi framework seems justified. However, the effectiveness of the board's committees is not merely a matter of recognition and establishment, as ensuring these alone could lead to ceremonial board activities that only lend a false legitimacy to the board's decisions. Therefore, the following discussion will move to the issue of the committees' composition, dealing with the question of who should serve on these committees so that they can play their role in ensuring effective corporate governance.

4.3.2 Composition of the board's committees

Focusing now on the composition of these three committees, it can be observed that the presence of independent directors in the board's committees in Saudi Arabia is not adequately advocated, as evidenced by the fact that the Saudi framework requires the audit,[734] nomination,[735] and compensation[736] committees to be composed of NEDs providing that each committee has at least one independent director, and that the audit committee's chairman is independent.[737] This is a notable departure from the approaches of the UK and Delaware, as in Delaware the Manual requires the audit, nomination, and compensation committees to be composed entirely of independent directors,[738] and similarly, in the UK the Code requires the audit and remuneration committees to be composed entirely of independent directors,[739] and that the majority members of the nomination committee are independent directors.[740]

In light of this significant divergence, the research argues that under the Saudi framework, the lower statutory presence of independents in board's committees is detrimental to the company and its shareholders, because as indicated earlier, many of the board's major decisions are taken inside such committees. These committees are responsible, as will be

[733] Arcot, Bruno and Faure-Grimaud (n 215).
[734] Article 54 (a) of the Corporate Governance Regulations 2017.
[735] Article 64 of ibid.
[736] Article 60 of ibid.
[737] Article 54 (b) of ibid.
[738] Sections 303A.04, 303A.05, and 303A.07 of the New York Stock Exchange Listed Company Manual.
[739] Provisions 24 and 32 of the Corporate Governance Code 2018.
[740] Provision 17 of ibid.

discussed below, for many of the sensitive decisions around which conflicts of interest typically arise, such as monitoring the financial reporting systems, reviewing financial statements and corporate accounts, appointing and dismissing the external auditor, electing directors, appointing and removing senior managers, setting remuneration for both directors and top management, and reviewing proposed related party transactions.

Furthermore, the extent to which the interests of shareholders, especially minority ones, are protected is likely to be affected in line with non-independent directors' tendency towards maximising their own interests. As has been demonstrated by the relevant empirical studies, fraudulent activities in the form of earning managements (the practice of inflating the company's financial position) can be eliminated in companies whose audit committee is independent.[741] This finding is endorsed by another empirical study, which concluded that an independent audit committee is associated with transparency in financial statements as it lowers the chance of earnings management.[742] Other empirical studies have produced similar results supporting the positive relationship between independent audit committees and the integrity of financial reporting where the independence of the committee is found to play a significant role in reducing corporate fraud.[743] A positive relationship between independence and the reduction of agency cost is also found when examining the composition of nomination and remuneration committees and its effects on agency cost and company performance.[744] As Williamson suggests, the absence of an independent remuneration committee implies that managers will *"appear to write their own contracts with one hand and sign them with the other."*[745] That being the case, with a significantly lower presence of independents, as is the case in Saudi Arabia,[746] the likelihood of impairing the integrity of many sensitive and major decisions will be higher. The negative effect of the weak representation of independents in board committees may go beyond the company and its shareholders to the wider capital market, thus undermining shareholders' confidence in the integrity of the market, a confidence that is needed to attract both local and foreign capital.

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[741] DeFond and Jiambalvo (n 706).
[742] Klein (n 706).
[743] Bédard, Chtourou and Courteau (n 706); Beasley (n 642); Abbott, Parker and Peters (n 706).
[744] Zajac and Westphal (n 706); MS Narasimhan and Manju Jaiswall, 'Role and Functioning of Remuneration Committee in Improving Corporate Governance' (2007) 6 The IUP Journal of Corporate Governance 41; Fauzi and Locke (n 729).
[745] Williamson (n 554).
[746] See Section 4.2.3 of this thesis for a detailed discussion of the board's independence.

Building on these arguments, it would be appropriate to reform the current rules related to the proportion of independents by increasing their number to ensure that they dominate the committees' composition and have an upper hand in the decision-making process. Such a reform would align the Saudi framework with its counterparts in the UK and Delaware, and ensure the integrity of the board's decisions. Second, it could be said that by requiring a greater presence of independents on the board, the UK and Delaware (as opposed to Saudi Arabia) have already taken a step to ensure that sufficient independents are available to serve on the board's various committees. In other words, fixing the issue of independents' representation in committees under the Saudi framework starts with fixing the rule related to their representation on boards, an issue that was discussed earlier. By ensuring that sufficient independents are present on the board, the board's committees can rest assured that there will be no shortage of independent members.

Now that the composition of the board's committees has been comparatively investigated and the Saudi position evaluated, the discussion will shift to the role of these committees as envisioned by each framework.

4.3.3 Role of the board's committees

An effective committee is one that assists the board in fulfilling its mandate, which essentially revolves around safeguarding the interests of the company's various stakeholders, especially its shareholders, and particularly in areas where specific expertise is needed. Therefore, the question of how effective the board's committees can be as a corporate governance mechanism should go beyond their establishment and composition to look into the actual role such committees are assigned under the given framework. With that in mind, the following discussion will comparatively explore the positions of each jurisdiction in regard to the role and responsibilities of the board's committees before moving to an evaluation of the Saudi approach.

The three jurisdictions take it upon themselves to regulate this matter by prescribing several responsibilities to be performed by each committee as a minimum.[747] Beginning with the audit committee, convergence can be observed in that the three jurisdictions

[747] Articles 103 and 104 of the Companies Law 2015; Articles 55, 61, and 65 of the Corporate Governance Regulations 2017; Provisions 17, 24, and 33 of the Corporate Governance Code 2018; Rule 7.1.3 of the Disclosure Guidance and Transparency Rules Sourcebook; Sections 303A.04, 303A.05, and 303A.07 of the New York Stock Exchange Listed Company Manual.

equally and mandatorily require this committee to be responsible for ensuring the integrity of the company's reports, accounts, and financial statements, ascertaining the fairness of the company's annual disclosures, and evaluating the soundness of its internal controls and risk management strategy. Furthermore, its role includes providing recommendations to the board regarding the appointment and removal of external and internal auditors, ensuring their independence and overseeing their work.[748] Moreover, and unlike the UK, both Saudi Arabia and Delaware further require the audit committee to review proposed related party transactions and to provide the board with opinions and recommendations on them prior to making a decision.[749]

As to the role of nomination committee, a similarity between the Saudi Arabia and the UK can be seen in that both recognise this committee as the competent corporate body responsible for designing nomination policies for appointments to the board as well as to senior management positions, along with providing the board with recommendations regarding director nominees in accordance with the approved policies.[750] Moreover, this committee is required to conduct periodic reviews of the necessary expertise that the board requires for it to respond effectively to the company's changing needs,[751] and to periodically evaluate the board and senior management.[752]

The Saudi framework also mandates the nomination committee to be responsible for annually ensuring the independence of independent directors and the absence of any conflicts of interest if a board member also acts as a member of the board of directors of another company.[753] On the other hand, Delaware seems to be relatively less stringent when it comes to the duties of the nomination committee, as it provides for a few main duties to be discharged by the committee as a minimum, leaving most of the detailed regulations of the committee's duties to the company to decide itself as part of the

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[748] Articles 103 and 104 of the Companies Law 2015; Article 55 of the Corporate Governance Regulations 2017; Provision 25 of the Corporate Governance Code 2018; Rule 7.1.3 of the Disclosure Guidance and Transparency Rules Sourcebook; Sections 303A.06 and 303A.07 of the New York Stock Exchange Listed Company Manual.
[749] Article 55 of the Corporate Governance Regulations 2017; Section 314.00 of the New York Stock Exchange Listed Company Manual.
[750] Article 65 of the Corporate Governance Regulations 2017; Provision 17 of the Corporate Governance Code 2018; Section 3 of the Guidance on Board Effectiveness 2018; Section 303A.04 of the New York Stock Exchange Listed Company Manual.
[751] Article 65 of the Corporate Governance Regulations 2017; Provision 17 of the Corporate Governance Code 2018; Section 3 of the Guidance on Board Effectiveness.
[752] Article 65 of the Corporate Governance Regulations 2017; Provision 17 of the Corporate Governance Code 2018; Section 3 of the Guidance on Board Effectiveness; Section 303A.04 of the New York Stock Exchange Listed Company Manual.
[753] Article 65 (7) of the Corporate Governance Regulations 2017.

committee charter that the company must have in place.[754] These main responsibilities include identifying prospective directors and providing the board with director nominees, in addition to overseeing the assessment of the board and management and designing corporate governance guidelines which are relevant to the company.[755]

Moving on to the roles of the remuneration committee, these are also largely similar, with no material difference to be found among the three jurisdictions. The main responsibilities of this committee include setting and revising policies for the remuneration of the board and the executive management and ascertaining the relationship between the remuneration and approved policies.[756]

Now that the role and responsibilities of the three committees have been comparatively explored, a few remarks can be made. The first is that the required roles and responsibilities of three core committees are largely similar, therefore, from this perspective, the Saudi framework is largely consistent with its counterparts in the UK and Delaware, with no material divergence. Second, despite the fact that the substance of the committees' roles is largely the same, the Saudi approach is more extensive as it addresses each of the three committees' responsibilities in detail. Such detailed responsibilities should be part of a separate guidance note, leaving the mandatory rules as well-defined and concise as possible so that members of these committees can easily grasp what their core roles are and how they can best discharge those roles, with the option to consult the guidance notes should they need further clarification. The challenge with instilling extensiveness in mandatory rules, as discussed in Chapter 3, is that when the given rule is a mandatory, over-extensiveness is likely to produce some loose terms which confuse both committee members and shareholders as to what constitutes good compliance, leading to practical difficulties in monitoring and enforcement. Therefore, to avoid such practical difficulties, dealing with the detailed responsibilities of committees through guidance notes might be more appropriate. This voluntary approach, as discussed in Chapter 3, places a lower regulatory burden on companies, paving the way for better compliance[757] in addition

[754] Section 303A.04 of the New York Stock Exchange Listed Company Manual.
[755] Section 303A.04 of ibid.
[756] Article 61 of the Corporate Governance Regulations 2017; Provision 33 of the Corporate Governance Code 2018; Section 5 of the Guidance on Board Effectiveness; Section 303A.05 of the New York Stock Exchange Listed Company Manual.
[757] Bartle and Vass (n 227) 2.

to lowering the costs associated with monitoring and enforcement by the public authorities.[758]

4.4 Directors' Duties

Earlier in this chapter, the importance of the board as the corporate organ to whom the decision-making power is delegated to was established and the rationale behind such delegation was discussed. As was noted earlier, this rationale revolves around shareholders practical inability to directly manage the company and their need for a qualified board that monitors the management on their behalf. The concern still remains that the board's discretionary power, if not regulated, enables directors to take advantage of their position to advance their private interests, causing harm to the company and its shareholders. Accordingly, legislators and regulators have provided a set of rules aiming at governing the board and reducing the probability of power abuse. Board governance rules can take two forms. One is concerned with the structure and composition of the board, as the present thesis discussed in detail at the beginning of this chapter. The second is concerned with the operations of the board particularly directors' duties, which will be the focus of the following discussion.

The importance of directors' duties in the context of corporate governance lies in the fact that they are viewed as one of the prominent governance mechanisms that respond to the agency problem by ensuring that directors operate within a solid legal framework which defines the legal obligations and behavioural expectations by which directors are bound when discharging their decision-making power and further stipulate the standard of review against which the decisions of directors are reviewed in order to determine whether they are fulfilling their responsibilities properly.[759] Having such a mechanism in place reduces the likelihood of directors betraying the trust entrusted in them by shareholders, and directs them to observe the interests of shareholders when exercising their supervisory powers.

That all being said, the following discussion will focus on the two primary duties that are typically the focus of the literature on directors' duties: the duty of care, skill and diligence, and the duty of loyalty. These will be discussed comparatively from three angles: the recognition of directors' duties; the source of directors' duties; and the standard

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[758] ibid.
[759] Andrew Keay, *Directors' Duties* (Jordan Publishing Limited 2016) 5–6.

of review when these duties are breached. The basis for selecting these three issues is that they are among the most important aspects of directors' duties in any jurisdiction, and as will be shown below, they are the areas where the major divergence among the three jurisdictions can be observed.

4.4.1 Recognition of directors' duties

The first step when discussing the Saudi framework in the area of directors' duties and ascertaining its effectiveness has to do with whether the framework recognises such duties in the first place, and if so, how that recognition is expressed. The objective here is to establish whether there is a solid foundation upon which legal obligations on directors are based, so that all relevant parties (i.e., directors, shareholders, and courts) are clear on what governs directors conduct. That being said, upon exploration of the Saudi framework and comparing it to its counterparts in the UK and Delaware, several observations can be made. But, before assessing the Saudi approach and exposing its areas of deficiency, it is important first to establish the positions of the UK and Delaware so that a comparative analysis can be performed.

Both the UK and Delaware explicitly recognise directors' main duties such as the duty of care, and the duty of loyalty and its subsidiary duties.[760] The difference however is that in the UK such duties are statutorily recognised in the CA 2006[761] and are in fact a codification of the long-established common law duties.[762] In Delaware, on the other hand, such duties are derived from the state's common law where the courts explicitly recognise them and provide guidance on how each duty can be breached and what judicial standard is applicable when assessing a director's presumed breach of duty.[763]

In the UK the duty of care is set forth in Section 174 of the CA 2006 which imposes a statutory obligation on directors to exercise reasonable care, skill, and diligence.[764] To satisfy this duty, directors should allocate adequate time, care, and diligence when exercising their managerial responsibilities, and make decisions only on an informed basis,

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[760] See Sections 171-177 of the Companies Act 2006.
[761] See Sections 171-177 of ibid.
[762] Calkoen (n 12).
[763] William M Lafferty, Lisa A Schmidt and Donald J Wolfe Jr, 'A Brief Introduction to the Fiduciary Duties of Directors under Delaware Law' (2011) 116 Penn St. L. Rev. 837; Calkoen (n 12).
[764] Section 174 of the Companies Act 2006.

including obtaining the skills and experience required to carry out their functions as directors, while always considering the ultimate impact and outcomes of their actions.[765]

As to the duty of loyalty, which takes several forms, mainly the duty to act in good faith, the duty to avoid conflict of interests, and the duty to promote the success of the company,[766] the CA 2006 codified it throughout Chapter 2 of Part 10.[767] A director satisfies his duty of loyalty when he at all times observes in good faith the best interests of the company and acts in a manner that advances such interests rather than his own interests.[768] This includes avoiding any conflicts of interest where such a director could abuse his position of trust and confidence to benefit himself at the expense of the company through the exploitation of any of the company's property, information, or opportunities.[769]

Similar to the UK, Delaware recognises directors' two main duties of care and loyalty.[770] These duties, unlike the UK, are not statutorily codified but derived from the Delaware case law.[771] Delaware's courts have recognised and developed such duties and other subsidiary duties over time, and provided guidance on how they should be interpreted, applied, and reviewed. The duty of care in this context means that directors are always required before making a business decision to be informed as much as reasonably possible of all the material information reasonably available to them. In doing so, directors should rely in good faith on the opinions and advice provided by the company's officers and advisors, in addition to making use in good faith of the company's reports and information. However, to fully satisfy this duty, directors should go beyond taking such information and advice at face value and should always pay close attention during meetings, be diligent and critical, and ask the right questions to satisfy themselves that they fully understand the issue at stake before they arrive at a business decision.

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[765] Section 174 (2) of ibid; See generally: Christopher A Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999) 62 Mod. L. Rev. 697; Keay (n 759) 212.
[766] See Chapter 2 of Part 10 of the Companies Act 2006; Michelle M Harner, 'A More Realistic Approach to Directors' Duties' (2013) 15 Transactions: Tenn. J. Bus. L. 15.
[767] See generally Chapter 2 of Part 10 of the Companies Act 2006.
[768] See generally Paul Davies and Jonathan Rickford, 'An Introduction to the New UK Companies Act' (2008) 5 European Company and Financial Law Review 48; Harner (n 766); Calkoen (n 12).
[769] Section 175 of the Companies Act 2006.
[770] Randy J Holland, 'Delaware Directors' Fiduciary Duties: The Focus on Loyalty' (2008) 11 U. Pa. J. Bus. L. 675; Lafferty, Schmidt and Wolfe Jr (n 763).
[771] Holland (n 770); Lafferty, Schmidt and Wolfe Jr (n 763); Calkoen (n 12).

It is important to note that the duty of care in Delaware is, contrary to the UK,[772] a fiduciary duty.[773] The implication of this is that the applicable standard for a breach of duty of care in Delaware, unlike in the UK, is gross negligence, where ordinary negligence by the challenged directors is protected by the business judgement rule.[774] Moreover, the fact that this duty is classified as a fiduciary duty in Delaware means that the legal remedies available in the event of a breach include equitable remedies,[775] whereas in the UK the legal remedies available are, unlike other duties of the CA 2006, of damages only.[776]

On the other hand, the duty of loyalty as defined by Delaware's courts entail that directors are required at all times to put the interests of the company and its shareholders ahead of their own interests. This encompasses refraining from using their position to advance their private interests, or to deprive the company from any benefit which the directors could add to it. To fulfil their duty of loyalty, directors must abstain from conflicts of interest situations that undermine the trust entrusted with them by shareholders such as taking advantage of confidential information to make private gain or benefit themselves or affiliated persons at the expense of the company.

Returning to Saudi Arabia, there are four possible sources from which directors' duties can be inferred and which are therefore relevant when attempting to establish how the Saudi framework approaches such duties. These potential sources are the *Sharia*[777] principles, the CL 2015, the CGRs 2017,[778] and Saudi judicial decisions. Upon exploration of these four sources to determine if they recognise directors' duties, several points can be made. To begin with, and except for the explicit references in the CGRs 2017 which will be discussed below, it can be concluded that neither the duty of care nor the duty of loyalty is explicitly recognised in the statuary law governing companies, namely the CL 2015, nor in the relevant reported judicial decisions on listed companies' disputes. However, such duties can be argued to be implied in one way or another throughout the CL 2015, albeit in a rather vague manner.

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[772] Section 178 of the Companies Act 2006.
[773] Lafferty, Schmidt and Wolfe Jr (n 763).
[774] Jennifer G Hill and Matthew Conaglen, 'Directors' Duties and Legal Safe Harbours: A Comparative Analysis', *Research Handbook on Fiduciary Law* (Edward Elgar Publishing 2018).
[775] ibid.
[776] Section 178 of the Companies Act 2006; *Cohen v Selby* (2001) 2001 BCLC 1 176.
[777] Sharia law is discussed and explained in detail in Section 2.3 of this thesis.
[778] See Chapter 2 and 3 for background information on CL 2015 and CGRs 2017.

Taking the duty of care first, it is evident that the CL 2015 falls short of any direct and clear reference to this duty. However, such duty is implied in this law, and the implication is derived from Article 78 (1) of CL 2015, which provides that the board of directors are collectively liable for compensating the company or shareholders for the harm caused by their mismanagement of the company's affairs or by violating the law's provisions or the company's articles of association.[779] This means that directors are not responsible for compensating the company or shareholders for harm that is not the result of their mismanagement. Therefore, it could be argued that subjecting directors to liability and compensation in the event of the company's mismanagement as per this article cannot happen without the pre-existing presumption of an implicit duty of care. That being said, it can also be inferred that the CL 2015 imposes an implicit obligation on the director to exert sufficient care and diligence to prevent the accusation - and thus the liability - that the company's affairs, including any decision, have been mismanaged or taken without care.

While this is an indirect and vague way of dealing with the duty of care, the vagueness is reduced through recourse to *Sharia* principles, particularly those governing contracts and agency, which help to fill the gaps in this area and provide some much-needed guidance on how the Saudi courts should assess directors' challenged decisions. Referring to *Sharia* law of contracts and agency in this area is consistent with Article 2 of the CL 2015 which establishes and clarifies the contractual nature of a company.[780]

As a starting point, this article establishes the relevance of contracts law when dealing with the CL 2015. The "contract" referred to in this article is the company's articles of association within which shareholders agree to establish the company and specify the roles and responsibilities of the company's various constituents, including the board of directors. From this contract emerges another contract, which is the service contract between the company and its directors where an agency relationship is born.[781]

Therefore, given that *Sharia* is the highest source of law in Saudi Arabia,[782] and that there is no codified law of contracts in Saudi Arabia with the result that the *Sharia* principles

[779] Article 78 (1) of the Companies Law 2015.
[780] Article 2 of ibid.
[781] The CL 2015 presumes that various matters concerning the board of directors will be dealt with in the company's constitutional documents such as its articles of association and bylaws, as the case may be. See for example Articles 63 (d), 75, and 76 of ibid.
[782] Articles 1 and 7 of the Basic Law of Governance 1992.

governing contracts and agency are applicable,[783] it is necessary to rely on *Sharia* principles where the CL 2015 is not adequate in recognising the duty of care or loyalty.

According to *Sharia,* the relationship between the company's shareholders and board of directors is categorised as an agency relationship where the directors play the role of "agents" and shareholders play the role of "principals".[784] In such a relationship, an agent owes his principal a duty of care and diligence to prevent liability in the event of harm and damage.[785] In other words, under *Sharia* principles an agent is not be responsible to the principal unless he is grossly negligent.[786] Therefore, an argument could be made on this basis that the presumption is that the agent (i.e., the director in this context) should exert a sufficient level of care in managing the company's affairs to shield him from the accusation of gross-negligence to avoid liability.[787]

While the above discussion outlines an interpretation of the position in Saudi Arabia, it is still reasonable to seek affirmation of this understanding from the relevant judicial decisions to establish whether or not Saudi courts presume a duty of care when directors discharge their responsibilities. Surprisingly, unlike the UK and Delaware, the number of relevant cases reported in the area of directors' duties and liability in joint stock companies is very modest, a situation which may be attributed either to a lack of adequate reporting by the judicial bodies or by a low actual number of liability suits brought before courts.[788] Despite this modesty, it can be inferred from two relevant cases related to a limited liability company that the Saudi courts implicitly require directors to exert a level of care and

[783] Carol Lee Childress, 'Saudi-Arabian Contract Law: A Comparative Perspective' (1990) 2 . Thomas LF 69.

[784] Sadiq Aljobran, *The Board of Directors of Joint Stock Company in Saudi Law*, pp 324–325; Abdulaziz Alkhayat, *Companies in Islamic Sharia and Positive Law*, vol 2 (4th edn, Alresalah Publishers 1994) 184.

[785] Mansour Albohoti, *Explanation of Muntaha Aliradat*, vol 3 (Alresalah 2000) 535.

[786] ibid.

[787] It should be mentioned that, as explained earlier in Chapter 1, although there are other Islamic countries such as Egypt and United Arab Emirates where Islam is the state's official religion and Sharia is a relevant source of law, their experience in dealing with directors' duties was deemed irrelevant for this study. This is because the extent of Sharia influence over their legal systems and legislations is largely uncertain in light of the absence of any constitutional obligation in those countries that oblige their legal institutions and legislations to adhere to Sharia law.

[788] It is worth noting that while judicial decisions in Saudi Arabia have recently been published, this has not been done in a consistent and systemic manner. On the contrary, rulings have been published selectively. That said, based on an examination of the judicial rulings available on the website of the Board of Grievances, and the Scientific Judicial Portal which is operated by the Ministry of Justice, none of the publicly available judicial rulings are directly relevant to directors' duties in listed companies, and very few published rulings could be said to be indirectly related to directors' duties in other forms of business associations, such as limited liability companies and general partnerships.

diligence to protect themselves from liability.[789] In these cases, the court dealt with the issue of whether the manager of the given limited liability company could be established to have mismanaged the company and thus should be held liable for the company.[790] In its ruling, the court held that the manager was not liable for the losses and damages which occurred during his time as a manager given that the plaintiff did not prove that such losses and damages could be attributed to gross negligence.[791]

Therefore, based on analogy, and building on the exact *Sharia* principles that govern the agency relationship either in a limited liability company or a joint stock company, it can be argued that this is likely to be the court's view towards the directors of joint stock companies. This analogy builds on the fact that the nature of the relationship between the directors of a limited liability company and a joint stock company is a principal-agent relationship, which should be governed by the same *Sharia* principles of agency. Moreover, from a regulatory point of view, both types of companies share prominent characteristics that render them comparable, and thus suitable for analogy. For example, both have a sperate legal personality, are managed by a separate body of directors, and their owners are not personally liable for the company's liabilities.

As to the duty of loyalty and other duties related to it, mainly the duty to act in good faith, the duty to act in the best interests of the company and shareholders, and the duty to avoid conflicts of interest, by exploring the various regulatory sources and judicial decisions it can be observed that the way such duties are approached under the Saudi framework is largely similar to the way the duty of care is dealt with. The exception, however, is that the duty to avoid conflicts of interest is explicitly recognised in the CL 2015, while the other forms are implied. To illustrate, Article 71 of the CL 2015 recognises the duty to avoid conflicts of interest by requiring the director to abstain from having a direct or indirect interest in the businesses and contracts that the company enters into, unless authorisation is obtained from the general assembly.[792] This article goes further, to provide the remedies available when a director breaches this duty and fails to comply with the relevant procedures, granting the company and any other interested party the right to sue him and request the profits or benefits realised by such a director to be paid back.[793] Moreover,

[789] *The Board of Grievances, Case No 760/1/Q 1428H, Appeal Division Decision No 609/S/7 (1430H)*; *The Commercial Court, Case No 3385, Appeal Division Decision No 1702 (1440H).*
[790] *The Board of Grievances, Case No. 760/1/Q 1428H, Appeal Division Decision No. 609/S/7 (1430H).* (n 789).
[791] ibid.
[792] Article 71 of the Companies Law 2015.
[793] Article 71 of ibid.

Article 72 of the CL 2015 deals with the other angle of conflicts of interest, which arises when a director is found to be competing with the company. In this regard, it provides that a director is prohibited from competing with the company in any business that falls within the company's field unless authorisation is obtained from the general assembly.[794] The failure of any director to abide by this article grants the company the right to sue him for proper compensation.[795]

On the other hand, the CL 2015 position is different in relation to the recognition of the other two forms of the duty of loyalty: the duty to act in good faith, and the duty to act in the best interests of the company and its shareholders. Beginning with the former, the CL 2015 lacks any explicit recognition of it; however, that duty is strongly implied when interpreting its various articles. For example, Article 74 of this law states that directors are prohibited from disclosing company secrets outside the general assembly meetings and from taking advantage of their positions to advance their interests or the interests of their relatives, and if this occurs then they must be dismissed and sued for compensation.[796] Furthermore, Article 68 (3) of the same law provides that a director shall be liable to the company if he resigns at an inappropriate time.[797] Therefore, the argument is that these obligations to never take advantage of the company's secrets and to choose the right time to resign would be impossible to fulfil without the law presuming another obligation, which is to act in good faith. In other words, it can be argued that the duty to act in good faith is the driver and prerequisite of the duty to act in the best interests of the company, as the obligation of having due regard to the interests of the company and abstaining from taking advantage of the position of directorship requires a state of mind which preserves good faith based on trust, honesty, and confidence.

To further reduce the uncertainty of the CL 2015's approach towards the duty to act in good faith, *Sharia* principles should be referred to. As was explained earlier, the relationship between directors and shareholders is viewed as an agency relationship governed by *Sharia* contracts and agency principles.[798] These principles[799] provide that contractual parties should base their dealings on confidence, trustworthiness, and good

[794] Article 72 of ibid.
[795] Article 72 of ibid.
[796] Article 74 of ibid.
[797] Article 68 (3) of ibid.
[798] Aljobran (n 784) 324–325; Alkhayat (n 784) 184.
[799] *The Holy Qur'an* 5:1, 83:1-3, 55:9, 4:58.

faith.[800] That being the case, whereas the CL 2015 lacks sufficient recognition of the duty to act in good faith, that duty would still be presumed based both on *Sharia* principles and the implications of several provisions of the CL 2015.

Turning to the duty to act in the best interests of the company, this is another area where the CL 2015 is silent on. However, the research argues that such a duty is recognised by implication, which can be inferred for two reasons. The first reason is that the director's explicit legal obligations to avoid conflicts of interest and abstain from competing with the company indicate an implicit obligation to act in the best interests of the company. What this duty is mainly concerned with is that the director should always advance the interests of the company and put them ahead of his own interests, and only take decisions that he genuinely believes will maximise the company's value. To fulfil this duty, a director should naturally abstain from any harmful act, such as engaging in conflict of interest situations, competing with the company, and any other form of exploitation of corporate opportunities. Building on this argument, the duty to act in the best interests of the company is tied up with the other duties of a director to avoid conflicts of interest and compete with the company, as the latter duties cannot be practically fulfilled without a presumed duty to act in the best interests of the company. The second reason is that according to the *Sharia* principles governing agency, when given discretion to act on behalf of the principal, an agent is expected to exercise discretion in a manner that serves the best interests of the principal. This again builds on the *Sharia* principles promoting trustworthiness, honesty, and confidence in any dealing.[801]

It is worth noting here that while the CL 2015's recognition of directors' duties is deficient and works only through implication endorsed by the relevant *Sharia* principles, surprisingly, the CGRs 2017, which was issued by the CMA as the implementing regulations of the CL 2015, followed a different approach and explicitly recognises not only the duties of care and loyalty,[802] but also the other subsidiary duties of loyalty, namely the duty to act in good faith, the duty to act in the best interests of the company and its shareholders, and the duty to avoid conflicts of interest.[803] Therefore, it could be said that whereas the CL 2015 lacked clear reference to directors' duties, the CGRs 2017 stepped in and explicitly recognised such duties in a clear manner. However, as will be discussed

[800] Abu-Tapanjeh (n 107).
[801] ibid.
[802] Articles 21 (a), 29, and 30 (17) of the Corporate Governance Regulations 2017.
[803] Articles 21 (a), 29, and 30 (17) of ibid.

below, the CGRs 2017 did not provide any further clarification of what these duties entail and how they are applied.

4.4.1.1.1 Assessment of the Saudi position on recognition of duties

Now that the positions of the three jurisdictions on the recognition of directors' duties have been covered, the remaining question is whether the Saudi position is appropriate in light of the above exploration. The prominent difference between the Saudi position on the one hand and those of the UK and Delaware on the other hand indicates an area of deficiency on the Saudi side. The absence of a clear recognition of directors' duties in Saudi Arabia established above is a concerning issue that should be considered by the country's legislators if the corporate governance framework is to be reformed to keep pace with the best international practises and to respond to the changing needs and challenges of the capital market. With that in mind, the case for explicitly recognising directors' duties and codifying the existing implicit duties under the CL 2015 and *Sharia* law is strong, for several reasons.

First, well recognised duties would assist directors in accessing and understanding their obligations so that they can discharge their role properly. In Saudi Arabia where much of the directors' duties are derived from *Sharia* principles, the codification of those principles in a simple form is necessary given that interpreting Islamic law requires a high level of specialised knowledge, and a grasp of how *Sharia* functions within the Saudi legal system. The codification, therefore, should in turn simplifies those duties especially to those who are unfamiliar with the *Sharia* law, ultimately enabling directors to exercise their role without over-dependence on external advice that may not always be available.

The above need is particularly acute in times when Saudi corporate law places many of the major corporate decisions in directors' hands, especially in time of crisis, exposing them to a much higher level of liability.[804] In such cases, the CL 2015's lack of clarity on how directors are expected to act, how their performance will be assessed, and what liability they could face, may put pressure on directors which could negatively affect their behaviours. The pressure could be higher in situations where directors are required to act quickly, necessitating statutory guidance to ensure that directors are aware of their obligations and have confidence in managing the company. The benefits of codification

[804] See Articles 71, 72, 74, 75, 78, 79, 80, 211, 212, and 213 of the Companies Law 2015.

come, *inter alia*, from the tick-box nature of the law which enables directors to design procedures that observe the law,[805] making the compliance process easier and facilitating decision-making. This is especially important given that well-defined processes reflect positively on the behaviours of individuals and reduce the negative effects of group thinking.[806]

Furthermore, the codification of directors' duties would also be advantageous for shareholders in that it increases their protection by ensuring that sufficient constraints on directors' discretionary power are in place. The codification and the associated certainty of the law should also motivate shareholders to take a greater part in monitoring and enforcement[807] knowing that the framework provides clear *ex post* criteria upon which shareholders can rely on to enforce directors' duties and hold directors accountable if they fail to observe their obligations. This is because the clearer the legal provisions are *ex ante*, the easier it will be for injured parties to enforce such provisions *ex post.*[808]

Lastly, the codification of directors' duties in the CL 2015 should, when done properly, promote best practises and ensure that directors universally abide by them across all Saudi listed companies. The idea is that the lack of explicit recognition of the exact content of directors' duties leaves them subject to interpretations by directors, companies, and shareholders, thus creating individual approaches across companies and directors. However, when duties are codified, very little room should remain for interpretation, thus advocating best practises and creating consistency within the Saudi capital market. Furthermore, a universal adoption of best practises would assist the country in its efforts to attract international investors, as they can have confidence that the framework keeps pace with the best international practises in investors' protection and accountability mechanisms, all of which should boost overall confidence in the fairness and integrity of the Saudi market.[809]

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[805] Harner (n 766).
[806] Renee Dye, Oliver Sibony and Vincent Truong, 'Flaws in Strategic Decision Making: McKinsey Global Survey Results' (2009) The McKinsey Quarterly, Online Edition; Marlene E Turner and Anthony R Pratkanis, 'Mitigating Groupthink by Stimulating Constructive Conflict' (1997)] Using Conflict in Organizations, SAGE Publications, 53.
[807] The impact of legal uncertainty on shareholder activism was discussed in Chapter 3.
[808] For more on the relationship between the certainty and clarity of legal rules and their subsequent enforcement see MacNeil, 'Uncertainty in Commercial Law' (n 446) 72.
[809] Section 2.2 of this thesis discussed the objectives of the Vision, among which are to stabilise and deepen the Saudi capital market, and to attract more foreign investment into it.

4.4.2 Sources of directors' duties

Having established the three jurisdictions' positions towards the recognition of directors' duties, and evaluated the Saudi position accordingly, the discussion now turns to another aspect, the source of directors' duties.

Unlike the UK, where the statutory law is the source of directors' duties,[810] and Delaware, where such duties are derived from the state's common law, the Saudi position is different in that no single source constitutes the primary source of directors' duties. To the contrary, directors' duties in both explicit and implicit terms are sporadically referred to in different sources in a rather disconnected way. The most explicit form of recognition of directors' duties is found in the CGRs 2017, with duties being implicitly recognised in *Sharia* principles, the CL 2015, and the very few reported judicial decisions. The research argues that this is an area of concern, that directors' duties should be approached in a more systematic and consistent manner, and that they should be regulated in the highest statutory source, which is the CL 2015.

While the recognition of directors' duties by the CGRs 2017 could increase the certainty of the Saudi framework in this area and eliminate much of its vagueness, dealing primarily with such a critical area in a lower implementing regulation such as the CGRs 2017 may not be appropriate and may even cause further uncertainty. For legal obligations to be fully binding and legally unchallenged, they should be part of the highest legislative source which is the CL 2015 in the Saudi case, not the implementing regulations which are of a lower status.

Among the challenges associated with the current approach is that it may affect the enforcement of directors' duties and undermine investors' confidence in the accountability framework within which those directors operate. The research argues that the legal obligations derived from implementing regulations such as the CGRs 2017 do not have the same binding effects of statutory laws because, unlike laws that are issued by the highest competent legislative body, implementing regulations are issued by the executive governmental agencies, whose legislative powers are limited and contingent on being precisely consistent with what the relevant statutory law provides. When the relevant

[810] It should be noted that while directors' duties in the UK are fully codified in the CA 2006, the common law remains relevant in interpreting such duties, as provided under Section 170 (4) of the CA 2006.

statutory law is absent in certain areas, the power of the relevant governmental agencies to regulate these areas and impose further obligations may be challenged by courts on the basis that the executive governmental agency lacks the proper authority to legislate. The mere possibility that this may happen is detrimental to the stability and certainty required for any market to develop. Furthermore, the CGRs 2017, as an implementing regulation, is subject to frequent and rapid amendment, which may also affect the stability and certainty of the legal rules. This is different to statutory laws, which typically take a long time to be changed and which undergo a higher level of scrutiny and deliberation, which means that legal obligations and rights will largely be predictable.

Moreover, the way in which the CGRs 2017 approach directors' duties seems neither systematic nor collective, as evidenced by the lack of proper context for references to those duties. While the approach of the CMA, the owner of the CGRs 2017, in stepping in and explicitly making reference to the duties can be defended in that the CMA aims at doing what it can within its powers to reduce the uncertainty and vagueness of the CL 2015 (which is a product of the legislative body) thus falling out of the former's scope, the issue of directors' duties are still better served if the entire framework including the statutory law addresses such duties via explicit and clear recognition, not implication, so that the approach throughout the entire framework is systematic and consistent.

It is worth noting that the case for addressing directors' duties in the statutory CL 2015 should not be played down by any possible argument that judicial decisions and *Sharia* principles should fill the existing gaps, and that therefore codification should not be a priority. The research argues that the need for the CL 2015 to explicitly recognise directors' duties and increase legal certainty is greater given that judicial decisions in Saudi Arabia provide very little guidance and to a large extent fail to fill the regulatory gaps, leaving directors and shareholders with nothing but speculation as to how such duties should be defined, and how courts will assess compliance. The most that can be gained from a judicial decision is relative guidance that may help investors and directors to more accurately speculate on the position of the framework in this regard. Nevertheless, even if judicial decisions were to provide any meaningful guidance, directors' duties would still need to be explicitly part of the statutory CL 2015 to be binding over all relevant matters given, as was established in Chapter 2, that Saudi Arabia, unlike the UK and Delaware, is a jurisdiction where judicial precedent does not apply, and the legal system does not recognise judicial precedent as a source of law. This means that judicial decisions have no binding power over other judges when they come to decide similar matters. It should be noted here that in the UK, where the case law on directors' duties is rich and judicial precedent applies, the case for codifying the common law principles on duties was established and the CA 2006 reintroduced those common law duties in a much simpler form. Therefore, given that the need for codifying directors' duties in the statutory source was established in a jurisdiction like the UK despite the guidance provided by its common law, the case for similar codification should be greater in a jurisdiction like Saudi Arabia where the judicial guidance is almost absent.

In this specific area, Saudi Arabia could and should learn from the UK's experience and build on its efforts that led ultimately to the full codification of the general duties of directors. It should be noted here that prior to the CA 2006, the UK had considered opting for a partial codification of the duties so that the codification of duties would not be exhaustive, leaving certain elements of the duties open for further development by the courts should the corporate circumstances change and unforeseen factors come into play.[811] However, the UK ultimately opted for full codification to ensure that directors' duties are authoritatively recognised, and that the nature and essence of those duties are clarified in a way that increases the duties' accessibility, certainty, and consistency.[812] Such clarification was deemed necessary to limit the discretion of the courts in dealing with directors' duties given the binding effect of the statutory duties.[813]

As to the value of explicitly codifying directors' duties in Saudi Arabia in the presence of *Sharia* law, two important points can be made. First, the modern corporate world and the increasingly complex and evolving nature of corporate challenges within it require a very high level of certainty and clarity through which the exact nature and content of directors' duties are regulated. This is not to say that codification should replace *Sharia* principles, but rather that codification should build on them so that clear principles are introduced in a well-defined and certain manner that is both accessible and easy to enforce. This is especially true given that *Sharia* law is a jurist's law which Islamic jurists are charged with

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[811] The Law Commission and the Scottish Law Commission, 'Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties' (1999) LAW COM 261 and SCOT LAW COM 173 para 4.6, 4.7 and 4.48; Dennis Davis, Farouk Cassim and Walter D Geach, *Companies and Other Business Structures in South Africa* (Oxford University Press, Southern Africa 2012) 111; PA Delport and others, 'Henochsberg on the Companies Act' 290; Irene-Marie Esser, 'Recognition of Various Stakeholder Interests in Company Management' 289.

[812] CLRSG, 'Modern Company Law for a Competitive Economy: Final Report' (2001) para 3.7.; John Lowry, 'The Codification of Directors' Duties: Capturing the Essence of the Corporate Opportunity Doctrine' (2006) 2 Corporate Board: Role, Duties & Composition.

[813] CLRSG (n 812) para 3.9; Lowry (n 812).

elucidating and interpreting in accordance with the relevant Islamic school to which each jurist belongs. As a jurist's law, *Sharia* therefore is subject to different interpretations, and the different approaches and interpretative methodologies applied by each school affect individual judges' views on what *Sharia* entails and provides in every matter. This, in turn, leads to individualistic interpretations of *Sharia* principles and potentially inconsistent judicial decisions, which increases the already existing vagueness and uncertainty of the Saudi framework, all of which justifies the need for codifying directors' duties in the CL 2015.[814]

4.4.3 Standard of review

Another aspect in relation to which the approaches of Saudi Arabia, the UK, and Delaware towards directors' duties should be discussed in order to make an informed conclusion on the appropriateness of the Saudi framework in relation to such duties is the standard of review that is applicable when such duties are breached. The term "standard of review" in this context refers to the tests and criteria used by courts to determine whether a given duty was breached, which can either be statutorily recognised or developed by the courts themselves. This area is important in that the first two aspects discussed earlier deal with the directors' duties *ex ante*, while the standard of review deals with those duties *ex post.*

Starting with the UK, it is evident that legislators' efforts to codify the common law duties did not focus only on providing a general statement of directors' duties, but also attached equal importance to the standard of review that is applicable when courts evaluate directors' decisions, thus providing greater certainty in this area. Section 174 of the CA 2006 which regulates the duty of care goes beyond merely recognising this duty, to further clarify the meaning of the duty and the standard against which a director's action will be assessed to determine whether the duty has been breached. In this regard, Section 174 (2) defines the meaning of care as the same level of care, skill, and diligence that a reasonably diligent person would exercise.[815] Two important tests are to be employed when applying this standard as stipulated under this section. The first is an objective test assessing the director's conduct taking into account, as a minimum, the general knowledge, skills, and experience that any other person exercising the functions of that director should possess.[816]

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[814] See Section 2.3.2 of this thesis for more on the enforcement of Sharia law in Saudi Arabia.
[815] See Section 174 (2) of the Companies Act 2006.
[816] See Section 174 (2/a) of ibid.

The other test is a subjective one assessing the challenged conduct against the higher level of experience and knowledge that the given director possess.[817]

As to the relevant standard of review for the duty of loyalty, it could be said that in the UK two standards are applicable depending on the circumstances of each case. There is a subjective standard relating to the director's state of mind which is concerned with the good intentions of that director.[818] This standard focuses on determining whether the director in question "honestly believed he was acting in the best interests of the company" when making the disputed decision.[819] If the court decides that this was the case based on the evidence provided, then that director would not be found in breach of his duty of loyalty. However, when the court finds no evidence which demonstrates that the director in question considered his disputed decision to be in the best interests of the company, it will then apply a stricter standard of review which is an objective standard focusing on establishing whether "an intelligent and honest man in the position of a director of the company could in the circumstances have reasonably believed that the transaction was for the benefit of the company."[820]

The extent to which standard of review is recognised in the UK is similar to that in Delaware, where the common law, in addition to recognising the duty of care and duty of loyalty, plays an essential role in providing the applicable standard of review when either duty is breached. In this regard, the applicable judicial standard for the duty of care and duty of loyalty is known as the business judgement rule, whose purpose is to establish whether the challenged director was grossly negligent when he made the disputed decision.[821]

The business judgement rule, which is a product of the Delaware common law, presumes that in making business decisions, directors have adhered to their duties and exercised sufficient care, informed themselves, and acted in good faith and in the best interests of the company and its shareholders, and for the court to believe otherwise, the plaintiff bears the

[817] See Section 174 (2/b) of ibid.
[818] Keay (n 759); Ross B Grantham, 'The Content of the Director's Duty of Loyalty' (1993) 1993 Journal of Business Law 149.
[819] *Regentcrest plc (in liq) v Cohen & Anor* (2001) 2001 BCC 494; *Item Software (UK) Ltd v Fassihi* (2004) 2004 EWCA Civ 1244.
[820] *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1970) 1970 Ch 62.
[821] Holland (n 770); Lafferty, Schmidt and Wolfe Jr (n 763).

burden of proving through facts that this was not the case.[822] The idea behind this rule is that Delaware's courts wish to avoid irrationally putting themselves in the position of the director and making decisions as to what would have been right or wrong for the company when a director's action could be linked to any reasonable corporate objective.[823] The courts through this rule aim only at determining whether before making his challenged action, regardless of its outcome, the director adhered to his fiduciary duties of care and loyalty, and made a fully informed decision in good faith, believing that his decision was in the best interests of the company and its shareholders.[824] When the business judgement rule is rebutted by the plaintiff by proving through facts a breach of either the duty of care or the duty of loyalty, the courts will shift to the much stricter "entire fairness standard".[825] In such a case, the burden of proof shifts from the plaintiff to the director in question, who must prove that the disputed action or transaction was "entirely fair" to the company and its shareholders, a task which includes establishing to the courts that the disputed transaction was a fair dealing at a fair price.[826]

It is worthwhile noting that the approach of the Delaware courts to the business judgements made by directors is said to be different than that followed in the UK, where directors' decisions do not enjoy the same level of protection as is found in Delaware's business judgement rule.[827] To illustrate, based on an analysis of 130 cases involving business judgement, directors' decisions in the UK were found to be prone to judicial examination to a larger degree than in Delaware, implying that directors cannot easily escape liability on the mere basis that their decisions were simply due to "business judgement".[828] Rather, the courts in the UK seem to concentrate more on the processes that precede and surround the decision in question and its context, instead of focusing on the characterisation of the decision as a business judgement or not.[829] In almost 130 cases, judges were found to had

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[822] *Guth v Loft, Inc* (1939) 5 2d 503 (Supreme Court) It states at 510 that: "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests.". *Aronson v Lewis* (1984) 473 2d 805 (Del: Supreme Court) It states at 812 that: "It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.".
[823] *Cede & Co v Technicolor, Inc* (1993) 634 2d 345 (Del: Supreme Court).
[824] *Smith v Van Gorkom* (1985) 488 2d 858 (Del: Supreme Court); *Moran v Household Intern, Inc* (1985) 490 2d 1059 (Del: Court of Chancery).
[825] *Cinerama, Inc v Technicolor, Inc* (1995) 663 2d 1156 (Del: Supreme Court); *Cede & Co. v. Technicolor, Inc.* (n 823).
[826] *Cinerama, Inc. v. Technicolor, Inc.* (n 825) It should be noted that this case states at 1164 that: 'From a procedural perspective, the breach of any one of the board's fiduciary duties is enough to shift the burden of proof to the board to demonstrate entire fairness.'; *Cede & Co. v. Technicolor, Inc.* (n 823).
[827] Andrew Keay and Joan Loughrey, 'The Concept of Business Judgment' (2019) 39 Legal Studies 36.
[828] ibid.
[829] ibid.

engaged in a systematic review of directors' business judgements, involving "the substantive decision matter."[830] For examples, judges were found to have examined details which demonstrate whether the director in question failed to consider a critical factor or overlooked an issue before taking the challenged action.[831] The judges' examinations also went beyond looking at corporate formalities such as board minutes and other formal documents,[832] as they paid close attention to boards' discussions to ascertain how the challenged action was taken and whether there had been "signs of thought and action, advice sought or rejected and motive."[833] Therefore, it can be said that the UK does not follow the business judgement rule in the same way it is followed in Delaware, meaning that it is harder for directors to avoid liability when they mismanage the company.

Now that the positions of the UK and Delaware regarding judicial standards of review have been explored, the remaining question is what approach is followed in Saudi Arabia, and whether it is suitable in comparison to the other two jurisdictions. As to the standard review of the duty of care and duty of loyalty, given that the CL 2015 does not explicitly recognise them, it is unsurprising that it falls short of reference to the relevant judicial standard of review. Once again, *Sharia* principles fill this gap by establishing that when determining whether an agent has breached his duty of care, the standard against which assessment is made should be whether the challenged director has exercised the same level of care that can be expected from an ordinary careful person when dealing with his own money. In other words, a director under *Sharia* principles is liable only if he is proven to have failed to act in the same manner as an ordinary careful person would have acted with his own money.

Based on the positions of the three jurisdictions in relation to the standard of review, it can be observed that the Saudi framework is notably different to the other two jurisdictions in that, unlike the UK and Delaware, it lacks any explicit reference to the applicable standard of review when either the duty of care or of loyalty is breached. For the standard of review when the duty of care has been breached, although as was mentioned above the presumption derived from *Sharia* is that the director's action would be assessed against the same level of care that could be expected from an ordinary careful person when dealing with his own money, this area still lacks certainty regarding the extent to which courts

[830] ibid.
[831] ibid.
[832] ibid.
[833] ibid.

would go to apply this standard. Unlike the UK, where the standard of review when breaching the duty of care is much clearer in that both subjective and objective tests will be applied, there is no such clarity in Saudi Arabia as to whether a director's action will be evaluated by taking into account the director's specific knowledge and experience. The challenge here lies in the uncertainty around what "ordinary careful" entails in this context, especially in light of the lack of legislative guidance and the modest judicial contribution. The generality of the principles, legal texts, and judicial decisions around this issue in Saudi Arabia have led some to argue that the standard of an "ordinary careful person" is an objective standard that does not take into account the level of knowledge and sophistication of the given director, thus protecting experienced directors from liability unless they are grossly negligent as assessed against the same level of knowledge possessed by ordinary careful people.[834] This is an important aspect for legislators in Saudi Arabia to consider so that experienced directors will act always in accordance with their level of sophistication and knowledge, which is mostly the reason they were elected to the board in the first place. When the specific and unique experience and skills of directors are not taken into account when determining whether they have exercised enough care prior to making the disputed decision, there will not be any great value in shareholders aiming at persuading talented and experienced professionals to join the board.

As to the standard of review of the duty of loyalty, again the Saudi position suffers from a great deal of uncertainty, in that apart from the duty to avoid conflicts of interest, there is no reference in either the CL 2015 or the CGRs 2017 as to which standard of review courts should use when this duty is breached. That being the case, the lack of legislative and judicial guidance on the applicable standards to be employed by the courts to review directors' alleged breach of either their duty of care or duty of loyalty will leave the door wide open for speculation by directors and shareholders alike. Either the courts will be too lenient by abstaining from questioning the judgement of a director on the basis that every decision made by a director is a commercial "business judgement", thus allowing directors to easily escape liability, or they will be too stringent by putting themselves in the position of the director, thus placing unnecessary and unreasonable expectations on directors and undermining their discretionary power, both of which are detrimental to the capital market. A difficulty also arises for directors as they cannot be certain how to properly satisfy their

[834] Aljobran (n 784) 339.

duty of loyalty, nor can they know with accuracy what is required from them to be viewed as compliant with this duty in the eyes of both their shareholders and the courts.

This problem becomes more challenging given that, as was discussed above, the duty of loyalty, which encompasses both the duty to act in the best interests of the company and to act in good faith, is primarily concerned with the state of mind of directors when taking or not taking a given decision. In the absence of legislative or judicial guidance as to what constitutes a breach of this duty or what the optimal conduct is, the challenge faced by directors is how to manifest their "good intentions". While the state of mind and required good faith "good intention" are inherently difficult to ascertain, the position of the UK in relation to the applicable standard when determining a breach of a duty of loyalty is much clearer and provides greater certainty and predictability than is available in Saudi Arabia. As was discussed earlier, two standards are relevant when reviewing an alleged breach of duty of loyalty in the UK: the subjective standard and the objective standard. The subjective standard is an evidence-based question which is concerned with whether the director in question genuinely believed he was acting in the best interests of the company.[835] When a court finds no evidence demonstrating that this was the case, it will then shift to the stricter objective standard which aims at ascertaining whether "an intelligent and honest man in the position of a director of the company could in the circumstances have reasonably believed that the transaction was for the benefit of the company.".[836] Therefore, while the UK approach is not entirely certain and predictable, as the judgement of the court is still based on the circumstances surrounding the challenged decision where the court attempts to ascertain the director's state of mind which could be an onerous task, it still offers considerable predictability and certainty, at least compared to the Saudi position.

Furthermore, the lack of guidance in the Saudi framework on the applicable standard of review of the duty of loyalty places unreasonable behavioural expectations on directors when managing their company's affairs, as the instances during which a duty of loyalty issue arises could be endless, and without a clear legislative statement as to what judicial standard will be applied, directors will be faced with endless possibilities. While this may not be the case in conflicts of interest situations (i.e., related party transactions and competition with the company) due to the much clearer procedural steps provided by the

[835] *Regentcrest plc (in liq.) v Cohen & Anor* (n 819); *Item Software (UK) Ltd v. Fassihi* (n 819).
[836] *Charterbridge Corporation Ltd v. Lloyds Bank Ltd* (n 820).

CL 2015 which serve as a safe harbour for directors, the position of the Saudi framework remains unclear on other instances of the duty of loyalty. The challenge here is that the duty of loyalty, unlike the duty of care, is closely concerned with the state of mind of a director when taking a given corporate decision. Accordingly, it could be said that the level of uncertainty in this area is so high that directors, shareholders, and courts will generally find it difficult to deal with any alleged breach. Therefore, there is an obvious need to bring certainty into the Saudi framework by making explicit reference to the standard of review applicable to the duty of loyalty.

The value of legal consistency and thus certainty lies in the fact that clearly defined legal obligations will increase the level of market predictability of how such obligations should be interpreted and satisfied.[837] Furthermore, an ongoing lack of legal certainty and consistency in relation to the applicable standard of review for directors' duties will contribute to higher litigation and enforcement costs, because the burden of proving a failure to adhere to a given duty will be greater if that duty is not defined as precisely and clearly as it should be in the first place.[838] This in turn complicates enforcement efforts, as injured parties will have a much harder time determining and proving that the given duty has been breached. The current situation could also have a negative impact on the development of the Saudi capital market and its ability to attract local and international investment. The reason behind this impact is that when the framework lacks a clear statement of the obligations of directors and which constraints they are bound by, shareholders cannot predict how courts will deal with alleged failures by directors and which legal remedies, if any, are available to them.

That all being said, there is a strong case for enhancing the Saudi framework on directors' duties through, *inter alia*, recognising the judicial standard of review relevant to directors' duties by codifying what *Sharia* principles indicate in this area. If this can be achieved, then the framework would be in a better position to promote effective corporate accountability and increase investor protection.[839]

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[837] MacNeil, 'Uncertainty in Commercial Law' (n 446) 72.
[838] ibid.
[839] It is worthwhile mentioning that in 2020 the MOC and CMA sought public consultation on proposed amendments to the companies law. Those proposed amendments included a statement of directors' duties in a manner similar to that of the UK which would recognise, among other matters, the duty of care and diligence and the duty of loyalty, in addition to stipulating the standard of review applicable for breaching the duty of care. This proposed standard of review takes into account the individual knowledge, skills, and expertise of a given director when determining whether he breached his duty. Nevertheless, ever since 2020,

4.5 Summary and Conclusion

The objective of this chapter was to assist in answering the thesis's main questions, which revolve around ascertaining the appropriateness of the new Saudi corporate governance framework. Through doctrinal and comparative analysis and supported by the available empirical evidence, the discussion in this chapter started by examining each of the three jurisdictions' approaches to board structure, including a discussion of the issues associated with CEO and chairman duality, the role and representation of NEDs, the role and representation of independent NEDs, and board committees, including their recognition, composition, and responsibilities. The discussion then moved to consider the board's operations, where the focus was on directors' duties. This part of the chapter focused on the recognition and source of directors' duties along with the applicable standard of review. The discussion in this chapter was largely developed around the agency theory, the importance of which lies in the fact that it lays the ground for understanding the regulatory approaches towards the board. The chapter explored this theory in detail, discussing its causes and possible solutions. Based on the prior discussion in Chapter 3 concerning regulatory modes in addition to the considerations associated with the agency theory along with the relevant empirical studies, the research critically discussed the Saudi position on issues concerning the board from two perspectives: one is the regulatory mode of the framework (i.e., mandatory or voluntary), and second is the substance of the rules.

With regard to board's composition, the research defended the present Saudi mandatory approach towards the prohibition of the duality of CEO and chairman roles, and the representation of NEDs and independent directors on the board and committees, along with the establishment of the board's three main committees. In this regard, and building on the discussion of Chapter 3, the research argued that the extent to which companies in Saudi Arabia are willing to comply with voluntary rules is questionable given that the Saudi capital market has various distinctive cultural characteristics, notably that hierarchical social status is strongly influential in corporate settings in the country. In such settings, the role of social relationships was argued to be more powerful than formal corporate governance arrangements, at least sometimes. The implication of this is that in the absence

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the MOC and CMA have made no further announcement regarding the status of these proposals and whether they will go ahead with the amendments. All in all, if such codification takes place then the position of the Saudi framework will significantly improve bringing it into a closer alignment with international practices and increasing the level of legal certainty regarding the accountability framework within which directors operate. See: 'The Ministry of Commerce and the Capital Market Authority Publish the Proposed New Companies Law For Public Consultation' <https://www.mc.gov.sa/ar/Pages/CSD.aspx> accessed 3 August 2020.

of a mandatory rule backed by the regulator and its public enforcement, the rights of shareholders, especially minority ones, are likely to be ignored in favour of pursuing the benefits of powerful shareholders and executives.

Furthermore, the research has shown that the ownership structure of the Saudi market influences the choice between a mandatory and a voluntary approach to corporate governance. This is because unlike the UK and Delaware, the Saudi capital market's ownership structure is characterised by concentrated ownership, with block-holders dominating listed companies. This structure could negatively affect companies' inclination to voluntarily comply with the governance rules for the benefit of their powerful controlling shareholders. Moreover, the presence of institutional investors is relatively low, leading to inadequate shareholder activism and a limited ability to design and enforce governance rules. The inadequate activism in Saudi Arabia should cast doubt on any promises of the benefits of a potential voluntary approach.

Taking all these concerns into account, prohibiting the duality of CEO and chairman positions, enforcing the greater presence and representation of NEDs, particularly independent directors, on boards and their committees, along with mandatory recognition of the board's three main committees are all critically important steps to ensure the integrity of the decision-making process, the protection of shareholders, and the survival and thriving of Saudi listed companies.

Nevertheless, in defending the Saudi mandatory approach towards many corporate governance issues, the research did not entirely dismiss the voluntary approach. Rather, it acknowledged the virtues of that approach arguing that a voluntary approach could have been utilised by the Saudi regulator in many instances where the use of binding provisions is not necessary, such as outlining the detailed responsibilities of the chairman, NEDs, independent directors, and committee members. Moving such rules along with other rules of a guiding and procedural nature into separate guidance notes would make the framework more accessible, sharper, and easier to comprehend, and would hopefully increase the compliance rate, raise awareness of corporate governance application, reduce the costs incurred by the public authorities in supervising the implementation of the rules, and eliminate the vagueness typically associated with excessive regulation.

As to the substance of the rules, the research concludes that, except for its approach towards the representation of independent directors, the Saudi rules governing structural aspects are suitable because they are consistent with the relevant empirical studies and are largely in line with the approaches of the UK and Delaware, and because such rules are critical to safeguarding the integrity of the company's decision-making process. While the research defends the Saudi approach towards most structural aspects, it nevertheless identifies a significant area of deficiency in the rules surrounding board independence. In this regard, the research argues that the Saudi position requiring the board to be composed of only two independent directors or one third of the board as a minimum, and the board's committees to have at least one independent director as a minimum, is inconsistent with the relevant theoretical and empirical evidence, most of which identifies the positive role of independent directors on the agency problem and firm value, particularly by protecting the interests of shareholders, serving as a check on management, safeguarding the integrity of the company's accounts, resolving conflicts of interest, and reducing agency costs. Furthermore, the discussion has shown that the Saudi position is strikingly different from those of the UK and Delaware, where independent directors are required to dominate the board. Accordingly, the research concludes that the Saudi approach towards board independence is defective, and that it undermines the effectiveness of the other structural governance arrangements compromising the integrity of the decision-making process, thus exposing companies and minority shareholders to a greater risk of corporate exploitation. With that in mind, the research proposes a reform of the Saudi rules based on the UK example by advocating for half the board, as a minimum, to be independent. The rationale behind this proposal is to align the Saudi framework with best international practices and with the relevant empirical evidence, while at the same time creating balanced boards in which all three categories of members are represented: executive, non-executive, and independent directors. The Delaware approach of requiring the majority of the board's directors to be independent was deemed by this research to be unsuitable for the Saudi capital market given the dominant presence of large shareholders in Saudi Arabia, which implies that the need for majority independent directors is not as pressing as it is in Delaware.

With regard to directors' duties, the research demonstrated that the Saudi framework suffers from uncertainty and deficiency in that the framework does not set out directors' duties and their applicable standards of review in a sufficiently manner leaving many of their critical aspects subject to speculation. The research has argued that the deficiency of the statutory CL 2015 makes recourse to the high-level uncodified *Sharia* principles governing contracts and agency inevitable in order to fill in the legislative gaps and reduce the existing uncertainty. Accordingly, the case for statutorily codifying such duties building on the relevant *Sharia* principles was established. The rationale behind codification builds on the inaccessibility of *Sharia* principles to those who are unfamiliar with Islamic law, and the fact that *Sharia* Law is a jurist's law leaves the door open for various interpretations by courts, which further increases the uncertainty in this area. Furthermore, although the CMA deserves to be acknowledged for attempting to step in and fill the legislative gaps in relation to directors' duties by dealing with them in the CGRs 2017, the research criticised this approach because directors' duties should not be part of the implementing regulations issued by an executive governmental agency, instead they need to be part of the statutory corporate law so that their legitimacy can be protected against any possible challenge by courts. The research also showed that the judicial contribution to the area of directors' duties is insignificant; thus, judicial guidance cannot be relied upon to fill in the legislative gaps. Even if courts were to provide clarification, the need for codification is still pressing given that judicial precedent does not apply in Saudi Arabia.

CHAPTER 5: ROLE AND REPRESENTATION OF SHAREHOLDERS

5.1 Introduction

The idea of separating the ownership and control in publicly held companies has proved crucial to the survival of those companies.[840] As was discussed in Chapter 4, economic and practical needs make this separation a necessity; however, it gives rise to an agency problem where the interests of the board may deviate from those of the shareholders.[841] Consequently, corporate governance has focused on tackling this phenomenon from different angles by providing arrangements that aim *inter alia* at ensuring the right structure and composition of the board and imposing legal duties on directors to ensure that they operate within a solid framework of accountability.[842]

Nevertheless, this separation raises another question that goes beyond the structure, composition, and duties of the board to encompass which model of board authority to follow, in terms of whether a delegation model such as that of the UK or a statutory model such as that of Delaware would be best. This question was the basis of the debate over the optimal allocation of powers between the board and shareholders in publicly held companies, during which the theories of director primacy and shareholders primacy emerged.[843] These two theories have since been influential in developing corporate laws and in designing corporate governance rules as they stand today,[844] and their significance derives *inter alia* from their implications for corporate governance frameworks in relation to the division of control rights within public companies and how they influence the frameworks' choices towards those matters.

Therefore, the purpose of this chapter is to discuss the positions of the three jurisdictions in relation to the allocation of decision-making powers from several perspectives, including agency theory and director/shareholder primacy theories, in order to ultimately assess the appropriateness of the Saudi approach. In doing so, the discussion will cover issues surrounding the allocation of decision-making powers, shareholders' appointment rights,

[840] Bainbridge, 'The Board of Directors' (n 574); Jensen and Meckling (n 145); Mallin (n 13).
[841] Berle and Means (n 532); Ross (n 533); Jensen and Meckling (n 145).
[842] Hermalin and Weisbach (n 575); Bainbridge, 'The Board of Directors' (n 574).
[843] Iman Anabtawi, 'Some Skepticism About Increasing Shareholder Power' (2005) 53 UCLA L. Rev. 561; Lynn A Stout, 'Bad and Not-so-Bad Arguments for Shareholder Primacy' (2001) 75 S. Cal. L. Rev. 1189.
[844] Stephen M Bainbridge, 'Director Primacy and Shareholder Disempowerment' (2005) 119 Harv. L. Rev. 1735; Lucian Arye Bebchuk, 'The Case for Increasing Shareholder Power' (2004) 118 Harv. L. Rev. 833; Anabtawi (n 843); Stout (n 843).

shareholders' meeting and voting rights, and shareholders' decision rights. These issues are chosen given that they provide an overall picture of how the given framework views control rights, and how such a view is reflected in the allocation of decision-making powers. Moreover, dealing with these issues helps in building understanding of the implications of the different legal approaches followed by the different jurisdictions in this regard. With that in mind, it is appropriate first to explore shareholders primacy theory and director primacy theory so that the context is set for the subsequent comparative discussion.

5.1.1 Shareholder primacy theory

Shareholder primacy theory views directors as the agents of the company's shareholders, whose main purpose should always be to advance shareholders' interests and maximise their wealth.[845] It is argued under this theory that shareholders, being the company's principals and equity owners, should exert control over the company and thus be empowered to get involved in the decision-making process as much as is needed to ensure that directors do not deviate from their sole purpose, consequently reducing the agency problem.[846] Under this theory, the objective of the corporate governance structure is to resolve the agency problem through arrangements that reduce the agency cost and align the interests of the agents with those of the shareholders.[847]

Shareholder primacists base their views on several arguments, chief among them the ownership argument, the residual claimant argument, and the agency problem argument.[848] The ownership argument essentially relies on the notion that the company is owned by shareholders who are its ultimate beneficiaries therefore they should be in charge of deciding how their property is managed and what course of action should be taken.[849]

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[845] Bebchuk, 'The Case for Increasing Shareholder Power' (n 844); Jill E Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2005) 31 J. Corp. l. 637.
[846] Fisch (n 845); Bebchuk, 'The Case for Increasing Shareholder Power' (n 844).
[847] Dalton and others (n 622); Hermalin and Weisbach (n 575); Shaker A Zahra and John A Pearce, 'Boards of Directors and Corporate Financial Performance: A Review and Integrative Model' (1989) 15 Journal of Management 291.
[848] Dalton and others (n 622); Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996).
[849] See generally Adolf Augustus Berle and Gardiner Coit Means, *The Modern Corporation and Private Property* (Transaction Publishers 1991); D Gordon Smith, 'The Shareholder Primacy Norm' (1997) 23 J. Corp. l. 277; Adolf A Berle Jr, 'Corporate Powers as Powers in Trust' (1930) 44 Harv. L. Rev. 1049; Milton Friedman, 'The Social Responsibility of Business Is to Increase Its Profits', *Corporate ethics and corporate governance* (Springer 2007).

In the residual claimants argument, shareholder primacists argue that a company is a nexus of contracts between and among the company's shareholders and other company constituents.[850] The parties to these contracts, for example the employees, managers, and creditors, enter into explicit contracts which mean they are entitled to fixed remunerations such as wages and interest fees.[851] In contrast, shareholders are left with an implicit contract which entitles them only to whatever remains after the company has satisfied all of its explicit obligations towards its explicit claimants.[852] Therefore, because shareholders are the "residual risk bearers", public companies should be managed in a way that maximises their wealth, and involving shareholders in the decision-making is one way to achieve that aim.[853]

Furthermore, advocates of shareholder primacy argue that increasing the decision-making power of shareholders would resolve the agency problem arising from the separation of ownership and control through empowering the principals to directly intervene in the company's affairs should the agents fail to act properly. In other words, when corporate governance arrangements fail to prevent a misalignment of the board's interests with those of the shareholders, the shareholders should be empowered to step in and exert control over the company.

5.1.2 Director primacy theory

At the other end of the spectrum is the director primacy theory which, in opposition to shareholder primacy, views the board as an independent decision-making body that is in a much better position to mediate between the often conflicting views and interests of the company's various constituents.[854] The board in this theory is required to observe the interests not only of the shareholders but also of the company's other stakeholders, such as employees, consumers, and creditors.[855] This does not mean that the board should not aim at maximising shareholders' interests; instead, the focus of the board should remain on observing shareholders' interests, but in doing so should consider the interests of other stakeholders, thus advocating for the vesting of more discretionary powers in the board and

[850] See generally Easterbrook and Fischel (n 848).
[851] ibid 36.
[852] ibid 36–37.
[853] ibid.
[854] Stephen M Bainbridge, 'The Case for Limited Shareholder Voting Rights' (2005) 53 UClA l. reV. 601.
[855] E Merrick Dodd Jr, 'For Whom Are Corporate Managers Trustees' (1931) 45 Harv. L. Rev. 1145; Bainbridge, 'The Case for Limited Shareholder Voting Rights' (n 854).

limiting the involvement of shareholders in the decision-making process.[856] Consistent with this view, director primacists argue that the company - and subsequently the board - does not exist for the sole purpose of increasing the wealth of shareholders, but instead that there is a social purpose which they should attain, encompassing job stability for employees, providing consumers with better products, and increasing the wellbeing of society at large.[857] That being the case, the purpose of any corporate governance structure is to motivate the board to increase the takings of all of the constituents of the company which take part in team production by balancing and mediating their competing interests.[858] This means that the position of shareholders under director primacy is that they voluntarily relinquish the management of the company to the board for their own benefit, and accept that they are one stakeholder within a wider group of stakeholders, all of which take part in team production.

Director primacists reject all the arguments used in favour of shareholder primacy, and cast doubt on their validity. To begin with, director primacists reject the ownership argument, opining that shareholders are not the owners of the company; rather, they are the owners of a security named "stock" which grants them a few limited rights such as dividend payments, the election and removal of directors, and voting in general meetings.[859] Even these rights are only exercisable through the board, as the body which decides to declare dividends, adds items to the general meeting agenda, and provides nominees for the board's seats. Therefore, any influence which can be exerted by shareholders over the company is indirect and mostly contingent on the willingness of the board to accommodate the shareholders' wishes, something which is inconsistent with actual ownership. That being the case, director primacists refuse the usage of ownership argument and consider it to be a misleading characterisation of the relationship between shareholders and publicly held companies.

Furthermore, the residual risk claimants argument does not go unchallenged by director primacists either, as they refuse to accept the idea that shareholders are the only residual

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[856] Dodd Jr (n 855); Bainbridge, 'Director Primacy and Shareholder Disempowerment' (n 844); Jennifer Arlen and Eric Talley, 'Unregulable Defenses and the Perils of Shareholder Choice' (2003) 152 University of Pennsylvania Law Review 577.
[857] Dodd Jr (n 855); Bainbridge, 'The Case for Limited Shareholder Voting Rights' (n 854).
[858] Margaret M Blair and Lynn A Stout, 'A Team Production Theory of Corporate Law' (1999) Virginia Law Review 247; Margaret M Blair and Lynn A Stout, 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 Wash. ULQ 403; Stephen M Bainbridge, 'Why a Board-Group Decisionmaking in Corporate Governance' (2002) 55 Vand. L. Rev. 1; Stephen M Bainbridge, *Corporation Law and Economics* (Foundation Press 2002).
[859] Stout (n 843).

risk bearers in public companies. On the contrary, they opine that nothing in corporate law suggests that shareholders are entitled to much less than other constituents, and that corporate law does not view shareholders as the sole residual claimants except when the company is bankrupt.[860] Other than a bankruptcy event, which is also disputed,[861] shareholders are allowed under corporate law to receive payments from the company in the form of dividends provided that the company is financially profitable and that the board decides to declare dividends. Therefore, to claim that shareholders are the sole residual claimants is argued to be a mischaracterisation which does not justify shareholder primacy.[862]

Lastly, while director primacists accept that there is indeed an agency problem in public companies and that the board can deviate from its original task, they believe that increasing shareholders' decision-making power is not the optimal solution. First, directors operate within a framework of accountability which, coupled with external forces such as the labour market and the market for corporate control, should control the directors' actions and render intervention by shareholders unnecessary. Second, an agency problem is an inevitable outcome and a natural result of vesting the discretionary decision-making power with persons other than owners. While this agency problem and the consequent costs could be reduced by eliminating this discretion, the fact that corporate laws did not choose to do so indicates that such discretion has overwhelming value.[863]

Now that these two fundamental theories have been discussed, the positions of the three jurisdictions can be explored to establish how control rights are approached and, where appropriate, to highlight how influential such theories are in shaping the governance structures in each framework.

5.2 Allocation of Decision-making Powers

When exploring the frameworks of the three jurisdictions in relation to the corporate body responsible for company decision-making, it can be observed that while they share some similarities, different approaches are taken in each case. The Saudi position in relation to

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[860] ibid.
[861] Ciepley argues that even in bankruptcy shareholders receive what is left after all obligations have been satisfied as heirs, not as legal owners. See: David Ciepley, 'Beyond Public and Private: Toward a Political Theory of the Corporation' (2013) American Political Science Review 139.
[862] Stout (n 843).
[863] Stephen M Bainbridge, 'Preserving Director Primacy by Managing Shareholder Interventions', *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015).

the board's powers and their allocation with shareholders is not largely different to that of Delaware, in that both the CL 2015 and DGCL statutorily recognise the board as the legitimate decision-making body, with the board enjoying the widest authority to manage the company's affairs in the manner it deems appropriate.[864]

Such powers must be exercised without prejudice to the legal provisions of the given corporate law and any restriction or constraints on such authority in the bylaws, or the certificate of incorporation in Delaware.[865] Nevertheless, as will be shown below, both jurisdictions leave some space for shareholders to be involved in decision-making by requiring the board to obtain shareholders' approval in certain matters. This approach is different to that taken by the UK, where the CA 2006 does not confer decision-making power to the board. Instead, reference to this aspect is made in the Schedule 3 of the Companies (Model Articles) Regulations 2008 (Model Articles)[866] which by a default rule vests the decision-making power in the board.[867] This means that in the UK, the board's powers are derived from the company's articles of association, and are therefore subject to shareholders' determination.[868] Although the UK's default position allocates decision-making power to the directors, who can either exercise their powers directly or delegate them to any other person or committee,[869] shareholders can still theoretically reallocate such power to themselves or limit the scope of the board's power through amending the articles of association.[870]

Based on the above, it can be said that although the board is recognised as the decision-making body in all three jurisdictions, a divergence is apparent in that the UK does so through the default Model Articles which are subject to shareholders' agreement. The implication of this divergence is that the board's authority to manage the company's affairs in Saudi Arabia and Delaware can be considered to be an original power that cannot be withheld or significantly restricted by shareholders, whereas in the UK that power is more of a contractual matter for shareholders to agree upon which means that shareholders have prominent role in decision-making. This divergence has been used to infer that director

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[864] Articles 68 (1) and 75 of the Companies Law 2015; Section 141 of the Delaware General Corporation Law.
[865] Article 75 of the Companies Law 2015; Section 141 of the Delaware General Corporation Law.
[866] The Model Articles is issued pursuant to the Companies Act 2006; see generally Schedule 3 of the Companies (Model Articles) Regulations 2008.
[867] Article 3 of ibid.
[868] Article 3 of ibid.
[869] Article 5 of ibid.
[870] Article 3 of ibid.

primacy is the prevailing concept in Delaware,[871] and that shareholder primacy is the defining element of the UK corporate governance framework.[872] It is worthwhile noting that the idea that the UK is a shareholder-centric jurisdiction is disputed, as some argue that director primacy is reflected in the UK framework.[873] Arguably, the facts that the CA 2006 does not recognise the board as the decision-making body and that shareholders can exercise the instruction right do not change the fundamental principle of board primacy in managing the company's day to day business, as evidenced by the default position of the Model Articles which vests the board with the power to manage the company's affairs.[874] This argument continues that even the instruction clause is not an indicator of shareholder primacy given that the only way for shareholders to instruct directors is through the specified procedure (a special resolution), provided that this right is stated in the articles of association.[875] In other words, shareholders cannot simply help themselves to control of the company's daily operations nor to any of the company's affairs except in the way prescribed in the law and articles of association. This idea is further reinforced by the fact that the majority of UK public companies have not adopted such a clause in their articles of association.[876] Accordingly, the board in the UK is argued to be an independent decision-making organ whose authority is a constitutional right, and thus it should not be thought of as subordinate to shareholders.[877]

All in all, and despite the different views on which theory actually prevails in the UK, it is indisputable that in all three jurisdictions the principle of separation of ownership and control is rooted, and the board of directors is seen as a fundamental element of the corporate structure in which the decision-making power is vested, either by statute or contract.

Now that the positions of Delaware and UK have been respectively established as board-centric in the former and arguably shareholder-centric in the latter, the remaining task is to

[871] Stephen Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008) 34–36; Stephen M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2002) 97 Nw. UL Rev. 547; Anabtawi (n 843).
[872] Susan Watson, 'The Significance of the Source of the Powers of Boards of Directors in UK Company Law' (2011) Journal of Business Law 597; Marc Moore, *Corporate Governance in the Shadow of the State* (Bloomsbury Publishing 2013) 28.
[873] Moore, *Corporate Governance in the Shadow of the State* (n 872) 28; Moore and Petrin (n 3) 77–80.
[874] Moore, *Corporate Governance in the Shadow of the State* (n 872); Moore and Petrin (n 3).
[875] Moore, *Corporate Governance in the Shadow of the State* (n 872); Moore and Petrin (n 3).
[876] Watson, 'The Significance of the Source of the Powers of Boards of Directors in UK Company Law' (n 872).
[877] Moore and Petrin (n 3); Moore, *Corporate Governance in the Shadow of the State* (n 872) 28.

establish the Saudi position, and whether it is appropriate. Based on the above exploration of the Saudi approach, the Saudi framework seems to sit in between those of the UK and Delaware in that it statutorily recognises the board as the legitimate decision-making body which enjoys the widest powers to manage the company without prejudice to the CL 2015 and the bylaws, but at the same time acknowledges shareholders' right to take part in decision-making, mostly in the form of approval rather than initiation. While the phrase "without prejudice to the law and bylaws" in Article 75 (1) of the CL 2015[878] may be interpreted by some as indicating that it is a default rule which implies that shareholders could agree otherwise in the bylaws as is the case in the UK, the research argues that this is most probably not the case, because the way the article is drafted does not suggest that shareholders can strip the board entirely of its decision-making power. Instead, what this article provides is that the right to manage the company is vested in the board, and that the extent of that right is unrestricted unless shareholders restrict it in the bylaws or certificate of incorporation. On this basis, and although the board's decision-making power is exercised in Saudi Arabia and Delaware to the extent specified in either the bylaws or certificate of incorporation, this should not be understood as indicating that shareholders can reallocate the decision-making power to themselves or significantly restrict the board powers in a way closer to that of the UK. That being the case, it can be said that while largely influenced by shareholder primacy, the Saudi position still manifests some features of director primacy in the form of recognising the board as the original decision-maker whose power to manage the company is statutorily provided for.

In considering whether the Saudi position is appropriate, the research argues that several factors come into play when deciding which approach to follow (i.e., board-centric or shareholder-centric). More specifically, three points can be made to assist in approaching this issue. Firstly, the case for statutorily recognising the board as the original decision-making body is strong and has its virtues, especially in a jurisdiction like Saudi Arabia where the dominant ownership structure is concentrated ownership.[879] Granting the board this power by statute shields the board from any negative influence that could be exerted by majority shareholders whose large shareholdings incentivise them to get involved in decision-making to a much larger degree than other shareholders. While this kind of involvement may sometimes be needed to monitor and discipline the board, the concern as

[878] Article 75 (1) of the Companies Law 2015.
[879] See Section 2.5 of this thesis for a detailed discussion of the ownership structure in the Saudi capital market.

discussed earlier,[880] is that this activism could lead to a situation where such involvement is initiated and maintained for the purpose of advancing the interests of majority shareholders at the expense of minority shareholders. Therefore, while the virtue of vesting the discretionary decision-making task in the board lies, among other things, in the fact that it underpins the mediation role of the board allowing it to balance the competing interests of the company's constituents such as shareholders, employees and creditors, the research adds that in a concentrated ownership market, the board's mediation role is particularly important as it goes beyond balancing the interests of shareholders on the one hand with other constituents on the other hand, to also balancing the interests of both majority and minority shareholders. This is critical from the perspective of shareholder protection, and is consistent with the position of the existing Saudi framework, which requires directors when discharging their responsibilities to act in the best interests of shareholders as a whole regardless of which shareholder elected them to the board. Additionally, given the pattern of major shareholdings in the Saudi capital market, major shareholders can amend the bylaws and control the board in a way that suits them with ease, which suggests that the matter should not solely be for shareholders to decide in the bylaws. Therefore, it is essential that the board's independence from shareholders is underpinned by statute to distance it from the potential abuse of block-holders as much as is reasonably needed.

With these points in mind, it should be noted that any effort to either further strengthen the position of the board or maintain its existing state has to be balanced by reforming directors' duties so that while the board retains much of its discretionary power, it exercises its wide powers within a robust framework of accountability, and the limited role of shareholders in decision making is compensated by at least providing them with clear and solid mechanisms with which to hold directors accountable. As was demonstrated earlier in Chapter 4 this is not yet the case in Saudi Arabia, as directors' duties suffer from a great deal of uncertainty, casting doubt on the ability of shareholders to hold directors accountable for wrongdoing.

Secondly, among the factors which should be considered by regulators when choosing between a board-centric approach and a shareholder-centric one is the type of market behaviour they want to encourage. This is because, the shareholders' activism which is typically encouraged is likely to be affected by the regulatory approach taken towards the allocation of powers between the board and shareholders. It is likely that shareholders in a

[880] See Section 4.1.1 of this thesis for more on the principal-principal problem.

board-centric jurisdiction will not be as motivated to engage in monitoring and disciplining tasks as those in a shareholder-centric jurisdiction. When the given framework places the decision-making power and major corporate transactions in the hands of the board and does not leave space for shareholders to assume a role in such decisions, there is no point in them going to the trouble of coordinating efforts and engaging in the monitoring and disciplining tasks. This lack of motivation can be attributed to the lack of meaningful mechanisms that enable shareholders to take part in the decision-making process which would empower them to influence the board's actions. This is of particular importance in jurisdictions where the framework is of a voluntary nature, such as the UK, which relies heavily on shareholders to monitor and discipline the board.[881] This also may justify why the UK dealt with the issue of allocation of powers in the Model Articles in the first place rather than using corporate statute as a way of giving those responsible for enforcing the corporate governance rules the opportunity to decide which powers should be vested in the board and how the board should exercise these powers.

5.3 Shareholders' Appointment Rights

As was discussed earlier in Chapter 4, ever since the separation of ownership and management in public companies, the constant issue with which the corporate governance literature has grappled is the dilemma of the divergence between the interests of directors and shareholders. The thesis has already shown that deviation between the interests of these two groups is almost inevitable unless appropriate controls are put in place. For that reason, corporate governance arrangements rose to prominence as they aim *inter alia* at responding to this dilemma. Many corporate governance arrangements have been introduced to tackle this issue, including rules concerning the structure and operations of the board along with directors' duties and the dynamics of the company's various organs such as board committees and auditors. However, none of the aforementioned mechanisms come close in strength to shareholders' powers to appoint and remove directors, which have arguably been the most significant governance tool.[882]

This right to appoint and remove directors has long been seen as a critical mechanism which strikes a balance between directors' discretionary powers on the one hand and

[881] The position of the UK in relation to monitoring and enforcement of its framework was explored and discussed in detail in Sections 3.23.4 of this thesis.
[882] Armour, Hansmann and Kraakman (n 159); Bebchuk, 'The Case for Increasing Shareholder Power' (n 844); Calkoen (n 12).

shareholders' control powers on the other.[883] This mechanism, as will be discussed below, assists in tackling agency problems not only between managers and shareholders (agent-principal) but also between majority and minority shareholders (principal-principal).[884] The prominence of appointment and removal rights can be attributed to the idea that they are categorised as *ex ante* and *ex post* tools. If shareholders can hire directors *ex ante*, they can search for loyalty, and if they can dismiss directors *ex post*, they can punish disloyalty.[885]

In the agency theory context, appointment rights generally follow ownership rights, and on this basis it is logical for shareholders as owners (principals) of the company's assets to be able to choose directors (agents) who they trust to look after their assets, and to remove those who fail to meet the principals' expectations.[886] In fact, the conferral of the appointment and removal powers to shareholders has long formed a critical pillar of corporate democracy that has underpinned corporate laws.[887] Therefore, it is imperative to comparatively explore the Saudi approach to them, to determine the overall suitability of the Saudi framework and ascertain its alignment with the best international practices.

To begin with, the Saudi framework recognises the significance of these two rights, as both are explicitly and statutorily provided for in it. The corporate statute makes it clear that the appointment of directors is among the fundamental rights of shareholders.[888] In this regard, the CL 2015 provides that every shareholder can nominate himself or other persons for board membership, based on his share in the capital.[889] The appointment of directors takes place at an ordinary general assembly where a simple majority is sufficient to confirm an appointment, and it is mandatory to use cumulative voting.[890]

Moreover, the CL 2015 stipulates that directors must be appointed for the term prescribed in the company's articles of association, provided that such term does not exceed three

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[883] Armour, Hansmann and Kraakman (n 159); OECD, *G20/OECD Principles of Corporate Governance* (n 2); Lucian A Bebchuk, 'The Myth of the Shareholder Franchise' (2007) Virginia Law Review 675; Mallin (n 13).
[884] Armour, Hansmann and Kraakman (n 159).
[885] ibid.
[886] Bebchuk, 'The Myth of the Shareholder Franchise' (n 883); John Armour and others, 'The Basic Governance Dtructure: The Interests of Shareholders As a Class' (2017) The Anatomy of Corporate Law: A Comparative and Functional Approach; Emiliano M Catan and Marcel Kahan, 'The Never-Ending Quest for Shareholder Rights: Special Meetings and Written Consent' (2019) 99 BUL Rev. 743.
[887] Roger C Bailey, 'Shareholder Control Over Management: The Removal of Directors' (1974) 20 McGill LJ 85; David Kershaw, *Company Law in Context: Text and Materials* (Oxford University Press 2012).
[888] Article 68 (3) of the Companies Law 2015.
[889] Article 68 (2) of ibid.
[890] Article 95 (1) of ibid; Article 8 (b) and Article 5 (11) of the Corporate Governance Regulations 2017.

years.[891] Directors may be re-appointed, unless the company's articles of association stipulate otherwise.[892] Voting in the general assembly is confined to the board's nominees, whose information has been previously and publicly announced.[893] The nomination committee[894] plays a vital role in the nomination of the board's directors including proposing the nomination [895] and inviting persons wishing to be nominated to the membership of the board to apply.[896] Moreover, boards are required to enable shareholders to vote on each candidate separately to prevent boards from attempting to mislead shareholders by grouping all nominees into a single vote.[897] Turning to the shareholders' right of removal of directors, shareholders under the Saudi framework may at any time remove all or some of the directors at a shareholders' meeting even if the company's articles of association provide otherwise.[898] The exercise of this removal right can be with or without cause,[899] and a simple majority is sufficient for the removal resolution to pass.[900]

In the UK, similar to Saudi Arabia, directors are appointed by shareholders through an ordinary resolution at a general assembly.[901] The ordinary resolution means that only a simple majority of shareholders (i.e., more than 50% of the shares entitled to vote) is required for their resolution to pass.[902] The CGC 2018 recommends that all directors be put forward for annual re-election by shareholders.[903] Similar to the Saudi approach, the CA 2006 provides that the nomination of each director has to be put to a vote at a shareholders' meeting in a separate resolution, meaning that a company must not put more than one director up for a vote in a single resolution unless otherwise agreed prior to the vote without any objection.[904] The process of nominating and appointing directors is another area of similarity with the Saudi framework, as in the UK the board's nomination

[891] Article 68 (3) of the Companies Law 2015.
[892] Article 68 (3) of ibid.
[893] Article 8 (c) of the Corporate Governance Regulations 2017.
[894] See Section 4.3 of this thesis for a detailed discussion of the composition and role of the nomination committee in each of the three jurisdictions.
[895] Article 65 of the Corporate Governance Regulations 2017.
[896] Article 68 of ibid.
[897] Article 14 (a, b) of ibid.
[898] Article 68 (3) of the Companies Law 2015.
[899] Article 68 (3) of ibid. While the CL 2015 does not explicitly provide for the right of removal without cause, its Article 68 (3) could be interpreted as providing that this action is possible. The wording of the article implies the interpretation as it grants the removed director the right to seek compensation if his removal was for an unaccepted reason or was carried out at an inappropriate time.
[900] Article 68 (3) of ibid.
[901] Section 160 (1) of the Companies Act 2006; Article 17 (1/a) of Schedule 3 of the Companies (Model Articles) Regulations 2008.
[902] Item 524 of 'Explanatory Notes of the Companies Act 2006'.
[903] Provision 18 of the Corporate Governance Code 2018.
[904] Section 160 (1) of the Companies Act 2006.

committee plays a crucial role in it, as evidenced in the CGC 2018 which expects the committee to be responsible for leading the process for directors appointments.[905] Shifting to the right to remove directors, it could be observed that similar to the Saudi position, such a right is statutorily provided, regardless of any agreement between the given director and the company providing otherwise, and any director can be removed with or without cause.[906] Removal can only take place at a shareholders' meeting, and a simple majority is sufficient for such a resolution to pass.[907]

Lastly, the position of Delaware is similar to that of Saudi Arabia and the UK in that the DGCL provides shareholders with the right to appoint directors.[908] However, unlike the Saudi and UK frameworks in which a simple majority is sufficient for appointment, directors in Delaware are appointed by a plurality of the votes of the shares present in person (or represented by proxy at the meeting and entitled to vote on the appointment of directors).[909] A plurality vote in this context means that the winning nominee only needs to secure more votes than a competing nominee, unlike a majority vote system where the winning nominee has to secure a majority of the shares voting or present at the meeting.[910] Nevertheless, following institutional investors' dissatisfaction with the reappointment of nominees for whom large numbers of votes had been withheld, the majority of large companies in Delaware have now switched from default plurality voting to majority voting, and Delaware's corporate statute was consequently amended to further facilitate this switch.[911] Furthermore, unlike Saudi Arabia where the use of cumulative voting is mandatory, in Delaware this voting method is only permissible if provided in the company's certificate of incorporation.[912] Unlike Saudi Arabia and the UK, and consistent with the availability of a written consent mechanism,[913] shareholders in Delaware can also appoint directors through written consent instead of at shareholders' meetings provided that the written consent right is provided for in the certificate of incorporation, and that

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[905] Provision 17 of the Corporate Governance Code 2018.
[906] See generally Section 168 of Companies Act 2006; Carsten Gerner-Beuerle, Philipp Paech and Edmund Philipp Schuster, 'Study on Directors' Duties and Liability, Prepared for the European Commission DG Markt' (2013) LSE Enterprise, London; Calkoen (n 12).
[907] Section 168 (1) of the Companies Act 2006.
[908] See generally Subchapter VII of the Delaware General Corporation Law.
[909] Section 216 (3) of ibid.
[910] 'Spotlight on Proxy Matters — The Mechanics of Voting' <https://www.sec.gov/spotlight/proxymatters/voting_mechanics.shtml> accessed 2 June 2021.
[911] Armour and others (n 886).
[912] Section 214 of the Delaware General Corporation Law.
[913] The written consent right is discussed in detail in Section 5.4.2 of this thesis.

directors are appointed with unanimous consent.[914] The appointment of directors through written consent can only be done with less than unanimous consent if all the directorships to which directors can be appointed at the annual meeting held at the effective time of the written consent are vacant and are filled by written consent.[915]

While the DGCL is silent on the processes around directors' nomination, this area is taken care of by the Manual which gives the nominating committee the responsibility of identifying suitable candidates.[916] The shareholders' right to directly nominate candidates is available through the process known as "proxy access" for shareholders to add their nominees so that they are voted on along with the board's nominees.[917] However, this right can only be exercised in Delaware's companies if it is provided for in the company's bylaws, which places shareholders in a weaker position in comparison to those in Saudi Arabia and the UK, who enjoy the right of nomination by statute.[918]

That all being said, Delaware's position regarding the right to remove directors is similar to that of Saudi Arabia and the UK in that shareholders are statutorily provided with the right to remove directors with or without cause, and a simple majority is sufficient for this resolution to pass.[919] In Delaware, if the board is classified[920] or the director being considered for a removal was voted for by cumulative voting then the without cause rule is inapplicable and shareholders seeking the removal action must provide a valid cause.[921]

As this overview has shown, the three jurisdictions are largely similar in recognising shareholders' right to appoint and remove directors, and similarity exists across them in the nature of these two rights, including some of the prominent rules surrounding the processes and roles of the company's various organs in relation to the nomination, appointment, and

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[914] Section 211 of the Delaware General Corporation Law.
[915] Section 211 of ibid.
[916] Section 303A.04 of the New York Stock Exchange Listed Company Manual.
[917] Section 971 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; Section 112 of the Delaware General Corporation Law.
[918] Section 112 of the Delaware General Corporation Law.
[919] Section 141 (k) of ibid; The simple majority vote rule for directors' removal is further upheld by courts in Delaware and this statutory rule cannot be manipulated by boards. On this issue, the Delaware Chancery Court in 2017 invalidated a corporate bylaw provision which provided that shareholders can only remove directors with a supermajority vote. The court in its decision held that this provision is inconsistent with Section 141 (k) of DGCL which enables shareholders to remove directors with a simple majority vote. See: *Frechter v Zier* (2017) 12038-VCG (Del: Court of Chancery).
[920] Classified boards are becoming less common among the largest US listed companies, mostly because of a trend of rising shareholder empowerment in the US along with shareholder activism that advocates against such a system, arguing that they are only useful as a management entrenchment device. See generally: Armour and others (n 886).
[921] Sections 141 (k/1) and 141 (k/2) of the Delaware General Corporation Law.

removal of directors. While this is a positive indicator that the Saudi framework is generally in line with those of the UK and Delaware in this area, a few notable differences could still be observed, chiefly the availability of cumulative voting and the way in which the removal right is dealt with, especially in the context of cumulative voting, and the rules on removal without cause.

Driven by the divergence observed in relation to cumulative voting and some aspects of removal rights, the following discussion will focus on these two issues in light of their significant role in corporate governance, in an attempt to understand the main considerations of these concepts, the rationale behind this divergence, and whether the Saudi approach is appropriate.

5.3.1 Use of cumulative voting in directors' appointment

The issue of cumulative voting in directors' appointments is particularly important given the different path followed by Saudi Arabia in this area. As was mentioned earlier, the CL 2015 mandatorily obliges companies to use cumulative voting to elect directors, in contrast to the UK which is silent in this area, and Delaware which permits the use of such a method only if the company's certificate of incorporation allows it. Before evaluating whether this approach is appropriate, it is necessary first to explain the concept of cumulative voting and present some of its main considerations.

Cumulative voting is a voting method used in the election of directors which grants every shareholder a voting power calculated based on the number of shares he holds multiplied by the number of candidates running for board seats.[922] In a cumulative voting system, a shareholder can either give all his votes to one nominee, or can choose to divide them among several nominees.[923] For example, if a shareholder holds 100 shares and there are five nominees for the board, such shareholder has 500 votes, which means that minority shareholders can guarantee that they appoint at least one director to the board regardless of any opposition of majority shareholders who traditionally have the upper hand in board

[922] Sanjai Bhagat and James A Brickley, 'Cumulative Voting: The Value of Minority Shareholder Voting Rights' (1984) 27 The Journal of Law and Economics 339; Aiwu Zhao and Alex Brehm, 'Cumulative Voting and the Tension between Board and Minority Shareholders' (2009) Proceedings of the New York State Economics Association 103; OECD Publishing, *Board Member Nomination and Election* (2012).
[923] Bhagat and Brickley (n 922); Zhao and Brehm (n 922); OECD Publishing (n 922).

elections.[924] Accordingly, cumulative voting differs from straight voting, which is the traditional way of voting, in that in the latter each share is entitled to one vote per nominee director. In straight voting, minority shareholders' chances of getting their nominee to the board are usually smaller.

Cumulative voting is advantageous in many ways. It significantly increases minority shareholders' chances of gaining representation on the board. In return, the composition of the board should be relatively balanced as cumulative voting prevents majority shareholders from entirely dominating the board, thus restricting their decision-making power. This encourages the board to consider the concerns of minority shareholders, and to take them into account when taking corporate actions. Furthermore, cumulative voting is argued to be effective in reducing the agency cost that is often associated with minority shareholders' monitoring efforts, as instead of solely engaging in costly and often failed shareholders' campaigns and proxy fights to influence the company's direction, cumulative voting guarantees the presence of a minority shareholders' representative on the board, which could be a more effective way to have a say in how the company's affairs are managed. All in all, and regardless of the number of directors representing minority shareholders on the board and whether they really can positively affect its operations, minority shareholders can benefit from such representation by having better access to information, reducing the classic information asymmetry, and perhaps even by creating alliances with independent directors.[925]

While these benefits may be appreciated when looking at things from the minority shareholders' perspective, another benefit of cumulative voting that should be appreciated by the board and majority shareholders is that the presence of a minority shareholders' representative who has been appointed by cumulative voting is advantageous to the board in that it enhances its reputation and increases the legitimacy and integrity of its decisions. This occurs because the decisions taken by a balanced board will mostly appear unbiased in the eyes of shareholders as a whole, rendering such shareholders, especially minority ones, less suspicious of and resistant towards those decisions. This should lower proxy fights, and make shareholders' voting smoother, both of which should reduce the agency

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[924] Bhagat and Brickley (n 922); Zhao and Brehm (n 922); Richard S Dalebout, 'Cumulative Voting for Corporation Directors: Majority Shareholders in the Role of a Fox Guarding a Hen House' (1989) BYU L. Rev. 1199.

[925] Luca Enriques and others, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies' (2017) The Anatomy of Corporate Law: A Comparative and Functional Approach.

costs associated with dissenting shareholders and proxy fights.[926] The reduction of agency cost occurs as a result of minority shareholders having access to the board's deliberations through their representative, as opposed to having to rely on costly and time-consuming shareholders' campaigns and proxy fights.[927]

Furthermore, the benefits associated with the use of cumulative voting are consistent with the evidence presented in the few available empirical studies in this area, which establishes a positive relationship between this method and firm value and the reduction of agency cost.[928] For example, one prominent and often cited empirical study is the research conducted by Bhagat and Brickley in 1984 whose aim was to ascertain whether the adoption of cumulative voting (or lack thereof) had an impact on the given company's stock price.[929] The authors comparatively examined the share prices of companies which had proposed an amendment decreasing the impact of cumulative voting and companies which had proposed an amendment increasing the impact of cumulative voting.[930] They found that at the time of the announcements, the stock returns of the first group were abnormally and negatively affected, whereas the stock returns of the other group were not affected.[931] This shows that shareholders view cumulative voting as a positive strategy and an efficient governance mechanism that should be welcomed. Moreover, the same study finds that the attitude which minority shareholders have towards the board is largely determined by the company's governance structure and arrangements rather than by the company's performance.[932] In other words, minority shareholders pay close attention to how powers are allocated and divided among the company's various groups, and when they view the allocation as unfair, tension between them and the board is likely to rise

[926] While the general principle of "one share one vote" and similar principles are advantageous in that they align financial contributions and control in public companies, they could sometimes weaken the protection of minority shareholders and leave them subject to the abuse of majority shareholders, whose sizable shareholdings allow them to steer the company in their preferred direction. This explains why jurisdictions like Saudi Arabia aim at controlling this imbalance by introducing governance mechanisms such as cumulative voting on directors' appointments as part of efforts to strengthen the position of minority shareholders and provide them with a chance to influence the company's affairs. For more on this aspect, see: ibid.

[927] Bhagat and Brickley (n 922); Zhao and Brehm (n 922).

[928] The lack of new empirical studies on cumulative voting, especially in the US, can be attributed to the fact that many US companies abandoned this method during the 1980s, therefore the current effects of cumulative voting in the US cannot be easily and accurately ascertained. However, this should not affect the validity and relevance of old studies, as the environment within which companies operate is still largely the same, especially in the sense that the ownership of companies listed in the US capital markets has remained dispersed.

[929] Bhagat and Brickley (n 922).

[930] ibid.

[931] ibid.

[932] Zhao and Brehm (n 922).

regardless of the company's performance. This is important, because when minority shareholders who could be long-term block-holders maintain such perceptions about the board, they may be compelled to engage in continuous rebellion against any proposal presented by the board, an activity that may be detrimental for the company and its shareholders. With that in mind, cumulative voting could be seen as a fair rule that eases the tension between the board and shareholders and assists in bringing their often conflicting views closer together.

Another study by Dodd and Warner in 1983 analysed a sample of companies which faced proxy fights over the board's seats.[933] Their study found that minority shareholders typically did not succeed in their efforts to elect their representatives to the board[934] except in companies adopting cumulative voting, in which minority shareholders were found to have much more success.[935] These findings emphasise the effectiveness of cumulative voting in empowering minority shareholders and helping to create a diversified board where different views can be represented.

Although cumulative voting has several virtues that have been empirically confirmed, it does not go unchallenged, and in fact some opponents of cumulative voting view it as an ineffective mechanism that could do more harm than good to a company and its shareholders. Generally, the argument they make is that a good director should not be subject to the interests of those who elected him, especially as the cornerstone of any successful board is the prevalence of mutual trust and respect among the board's directors. That being the case, they point out that cumulative voting may bring to the board someone who is short-sighted and not on the same page as his co-directors, as he most probably came from a position of hostility. As a result, this, arguably, is likely to cause tensions within the board and slow its functions down, thus hindering the board's supposedly smooth operations.[936] Before discussing these concerns, it should be mentioned that the reality today is that cumulative voting is applied in a small number of jurisdictions and even where this method is permitted, companies do not practice it often.[937]According to the OECD, one possible reason behind the hesitation to implement cumulative voting is that it

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[933] Peter Dodd and Jerold B Warner, 'On Corporate Governance: A Study of Proxy Contests' (1983) 11 Journal of financial Economics 401.
[934] ibid.
[935] ibid.
[936] Zhao and Brehm (n 922).
[937] OECD Publishing (n 922).

presumes a certain level of coordination among shareholders which is rare in practice, thus it may not be an optimal solution.[938]

With those concerns in mind, the research argues that opponents of cumulative voting exaggerate the negative effects of this governance tool and the potential harms brought by those who are appointed to the board based on the support of minority shareholders. As was discussed above, the empirical evidence supports the idea that cumulative voting in fact helps to reduce the hostility between the board and minority shareholders. Moreover, nothing in the cumulative voting method comes even close to disabling the board from exercising its functions or causing disruption among its directors. On the contrary, the most a minority shareholders' representative can achieve is to ensure that the voice of minority shareholders is heard on the board. To do so, he will mostly be compelled to work cordially with other directors to find common ground, particularly because ultimately, he will not be able to persuade the board to adopt any decision without the support of at least some of his fellow directors, who are in the majority. This is especially true given that cumulative voting does not alter the core principle of majority rule; rather, it only ensures that the voice of minority shareholders is heard in the boardroom.[939] Moreover, what cumulative voting opponents really fear may not be the tension or mistrust that minority shareholders' representatives may bring to the boardroom, but the discomfort of disagreement and having to deal with different views and opinions that may require them to make extra efforts and work out win-win solutions.

In response to the argument that shareholders' coordination is rare, and thus such a voting method may be ineffective, the research argues that while this view may appear valid at first glance, its relevance and validity is less clear in the modern business world where technology plays a critical role in facilitating communication among shareholders and makes it easier for them to attend, speak, and vote in shareholder meetings, and where different groups of shareholders can optimise technical means to coordinate their efforts.[940]

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[938] ibid.

[939] Charles M Williams, 'Cumulative Voting' (1955) 33(3) Harvard Business Review 108.

[940] While in Delaware as discussed above, federal and state communication rules could discourage shareholders from coordination and activism due to a fear of triggering a disclosure requirement or a mandatory takeover bid, this is not the case in the UK. On the contrary, the UK's Takeover Panel facilitates normal shareholders' actions by clarifying as part of its Practice Statement that the Takeover Code's provisions (e.g., the concept of "acting in concert") which may trigger mandatory offers to be made is inapplicable in cases where shareholders are considered by the Panel to be coordinating for the purpose of normal shareholder activism that does not aim at acquiring interests in the company's shares for the purpose of subsequently taking control of the board. See: Takeover Panel, 'Practice Statement No.26' (2009); For more on this topic, See: Iain MacNeil, 'Activism and Collaboration among Shareholders in UK Listed Companies' (2010) 5 Capital Markets Law Journal 419.

This is especially relevant given that many jurisdictions around the world, including Saudi Arabia, the UK, and Delaware, statutorily recognise the right of companies to hold shareholder meetings and vote on resolutions via electronic channels. Furthermore, a regulatory framework should not be discouraged by adopting a pessimistic and doubtful view of shareholders' inactivity, as such a view is counter-intuitive and goes against the conventional wisdom, endorsed by theorists and regulators, which advocates shareholders' activism and encourages monitoring and enforcement by market forces. Ironically, the whole concept of private enforcement and market discipline which underpins the voluntary model of corporate governance frameworks in many jurisdictions including the UK builds on the presumption of a certain level of shareholder coordination and activism. It is therefore unclear why such a presumption should differ with the application of cumulative voting.[941]

Lastly, given that the Saudi capital market is dominated by major shareholders whose interests are not guaranteed to be aligned with their fellow minority shareholders, and that under a straight voting system minority shareholders will have virtually no chance of securing their nominee's seat on the board, and based on the positive link between cumulative voting and firm value and the reduction in agency cost which have been established above, the Saudi approach can be regarded as well justified. The fact that the UK is silent in this area and that Delaware does not statutorily impose cumulative voting should not discourage Saudi Arabia from retaining its current approach. As has been discussed above, as a voting system it is both theoretically and empirically thought of as a positive and effective governance mechanism that empowers shareholders and assists in balancing power among a company's various groups. Moreover, cumulative voting like any other governance mechanism has to be considered in the specific local context of each jurisdiction, bearing in mind the special considerations of its capital market. In this regard, two prominent empirical studies analysing data from the 1990s found that controlling shareholders secure private benefits across jurisdictions, but that these private benefits are notably lower in dispersed ownership markets such as the UK and the US, and are extraordinary high in countries where ownership is concentrated, such as Italy, France, and

[941] This is particularly relevant given that shareholder activism is increasing, especially in the presence of institutional bodies such as the Investment Association (IA) in the UK which aim at ensuring good corporate governance practices in the companies in which their members invest; see: MacNeil, 'Activism and Collaboration among Shareholders in UK Listed Companies' (n 940); The stewardship activity of the IA's members is believed to have significantly contributed to the rise of shareholders activism in the UK's listed companies over the past years. See: The Investment Association, 'STEWARDSHIP IN PRACTICE: IA Stewardship Survey' (2018).

Brazil, in some countries reaching as high as 65%.[942] The findings of these two studies indicate a relationship between the ownership structure and the abuse of minority shareholders, establishing that the situations in concentrated markets are far worse than in dispersed markets. That being the case, special rules that aim at protecting minority shareholders are strongly needed to balance the powers within publicly listed companies and ensure the equal treatment of all shareholders.

With these considerations in mind, it can be said that while cumulative voting could prove useful even in the UK and Delaware, the needs of these markets for such a governance mechanism are not as pressing as in Saudi Arabia, because the ownership structure of their companies is more dispersed, so the tensions between major and minority shareholders are unlikely to be the same as they are in the Saudi market due to the lower prevalence of majority holdings in dispersed markets. Additionally, as Chapter 4 discussed, the capital markets in the UK and the US, unlike Saudi Arabia, benefit from the role played by market forces and the active market for corporate control in pressuring boards to adopt better practices, both of which make the need for such a voting system less urgent. The situation is even more worrying given that, unlike the UK and Delaware where independent directors are adequately represented on boards and their committees, the Saudi framework has a poor representation of independent directors both on boards and their committees.[943] Therefore, imposing cumulative voting through a mandatory rule in Saudi Arabia is one way to compensate for the weakness of market forces, the inactive market for corporate control, and perhaps most importantly, the weak representation of independent directors.[944]

5.3.2 Availability of removal right

In any jurisdiction, the removal right typically follows and complements the appointment right, operating as an *ex post* mechanism that shareholders can use as a last resort to punish

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[942] See: Tatiana Nenova, 'The Value of Corporate Voting Rights and Control: A Cross-Country Analysis' (2003) 68 Journal of Financial Economics 325'Analysing the value of corporate voting rights, specifically of the control block of votes in a sample of 661 dual-class firms in 18 countries, in 1997, and calculating private benefits based on share price differentials for dual class firms.'. See also: ALEXANDER Dyck and LUIGI Zingales, 'Private Benefits of Control: An International Comparison' (2006) 59 A Reader in International Corporate Finance' Analysing 393 controlling blocks sales in 39 countries, and calculating private benefits based on the control premia in sales of control block.'.

[943] The weak Saudi position in relation to the representation of independent directors was discussed in detail in Section 4.2.3 of this thesis. The same section discussed the role of independent directors in balancing the distribution of power between the board and shareholders and mitigating agency costs.

[944] The inactive market for corporate control along with the absence of an independent and investigative financial media in Saudi Arabia were discussed in Section 2.6 of this thesis.

directors for mismanagement.[945] Provided that shareholders employ it properly, the right to remove directors is a very powerful tool for tackling agency costs, even to a greater degree than the right to appoint directors,[946] as it threatens the stability of a member's directorship thus encouraging him to act responsibly. The actual removal or the threat of such is presumed to ensure that boards refrain from exploiting corporate assets, or taking any action (or inaction) that may compromise shareholders' position.[947] If directors observe their duties and manage the company's responsibly then shareholders will not want to exercise their removal right. The value of this right is that, as opposed to other control rights (i.e., approval and proposal rights) which affect only a given matter at a specific time, it affects and influences all matters which are important to shareholders even before such a right is actually used.[948] This is because a board will be incentivised at all times to act properly and meet shareholders' expectations in every important matter it handles to avoid potential removal, thus reducing the need for shareholder activism in certain circumstances. It is therefore unsurprising to see the convergence among the three jurisdictions in this area observed above, where in principle the removal right is statutorily provided for shareholders, and that many of the rules surrounding the right are also similar, including removal by a simple majority vote and removal with or without cause.

Considering this convergence, two main points should be made regarding the Saudi position towards the removal right. First, from a comparative perspective, the Saudi framework appears to be largely in line with the positions of the UK and Delaware, both of which are considered leading examples of advanced governance frameworks, along with the OECD's Principles of Corporate Governance which are highly regarded. This is a positive indicator that the Saudi framework is on the right track and is not deviating from the most basic shareholder rights, as the OECD's principles are generally meant to be appropriate in all jurisdictions, regardless of their legal and market characteristics.

The second main point is that the Saudi position of allowing removal without cause is generally considered good practice as it is intended to remove any constraint on shareholders' removal right that may hinder its effectiveness, consistent with the idea that shareholders (as principals) are entitled to choose and replace their agents at any time at their discretion, as the "with cause" requirement significantly constrains this discretionary

[945] Armour and others (n 886).
[946] ibid.
[947] Lucian Arye Bebchuk, 'Empowering Shareholders' (Harvard Law School Working Paper 2003).
[948] Bebchuk, 'The Myth of the Shareholder Franchise' (n 883).

power. However, one issue in the removal mechanism as regulated in the Saudi framework requires regulatory attention. Although removal without cause can be inferred from CL 2015 as discussed earlier, it is not clear how the framework reconciles the option of removing directors without cause with the mandatory rule of cumulative voting on directors' appointment. To explain, as was established above, cumulative voting paves the way for a director nominated by minority shareholders to take a seat on the board by allowing the minority to combine their votes behind at least one nominee, guaranteeing his success in making it onto the board. However, the removal of directors without cause could have a negative impact on minority shareholders' ability to appoint their representatives on the board, thus rendering the cumulative voting system useless. This explains why although Delaware's framework provides for non-mandatory cumulative voting and also provides for without cause removal, it still prohibits such removal from taking place if the disputed director was voted onto the board by cumulative voting, stipulating that such a director shall not be removed if the votes cast against his removal are enough to appoint one director unless a cause is presented. In other words, it seems counterintuitive to mandatorily impose cumulative voting when appointing directors and at the same time permit removal without cause.

Therefore, Saudi regulators need first to clarify the statutory position towards "without cause" removal in crystal clear terms, and second to regulate it in a way that takes into account the cumulative voting rule. A possible way to approach this problem in the Saudi framework is not necessarily by prohibiting the use of cumulative voting in directors' appointments, as the research argued earlier in favour of retaining the current mandatory cumulative voting rule and established the need for such a mechanism; nor is it to impose a requirement of removal with cause in all cases, as this is likely to frustrate shareholders' efforts to replace ineffective directors. Instead, the Saudi framework should retain the cumulative voting rule but may also find it logical and beneficial to introduce another mandatory rule which prohibits the "without cause" removal of any director if the votes against the resolution for his removal are sufficient to appoint one director.

This approach would be appropriate for two reasons. One is that it upholds the purpose of the cumulative voting rule, which is enabling minority shareholders to appoint their representatives to the board, while shielding this privilege from majority shareholders' potential abuse by preventing them from hindering the effectiveness of the cumulative voting mechanism. The second is that it does not entirely prevent the possibility of the removal of the minority's underperforming or disloyal representative if the majority shareholders are able to convince the minority shareholders of the unsuitability of their representative and gain their support in this regard.

The requirement of a cause when attempting to remove a director who was voted for by cumulative voting should not be viewed as undermining shareholders' authority or entrenching boards over shareholders. On the contrary, this requirement simply aims at resolving the principal-principal tension rather than the principal-agent tension. In other words, the purpose of such a requirement is not to protect directors from potential removal by shareholders, but to protect minority shareholders from possible abuse by majority shareholders who may wish to attack the cumulatively voted director by attempting to remove him from the board shortly after he has been appointed. This is particularly true given that significant holdings of major shareholders allow them to pass a removal resolution quite easily, especially in the presence of the simple majority vote rule. Allowing majority shareholders to remove minority shareholders' representatives without cause compromises the position of minority shareholders and renders the cumulative voting mechanism meaningless. Imposing such a requirement does not, however, protect minority representatives from being removed if they are found to be underperforming or disloyal, as all the requirement can do is to require those who want him ousted to present a legitimate reason for the removal, enabling the shareholders as a whole to evaluate whether there is a strong and honest case for removing the given director, and also providing the director and the minority behind him with the right to take the matter to court should the reason behind the removal be illegitimate.

5.4 Shareholders' Meeting and Voting Rights

The third issue for which the Saudi framework's approach towards the allocation of powers can be evaluated is its approach to shareholders' meeting and voting rights. The importance of such rights lies in their direct impact on the exercise of control rights, mainly in the form of shareholders' ability to exercise their approval and proposal rights, which will be discussed below. Put differently, the assessment of shareholders' rights in decision-making should not be made solely based on whether a given framework grants them an approval or proposal right in isolation from other regulatory mechanisms that are prerequisites to those rights. After all, shareholders' meetings are the venue at which shareholders can exercise their approval and proposal rights. Accordingly, when aspects governing shareholders' meetings and voting are not appropriately regulated, the ability of shareholders to effectively take part in the monitoring and disciplining tasks is called into question.

Furthermore, shareholders' meetings and voting rules are among the areas in corporate law where the influence of director/shareholder primacy theories[949] can be seen, as the particular theory upheld by a given framework is likely to drive the regulatory choices in a certain direction. The discussion below will therefore also touch upon the impact of director/shareholder primacy on the rules governing shareholders' meetings and voting. This is because such rules are among the means through which directors can be empowered over shareholders in a board-centric jurisdiction, or alternatively, shareholders can be empowered over the board in a shareholder-friendly jurisdiction. At the end of the day, and as seen earlier in this thesis in relation to Saudi Arabia and the UK, and to a lesser extent Delaware, most major decisions are discussed and taken at shareholder meetings, therefore the party with the upper hand in such settings will ultimately control the company's affairs.

With these points in mind, it is essential to comparatively assess the Saudi framework in relation to shareholders' meetings and voting rules to determine whether those rules are designed in such a way that facilitates the role of shareholders and equips them with the necessary tools to monitor and discipline the board. In doing so, the discussion will start with an exploration of the high-level rules governing shareholders' meetings and voting in general before engaging in a more focused analysis.

An examination of the rules surrounding shareholders' meetings and voting in the three jurisdictions reveals the influence of director/shareholder primacy, as evidenced by the divergence seen in this regard. The three jurisdictions do have several similarities in this area, including that they all mandatorily require companies to hold an annual shareholders' meeting during each fiscal year, at which much of the mostly board-determined agenda is dealt with, such as directors' election and re-election and other business matters that boards deem appropriate to discuss with shareholders.[950] Moreover, to encourage the participation

[949] See Section 5.1 of this thesis for a detailed discussion of shareholder/director primacy theories.
[950] Article 87 of the Companies Law 2015; Article 13 of the Corporate Governance Regulations 2017; Section 336 of the Companies Act 2006; Section 211 of the Delaware General Corporation Law; While Delaware's state law does not impose such a requirement unless directors were not elected by a written consent or unless holding an annual meeting is provided for in the company's certificate of incorporation or

of shareholders in such meetings and the effective exercise of their voting rights, the frameworks in all three jurisdictions allow shareholders' meetings to be held and the resolutions to be voted on via electronic channels, and require companies to take the necessary measures to ensure that such mechanism is used in a way that enables shareholders to attend, speak and vote effectively.[951] That said, prominent differences exist in relation to special meetings, which are usually held in between annual meetings with agenda largely determined by the requesting shareholders, and the availability of the written consent mechanism where shareholders can take decisions by a written resolution without the need for any meeting.

Turning to the special meeting mechanism, while the three jurisdictions recognise the board as the original body in which the power to call such meetings is vested, a notable difference exists in whether shareholders enjoy such a right. The Saudi framework vests this power originally in the board;[952] however, the framework recognises the power of shareholders to do so in two cases.[953] The first case is when the request to call a special meeting is submitted by shareholders representing at least 5% of the company's capital.[954] The second case is when a request is submitted to the CMA by shareholders representing at least 2% of the capital citing any of the legal grounds provided in the CL 2015.[955] Similarly, the UK's approach is that apart from the power of the board to do so[956], ordinary shareholders holding at least 5% of the company's voting rights can request that the board calls a general meeting provided that the request states the general nature of the business to be dealt with at the general meeting, and may include the text of a resolution that the shareholders requesting the general meeting wish to be moved at it.[957]

In contrast to Saudi Arabia and the UK where, in accordance with their shareholder-friendly approach, shareholders are statutorily provided with the power to call a shareholders' meeting, shareholders in Delaware, in line with its director-primacy approach, do not have the same power unless the company's certificate of incorporation or

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bylaws, the Manual mandatorily requires companies listed in the NYSE to hold an annual shareholders' meeting during each fiscal year. See: Section 302 of the New York Stock Exchange Listed Company Manual.

[951] Article 86 (3) of the Companies Law 2015; Article 13 (f) of the Corporate Governance Regulations 2017; Section 360A of the Companies Act 2006; Section 211 (a, b) of the Delaware General Corporation Law.

[952] Article 90 of the Companies Law 2015.

[953] Article 90 of ibid.

[954] Article 90 of ibid.

[955] Article 90 (2, 3) of ibid.

[956] Section 302 of the Companies Act 2006.

[957] Section 303 (4) of ibid.

bylaws explicitly authorises them to do so.[958] While Delaware's framework is restrictive regarding shareholders' special meetings, it is nevertheless stronger than those of Saudi Arabia and the UK in relation to shareholders' action by written consent without the need for a meeting, and without the need for such consent to pass unanimously. This right is absent in publicly listed companies in Saudi Arabia and the UK, whereas Delaware's framework explicitly provides shareholders with it. To illustrate, the DGCL stipulates that unless the company's certificate of incorporation provides otherwise, any action required to be taken at any annual or special meeting can instead be taken by written consent. For such consent to be valid it must, among other rules,[959] be signed by a number of shareholders not less than the minimum number of votes that would be necessary to authorise or take such action at a meeting at which all shares entitled to vote thereon were present and voted.[960]

It should be mentioned that in the UK, Section 281 (4/a) of CA 2006 preserves the common law rule of "unanimous consent" that is governed by the Duomatic principle "the Principle" and which applies to both private and public companies. However, the focus of the discussion is the "written consent mechanism", as regulated in Delaware, which is referred to in Section 281 (1/a) of CA 2006 in the context of private companies. These two mechanisms (i.e., unanimous consent and written consent) are not equivalent given that they differ materially and operate differently. More specifically, in establishing unanimous consent all shareholders must agree on the resolution for it to pass, whereas the written consent can pass if it is only agreed by the same number of votes that would have been required should the matter have been voted on at a shareholders' meeting along with the other different procedures associated with each of them. Furthermore, "unanimous consent" as opposed to the "written consent mechanism" is rarely relevant in publicly listed companies given that it is almost impossible for any resolution to pass unanimously in publicly listed companies whose shares are typically owned by thousands of shareholders, whose interests and views are often conflicting. That all being case, and considering the explicit clarification provided in the Explanatory Notes of CA 2006 which specifically states that private companies can pass resolutions either as a written resolutions or at meetings of their members, whereas public companies can pass

[958] Section 211 (d) of the Delaware General Corporation Law.
[959] See generally Subchapter VII of ibid.
[960] Section 228 (a) of ibid.

resolutions only at a meeting of their members,[961] it can be said that "written consent" as applied and regulated in Delaware is absent for the UK's publicly listed companies. It is also worthwhile mentioning that the Duomatic principle has not yet been judicially tested in publicly *traded* companies, as there have only been a few common law cases involving the issue of unanimous consent in public companies, all of which were *not traded* and involved only a handful of shareholders.[962]

Turning to the voting rules and associated aspects such as the voting power attached with each vote, the manner in which voting is to be carried out, and the right (or lack thereof) to vote by proxy, the three jurisdictions share many similarities and also have some notable differences, as will be shown below. Regarding the voting power attached to each share, the Saudi position is similar to those of both the UK[963] and Delaware in that the general principle is "one share one vote".[964] However, the Saudi framework leaves the question of how voting by shareholders is to be carried for the company and its shareholders to decide in the articles of association.

Lastly, in relation to the right to vote by a proxy, it is evident that the three jurisdictions are similarly keen on encouraging participation of shareholders in shareholders' meetings and effective voting on their resolutions. This is illustrated by the fact that the CL 2015 and the relevant implementing rules along with the CA 2006 and DGCL all provide that shareholders have the right to attend and vote in such meetings by themselves or through a proxy.[965] When a proxy is used, several procedures as set under each framework have to be

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[961] Item 523 of 'Explanatory Notes of the Companies Act 2006' (n 902); Sarah Worthington Paul L. Davies, *Gower's Principles of Modern Company Law* (SWEET & MAXWELL 2016) 15–8.

[962] For example, see: *Re Finch (UK) plc* (2015) EWHC 2430 (Ch) "concerning a public company owned by two shareholders". *Bairstow & Ors v Queens Moat Houses Plc* (2001) EWCA Civ 712 "concerning directors of a public company seeking to use the Principle in relation to decisions of its subsidiaries which are privately held". *Re Torvale Group Ltd* (1999) 2 BCLC 605 "concerning the Principle in relation to a class of shares owned entirely by a single institutional shareholder".

[963] It is worthwhile mentioning that in the UK, dual class shares structures where shares of the same class can have differential voting rights were recently permitted in a Premium Listing, subject to several conditions and limitations, following the UK Listing Review led by Lord Jonathan Hill which was published on March 3rd, 2021. See: Lord Jonathan Hill, 'UK Listing Review' (2021) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966133/UK_Listing_Review_3_March.pdf> accessed 2 June 2021.

[964] Articles 86 and 113 (1) of Companies Law 2015; In the UK this applies to voting on written resolutions, noting that all equity shares of a class admitted in the premium market are required to have an equal number of votes. See: Section 284 of Companies Act 2006; Rule 7.2.1A (3) of UK Listing Rules; This is the default position in Delaware unless determined otherwise in the certificate of incorporation or the bylaws. See: Section 212 (a) of the Delaware General Corporation Law.

[965] Articles 86 and 113 (2) of the Companies Law 2015; Section 324 of the Companies Act 2006; Section 211 (a/2) of the Delaware General Corporation Law; 17 C.F.R. § 240.14a-8 (2005).

followed, most of which are not materially different and are aimed at facilitating the exercise of this right.[966]

Now that the legal positions of the three jurisdictions on shareholders' meetings and voting have been explored, it can be concluded that while they all approach many of these aspects in a similar manner, several prominent differences are observable, especially regarding shareholders' ability to call special meetings, and their ability to pass resolutions with written consent. Therefore, the focus of the following critical analysis will be driven by these differences in order to establish the suitability of the Saudi framework in these areas.

5.4.1 Shareholders' special meetings

As was explored above, different regulatory approaches are taken to special meetings. In summary, both Saudi Arabia and the UK statutorily grant shareholders holding a certain amount of shares the right to call a shareholders' meeting without making that right contingent on the company's articles of association. This is contrary to Delaware, where the corporate statute vests such power in the board and prevents shareholders from exercising this right unless the certificate of incorporation or bylaws provide otherwise. While the UK approach is understood to be consistent with its shareholder-friendly jurisdiction, and Delaware's model is in line with its director primacy approach, the question prompted by the evident divergence is whether the Saudi approach of following the UK's lead is appropriate. As will be demonstrated below, the research argues that the Saudi position is appropriate and that such a right is pivotal in any effective corporate governance framework regardless of which theory it embraces.

To begin with, the right to take part in decision-making at the shareholders' special meetings has been among the coveted rights by shareholders. These meetings are specifically requested by shareholders from time to time as they deem appropriate. Unlike the annual shareholders' meeting whose date, place, and agenda are largely determined beforehand by the company's board, special meetings give shareholders the opportunity to dictate when to meet, the issues they wish to be discussed, and which resolutions to vote on. When shareholders are dissatisfied with the company's performance or the board's behaviour, they simply do not have to hold their anger until the next annual meeting when

[966] Article 48 (a, b) of the Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016; Section 212 of the Delaware General Corporation Law; 17 C.F.R. § 240.14a-8 (2005).

it may be too late for action. Instead, they can call a special meeting to discuss the issues at stake and take action quickly. Such action could, depending on the jurisdiction, include the replacement of the incumbent directors with others who are more capable, changing the bylaws, or simply instructing the board to take (or refrain from taking) a specific action.

While generally speaking any decision to be made at a special meeting can also be made at one of the annual meetings which all companies must hold every twelve months, the virtue of a special meeting mostly lies in the timing and agenda. In other words, special meetings provide shareholders with an earlier opportunity to act. Most of the time, the agenda of the statutory annual meeting is typically concerned with the election of directors, filling board vacancies, the amendment of bylaws, the approval of major transactions, and other material matters which can either be added by the board at its discretion or imposed by the given corporate statute.[967] Special meetings in contrast have no prescribed agenda, and it is for the requesting shareholders to indicate the items they wish to be discussed and the actions they wish to vote on, provided that such items are within shareholders' powers.[968]

The importance of this right is even greater when either the corporate law or the company's bylaws equip shareholders with other influential rights, such as the right to remove directors and fill board vacancies, or to enlarge the board beyond its current size by creating new seats.[969] These rights can thus be employed by shareholders to change the board's composition or at least to achieve significant representation on it in between annual meetings so that minority shareholders may gain more leverage over the board.[970] More importantly, the rights can be employed to change the rules governing the board through amendment of the bylaws such as adding or deleting provisions related to board size, eligibility requirements for serving on the board, and proxy rules.[971] These mechanisms can be particularly helpful in jurisdictions such as Saudi Arabia where, as Chapter 4 discussed, majority shareholders dominate the board, and the representation of independent directors is significantly lower than in the UK and Delaware. Therefore, coupled with cumulative voting and written consent mechanism which will be discussed

[967] See generally: the Companies Law 2015; the Companies Act 2006; the Delaware General Corporation Law.
[968] See generally: the Companies Law 2015; the Companies Act 2006; the Delaware General Corporation Law.
[969] Catan and Kahan (n 886).
[970] ibid.
[971] See generally: the Companies Law 2015; the Companies Act 2006; the Delaware General Corporation Law.

below, the special meeting mechanism is an effective governance tool that minority shareholders can make great use of.

Another significant benefit of the special meeting mechanism is that it encourages shareholder activism as it presents them with a real opportunity to hold the board to account for their performance. This makes such a right a precondition for any effective governance framework, especially in jurisdictions whose corporate governance frameworks are more reliant on monitoring and discipline by market forces. This is particularly true given that the positive link between the availability of this right and an increase in shareholder activism has been empirically ascertained. For example, one study which analysed the evolution of shareholders' right to call special meetings in S&P 500 companies from 2005 to 2017 found that the likelihood of shareholders requesting a special meeting increased by 23% in companies which had recently provided shareholders with this right.[972]

It should be noted, however, that the positive effects promised by this right should not be viewed in isolation from any other rights which should first be available for shareholders to exercise under any given framework so that the special meeting mechanism can be meaningfully used. With that in mind, the research argues that the statutory recognition of the special meeting mechanism is particularly appropriate in jurisdictions where shareholder primacy is prevalent, such as the UK, and to a lesser extent Saudi Arabia. This is because for the special meeting to be meaningfully used, the given framework has to complement it with other rights, such as the right to elect and remove directors, the right to amend the bylaws, and the right to approve and propose actions. Without those rights, calling a special meeting would be pointless for shareholders. After all, in the context of shareholder activism, calling a special meeting is merely the means, whereas the other rights are the ends.

Now that the advantages of the right to call a special meeting have been discussed, the remaining task is to discuss Delaware’s approach and demonstrate why Saudi Arabia should stick to its current approach of statutorily providing this right following the UK’s example. While some might argue that Delaware’s framework in principle does not prevent shareholders from enjoying such a right as long as it is agreed upon in either the certificate of incorporation or the bylaws, and thus it does not matter whether the corporate

[972] Catan and Kahan (n 886).

statute grants it or not, the research argues that as will be demonstrated below, such an approach is likely to hinder the effectiveness of the corporate governance framework and increase the vulnerability of the already vulnerable shareholders.

For a start, while Delaware's position of leaving such right for the board and shareholders to negotiate is generally consistent with its director primacy approach and the expectations of private ordering, such a position seems to overly rely on the misconception that shareholders will have the energy and resources to engage in endless fights against the board and majority shareholders in order to change the company's governance structure and restrict the board's powers. This idea has been debunked and was shown to be unconvincing both theoretically and empirically in Chapter 4 of this thesis. As was discussed earlier,[973] shareholders generally prefer to sell their shares when they are dissatisfied with the company's governance structure or performance rather than to engage in costly and time-consuming battles against the board. Nevertheless, while shareholders generally tend to stay inactive or dispose of their shares when frustrated by the company's governance structure or performance, this does not necessarily imply that they are not keen to exert pressure on the board if they are empowered to do so. On the contrary, the value shareholders place in the right to call a special meeting and how it induces activism can even be observed in a board-centric jurisdiction like Delaware, where such a mechanism is only permitted if explicitly provided in the certificate of incorporation or bylaws. Even there, the amendment of bylaws to include such a right has been one of the most common proposals requested by shareholders,[974] clearly indicating how hungry shareholders are to have this right at their disposal. The need to make it more accessible to shareholders is further emphasised given the increasing role of index funds whose strategy is to buy shares and hold them for long time, implying that voting with their feet is increasingly becoming a less valid option, as stewardship by such funds is becoming unavoidable.[975]

Furthermore, even if shareholders are ready to engage in costly fights against the board to enhance its governance structure, boards in Delaware, having the upper hand, can and have continuously made it harder for shareholders to exercise such a right by subjecting it to many restrictions.[976] In order to demonstrate the need for the corporate statute to take care

[973] See Section 3.2.4 of this thesis for the relevant empirical evidence.
[974] Catan and Kahan (n 886).
[975] MacNeil, 'Activism and Collaboration among Shareholders in UK Listed Companies' (n 940).
[976] Alex Walsh, 'Do Shareholders Actually Have "Contracts" with Delaware Corporations?' (2017) <https://www.theregreview.org/2017/10/24/walsh-shareholders-contracts-delaware/>; Meredith Foster,

of this issue instead of relying on a false hope that companies and shareholders will somehow work it out, we only need to look at how the right is significantly restricted in many companies incorporated in Delaware.[977] As will be shown below, many of them have deployed strategies aiming either to eliminate the right altogether or put several limitations on it, rendering it harder for shareholders to exercise.

The tricks and restrictions employed by boards in this regard are numerous, but they all aim either to prevent shareholders from enjoying this right or at least to frustrate their efforts to do so. When the right is not statutorily provided, the first and most obvious restriction boards can place is to simply exclude it from their company's bylaws. In Delaware, the right can easily be removed from shareholders via an amendment of the bylaws approved by the board without shareholders' consent, unless such a right is provided under the company's charter.[978] Other common restrictions imposed by boards include the requirement of a higher threshold for calling a meeting,[979] and requiring the special meeting to be submitted only by shareholders who have their real names in the shares record.[980] In terms of the former restriction, it is found that in 50% of Delaware's S&P 500 companies, the minimum threshold to call a special meeting is between 20-25% of the votes entitled to vote.[981] This threshold is significantly higher than the statutory threshold set in Saudi Arabia and the UK, whose frameworks provide this right for shareholders holding at least 5% of the shares. It is therefore perhaps unsurprising that from 2005 to 2017, shareholders in Delaware submitted 122 proposals requesting that their company reduce the threshold required for calling a special meeting. With this high threshold in mind, one virtue of the Saudi and UK frameworks is that because this matter has already been taken care of by non-conflicted legislators, the threshold they provide is reasonable and practical. On the one hand it is large enough to prevent shareholders from

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'Special Meetings and Consent Solicitations: How the Written-Consent Right Uniquely Empowers Shareholders' (2018) 128 Yale LJ 1706; Marina Petrova, 'Capital Formation for Internet Companies: Why Facebook Stayed Private for So Long and What That Means for Investors' (2011) 12 J. Bus. & Sec. L. 305.

[977] Walsh (n 976); Foster (n 976); Petrova (n 976).

[978] While the default rule in Delaware's framework is that a company's bylaws can only be changed by shareholders, the company's certificate of incorporation can provide the board with the power to do so. That being the case, it is no surprise that in Delaware, the certificate of incorporation of most companies provides boards with such a power. See: Section 109 (a) of the Delaware General Corporation Law; See: Walsh (n 976).

[979] Foster (n 976).

[980] Petrova (n 976); Jeffrey Hartlin, 'The SEC Approves the Elimination of Broker Discretionary Voting in All Director Elections' (2009) <https://www.paulhastings.com/insights/client-alerts/the-sec-approves-the-elimination-of-broker-discretionary-voting-in-all-director-elections>; FINRA, 'It's Your Stock, Just Not in Your Name: Explaining "Street Names"' (2015) <https://www.finra.org/investors/insights/its-your-stock-just-not-your-name-explaining-street-names>.

[981] Foster (n 976).

calling too many special meetings which may be part of malicious activism, and on the other hand it is small enough to enable and encourage serious shareholders to coordinate their efforts to call a special meeting so that they are able to challenge the board.

Turning to the restriction imposed by some boards which provides that special meetings requests can only be accepted from shareholders whose shares are held in their name in the record, the research argues that this is another obstacle which reduces the probability of shareholders' success in making such meetings happen, as between 70-80% of shares are registered in a street name,[982] and consequently, shareholders cannot make use of the special meeting mechanism unless they go to the trouble and time-consuming process of requesting their brokers to change the relevant records.[983]

Another strategy implemented by many of Delaware's companies' boards is confining this right to long-term shareholders, typically those who have held their shares for a minimum of one year.[984] This has been done despite the fact that as of 2018, the average ownership period for shares traded in the NYSE was nine months,[985] meaning that such a restriction reduces the chances of shareholders submitting special meeting requests. These practices are only a few examples among many others of what boards do when fundamental governance rights are placed in their hands. These restrictions, along with other regulatory obstacles related to proxy and disclosure rules that are imposed by both state and federal laws, contribute to the barriers which shareholders in Delaware face, which are likely to frustrate their efforts in communicating among themselves (e.g., triggering a disclosure requirement or a poison pill), all of which casts doubt on shareholders' ability to exercise their right to call a meeting.[986]

It should be noted that from the board's perspective, it is obvious why refusal to grant shareholders this right is sometimes seen as justified. Simply put, granting shareholders this right encourages them to be active and to take greater part in monitoring and disciplining tasks, motivating them to target their boards more frequently and earlier than

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982 Petrova (n 976); Hartlin (n 980); FINRA (n 980).
983 Petrova (n 976); Hartlin (n 980); FINRA (n 980).
984 Foster (n 976).
985 Ted Maloney and Robert Almeida, Jr, 'Lengthening the Investment Time Horizon' (2019) <https://globalfundsearch.com/wp-content/uploads/2019/12/Lengthening-the-Investment-Time-Horizon.pdf>.
986 the William Act, 15 U.S.C.A. § 78m (d); 17 CFR § 240.13d-5 (b) (1) (2018) ('When two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of Sections 13 [d] and [g] of the Act.').

the board would prefer. However, corporate governance arrangements should not be determined only by what makes sense from the board's perspective or what is most convenient for its directors. Rather, they should be determined by what is right and fair from the perspectives of all the company's various groups, especially both the board and shareholders. The objective should be to create an optimal framework within which the board is enabled to exercise its functions freely and with the right amount of discretion, while also allowing shareholders to take a sizeable role in the decision-making without unreasonably disrupting the board's operations. It is therefore both unrealistic and impractical to leave such a matter for companies to decide, expecting that the board will simply voluntarily empower shareholders at its expense, or that shareholders will bear the costs and trouble to force the board to do so. This is particularly true in the modern business world in which shareholders are becoming more active, especially following the adoption of stewardship codes and the rise of index funds and their unavoidable stewardship role.[987] While these arguments are relevant when discussing shareholders' rights in general, their relevance is even greater when discussing the special meeting right, as this right creates the venue at which shareholders can exercise all other rights.

Therefore, based on the above analysis, given the negative impact of Delaware's approach on shareholders, and in light of the theoretical and empirical studies which established the value of statutorily granting this right, the Saudi approach of following the UK's lead by statutorily regulating this right is justified. Doing so balances up the unbalanced powers between the board and shareholders, and assists in creating an effective governance framework that can cope with an increasing level of shareholder activism.

5.4.2 Shareholders' action by written consent

The second issue which falls under the topic of shareholders' meeting and voting rights is the right to take action through written consent as regulated under the three jurisdictions. This issue is selected on the basis that the written consent mechanism, along with the special meeting mechanism, constitutes the two most typical tools shareholders can use to exert influence over the company outside annual shareholders' meetings. Therefore, it is necessary for this mechanism to be discussed in order to fully establish its main considerations before evaluating the Saudi position on the matter.

[987] MacNeil, 'Activism and Collaboration among Shareholders in UK Listed Companies' (n 940).

Acting by written consent is an alternative way for shareholders to propose actions in addition to the typical venues of annual or special meetings. In contrast to shareholders' meetings where an invitation for a meeting must first be made, and shareholders must attend together on the same day and at the same time to discuss and vote on proposed actions[988], acting by written consent accelerates the decision-making process and enables shareholders to circulate among themselves a written proposal at any time, containing the nature of the business matter to be dealt with and the proposed action to be taken. This mechanism functions without holding a meeting, allowing shareholders to consider such proposals at their convenience, without needing to wait until the next annual meeting or calling a special meeting, and can choose either to sign it or refrain from signing it if they disapprove of it.[989] Interestingly, this powerful mechanism is not equally recognised across the three jurisdictions. The Saudi and UK frameworks do not provide shareholders in public companies with the right to take action by written consent in the way Delaware does.[990] Their position is therefore contrary to that of Delaware, where the right is statutorily recognised.[991]

Driven by the divergence found across the three jurisdictions in this area, the question to be addressed here is why Saudi Arabia and the UK, unlike Delaware, have remained silent in respect of the written consent right, and whether their positions are appropriate. In an attempt to understand the rationale behind this divergence, the research argues that both Saudi Arabia and the UK seem to have been influenced by the widespread view advocated by boards and many large institutional investors which disregard the written consent right and undermine its value in comparison to shareholders' meetings generally and special meetings in particular. More specifically, it has long been opined that the written consent mechanism is not needed due to the availability of shareholders' meetings[992] including the special meeting mechanism, with opponents of written consent arguing that both mechanisms serve the same purposes, which are mainly appointing and removing directors along with proposing corporate action in between annual meetings.

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[988] For more on how the special meeting right functions, see the prior discussion of the special meeting right set out above in this chapter.
[989] See generally Subchapter VII of the Delaware General Corporation Law.
[990] In the UK, this right is only provided for private companies. See: Section 281 (1/a) of the Companies Act 2006.
[991] Section 228 (a) of the Delaware General Corporation Law.
[992] Leo Herzel, Scott J Davis and Daniel Harris, 'Consents to Trouble' (1986) The Business Lawyer 135.

In addition, boards argue that both mechanisms are not only interchangeable but that the special meeting mechanism is a much better choice for shareholders to exert influence over the company's affairs due to its associated requirement of giving prior notice to other shareholders and to the relatively lower voting threshold.[993] That being said, boards often question the value of the written consent when the special meeting mechanism is already available, when rejecting calls from shareholders to provide the written consent right. Several examples of boards' arguments can be found in companies' responses to shareholders' requests to grant a written consent right.[994] For instance, PayPal responded to such a proposal by arguing against it based on the availability of the special meeting mechanism which, according to PayPal, is advantageous over the written consent mechanism in that it gives shareholders prior notice, allows them to engage in transparent deliberation and meaningful discussion prior to voting, and enables the board to assess and present its opinions on the proposed action.[995] Another example is the response of 3M to a similar proposal made by its shareholders. In its response, 3M's board argued that the written consent mechanism is unnecessary as shareholders who seek to initiate actions can make use of the special meeting mechanism which is already provided under the company's bylaws without needing to wait until the next annual meeting.[996]

Importantly, the idea that these two mechanisms are interchangeable seems to be upheld not only by boards but also by many large institutional investors, whose support of such a view and acceptance of boards' claims at face value is concerning. Many large institutional investors not only view such mechanisms as interchangeable, but some even favour the special meeting mechanism and claim it is a more useful tool. For example, CalSTRS, a powerful institutional investor, states in its strategy that investors should be provided with the special meeting mechanism or the written consent mechanism.[997] This view is echoed in the voting policy of BlackRock, which indicates that BlackRock may vote against the

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[993] See for examples: 'Verizon Communications, Inc., Proxy Statement (Form 14A) 27 (March 19, 2012).'; 'Altaba, Inc., Proxy Statement (Form 14A) 39 (September 11, 2017).'; 'General Electric Company, Notice of 2014 Annual Meeting & Proxy Statement (Form 14A) 48 (March 10, 2014)'.

[994] See for examples: 'Verizon Communications, Inc., Proxy Statement (Form 14A) 27 (March 19, 2012).' (n 993); 'Altaba, Inc., Proxy Statement (Form 14A) 39 (September 11, 2017).' (n 993); 'General Electric Company, Notice of 2014 Annual Meeting & Proxy Statement (Form 14A) 48 (March 10, 2014)' (n 993).

[995] 'PayPal Holdings, Inc., Proxy Statement (Form 14A) 64-65 (April 13, 2017).'

[996] '3M Company, Proxy Statement (Form DEF 14A) (March 26, 2014).'; For other examples of companies rejecting shareholders' calls for granting written consents using the same arguments, See: 'Quest Diagnostics, Proxy Statement (Form 14A) 64 (April 10, 2016)'; 'Shareowner Proposals: Proposal No. 7: Right to Act by Written Consent, HONEYWELL (2016)'; 'Textron Inc., Proxy Statement (Form 14A) 51 (March 6, 2018)'.

[997] CALSTRS, 'Corporate Governance Principles' (2021) <https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf> accessed 5 May 2021.

adoption of the written consent mechanism when the special meeting mechanism is available.[998] Therefore, it is unsurprising that in 37% of Delaware's S&P 500 companies, the written consent is available, whereas in 56% of such companies the special meeting is available.[999] This is also true for Delaware's Russell 1000 companies, as in 34% of them shareholders are provided with the written consent mechanism, whereas in 44% they are provided with the special meeting mechanism.[1000] These numbers clearly reflect boards' general preference to allow the special meeting right and disapproval of the written consent mechanism.

With those views in mind, and despite the claims that the two mechanisms of special meeting and written consent are similar in nature and somehow interchangeable, it can be argued that such claims should not be accepted at face value, and that their validity is questionable given that the two mechanisms are in fact quite different from each other both procedurally and practically, rendering them non-substitutable. To demonstrate, the regulatory procedures associated with written consent are relatively lower than those required to call a special meeting, thus making the former easier for shareholders to use should they wish to influence the company's affairs. In contrast to calling a special meeting, which is an option only open to shareholders owning specific sizable shareholdings of the company,[1001] the written consent mechanism allows any shareholder, regardless of how many shares he owns, to influence the company's affairs by initiating written consent, and the company has to circulate it to other shareholders on his behalf. Consequently, the written mechanism could motivate shareholders to be more active and encourage other inactive shareholders to get involved, because the burden of who should take the first step has already been taken on by other shareholders. Therefore, it could be said that it is not as costly and time consuming as the special meeting mechanism given that in the latter shareholders must first coordinate with other shareholders whose shareholdings satisfy the quorum requirement to call a special meeting, and once they have

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[998] BlackRock, 'Proxy Voting Guidelines for U.S. Securities' (2021) <https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf> accessed 5 May 2021.

[999] 'FactSet Research Systems. Inc., SHARKREPELLENT, 2018.' <https://sharkrepelent.net> (as cited in Meredith Foster, 'Special Meetings and Consent Solicitations: How the Written-Consent Right Uniquely Empowers Shareholders' (2018) 128 Yale LJ 1706).

[1000] ibid (as cited in Meredith Foster, 'Special Meetings and Consent Solicitations: How the Written-Consent Right Uniquely Empowers Shareholders' (2018) 128 Yale LJ 1706).

[1001] In both Saudi Arabia and the UK, the minimum threshold is 5% of the shares entitled to vote, whereas in 50% of Delaware's S&P 500 companies, the minimum threshold to call a special meeting is between 20-25% of the shares entitled to vote. See: Article 90 of the Companies Law 2015; See: Section 303 (4) of the Companies Act 2006; For the statistics in Delaware, see: Foster (n 976).

their support, they must circulate the proposed resolution among other shareholders hoping that they will actually attend the requested meeting and approve the resolution.

Furthermore, the written consent mechanism is different to the special meeting mechanism and advantageous over it as it escapes many of the restrictions typically imposed by boards on the right to call a special meeting.[1002] In Delaware, the DGCL stipulates that, unless the company's certificate of incorporation provides otherwise, shareholders shall be allowed to take action through written consent, and the board is prohibited from amending the bylaws to the effect of either depriving shareholders of that right, or making it difficult for them to exercise it without their prior approval.[1003] Should the board wish to disarm shareholders from using this mechanism or place any restriction on it, an amendment of the company's certificate of incorporation is needed, for which the approval of *both* shareholders and the board is required.[1004] This view was upheld by the ruling of the Delaware Supreme Court in 1988 which held "bylaws which effectively abrogate the exercise of [the right to act by a written consent] are in invalid.".[1005] This ruling was provided having reviewed a case concerning an amendment of a company's bylaws which placed a minimum period of twenty one days before an action taken by written consent was to become effective.[1006] Accordingly, when a company’s certificate of incorporation does not eliminate or restrict this right, not only are boards prohibited from eliminating the right altogether, they are also prohibited from restricting it in any way that renders it difficult to exercise without shareholders’ prior approval. This means that boards cannot go behind shareholders’ backs, as they typically do on the special meeting right, to amend the written consent right, rendering it largely immune from boards’ manipulation.

Turning to the argument that the special meeting right is preferable given the prior notice requirement and the argument that all shareholders have the chance of adequate conversation with each other prior to voting on the proposed action, these presumed values appear to be overvalued. The former argument appears to have no merit given that pursuant to the US federal laws, shareholders of public companies who are soliciting written consent from more than ten shareholders are required to submit a consent-

[1002] See Section 5.4.1 of this thesis which presented a detailed discussion of the limitations and restrictions placed by boards on the special meeting right.
[1003] See Section 228 and generally Subchapter VII of the Delaware General Corporation Law.
[1004] See Section 228 and generally Subchapter VII of the Delaware General Corporation Law.
[1005] *Allen v Prime Computer, Inc* (1988) 540 2d 417 (Del: Supreme Court).
[1006] ibid.

solicitation statement on Schedule 14A,[1007] in addition to submitting preliminary consent-solicitation materials at least ten calendar days prior to mailing the final materials.[1008] Therefore, given that written consent relies on the endorsement of the majority of outstanding shares, most written consent would need to solicit more than ten shareholders.[1009] That being the case, proper notice of the written consent would be given to the board,[1010] allowing it to evaluate it and submit its related recommendation or to provide shareholders with a counter written consent.[1011]

The argument that the special meeting mechanism, unlike the written consent, allows shareholders to engage in transparent deliberation and meaningful discussion prior to voting seems unrealistic and overlooks the reality that the vast majority of shareholders' meeting are poorly attended.[1012] This reality may in part explain the rationale behind the significant increase in the number of public companies shifting entirely from physical shareholders' meetings to virtual ones.[1013] This trend, along with the fact that most shareholders vote by proxy instead of attending shareholders' meetings,[1014] raises doubts about the validity of the "transparent deliberation and open discussion" argument. With these points in mind, and contrary to boards' claims, the written consent mechanism would actually compensate for the poor attendance of shareholders' meetings and encourage a greater involvement of shareholders in the company's affairs, as they can do so at their convenience without incurring the cost of attending those meetings in person.

Furthermore, while the virtue of the special meeting right lies in the fact that it allows shareholders to take action quicker than waiting for the next annual meeting, the virtue of the written consent right lies *inter alia* in the fact that it empowers shareholders to take

[1007] Ethan Klingsberg, 'Action by Written Consent: A New Focus for Shareholder Activism' (2010) <https://corpgov.law.harvard.edu/2010/07/05/action-by-written-consent-a-new-focus-for-shareholder-activism/> accessed 7 May 2021; 17 C.F.R. § 240.14a-2 (b) (2) (2018).
[1008] 17 C.F.R. § 240.14a-6 (a).; Foster (n 976).
[1009] Foster (n 976).
[1010] Eric S Robinson, 'Defensive Tactics in Consent Solicitations' (1996) The Business Lawyer 677.
[1011] Catherine Bromilow and others, 'Director Dialogue with Shareholders' (2014) THE CORPORATE BOARD <https://www.weil.com/-/media/files/pdfs/directordialoguewithshareholders.pdf> accessed 5 May 2021.
[1012] Elizabeth Boros, 'Virtual Shareholder Meetings' (2003) 3 Duke L. & Tech. Rev. 1; Brad Loncar, 'Investment Tip: Annual Shareholder Meetings Are Undervalued' (2014) <https://www.loncarblog.com/brads-blog-annual-meetings> accessed 5 May 2021; Foster (n 976); See generally Bainbridge, *The New Corporate Governance in Theory and Practice* (n 871).
[1013] Francois Brochet, Roman Chychyla and Fabrizio Ferri, 'Virtual Shareholder Meetings' (2020] Available at SSRN; Lisa A Fontenot, 'Public Company Virtual-Only Annual Meetings' (2017) 73 Bus. Law. 35.
[1014] Bainbridge, *The New Corporate Governance in Theory and Practice* (n 871).

action quicker than by convening a special meeting by which time it might be too late for shareholders to reverse a board's actions.

It is understandable why boards often oppose the written consent right, as it encourages shareholders to undermine their authority by exposing the board to a continuous risk of replacement. This is particularly relevant given that among the purposes of this mechanism is management's replacement, especially during a hostile takeover. In such an event, prohibition of the written consent right prevents shareholders from acting in concert via written consent prior to the next annual meeting, before which the potential hostile takeover is likely to be dropped for various reasons such as a change in the share price or uncertainty as to whether sufficient votes will be cast in favour of the takeover.[1015] Similarly, a hostile takeover would possibly have resulted in a different outcome were shareholders provided with the written consent mechanism, as then the acquirer could have approached them directly and solicited written consent in favour of the transaction. From this perspective, prohibition of the written consent right interferes directly with shareholders' right to remove directors, explaining why it is among the tactics employed by boards to frustrate shareholders when attempting to exercise their removal right.

However, institutional shareholders taking the same stance of opposing the written consent right is thought provoking given that they themselves could make use of it to take action quickly. A possible rationale for institutional shareholders' rejection of this mechanism is that in public companies, especially in a concentrated ownership market like that of Saudi Arabia where this type of shareholder is dominant,[1016] institutional and large shareholders typically have the upper hand in managing the company. Therefore, they are in a much better position to choose a board to their liking and to influence the board's decisions both behind the scenes and in public. With that in mind, they may not need a written consent mechanism to exert influence. In other words, if the written consent mechanism is available, it is mostly minority shareholders who may make use of it, potentially exposing the board and the influential shareholders behind it to numerous fights and battles that none of them is willing to face. This is particularly true given the that the written consent mechanism, unlike the special meeting mechanism which must be submitted by shareholders who own large shareholdings, can be used by any shareholder regardless of how many of the company's shares he owns. Consequently, providing shareholders with

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[1015] Klingsberg (n 1007); Catan and Kahan (n 886); Foster (n 976); See generally Kini, Kracaw and Mian (n 172).
[1016] See Section 2.5 of this thesis for more on the ownership structure of the Saudi capital market.

the written consent right would normally encourage them to more frequently intervene in the decision-making process, second-guess the board's judgement, and subject its actions to continuous scrutiny, something that neither the board nor the large shareholders backing it are prepared to endure.

Interestingly, a relevant empirical study found that in companies where the special meeting right was already granted and then the written consent right was granted at a later stage, 47% of the written consent requests were submitted by shareholders who prior to making such requests had never requested a special meeting of the same company's shareholders.[1017] Additionally, the available data indicates that in companies where both rights are available, the written consent right is more frequently employed by shareholders, especially in order to secure a stronger presence in the board.[1018] These findings demonstrate how much value shareholders place on the written consent mechanism, and strongly suggest that it is more powerful and attractive than the special meeting mechanism.

Based on the above considerations and given the stated advantages of the written consent right, it can be concluded that while that right shares a few similarities with the special meeting right, several significant differences exist which debunk the argument that the two rights are somehow interchangeable. Accordingly, Saudi Arabia and the UK should reconsider their positions towards written consent and learn from Delaware's experience in this regard. As to the question of whether Saudi Arabia should provide for written consent, and if so, which regulatory form this provision should take, the research argues that in the light of the theoretical and empirical analysis discussed above, there is a strong case for introducing written consent into the Saudi's framework. However, given the mandatory nature of the Saudi framework which means that whenever the regulator is introducing new concepts it does so mandatorily, caution should be exercised prior to introducing the written consent right.

The fact that the Saudi's framework has not recognised written consent as yet, and that boards and influential shareholders are likely to oppose it suggests that it needs to be introduced carefully so that all parties involved become familiar with it and the way it functions over time. As Chapter 3 discussed, mandatory rules usually involve public

[1017] Catan and Kahan (n 886).
[1018] Foster (n 976).

enforcement, rendering the monitoring of compliance and subsequent enforcement more challenging given the vagueness often associated with such type of rules. This implies that once the written consent right is mandatorily provided and the compliance thereof is monitored, there will be little room for companies and shareholders to learn and for this mechanism to evolve, which might place unreasonable pressure on companies. Another reason for approaching this issue with caution is that while the concept of written consent has been established to be advantageous, it is yet to gain the full attention it deserves from academia and practitioners, possibly due to having been overshadowed by the special meeting right. Therefore, more theoretical and empirical studies may be needed to fully evaluate its impact on the agency cost and firm value.

Taking these considerations into account, the need to *mandatorily* impose such a rule in Saudi Arabia may not be pressing at the moment, especially in light of the availability of the special meeting right which, although different as discussed above, nevertheless offers shareholders a useful and powerful path to exercising control which means they are not left powerless under the current framework. A better alternative to regulate the written consent right in Saudi Arabia is to introduce it either via a default rule in the CL 2015 or through an enabling rule which makes its availability contingent on its presence in the company's bylaws. This way, the mandatory framework of Saudi Arabia could manifest some forms of flexibility. Therefore, when a board considers this right to be inappropriate, it would need to build a strong case for barring shareholders from exercising it and persuade shareholders to support its stance. Introducing written consent by a default rule or enabling one would pave the way for this right in the Saudi capital market in the hope of softening potential opposition to it by boards and major shareholders who might lobby against it.

Lastly, regulating the written consent right through a default or enabling rule may reduce the probability of minority shareholders abusing it, as granting them this right without negotiation with boards and other large shareholders may lead to endless written consents that may form part of malicious activism. Such malicious activism is likely to be detrimental to a company as it exhausts corporate resources and shareholders' time and energy.

5.5 Shareholders' Decision Rights

The fourth issue through which the position of the Saudi framework in regard to the allocation of powers will be evaluated is shareholders' decision rights, namely the approval right and the proposal right.[1019]

Despite the fact that boards in all three jurisdictions enjoy the decision-making power - by statute in Saudi Arabia and Delaware and by contract in the UK - it is apparent that such decision-making power is not confined entirely to the board. To explain this further, in all three jurisdictions shareholders are entitled to be involved in decision-making in certain instances, mostly in the form of approval. In the UK, for example, the CA 2006, the Model Articles, and the LR all reserve the ultimate decision-making power to shareholders on several specified occasions. Among these occasions: amending the company's articles by special resolution;[1020] approving a substantial property transaction;[1021] disapplying shareholders' pre-emption rights by special resolution[1022], declare dividends,[1023] and issue different classes of share.[1024] Furthermore, shareholders have a prominent role in certain transactions, particularly Class 1 transactions and related party transactions, both of which require shareholders' approval.[1025]

Similarly, although Delaware is categorised as a board-centric jurisdiction, shareholders there share the decision-making power with the board in a few instances. For example, shareholders are able to decide on the election and removal of directors[1026] in addition to the adoption, amendment, and repeal of bylaws.[1027] Furthermore, shareholders' approval is required for some major corporate transactions, such as mergers;[1028] the sale of all or

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[1019] The link between the meeting and voting rights (i.e., special meeting and written consent rights) and the decision rights (i.e., approval and proposal rights) was included in the discussion of shareholders' meeting and voting rights.
[1020] Section 21 of the Companies Act 2006.
[1021] Section 190 of ibid.
[1022] Section 571 of ibid.
[1023] Article 70 of Schedule 3 of the Companies (Model Articles) Regulations 2008.
[1024] Article 43 of ibid.
[1025] Rules 10 and 11 of the UK Listing Rules.
[1026] Section 141 (k) of the Delaware General Corporation Law.
[1027] Section 109 (a) of ibid.
[1028] Section 251 (c) of ibid.

substantially all of the company's property and assets;[1029] the company's dissolution;[1030] and amendment of the company's certificate of incorporation.[1031]

In Saudi Arabia, similar to the UK and Delaware, the framework leaves some space for shareholders' intervention by constraining the board's powers in taking certain major corporate decisions by requiring the approval of the shareholders. These decisions include the amendment of the company's articles of association;[1032] increasing or reducing capital;[1033] the dissolution of the company;[1034] mergers;[1035] the election and removal of directors;[1036] dis-applying pre-emptive rights;[1037] approval of shares buy-back, approval of transactions in which a director has an interest;[1038] and approval of dividend payment.[1039]

Notably, as per the CL 2015 the board's decision-making power can be restricted if shareholders decide to amend the bylaws so that corporate matters requiring their prior approval are wider than those already specified in the CL 2015 and the CGRs 2017.[1040] The only matters which can be reallocated to shareholders without the need to amend the bylaws are those concerning the sale or mortgage of the company's assets or the discharge of the company's debts and obligations, in which cases the general assembly can pass a resolution restricting the board's powers.[1041]

Importantly, perhaps the most powerful form of shareholder interference is their ability to directly propose an action in a specific way in relation to a specific matter. In this regard, the position of shareholders in the UK and Delaware is much stronger than it is in Saudi Arabia, as evidenced by the default rule of the UK Model Articles which explicitly grant shareholders the power to pass a special resolution instructing directors to act in a specific manner in a specific matter.[1042] In Delaware, shareholders can theoretically instruct the

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[1029] Section 271 (a) of ibid.
[1030] Section 275 (b) of ibid.
[1031] Section 242 (b) of ibid.
[1032] Article 88 (1) of the Companies Law 2015.
[1033] Article 94 (4) of ibid.
[1034] Article 94 (4) of ibid.
[1035] Article 94 (4) of ibid.
[1036] Article 68 (3) of ibid.
[1037] Article 140 of ibid.
[1038] Article 71 (1) of ibid.
[1039] Article 12 of the Corporate Governance Regulations 2017.
[1040] Article 75 (1) of the Companies Law 2015.
[1041] Provided that the bylaws do not authorise the board to handle these matters on its own. See Article 75 (2) of ibid.
[1042] Article 4 of Schedule 3 of the Companies (Model Articles) Regulations 2008.

board to take (or not to take) an action in a specific matter through the company's proxy statement. To do so, a shareholder must first present his proposal to the company and request the inclusion of that proposal in the company's proxy card for shareholders to either approve or disapprove, subject to several procedural and eligibility requirements.[1043] In contrast, the position of Saudi Arabia is notably different, as nothing in the CL 2015 or the CGRs 2017 explicitly suggests that shareholders have the right to directly instruct the board to take or refrain from taking a specific action. While both CL 2015 and CGRs 2017 make reference to instances where shareholders have decision-making powers, those instances are all related to the approval of decision which has been recommended by the board beforehand.[1044]

Now that the position of each jurisdiction has been established in relation to the approval right and the proposal right, several observations can be made, the first of which is that both convergence and divergence can be seen. Convergence is evident in that in all three jurisdictions shareholders enjoy the approval right in several instances as detailed above, all of which are similar in nature. The divergence among them, however, is that the proposal right in the Saudi framework, unlike in the UK and Delaware, remains unclear as the framework lacks any clear reference to it. This will be discussed below, as the focus now turns to the convergence seen in relation to the shareholders' approval right.

5.5.1 Shareholders' approval right

Although the three jurisdictions all recognise shareholders' approval right and provide similar decisions for which shareholders' approval is required, Saudi Arabia diverges from the other two in specifying a higher number of decisions requiring shareholders' approval than the frameworks in the UK and Delaware. These decisions are recognised by both the CL 2015 and CGRs 2017, which constitute the primary sources of corporate governance rules. The research argues that this is an advantage which the Saudi framework has over the other two jurisdictions, as it contributes to shareholders' protection. While one could argue that shareholders in the UK and Delaware can increase their approval-required decisions if they wish by amending the articles of association or bylaws so that the Saudi framework would not have additional value, the research argues that the advantage of the

[1043] For more details on proxy rules, including which legal grounds can be used by companies to reject shareholders' proposals and what shareholders can do in such an event, see: 17 C.F.R. § 240.14a-8 (2005).
[1044] See generally Part 5 of the Companies Law 2015; See generally Part 2 of the Corporate Governance Regulations 2017.

Saudi framework is that the framework itself has already taken care of this matter on behalf of shareholders, saving them the trouble of attempting to coordinate their efforts and persuading other shareholders to agree to change the constitutional documents, a process that is often onerous even in the UK and Delaware, where shareholders are in a much better position to do so.[1045]

The three jurisdictions' recognition of shareholders' approval right indicates how much values legislators place on this mechanism. That being the case, although the approval right is typically seen as a protective mechanism enabling shareholders to have a say in the company's affairs, thus controlling the board's discretion, jurisdictions should be cautious when approaching this aspect and should carefully choose which matters require shareholder approval and which are best left at the board's discretion. This is especially true given that the regulatory trend in recent years has been towards diluting board powers in favour of shareholders.[1046] This trend is linked to the global development of ESG investing and stewardship,[1047] and it builds on the belief that empowering shareholders to exert more control over the board could be a solution to the agency problem. Yet, the values associated with shareholders' empowerment seem to have been difficult to ascertain empirically. For example, several studies exploring the effects of shareholders' empowerment on firm value have produced mixed results. On the one hand, three studies which aimed at ascertaining the effect of such empowerment on firm value found that shareholders' empowerment negatively affects firm value.[1048] Meanwhile, another group of studies suggest that shareholders' empowerment positively affects firm value.[1049] Therefore, the findings of these studies along with the already existing state of information asymmetry between the board and shareholders cast doubt on shareholders' ability to make

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[1045] See Sections 3.2.4, 3.4.2, and 3.4.4 of this thesis for a detailed discussion of the challenges facing shareholder activism.

[1046] John G Matsusaka and Oguzhan Ozbas, 'A Theory of Shareholder Approval and Proposal Rights' (2017) 33 The Journal of Law, Economics, and Organization 377.

[1047] ESG investing refers to the Environmental, Social and Governance investment strategies that have been increasingly employed by institutional investors and funds over recent years and which aim at creating and sustaining a positive long-term impact on the environment, society, and corporate performance. See: R Boffo and R Patalano, *ESG Investing: Practices, Progress and Challenges* (OECD Paris 2020).

[1048] David F Larcker, Gaizka Ormazabal and Daniel J Taylor, 'The Market Reaction to Corporate Governance Regulation' (2011) 101 Journal of financial economics 431; Ali C Akyol, Wei Fen Lim and Patrick Verwijmeren, 'Shareholders in the Boardroom: Wealth Effects of the SEC's Proposal to Facilitate Director Nominations' (2012) Journal of Financial and Quantitative Analysis 1029; Thomas Stratmann and JW Verret, 'Does Shareholder Proxy Access Damage Share Value in Small Publicity Traded Companies' (2012) 64 Stan. L. Rev. 1431.

[1049] Bo Becker, Daniel Bergstresser and Guhan Subramanian, 'Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable's Challenge' (2013) 56 The Journal of Law and Economics 127; Jonathan B Cohn, Stuart L Gillan and Jay C Hartzell, 'On Enhancing Shareholder Control: A (Dodd-) Frank Assessment of Proxy Access' (2016) 71 The Journal of Finance 1623.

informed decisions that are for their own good and on the value of placing such decisions in shareholders' hands. In fact, both small and institutional shareholders are typically not well informed of the nature of the decisions presented to them and their long-term consequences.[1050] The former's ownership is too small to motivate them to afford the price of being informed, while the latter's shareholdings are often too diversified to encourage a deep assessment of each proposed decision.[1051]

Furthermore, it is argued that shareholders' approval right is not as effective as expected in mitigating the agency problem.[1052] While the approval right does indeed constrain management's ability to advance their personal interests, it does not necessarily maximise shareholder value,[1053] because management could get shareholders to approve even the least-beneficial decisions if the alternative option (i.e., the status quo) is unattractive for shareholders.[1054] In other words, it is found that as long as the outcome or effect of the action requiring approval is similar to that of not taking action, shareholders will likely approve it. The implication is that shareholders could sometimes be pressured to approve the board's proposals due to a fear that if they do not then the board will pursue no action at all. With all of the above considerations in mind, the final point to be made is that while Saudi Arabia, along with the other two jurisdictions, should not be discouraged entirely from empowering shareholders through recognising the approval right, they should approach this aspect in a cautious manner and on an informed basis, where both the advantages and disadvantages of each matter are evaluated.

5.5.2 Shareholders' proposal right

Now that some important points have been made as to shareholders' approval right, the focus turns to the other important issue pertaining to shareholders' empowerment, which is shareholders' proposal right. As was established above, the most remarkable difference across the three jurisdictions is that the proposal right remains unclear in the Saudi framework, unlike the UK and Delaware, as the Saudi framework falls short of any clear reference to it. That being said, the question is whether such a right is recognised by way of implication, and whether the various regulations could be interpreted to infer it.

[1050] Matsusaka and Ozbas (n 1046).
[1051] ibid.
[1052] ibid.
[1053] ibid.
[1054] ibid.

Exploration of the CL 2015 and the CGRs 2017, both of which are the primary sources of corporate governance rules in Saudi Arabia, shows that the only time these sources refer to shareholders' role in decision-making is in the context of them exercising their approval right.[1055] Furthermore, in several instances where the rights of shareholders are addressed, the right to instruct the board or to propose an action is ignored. For example, Article 96 of the CL 2015 provides that every shareholder has the right to discuss the items included on the general meeting's agenda and to raise questions on them to the board, and that the board must answer any questions to an extent that does not jeopardise the company's interests, and that in the event the given shareholder finds the answer to be unsatisfactory he has recourse to the general meeting whose decision in this matter is binding.[1056]

This article appears to suffer from a lack of clarity, since the reference to "binding decision" of the general meeting in the event of the board's unsatisfactory answer does not tell us much about what kind of "decision" could be made by the general meeting in this context. The only possible interpretation is that the decision referred to in the article is one that obliges the board to provide a better answer to the question raised by the unsatisfied shareholder, therefore an inference of shareholders' ability to instruct the board directly cannot be established from this article. Moreover, Article 110 of the CL 2015, which is of critical relevance given that it establishes the statutory rights associated with a stock, provides that among the rights associated with every stock is the right to attend general meetings and vote on their decisions, without further reference to any right to instruct the board or propose any action.[1057] Nevertheless, the strongest context from which a reference to shareholders' right to propose could be inferred is Article 14 of the CGRs 2017, which primarily addresses the issue of preparing the general meeting's agenda. This article stipulates that the board must take into account when preparing the general meeting's agenda the issues that shareholders want to be included, and that shareholders owning 5% or more of the company's shares have the right to add one or more items to the meeting's agenda.[1058] While this article could be used as a basis for arguing that shareholders under the Saudi framework can theoretically influence the board by requesting that it adds an item to the meeting agenda so that the general meeting is presented with the opportunity to

[1055] See generally Part 5 of the Companies Law 2015; See generally Part 2 of the Corporate Governance Regulations 2017.
[1056] Article 96 of the Companies Law 2015.
[1057] Article 110 of ibid.
[1058] Article 14 of the Corporate Governance Regulations 2017.

vote on the issue of concern and make a decision, that inference falters when the article is read in conjunction with Article 15 of the CGRs 2017.

Article 15 of the CGRs 2017 addresses the management of the general meeting, and in doing so provides that shareholders have the right to discuss the topics included on the general meeting's agenda and to raise questions about them, and that the board must answer such questions to an extent that does not jeopardise the company's interest.[1059] Put differently, while shareholders have the right to add an item to the general meeting's agenda on any issue as per Article 14, Article 15 clarifies the scope of shareholders' powers in relation to that agenda, which is to discuss and raise questions, without reference to their right to vote on them. Therefore, should the Saudi legislators intend to grant shareholders the right to instruct and propose, then that right would have been recognised clearly either in the CL 2015 as part of the rights associated with stocks, or at least in the CGRs 2017 when it addresses shareholders' options in the general meeting. The lack of reference to this right raises significant doubt as to whether the Saudi framework intended to empower shareholders to the same extent as in the UK and Delaware, or whether that right was excluded intentionally.

All in all, the case for explicitly recognising shareholders' proposal right is strong, as doing so allows shareholders to have a say in the company should the board and other corporate governance arrangements fail to safeguard their interests. This right creates incentives for shareholders to participate in monitoring and enforcement in the knowledge that they have a way to correct the board's actions if they can join together with other shareholders and coordinate their efforts. Given the current state of the Saudi capital market, which is categorised as predominantly one of concentrated ownership, along with the absence of regulatory mechanisms which empower shareholders to exercise a greater role in decision-making, the incentives for shareholders to engage in monitoring and enforcement is low.

Worthy to note that in Saudi Arabia, where shareholders' approval right is recognised, the right should not be considered enough by itself to balance the powers between the board and shareholders, nor can it substitute the proposal right, as each affects corporate behaviours in different ways, and the two are conceptually different. The discussion above questioned the potential of shareholders' approval right as an effective tool in controlling the agency problem, suggesting that the proposal right is viewed as a more effective

[1059] Article 15 of ibid.

corporate governance mechanism. Moreover, the latter right is believed to be more positively influential in pressuring boards to be more active and to take action that will contribute to maximising shareholders' wealth. While strong appointment rights (and particularly the right of removal) can significantly mitigate the risk of directors' mismanagement,[1060] sole reliance on them might not be always desirable for shareholders who are generally pleased with the board's performance but disagree with some of its decisions, which would mean removal is an unattractive action. The uncertainty surrounding the proposal right in the Saudi framework means that when shareholders want a specific action to be taken by the board, they are likely either to exercise the removal right even in cases where they believe such action is not optimal, or to refrain from doing so and abstain from taking any disciplinary action due to not wanting to replace the board entirely.

It should also be noted that while not every proposal is guaranteed to find its way to general meetings, the pressure imposed on boards by such proposals is found to induce boards to negotiate with the proposing shareholders and reach a satisfactory settlement. This is evidenced by a study whose findings from its sample show that more than 40% of proposals submitted by shareholders in the US between 1997-2015 were retreated before they were put to a shareholders' vote, typically following negotiations with the company's management.[1061] This finding is further endorsed by several other studies, one of which finds that between 1988-1993 72% of companies which were pressured by the California Public Employees' Retirement System (CalPERS) changed their practices accordingly.[1062] Another study shows a similar effect in the UK, finding that 116 of 133 proposals submitted by shareholders to companies were rescinded after the companies entered into negotiations with the proposing shareholders.[1063] These findings strongly indicate that boards are more likely to reconsider their views in order to satisfy shareholders if the boards feel threatened by a shareholder's proposal.

While such findings ascertain the effectiveness of the proposal right in pressuring boards to adopt better practices and behave more responsibly, caution is needed as some empirical

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[1060] See Section 5.3 of this thesis.
[1061] John G Matsusaka, Oguzhan Ozbas and Irene Yi, 'Opportunistic Proposals by Union Shareholders' (2019) 32 The Review of Financial Studies 3215.
[1062] Michael P Smith, 'Shareholder Activism by Institutional Investors: Evidence from CalPERS' (1996) 51 The journal of finance 227.
[1063] Bonnie G Buchanan and others, 'Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom' (2012) 49 American Business Law Journal 739.

studies also suggest that sometimes the right to propose can be abused to push boards to accommodate activists' personal interests without regard to those of other shareholders, especially when exercised by activists whose interests are not the same of their fellow shareholders.[1064] This could be a concern in Saudi Arabia where the presence of block-holders is strong, raising the possibility that minority shareholders could be affected by selfish proposals by those block-holders.

5.6 Summary and Conclusion

The objective of this chapter was to discuss the positions of the three jurisdictions in relation to the allocation of decision-making powers from several perspectives, including agency theory and director/shareholder primacy theories. Ultimately, the chapter sought to assess the appropriateness of the Saudi framework's various arrangements in relation to companies' governance as a whole, in response to the thesis's main questions. The discussion encompassed the issues surrounding the allocation of decision-making powers, shareholders' appointment rights including the appointment and removal of directors, shareholders' meeting and voting rights covering special meeting and written consent rights, and shareholders' decision rights comprising approval and proposal rights. Similar to the research's approach in the previous chapters, the issues tackled in this chapter were discussed through doctrinal and comparative analysis supported by the relevant empirical evidence.

With regard to the allocation of powers between the board and shareholders, after discussing the shareholder primacy and director primacy theories and explaining the relevance of those theories in corporate governance, the research discussed approaches to the allocation of decision-making powers in the three jurisdictions, establishing Saudi Arabia as a jurisdiction whose corporate governance framework is similar to that of the UK in that it is largely influenced by shareholder primacy, with some features of director primacy in the form of recognising the board as an original decision-maker whose power to manage the company cannot be withheld by shareholders. In this regard, the research distinguished the Saudi approach from that of the UK and Delaware, characterising it as sitting in the middle of those two jurisdictions by statutorily vesting decision-making power in the board while at the same time empowering shareholders to participate in the

[1064] Tracie Woidtke, 'Agents Watching Agents?: Evidence from Pension Fund Ownership and Firm Value' (2002) 63 Journal of Financial economics 99; Ashwini K Agrawal, 'Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting' (2012) 25 The Review of Financial Studies 187; Matsusaka, Ozbas and Yi (n 1061).

company’s affairs to a larger degree than in Delaware. The influence of shareholder primacy on the Saudi’s framework could further be seen in other shareholders’ control rights, particularly in relation to appointment, meeting and voting, and decision rights.

As to the other issue of shareholders’ role in directors’ appointment and removal, the research established that while similarities exist among the three jurisdictions towards appointment and removal rights, a few prominent differences exist, particularly in relation to the use of cumulative voting in directors’ appointment and the removal of directors without cause. Regarding the cumulative voting, the research showed that this method is mandatorily required in the Saudi framework whereas the UK is silent on it and Delaware allows it only if it is included in the company’s certificate of incorporation. In critically analysing the remarkable Saudi position in this regard, the research presented the arguments for and against cumulative voting, and criticised its opponents’ views by establishing that the pros of cumulative voting outweigh its cons. In particular, and supported by the empirical evidence, the research argued that this voting method balances the board’s composition and ensures that the wider interests of all shareholders, including minority, are taken into account. It also demonstrated its impact on reducing agency cost, as minority shareholders are able to influence the board’s views through their representatives rather than engaging in hostile fights that are typically costly and time-consuming. While the research argued that the UK and Delaware could also realise the benefits of cumulative voting, the need for it was shown to be less pressing in those developed markets due to the more active role of market forces and the stronger presence of independent directors. The research concluded that the current Saudi approach of mandatorily imposing cumulative voting for directors’ appointment is appropriate, as it is one way to compensate for the absence of market forces, the inactive market for corporate control, and importantly, the weak representation of independent directors.

Turning to the other issue of the right of removal of directors, although the research established that similarities exist across the three jurisdictions in that they all statutorily provide for shareholders’ removal right by a simple majority and without cause, the research suggested that the Saudi position is less certain on the right of without cause removal, and clarification was shown to be needed especially in relation to the mandatory cumulative voting requirement in directors’ appointment. To tackle this problem, the research proposed introducing a rule which in effect prevents the removal of any director without cause if the votes against his removal are enough to appoint one director. This solution could preserve the value of cumulative voting and protect the minority representatives from majority shareholders' abuse.

Regarding shareholders' meeting and voting rights, the research concluded that while the three jurisdictions approach many aspects of these rights in a similar manner, several prominent differences can be observed, especially in relation to shareholders' special meetings and written consents. On the former right, the research provided a detailed critical analysis of Delaware's position, which makes such right contingent on the articles of association, exposed the harsh reality which shareholders in Delaware's companies have endured for a long time, and illustrated the tactics employed by boards to either prevent shareholders from the right to call special meetings altogether, or to make it very difficult for them to exercise. Subsequently, the research concluded that it is unrealistic to expect boards to voluntarily empower shareholders at their own expense, and therefore the Saudi and UK approaches of statutorily providing shareholders holding a minimum of 5% with the special meeting mechanism is suitable. Such an approach balances the allocation of control rights between boards and shareholders and increases the level of shareholder activism, both of which can assist in creating an optimal framework within which the board is enabled to discharge its discretionary powers, and shareholders are permitted to reasonably intervene in the decision-making.

The research then moved on to discuss shareholders' action by written consent. In this regard, this mechanism was shown to be explicitly recognised in Delaware, but absent from the frameworks of publicly listed companies in Saudi Arabia and the UK. To understand the rationale behind this divergence, the research first defined this concept and established its significance in public companies, especially in comparison with the special meeting mechanism which is often thought of as an alternative path. The idea that these two rights are interchangeable and that the special meeting right has more value was suggested here to be influencing the regulatory approaches of Saudi Arabia and the UK. The research challenged such a view and shed light on the procedural and practical differences that exist between the two mechanisms, demonstrating the unique value brought by the written consent mechanism. In particular, the discussion noted the speed at which this mechanism allows shareholders to take action, the lower cost associated with such a mechanism, and the lower regulatory requirements for written consent.

The research concluded the analysis of written consent by recommending that the Saudi legislator should consider introducing the written consent mechanism through a default rule in the CL 2015 or through an enabling rule which makes the availability of such a right contingent on its presence in a company's bylaws. This proposed approach assists in elevating the position of shareholders by enhancing their ability to influence the board's decisions, and at the same time avoids a mandatory approach so that this mechanism finds its place slowly within the Saudi market thus to lowering the expected boards resistance against such a mechanism as has been witnessed in Delaware.

The discussion then moved on to address the final issue of this chapter, shareholders' decision rights, where it first established that although the three jurisdictions equally recognise shareholders' approval right, a striking difference between the jurisdictions was evident in terms of shareholders' proposal right. This right was demonstrated to be uncertain in the Saudi framework, while it was present in the UK and Delaware. In an attempt to establish the existence of such a right even by way of implication in Saudi Arabia, the research investigated the Saudi framework's rules on shareholders rights and the context within which they are presented, concluding that such a right could not be solidly inferred. The suggestion here is therefore that the lack of any clear reference to this right casts doubt on whether the Saudi framework intends to empower shareholders to the same extent as in the UK and Delaware, or whether that right was excluded intentionally. The effectiveness of the Saudi framework could be adversely affected by this uncertainty, as this is likely to discourage shareholder activism, a force that is typically a critical pillar of any effective corporate governance framework.

Based on this chapter's analysis of the three jurisdictions' approaches towards the allocation of powers between boards and shareholders, the chapter established that the corporate governance system in each jurisdiction is largely consistent with the overarching concept upon which it is based. In Saudi Arabia and the UK, the rules are generally designed to further emphasise their shareholder-friendly legal frameworks by enabling shareholders to take greater role in the monitoring and disciplinary tasks. This is in contrast to the Delaware's position which, consistent with its director primacy approach, empowers boards over shareholders and limits the involvement of the latter in the decision-making. Furthermore, the ownership structure of the Saudi market, particularly the dominant presence of large shareholders and the vulnerability of minority shareholders, was argued by the research to be in play in several corporate governance issues which affect the regulatory approaches.

Lastly, the chapter concludes that the effectiveness of appointment and decision rights in tackling agency costs and balancing the decision-making powers is highly dependent on the accessibility to information and availability of meeting and voting rights that facilitate shareholders' special meetings and actions generally. As shown in the three jurisdictions, appointment rights are weakened by the regulatory restrictions in place relating either to the special meeting mechanism, as in Delaware, or the written consent mechanism, as in Saudi Arabia and the UK. Boards exploit these restrictive rules, as demonstrated in Delaware, to frustrate shareholders' efforts to intervene in the decision-making process, thus complicating (and sometimes blocking) shareholders' attempts to take part in monitoring and disciplinary tasks.

CHAPTER 6: CONCLUSION

6.1 Summary and Conclusion

The objective and the main question of this thesis revolved around evaluating the appropriateness of the new Saudi corporate governance framework in comparison with the frameworks of the UK and the US State of Delaware, along with the extent to which the Saudi framework is aligned with the best international corporate governance practices. To answer this question, the research engaged in a doctrinal comparative legal analysis of the framework's most prominent aspects, with the support of the relevant available empirical studies. As the objective was to evaluate the entire framework rather than a single aspect of it, the scope of this thesis has been comprehensive in covering the Saudi framework from three key angles, namely: 1) the design and approach of the framework, where issues concerning its regulatory mode, flexibility, and enforcement were discussed; 2) the structure and operations of boards of directors, covering issues related to the board's composition, independence, and directors' duties; and 3) the role and representation of shareholders, covering issues related to the allocation of powers between board and shareholders in addition to shareholders' appointment, meeting and voting, and decision rights.

The discussion of this thesis was built largely around agency theory and director/shareholder primacy theories, regarded among the most influential theories that have driven corporate governance practices as they stand today. The research discussed the above issues and evaluated the respective frameworks' approaches towards them from two perspectives, one being the regulatory mode of the given framework (i.e., mandatory or voluntary) and the second being the substance of the rules.

Having provided an overview of Saudi Arabia in **Chapter 2** explaining the country's historic, economic, political, and legal context, the research concluded that the economic position of Saudi Arabia, which has been ranked as the 19th largest economies in the world, along with the large size of its exchange indicate a critical need for its corporate governance framework to be as robust, advanced, and optimal as possible. A case for the constant review of its legal framework was built and shown to be all the stronger in the light of the country's ambitious 2030 Vision which, along with the CMA's strategic plans, aims at widening the market's investment base and attracting more foreign investment. This is particularly the case following the admission of the Saudi exchange into international indices, which means that the corporate governance framework is under greater scrutiny from international investors, especially strategic ones. For both local and international investors, the availability of a sound corporate governance framework is critical in order to continually invest, as it instils and maintains confidence and trust in the integrity of a given market. In addition, the research concludes that the context within which the Saudi framework operates is different in many respects to its counterparts in the UK and Delaware. Chief among those differences is its Sharia-based legal system, the inapplicability of judicial precedents, its market's concentrated ownership structure, and the weak roles of the market for corporate control and the financial media, all of which were the basis for the discussion that followed in **Chapters 3, 4, and 5**. The research concluded that such differences should always be considered when assessing a given corporate governance solution, as they all affect the extent of the agency problem in a given jurisdiction and the effectiveness of its corporate governance mechanisms. The indication here is that the corporate governance rules in the UK and Delaware would not always necessarily be suitable for the Saudi capital market. Nevertheless, the research also established that the generality of Sharia principles in respect of business aspects and the procedural nature of corporate governance rules indicate that in principle, reforming the Saudi framework based on the legal models of the UK and Delaware is possible when the undertaking is carefully approached.

Turning again to the thesis's main question concerning the appropriateness of the Saudi framework, particularly in respect to the regulatory mode and the substance of the rules, the research makes the following points.

On the regulatory mode of the Saudi framework, the research explored the historic, economic, political, and legal context within which the Saudi framework operates, established the cultural and market-specific considerations of the Saudi capital market, presented, and challenged the main considerations around voluntary and mandatory approaches and the enforcement thereof. Having done so, it established the position of each jurisdiction towards the rules surrounding the board's structure and the board's operations (i.e., the duality of the CEO and chairman positions, the presence and representation of NEDs in the board and its committees, the role of independent directors, as well as the rules on board committees, and directors' duties) along with shareholders' role and representation (i.e., the allocation of powers, appointment rights, meeting and voting rights, and decision rights). Consequently, the research concluded that the Saudi framework is mandatory in nature, as evidenced by its heavy reliance on statutory and binding rules and the explicit recognition of the regulator's powers to monitor and enforce the compliance thereof. In discussing whether the mandatory approach is appropriate for the Saudi capital market or whether a voluntary approach operating on a *Comply or Explain* basis would be preferable instead, the research first established that neither of the two approaches is inherently superior to the other, and that the choice between them has to be made based on what suits the given jurisdiction best, depending on its individual and jurisdiction-specific characteristics. With that in mind, the research concluded that, considering the various theories and assumptions of the voluntary and mandatory approaches, and taking into account the relevant empirical studies as well as the market-specific and cultural considerations in Saudi Arabia, the Saudi mandatory approach is appropriate.

The argument this research developed throughout the thesis, specifically in **Chapters 3, 4, and 5**, and upon which the discussion regarding the regulatory mode was based, is that despite the global popularity of the voluntary approach and notwithstanding the challenges often associated with the mandatory approach, the current conditions and characteristics of the Saudi capital market justify the preservation of the mandatory regime, and that replacing the existing mandatory regime with a voluntary one would be a futile endeavour, as such a shift is likely to do more harm than good. In this regard, the research argued that the success of a voluntary framework is heavily dependent on several prerequisites such as strong shareholder activism, shareholder coordination, the existence of stewardship obligations, and the presence of an active market for corporate control along with an independent investigative financial media. The research exposed the absence of these conditions in the Saudi capital market, and concluded that this absence, along with the concentrated ownership structure, necessitate that the Saudi mandatory regime remains in place.

Furthermore, the research argued that a voluntary approach is likely to struggle in Saudi Arabia given the role of informal relationships, such as tribal or familial associations, that can be sometimes more influential than formal corporate governance arrangements, thus implying that in the absence of a mandatory framework backed by the regulator and public enforcement, the rights of shareholders (especially minority ones) are likely to be abused. Importantly, the research challenged the assumptions of the voluntary approach and the effectiveness thereof even in the UK and Europe where such approach is in a better position to survive concluding that judging from companies' perfunctory compliance and shareholders' attitude towards monitoring and enforcement in those jurisdictions the virtues of voluntary approach should be called into question. The research also concluded that the Saudi legislator should not be discouraged from retaining the mandatory approach because of the argument that companies differ in their circumstances, and that for a given framework to be effective it needs to be flexible enough to accommodate a range of circumstances, something that only the voluntary approach can do. Building on the discussion in **Chapter 3**, the research instead established that flexibility is not as relevant as has been claimed, and that many companies in jurisdictions operating under a voluntary framework do not make use of this flexibility, as evidenced by their perfunctory compliance. The research did not submit to the argument that flexibility can only be offered under a voluntary framework. On the contrary, the mandatory framework was established to be capable of manifesting flexibility in areas where it is reasonably expected that a company's circumstances would indeed benefit from flexibility, by regulating such areas through default rules. The value stemming from such an approach is that shareholders in such cases will be in a better position to enforce default rules as they are supported by the statute, thus benefiting from statutory protection.

On enforcement, having explored the primary considerations surrounding public and private enforcement along with market discipline, the research concluded that the Saudi framework, consistent with its mandatory nature, rightfully invests the CMA with reasonable monitoring and sanctioning powers that are essential for it to discharge its role properly. This position increases the compliance rate, improves shareholders' protection, reduces the burden on shareholders, encourages shareholder activism, and more importantly ensures that governance standards of universal importance are equally applied across companies, thus improving the quality of corporate governance in the Saudi capital market.

Importantly, while the research advocates the preservation of the mandatory mode, it also recommends that the Saudi framework selectively employs a voluntary approach in areas where the framework is unnecessarily extensive. This recommendation is based on the earlier observation made by the research that the Saudi framework, as opposed to those of the UK and Delaware, suffers from regulatory over-extensiveness. This observation was supported throughout the thesis and was found to be particularly present in rules pertaining to the role and responsibilities of NEDs, independent directors, and board committees.

The proposal put forward by the present research is therefore to move those detailed and over-extensive rules that are mostly of a procedural nature into separate guidance notes which are of a voluntary nature, so that the remaining fundamental governance principles and prominent governance obligations are as well-defined and concise as possible. Doing so would make it easier for those targeted by the rules to understand their roles, which in turn should pave the way for meaningful compliance, raise awareness about corporate governance applications, place a lower regulatory burden on companies - thus providing them with a certain level of flexibility-, enable shareholders to assess what constitutes proper compliance, reduce the level of uncertainty that are typically associated with mandatory rules, and reduce the costs associated with monitoring and enforcement by public authorities. On enforcement by public authorities, the research has argued that clarity is needed as to whether the CML 2003’s various enforcement measures (which were intended originally to address violations of securities law) can be used by the CMA in relation to violations of the corporate governance rules which are subject to the CL 2015’s enforcement measures. This additional clarity, or explicit inclusion of such measures in the CL 2015, should enhance the public enforcement undertaken by the CMA by putting at its disposal various sanctioning tools ranging from lighter measures to harsher ones so that the enforcement action taken is proportionate to the violation in question.

As to the substance of the rules, and beginning with the rules surrounding the board’s structure and operations (i.e., board composition, board committees, and directors’ duties) the research concluded that, except for its approach towards the role of NEDs, the representation of independent directors, and directors’ duties, the Saudi approach to other structural aspects (i.e., the duality of CEO and chairman, representation of NEDs, and board committees) is appropriate as it is consistent with the relevant empirical studies and largely in line with the approaches of the UK and Delaware. As was mentioned above, the research identified three significant areas of deficiency in the Saudi framework in the form of 1) its approach towards the role of NEDs; 2) the representation of independent directors; and 3) directors’ duties.

Regarding the role of NEDs, the research concluded that although the Saudi framework requires the majority of the board's seats to be occupied by NEDs, the framework, unlike the UK and Delaware, falls short of any reference to their specific role and responsibilities. This led to the conclusion that the Saudi approach in this area is deficient and that regulatory intervention is needed. Leaving this area unaddressed means that the majority of board members in the Saudi listed companies are not aware of the nature of the particular role they should play on the board. This is important given that NEDs are typically entrusted with certain key roles including the appointment and removal of executive directors, monitoring the performance of executive directors along with top management, challenging the company's management, and holding the management accountable for their decisions. Greater clarity would assist NEDs in exercising their role more effectively and enable shareholders to evaluate their performance against the performance of other directors.

In relation to board independence, the research argued that the Saudi position of requiring the board to have at least two independent directors or that they should make up one third of the board as a minimum and that the board's committees should have at least one independent director as a minimum is inconsistent with the many empirical studies which have reported the positive influence of independent directors on the agency problem and firm value. Furthermore, the discussion showed that such a position is strikingly different from those of the UK and Delaware, where independent directors are required to dominate the board. Accordingly, the research concluded that the Saudi approach towards board independence is notably deficient, and that it undermines the effectiveness of other structural governance arrangements - thus compromising the integrity of the decision-making process- and exposing companies and minority shareholders to a greater risk of corporate exploitation. With that in mind, the research proposed a reform of these rules based on the UK example, advocating for half the board, as a minimum, to be composed of independent directors. This change would align the Saudi position with international practices and, perhaps more importantly, bring it into line with the empirical evidence of the positive role of independent directors in protecting the interests of shareholders as a whole by serving as a check on management, safeguarding the integrity of the company's accounts, resolving conflicts of interest, and reducing agency costs.

As to the Saudi approach towards directors' duties, the research concluded that the Saudi framework suffers from a great deal of uncertainty and deficiency in that, unlike its counterparts in the UK and Delaware, it does not statutorily recognise directors' duties and the applicable standards of review in a clear and systematic manner, leaving many critical aspects subject to speculation. The discussion established that in the absence of clear and certain statutory rules governing this area, recourse to the high-level uncodified *Sharia* principles governing contracts and agency is inevitable in order to fill in the legislative gaps and reduce uncertainty. The level of uncertainty is further affected by the low judicial contribution to this area; thus, judicial guidance cannot be relied upon to fill in the legislative gaps. Therefore, the research concludes that the case for statutorily and explicitly codifying such duties building on the relevant *Sharia* principles is strong. The rationale behind this codification builds on the inadequacy of reliance on the general principles of *Sharia*, as they are not as accessible to those who are unfamiliar with Islamic law, and that the fact that *Sharia* Law is a jurist's law also leaves the door open for various interpretations by courts, leading to inconsistent judicial rulings, increasing the uncertainty in this area. Furthermore, although the research hails the CMA for attempting to step in to fill in the abovementioned legislative gaps through the CGRs 2017, the research criticised this approach given that directors' duties, as critical as they are, should not be part of implementing regulations that are issued by an executive governmental agency, and that they need to be part of the statutory corporate law so that their legitimacy is protected against any possible challenge by the courts. Even if the courts were to provide clarification as to the nature and scope of directors' duties, the need for codification is still pressing given that, unlike the UK and Delaware, judicial precedent does not apply in Saudi Arabia, and the legal system in the country does not recognise judicial precedent as a source of law.

Having presented the research's conclusions on the substance of the rules governing the board's structure and operations, the thesis now shifts to its conclusions regarding the rules on shareholders' role and representation (i.e., the allocation of powers, appointment rights, meeting and voting rights, and decision rights). With regard to the allocation of powers between the board and shareholders, the research ascertained the significant influence of shareholder primacy over the Saudi framework as can be seen in issues related to shareholders' control rights, particularly those concerning appointment, meeting and voting, and decision rights. Nevertheless, the research argued that the Saudi framework manifests some features of director primacy, in the form of recognising the board as an original decision-maker whose authority cannot be withheld by shareholders. The research further distinguished the Saudi approach from that of the UK and Delaware by characterising it as sitting in the middle of those two jurisdictions, as evident by statutorily vesting the decision-making power in the board while at the same time empowering shareholders to participate in the management of the company's affairs to a much larger degree than is allowed in Delaware. The research concluded that retaining the current element of board primacy in the Saudi framework through recognition of the board's original power to manage the company's affairs is appropriate, and in fact is critical so that the board can exercise a mediation role between majority and minority shareholders and reduce principal-principal conflict, given the concentrated ownership nature of the Saudi market. Allowing shareholders to significantly restrict or withhold the board's power to manage the company's affairs would undermine the board's position and negatively affect its independence.

Turning to the Saudi approach to appointment, meeting and voting, and decision rights, the research demonstrated that similarities exist among the three jurisdictions, and concluded that the Saudi approach towards many of those aspects is appropriate, as it is both empirically endorsed and consistent with the positions of the UK and Delaware. However, the research identified a few prominent differences where the Saudi framework deviates from the two jurisdictions, specifically in the use of cumulative voting in directors' appointment, the removal of directors without cause, the written consent, and the proposal right.

Regarding cumulative voting, the research concluded that the Saudi position of mandatorily imposing cumulative voting is justified given that, as endorsed by the empirical evidence, this voting method increases the representation of minority shareholders, ensuring the adequate representation of shareholders as a whole along with reducing the agency cost. Furthermore, the research argued that this voting method should compensate for the modest role of market forces in Saudi Arabia.

In relation to removal of directors, the Saudi approach was shown to be largely similar to that of the UK and Delaware in that it statutorily provides for the removal right to be exercised via a simple majority vote, and with or without cause. However, the research identified some uncertainty in the Saudi framework in relation to the availability of *without cause* removal, which was argued to be especially troubling in the presence of the mandatory cumulative voting requirement which implies that the cumulative voting requirement would be meaningless. To tackle this problem, the research proposed introducing a rule which in effect prevents the removal of any director without cause if the votes against his removal are enough to appoint one director. This proposal would both preserve the value of cumulative voting and protect minority representatives from potential abuse by majority shareholders.

As to shareholders' meeting and voting rights, the research explored the legal positions of the three jurisdictions in this respect and concluded that while they all approach many of these aspects in a similar manner, several prominent differences could be observed, particularly in relation to special meetings and written consent. With regard to the special meeting right, the research began by establishing the significance of this right as a governance tool, before showing that, contrary to Delaware's approach which makes such a right contingent on the company's articles of association, both Saudi Arabia and the UK statutorily grant shareholders holding a certain amount of shares the right to call a shareholders' meeting without this contingency. Subsequently, a detailed critical analysis of Delaware's position was set out, and the tactics used by boards to restrict this right and the harsh reality which shareholders of Delaware's companies have endured for a long time were described. With all that in mind, the research concluded that the Saudi position, which builds on that of the UK, is suitable and is empirically endorsed as it balances the allocation of control rights and encourages shareholders' activism, both of which assist in creating an optimal governance framework.

As to shareholders' right to take action through a written consent, the research showed that this mechanism is explicitly recognised in Delaware but absent in the framework of publicly listed companies in Saudi Arabia and UK. After defining the concept and discussing its main considerations, the discussion dealt with the claims of its opponents, which mainly revolve around the argument that the concept is meaningless in the presence of the special meeting right, that is viewed as a superior alternative. The research challenged this view and shed light on the significant procedural and practical differences that exist between the two mechanisms, thus debunking the argument that the two rights are substitutable, and demonstrating the unique value brought by the written consent mechanism through its relative speed, low cost, and lower regulatory requirements. The research concluded that this mechanism is powerful, and that it provides shareholders with another channel through which they can affect the company's affairs; thus, the Saudi framework would benefit from the availability of such a mechanism. With that in mind, the research proposed introducing the written consent right through a default rule in the CL 2015, or through an enabling rule making the availability of the right contingent on its presence in the company's bylaws. This proposed approach is intended to provide shareholders with another tool with which to influence the company's affairs, and to elevate the position of shareholders, especially minority ones. On the other hand, abstaining from a mandatory approach and gradually introducing this right through an enabling or default rule should assist in paving the way for a healthier dialogue between boards and shareholders so that the expected board resistance can be managed. This is especially true given the presence of the statutory special meeting right, which means that shareholders in the Saudi capital market would still be able to exert influence over the board, and that mandatorily providing the written consent right is not needed.

As to the proposal right, the research attempted to establish its availability in the Saudi framework by investigating the regulatory sources governing corporate governance, and concluded that this right could not be solidly inferred in the absence of explicit and certain recognition. The Saudi position on this right was demonstrated to be inadequate, as it is inconsistent with the best international practices and the available empirical evidence which ascertains the positive role of this right in controlling the agency problem. The research therefore concluded that this is another area of deficiency and uncertainty in the Saudi framework, and that this uncertainty is likely to adversely affect shareholders' activism and undermine the effectiveness of the Saudi framework by confining shareholders' powers to the limited matters that are presented to them for approval by the board on a selective basis. Accordingly, the research recommends that this issue be reviewed by the Saudi legislator to clarify its position and explicitly afford shareholders the proposal right so that they can challenge boards and play a meaningful part in their monitoring and disciplining tasks.

Finally, now that the thesis has covered all the aspects and issues that were intended to be discussed and provided a comprehensive assessment of the Saudi corporate governance framework, the following concluding remarks can be made. The first is that despite the unique features of Saudi Arabia, chiefly its Sharia-based legal system and its concentrated ownership structure, the research has established the possibility of reforming the Saudi corporate governance framework by building on the models of the UK and Delaware. While the research argues that *Sharia* does not in itself preclude such a possibility if proper and careful adaptation is undertaken, it also establishes that Saudi Arabia's market-specific considerations such as ownership structure, distinct cultural characteristics, and internal and external contextual factors can all render this possibility unfeasible. This has been taken into account throughout the discussion presented in the thesis, which has considered the individualistic factors when evaluating each issue in turn. The second is that the concentrated ownership structure of the Saudi market, shareholder primacy, and investors' protection considerations have been shown by the research to affect the regulatory approaches towards the majority of corporate governance issues. The third is that the mandatory mode of the Saudi framework was demonstrated to be needed to compensate for the modest (if not absent) role of market forces and the various internal and external factors that are believed to be crucial to the success and effectiveness of a voluntary framework.

All in all, this research has established that the new Saudi corporate governance framework is in line with the best international practices in many respects, and that many of the framework's different approaches are both appropriate and justified as per market-specific considerations. Nevertheless, it has also highlighted several areas in which the framework suffers significant deficiencies, demonstrating the pressing need for legislative reform in relation to excessive regulations, the role of NEDs, the low level of independent directors' representation, the content and scope of directors' duties, shareholders' proposal right, and availability of light and proportionate public sanctions. The research has proposed specific regulatory solutions for each of these areas which, if adopted, would bring greater clarity and certainty to the framework, reconcile it with the empirical evidence, and increase its alignment with the best international practices, all of which would significantly enhance its effectiveness. The table below summarises the reforms which are proposed based on the analysis presented in this thesis.

6.2 Contribution to Knowledge

This thesis contributes to the existing knowledge in different ways. To the best of the researcher's knowledge, it is the first study which has subjected the new Saudi corporate governance framework to a detailed and comprehensive analysis covering the fundamental governance aspects rather a single one, so that an overall evaluation of the appropriateness of this framework as a whole could be presented. In doing so, the thesis engaged the relevant available empirical evidence, and used two different legal models of corporate governance to fully inform the discussion (the UK and Delaware). The Saudi framework can benefit from the different solutions these two models provide, especially as they differ in their regulatory mode, given that the UK operates a voluntary framework whereas Delaware operates a mandatory one.

Furthermore, through critical analysis and interpretation the thesis established the Saudi position on several fundamental governance areas where the framework's rules are loosely defined or ambiguous. Chief among these areas are directors' duties and the applicable standard of review, the role of NEDs, the removal of directors without cause, and shareholders’ proposal right. Importantly, contrary to the conventional wisdom that the voluntary approach is optimal in the context of corporate governance regulations, the thesis developed the argument that the mandatory approach is most appropriate in Saudi Arabia where the ownership structure is concentrated, the informal relationships are influential, shareholder activism is absent, the market for corporate control is inactive, and the role of the financial media is modest, thus establishing that a mandatory approach is actually needed to compensate for the modest internal monitoring and enforcement mechanism in the Saudi market.

Additionally, the thesis identified areas where the Saudi framework deviates from the UK and Delaware approaches, and defended the Saudi approach in such instances by arguing that the Saudi current characteristics justify the deviation due to the different regulatory and cultural environment within which directors in Saudi listed companies operate. Examples include the mandatory prohibition of combining the position of a CEO with the chairman, and the mandatory obligation to use cumulative voting in directors’ appointment. Moreover, among the thesis’s contributions is that it identified and exposed several fundamental areas of deficiency, chiefly the undefined role of NEDs, the notably low representation of independent directors, and the uncertainty surrounding both the content and scope of directors’ duties, and shareholders’ proposal right. The thesis proposed specific legal reforms that are suitable to the national context to ensure their feasibility and which, if adopted, would enhance the framework’s effectiveness and significantly contribute to the development of appropriate corporate governance rules in Saudi Arabia. Therefore, it can be said that this thesis and its findings represent a valuable reference for Saudi legislators, regulators, and legal practitioners. In particular, it provides a road map for Saudi legislators to follow when assessing the current framework and determining appropriate legislative reforms.

Table 1. List of Proposed Reforms to the Saudi Corporate Governance Framework

Legal Matter	Current Saudi Position	Proposed Reform
Regulations and mandatory enforcement.	Detailed and over-extensive rules and procedures associated with main provisions of the framework, mainly found throughout the CL 2015 and CGRs 2017, most of which are mandatory.	To separate main and fundamental corporate governance provisions from the detailed provisions that are primarily of a procedural nature. The latter to be part of separate guidance notes of a voluntary nature operating on a *Comply or Explain* basis.
Role of NEDs.	The Saudi framework is silent on the specific roles and duties of NEDs, making no reference to this area.	A voluntary article to be added to the CGRs 2017 which defines and emphasises NEDs' roles in appointing and dismissing members of the management team, monitoring their performance, challenging their views and actions, providing advice as needed, providing strategic guidance, and holding them to account, in addition to communicating the concerns and views of third parties such as

		shareholders, employees, and other relevant groups. An alternative path would be to deal with this area via the abovementioned separate guidance notes.
Independence of board members.	Article 16 of the CGRs 2017 provides that independent directors must occupy at least two seats or one-third of the board's seats, whichever is greater.	An amendment to Article 16 of the CGRs 2017 requiring half of the board's members, as a minimum, to be independent.
Independence of chairmen and members of board committees.	The Saudi framework requires that the audit, nomination, and compensation committees have at least one independent director each, and that only the audit committee's chairman must be independent.	Amendments to Articles 54, 60, and 64 of the CGRs 2017 increasing the minimum required number of independent members in the audit, nomination, and compensation committees to two members, and to also require the chairman of the nomination and compensation committees to be independent.
Directors' duty of care.	The Saudi framework does not explicitly recognise the duty of care in the statutory law governing companies; the CL 2015. Rather, it is recognised by way of implication in Article 78 (1)	A new article to be added to Part 5 of the CL 2015 establishing a clear and certain duty of care based on the UK's model with reconciliation.

	of the CL 2015 in a vague and uncertain manner.	
Directors' duty of loyalty.	The Saudi framework does not explicitly recognise the duty of loyalty and its various forms (the duty to act in good faith and the duty to act in the best interests of the company and shareholders). Rather, they are recognised by way of implication. The exception is the duty to avoid conflicts of interest, which is explicitly recognised in the CL 2015.	A new article to be added to Part 5 of the CL 2015 establishing a clear and certain duty of loyalty (including its various forms) based on the UK's model with reconciliation.
Standard of review when the duty of care or loyalty is breached.	The Saudi framework does not explicitly and statutorily recognise the applicable standard of review when either the duty of care or of loyalty is breached. This area is primarily covered by non-codified Sharia principles.	New articles to be added to Part 5 of the CL 2015 establishing a clear and certain standard of review when either the duty of care or of loyalty is breached building on the relevant non-codified Sharia principles and the UK's model with reconciliation.
Shareholders' proposal right.	The Saudi framework is absent of any explicit and certain provision that	Amendments of Articles 96 and 110 of the CL 2015 and Article 14 of the CGRs 2017 to explicitly establish a clear and certain

	recognises shareholders' proposal right.	shareholder proposal right with appropriate controls to prevent shareholders from abusing that right.
Written consent right.	Absence of written consent right.	A new enabling article to be added to Part 5 of the CL 2015 providing shareholders with the written consent mechanism if it is provided in in the company's bylaws, based on Delaware's model with reconciliation.
- The right to remove directors without cause. - Cumulative voting in directors' appointments.	- Implicit recognition of the without cause removal in the CL 2015. - Cumulative voting is mandatorily required in directors' appointments.	- To clarify Article 68 (3) of the CL 2015 to explicitly recognise shareholders' right to remove directors without cause. - An amendment to Article 68 (3) of the CL 2015 to prevent the removal of any director without cause if the votes against his removal are enough to appoint one director.
Public enforcement and associated sanctions.	In accordance with the CL 2015, non-compliers with the Saudi framework may be subject to fines or imprisonment. However, it	A new article to be added to Part 11 of the CL 2015 recognising the CMA power to impose the same sanctions that are provided

	is uncertain whether the CMA can impose other sanctions that are provided in the CML 2003 (i.e., delisting a given company, suspending its listing, preventing wrongdoers from serving as directors, public censure, and reprimand).	in the CML 2003 (i.e., delisting a given company, suspending its listing, preventing wrongdoers from serving as directors, public censure, and reprimand).

Legislations

Saudi Arabian Legislations

Laws

Basic Law of Governance 1992

Capital Market Law 2003

Companies Law 1965

Companies Law 2015

The Implementation Mechanism of the Judiciary Law and the Board of Grievances Law 2007

Regulations

Corporate Governance Regulations 2006

Corporate Governance Regulations 2017

Listing Rules 2017

Mergers and Acquisitions Regulations 2018

Rules on the Offer of Securities and Continuing Obligations 2017

Regulatory Rules and Procedures issued pursuant to the Companies Law relating to Listed Joint Stock Companies 2016

United Kingdom Legislations:

Laws

Companies Act 1985

Companies Act 2006

Financial Services and Markets Act 2000

Regulations and Codes

Admission and Disclosure Standards 2018

Corporate Governance Code 2018

Schedule 3 of the Companies (Model Articles) Regulations 2008

Disclosure Guidance and Transparency Rules Sourcebook

Stewardship Code 2020

Listing Rules

United States Legislations

Laws

Delaware General Corporation Law

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Sarbanes-Oxley Act of 2002

Securities Act of 1933

Securities Exchange Act of 1934

William Act of 1968

Regulations

17 C.F.R. § 240 (2005)

17 CFR § 240 (2018)

New York Stock Exchange Listed Company Manual

Rules of the Court of Chancery of the State of Delaware

Cases

Saudi Arabian Cases

The Board of Grievances, Case No 760/1/Q 1428H, Appeal Division Decision No 609/S/7 (1430H)

The Commercial Court, Case No 3385, Appeal Division Decision No 1702 (1440H)

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Bairstow & Ors v Queens Moat Houses Plc (2001) EWCA Civ 712

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

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Guth v Loft, Inc (1939) 5 2d 503 (Supreme Court)

Moran v Household Intern, Inc (1985) 490 2d 1059 (Del: Court of Chancery)

Smith v Van Gorkom (1985) 488 2d 858 (Del: Supreme Court)

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