

Saudi Arabia Law Outline for a Legal Perspective on an Annual Board "Statement of Significant Audiences and Materiality"

Setting the legal landscape

1. Briefly explain the broader legal landscape regarding the obligations that a company has to its stakeholders or with regard to its impact on stakeholders, and in particular whether its primary duty is or is not to shareholders over all other stakeholders.

Shari'ah

Saudi Arabia is an Arab Islamic state and the Holy *Qur'an* serves as the constitution of the country together with the *Sunnah* (the traditions of the Prophet Muhammad, (PBUH)). Together, these form the Islamic *Shari'ah* which is the foundation of all Saudi Arabian laws.

Shari'ah principles are often expressed in general terms, providing Saudi courts with considerable discretion as to their application. Moreover, there are different schools of Islamic jurisprudence, and they construe certain of the precepts differently. The *Hanbali* school of Islamic jurisprudence is generally followed in Saudi Arabia, and within the *Hanbali* school there are majority and minority views on various issues, any of which may be applied in a particular case. In addition, there have been instances where principles of other schools of Islamic jurisprudence have been applied by Saudi courts where this was considered to be appropriate in the interests of justice and fairness with respect to the particular matter in question.

As a result, a Saudi court has considerable discretion to apply the basic precepts to a particular set of circumstances. Saudi courts generally regard themselves as competent, consistent with general *Shari'ah* principles, to determine each particular case before them as they consider is necessary to achieve an equitable result in all the circumstances of that case.

There is not the same degree of sophistication (or, for that matter, certainty) under Saudi law with regard to many legal concepts and Saudi courts can be expected to apply a combination of discretionary powers and established legal principles. This flexibility, combined with the absence of legal precedent which is binding on the courts, may provide scope for what in some jurisdictions has become known as "judicial activism" to extend the reach of traditional company law obligations to a broader stakeholder group. However, for the present, the recognition of company law obligations to stakeholders who are not shareholders or creditors is not a strong feature of Saudi Arabian jurisprudence.

The Companies Law

Saudi Arabia also has a Companies Law which was issued in 1965¹ (**Companies Law**). With some amendment this remains in force today. The focus of the Companies Law is on the procedural issues relating companies rather than issues of corporate governance. Concepts of honesty and good faith are key elements of *Shari'ah* and underpin many of the legal obligations of companies and directors that are found in the Companies Law. One example is

¹ Royal Decree No M/6 of 1385H. As at 1 December 2015, an official English translation of the New Companies Law had not been published.

[place document reference]

the duty of directors to adhere to core ethical values: "carry out his duties in a responsible manner, in good faith and with due diligence".

A new Companies Law (1437H/2015G) was published by the Ministry of Commerce and Industry on 9 November 2015 (**New Companies Law**). The New Companies Law will come into effect 150 days after its publication in the Saudi Gazette. As at 1 December 2015, publication in the Saudi Gazette had not occurred. The New Companies Law will supersede the 1965 Companies Law.

The scope of the legal duties of companies and their directors appears not to have been extended significantly by the New Companies Law.

Regulatory Framework

2. To what legal tradition does the jurisdiction belong, i.e. civil/common law, mixed?

Civil Law.

3. Are corporate/securities laws regulated federally/nationally, provincially or both?

Nationally.

4. Who are the government corporate/securities regulators and what are their respective powers?

The principal Saudi Arabian companies and securities regulators are:

- Ministry of Commerce and Industry (MOCI) - general oversight role of companies
Saudi Arabian General Investment Authority (SAGIA) - administers the foreign investment law regime
- Saudi Arabian Monetary Authority (SAMA) - oversight role for the financial sector
- Capital Markets Authority (CMA) - oversight role for securities and investment business activities

5. Does the jurisdiction have a stock exchange?

Yes, the Tadawul.

Incorporation and listing

6. Do the concepts of "limited liability" and "separate legal personality" exist?

Companies established with limited liability are the most common form of company. Where a company is established with legal liability a distinction is drawn between the liability of the company and the liability of its shareholders so in that sense the concept of separate legal personality exists.

7. Did incorporation or listing historically, or does it today, require any recognition by the company or its directors of a duty to society, an obligation to take account of the company's social or environmental impacts, or to respect its stakeholders?

There is law or tradition which extends the reach of the duties of a company or its directors to society or which requires them to take account of the company's social or environmental impacts. However, Article 76 of the Companies Law (Article 78 of the New Companies Law)

may provide scope for third parties to argue that such obligations exist or be recognised, at least in the case of directors (see section 9 below).

In the case of publicly listed companies (called joint stock companies²), those companies must adhere to the requirements of Companies Law and the Capital Markets Authority (CMA). The CMA regulates the Saudi Arabian Capital Market by issuing rules and regulations to implement the requirements of the Capital Market Law. This Law aims to create an appropriate investment environment, boost confidence, and reinforce transparency and disclosure standards in all listed companies and protect investors from illegal acts in the market.

The CMA has issued Listing Rules and regulations dealing with market conduct, offers of securities. Amongst other things, these rules and regulations impose continuing disclosure obligations to the investing public in relation to the company's business and regulations related to Corporate Governance (Corporate Governance Regulations).

8. Do any stock exchanges have a responsible investment index and is participation voluntary? (See e.g. FTSE4Good, Dow Jones Sustainability Index, the Johannesburg Stock Exchange's Socially Responsible Investment Index).

Not in Saudi Arabia.

Directors' Duties

9. To whom are directors' duties generally owed?

Directors of limited liability companies and joint stock companies are responsible for damage suffered by the company, its shareholders or third parties due to their mismanagement of the company's affairs or their breach of the Companies Law or the provisions of the company's articles of association. Claims must be brought within three years of the company acquiring knowledge of the wrongful act.³

Additionally:

- a) The company and shareholders are given statutory rights to commence lawsuits against directors for their errors though in the case of shareholders this may not be done in competition with the company and the shareholder must be able to show that the error caused special damage and the right to compensation is restricted to actual damage/loss incurred.⁴
- b) Duties are imposed in relation to joint stock companies under both the Companies Law and the listing rules of the Tadawul.
- c) Sharia principles of accountability (trust, fairness and transparency), are considered to impose additional fiduciary duties on directors of all types of company, for example, to avoid conflicts of interest and to act in the best interests of the company.
- d) There may be scope for duties of the directors to be owed to a much broader group than may be the case in many other jurisdictions because the door appears to be left open for anyone suffering loss caused by the wrongful acts or omissions of a director to make a legal claim against them. However, in practice it would seem to be unusual

² Joint stock companies (which may not be listed companies) are the required corporate vehicle for certain types of regulated business activity.

³ Article 76 of the Companies Law and Article 78 of the New Companies Law

⁴ Article 80 of the New Companies Law

for claims to be made by other than the company's immediate stakeholders (such as shareholders and creditors).

10. What are the duties owed by directors - please state briefly. Please indicate if there are any express or implied duties to avoid damage to the company's reputation.

The Companies Law codifies a number of legal duties in relation to joint stock companies.⁵ The principal ones are:

- A duty to avoid conflict of interests: Article 69 of the Companies Law and Article 18 of the Corporate Governance Regulations.⁶
- A duty not to participate in a competing business: Article 70 of the Companies Law and Article 18 of the Corporate Governance Regulations.⁷
- A duty not to take loan from the company: Article 71 of the Companies and Article 18 of the Corporate Governance Regulations.⁸
- A duty to maintain confidentiality: Article 72 of the Companies Law.⁹
- A duty to adhere to core ethical values: Article 11 of the Corporate Governance Regulations.
- A duty to be accountable: Article 76 of the Companies Law.¹⁰
- A duty to act within his/her powers: Article 73 of the Companies Law and Article 11 (h) of the Corporate Governance Regulations.¹¹
- A duty to submit the company's annual report: Article 9 of the Corporate Governance Regulations.

The overarching reach of Shari'ah also provides scope for duties to arise on ethical grounds.

11. More generally, are directors required or permitted to consider the company's impacts on non-shareholders, including impacts on the individuals and communities affected by the company's operations? Is the answer the same where the impacts occur outside the jurisdiction? Can or must directors consider such impacts by subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?

By extending the scope of directors' potential liability to "third parties" this provides scope for outsiders to file claims against directors if they are injuriously affected by the wrongful acts or mismanagement of the company's directors.

⁵ The legal duties contained in the Companies Law are largely replicated in the New Companies Law

⁶ Article 30 of the New Companies Law

⁷ Article 24 of the New Companies Law

⁸ Article 73 of the New Companies Law

⁹ Article 74 of the New Companies Law

¹⁰ Article 78 of the New Companies Law

¹¹ Article 75 of the New Companies Law

However, there is no specific legal requirement for directors to consider the company's impacts on non-shareholders unless the company is a listed public company in the context of continuing disclosure.

It is at least theoretically possible for liability to arise where there are claims by third parties related to impacts affected by the company's operations. It would seem to follow that it should be permissible for directors to consider those possible impacts when making decisions. In practice it is probable that few if any directors would consider that they have an obligation to do so. However, the overriding duties of the directors are to the company and its shareholders.

12. If directors are required or permitted to consider impacts on non-shareholders to what extent do they have discretion in determining how to balance different factors including such impacts? What additional liabilities, if any, do the board or individual directors assume in exercising such discretion?

Whilst it is not impermissible for directors to consider impacts on non-shareholders, their fundamental duties are owed to the company and its shareholders.

There is the potential for conflicts to arise between the interests of the company and its shareholders and third parties. Except in the area of securities laws, there is no requirement for directors to take account of the impacts on non-shareholders and were they to do so and weigh those interests in their decision making process that could leave them exposed to claims that they have not discharged their overriding duties to the company and its shareholders.

13. What are the legal consequences for failing to fulfil any of the duties described above; and who may take action to initiate them? What defences are available?

A failure to discharge duties imposed by the Companies Law and other Laws applicable to directors' conduct could result in financial penalties and claims for financial compensation.

The directors of a joint stock company are jointly liable to the company and its shareholders for damage caused by the violation of the Companies Law, the company's articles of association or their mistakes in the performance of their work¹².

Directors of an LLC company (the most commonly used limited liability company vehicle) are jointly liable to the company, its shareholders or third parties due to their maladministration of the affairs of the company or their violation of the Companies Law or the company's bylaws.¹³

There may also be the potential for legal claims by affected third parties based on Shari'ah principles relating to the prohibition of acts that are injurious to others.

Can these issues give rise to other causes of action or regulatory routes whereby a stakeholder can exert pressure on a company with regard to its actions?

If the act in question was criminal in nature, the Bureau of Public Prosecutions could commence criminal proceedings. There is the potential for other regulators to become involved depending on the factual background.

14. Are there any other directors' duties which are relevant to the interests of stakeholders?

See above.

¹² Article 168 of the Companies Law and Articles 79 and 80 of the New Companies Law

¹³ Article 76 of the Companies Law and Article 165 of the New Companies Law

15. **For all of the above, if these exist in your jurisdiction, does the law provide guidance about the role of supervisory boards in cases of two tier board structures? What obligations are owed by senior management who are not board directors? Is this determined by law if no specific contractual provision applies?**

Saudi Arabian companies do not have supervisory boards. However, the role of the corporate assembly of shareholders is in some ways comparable to that of a supervisory board. That is because decisions of the corporate assembly may have paramountcy.

The legal obligations of senior management would be found in contracts of employment and those contracts may by implication require the manager to adhere to obligations in company manuals and policies.

Reporting

16. **Are companies required or permitted to disclose the impacts of their operations (including stakeholder impacts) on non-shareholders, as well as any action taken or intended to address those impacts? Is this required as part of financial reporting obligations or pursuant to a separate reporting regime? Please specify for each reporting route whether it is mandatory or voluntary.**

There is no such requirement under Saudi law.

17. **Please describe any mandatory reporting requirement, major voluntary initiative or trend towards voluntary reporting with regard to transparency (for example, payments to government or state-owned entities, reports on government orders to undertake surveillance or interception, reports on tax payments etc.).**

There are none.

18. **Do legal reporting obligations extend to such impacts outside the jurisdiction; to the impacts of subsidiaries, suppliers and other business partners, whether occurring inside or outside the jurisdiction?**

If the reporting obligations consolidate subsidiary companies, the activities of those companies will be reported. However, Saudi law does not impose reporting obligations outside Saudi Arabia or more generally.

19. **Who must verify these reports; who can access reports; and what are the legal or regulatory consequences of failing to report or misrepresentation? Is there a regulator tasked with investigating complaints of misreporting?**

Depending the circumstances, any of the key corporate regulators may investigate complaints of misreporting which fall within their regulatory area.

20. **What is the external assurance regime for reporting on a company's impacts on stakeholders? Please specify any mandatory requirements and also where reporting is voluntary what the current market practice is as regards third party assurance.**

There is none.

Please summarise any regulatory guidance on reporting that relates to impacts on non-shareholder stake-holders.

Stakeholder engagement

21. **Are there any restrictions on circulating shareholder proposals which deal with impacts on non-shareholders, including stakeholder impacts?**

Only as discussed above.

22. **Are institutional investors, including pension funds, required or permitted to consider such impacts in their investment decisions? What is the legal duty that pension funds owe with regard to investment decisions in this regard?**

The powers and duties of such investors and pension funds would be determined by their constituent documents.

- fund How does the legal duty of the fund align with term and contractual performance criteria of managers - does this facilitate or deter consideration of such impacts?**

The duty would have to be taken into account by the fund manager and adhered to in the performance of its duties. This would facilitate consideration of the impact of the legal duty.

23. **Can non-shareholders address companies' annual general meetings?**

Unless permitted by the shareholders, no person may address shareholders meetings other than the directors, shareholders or the company's auditor.

- What is the minimum shareholding required for a shareholder to raise a question at a company's AGM?**

There is no minimum shareholding requirement to raise a question at a shareholders meeting.

Other issues of corporate governance

24. **Are there any other laws, policies, codes or guidelines or standards applied in the context of particular contractual relationships (for example project finance) or through adherence to particular sustainability principles (for example the UN Global Compact, the OECD Guidelines for Multinational Enterprises ("OECD Guidelines") etc.), related to corporate governance that might encourage companies to consider in a structured way their impacts upon and the interests of their wider stakeholders including through a stakeholder engagement process?**

Special requirements may arise in a number of situations.

The CMA has issued Corporate Governance Regulations for companies listed on the Saudi Stock Exchange (joint stock companies). The purpose of these regulations is "to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders."

In the context of stakeholders, Article 10 of the CMA's Corporate Governance Regulations includes the following within the main functions of the board of directors:

- e) "Outlining a written policy that regulates the relationship with stakeholders with a view to protecting their respective rights; in particular the policy must cover the following:
 - 1) Mechanisms for indemnifying the stakeholders in case of contravening their rights under the law and their respective contracts.
 - 2) Mechanisms for settlement of complaints or disputes that might arise between the company and the stakeholders.

- 3) Suitable mechanisms for maintaining good relationship with customers and suppliers and protecting the confidentiality of information related to them.
- 4) A code of conduct for the company's executives and employees compatible with the proper professional and ethical standards and regulate their relationship with the stakeholders. The Board of Directors lays down procedures for supervising this code and ensuring their compliance therewith.
- f) Deciding policies and procedures to ensure the company's compliance with the laws and regulations and the company's obligation to disclose material information to shareholders, creditors and other stakeholders."

The term "stakeholder" is given a broad meaning in the Regulations. It refers to:

"Any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community."

- 25. Are there any laws requiring representation of particular stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?**

No.

- 26. Are there any laws requiring gender, racial/ethnic, religious or other stakeholder constituencies (i.e. employees, representatives of affected communities) on company boards?**

Prescribed types of business activity must be carried out exclusively by companies which are 100% Saudi owned and managed. In other cases, minimum levels of Saudi equity participation in the company may be required.

There may be a requirement for a Saudi company to have a manager with a Saudi nationality.

- 27. In your jurisdiction is there any legal route whereby a parent company can incur liability with regard to the impacts that one of its subsidiaries has had on stakeholder groups? Are there any serious proposals to impose such responsibility?**

If the subsidiary company is a limited liability company, the parent would generally be protected against liabilities of the subsidiary. However, liability could arise if and to the extent of a) the amount unpaid on the capital in the subsidiary subscribed by the parent company and b) any guarantees of the subsidiary's liabilities given by the parent company.

- 28. Are you aware of any incoming law proposals that are relevant to the issues raised in this questionnaire? If so please describe, providing an indication of the anticipated date the legislation will come into force or be adopted.**

Only the New Companies Law, though it seems unlikely that this will affect the responses in this questionnaire.