

Rights of Shareholders under Saudi Company Law 1965

A thesis submitted for the degree of Doctor of Philosophy

By

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December 2013

Abstract

The thesis examines the efficacy of the provisions of Saudi Company Law 1965 in terms of protecting the rights of minority shareholders in joint stock companies (JSCs). The aim is to assess the effectiveness of the current form of SCL 1965 in this regard and to suggest a reform scheme.

This research finds that SCL 1965 does not adequately provide minority shareholders with all the rights that they should enjoy. Accordingly, minority shareholders are often subject to the controlling influence of majority shareholders, who are generally in charge of the company's management. As a result, minority shareholders either do not exercise or do not enjoy certain rights, and they therefore forfeit their natural and intended role under this law, which is to oversee and control the activities of the board of the company, and in so doing to defend their interests. Despite the Saudi government intentions to conduct a range of reforms, particularly in the field of trade, SCL 1965 has not been modified to any significant degree; it is still not sufficiently effective, and does not address many important points relating to shareholders' rights in listed companies. Therefore, there are important decisions that need to be made on the part of the Saudi legislature in terms of improving the investment environment in KSA, including improving the level of protection for investors in JSCs; these decisions will help to attract more investors into the Saudi financial market.

This thesis suggests ways in which to improve the level of protection for minority shareholders in Saudi listed companies against any encroachment on their interests within the company. In this respect, it suggests recasting the provisions relating to minority shareholders, especially SCL 1965.

Dedication

This thesis is dedicated to my father and mother, and to my wife for their unending love and support.

Acknowledgement

All Praise be to Almighty Allah; through whose mercy this this project was completed.

I would like to thank to my second supervisor, Professor Peter Jaffey, who reviewed my research and provided insightful recommendations before submission.

I am also indebted to my sponsor, the Saudi Arabia, for awarding me the scholarship.

Finally, I am grateful to all my brothers, sisters and friends for their help and inspiration.

Abbreviations

ACRSC	Appeal Committee for the Resolution of Securities Conflicts
AGM	Annual General (shareholder) Meeting
BLG	Basic Law of Governance
CA 2006	Company Act 2006 (in UK)
CG	Corporate Governance
CL	Company Law
CMA	Capital Market Authority
CML	Capital Market Law (in Saudi Arabia)
CRSD	Committee for Disputes Settlement of Securities
CSC	Council for the Saudi Chambers of Commerce and Industry
EGM	Extraordinary General (shareholder) Meeting
GAFC	General Administration for Companies
GM	General (shareholder) Meeting
MOCI	Ministry of Commerce and Industry (in Saudi)
SAR	Saudi Arabian Riyal
SCGRs	Saudi Corporate Governance Regulations
SCL 1965	Saudi Company Law No. 1965
Tadawul	Saudi Stock Market

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Chapter 1: Introduction

1.1 Introduction

Commercial companies in general are of great importance to society and to the economy of all countries around the world, as the profits they generate benefit both individuals and governments. Commercial companies can be divided into two main types: personal/private companies and capital/public companies. The most well-known of the latter are joint stock companies (referred to as JSCs), which are often engaged by governments to implement important economic projects; thus, these companies play a significant role in the economic life of the state as well as in social and political life. JSCs are considered an effective tool for collecting funds (sometimes in huge quantities) through selling shares directly to the public; individuals who purchase these shares become partners (albeit unequal) in the company (to the extent of their ownership of the capital). As well as receiving a proportion of the profits generated (dividends), each shareholder is responsible for the company's debt, but only in relation to the number of shares s/he owns. JSCs are treated with care by the states that regulate them (through the issuance of particular legislations) in order to satisfy their common interests, i.e. the interests of both the state and the shareholders (represented by the company), and accordingly, the rights of shareholders enjoy considerable protection.

A JSC is a company with a legal personality represented by natural persons; there are two parties, namely the board of directors, and the general meeting (referred to as GM), which represents the company's shareholders. Each has specific terms of reference according to national law and the constitution of the company, which serve to regulate and organize their duties and achieve the objectives for which the company was established. The board of directors guides the company in achieving its goals, while the GM supervises the performance of the company's board, and ensures the correct functioning of the company as it was planned, as well as monitoring the company's employees and the auditing process. The GM resembles the state parliament and the board of directors the executive power within the state. However, in reality, the board of the company may dominate the management of the company because the GM may be insufficiently equipped to fulfil its duties; the board of directors may then exceed the powers stipulated under company law or in the constitution of the company, and this may result in adverse consequences for the company and its shareholders.

In recent years, KSA has witnessed an increase in the number of JSCs, and the inclination of a large number of Saudis as well as foreign nationals to invest in them. The number of JSCs rose to 150 by the end of 2011,¹ and the total volume of subscriptions during 2011 reached about 3 billion Riyals, compared with 7.6 billion Riyals in 2010.² Most of these JSCs are run by major shareholders; the role of minority shareholders is weak, despite the fact that Saudi legislators have enacted a set of rights for all JSC shareholders. It is worth noting that shareholders do not always fully exercise their rights; this has been attributed to their poor culture of investment, and the fact that many of those rights need to be clarified, highlighted and analysed in order to enable shareholders to exercise their rights in a more effective and practical manner. There may also be certain gaps in the Saudi Company Law (referred to as SCL 1965) or other relevant laws. In any case, this research focuses on the financial and administrative rights of shareholders in JSCs in accordance with SCL 1965.

Accordingly, a significant objective of this research is to enumerate the rights of shareholders in JSCs. Another objective is to highlight any points of weakness in SCL 1965 regarding the issue of shareholders' rights. More importantly, the research objective is to propose recommendations to rectify these defects or disadvantages in the provisions of SCL 1965, in order to keep pace with the current developments in company law worldwide and to provide a basic grounding to ensure equality among shareholders. An additional objective is to promote and augment the investment culture of minority shareholders.

1.2 Reasons of Choosing This Study

The main motive behind the selection of this subject is explained in the light of the following:

- 1- Most of the studies currently available in KSA deal only in general terms with the subject of companies; most of them focus on the various types of companies, their modes of establishment, and the importance of the board of directors. Too little research has been conducted on examining the rights of shareholders in JSCs in particular. Despite the importance of protecting the rights of JSC shareholders, the subject has received insufficient attention, and JSCs have not been discussed in a satisfactory manner by researchers; this in

¹ The Saudi Capital Market. For more information see <www.Tdawal.com> accessed 7 December 2013.

² The Annual Report of the fiscal year 2011 of Saudi Capital Authority. For more information see <www.cma.org.sa> accessed 7 December 2013.

contrast to the case of western countries, including the USA, France, and the UK. Therefore, KSA could benefit from the experiences of developed countries in this matter, thereby avoiding the mistakes that they have made.

- 2- There have been no legal studies on the rights of shareholders in JSCs in KSA within the western literature. As this subject has not been covered, it needs a comprehensive study of the legal terms.
- 3- The government of Saudi Arabia is working to attract foreign companies and international investors, which has led to increasing numbers of JSCs in KSA in recently years; therefore, there is a need for competent research studies that clarify the rights of shareholders in such companies inside the Saudi legal system.
- 4- SCL has not been updated since its establishment in 1965, and there are many legal gaps; these need comprehensive and urgent reconsideration, and this study could assist in addressing any such gaps.

1.3 Research Methodology

This study employs the critical analysis method in assessing the provisions under SCL 1965 (specifically, Part V- Corporations). In order to examine the rights of shareholders in JSCs, other related regulations are also examined, such as the Saudi Corporate Governance Regulations No. 1/212/2006 (referred to as SCGRs), and legal texts and academic literatures relating to the issues under consideration. For the purpose of the research analysis, reference is made to UK Companies Act 2006 and to the regulations of certain other countries in this respect as basis to assess and improve the provisions of SCL 1965 and to suggest possible reforms with regards to shareholders rights and their role in listed companies.

1.4 Choosing the UK for Comparison

The reasons for choosing the United Kingdom in this study are due to several important factors, including the following:

First of all, the UK ranks among the advanced countries in the field of company law, and it has had experience with commercial companies, particularly listed companies, for a long time, which have contributed to the growth and development of the state. Therefore, the UK CA 2006 is an old law, and it represents an important source for many countries, especially, developing countries. It will be useful to take advantage of this UK legislation, as it could greatly assist developing the SCL 1965. The latest UK CA 2006 was issued in 2006 and it is continuously updated³.

The second factor is that the legal forms of companies in the UK and KSA are similar, and they can be categorized into the following types: corporations, cooperatives, partnerships, sole traders and limited liability companies.

The third factor, the UK belongs to the ‘common law’ countries, and has three main sources for forming laws: legislation and case law as well as the laws issued by the European Union⁴. The legal system in the UK is flexible and adapts to developments in the field without any undue complexity or having to pass through complicated procedures comparing to the KSA, which is classified as a developing country, and it is a ‘civil law’ country; it does not use juridical precedents as a source of law. Therefore, the legislation is the primary source of law, which must be ratified by the King; the courts apply those codes and do not derogate from them. For example, under SCL, a judge may not issue a judgment on his own initiative in order to cover any apparent gap in the law. This is why the Saudi system is considered rigid and inflexible; issuing a new law requires a package of prolonged

³ The UK is advanced in the field of research on world trade and business (unlike KSA); we find that there have been many researches and legal studies providing recommendations, in particular in the fields of commercial companies and shareholders’ rights; these have contributed to the development of company law and the strengthening of the position of shareholders. Amongst these are: Shareholders, Remedies: A Consultative Document, 1998; Cadbury Committee, Financial Aspects of Corporate Governance, 1992; Hampel Committee, Final Report on Corporate Governance, 1998; Greenbury Committee, Report on Directors’ Remuneration, 1995; Combined Code, 1998; and Walker’ Review: A Review of Corporate Governance in UK Banks and Other Financial Industry Entities, 2009.

⁴ For example, in the field of legislation for companies, there are three particular directives, which are: The Takeover Directive (Directive 2004/25/EC); The Transparency Directive (Directive 2004/109/EC); and The Directive on the Exercise of Certain Rights of Shareholders in Listed Companies (Directive 2007/36/EC) (Shareholders’ Rights Directive).

measures.⁵ The comparison between these two different judicial systems should greatly enrich this research, enabling the researcher to add a set of new ideas and to offer solutions to the legal problems in the current SCL 1965.

The final factors, the majority of international companies that invest in KSA come from common law countries such as the UK and the USA; thus, in order to make KSA an attractive location for foreign investment, it is necessary to modify SCL 1965 (in line with the developments in company acts worldwide, including, for example, the protection of investing shareholders, whether local or foreign).

1.5 Research questions and aims

This research examines whether and to what extent the current form of Saudi Company Law 1965 is effective in protecting the minority shareholders' rights and their role in listed companies from any oppressive practices on the part of the controlling shareholders. Therefore, the investigation of minority shareholders' issues will include evaluating the Company Law and related regulations in KSA. Additionally, this research examines the main obstacles facing the minority shareholders in Saudi listed companies in order to develop and improve general shareholder practice.

This research aims to shed light on two important aims, which are to:

- 1 Ensure that the shareholders in JSCs enjoy effective rights, and that SCL 1965 provides them with full protection, on an equal footing in terms of rights and treatment.
- 2 Highlight the weaknesses of SCL 1965 regarding the rights of shareholders in JSCs, and provide a range of different solutions to the problems concerning the rights of shareholders, so that there is a business environment characterized by justice and fairness for all shareholders in JSCs.

⁵ For instance, the new SCL was completed in 2007 but it has not yet been adopted because it must pass through a long series of complex legal proceedings. This is one of the reasons why making law in KSA is considered underdeveloped.

1.6 The Chapters

In addressing the issues and questions raised above, this thesis is organized in a number of chapters; each chapter focuses on a particular area, and in doing so a number of further questions are raised.

Chapter 1 has presented an overview of the contents of this study; it contains, as detailed above, the reasons why this topic was chosen, the research methodology, the research questions and aims, and now the thesis structure. In brief, the rights of shareholders are the main concern of this study, assessing the extent to which they are protected in KSA. In order to reach this aim, it is necessary to fully comprehend the situation in KSA with regard to its legal system, the competencies of the state authorities, SCL 1965 and its history and development, plus other related matters. All of these matters are addressed in Chapter 2, and a conclusion is presented at the end.

In order to understand the position and role of shareholders in the JSC, we must more fully comprehend the context; in this regard, Chapter 3 concentrates on two aspects. Firstly, the nature and meaning of the term company are reviewed, which is based on two main theories: contractual and institutional. However, each theory places JSC shareholders in a different position. Accordingly, a number of questions concerning JSCs and their shareholders must be addressed, such as:

- Is the company founded by the state, or is it only a contract between people?
- With respect to shareholders, where do they stand in these two situations?
- Do shareholders actually own the company, or are they only contributors in the capital for the sake of obtaining profits?
- How is power and authority distributed within the company?
- Who are the most significant and influential persons within it?
- Where does any permanent power lie?
- What powers do shareholders have?

In the second part of this chapter, having identified the position of shareholders in JSCs, additional matters relevant to this subject are addressed, which revolve around the meanings of share and shareholder, as well as the various types of shares and their characteristics; how a person becomes a shareholder in a JSC is also addressed, and what happens when they lose membership of the company.

Chapter 4 reviews shareholders' rights, more particularly financial rights, which must be protected by both SCL 1965 and the company's constitution. Therefore, the following questions are addressed in this chapter:

- Among the rights to which a shareholder is entitled, what are the financial ones?
- What obstacles face them in practicing such rights?
- Are shareholders granted those rights by SCL 1965?

The first of these is the right to transfer shares; the second right is known as the pre-emption rights; and the third significant right is the right of shareholders to receive profits at the end of each fiscal year. In addition, shareholders have a right to have the value of their shares reimbursed if or when their company goes into liquidation. All of these rights and other related topics under SCL 1965 are discussed in this chapter.

In Chapter 5, the question of shareholders' rights is discussed, more specifically in relation to shareholders' meetings within the JSCs. When shareholders own shares in a company, they contribute to its capital; this, in turn, affords them a set of rights at the GMs. Examples of such rights include the right to be called to attend the GM, which is considered the foremost right granted to shareholders (and shall be exercised); another is that it is acceptable that a shareholder can appoint a proxy to attend the GM if the former is unable to attend in person. When shareholders attend the GM, they can exercise a number of rights, such as the right to debate issues, vote, and enquire about any area or function of the company. Prior to discussing shareholders' rights in meetings, it is important to clarify a number of points, such as the different types of GM, the resolutions taken at GMs and their validity, the requirements of GMs, reasons why shareholders fail to attend GMs, and suggestions for increasing shareholder participation in GMs.

In Chapter 6, the main questions are:

- What are the remedies and means available under the SCL 1965 to protect the minority shareholders from the board of directors or from the controlling shareholders (who look after their own personal benefits, regardless of the minority's opinion)?
- Are the statutory remedies and means of the Saudi system workable and effective?
- Do they defend the rights of minority shareholders?
- How can minority shareholders enforce their rights inside and outside the company?

- What are the shortcomings within SCL 1965?

This chapter is divided into four main sections: the first concerns company action (which can be initiated by the company or by its shareholders), and covers company action and derivative action; the second section concerns personal suits; the third section concentrates on the statutory remedies available to shareholders that can be used without litigation; and the fourth section covers the penalties under the SCL 1965. The final section discusses the competence of the courts in shareholder litigation.

Chapter 7, the final chapter, is the conclusion of the study and contains recommendations to fill the gaps in SCL 1965, aimed at improving the situation of shareholders in listed companies in Saudi Arabia.

Chapter 2: General Overview of KSA

2.1 Introduction

The previous chapter gave an overview of the contents of this study; it contained the reasons why this topic was chosen, the research methodology, the research questions and aims, and the thesis structure. In brief, the right of shareholders is the main concern of this study, assessing the extent to which they are protected in KSA. In order to reach this aim, it is necessary to fully comprehend the situation in KSA with regard to its legal system, the competencies of the state authorities, Saudi Company Law and its history and development, and other related matters. All of these matters are addressed in this chapter, and a conclusion is presented at the end.

2.2 KSA legal System

Life in the Arabian Peninsula used to be very simple; most of the inhabitants depended on agriculture and animal husbandry. Commercial activities were present but they were very limited, and commensurate with the status of the population. Large parts of the Arabian Peninsula then came under the sway of the Ottoman Empire, and all business activities within the region were subject to the articles of the Justice Magazine.⁶ The Justice Magazine is considered to be the first fully coded body of Islamic civil law because it was based on the official regulation of Islamic jurisprudence; it was formally issued through a decree in 1869. In 1876, the Articles were applied mandatorily in the courts of all Islamic regions controlled by the Ottoman Empire. The Magazine comprised 1,851 Articles, which were divided into 16 chapters; one of these was dedicated to companies, and it included the legal provisions for various civil transactions, such as sales, leases, guarantees, agencies and others, which tightly regulated the disparate doctrinal issues.⁷ Many Arab countries have built their law systems based on the provisions of the Magazine, such as Jordan, Egypt, Iraq, and the Gulf states. As with the other Arab states in the Middle East region, KSA is a developing country. The establishment of this country was based on the principles of Islam. Since it was formally founded in

⁶ Mohammad Albaga, *Codification of the articles of the Justice Magazine*, College of Sharia, Damascus University.2009. P: 746.

⁷ See <http://www.moj.ps/ar/index.php?option=com_content&view=article&id=11&Itemid=19 > accessed 20 January 2013

1932 by King Abdul-Aziz bin Saud (1881-1953), the legal system has been mainly derived from the rules of Islamic law; this is in addition to other legislations made by the relevant state authorities.⁸ Islamic law⁹ depends on a variety of sources¹⁰; the most important one is the Holy Qur'an, which was revealed by Allah (God) to His Prophet Mohammad (Peace be upon Him).¹¹ Islam has a noticeable impact on various aspects of life within the state, and this is confirmed in Article 8 of the Basic Law of Governance (hereafter BLG) in KSA.¹² The influence of Islamic rules and principles is quite clear in areas such as family affairs, divorce and marriage issues and criminal law, whereas certain other fields are not fully covered by these Islamic provisions; these latter pertain to laws dealing with industry, business, commerce and administrative issues.¹³

Riyadh is the capital city of KSA, and the official language of the country is Arabic; KSA follows the lunar calendar. The regime of government is a monarchy; there is no history of democracy.¹⁴ The features of the legal system in KSA seem to be rather vague and complex (due to its structure); however, some of the contradictions are because the structure is a combination of traditional and modern legal theories.¹⁵

It could be said that is not surprising that KSA is a religious state; the birthplace of Islam is the city of Mecca, as it was developed there by the Prophet Muhammad in the 7th Century. The two holiest

⁸ Ana Echagüe & Edward Burke. *Strong Foundations? The Imperative for Reform in Saudi Arabia*. Working Paper. FRIDAY. 2009. p. 9. Available at <<http://www.fride.org/publication/632/strong-foundations?:-the-imperative-for-reform-in-saudi-arabia>> accessed 20 January 2013

⁹ Lewis (2001) explains that the religion of Islam means 'submission', and those who believe in it are called Muslims, and they obey Allah's instructions. In fact, the legal system in KSA is based on Islamic Law which includes five main Pillars, namely the testimony of faith - there is no God but Allah, and Mohammed is His Messenger; doing five prayers a day; giving alms (Zakat); fasting in the month of Ramadan from sunrise to sunset; and performing pilgrimage (Hajj) to Mecca if capable. See: Jan Michiel Otto; *Sharia Incorporated, A Comparative Overview of the Legal Systems of Twelve Muslim Countries in Past and Present*, Sharia and National Law in Saudi Arabia. Amsterdam University Press. 2010. & Mervyn. K. Lewis. *Islam and accounting. Accounting Forum*, Vol. 25. (2001). pp. 104-106.

¹⁰ The main Islamic sources are the Qur'an and the Sunnah (the traditions of the Prophet). The secondary sources are the analogies (Al-Qiyas) and unanimous agreement (Al-ijma). For more details see: John Burton, *The Sources of Islamic Law: Islamic Theories of Abrogation*. Edinburgh: Edinburgh University Press, 1990.

¹¹ The rules, regulations, and provisions mentioned in the Qur'an and the Sunnah - the deeds, utterances and approvals of Prophet Mohammed constitute the Islamic Law.

¹² The Basic Law of Governance issued by Royal Order No. A/90 on 1 March 1992.

¹³ Ayoub M. Al-Jarbou. *Judicial Independence: Case Study of Saudi Arabia. Arab Law Quarterly*. Vol. 19. 2004. pp. 5-54

¹⁴ Sultan Al Qahtani. *The relevance of the international Financial Reporting Standards to Saudi Arabia: Stakeholders Perspective*. Thesis, University of Sterling. Ph.D. Thesis. 2010. p. 84.

¹⁵ Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 140

mosques for Muslims are located in Mecca and in Medina;¹⁶ the first is the point of direction for Muslims at prayer and it is where pilgrimage is performed, and the second is visited to worship the Prophet Muhammad. In this context, Al-Farsy asserted, “In unifying the Arab States into a cohesive nation, it is Islam, which, like a spinning wheel, weaves the various Arab peoples together into one strong fabric. It was the tie of faith rather than anything else that enabled King Abdul-Aziz to found his Kingdom; if Arabs are ever destined to unite again in one nation or in a federation of nations it will be through their religion.”¹⁷

KSA is the modern state, and it has been affected in its development (like others) by the civil laws applied in the region; most of the surrounding countries have been affected directly or indirectly by civil law even if they are based on religious grounds. Since the establishment of KSA, there has been a dual legal system, as in other Muslim countries; its legal system can be divided into Islamic law and modern laws but they function in combination.¹⁸ However, it can be argued Islamic law is the dominant legal system in KSA, although it is affected by the civil laws of France and Egypt; one can find a great many articles derived from those foreign legal systems. Egypt in particular played a significant role in establishing the laws of the Saudi state; this is due to its experience in the region, and if we examine SCL 1965, one could conclude that it is a near-copy of the Egyptian Companies Act, and one must acknowledge that French Company Law played a major role in the formulation of those provisions.¹⁹

It could be argued that this history explains why the laws and regulations of KSA are so rigid and inflexible, and why there are problems within them; this is unlike the case of countries that follow the common law system, which is more flexible, and we find this fact in the comparative legal studies conducted between the legal systems of different countries. For example, in the area of the subject of this research (the rights of shareholders and investors), in the countries that follow the common law,

¹⁶ In this context, Menoret mentioned, “Islam is inseparable from Saudi consciousness and national pride, not only because Arabia houses the holy places of Mecca and Medina, but also because it was the centre of the first indigenous Arab-Muslim resistance to foreign domination. Even for the youngest Saudis, therefore, Islam is the key to their self-perception and their affirmation of national sentiments”.

See: Pascal Ménoret. *The Saudi Enigma: A History*. London: Zed Books, 2005. p. 100

¹⁷ Fouad Al-Farsy, *Modernity and Tradition: The Saudi Equation*. Kegan Paul International, London. 2009. p. 21.

¹⁸ Frank E. Vogel. *Islamic Law and Legal System: Studies of Saudi Arabia*. Brill Academic Publishers. Boston. 2000. p. 322

¹⁹ Maren Hanson. *The Influence of French Law on the Legal Development of Saudi Arabia*. *Arab Law Quarterly*. Vol. 2, No. 3.1987, Pg.:291 Statutory Derivative Action in Australia: An Empirical Review of

the protection of shareholders and investors is stronger and more durable when compared with countries that follow the civil law system. This fact was clarified in the study carried out by La Porta and others, which describes the differences between the civil law system and the common law system. La Porta et al. said at the end of their study, “In this paper, we have examined law governing investor protection, the quality of enforcement of these laws, and ownership concentration in 49 countries around the world. The analysis suggests three broad conclusions. First ... countries whose legal rules originate in the common law tradition tend to protect investors considerably more than the countries whose law originate in the civil law, and especially the French civil law tradition... Second, law enforcement is strong in common law countries as well, whereas it is the weakest in the French civil law countries.”²⁰

Having said that, the civil pattern played a significant role in formulating SCL 1965, the effects of which are still present; therefore, there should be no hindrance to reconsidering the provisions of SCL 1965, particularly those that are related to the protection of shareholders and investors. Indeed, it is necessary to assess the civil model in order to identify solutions to the problems and shortcomings inherent within the current KSA legislative law, and to take advantage of the laws of those developed countries that follow the common law system, such as in the United Kingdom,²¹ which has experience in developing legal provisions to cope with the current era.

It should be noted that KSA is undergoing a wave of legal reforms in various areas, particularly with regard to the fields of economics and commerce,²² which started before its accession to the World Trade Organization (WTO).²³ Each member of the Organization makes commitments to develop its laws in order to make them more flexible and to comply with the laws of the other Member States. Thus, the world has become a small village, in which the transfer of funds between countries is eased, global markets are freed of restrictions, transnational companies are encouraged to grow, and the

²⁰ La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., *Law and Finance*, Journal of Political Economy, Vol: 106, 1998. pp. 40.

²¹ Sources of legislations

²² Royal Order 7/b/12661 on 18 May 2003

²³ Saudi Arabia became the 149th member of the WTO on 11 December 2005, after 12 years of negotiation (initiated 13 June 1993). See <www.wto.org/english/thewto_e/acc_e/a1_arabie_saoudite_e.htm> accessed 22 January 2012

movement of goods and services between countries is facilitated.²⁴ All of this means that KSA has no option but to develop, adjust and change its laws; otherwise, KSA will rotate in a vicious circle of legal incompatibilities that will negatively affect its plans for the future.

2.3 Basic Law of Governance (KSA Constitution)

It is often argued that KSA does not have constitutional law as it is commonly understood on the grounds that the main source for its legislation is Islamic Law, which is derived from the Qur'an, and which must be interpreted only by scholar in Islam.²⁵ However, it can be argued that the Basic Law of Governance (referred as to the BLG) serves a constitutional function. The BLG determines the main principles of the state and sets out the relationships among the various regional authorities; thus, it functions as constitutional law. It is generally agreed by commentators that the BLG should be more specific and is in need of some clarification. The BLG includes, like many constitutions, certain matters that are liable to interpretation, where rights are not clearly stated or reserved, and with no guarantee that they will be respected.²⁶

The BLG was issued in 1992; it is the first written constitution in the history of the Kingdom. The BLG consists of 83 Articles divided into nine chapters: General Principles, Monarchy, Features of the Saudi Family, Economy, Rights and Duties, Authorities of the State, Financial Affairs and General Provisions. The BLG is based on the premise of justice, consultation and equality in accordance with the Islamic Shari'ah.²⁷ The enormous impact of Islamic Law is explicitly obvious throughout the BLG within Saudi legal system, and it is ranked second only to Shari'ah in regard of legislative importance; these are followed by The Consultative Council Law and The Regional Law.²⁸

²⁴ Palepu, Krishna, Khanna, Tarun and Kogan, Joseph, *Globalization and Similarities in Corporate Governance: A Cross-Country Analysis*. Harvard NOM Working Paper No. 02-31; Strategy Unit Working Paper No. 02-041; Harvard Business School Working Paper No. 02-041. 2002. p. 4-5

²⁵ Article 1 of the Basic Law of Governance states, "The Kingdom of Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam and its constitution shall be the Book of God and the Sunnah (Traditions) of His Messenger, may God's blessings and peace be upon him".

²⁶ F. Gregory Gause. *Oil Monarchies: Domestic and Security Challenges in the Arab Gulf States*. USA. The Council on Foreign Relations. 1993. p. 108.

²⁷ Article 8 of the Basic Law of Governance

²⁸ Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 151

The first Article in the BLG underscores that the basis for all aspects of life in the state is Islam, which is the source of legislation (in particular, the Qur'an and the Sunnah). These two scriptures are also considered the constitution of the state; "The Kingdom of Saudi Arabia is a fully sovereign Arab Islamic State. Its religion shall be Islam and its constitution shall be the Book of God and the Sunnah (Traditions) of His Messenger."²⁹ The Islamic religion, clearly, plays an essential role in all aspects of life in the Saudi state, and this is indicated in Article 7 of the BLG, which states that the Holy Quran and the Prophet's Sunnah (Traditions) together underwrite the laws of the Kingdom.

2.4 Authorities of the State

As is the case in most countries, the authorities of the state are divided into three sections, namely the legislative, the executive, and the judiciary. The state constitution defines the mandate of each. However, it can be said that in KSA there is a fourth authority beside these three, which is the role of the King; the BLG defines them all, and determines their jurisdiction as well as any associations between them.³⁰

It can be noticed that even though those authorities are separated, there is a close correlation among them, and this is particularly so between the executive and legislative authorities. The executive authority often assumes that one of its tasks is legislation; nevertheless, there is still a strong correlation between them, acting as if they are one authority.³¹ In fact, it is quite difficult to distinguish between the three authorities in Saudi government, i.e. between the executive, the legislative and judicial authorities.³²

2.4.1 Executive authority

The King, the Council of Ministers, local governments and ministry subsidiaries, in addition to other public, independent and quasi-independent agencies, constitute the executive body in KSA.³³ The Council of Ministers is the highest executive authority in the state, and therefore it is considered the

²⁹ Art. 1 of the Basic Law of Governance

³⁰ Article 44 of the Basic Law of Governance

³¹ Ayoub M. Al-Jarbou. Judicial Independence: Case Study of Saudi Arabia. *Arab Law Quarterly*. Vol 19. 2004. p.18

³² Ana Echagüe & Edward Burke. *Strong Foundations? The Imperative for Reform in Saudi Arabia*. Working Paper. FRIDAY. 2009. Pg.:9

³³ Ibp USA. *Saudi Arabia Company Laws and Regulations Handbook* Ibp.com, International Business Publications, USA. Update in 2012. P: 44

dominant authority over all executive powers.³⁴ In addition to his executive authority, the King also has legislative power. He is the head of the executive authority, and has absolute power over it; all state authorities report to him, and he is the reference point for all the authorities within the state.³⁵

The King holds certain particular responsibilities, such as guiding the policies of the country and supervising the performance of the ministries and governmental organizations, in addition to leading the Council of Ministers; he also provides guidance to various state agencies, and enhances the consistency, continuity and unity of the Council of Ministers.³⁶

In relation to the Council of Ministers, it has the power to determine domestic, foreign, financial, economic, educational and defence policies as well as all the public affairs of the state, and it supervises their implementation; it holds the executive branch, and it is the reference point for the financial and administrative affairs in other ministries and governmental bodies.³⁷ Among the main tasks for the Council of Ministers, as a direct executive authority are:³⁸ to control executive and administrative affairs, to follow up the implementation of laws, measures and decisions; to establish the necessary bodies and organizations required for public welfare, to supervise the implementation of development plans and projects in the country, and to establish bodies to revise the conducts of ministries and other governmental departments.

2.4.2 Legislative Authority

The legislative authority in KSA can be defined through the term Regulatory Authority;³⁹ the legislative authority is divided between more than one party: the King, the Council of Ministers and the Shura Council, i.e. the consultative council or parliament.⁴⁰ However, the role of the latter has recently become advisory,⁴¹ even though the core duty of the Shura Council is to enact laws and

³⁴ Ibrahim Al-Harbi. *Democracy in Islamic and international law: A case study of Saudi Arabia*. PhD Thesis. School of Law, Brunel University. 2010. Pg.:194

³⁵ Article 45 of the Basic Law of Governance.

³⁶ Article 29 of the Law of the Council Of Ministers issued by the Royal Order No. A/13 on 20 August 1993.

³⁷ Article 19 of the Law of the Council Of Ministers

³⁸ Article 24 of the Law of the Council Of Ministers

³⁹ Allah alone is the legislator in Islamic Shari'ah, and the word 'regulation' is used in the Kingdom as equivalent to the secular law ('legislation').

⁴⁰ Article 19 of the Law of the Council of Ministers and Article 67 of the Basic Law of Governance

⁴¹ Article 18 of the Law of the Shura Council issued by Royal Order No. A/91 on 1 March 1992

regulations, like any other parliament in other countries.⁴² Actually, this is stipulated under Article 67 of the BLG: “The regulatory authority shall have the jurisdiction of formulating laws and rules conducive to the realization of the well-being or warding off harm to State affairs in accordance with the principles of the Islamic Shari'ah. It shall exercise its jurisdiction in accordance with this Law, and the Laws of the Council of Ministers and the Shura Council”.

In fact, the foundation of KSA legislation is based on the principles of Islamic Shari'ah law, and no legislation may oppose it. In general, the rules of Shari'ah regulate all aspects of life, such as trade, economy, crime, punishment and social areas. According to Shari'ah law, the King is considered the father of the state; he is the top of the pyramid, and all three authorities defer to him.⁴³ Therefore, the powers of the king are wide and unrestricted, including the enactment, amendment or repealing of laws, by Royal Order; in general, no legislation is enforceable unless it has been approved by the King.⁴⁴ Therefore, the King is free to accept or reject any law proposed by the two legislative bodies.⁴⁵ The king is only required to abide by Islamic Shari'ah; other than this, there are no limitations to the authority of the King provided in the BLG.⁴⁶

The Council of Ministers is entitled (besides its executive authority) to exercise legislative powers.⁴⁷ The other legislative branch is the Shura Council; it has the power to issue laws and regulations, to assess and revise them and then to take further decisions on them.⁴⁸ This Shura Council was established in 1992 on the basis of a royal decree, and its members are nominated by the King; he also has the power to expel members and to prorogue the Council.⁴⁹

Certain factors need to be taken into account when the legislative authority seeks to enact new legislation; the legislature must be mindful of the fact that the Holy Quran and Sunnah are the main components of the KSA constitution, and that any legislation must not compromise or contradict them.

⁴² The Shura Council consists of 12 committees that deal with various issues, such as foreign affairs, health and social affairs, education, finance, culture, administration, economy and industry.

⁴³ Article 44 of the Basic Law of Governance

⁴⁴ Article 26 of the Law of the Council of Ministers

⁴⁵ Abdullah F. Ansary. *A Brief Overview of the Saudi Arabian Legal System*. Globalex. 2008. Available at <www.nyulawglobal.org/globalex/saudi_arabia.htm#_ednref46> accessed 30 May 2012.

⁴⁶ Ayoub M. Al-Jarbou. Judicial Independence: Case Study of Saudi Arabia. *Arab Law Quarterly*. Vol 19. 2004. p. 19.

⁴⁷ Articles 20 and 21 of the Law of the Council of Ministers

⁴⁸ Articles 15 and 18 of the Law of the Shura Council

⁴⁹ Article 12 of the Law of the Council of Ministers

These two scriptures constitute the foundation of the country, and are the supreme sources of knowledge and law. Thus, any the new legislation shall not contradict the provisions of the fundamental laws of the country. Also, the legislative authority has the responsibility of establishing new legislations for the sake of developing the country and protecting its public welfare in a manner that is compatible with Islamic Law.⁵⁰

To summarize the above, the legislative powers in this country are correlated in a manner that seems unduly complex, being under the purview of bodies: the Council of Ministers, the King, the Supreme Judicial Council and the Shura Council (all of which take part in designing and enacting legislations).⁵¹ The final enactment of any new legislation in KSA takes various forms, the most common of which are: 1) Royal Orders, 2) Royal Decrees, and 3) subsidiary resolutions,⁵² which are discussed below.

2.4.2.1 Royal Orders

This is a formal written document reflecting the direct and individual will of the King, and it is often issued according to a specific formula; it bears the signature of the King alone. Here, we should be cognisant of the fact that a Royal Order is an expression of the will of the King as a monarch and not as the head of the Council of Ministers; this because the Chairman of the Council of Ministers is not necessarily the King. Thus, the King's will is direct and individual, i.e. not restricted by referring to any legislative authority, be it the Council of Ministers or any other official department of state.⁵³

The legal basis of a Royal Order is the King's power of discretion as supreme head of the three authorities,⁵⁴ and there is no specific timeframe involved in the issuance of Royal Orders, as with the other enactment formulae. The Royal Order, with all these characteristics, is considered the most powerful organizational tool in KSA, and it is valid as soon as it is announced; it cannot be overturned by any means. Thus, in the judgments considered by the Board of Grievances (Diwan AlMadhalim),

⁵⁰ Abdullah F. Ansary. *A Brief Overview of the Saudi Arabian Legal System*. Globalex. 2008. Available at <www.nyulawglobal.org/globalex/saudi_arabia.htm#_ednref46> accessed 30 May 2012.

⁵¹ Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 159

⁵² Latham & Watkins. *Doing Business in Saudi Arabia*. 2010. p. 2. Available at <www.lw.com> accessed 7 February 2010.

⁵³ The Basic Law of Governance Article 44 states, "the authorities of the state consist of the following: the judicial authority; the executive authority; the regulatory authority. These authorities cooperate with each other in the performance of their duties, in accordance with this and other laws. The King shall be the point of reference for all these authorities".

⁵⁴ Articles 55 and 56 of the Basic Law of Governance

Royal Orders are considered as being of sovereign competence, i.e. not within its purview, based on the fact that the King has absolute power.⁵⁵

2.4.2.2 Royal Decrees

A Royal Decree is an official document that reflects the will of the King in terms of approving a matter raised before him, i.e. it is an expression of royal approval. The matter in question would have been previously presented to the Council of Ministers and the Shura Council, and one or both of them would have taken a decision on it that then requires the approval of the King before it can be applied and officially enforced. Most Royal Decrees are to approve the draft of some new system or law, or to approve international agreements.⁵⁶ In fact, the Royal Decree has its origins in the Council of Ministers, and its importance arises from the fact that it second only to a Royal Order in legislation. Thus, a Royal Decree requires the King's approval in order for the proposed legislation to become official and effective, and then to be published in the Official Gazette.⁵⁷

This characteristic distinguishes the Royal Order from the Royal Decree, as the former does not need the involvement of the Council of Ministers because, as stated above, the King is the head of the three authorities and has the power to issue any legislation without referring to the legislative authority. The Royal Decree is nevertheless important because it draws its strength from the Council of Ministers and the Shura Council, which are the authorities responsible for the legislation and regulation of all areas pertaining to government: financial, commercial, social, judicial and others.⁵⁸ Finally, all ministers, when seeking to issue legislations related to their ministries, must refer to the Council of Ministers for approval, and then their proposals are forwarded to the King for approval through Royal Decree.⁵⁹

2.4.2.3 Subsidiary Legislations (Regulations)

These are defined as regulations that the executive authority enacts, often empowering the competent minister to issue a set of rules to assist in the implementation of some Royal Decrees governing the interests of the state; the Council of Ministers and any other appointed ministers or government

⁵⁵ The Board of Grievances, Case No. 149/T/1 in 1992. Often, Royal Orders are issued for the sake of enacting new laws and regulations that are necessary for the benefit of the state or its people. Examples of legislations issued by Royal Order are the issuance of the BLG in 1992, the Allegiance system in 2006, and the establishment of an anti-corruption body in 2011; Royal Orders are also used for the appointment of ministers, ambassadors, etc.

⁵⁶ Article 20 of the Law of the Council of Ministers

⁵⁷ Article 23 of the Law of the Council of Ministers

⁵⁸ Article 19 of the Law of The Council of Ministers

⁵⁹ Article 22 of the Law of The Council of Ministers

agencies have the power to enact such rules and regulations, in order to facilitate the implementation of Royal Orders and Decrees. Examples of subsidiary legislations are: all executive regulations, lists, codes, ministerial rules and procedures, and ministerial decrees and decisions, in addition to memoranda, explanatory notes, ministerial documents and decisions.

Subsidiary regulations are second only Royal Decrees and do not need to be ratified by the King or approved by the Council of Ministers; this is in contrast with Royal Orders and Decrees, which are subject to the power of the King. However, sub-regulations can be issued by all executive, judicial or legislative authorities as long as they are given the jurisdiction to do so.

As the goal of subsidiary regulations is to assist the various ministries and governmental bodies in implementing Royal Decrees and Orders, they are easier to issue and more flexible; they may be amended as and when necessary. This is unlike the established laws, which need convoluted processes in their issuance or if they need to be amended; subsidiary regulations are more responsive to change, whether economic or otherwise, as they can be issued and modified easily.⁶⁰

2.4.3 Judicial Authority

The Judicial Authority is the third element in the Authorities of the State;⁶¹ Article 46 of the BLG states that the Judiciary Authority is independent, and that judges are not subject to any authority except Shari'ah. The right of litigation before the courts is equally guaranteed to all citizens and residents.⁶² In 2007, the judicial system was updated to replace the one issued in 1975;⁶³ it is the latest judicial system in the Kingdom, and nearly two billion dollars was allocated for this reform process.

⁶⁰ Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 159

⁶¹ Article 44 of the Basic Law of Governance states, "Authorities in the State shall consist of Judicial Authority, Executive Authority, and Regulatory Authority. These authorities shall cooperate in the discharge of their functions in accordance with this Law and other laws. The King shall be their final authority."

⁶² Article 47 of the Basic Law of Governance

⁶³ Issued by Royal Order No. M/18 dated on 26 March 2007. The new system provides that courts should be as follows: 1- Supreme Court, 2- Appeal Courts, and 3- Courts of First Instance, which include the general courts, summary courts, criminal courts, personal status courts, commercial courts and labour courts. In general, the Supreme Judicial Council may establish other specialized courts in accordance with the King's approval. See: Article 9 of the Law of the Judiciary, issued by Royal Decree No. M /78, on 1 October 2007.

The new system includes the appellate Courts of Cassation, and the establishment of Courts of Appeal in all regions of KSA, according to a currently planned timeframe, so that these courts shall consider the particular provisions that can be appealed. The new system also allows for the creation of specialized courts, namely, labour courts (transferring the jurisdiction of committees for labour disputes for the purposes of settlement),

The Judicial system is divided to two main forms, Shari'a Courts⁶⁴ and Administrative Courts (Board of Grievances⁶⁵). Besides these forms, there is another type known as Quasi-Judicial Committees, of which there are more than 75.⁶⁶ These are administrative tribunals exercising and performing judicial duties for the consideration of certain disputes according to certain procedures;⁶⁷ however, they are committees affiliated to governmental executive departments, such as the Saudi Monetary Agency, CMA, MOCI and others. All these committees are composed of technocrats as well as administrative and legal teams from outside the judicial system.

It has been argued that some tribunals combine the task of the prosecution, trial and execution at the same time, which detracts from the principle of the independence of such committees. For example, the Committee for the Resolution of Securities Disputes (referred to as the CRSD) is considered as a body independent of the CMA, but in reality its members are appointed by the CMA. Therefore, it is assumed that their appointment is through the Law of the Judiciary (to ensure their independence from any interventions from other government bodies⁶⁸); however, in this case, the Committee members are like employees who are subject to the CMA's authority.

Some committees can hand down strong penalties, such as imprisonment. This was evident in the verdict against the chairman of the board of Bishah Agriculture Co. who was found guilty of insider trading and to be in breach of his duties.⁶⁹ Some corporate specialists argue that the CRSD should not

commercial courts (now dedicated to considering trade disputes), and personal status courts (formerly courts of security and marriage, taking over all decisions relating to personal status).

The most prominent features of the new system is the change of name from Supreme Judicial Council to Supreme Council of Judgment, and the change in its competence; it now considers the functional affairs of judges, and look into the affairs of the courts to determine their jurisdiction in terms of place and type.

⁶⁴ Shari'a Courts consist of the Supreme Judicial Council, the Courts of Appeal and First-Instance Courts (General Courts, Summary Courts).

⁶⁵ The Board of Grievances was established in 1955 by Royal Order No. M/51. It is considered as an administrative judiciary system. Also, the Board has authority over commercial dispute cases resulting from SCL 1965; however, applications that result from outside the CL fall under the jurisdiction of the Committee for the Resolution of Securities Disputes (subject to the Saudi Capital Market Authority).

⁶⁶ Yousef Al-hadeethi. *Quasi-judicial Committees in Saudi Arabia*. Centre for Judicial Studies. 2009. Available at < <http://www.cojss.com/search.php?s=415> > accessed 8 February 2012.

⁶⁷ Mansour S. Alknezan. *Quasi-judicial committees, problems and solutions*. Riyadh Newspaper, Vol 15869 on 05 Jun 2011. available at < <http://www.alriyadh.com/2011/06/08/article639561.html> > accessed 8 February 2012.

⁶⁸ According to the Article 1, "Judges are independent and, in the administration of justice, they shall be subject to no authority other than the provisions of Shari'ah and laws in force. No one may interfere with the Judiciary".

⁶⁹ See <http://www.cma.org.sa/Ar/News/Pages/CMA_N528.aspx> accessed 9 February 2012.

pass such sanctions, on the grounds that sanctions such as prison are criminal penalties that may only be imposed by the Bureau of Investigation and Public Prosecution; they argue that this is the only competent authority for such sentencing, and that such matters should not be decided by quasi-legal committees.

Within a government agency, there may be more than one committee; each committee is designed to consider specific issues, and they should not interfere with the competence of the courts mentioned above; their particular powers are always determined by the decision for establishing them.⁷⁰ Actually, the establishment of committees is based on one of the main four tools, which are: Royal Orders, Royal Decrees, decisions of the Council of Ministers, or ministerial decisions.⁷¹

However, it is noteworthy that the reforms made to the judicial system have not delivered concrete improvements on the ground; the judicial system is still suffering from a lack of cadres and the complex nature of appointment, and there is no prestige in this body because of poor achievement rates and long periods of time needed for litigation. It could be said that the main reasons for this latter are: the huge number of suits before the general courts and the administrative courts, and the current shortage in the number of judges in contrast with the large number of suits; for example, the number of judges in KSA is approximately 1,250 (according to recent statistics), and they preside over approximately 800,000 suits per year, with an increase of upward to 12% per year.⁷² As a result, there is only one judge for every 32,000 citizens, whereas in the countries neighbouring KSA, there is a judge for every 3,000 residents; the ideal is to have a judge for every 2,000 residents.⁷³

These problems were recently confirmed in a statistical report delivered by the Saudi Ministry of Justice, which revealed that the average workload for judges in Saudi courts was 94 cases per month for each judge. According to the President of the Board of Grievances, a large number of suits need highly qualified judicial staff, and therefore, it is necessary to reconsider how judges and their staff are trained and appointed.⁷⁴ This is an urgent matter, as should the current situation not be reconsidered, it will

⁷⁰ Creating such committees emanate from the need of the government to fill the gaps in the judicial system.

⁷¹ Ibid. These committees or tribunals shall not be decided upon by anything less than a ministerial decision.

⁷² See <<http://www.moj.gov.sa/ar-sa/Pages/Default.aspx>> accessed 10 February 2012.

⁷³ Menif alKhudair. *Judges in the Boards of Charities*. Rafha News on 20 November 2010. Available at <<http://www.rafha-news.com/articles-action-show-id-384.htm>> accessed 10 February 2012.

⁷⁴ He mentioned this in an interview with Al Jazeera Newspaper. Vol. 13348 on Saturday 20 November 2010.

have negative consequences for litigants, whether individuals or companies, and this will lead to reluctance on the part of foreign companies to invest in the country, merely because there are problems in the judicial system; it will also affect KSA's reputation and credibility amongst nations.

On the other hand, in KSA the system of judicial precedent is not used as a source of legislation, and many of the judgments handed down are not published in the public domain. It may be that a judge is minded to hand down a verdict based on discretion but that it would be contrary to his colleagues in considering a similar case; however, he may not do so as he does not have the power to set new law.⁷⁵

The importance of precedent lies in its ability to create new legal texts, and this strengthens the confidence of both litigants and investors in the local judicial system, which in turn helps to attract foreign investment. Precedent enriches jurisprudence and facilitates the tasks of lawyers, as lawyers depend on the orientations of any likely judgment to establish grounds for their client's defence. The system of precedent assists in filling the gaps in legislation or in addressing the inability of regulatory frameworks to keep pace with developments in various fields. Also, it benefits researchers (as well as judges), who can then become acquainted with the varying published decisions and assess how they correlate with unified principles; this can assist judges and legal advisers in deciding how they should proceed in similar subsequent cases.⁷⁶

2.5 Company Law of 1965

The Kingdom was unified in 1932; the discovery of oil was an important factor in changing the pattern of life in the state and its populace, which led to an increase in business investment and a wide variety of economic projects. The government founded a package of laws and regulations, of which a key one

⁷⁵ Actually, judges are entitled to issue rulings according to their own interpretation of Islamic Shari'ah, where most of them follow the Hanbali School of jurisprudence. For more details see: Ana Echagüe & Edward Burke 'Strong Foundations'? *The Imperative for Reform in Saudi Arabia*. Working Paper. FRIDAY. 2009. p. 9. available at <<http://www.fride.org/publication/632/'strong-foundations'?:-the-imperative-for-reform-in-saudi-arabia>> accessed 11 February 2012.

⁷⁶ However, it should be noted that many legal specialists demand the codification of Shari'ah provisions in order to prevent judges from exceeding their power of discretion, to allow lawyers and litigants to expect a reasonable judgment in advance, and to facilitate quick decisions on the suits before judges. Thus, they see the codification of Islamic law as contributing to the development and modernization of the judiciary. Cited from: Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 166

was Company Law.⁷⁷ This law was enacted for the first time by Royal Decree in 1965, and represents the first legislation that regulated business transactions and all commercial operations in KSA; it was modified in 1982, and then again in 1998.⁷⁸

However, there are very few legal articles within this law and they do not cover all corporate affairs in general, or JSCs in particular; the number of legal articles that cover the provisions of JSCs is less than 100, and, unfortunately, the number of articles relating to the rights of shareholders does not exceed 15. When reading this law, it is clear that there are gaps in the legislation, and this is in need of urgent attention.⁷⁹

It could be said that the reasons behind this lies in the fact that SCL 1965 was formed to a great extent according to the Egyptian Companies Act, which was derived from the French Companies Act and the Articles of the Justice Magazine; therefore, many of the provisions within Saudi law were formed according to the French/Egyptian model. The other element that also contributed to the formulation of Saudi law was Islamic law (Islamic jurisprudence), which identified the general principles of law in KSA.⁸⁰ As a result, SCL 1965 has been affected by various laws from different environments; French, Ottoman, Egyptian and Islamic law as well as the local environment and its traditions, all of which contributed directly or indirectly in the drafting and construction of the provisions of the current law.

SCL 1965 have been modified more than once, but the fundamental weaknesses have not been addressed; and over time, local businessmen and foreign investors have expressed discontent towards the current law. Although sharp criticisms have been levelled at this law, a long period of time has now passed without any significant modifications, and it no longer keeps pace with modern

⁷⁷ Jan Michiel Otto. *Sharia Incorporated, A Comparative Overview of the Legal Systems of Twelve Muslim Countries in Past and Present, Sharia and National Law in Saudi Arabia*. Amsterdam University Press. 2010. p. 146

⁷⁸ SCL 1965 consists mainly of eight types of business entities, which are: general partnerships, limited partnerships, partnerships limited by shares, Limited Liability Companies, variable capital companies, Joint Stock Companies (corporations), cooperatives and joint ventures. Also, it became a legal reference for those companies. It consists of 15 chapters and 233 Articles, wherein the largest share of provisions is for listed companies. The limited liability company is the most common form of company in KSA, and is also suitable for equity participation by foreign investors. For more details see: Latham & Watkins. *Doing Business in Saudi Arabia*. 2010. Available at <www.lw.com> accessed 10 February 2012. Also see the Saudi Company Law, 1965. Articles 48 to 148

⁷⁹ The situation in the UK is different; the CA 2006 is comprehensive and covers many issues that have been included in the SCL965.

⁸⁰ R Lewis & C Mallat. *Commercial Law in the Middle East*. Centre of Islamic & Middle Eastern Law, Available at <<http://www.soas.ac.uk/cimel/materials/commercial-intro.html>> Accessed 12 October 2012

developments in commercial activities, notably the trend of the Saudi government to move towards privatization and attracting foreign investment as well as joining the WTO, which requires developing national laws to be more compatible with international trade. The Saudi government, in 2007, prepared the final draft of the new law, which will replace the old law, but unfortunately, so far it has not been ratified by the Council of Ministers, which means that it has been in the process of being approved for more than five years.

As noted above, there have been several attempts at amending SCL 1965 but they all faced obstacles; the most notable ones are bureaucratic delays and centralized decision-making. It is surprising that no substantial modifications or additions have been introduced to the current law so far; this is certainly the demand of a great many specialists and concerned professionals because the law as it currently stands is not fully fit for purpose, being largely out of date and containing too few articles. As for those who argue that the SCGRs, issued in 2006, covers some of these flaws, this argument is criticized because most of the articles within the SCGRs are taken from SCL 1965; on the other hand, the SCGRs was only ever designed to be a guide and is not binding (more on this below). Generally speaking, KSA is considered a developing country, with little experience in the world of business and trade; therefore, it needs the expertise of other countries, especially developed countries such as the UK. UK laws represent is a good model to follow, and should be used to contribute to the development of the laws of KSA, making them more modern and flexible.

2.5.1.1 Shareholders' Rights under SCL 1965

Shareholders in listed companies under the Saudi system enjoy a particular set of rights. The source of most of these rights is SCL 1965, and the others are distributed among CML (and its implementing regulations such as the Listing Rules) and the CGRS; all of these rights are directly related to the proportion of each individual's ownership of the company's capital. The share holder is accordingly entitled to certain rights, the important of which are: the right to receive a proportionate share of any profits as they are distributed, the right to take his share of the assets in the case of liquidation, the right to attend the company's General Meetings, to debate and express opinions, and to vote on any GM decisions, the right to supervise and follow up the activities of the board of directors, the right to obtain information about the company without compromising its interests, and the right to dispose of

shares and leave the company.⁸¹

In general, the existence of the shareholders' rights detailed in SCL 1965 does not mean that there is effective protection of those rights, and the existence of those rights does not mean that they are exercised by the shareholders in an effective manner; therefore, the effectiveness of shareholders' rights in the company cannot be assured without taking into account several associated factors. The factors that are particularly significant in this regard are the structure of the ownership of the company (this seriously affects the level of protection for shareholders' rights), the legal system (as mentioned above), cultural and religious traditions, and the political atmosphere; these are in addition to the general difficulties associated with commercial and industrial activity.⁸²

Thus, one significant factor is the ownership structure; this plays a crucial role in shaping the protection of shareholders' rights; the more the ownership is concentrated in the hands of a few individuals, the more the minority shareholders become vulnerable.⁸³ In addition, the civil litigation system in KSA has consequences for the level of protection for shareholders' rights. This has been confirmed in various legal studies but perhaps the most prominent and well known is that conducted by La Porta and his colleagues. They argued that the system of common law countries provides more protection for JSC shareholders and creditors against any manipulation by the company board or large shareholders.⁸⁴

Those countries that follow the French civil law system are those where corporate managers have greater freedom to act without fear of intervention from the minority shareholders in the company's management.⁸⁵ This is actually what we find in the Saudi system, where the majority shareholders in

⁸¹ Saudi Company Law, 1965. Article 108. See also Article 3 of the CGRs. Also, Listing Rules. Article 39 states, "an issuer with listed shares must ensure equality of treatment for all holders of shares of the same class in respect of all rights attaching to such shares".

⁸² Jill Solomon & Aris Solomo. *Corporate Governance and Accountability*. John Wiley & Sons Ltd. 2004. Pp: 17.

⁸³ Nabil Baydoun, Neal Ryan & Roger Willett. *Corporate governance in five Arabian Gulf countries*. *Managerial Auditing Journal* 28.1. 2013. pp: 8

⁸⁴ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny. *Law and Finance*, *Journal of Political Economy*. No. w5661. 1998. pp: 86.

⁸⁵ However, the pre-emption rights are not sufficient to protect shareholders in regard to issuing low-price shares and dilution of their shareholdings; this is in common law jurisdictions, whereas the countries that follow the French method have better pre-emption rights. Cited from: Mahmoud Al-Madani. *Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward?*. PhD Thesis. University of Leeds. 2011. pp: 59.

the company have a strong presence in the management, and can impose their agendas without regard for the minority shareholders. Most of the listed companies in KSA were originally family companies that became JSCs, and they are still managed by the owners, who are generally the majority shareholders.⁸⁶

It could be said that the reason for the Anglo-Saxon countries following the common rather than the civil law system is because of the existence of explicit laws governing the rights of minority shareholders, monitoring their application, and not allowing contravention; this was explained by Lazarides.⁸⁷ In regard of the protection of shareholders' rights, the states following the Anglo-Saxon system have more ownership protection than those of the Continental Europe system. This kind of protection usually stems from the legal system and judicial structure, which together maintain effective control of capital market. However, there is a kind of balance between responsibilities and rights in this environment.⁸⁸

2.5.1.2 The Importance of Protecting the Rights of Shareholders in JSCs

There are two key factors in the protection of the shareholders' rights in JSCs; the most important of these is the principles of justice and fairness. In general, the position of minority shareholders in a company is inferior to that of the controlling shareholders (due to the latter's possession of huge numbers of shares in the company's capital); thus, the minority shareholders are in a weak position relative to the other players in the company.⁸⁹

This is evident in SCL 1965, which accords those who owns greater numbers of shares more control over the company; the generally accepted principle is that the dominant shareholders should have the right to participate to a greater extent in the administration of company affairs than minority parties; however, it is unacceptable for them to ignore the legitimate rights and interests of minority shareholders. Justice and fairness require that minority shareholders be treated fairly, and that no

⁸⁶ Nabil Baydoun, Neal Ryan & Roger Willett. Corporate governance in five Arabian Gulf countries. *Managerial Auditing Journal* 28.1. 2013. p. 7

⁸⁷ T, Lazarides. *Minority Shareholder Choices and Rights in the New Market Environment*. p. 4. 2009, Available at: <<http://ssrn.com/abstract=143267>> Accessed 24 February 2010.

⁸⁸ Ibid.

⁸⁹ Andrew Hicks & Andrew Hicks. *Cases and Materials on Company Law*. 6th Edition. Oxford. Oxford University Press. 2008. p. 425

particular class of shareholder should be able to influence events at the expense of another.⁹⁰ This does not mean that there shall be full equality among shareholders; rather, respect shall be maintained for the weaker shareholders' equity, and their rights shall not be violated by any stronger party in the company.

Thus, the minority shareholders' rights should not be neglected even if the majority shareholders own most of the shares in the company,⁹¹ and this shall not lead to their domination over the company's decisions, in particular those that do not support the interests, benefits and rights of the minority shareholders and the company in general.

Therefore, the majority shareholders, when exercising their right in managing the company and participating in decision-making shall seek the achievement of the general interests of the company and not their own interests; the company is a mere business venture that aims to achieve financial returns for shareholders. It is only just and fair that majority shareholders take into account the interests of other shareholders in the company even if their proportion is small; it is not true that the value of the interests of the majority is superior to the value of the interests of the minority.

However, concerning this point, the Global Corporate Governance Principles of the ICGN (the International Corporate Governance Network), which were revised in 2009, advocates, "Boards should treat all the company's shareholders equitably and should respect and not prejudice the rights of all investors. Boards should do their utmost to enable shareholders to exercise their rights...and should not impose unnecessary hurdles."⁹² Unfortunately, this does indeed happen in most developing countries; the position of minority shareholders is weak in listed companies in KSA, while the position of majority shareholders in the company is relatively strong, and they tend to have the upper hand in management decision-making and can direct it as they think best suited to their own interests first (the interests of the company in general are often neglected). This is why it is important to draw the attention to the fact that although the majority shareholders have the right to a stronger position than

⁹⁰ Naveen Kumar & J. P. Singh. *Corporate Governance in India: Case for Safeguarding Minority Shareholders Rights*. *International Journal of Management & Business Studies*. Vol. 2, Issue 2, April - June 2012. p. 8

⁹¹ Finweek. *Shareholders' Rights*. 2005. pp. 4-5. Available at: <www.search.proquest.com.vezproxy.brunel.ac.uk:2048/docview/215674722?accountid=14494> Accessed 24 February 2010.

⁹² ICGN. *Global corporate governance principles: Revised*. London. International Corporate Governance Network. 2009. p. 9. Available at <www.icgn.org> Accessed 25 January 2012.

the minority shareholders (because they own more shares), they do not have the right to prejudicially abuse this position; the strong must be restricted by certain constraints to protect everyone, and this must be subject to the provisions given in the relevant laws.

On the other hand, and of no less importance, justice and equity must be maintained through protection as well as constriction; minority shareholders must be afforded a series of provisions that protect them when exposed to any attack on their rights or interests, and this protection must exist even if there are not violations of those rights or interests. What matters is that those legal provisions should protect the minority shareholders against the dominant shareholders with regard to the fate of the company and its shareholders generally. The powers granted to the majority shareholders in a JSC should not be used in a way that is harmful to the minority and their interests in the company, i.e. power cannot be provided to the majority shareholders without corresponding accountability.⁹³

The second key factor is the economic one; the greater the protection that is accorded minority shareholders in JSCs, the greater the attraction to participate and invest in these companies. The shareholder, regardless of being a national or a foreigner, looks for security for his money, and endeavours to make sure that it will be invested wisely by people who have no narrow interests, but are only seeking to achieve the company's goals. In this manner, it is entirely normal for the investor to wish to safeguard his interests and to exercise his rights. No matter how long the term of the investment, the truth of the company will be revealed to all, and it will be clear if it was managed to achieve the interests of the company and its shareholders as a whole, or was just to achieve the interests of a particular class; this will be reflected in the company's public reputation.

Adequate protection of shareholders' rights is the key reason for investors being attracted to invest their money in a company; this is in addition to reasonable and appropriate restrictions on their obligations.⁹⁴ It is true that minority shareholders have non-controlling shares in the capital, but they are considered an important source of finance for listed companies; consequently, their opinion within the company must be respected, and they should be suitably protected against any possible abuse or injustice. Fundamentally, although majority shareholders may have a bigger say over company affairs (because they own more shares), it does not logically follow that shareholders' rights increase or

⁹³ L Sealy & S Worthington. *Cases and Materials in Company Law*. 8th Ed. Oxford: Oxford University Press, 2010, p. 596

⁹⁴ *Ibid*, p. 458.

decrease according to the percentage of shares in the company's capital. The existence of such protection for minority shareholders will contribute to the company's growth through providing more liquidity; this will ensure that the company will not need to borrow from creditors such as banks, which often entail financially onerous obligations.

From the economic perspective, it is believed that protecting minority shareholders delivers various benefits, in particular for the growth of a country's GDP.⁹⁵ For instance, the volume of savings, through being strengthened, could increase; in addition, these savings could be directed into appropriate fields of investment, leading to further increases in capital; moreover, investment regulations could be adjusted to benefit the business environment, and, as a result, capital would more easily flow toward productive areas. For the above reasons, this kind of protection would appear to be a prerequisite to economic growth.

Many studies have indicated that the greater the level of protection for shareholders, the greater the attraction to invest, which in turn improves the business environment, increases financial and economic stability, and raises the level of transparency and credibility in the business environment for those investors; this suggests that there is a strong relationship between the effectiveness of the protection of shareholders' rights and the development of a country's economy. For example, the UK is a developed country with a strong reputation for investment and business, wherein protecting minority shareholders is effective and durable against any prejudicial moves by company directors (whether shareholders or managers), and where strong rules and standards for liability are applied. This is unlike the case with Continental European countries and Middle East countries, including KSA, where manipulation and the promotion of special interests are evident.⁹⁶

2.6 The Impact of Corporate Governance on Minority Shareholder Protection

Shareholders' rights are protected through many sources: the law, the judicial system, regulatory control measures, or adopting the company codes of Corporate Governance (referred to as CG),

⁹⁵ R, La Porta & others. *Investor protection and corporate governance*, *Journal of Financial Economics*. 2000, 58(1-2), p. 137

⁹⁶ Enriques Luca. *The Law on Company Directors' Self-Dealing: A Comparative Analysis*. *International & Comparative Corporate Law Journal*, Vol. 2, p. 297, 2000. p. 303.

including the CG principles and internal control systems.⁹⁷ Furthermore, CG principles offer a range of measures for improving the practices of within the business environment, making them more transparent, accountable and responsible; CG may be considered as one of the most important sources for improving shareholder protection.⁹⁸ Not only does CG address the protection of minority shareholders, it also offers a great deal of advice for anyone who has a relationship with a listed company. It can be argued that CG contributes to raising the level of shareholder control over the company through a combination of internal and external mechanisms, as well as protecting the beneficiaries of a company, and creating an environment free from corruption (thereby attracting additional capital).⁹⁹

The CG principles among countries are not identical;¹⁰⁰ this is due to differences in the economic, political and other aspects of each state. It is the same when attempting to define CG; it is not possible to give one definition because of varying perspectives of those who have tried to do so. In fact, it could be defined in relation to economics or to law, and these will deliver different definitions. Thus, the definitions of CG differ according to subject-matter (business, economics, investment, etc.), in addition to where it is practiced (in regard to the level of a country's development). It also depends on the type of trade policy followed, the practitioner, and the researcher or theorist.

Nevertheless, in general, CG can be referred to as “the system by which companies are directed and controlled”.¹⁰¹ This definition appeared for the first time in the Cadbury Committee (1992); however, it is too broad and does not give specifically explain all the aspects of CG. Recently, Plessis described CG more accurately, thus: “It is the process of regulating and overseeing corporate conduct and of balancing the interests of all internal stakeholders and other parties who can be affected by the corporation's conduct in order to ensure responsible behavior by the corporation and to achieve the maximum level of efficiency and profitability for the corporation.”¹⁰²

⁹⁷ Lazarides, Themistokles G., *Minority Shareholder Choices and Rights in the New Market Environment*. July 10, 2009. Available at: <<http://ssrn.com/abstract=1432672>>accessed 15 February January 2012.

⁹⁸ Nabil Baydoun, Neal Ryan & Roger Willett. *Corporate governance in five Arabian Gulf countries*. *Managerial Auditing Journal* 28.1. 2013. p. 6

⁹⁹ Gregory, Holly J., & Marsha E. Simms. *Corporate governance: what it is and why it matters*. The International Conference of Anti-Corruption. Durban, South Africa. 1999. p. 1

¹⁰⁰ Organisation for Economic Co-operation and Development (OECD). 2004. p.13

¹⁰¹ The UK Cadbury Report (1992)

¹⁰² J, Du Plessis, *Corporate law and corporate governance lessons from the past: ebbs and flows: but far from “the end of history...”*: Part 1, *Company Lawyer*. 30(2), 2009. p. 44.

As mentioned above, there are many definitions for CG but for the purposes of this study, a suitable would be: “Corporate governance is the framework of laws, rules, and procedures that regulate the interactions and relationships between the providers of capital (owners), the governing body (the board or boards in the two-tier system), senior managers and other parties that take part to varying degrees in the decision making process and are impacted by the company's dispositions and business activities. Corporate governance defines their respective roles and responsibilities and their influence in steering the course of the company.”¹⁰³

This definition indicates that CG is an integrated network that addresses the rights and interests of all parties, including shareholders (whether majority or minority), through the various relevant laws. These laws include binding legal rules designed to protect the owners of those interests, including, for example, protecting the weaker party in the company from the stronger party. It is worth mentioning that these laws are to be taken seriously with regard to company governance and finance (along with the proper oversight of the relevant legal bodies) if the company is to thrive.¹⁰⁴

Theoretically, the concept of CG is related to various other fields, such as economics, management, finance and sociology. Hence, the CG system can be explained in relation to these fields;¹⁰⁵ however, most researchers working on the concept of CG contend with two main theories: the theory of agency, which is related to finance and economics, and stakeholder theory, which is related to the social perspective of CG.¹⁰⁶

Given the increasing attention being paid to CG, many institutions are keen to study and analyse it, and

¹⁰³ Miguel A. Mendez. *Corporate governance; a US / EU comparison*, available at <www.forumpartnerships.zsi.at/attach/miguelmendezfinal.pdf> Accessed 26 January 2012

¹⁰⁴ R, La Porta & others, *Investor protection and corporate governance*, *Journal of Financial Economics*. 2000, 58(1-2), p. 5. The most common definition of corporate governance used is the one by the OECD: ‘Corporate governance involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interest of the company and its shareholders and should facilitate effective monitoring’. Cited from OECD Principles of Corporate Governance 2004, p. 11. Also available at <www.oecd.org/dataoecd/32/18/31557724.pdf> accessed 26 January 2012.

¹⁰⁵ Some major theories have sought to interpret the concept of corporate governance, the earliest of which was the agent-principal relationship. A variety of approaches appeared to expand that theory to others, such as to stakeholder theory, stewardship theory, transaction cost theory, and finally resource dependency theory.

¹⁰⁶ Christine M. *Corporate Governance and Accountability*. New York, Oxford University Press. 2004. p. 16.

to develop specific criteria to apply through it. Some of these institutions are: the Organisation for Economic Co-operation and Development (OECD), the Bank for International Settlements represented in the Basel Committee, and the International Finance Corporation (IFC).¹⁰⁷

Perhaps, the most important CG principles are those issued by the OECD in 1999, which is charged with assisting all Member States as well as non-members in the development of legal and institutional frameworks for the application of CG (both public and private companies, whether listed in the capital markets or not), through providing a number of guidelines to strengthen CG practices, the efficiency of capital markets, and the stability of the economy as a whole. Those principles have been divided into five major groups, as in the following:

- 1) The Rights of Shareholders; this includes the right to transfer ownership of shares, vote in the GM, select the board of directors, and receive profits; these are in addition to the right to participate freely and effectively in the GMs.
- 2) The Equitable Treatment of Shareholders; this means equality between shareholders within each category, as well as their right to vote in the GM on all important decisions in the company, and working to protect them from any dubious acquisition or merger, in addition to their right to access all transactions of board members or executive managers.
- 3) The Role of Shareholders; which means respecting their legal rights, compensation for any violation of those rights, enhancing their role in the control of the company and accessing any information required. Stakeholders denote bondholders, banks, customers and others who are linked to the company through their interests.
- 4) Disclosure and Transparency; this entails disclosing any important company information (including to the auditor), detailing the ownership of the majority of the shares, and listing the interests of the members of the Board of Directors and managers. This all provided that exposing such information shall be done in a fair manner between shareholders and stakeholders, and without any undue delay.

¹⁰⁷ Mohammad H. Youseif. *Governance Guidance & Objectives with reference to Application in Egypt*. Dar Al Marifah. 2007. p. 7

5) The Responsibility of the Board; this includes the structure and legal duties of the Board of Directors, how to select its members, its core functions, and its role in overseeing the executive management of the company.

The question that arises here is: what is the status of CG in KSA? Has it contributed to raising the level of protection of minority shareholders in JSCs against the more dominant parties in the company? KSA was the second state in the Gulf Cooperation Council (GCC),¹⁰⁸ after Oman,¹⁰⁹ to adopt CG for its public companies. The Saudi Corporate Governance Regulations (referred to as SCGRs) have been historically voluntary since their issuance in 2006. It was during that year that the Saudi Stock Market (referred to as Tadawul) crashed, and the general index fell nearly by 25%.¹¹⁰ The CMA insisted on issuing new rules to prevent further crises; it announced a first draft code of the SCGRs with many applications, all of which were optional until the beginning of 2009, becoming compulsory in 2010 for listed companies in terms of implementation. However, the listed companies are now only required to demonstrate adherence to the SCGRs on a ‘comply or explain’ basis.¹¹¹

It could be said that the objective of the SCGRs is to provide a general guideline of best practice for listed companies and their shareholders; this was meant to increase the level of protection for all shareholders, especially the minority ones. Furthermore, in 2009, Saudi listed companies were required to establish audit committees comprising at least three non-executive directors (one of whom had to come from a financial background).¹¹² The audit committee was to be responsible for, amongst other things, establishing robust internal controls, dealing with external auditors, and devising appropriate accounting policies.

The SCGRs cover five main areas, which are: the introduction and definition of CG, the rights of shareholders and the GM, disclosure and transparency, the board of directors, and closing provisions.

¹⁰⁸ Gulf Cooperation Council (GCC) is: KSA, Qatar, Oman, Bahrain, UAE and Kuwait.

¹⁰⁹ Issued by Circular No. 11/2002 Dated 3 June 2002, as Amended by Circular No. 1/2003. Available at <www.soharpower.com/Uploadimage/ccg%20eng.pdf> accessed 28 January 2012.

¹¹⁰ See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009 p. 8. Available at <www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf> accessed 26 January 2012.

¹¹¹ See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009 p. 8

¹¹² See <<http://cma.org.sa/ar/Pages/home.aspx>> accessed 28 January 2012.

A great deal of criticism has been directed at this list within the SCGRs, and some of the shortcomings shall now be reviewed in brief.

Most of SCGRs are just recommendations, except for those stated as being mandatory, i.e. they are optional in application and there is no penalty for non-compliance. This is somewhat negative because it opens the way for many companies to evade following the provisions. The SCGRs are completely free of any definition of what is meant by the term CG, although it is the term that needs the most clarification, due to its novelty on the one hand, and the need for each person to be aware of its gravity and to know what it entails on the other; many shareholders do not know the full meaning of the concept of CG.¹¹³

The SCGRs also overlook any consideration of the employment of modern technology (Internet and video conference) in holding GMs. As a result, it has deprived many shareholders from voting on GM decisions online or through any other modern means of communication. Undoubtedly, this gap has had negative consequences for many shareholders, as it is not reasonable to ask a shareholder who owns a limited number of shares to travel from one city to another in order to vote on GM resolutions in person when modern means of communication should suffice, i.e. he should be able to vote on GM matters wherever he is, in a secure manner and without incurring travel, accommodation and other expenses. In addition, the lack of employment of modern technology in GM meetings is inconsistent with the need for speed and credibility, on which business is based.

Despite the above, the SCGRs deal well with the issue of disclosure and transparency, which is arguably the most important aspect in the context of CG, but they overlook stating any sanctions for violating the rules of disclosure and transparency.

A further issue is that many of the provisions within the SCGRs are actually listed as obligatory and

¹¹³ Although the SRCG has been in force since 2006, and although some of its articles have become mandatory, the regulation does not provide a clear definition of corporate governance. Therefore, there is some confusion over the concept, even among those who work in the business and commercial environment. The term corporate governance in Arab countries is not clearly understood and most executives refer to it only in general terms. It is believed that should the CMA establish such a definition, the evident ambiguity surrounding its meaning would be reduced; indeed, it is not acceptable for any regulation to refer to terms that are not clearly defined, particularly those that form the main core of the regulation. See : Kaled AIKhatib & Essam AIGaret. *Governance concepts and it applications, the case of Jordan & Egypt*. Work paper. Damascus University. Date unknown.

binding within SCL 1965. The CMA, when preparing the regulations, quoted many of the provisions from SCL 1965, which caused some problems. For example, Article 3 of SCGRs is taken from the first lines in Articles 108 and 78 of SCL 1965; Article 5(A) of SCGRs is taken from the ending of Article 84 of SCL 1965; Article 5(B) of SCGRs is taken from Article 87 of SCL 1965; Article 5(C) of SCGRs is included in Article 87 of SCL 1965; and Article 5(G) is in Article 94 of SCL 1965.

All the above SCGR articles are stated as being for guidance only, and so the CMA had to reassert that they are indeed mandatory in order to avoid any conflict and ramifications for JSCs, and in order not to violate any provisions of higher legislation. In terms of application, the provisions of SCL 1965 are paramount. Therefore, the SCGRs that are taken from SCL 1965 are in fact obligatory and should be followed accordingly, not on the basis of or in accordance with the concepts stated in the SCGRs. Thus, corporations tend only to apply those SCGRs that are included in SCL 1965 under threat of penalty, being unable to argue that they are not mandatory, even though those same regulations are stated as being for guidance only in the SCGRs. Owing to these problems, the SCGRs must be modified to comply with SCL 1965, and all conflicts should be resolved by MOCI and the CMA in the public interest.

Unfortunately, it was thought that the application of the SCGRs would contribute at least to addressing the shortcomings within the provisions of SCL 1965 until a modern CL had been issued, but it did not; it was the duty of the CMA, which issued the regulations, to cooperate with other relevant bodies, such as MOCI, to coordinate over their contents, and to fill some of the gaps in SCL 1965. Some may argue that the SCGRs are for guidance and should not be mandatory; certainly, most of the principles in the SCGRs take the form of guidance, but it does not matter that some of them be deemed mandatory when needed. This is now the case with the SCGRs in KSA, wherein some are now deemed mandatory; indeed, there is no reason why a rule should not be mandatory if it is in the public interest or if it is to correct a mistake.

On the other hand, one of the defects in the SCGRs is that there are many contradictions between its articles and the provisions of SCL 1965. For example, Article 88 of SCL 1965 requires publication twenty-five days before the date of any GM, whereas the SCGRs require only twenty days¹¹⁴. Also, incompatibility exists between Article 79 of SCL 1965, which is related to the issue of the board of directors appointing a chairman and a managing director from among its members and the possibility

¹¹⁴ Article 5 (C) of the SCGRs.

that one board member could occupy both posts, and the SCGRs, which states,¹¹⁵ “(D) It is prohibited to conjoin the position of the Chairman of the Board with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager”. The irony is that the text uses the word ‘prohibited’ although the context is for guidance only. In any case, such conflicts are not in the interests of the company and its shareholders, and for any defect the law or regulations, there must be clear and accurate legal provisions to prevent confusion in their application.¹¹⁶

Economists have noted that the current SCGRs are (theoretically) being applied in JSCs but that many companies are trying to evade their application. This situation will open the door to corruption on the part of those companies, and therefore the competent authorities must endeavour to enforce the application of the SCGRs in order to close that door before those members of boards of directors and corporate officials who wish to exploit the absence of application can damage the company and its shareholders.

According to a research presented by The Council for the Saudi Chambers of Commerce and Industry (CSC),¹¹⁷ the poor application of the SCGRs in companies is considered one of the factors feeding the economic corruption now evident in KSA. The CSC stresses that there are several reasons behind the spread of corruption in companies and institutions nowadays: poor transparency and accountability, the difficulty of identifying the criteria that constitute the basis for contracts and transactions and selecting tenders, corporations carrying out projects with no real feasibility studies, and weakness or lack of competition; in this latter, many leading business companies are actually monopolies and they seek to gain the trust of decision makers in other companies or in governmental institutions in order to make deals, obtain supply contracts, or implement projects. In addition to fraud and corruption conducted in this manner, some companies are pushed into searching for underhand ways to dispose of

¹¹⁵ Article 12 (D) of the SCGRs

¹¹⁶ Another aspect of no less importance is that the SCGRs do not mention the penalties when the violating the obligatory rules, leaving this matter to CMA, which has the right to punish according to its estimation. Therefore, it is necessary to state in the list the sanctions and penalties for violating corporate disclosure and transparency rules as laid down in the regulation, the most important of which is to impose fines on offending companies, stop their trading in the capital market, and announce it to the public.

¹¹⁷ The Council for Saudi Chambers of Commerce and Industry is the official federation for the 28 Saudi Chambers. The Council was formed as per Royal Decree # R/6 dated March 1980 with its head office in Riyadh. Its main objective is to observe the common interests of the Saudi Chambers, represent them on local and international levels and assist in the enhancement of the private sector's role in the development of the national economy. More information see <<http://www.csc.org.sa>> accessed 30 January 2012.

their products through kickbacks and bribes, paid to other companies or governmental institutions.

In the respect of directors' remuneration and compensation, the SCGRs explains that they can be in the form of salary, attendance allowance for meetings, benefits in kind, or a certain percentage of the profits; they may combine two or more of these.¹¹⁸ It is believed that these rewards are often high because the profits generated by JSCs are also often high; we must also take into account that the regulations allow directors to retain membership of five companies.¹¹⁹

Essentially, many members of boards of companies are also members of other boards, although they are not working full-time and are unable to follow up all the affairs and situations of their various companies. This leads us to conclude that the regulations open the door wide to a few members of corporate boards obtaining greater financial rewards, and dominating a large number of boards, while many scientific, highly qualified and competent professionals are prevented from membership.¹²⁰

It is suggested, in this regard, to amend the above text as follows, "A person may be a member of the Boards of Directors of three JSCs at most at any one time in his personal capacity, and may also be representative of a legal person in the Boards of Directors of three JSCs at most; in all cases, the person may not be a member of boards in more than five JSCs, in his personal capacity in some and as a representative of a legal person in others, and any membership obtained on the board of a JSC that is contrary to the provisions of this article is considered void accordingly."

In general, protecting the rights of minority shareholders is actually the fundamental goal of corporate governance; this is in addition to providing the necessary legal devices that help them exercise their rights and counter any oppression on the part of majority shareholders. However, minority

¹¹⁸ Saudi Company Law 1965. Article 17 provides, "The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of a lump sum amount, attendance allowance, rights *in rem* or a certain percentage of the profits. Any two or more of these privileges may be conjoined".

¹¹⁹ Article 12 of the SCGRs states, "(H) A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time". However, according to Article 9(B), the Board of Directors' Report must contain the names of all board members and their membership in other listed companies and organizations. In this respect, the CMA imposed a fine £13,183.20 against *Albaha for Investment and Development* for breaching this article. Consequently, it is argued that such sentences be imposed on all directors who do not declare their membership of other bodies, either in the report or in the public domain. Such a step would increase the level of disclosure inside the company and avoid any conflict of interests.

See <www.cma.org.sa/Ar/News/Pages/CMA_N_1010.aspx> accessed 26 February 2012.

¹²⁰ Qatar Company Law 2002

shareholders should not have to depend on company rules alone in seeking to preserve their rights.¹²¹ In this regard, the OECD emphasizes that, “[T]o ensure an effective corporate governance framework, it is necessary that an appropriate and effective legal, regulatory and institutional foundation is established upon which all market participants can rely in establishing their private contractual relations”.¹²²

In the case of KSA, there is an opportunity the CMA to enhance the protection of minority shareholders through the following procedures: increase the accountability of the members of board of directors, reduce the power of controlling shareholders in the company, grant minority shareholder extra tools to strengthen their participation in decision making, and force listed companies to adopt electronic communication.

In fact, it has been argued that reforming the laws concerned with investor protection and improving judicial quality are quite difficult, lengthy, and require the support of politicians and relevant bodies; on the other hand, improving corporate governance at the firm-level seems to be a feasible goal.¹²³ However, it is the CMA that has the greatest opportunity to adjust the SCGRs and to change its status from being ‘comply or explain’ to being obligatory, particularly given that reforming the CL has taken longer than expected.

In its Report on Observance of Standards and Codes (ROSC), the World Bank mentioned that CG in KSA is still in a nascent concept but one that reflects the international standard, particularly the OECD principles;¹²⁴ however, the CMA is still in the process of finalisation, and therefore still has the opportunity to improve the text and enhance the implementation of the SCGRs. In this, the CMA and all public agencies and private parties (such as listed companies, universities, media, etc.) should play a role in educating all parties engaged in the capital market (such as directors, shareholders, auditors, etc.). Furthermore, workshops, seminars and committees should be established to assess the efficacy of the SCGRs, determining how to improve the implementation of the regulations, identifying the parties that can benefit from their implementation, and addressing the problems facing that

¹²¹ Cited from: Mahmoud Al-Madani. *Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward?* PhD Thesis. University of Leeds. 2011. p. 56

¹²² Organisation for Economic Co-operation and Development (OECD) 2004, P: 31.

¹²³ Leora F. & Klapper Inessa Love. Corporate governance, investor protection, and performance in emerging markets. *Journal of Corporate Finance*, Vol 10, 2004. p. 22

¹²⁴ See: Report on the Observance of Standards and Codes (ROSC), *Corporate Governance Country Assessment, Kingdom of Saudi Arabia*. 2009 p. 12. Available at:

<www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf>accessed 5 February 2012.

implementing; these together would serve to create reasonable recommendations and to improve the reputation of the SCGRs.

2.7 Legal Forms of Companies under Saudi Company Law 1965

According to SCL 1965, a company is defined as a contract under which two or more persons commit to contributing in an enterprise in order to generate profits by providing a share of money or services, for sharing what may result from this project, be it profit or loss.¹²⁵ Therefore, companies under SCL 1965 have a legal entity except a joint venture.¹²⁶

In addition, without prejudice to such companies, as it is known in Islamic jurisprudence, any company that does not assume one of the above mentioned forms shall be considered null and void, and the persons who make contracts in its name shall be personally and jointly liable for the obligations arising from such contracts.¹²⁷

In fact, the classification of companies in the Saudi system is based on the French Commercial Law, which played a major role in the formulation of company laws of many countries in the Middle East, such as Egypt, Jordan and the Arab Gulf states; the provisions of the Saudi Company Law were largely derived from the Egyptian Company Law.¹²⁸

The main authorities responsible for regulating, supervising and monitoring companies in KSA are four, namely, the MOCI,¹²⁹ the CMA,¹³⁰ the Saudi Arabia Monetary Agency (SAMA),¹³¹ the Saudi

¹²⁵ Saudi Company Law, 1965 Article 1

¹²⁶ Saudi Company Law, 1965 Article 13, According to SCL1965 A joint venture is considered a temporary company between partners to do a specific operations, such company doesn't need to official register, also doesn't have name or legal personality.

¹²⁷ Saudi Company Law, 1965 Article 2

¹²⁸ Maren Hanson. *The Influence of French Law on the Legal Development of Saudi Arabia*. Arab Law Quarterly. Vol. 2, No. 3.1987, p. 290. Available at<www.jstor.org/stable/3381697>accessed 6 February 2012

¹²⁹ General Administration for Companies at the MOCI undertakes considering applications for establishing new JSCs and reviewing their performance. In addition, the MOCI is responsible for registering and monitoring companies, balance sheets, and supervising the implementation of the Company Act. For more information See<www.mci.gov.sa>accessed 6 February 2012

¹³⁰ In general, the CMA is responsible for organizing and developing the capital market by issuing laws, regulations, and instructions necessary for applying the provisions of the law in the capital market. The CMA is an independent legal body, and it shall not undertake any business, have a special interest in any project, or acquire or issue any securities. It works on developing methods for bodies and departments acting in the trading

Organization for Chartered Public Accountants (SOCPA),¹³² and the Shura (Consultative) Council. The role of these bodies is significantly important in protecting investors' rights; they create rules and regulations whose aims are to protect investors and preserve the market's integrity, in addition to ensuring that those rules are implemented in the proper manner.¹³³

2.8 Joint Stock Company

JSCs differ from closed joint stock companies in several ways. The former is a type of public companies, however, the most important characteristic of a private company is that the company's founders, who signed the contract to set up a company, restrict any IPOs (Initial Public Offerings) in the capital of their company only to themselves, i.e. the company founders do not offer any of the company's shares for public subscription, where the founders of that company share the financial ability and the desire to cover the company's capital, and thus to manage the company affairs.¹³⁴

In the mid1930s, the first Saudi listed company was born, namely the Arab Automobile Company, and there were about 14 companies by 1975. A number of large corporations and joint stock banks were established due to the rapid economic expansion of the 1970s, besides the Saudisation of parts of

of securities, reduces the risks associated with transactions in securities, and regulates disclosure of information related to securities, as well as to protect investors of securities from unfair practices like fraud, deceit and manipulation; and to prevent any securities in the market or suspend issuing and trading them if it considers that necessary as a temporary measure. See<www.cma.org.sa>>accessed 9 February 2012. Also, the Saudi Capital Market Law.

¹³¹ The Central Bank of KSA was established in the era of King Abdulaziz (in 1952). Mr. George A. Blowers (a US citizen) was the first governor of SAMA, and formed SAMA's first board. Its functions are: issuing the national currency, acting as a banker to the government, supervising commercial banks, managing the Kingdom's foreign exchange reserves, and promoting the growth of the financial system. For more information see< www.sama.gov.sa > Home > About SAMA> accessed 9 February 2012.

¹³² Saudi Organization for Certified Public Accountants (SOCPA) is a professional organization which operates under the supervision of the MCI in order to promote the accounting and auditing profession. Its objectives are: to review, develop and approve accounting and auditing standards. It also monitors the performance of certified public accountants. In addition, it established SOCPA fellowship examination rules and organizes CPE courses, publishes periodicals, books and bulletins, and participates in relevant local and international committees and symposiums. For more details, For more information see<<http://www.socpa.org.sa>> accessed 9 February 2012.

¹³³ See: Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. p. 172

¹³⁴ Saudi Company Law, 1965. Article 49 provides, "the capital of a corporation that offers its stock for public subscription shall not be less than ten million SAR. In the all other cases, the capital of a corporation shall not be less than two million SAR".

foreign banks (and their capital) at that time.¹³⁵ However, this research focuses on listed companies; all other companies are beyond the remit of this research.

SCL 1965 defines a JSC as a company whose capital is divided into portions called shares, equal in value, and characterized by susceptibility to negotiation through commercial methods, and the commercial partners' liability is confined to the proportion each one of them has contributed in the company's capital; also, it is not titled by the names of the partners.¹³⁶ In terms of the name of a JSC, it must be derived from the purpose of the establishment of the company, and it may include the name of one of the natural persons if the purpose of the company is to invest a patent registered in the name of such person, or unless the company acquires a commercial firm and adopts the name of the latter as its own name;¹³⁷ in such cases, the phrase 'joint stock company' should be added to the name to refer to the type of the company.

It has been argued that listed companies in KSA are like their counterparts in the GCC in terms of ownership, i.e. they are very 'centred',¹³⁸ this is not surprising for various reasons, such as the region's socio-economic, socio-political, and nomadic norms and traditions.¹³⁹ Usually, rich families and individual investors have the greatest share of capital in various sectors, where 90% of 57% of Saudi Capital Market are owned by families.¹⁴⁰ Thus, they are the major shareholders of banks, and they occupy their boards of directors; for example, three out of the ten listed Saudi banks are founded by single families, such as Bank Al-Jazira, Al Rajhi Bank, or by a small number of allied families such as

¹³⁵ Actually, Saudi Company Law, 1965 Article 13(A), which is concerned with the conditions of registration and admission to listing shares, stipulates that there must be sufficient liquid market for the shares subject for the application for registration and admission to listing. Along with this, there must be at least 200 public shareholders, and at least 30% of the class of shares subject to application are owned by the public. However, pursuant to Article 15(B), the expected value of an IPO must be SR 100 million or more. See: The Listing Rules, dated 4 October 2004. For more information see < www.cmaorg.sa > accessed 10 February 2012.

¹³⁶ Saudi Company Law, 1965 Article 48

¹³⁷ Saudi Company Law, 1965 Article 50

¹³⁸ Cited from C. Mallin, *Corporate Governance*. Oxford: Oxford University Press, 2004, p. 54. However, the family-owned firm is more prevalent around the world, ranging from small businesses to large businesses, especially in KSA. In this context, Cadbury opined that family corporations "are one of the foundations of the world's business community. Their creation, growth and longevity are critical to the success of the global economy".¹³⁸ For more details see: R. Brunera, R. Conroya, J. Estradab, M. Kritzmanc & W. Lia, Introduction to Valuation in Emerging Markets, *Emerging Markets Review* 3. Issue 4, 2002. Also A. Cadbury, *Family Firms and their Governance, Creating Tomorrow's Company from Today's*, Egon Zehnder International, Great Britain, 2000, p.5.

¹³⁹ Majdi Quttainah & William Paczkowski. *Corporate governance and initial public offerings in the Kingdom of Saudi Arabia*. Cambridge University Press. 2012. pp. 273-264

¹⁴⁰ Ibid

Bank Al Belad.¹⁴¹ Foreign share constitutes only 3% of the total market, while cross ownership of JSCs is only 2%.¹⁴²

As for Saudi ownership of the listed companies in the Tadawul, it is estimated at about 37% of the total capital market; however, these have significant influence over the capital of large listed companies, where the value of Saudi contribution in the Saudi Basic Industries Corporation (SABIC) is 75% of the company's capital, it is 83.6% in the Saudi Telecommunications Company (STC), and 76% and 70% in the electricity and telecommunications sectors.¹⁴³

The ownership structure is based largely on the rich families and the state; these are the two largest shareholders in JSCs, where their influence on the company is quite clear, and they dominate the company's management directly, which could undermine the minority shareholders' rights and their ambitions.¹⁴⁴

In this context, Lazarides shows that in the Continental Europe system the markets are less liquid, and governments do not have the same capacity to monitor and control them; this is because firms are controlled by a small number of shareholders such as banks and families.¹⁴⁵ Typically, as is the case in most countries in developing markets, there is the situation where corporate ownership is concentrated to the degree that one person can have effective control of the firm, and therefore the nature of the agency problem shifts away from the conflict between shareholder and manager to the conflicts among the controlling owners as a manager and the minority of shareholders.¹⁴⁶

2.8.1 Incorporation Procedures for JSCs

Establishing a company is subject to certain procedures, and these differ from those of other companies (due to their importance). These procedures start with issuing a Royal Decree or

¹⁴¹ Mohammed S Al-Dohaiman. *Capital Structure in Saudi Arabian Listed and Unlisted Companies*. PhD Thesis. Department of Accounting and Finance, University of Stirling, 2008, p. 130

¹⁴² *ibid*

¹⁴³ Cited from <www.kamconline.com/Newsdetails.aspx?newsId=44081&language=ar> accessed 15 February January 2012.

¹⁴⁴ Nabil Baydoun, Neal Ryan & Roger Willett. Corporate governance in five Arabian Gulf countries. *Managerial Auditing Journal* 28.1. 2013. p. 8

¹⁴⁵ T, Lazarides. *Minority Shareholder Choices and Rights in the New Market Environment*. Available at: <<http://ssrn.com/abstract=1432672>> accessed 15 February January 2012.

¹⁴⁶ F. Fan & S. Claessens, *Corporate Governance in Asia: A Survey*. International Review of Finance, Vol. 3, 2002, p. 74.

ministerial decision authorizing the establishment, depending on the nature of the company's activity, and the company gains the status of 'juristic person' only after the issuance of a decision by the Minister of MOCI, declaring the establishment of the company and publishing it in the Official Gazette.¹⁴⁷ The purpose of this is to enable the state to control the establishment of JSCs, to emphasize the gravity of the project in question, and to protect public funds.

In fact, JSCs often arise to undertake huge projects; so upon their founding, several procedures must be taken. Those include ones related to the technical aspects of the company, such as technical studies, or the establishment of factories and the purchase of machinery and raw materials; others include aspects the regulatory procedures necessary to establish the company. The actions concerning the technical aspects are not the subject of this search; however, the statutory procedures are those that do concern this research.

Generally speaking, founding a JSC passes through more than one stage. In the preliminary stage, SCL 1965 requires those who wish to establish a JSC submit a request for establishing a company signed by at least five of the founders; the request shall show how to subscribe to the capital of the company, the number of shares specified for the founders themselves, and the amount subscribed by each one of them; also, a copy of the company's memorandum of association and its bylaws, signed by each one of the incorporators and other founders must be attached.¹⁴⁸ However, the company's articles must be identical to the standard bylaws for JSCs issued by the Minister of MOCI.¹⁴⁹ The founders must attach with the license application a study that demonstrates the economic feasibility for the company's goals unless the study has been provided to another competent governmental authority that has authorized the establishment of the project.

This is the preliminary stage of the establishment of a JSC. Article 53 of SCL 1965 defines the founder as everyone who signs the contract of a JSC or requests a foundation license, or anyone who

¹⁴⁷ Saudi Company Law, 1965 Article 52

¹⁴⁸ Saudi Company Law, 1965 Article 52. SCL 1965 excludes certain types of JSCs, i.e. those that cannot be established without an authorization issued by a Royal Decree upon the approval of the Council of Ministers offered by the Minister of MOCI. These companies are: concessionary companies, companies managing a public utility, companies receiving a subsidy from the Government, companies in which the Government or any other public legal person participates, and companies engaged in banking activities. All other JSCs may be established under authorization issued by the Minister of MOCI and published in the Official Gazette. See: Saudi Company Law, 1965 Article 52

¹⁴⁹ Saudi Company Law, 1965 Article 51

offers a share in kind when establishing it, or actually participates in the establishment of the company. It is not required that the founder should be a natural person; it is possible that all or some of the founders be legal persons. The founders in Saudi system are not those who agree on the idea of establishing a company and sign a contract for it; rather, the circle of founders includes every person who has a role in the establishment of the company.

As long as the founder is a party to the contract, she/he must be legally fully competent to act, so that the founder may bear civil and criminal liability on the failure to establish the company; also, the juristic person may become a founder of a JSC, provided that the establishment of such a company falls within the objectives, i.e. there must be a link or relationship between the purpose of the legal person that takes part with others to establish the JSC and the purposes and activities of the company to be established. However, all the founders can be natural persons, or involve juristic persons, or all be juristic persons.

Every founder must be a partner in the company to be established, wherein Saudi law requires that the founders subscribe to the shares of the company to be established, and set a maximum for the total percentage of shares for the founders in the company's capital that they seek to set up; the minimum number of founders in JSCs is five.¹⁵⁰

The second stage of incorporation for JSCs entails inviting the public for subscription in the company's shares through banks authorized by the Minister of MOCI, where the founders shall leave sufficient copies of the company's articles at the banks authorized to receive subscription applications, and each interested person may obtain a copy at a reasonable price.¹⁵¹

The IPO will remain open for not less than ten days, and not more than ninety days; if the subscription does not cover the whole capital within the assigned period, it is possible (by the permission of the Minister of MOCI) to extend the subscription period for a period not exceeding ninety days.¹⁵² Subscription is made by signing a document (by the subscriber or someone on his/her behalf); the document contains, in particular, the company name, purpose and capital, the conditions of

¹⁵⁰ Saudi Company Law, 1965 Article 48

¹⁵¹ Saudi Company Law, 1965 Article 55

¹⁵² Saudi Company Law, 1965 Article 56

subscription, the name, nationality and address of the subscriber, the number of shares of subscription, and the subscriber's commitment to accept the company's articles as approved by the constituent general meeting.

The IPO proceeds shall be deposited in the name of the company under formation, in a bank designated by the Minister of MOCI, and shall be delivered only to the board of directors after the publication of the establishment of the company, in accordance with Article 63. Then, to allocate each subscriber the number of shares she/he subscribed for, if the number of shares subscribed for exceeds the number offered for the IPO, shares will be distributed to subscribers according to percentage of subscription of each one of them, taking into account whatever is determined by the Minister of MOCI in each case for small subscribers.¹⁵³

The last stages in the establishing a company begins after the IPO has finished; the founders call all subscribers to the constituent general meeting, whose mission is to complete the establishment procedures; it convenes after fifteen days from the date of the call. Each subscriber (regardless of the number shares) has the right to attend this meeting. However, it is necessary for the meeting to be legal to be attended by a number of subscribers representing half of the capital at least; if this majority is not available, another call for a second meeting within 15 days shall be made, and this meeting is considered legal regardless of the number of subscribers attending, where the decisions of this meeting are issued through an absolute majority of the shares represented therein.¹⁵⁴

Fundamentally, the tasks of this meeting are to view the report of the founders' committee, which must include complete information and data for all acts of incorporation and procedures with supporting documentation, validation and compliance with the law and the company's articles. This is in addition to checking the expenses of incorporation, having discussions and taking appropriate decisions. Electing the first board, and the auditor or auditors, and determining their remuneration, or authorizing the Board of Directors to determine these, are also entailed.

The procedures for JSC establishment end by the Minister of MOCI issuing a decision to declare the establishment, where the founders must submit within fifteen days following the convening of the

¹⁵³ Ibid

¹⁵⁴ Saudi Company Law, 1965 Articles 60 & 61

meeting a request to the Minister to declare the establishment of the company; issuing this decision of declaration of establishment is made after the Minister has verified the validity of the incorporation procedures.

The company is considered accordingly founded from the date of issuance of the Minister's decision declaring its establishment; the consequences of this decision are as follows: not hearing the case of invalidating the company for any violation of the provisions of SCL 1965 or its Memoranda or bylaws; transferring all actions carried out by the founders of the company to its pact; the company bearing all the expenses incurred by the founders during the period of incorporation; publishing in the Official Gazette (at the expense of the company) the decision of Minister to declare its establishment together with a copy of the company's constitution; and the members of the board of directors being required, within fifteen days from the date of the mentioned resolution, to request registering the company in the Register of Companies at the General Administration for Companies (referred to as GAFC), as well as registering it in the Commercial Register (in accordance with the provisions of the Commercial Register).¹⁵⁵

2.8.2 Founders' Duties and Rights

Article 55 of SCL 1965 stipulates that the founders are jointly responsible for the validity of the data contained in the subscription prospectus and the completion of the data referred to in that article. As a result of the decision to declare the establishment of the company, all actions carried out by the founders for the company shall be transferred to its account; also, the company shall bear all expenses incurred by the founders during the period of establishment; if it is not established in accordance with SCL 1965, the subscribers then may reclaim the sums they paid or shares in kind that they gave, and the founders will be jointly liable for the fulfilment of this obligation (and compensation where required). Thus, the founders bear all the expenses incurred during the establishment of the company, and are jointly liable to third parties for acts and conducts made by them during the period of incorporation.¹⁵⁶

Article 100 of SCL 1965 confirms that cash shares subscribed by the founders shall not be traded,

¹⁵⁵ See: Report on the Observance of Standards and Codes (ROSC), Corporate Governance Country Assessment, Kingdom of Saudi Arabia. 2009, p. 14. Available at <www.worldbank.org/ifa/ros_cg_saudia_arabia.pdf> 30 January 2012

¹⁵⁶ The Saudi Company Law, No.1965. Article 64

along with the shares in kind and quotas of establishment, before the announcement of the budget and of the profit and loss calculations for two full fiscal years of no less than twelve months for each of them from the date of establishment of the company.

Nevertheless, during the period of this ban, the transfer of ownership of cash shares in accordance with the provisions of sale of rights, from one founder to another, or to a member of the board of directors for submission as guarantee for the management, or from the heirs of one of the founders to others in the event of his death, the provisions of this article apply to whatever is subscribed by the founders in the case of any increase in value before the end of the period of the ban.¹⁵⁷

2.8.3 Shareholders' Duties and Rights

Shareholders here are the non-founder shareholders; SCL 1965 contains many shareholder rights as well as the corresponding obligations, which will be described briefly. Article 57 of SCL 1965 states that the shareholder's first commitment is to pledge upon subscription to accept the company's articles as approved by the constituent general meeting; the subscription or the owning of shares indicates acceptance by the shareholders of the articles of association, as well as their commitment to the decisions issued by the shareholders' meetings.¹⁵⁸ This is in addition to the right of each shareholder (regardless of the number of shares) to attend the constituent meeting.¹⁵⁹

In fact, each shareholder has the right to raise a liability case against the board members assigned by the company for any violation that may cause harm; he may not file the aforementioned suit unless the rights of the company are made clear, and the shareholder shall notify the company of his intention to file the suit.¹⁶⁰

Each shareholder who holds twenty shares has the right to attend the GMs, even if the company's articles state otherwise.¹⁶¹ Every shareholder has the right to discuss the issues on the GM agenda, and to ask the members of the board of directors and the auditor relevant questions.¹⁶² On the other hand, the shareholder commits to pay the value of shares on the dates designated; if he fails to fulfil the

¹⁵⁷ The Saudi Company Law, No.1965. Article 100

¹⁵⁸ Saudi Company Law, 1965 Article 96

¹⁵⁹ Saudi Company Law, 1965 Article 61

¹⁶⁰ Saudi Company Law, 1965 Article 78

¹⁶¹ Saudi Company Law, 1965 Article 83

¹⁶² Saudi Company Law, 1965 Article 92

commitment by the due date, the board of directors (after warning shareholder through a written letter) may sell the share at a public auction. However, any shareholder who does not fulfil that commitment until the day of the auction shall pay the value due plus the expenses incurred by the company, where the company takes the due amounts from the proceeds of the sale and returns the rest to the shareholder.¹⁶³

2.8.4 Share Capital of JSCs

Shareholders in listed companies are a significant element because they provide funds. Actually, the capital is the guarantee for the creditors of the company; it reveals the company's financial position. These companies usually have large capital reserves because they are established in order to achieve large-scale projects, and capital is raised through the subscription of major shareholders as well as minority shareholders. The capital of listed companies in KSA should not be less than 10 million SAR,¹⁶⁴ where the capital of the company is divided into shares of equal value, which are negotiable.¹⁶⁵ Additionally, SCL 1965 stipulates that the paid-up capital at incorporation shall not be less than half the minimum at least, and the value per share not less than 50 SAR; the value of the share is paid either once or through determined payments which are stipulated in the company's relevant article.¹⁶⁶ There has been a recent change in the law that allows JSCs to issue preferred shares without voting in an amount up to 50% of the capital.¹⁶⁷

SCL 1965 allows the shares offered in the capital of the company to be either shares in-cash or in-kind.¹⁶⁸ In respect of quotas in-kind, they are subject to certain conditions in order not to exaggerate their assessed value.¹⁶⁹ Shares are traded according to certain rules but some shares are prevented from being traded for gain or benefit for a certain period of time; for example, shares of warranty for board members are prevented from being traded until the end of the period specified for hearing any liability suit against the board of directors,¹⁷⁰ and the shares of the founders (either in cash or in kind) may not be exchanged or traded before the publication of the budget and the profit and loss

¹⁶³ Saudi Company Law, 1965 Article 110

¹⁶⁴ Saudi Company Law, 1965 Article 49

¹⁶⁵ Saudi Company Law, 1965 Article 48

¹⁶⁶ Saudi Company Law, 1965 Article 110

¹⁶⁷ Royal Decree No: M/22 Issued on 4 February 1992

¹⁶⁸ Saudi Company Law, 1965 Article 99

¹⁶⁹ Saudi Company Law, 1965 Article 60

¹⁷⁰ Saudi Company Law, 1965 Article 68

calculations for two full fiscal years, a period of not less than twelve months for each type, from the date of the company's establishment.¹⁷¹ Generally, one of the advantages of JSC shares is that they can be traded except for certain particular cases stipulated by law or by the company's articles.¹⁷²

According to SCL 1965, JSCs have the right to raise capital if a resolution in an EGM is taken, once or more often according to need, provided that the original capital is fully paid.¹⁷³ It is the company shareholders' priority right to subscribe to the shares of the new shares of the company before any third party from outside the company, in accordance with their ownership of shares in the capital of the company.¹⁷⁴ On the other hand, the EGM may decide to reduce the capital if it exceeds the needs of the company, or if it has suffer losses; in the latter case alone, capital reduction can be made below the limit specified in the law.¹⁷⁵

2.8.5 Board of Directors in JSCs

A JSC is managed by its major organs, which are the board of directors and the GM. Each has its own tasks set by law and the company's articles, such that they not to overlap; they work with each other in order to achieve the company's goals. In fact, the board of directors holds the broadest range of powers in the management of the company, but taking into account the tasks reserved for the GM as it may (within its limits) authorize one or more of its members or others to perform certain act or acts.¹⁷⁶ The status is the same in KSA, the UK and the USA, regarding the board of directors, where it attends to both executive and non-executive affairs.¹⁷⁷

As in many countries, the type of board of directors is based on a single-tier structure; the CMA conducts its work through a set of specialist sub-committees, such as for auditing, nomination and remuneration. All these committees have become mandatory in KSA.¹⁷⁸ Additionally, the GM officially requests that the company be compliant with Shari'ah law in appointing an independent

¹⁷¹ Saudi Company Law, 1965 Article 100

¹⁷² Saudi Company Law, 1965 Article 101

¹⁷³ Saudi Company Law, 1965 Article 134

¹⁷⁴ Saudi Company Law, 1965 Article 136

¹⁷⁵ Saudi Company Law, 1965 Article 149

¹⁷⁶ In this sense, the Article 3 of the Companies (Model Articles) Regulations 2008, No. 3229 provides that "Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company".

¹⁷⁷ Mallin, C. *Corporate Governance*. Oxford: Oxford University Press. 2004

¹⁷⁸ Resolution of CMA Number 1-36-2008 issued on 10/11/2008.

board called the Shari'ah Supervisory Board, whose function is to supervise the application of Islamic rules on the products and services offered all Islamic institutions.¹⁷⁹

The board of directors consists of a number of shareholders not less than three and not more than eleven; they are appointed through a series of votes in the GM for the period stipulated in the company's bylaws,¹⁸⁰ provided that their terms shall not exceed three years.¹⁸¹ There is however an exception, as the members of the first board of directors may be appointed for a period not exceeding five years, together with the first auditor, the director may be reappointed more than once unless the company's articles stipulate otherwise.¹⁸²

In fact, the majority of the members of the board must be non-executive;¹⁸³ also, the board of directors must have no less than two independent members or one-third, whichever is greater.¹⁸⁴ A member of the board of directors shall not act as a member of the board of directors in more than five listed companies at the same time.¹⁸⁵ Each member of the board of directors must be the owner of a number of shares in the company worth at least ten thousand SAR (equivalent to GBP 1,665),¹⁸⁶ with the exception of board member who represents a legal person. These shares shall be deposited within thirty days from the date of appointment of the member in a bank appointed by the Minister of MOCI; these shares are allocated to ensure the responsibility of the members, and remain non-negotiable until the end of the period specified to hear any case of liability set forth in law, or until taking a decision in

¹⁷⁹ Majdi Quttainah & William Paczkowski. *Corporate governance and initial public offerings in the Kingdom of Saudi Arabia*. Cambridge University Press. 2012. p. 263-264 Available at<<http://lib.myilibrary.com?ID=357206>> 30 January 2012.

¹⁸⁰ The Saudi Company Law, No.1965. Article 66, also article 12(A) of the CGRS

¹⁸¹ The case in the UK is a bit different, where the members of the board are appointed by the board itself upon a proposal from nomination committee; and those members need to be approved by shareholders at the next general meeting. Cited from: Technical Committee of the International Organization of Securities Commissions. *Board Independence of Listed Companies*. Final Report. in Consultation with the OECD. c2007. P.: 4. Available at<www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf> 5 February 2012.

Article 20 of the Table A provides that a director is appointed by ordinary resolution by shareholders, or by a director's decision. However, it is subject to the company's articles.

¹⁸² The Saudi Company Law, No.1965. Article 62 (3)

¹⁸³ The Saudi Company Law, No.1965. and Article 12(C) of the CGRS

¹⁸⁴ Article 12(E) of the CGRS. The CGRS defines the Independent Member: "A member of the Board of Directors who enjoys complete independence". And the Non-executive director: "A member of the Board of Directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary".

¹⁸⁵ Ibid Para (H)

¹⁸⁶ One SAR=6.00320 GBP.

any such lawsuit.¹⁸⁷ If any member of the board of directors does not offer his ‘guarantee shares’ within the time specified, his membership shall be invalidated by virtue of law.¹⁸⁸

The company’s bylaws detail how membership of the board may be terminated, and a GM may vote to isolate one, some or all board members at any time, even if the company’s articles stipulate otherwise; they may only do this without prejudicing the rights of the isolated member(s), who may question and challenge the company if such isolation occurs without acceptable justification, or it occurs at an inopportune time. Any member of the board may retire on condition that it shall be within a reasonable timeframe; otherwise, will be responsible before company.¹⁸⁹

The directors may not take loans whose lengths exceed three years, sell or mortgage company properties or stores, or discharge the company’s debtors from their obligations unless otherwise permitted in the company’s articles under the conditions set out under the law.¹⁹⁰ If the company’s articles do not include any rules in this regard, it is not permissible for the board to do the aforementioned actions without being granted permission by the GM, unless such behaviours are naturally included in the purposes of the company.

The company’s articles detail the manner in which the members of board are rewarded. This reward may be a specified salary or an allowance for attending sessions, or benefits in kind, or a certain percentage of the profits; it may be a combination of two or more of these. However, if the remuneration is a certain percentage of the company’s profits, it shall not exceed a ratio of 10% of the net profits after deducting expenses, consumptions and reserves, as established by the GM and pursuant to the provisions of SCL 1965 (or by the company’s articles) and only after dividend distribution to shareholders of at least 5% of the net profit; each estimate otherwise shall be void.

The board of directors appoints the chair from among its members, together with a representative member, and it is possible to combine the two positions in one member. The company’s articles also describe in detail the duties of both the chair and the representative member, and the special remuneration earned by each, in addition to any bonus assigned to the members of the board. If the

¹⁸⁷ The Saudi Company Law, No.1965. Article 110

¹⁸⁸ The Saudi Company Law, No.1965. Article 68

¹⁸⁹ Saudi Company Law, 1965 Article 79

¹⁹⁰ Saudi Company Law, 1965 Article 73

bylaws do not stipulate the provisions in this regard, the company's board undertakes assigning the competencies and identifying any special remuneration.¹⁹¹ Nonetheless, it could be said that one of the faults evident in SCL 1965 is that it accords the board of directors a great deal of authority in determining the directors' remuneration and bonuses; the wages assigned to the board members of companies in KSA tend to be inordinately high, and many minority shareholders complain about this and the fact that they are set by the board of directors themselves; certainly, the board of directors often seek to satisfy personal interests, regardless of the objections of the minority shareholders.

The board of directors undertakes to discharge its managerial duties within the limits of its competence, but it is also responsible for compensating parties for any damages arising from wrongful acts. The members of the board shall be jointly liable for compensating the company, shareholders or third parties for any damage arising from wrongful management of company affairs, or for violating the provisions of SCL 1965 or company bylaws; any complaint that is not in accordance with these conditions shall be considered null and void. The responsibility for compensation includes all members of the board if the damage results from a decision issued unanimously; in resolutions made by majority voting, the opponents shall not be held responsible as long as their rejection of the offending resolution is expressly detailed in the minutes of the meeting. Furthermore, being absent from the meeting at which the offending decision was made shall not be considered a reason for exemption from liability, unless that member can prove that he was not aware of the resolution or was unable to object to it after learning of it.¹⁹²

The company may file a responsibility suit against the members of the board because of errors that resulted in damage to the shareholders; the GM may decide to such a this case and to appoint a representative for the company to expedite it. Should company be dissolved, the liquidator conducts the ensuing lawsuit after obtaining the approval of the GM.

2.8.6 Shareholder General Meetings (GM)

The GM is considered the highest authority in the company. GMs express the views of the shareholders in the company, and clarify the purposes and objectives of the company; these are achieved through voting, and through voting, the GM monitors and assesses the performance of the

¹⁹¹ Saudi Company Law, 1965 Article 74

¹⁹² Saudi Company Law, 1965 Article 76

company's board. SCL 1965 accords each shareholder who owns twenty shares or more the right to attend the GM even if the provisions of the company's bylaws stipulate otherwise; each shareholder may appoint (in writing) another shareholder (non-board member) to attend the GM and vote on his behalf,¹⁹³ and the MOCI is entitled to send a delegate (or more if need be) to attend the GMs as an observer.¹⁹⁴

Except for matters that are specific to EGMs, the GM is competent in all matters relating to the company; it is held at least once a year, usually the six months following the end of the company's fiscal year. A further meeting may be arranged should the need arise. As well as the competencies specified for an EGM, it may issue resolutions on matters that are normally under the purview of the GM, with the same terms and conditions prescribed for any recent GM.

It is axiomatic that the GM may not pass any amendments that would relieve the shareholders of their basic rights, which emanate from being a partner in the company as per the provisions of law or of the company's articles. Also, it is forbidden in any way to increase the financial burden of the shareholders, or to change the purpose the company for which it was established (as stated in the memorandum of association), or to transfer the company's head office to any location outside KSA, or to modify the nationality of the company. On the other hand, if a GM resolution modifies the rights of a certain class of shareholders, such a decision shall not take effect without the approval of those who have the right to vote on their own association, in accordance with the provisions set forth for GMs.

Generally, a GM is held through an invitation delivered by the company's board in accordance with the conditions set forth in the bylaws.¹⁹⁵ Furthermore, the board must call a GM if requested by the auditor or a number of shareholders representing at least 5% of the capital; GAFC, at the request of a number of shareholders representing at least 2% of the capital, or based on a decision of the Minister of MOCI, may call an EGM if one month passes after the designated meeting has not convened. The call to convene a meeting shall be published in the Official Gazette and a daily newspaper, and shall be distributed in the main centre of the company at least twenty-five days before the date of that meeting.¹⁹⁶ If all shares are nominal, it is sufficient to invite shareholders on the designated date

¹⁹³ Saudi Company Law, 1965 Article 83

¹⁹⁴ Ibid

¹⁹⁵ Saudi Company Law, 1965 Article 85

¹⁹⁶ Saudi Company Law, 1965 Article 89

through registered letters, which shall include the agenda; a copy of the invitation and agenda must be sent to GAFC at the MOCI within the period specified for publication.

2.8.7 Company Account

Listed companies have one or more certified accountants (according to need), and the GM determines their bonuses and period of work; it may also reappoint them, as well as substitute them at any time without prejudice to their rights.¹⁹⁷ The auditor is entitled to all the time he needs to see the company's books and records and other documents that he may determine important and pertinent to the completion of his work; he may also ask for extra data and clarification as he deems necessary, and may also investigate the company's assets and liabilities.¹⁹⁸

All employees in the JSC must assist in facilitating the work of the auditor in the public interest of the company; disrupting the work of the auditor in any way is considered a punishable offence. The auditor must submit an annual report that includes the attitude of the company directors with regard to enabling him in obtaining the data and clarifications requested by him, together with any revelations in relation to violations of the provisions of SCL 1965 or the provisions of the company's bylaws, in addition to his opinion on the how the company's accounts accord with reality. The auditor's report shall be recited at the GM, and if the report of the board of directors is approved without considering the auditor's report, then its decision will be null and void.¹⁹⁹

One of the rights guaranteed by SCL 1965 for shareholders is the right to discuss the auditor's report during the AGM, and the auditor will be responsible for any errors or negligence, and must to compensate for any damage caused to the company or its shareholders if the error is made by him.²⁰⁰ However, it has been suggested that the provisions for auditors under the law need comprehensive reconsideration to enable those auditors to expedite their duties in full; their position is still weak and subject to the authority of the board of directors of the company.

¹⁹⁷ Saudi Company Law, 1965 Article 130

¹⁹⁸ Saudi Company Law, 1965 Article 131

¹⁹⁹ Saudi Company Law, 1965 Article 132

²⁰⁰ Saudi Company Law, 1965 Article 133

2.8.8 Company Liquidation

SCL 1965 mentions certain cases where a JSC is in a state of liquidation, in particular when the company is at the end of the period specified for it, it has achieved the purpose for which it was founded, or it has become impossible for the company to achieve its objectives. Also, the company may be terminated when all the quotas or shares are returned to one partner, or when three-quarters of the company capital (or more) is lost, where it would be possible to reinvest the rest fruitfully. Further, the partners may agree to dissolve the company before the end of its term (unless the company's articles provide otherwise) or integrate the company with another one; the courts may decide to dissolve the company at the request of an interested party, provided that there are well-grounded reasons for doing so.

If a decision for liquidation is taken by an EGM, it must be attended by shareholders representing at least two-thirds of the company's shares subscribed, and the resolution must be approved by at least 75% of the total shares represented at the meeting; the resolution is subject to the procedures of approval, registration and publication as stipulated in the law.

Whether the resolution issued to liquidate the company has been issued by EGM or by the Commercial Court, there are certain provisions that should be applied in terms of how to run the liquidation proceedings, such as appointing a liquidator (or more if need be) to oversee the company's business, maintain the funds and assets, pay its debts, and settle its accounts. Also, during the liquidation period, the company ceases its business from the date of issuance of the resolution in the case of voluntary liquidation, and from the date of issuance of the court's decision in the case of compulsory liquidation. Also, all contracts and receipts, advertising and other documents issued by the company shall declare that it is under liquidation.²⁰¹ The legal personality of the company continues until the completion of the liquidation.

2.9 Conclusion

The source of the laws in KSA is the legislative authority represented by the King and the Council of Ministers. After a law has been issued, the executive authority is charged with overseeing its implementation. It can be argued that the problem in issuing laws in KSA is the long and complex

²⁰¹ Saudi Company Law, 1965 Article 12

procedures involved; issuing a law can take a long time, for example, the new CL was completed in 2007, but it has not yet been approved. Here, an important point must be paid attention: suppose that the new law is issued next year, it is likely that it will still contain legal faults that need to be modified, and this will necessitate yet further consultation with all those concerned with the law, including businessmen, shareholders, lawyers, judges and others. On the other hand, the proposed law was drafted in 2007, and thus it cannot be claimed to be modern in the full sense of the word; it is closer to being a law only partially amended, and it is unlikely to cover all the provisions required of it in this modern era.

Additionally, the legislative system in KSA has a defect in that it does not consider the judgments of court as a source of law; legal precedent is considered an important factor in the development of law and in any modification to address gaps in the legislation. In this context, in the Anglo-Saxon countries, case law and legal precedent are of great importance and represent a basic source of legislation (along with their parliaments); thus, the UK system is flexible and advanced, and the process of enacting laws proceeds more easily and with fewer complications than in the Saudi system. Development and change in any country require a flexible environment so that reality can be dealt with quickly, but, unfortunately, the legal system in KSA is rigid, and enacting laws passes through highly complex procedures. Therefore, the development and implementation processes of any law are difficult and cannot be done sufficiently quickly.

A JSC is a legal person, with rights and obligations. The company is managed through its main organs, and the board of directors and the GM play a significant role in the life of the company. The law states the duties and responsibilities of each, and distributes power between them according to their need. This is the case at least in theory, but in practice the board of directors in KSA is the dominant force in the company, and has absolute power; this is because it is managed by the owners of large quotas, who are usually members of the board, and the distribution of power between these bodies is not equitable. Certainly, it is believed that the concentration of ownership within a few shareholders is the main reason for the growing strength of the board of the company over the resolutions of the GMs; at the present time, there is no significant role for other shareholders in the Saudi market.

Largely due to the absence of an important role for the shareholders inside the company, GMs no longer exercise their role as they should, and have become no more than an ineffective parliament. There is no real participation in company decisions and that is for various reasons that will be discussed later (see 4.5). Actually, this has made the board of directors the highest authority in the company, and satisfying personal interests has become the overriding goal of the members of the board of directors, largely at the expense of minority shareholders.

The most important questions to be answered before discussing shareholders' rights are: what is the legal status of shareholders in listed companies? What is their role within these companies? What are the reasons that make the role of shareholders weak? These are the issues that shall be addressed in the following chapters.

It could be said that one of the main reasons for the weakness of SCL 1965 is that the law is old; it was issued in 1965 and the amendments made to it have not been sufficiently substantial. Therefore, the law is still weak and vague in many of its provisions, and does not mention many cases. As a result of these defects in SCL 1965, the role of shareholders in JSCs is unclear, and their position within the company remains ineffective. This law has failed to address many important issues relating to shareholders and their rights within the company.

However, this research represents an attempt at revealing the true relationship between the apparent lack of protection for minority shareholders in JSCs and the concentration of ownership on the part of a few shareholders. In the next chapter, this study focuses on the position of shareholders in JSCs, both theoretically and under the law, and it highlights the position and the rights of shareholders. Thereafter, this study concentrates on shareholders' rights in JSCs according to SCL 1965.

Chapter 3: The Position of Shareholders in JSCs

3.1 Introduction

In order to understand the position and role of shareholders in the JSC we must more fully comprehend the context; in this regard, this chapter concentrate on two aspects. For the first, we will review the nature and meaning of company, which is based on two main theories: contractual and institutional. However, each theory places JSC shareholders in a different position. Accordingly, number of questions concerning JSCs and their shareholders must be addressed, such as: is the company founded by the state, or is it only a contract between people? With respect to shareholders, where do they stand in these two situations? Do shareholders actually own the company, or are they only contributors in the capital for the sake of obtaining profits? How is power and authority distributed within the company? Who are the most significant and influential persons within it? Where does any permanent power lie? What powers do shareholders have?

The position of shareholders in JSCs and the rights they should enjoy will be become clear when these questions are answered. In the second part of this chapter, having identified the position of shareholders in JSCs, we address additional matters relevant to this subject, which revolve around the meanings of share and shareholder, as well as the various types of shares and their characteristics; we also address how a person becomes a shareholder in a JSC, and what happens when they lose membership of the company.

3.2 Company Theory

The two different theories deliver different descriptions of companies, and accordingly the place and role of the shareholders in them also differ. Generally, shareholders can be considered owners of the company when considering the company as a private entity, but if the company is considered an institution created by the state, its shareholders are the providers of capital and are separate and distinct from the company.²⁰²

²⁰² Morton J. Horwitz. Santa Clara revisited: *the development of corporate theory*. *W. Va. L. Rev.* 88. 1985, p. 218

3.2.1 Contractual Theory of Corporation

Contractual theory is considered the oldest attempt at trying to explain the nature of corporation; this theory is based on the idea that a JSC is merely a kind of contract, and that the JSC is dominated by the will of the shareholders from its inception to its closure.²⁰³ The corporation, in this sense, is established through a legal act of will (represented in the agreement of the shareholders) to produce it, and this legal disposition meets the traditional elements of a contract. The partners provide money in return for certain rights such as sharing in potential profits.²⁰⁴

In accordance with contractual theory, the company is considered a nexus contract; this contract is a private contract that falls under the purview of private law. Therefore, the role of the state in such contracts is limited as it must respect the principle of freedom for private parties to enter into contract.²⁰⁵ Consequently, shareholders are considered the owners of the company, and the relationship between them and the managers of the company is based on the nature of the agency; the managers and directors of the board are the agents who work to achieve the interests of the (principal) owners of the company, which are the interests of the company itself.²⁰⁶ Therefore, there are no minority shareholders as the interests of all of them are equal.

The company contract is the legal force that determines how the company exercises its activities; it states the purpose of the company or the activity that the company will undertake, determines the amount of capital required, describes how the capital is to be managed, organizes the relations among the partners and between them and any third party, and details how the company may be dissolved; all of these depend on the will of the partners. Thus, contractual theory treats a JSC as a private contract represented in its memorandum and articles of association; any modification in the company contract is subject to the general rules of civil law. Thus, any decision to modify the memorandum or articles of association of the company regarding the rights of shareholders requires consensus by shareholders

²⁰³ Ahmed Al-Melhem. *Kuwaiti Commercial Companies Law and the Comparative*. Kuwait University Press, Kuwait, 2009, p. 830

²⁰⁴ Mary Stokes. *Company Law and Legal Theory*, in William Twining (Ed), *Legal Theory and Common Law*. Oxford: Blackwells, 1986. 155

²⁰⁵ Henry N. Butler. *The contractual theory of the corporation*. *Geo. Mason UL Rev.* 11 .1988. p. 99

²⁰⁶ Ireland, Paddy. *Company law and the myth of shareholder ownership*. *The Modern Law Review* 62, no.1. 1999: 33

on the amendment. The French Civil Code, in Article 1134, stipulates that contracts are not alterable except for being approved by all contracting parties.²⁰⁷

According to this theory, there should be full consensus on the part of all shareholders when making an amendment. If the company needs to increase its capital, issue bonds or establish a financial reserve, this requires the consent of all shareholders; however, this may be impractical, as a JSC may have a large number of shareholders and it may not be possible for them all to agree on a decision. According to the concept of full consensus if one shareholder objects to a resolution, then that resolution cannot be passed; this is incompatible with the idea that JSCs that need to be flexible in making decisions.²⁰⁸

Contractual theory developed the concept of consensus through jurisprudence; advocates argued for it when the features of JSCs first emerged in the sixteenth and seventeenth centuries, influenced the French Revolution, which demanded complete freedom, including freedom of trade. As a result of the inability of contractual theory to fully comprehend the concept of JSC, the supporters of this theory considered the possibility of allowing a company to modify its articles according to need through voting at a GM, provided that any such modification is subject to the approval of the majority of shareholders, rather than consensus, where all shareholders commit to respect the opinion of the majority when they join the company.²⁰⁹

Contractual theory evolved further through the arguments of Jurist Thaller in 1893; he established what is known as the theory of the “basic rights of the shareholder”. Also at this time, companies developed the concept of an independent legal personality, which is free to act, and which is distinct from the shareholders.²¹⁰ Therefore, the GM of the company is entitled to modify the articles of association, but this power is not absolute; it is constrained by the condition of being non-prejudicial to the fundamental rights of the shareholders, and the company or the legal personality has no right to abolish it without the consent of those shareholders.

²⁰⁷ Article 1134 provides that “Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith”.

²⁰⁸ Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, KSA.1996. p. 156

²⁰⁹ Tamma, Alshammiri, *Commercial Companies Law of Kuwait*, First Edn, Kuwait: Dar Alketab Publishing, 1986, p. 80.

²¹⁰ Frédéric Gilles Serpoul. *Shareholder Protection and Stock Market Development in France (1852-2007)*. P: 30-31.2009. Available at SSRN<<http://ssrn.com/abstract=1529271>>accessed 17 January 2012.

Thaller listed a set of rights that shall not be compromised by the company: a shareholder's right to be heard and taken into consideration, the right not to be excluded from the company, the right to limit the liability of the shareholder to the amount he owns in the company, and the right to dispose of his shares. Modern jurisprudence then further developed this theory, and gave GMs greater powers together with increasing the rights of the shareholders; the shareholders now have more financial and administrative rights, including the right to attend any GM, and to vote on its decisions, the right to sue on behalf of the company to save its interests, the right to sue to defend his own interests, as well as the right to ask the judiciary to cancel or dissolve the company if there is a legal reason to do so; these are in addition to the right to obtain information about the company in a timely manner that enables him to learn of the status of the company, and the right to take part in the management of the company.

3.2.2 Institutional Theory

Some jurists and commentators believe that contractual theory is no longer valid as the basis for shareholders' rights in JSCs; they argue that this approach to corporation contradicts the legal concept of corporation when the entity is founded by the state.²¹¹ Therefore, the right to establish a company should include a public aspect, as its existence is dependent on the will of the state.²¹²

Jurists, in this theory, believe that a JSC is no longer necessarily created by the will of shareholders, but rather it may be created based on laws set in advance; this could be a contract that is coherent with other individual companies (with limited members) to some extent, which could be applied to the JSC at its time of establishment, although this situation would be less relevant when the shareholders enter the IPO phase. Therefore, contractual theory is not consistent with all JSCs, which consist of a very large number of shareholders, unlike individual companies; in addition, the legislature clearly plays a role in regulating them, which means that the shareholder who receives the shares is not a party in the contract of the company but a shareholder in the capital, and he only has to submit to the provisions stipulated by the legislator and organized by the company's constitution.²¹³

According to this theory, shareholders are not considered as owners of the company, unlike the case in contractual theory, and so their relationship with the company can be described as being members;

²¹¹ Henry N. Butler. *The Contractual theory of the corporation*. Geo. Mason UL Rev. 11. 1988, p. 100

²¹² Aloy Soppe. *Sustainable corporate finance*. *Journal of Business Ethics* 53, no. 1. 2004, p. 215

they constitute just one party of all those who have relations with it, in accordance with the various contracts that state their rights and that constitute the entire corporate enterprise.²¹⁴ That is why the board of directors is considered a member of a JSC as well as the GM, auditors and employees; each member has certain duties and rights and the source of these authorities is the law and the company's constitution.²¹⁵

However, when a shareholder receives his shares through the stock market and then sells them after a few days, it is hard to consider him as a party to the contract of the company, as is the case of contractors in other usual contracts; so, the legislature did not want to leave these companies to the desire of their founders, but intervened through peremptory texts to protect stakeholders and dealers within the company equally in order to support the trust and credit that must exist within the business community. The legislature is also concerned with protecting the national economy and national interests, resulting in some argue that, in JSCs, the contractual feature is of limited importance.

JSCs thus consist of two key parts, which are the board of directors and the GM. Some liken a JSC to a democratic state, wherein the shareholders are members of the state and the GM is the legislative authority, whereas the executive authority is the company's board. The GM decides upon the general plans of the company, discusses the annual budget, receives the reports of the board, and controls the performance of the company, whereas the board implements the company's policies and achieves its interests; the shareholders in the company are like individuals who have rights, as stipulated by the law, on the basis that they are members of the company.²¹⁶

In brief, institutional theory, with regard to JSCs, is based on the following arguments:²¹⁷ firstly, the legislature intervenes to a considerable extent in organizing commercial companies, particularly JSCs, through peremptory provisions at all stages of the life of a company, from the establishment phase to the liquidation phase, wherein the will of individuals does not play a significant role; they only obey those provisions. Secondly, at a fundamental level, contracts are designed on the basis of the contrasting interests of the parties, although this feature evaporates in JSCs, as the interests of their members coincide in a common goal, which is to achieve profits and avoid losses as far as possible.

²¹⁴ David Millon. *Theories of the Corporation*. Duke Law Journal, Vol. 1990, No. 2, Frontiers of Legal Thought. 1990, p. 30. Available at < www.jstor.org/stable/1372611 > accessed 14 February January 2012.

²¹⁵ Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, KSA. 1996, pp. 63 – 165

²¹⁶ Mustafa Kamal Taha . *Business Companies*. AlFikr AlJamei House . Alexandria . 2007 – 240

²¹⁷ Tummah Alshemmri, *Al-Waseed fe Derasat Qanoon*. Third Edition, the State of Kuwait, 1999, p. 81

Thirdly, it is based on the idea of common interests, which enables the parties amend the provisions of the act of establishing the company through the majority agreement of its parties; this differs from the nature of a contract, which is based on the idea of consensus to modify its provisions. Fourthly, a legal person arises from a JSC, and this person has its own will, which is independent of the natural persons and will of the shareholders in the company; this legal personality continues into the liquidation phase, to the extent necessary to complete it.

3.3 The Nature of JSCs under SCL 1965

The Saudi legislature has not specified precisely the legal nature of a JSC; however, many jurists agree that a company, in accordance with SCL 1965, is merely a contract. Article 57 of SCL 1965 states, “A) The subscriber, or his representative, shall sign a document setting forth specifically the company’s name, object and capital, the conditions of subscription, the subscriber’s name, address, occupation and nationality, the number of shares subscribed by him, and a covenant to accept the company’s bylaws established by the constituent general meeting. B) The subscription shall be final and unconditional. Any condition laid down by the subscriber shall be considered nonexistent.”

It is understood clearly from the above article that the IPO process of the company’s shares, in accordance with SCL 1965, is a contract between the company’s subscribers. This means that this contract is between one party, which is the company, and the other party, which is the subscriber. Therefore, the issuance prospectus is considered to be an offer by the company to the subscribers, and signing the prospectus is an approval on their part. The company is based on a network of contracts, not only between it and the shareholders or founders, but, in fact, a variety of parties participating with it, such as employees, creditors, managers, distributors and others, and the company must protect their interests, as it does with shareholders.²¹⁸

In general, all the parties to the contracts with the company have an interest related to running the company; those contracts arrange the contrasting obligations and duties of each party. Perhaps the most important of these contracts is the contract between the company and its subscribers, due to the consequent establishment of the rights and duties of the shareholders within the company.

However, the constitution of the company, like other contracts, must be subject to the general legal

²¹⁸ E. M. Dodd. *For Whom Are Corporate Managers Trustees?* 45 *Harv. L. Rev.* 1932, p. 1158

rules pertaining to contracts, wherein the parties should have the contractual capacity to make a contract with free will. On the other hand, the objective of the company's formation shall be a legitimate one and can be achieved, and thus the company must be established for legitimate reasons. A company contract is different from other contracts in that it should meet certain criteria stipulated by law, specifically SCL 1965. This law details certain conditions that shall be met: the agreement of at least five persons to found a JSC,²¹⁹ whether they be natural or legal persons, but not employees of the state. In addition, it is required that each of them contribute in the capital; the share provided by them may be in cash or in kind.²²⁰ Thus, the people who founded the company have the wherewithal to achieve the goals of the company. The aim of founding the company is to achieve financial gains; this is common to all shareholders and not to a certain class, and in the case of loss, the shareholders bear it, each one according to his share in the capital of the company. Finally, it is mandatory to gain the approval of the relevant competent authority before establishing the company; the company appears only after it is approved by MOCI.

Most civil law countries consider the company as a contract between two or more people; for example, we find that French Civil Law stipulates, "Company is a contract between two or more persons agreeing to constitute a common stock with intent to sharing any profit arising therefrom".²²¹ Directly or indirectly, most of the Arab countries consider a JSC to be contract between two or more people, and this is the case in SCL 1965, which states, "A company is defined as a contract under which two or more persons undertake to participate in an enterprise for profit, with each contributing a share in the form of money or service, with a view to dividing any profit (realized) or losses (incurred) as result of such enterprise".²²²

The above denotes that a company is a contractual agreement between two or more parties; their commitment is to work together in order to achieve profit, and those same people contribute with shares in the capital in the form of money or services, with the aim of sharing profits or losses resulting from the project.

Despite the lack of a definition for company in institutional theory, this theory remains the only one that allows us to explain the possibility of amending the shareholders' rights, and that it explains

²¹⁹ Saudi Company Law, 1965 Article 52

²²⁰ Saudi Company Law, 1965 Article 53

²²¹ Article 1832

²²² Saudi Company Law, 1965 Article 1

considering the members of the board of directors of the company and its managers not as merely agents for the company, but as being the authority charged with achieving the common purpose upon which the company is established; it is the idea that, finally, justifies the continuous intervention of the legislature, which is due to the desire to control corporate activities in the economic life of the country and to protect public funds.

In fact, company law gives all parties in the company's contract a series of rights and duties, and at the same time, it also gives the state a number of powers that enable it to play a key role in the establishment and operation of companies. In this respect, *Bratton Seymour Service Company Ltd v Oxborough* showed that “[t]he contract between a company and its members formed by the company's articles derives its binding force not from a bargain struck between the parties but from the terms of the statute...”²²³

JSCs are not absolutely private contracts signed between private parties, and therefore the description of a company is similar to a project organized by rules; some of them are stated in the company's constitution, and the others by law. Thus, it is not true that a company is free, in general, to exclude the application of the rules of law, as the most important of those rules are binding.²²⁴ It is clearly stated in SCL 1965 that, when creating a JSC, the company must provide the particular model of company establishment to the competent government department (MOCI);²²⁵ the Minister of MOCI shall not issue the licence without having examined a study that is submitted by the company and that demonstrates the economic feasibility of the purposes for which the company is being established, unless the company has provided such a study to another competent governmental entity authorized to set up the project.²²⁶

Based on the foregoing, it can be said that a company is not a pure contract nor a pure institute, but

²²³ [1992] B.C.C. 471

²²⁴ Melvin Aron Eisenberg. *Contractual Freedom in Corporate Law*. *Columbia Law Review*, Vol. 89, No. 7 (Nov., 1989), pp. 1486-1487. Columbia Law Review Association, Inc. Available at <<www.jstor.org/stable/1122809>> accessed 17 February January 2012.

²²⁵ Saudi Company Law, 1965 Article 51

²²⁶ Saudi Company Law, 1965 Article 52. The licence application shall be signed by at least five partners in accordance with the conditions stated by MOCI. Thus, the state is involved from the inception of the company, i.e. its establishment, and this continues after the company is established; for example, in any requests for increasing or decreasing the capital, any amendment to the company's bylaws, and any modification of the company's goals and objectives, all of which should be sent to MOCI and the CMA; such situations should be approved by the competent governmental authority.

rather a legal entity based on contractual and regulatory rules, with a different ratio of each according to the type of the company; the amount of contractual rules increases in individual's companies, while the amount of regulatory rules increases in capital companies. The legal nature of the company combines the idea of the contract and the idea of the institute at the same time; it cannot accept any of the two views absolutely.

3.4 The Nature of a Shareholder's Position in a Company and the Basis of his Rights

It is now clear that a JSC has a legal personality independent from shareholders; therefore, it owns itself. Once the license from the Minister of MOCI has been received and the establishment of the company has been announced in the official Gazette,²²⁷ the company becomes a legal entity independent of the founders and subscribers. The consequent result of the decision to declare the establishment of the company is to transfer all actions conducted by the founders to its pact; also, the company undertakes to pay all the expenses incurred by the founders during the period of establishment.²²⁸ Undoubtedly, the principle of company independence has been agreed upon among various legal jurisdictions for a long time, particularly in developed countries; for example, in the UK, in the case *Salomon v. A Salomon & Co Ltd*, Lord Macnaghten said, "The company is at law a different person altogether from the subscribers to the memorandum".²²⁹

Such judicial decisions clearly explain that shareholders of JSCs do not legally possess any portion of the company's assets according to the relevant laws, and the corporation is the only owner of all assets in it; therefore, all the property is under the name of the company.²³⁰ Accordingly, shareholders usually invest their money in shares, not in bonds, because they aspire to gain profit. The fact that the shareholders are owners of shares, not owners of the company, results in the shareholder's responsibility for the company's debts being limited to the amount of his shares; in fact, a share is not considered money, but an interest measured by a sum of money.²³¹ Thus, it is the ownership of shares that entitles shareholders to their rights in the company, not their being owners; however, these rights

Saudi Company Law, 1965 Articles 64 & 65

²²⁸ Saudi Company Law, 1965 Article 56

²²⁹ [1897] AC 22

²³⁰ See: Ireland, Paddy, *Company Law and the Myth of Shareholder Ownership*, 62 M.L.R (1999) p. 32; Mayson, Stephen W., *Company Law*, 15th Edn, London, Blackstone Publishing, 1998, p. 175.

²³¹ [1901] 1 Ch 279, p. 288.

are limited to what is stated in the law or in the constitution of the company.²³² Shares belong to shareholders in a JSC, and as a result, they have the right to do what they want with them, such as sell or gift them; therefore, there is a difference between ownership of shares and ownership of a company.²³³

According to the above, share bearers in a JSC are not the owners of the company, but they are one of the important financial sources for the company. Shareholders provide money for the company in order to obtain financial return, and their responsibility shall be as much as their share in the company's capital; they are not responsible for more than that, and the company is not obliged to deliver positive outcomes for shareholders, i.e. it does not guarantee to pay the shareholder any financial gains each year. The shareholder must be able to withstand the failure of the company, and therefore, the shareholder must have a special position within the company, i.e. he is in a position different from the owners and other stakeholders.

The company actually makes many contracts with other parties, such as creditors, employees and suppliers, who become stakeholders and who have certain rights through these contracts.²³⁴ Thus, shareholders are not protected because the activities and decisions of the company cannot always be predicted.²³⁵ F. Easterbrook and D. Fischel, say that shareholders are 'residual risk bearers'; "We believe that shareholders are residual claimants to the firm's income. Bondholders have fixed claims, and employees generally negotiate compensation schedules in advance of performance. The gains and losses from abnormally good or bad performance are the lot of the shareholders, whose claims stand last in the end."²³⁶

Due to the enjoyment of the shareholders of their position in the company, most legal jurisdictions accord them a wide range of rights that are not given to other interest owners; for example, the right of shareholders to attend the GMs and to discuss the agenda, voice their opinion, vote on resolutions, and object to any issues raised; they also have the right to appoint (and remove) directors,

²³² Ross Grantham, *The Doctrinal Basis Of The Rights of Company Shareholders*. The Cambridge Law Journal 57.3 .1998. pp. 5 62-3

²³³ Gower's *Principles of Modern Company Law*, Paul L. Davies (Ed.), 6th Edn, London, Sweet & Maxwell Publishing, (1997), p. 301.

²³⁴ Cheflins, Brian R., *Company Law: Theory, Structure, and Operation*, Oxford: Clarendon Press, (1997), p. 54

²³⁵ See Jensen, M. and Meckling, W. (1976), Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*. 3.

²³⁶ Easterbrook, F. & Fischel, D., *Voting in Corporate Law*, 26 *J. L. & Econ.* 1983. p. 403.

and in certain cases they may file a suit against them. In general, the shareholders in the company have a variety of rights, whether financial or managerial, stipulated in the relevant laws and in the constitution of the company.

These rights are a real force conferred to them by virtue of their position in the company, and give them the right to participate in the management of company affairs. However, it is noticeable that they often do not exercise those rights in the proper way, and thus they lose some of their power within the company to another party. For instance, many shareholders do not actually exercise their rights at the GM, which is the entity that is supposed to support the board of directors in their efforts to control the company. There are many reasons for the absence of shareholders participating in the GM, and perhaps the most important is the large number of shareholders; this may mean an individual shareholder expects that his vote will have no value in company decisions, or it may be simply that some shareholders do not care about the minutiae of running the company, but are only focused on the financial benefits. Nevertheless, if the company does not meet their expectations, then the easiest way for them to leave the company is to sell their share in it.

Making money for its shareholders is not the only goal of the company;²³⁷ the company cannot be limited only to the members of the board of directors and its shareholders because there are stakeholders other than shareholders who are in relationships with the company via contracts that legally bind the two parties. Based on this, there is an obligation on the company to take their interests into account, as well as towards the wider community.²³⁸ The company must not ignore the rights of non-shareholders, as there is full protection of their interests through by the provisions of the law and the company's articles.²³⁹ There are several ways to protect the interests of those other groups; for example, company employees, according to the Saudi System, are under the protection of labour laws, and in the UK, CA 2006 in S. 172 commits members of the board of directors to work in good faith in order to achieve the interests of the company, including the interests of its employees and staff.²⁴⁰

²³⁷ See Dodd, E., *For Whom Are Corporate Managers Trustees?* 45 *Han' L. Rev.*1932. p. 1145.

²³⁸ Milton, David, *Theory of the Corporation*, D.L.J .1990. P: 229

²³⁹ Kraakman, Reinier, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock. *The anatomy of corporate law: a comparative and functional approach*. Oxford: Oxford University Press. 2009. p. 100. However, many western countries in the EU now have mandated employee protection in at least some large companies.

²⁴⁰ Duty to promote the success of the company. (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to— (a) the likely consequences of any decision in the long term, (b) the interests of the company's employees,

Also, there is a set of provisions under the Saudi CL for protect the interests of the company's creditors.²⁴¹ Furthermore, we find emphasis on the importance of protecting the interests of non-shareholders in the case of *Lonrho v. Shell Petroleum Co Ltd*, which ensured that directors should care for the interests of non-shareholders, holding, "These are not exclusively those of its shareholders but may include those of its creditors".²⁴²

3.5 Definition of a Share

There is no specific definition of the term share within SCL 1965, as is the case in many countries, and in general, jurists define share in several ways. Nevertheless, it is important to clarify the meaning of the term share if the rights and obligations of shareholders are to be properly determined. The Saudi Capital Market (Tadawul) defines a share as an investment that represents an ownership portion in a company, and accords its owner the right to receive a part of the profits of the company and its assets;²⁴³ it is also defined as an instrument issued by JSCs with a certain nominal value, representing a partner's share in the capital.²⁴⁴ A share is thus defined as a part of the company's capital, and it gives its owner the right to a share of the profits achieved by the company (and approved by GM) to be distributed to shareholders.²⁴⁵ Due to the above, a share can be defined as an instrument that represents equal parts in the ownership of the company's capital (whether in kind or in cash), that is owned by multiple parties, that is indivisible and negotiable, and that entitles its bearer certain rights and imposes certain responsibilities.²⁴⁶

A definition of share is not included in the CA 2006 of the UK;²⁴⁷ it could be that the most common judicial definition is that of Farwell J. in the case *Borland's Trustee v Steel Brothers & Co Ltd*,²⁴⁸ where he says, "A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series

²⁴¹ For example Article 143 of SCL 1965 states, "(1) If the reduction of capital is due to an excess in capital over the company's need, the creditors must be invited to express their objections within sixty days from the date of the publication of the resolution for reduction in a daily newspaper and distributed in the head office of the company".

²⁴² [1980] 1 WLR (HL) 627.

²⁴³ See <http://cma.org.sa/cma_ar/glossary/frameset_t.htm> accessed 26 February January 2012.

²⁴⁴ Fread ALarini, *Commercial Companies*, Cairo, DAr Aljamah Publishing. 2007. p. 314

²⁴⁵ Mohamad Almajmah. *Moajam Almstlahat Alislameh* . Obeikan Publishing. 2010. p. 210

²⁴⁶ Model Articles of a Saudi Joint Stock Company, Article 7

²⁴⁷ S.540 of the CA 2006 of the UK provides "(1) In the Companies Acts "share", in relation to a company, means share in the company's share capital".

²⁴⁸ [1901] 1 Ch. 279

of mutual covenants entered into by all the shareholders *inter se* in accordance with Companies Act (now the CA 2006, S.33 (1)). The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.”²⁴⁹ Nevertheless, RR Pennington sees that in formally registered companies, shares are a kind of immaterial tradable ownership that result in a group of rights and obligations associated with some benefit in a company with economic activities and owned by certain people, laying no debts.²⁵⁰

3.6 Features of Shares

A share is considered as the shareholder’s portion in the capital of the company, and this share has a certain financial value; ownership of it entitles the holder to a set of rights and requires of him some obligations. The question that should be asked here is: What are the characteristics of a share? Also, what are those rights given to a shareholder in accordance with those characteristics? In general, SCL 1965 mentions several features of shares when referring to JSCs; the most important of which are that a share is freely negotiable, and that a shareholder’s liability is limited. Then, it mentions another feature of shares in Article 98, which is that a share is indivisible, having a stated nominal value. Each of these features are discussed in the following subsections vis-à-vis multiple shareholders’ rights in a JSC.

3.6.1 Shares Are of Equal Nominal Value

One of the features of shares in JSCs is that they are of nominal equal value, and this is stated in Article 48 of SCL 1965, “A) The capital of a corporation shall be divided into negotiable shares of equal value”. The equity of the value of shares means that it is not possible to issue shares in a different nominal value; the purpose behind this is to unite the rights and duties conferred by shares of the same type upon their holder, and this would facilitate the process of share trading in the capital market, the exercise of the voting process in the shareholders’ assemblies, and the distribution of profits and losses. Therefore, the capital can be divided into different classes of shares, provided that the nominal value of each class is equal.²⁵¹

²⁴⁹ Sealy & Worthington. *Cases and Materials in Company Law*. 8th Ed. Oxford: Oxford University Press, 2010, p. 518

²⁵⁰ Pennington, Robert, *Can Shares in Companies be Defined?* 10 Co. Law. 1989. p. 144.

²⁵¹ Fread ALarini, *Commercial Companies*, Cairo, Dar Aljamah Publishing. 2007. p. 204

Thus, the company may issue premium shares that entitle their owners to priority in profits, or in the output of liquidation, or in both; however, there must be equality between similar shares that belong to a certain class.²⁵²

However, it is important to distinguish between the types of value, i.e. whether it be of nominal, actual or commercial value. The nominal value is the result of dividing the company's capital by the number of shares; therefore, the nominal value of the total shares represents the company's capital. Article 49 of SCL 1965 stipulates that the value of the share shall not be less than 50 SAR. The issuance value is the value at which the share is issued; the issuance value shall be identical to the nominal value when the company is founded. Article 98 of SCL 1965 states that shares shall not be issued at less than their nominal value, but they may be issued at higher than this value if the company's bylaws state so, or the GM approves it. The commercial value is the share's value in the stock market, which is subject to going up or down, depending on many factors relating to the financial market in general, such as new ventures, political and economic conditions of the state, as well as the amount of profit offered by the company, the rise in the value of its assets, and the prospects for the company's future projects. The actual value is the part that a share deserves in the net assets of the company after deducting its debts and obligations. If the company succeeds, the actual value of the share rises; if it does not, the actual value falls, and this value is given to the shareholder upon liquidation of the company.

3.6.2 Indivisibility of the Share

Shares are characterized as being indivisible, i.e. the ownership of a share may be shared by more than one person, regardless of the reason for owning it, e.g. whether it is a gift, bequest or inheritance. Article 98 of SCL 1965 explicitly stipulates, "A) Shares of stock of companies shall be indivisible as far as the company is concerned. If a share is jointly owned by several persons, these must elect one of their numbers to exercise their rights attached to such share on their behalf." Therefore, those rights cannot be divided; for example, not all the owners of a share may attend and vote during a GM; therefore, there must be someone who represents them before others, and that person shall be jointly responsible for the obligations arising from their ownership of the share. The company in this context recognizes the share more than the shareholder.²⁵³

²⁵² Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, KSA.1996. pp. 160-259

²⁵³ Munir Ibrahim al-Hindi, *Securities and capital markets*. 230 Facility knowledge, Alexandria, 1991. p. 230

3.6.3 Share Transferability

Shares are characterized as being freely traded; shares can be traded to others without the consent of other shareholders, unlike the transfer of quotas in personal companies. Thus, every shareholder can transfer the ownership of his shares to another person through commercial means very easily.

Therefore, by virtue of their ownership of the shares, a shareholder is entitled to their free disposal; he can treat his share as he likes, such as to sell, donate or mortgage it as well as to authorize someone to do these.

This property is one of the most important characteristics of JSCs, and it one that encourages investors to join these companies. SCL 1965 provides this feature explicitly in Article 48; shareholders, according to SCL 1965, can deal in shares in the stock market through licensed brokers, after fulfilling the required conditions. In certain cases, the law or the company's bylaws restrict the negotiability of the company's shares in the public interest;²⁵⁴ such a restriction is limited to a specific period, for example, in the case of founders' shares and the shares of the members of the board of directors; in any case, share trading cannot be prohibited.²⁵⁵

3.6.4 Shareholder's Liability is Limited to Share Value

The shareholder is not liable for the debts of the JSC except for within the limits of his ownership of shares; nor does he acquire the status of merchant because of his contribution in the company's capital.²⁵⁶ This feature is one of the most important characteristics of shares in JSCs, and it encourages a great many people to invest their money in JSC shares instead of shares of other companies. The company is to bear the risks regardless of its levels debt or the extent of its loss; the company here has a legal entity independent from the shareholders. Nothing contrary to this can be agreed upon even if mentioned in the memorandum of association or through a decision taken by the GM.

CA 2006 in the UK states that JSC shareholders shall only bear limited liability, which must not involve their personal property; as a result of this, the financial liabilities cannot be extended by any

²⁵⁴ Article 544 of the AC 2006 provides, "(1) The shares or other interest of any member in a company are transferable in accordance with the company's articles. (2) This is subject to (a) the Stock Transfer Act 1963 (c. 18) or the Stock Transfer Act (Northern Ireland) 1963 (c.24 (N.I.)) (which enables securities of certain descriptions to be transferred by a simplified process), and (b) regulations under Chapter 2 of Part 21 of this Act (which enable title to securities to be evidenced and transferred without a written instrument)."

²⁵⁵ Saudi Company Law 1965 Article 101

²⁵⁶ Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, KSA.1996. p. 168

resolution issued by the company. There is a key difference between a JSC and its shareholders in that a JSC has a separate legal entity with an independent personality, which is reflected in liability; this basic principle was established by the House of Lords in the case of *Salomon v A Salomon & Co Ltd*,²⁵⁷ which found, “The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is precisely the same as it was before, the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the act.”

Moreover, as stated in S.58 of CA 2006, JSCs must mention ‘Public Limited Company’, or ‘plc.’ in their names. As a public company, otherwise it may be considered to have committed a criminal act.²⁵⁸

3.7 Types of JSC Shares

JSCs have the right to issue various categories of shares that give their holders different rights; therefore, a shareholder’s rights are dependent to the type of shares he has. JSCs issue shares with certain rights in order to attract certain categories of investors, and certainly the existence of different classes of shares and shareholders tends to encourage investors to invest their money in such companies. The company may deliberately issue such shares in order to preserve the voting power of the current shareholders, whereupon, for example, it issues preference shares that have no voting rights. In general, this diversity is due to the nature of the quota provided on the one hand, where shares are divided into monetary or in-kind contribution shares, and due to the nature of the rights associated with the share on the other hand, where shares are ordinary or preference shares. Shares can also be divided according to whether the shareholder has recovered the value of the share or not, into dividend and enjoyment shares, and finally, they can be divided according to the manner in which they are traded: registered, bearer and ordered shares.

It could be said that the most well-known shares issued by JSCs (and by far the most common) are the

²⁵⁷ [1897] AC 22.21.

²⁵⁸ See: S. 1197-1198

ordinary shares and the preference shares. Nevertheless, there are various sub-types that are issued by JSCs according to particular needs, of which the most usual are: deferred shares, non-voting shares, shares with limited voting rights and employee shares. The most important of these types are stipulated for in SCL 1965, and accordingly are reviewed in the following subsections.

According to SCL 1965, JSCs shares can be divided according to the nature of the proportion, which is either monetary or in-kind; however, in the case of monetary shares, the payment of its value should not be less than a quarter of its nominal value.²⁵⁹ Monetary shares are tradable once the company receives the approval of the CMA; in-kind shares (such as land, real estate, equipment) are accredited by the Saudi CL but are subject to certain provisions. In-kind shares shall not be handed to their owners before the transfer of full ownership of these shares to the company.²⁶⁰ When offering in-kind proportions, GAFC, upon the request of the founders, appoints one or more experts, in order to verify the assessment of the in-kind shares; the expert reports to the GAFC within thirty days from the date of assigning him to such task, and the GAFC may (upon the expert's request) grant him another period not exceeding thirty days. GAFC sends a copy of the expert's report to the founders who should, in turn, distribute it to subscribers fifteen days at least prior to the constituent meeting. The report is to be kept in the company's head office, where any interested person may see it.

The report shall be presented at the constituent meeting for deliberation; if the constituent meeting decides to reduce the return specified for in-kind proportions, or to reduce the special benefits, then the providers of the in-kind shares and the beneficiaries of any special benefits must accept this reduction during the meeting; if they refuse to accept this reduction, the memorandum of association is considered null for all parties.²⁶¹ The purpose of these measures is to ensure credibility and accuracy in the process of assessing the in-kind shares in order to protect the shareholders, and make sure they conform to the real value; such share values may be exaggerated by owners who might seek to raise their value in order to gain a larger share in the company.

²⁵⁹ As stipulated explicitly in Article 58 of Saudi Company Law 1965

²⁶⁰ Saudi Company Law 1965 Article 60

²⁶¹ Saudi Company Law 1965 Article 59(4)

3.7.1 Ordinary & Preference Shares

The general rule is that all JSC shares are shares of equal nominal value, as an application of the principle of equality between shareholders in the rights and obligations stipulated in the CL and the company's memorandum and its articles, as explicitly stipulated in Article 103 of SCL 1965, "1) Shares carry equal rights and obligations".

If the company has a single class of shareholders, then certainly they are the owners of ordinary shares; the owners of these shares are the common shareholders in the company, and that is why some scholars consider the holders of ordinary shares to be the owners of the company (because they contribute the largest part of the capital). This means that the owners of these shares have an important role in monitoring the performance of the company's management in order to achieve the interests of the company itself and its shareholders. The most important characteristic of ordinary shares is that the bearer has a set of rights, including the right to attend the GM, as well as the right to vote;²⁶² for example, SCL 1965 gives one vote per ordinary share, and prevents the share from having more than one vote. In addition, a company is allowed to issue such ordinary shares in a different class.²⁶³

Ordinary shares, as the name implies, are also called 'common' shares;²⁶⁴ they do not accord their owners any preferential rights, and they are considered equal at the GMs, in dividing profits, at liquidation, etc. However, they take their share of the profits only after the owners of preference shares, in accordance with the company's articles.²⁶⁵ Thus, the shareholders of ordinary shares do not receive a fixed annual profit as is the case with the owners of preference shares; rather, their profits depend on the company's financial status and what has achieved by the end of each fiscal year.²⁶⁶ On the other hand, when the company is under liquidation, for whatever reason, the owners of ordinary shares are returned the value of their shares, after fulfilling their obligations to the company, such as satisfying the rights of creditors and preference share owners; if a surplus remains after liquidation, then it is distributed among ordinary shareholders, each according to his share in the capital (they

²⁶² Stephen Griffin. *Company Law: Fundamental Principles*. England. Pearson Education Limited. Third Edition. 2000. p. 31

²⁶³ *ibid*

²⁶⁴ Gower, L. C. B. *Gower's Principles of Modern Company Law*. London: Sweet & Maxwell, 1997. p. 826

²⁶⁵ Ben Pettet, John Lowry & Arad Reisber, *Pettet's Company Law: Company and Capital Markets Law*. Pearson Education Limited. 2009. p. 294

²⁶⁶ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011. p. 537

receive nothing should there be no surplus after the liquidation).

As for preference shares, SCL 1965 entitles the GM to decide to issue these, or to convert ordinary shares into preference ones, unless the company's articles provide on the contrary. Therefore, there should be a provision in the law or in the company's articles authorizing the issuance of such shares.²⁶⁷ It could be argued that preference shares afford their owners additional rights and privileges not found in ordinary shares; these may be of a managerial or financial nature, or both. If the aim of ordinary shares is the generation of capital, then preference shares encourage investors to join the company for additional features.

Generally speaking, there are several ways to issue shares; when founding a company, it is possible to allocate preference shares alongside ordinary shares, and when the company already exists, it may issue preference shares to increase its capital, either through converting bonds, or converting ordinary shares into preference ones. When the company is generating profits, it is entitled to distribute preference shares to shareholders, each according to his share; the final way is by converting an amount of the optional reserve into capital and customizing it to issue preference shares.²⁶⁸

Preference shares take either of two forms; the first is shares that give their owner preferential rights or priority in receiving a certain percentage of the profits before other shareholders, i.e. before the holders of ordinary shares. The second form is shares with multi-votes that give each share more than one vote; given that these shares offer minority shareholders the opportunity to control the company's decisions through multiple votes, even though they do not own the majority in the capital, some legislatures have prevented the issuance of such shares; this is stipulated in Article 103.2 of SCL 1965: "Preferred shares may vest their holders with priority in the receiving certain dividends and/or in receiving their paid-in capital upon liquidation, or with any other benefits, but no multiple-vote shares may be issued".

There are two key reasons for the company wishing to issue preference shares: to increase the financial resources available to the company through attracting a certain category of investor, and to use other

²⁶⁷ In the UK, the Model Articles allow the company to issue different shares have different rights, S. 2 provides, "Subject to the provisions of the Act and without prejudice to any rights attached to any existing shares, any share may be issued with such rights or restrictions as the company may by ordinary resolution determine".

²⁶⁸ Ahmed AlMelhem. *Kuwaiti Commercial Companies Law and the Comparative*. Kuwait University Press, Kuwait, 2009, p. 856

people's money without involving them in the administration (most preference shares do not have the right to vote, nor can they participate in management). Therefore, the company can acquire what it needs in the form of additional funds without any interference on the part of shareholders in the management.

There are several types of preference shares, such as cumulative and non-cumulative preference shares, convertible preference shares, participating and non-participating preference shares, convertible and non-convertible preference shares and redeemable and non-redeemable preference shares.²⁶⁹ Also, the company can issue preference shares convertible into ordinary shares at a particular time, or in certain cases, or when shareholders wish; the aim of these shares is to encourage investors to contribute to the company by reducing the risks they might face, where the conditions of the issuance of these shares include giving their holders the right of option to convert them into a certain number of ordinary shares.²⁷⁰

The company's articles may also allow the preference shareholders to receive part of the remaining profits together with the owners of ordinary shares, i.e. after fulfilment of their own preference shares first. Ordinary shareholders participate in the remaining profits under agreed terms, and preference shareholders may participate in the form of a rate akin to what ordinary shareholders receive. Thus, if the dividends for preference shareholders are 10% for example, ordinary shareholders shall then also receive 10% but only after the completion of the preference shareholders; what remains of the profits can then be distributed among the holders of ordinary and preference shares in an agreed-upon manner.²⁷¹

JSCs shall not issue any new preference shares that affect the rights of the existing preference shareholders because such an issuance would affect the priority that they enjoy; this is explicitly stipulated in Article 86 of SCL 1965. This provision shall also apply when modifying or cancelling the planned priority rights of preference shares in the company's articles.²⁷²

With regard to the attitude of Islamic law in terms of priority to profits in preference shares, or in terms

²⁶⁹ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011, p. 536-537

²⁷⁰ Brenda Hannigan. *Company Law*. Oxford: Oxford University Press. Third Edition. 2009, p. 331

²⁷¹ *ibid*

²⁷² Saudi Company Law 1965 Article 103

of priority access to the company's remaining funds after liquidation, some argue that the issuance of this type of share is *haram* (taboo or forbidden); they argue that shareholders are all equal in their rights. Resolution No. 63(7/1) 1992 issued by the Fiqh Council for the Organization of the Islamic Assembly (at its seventh conference) says, "It is not allowed to issue preference shares that have financial characteristics, leading to a capital guarantee or ensuring an amount of profit, to be provided upon liquidation or at the distribution of profits; however, some shares can be given characteristics related to procedural or administrative matters on condition that these should be stipulated in the subscription document".

The reason for this is that the owners of preference shares do not inject any extra money or do any extra work to deserve such an increase in profit. Moreover, the fixed ratio taken by the owners of preference shares from the profits is, in fact, a form of interest (usury) because it is an unreciprocated increase, and interest is taboo, as the company might not achieve profits other than this ratio; this will cause harm or injustice to the other shareholders, and will undermine their rights, something that is not permissible in Islam. In addition, the company is based on risk (either it achieves profits or losses); the loss is actually in the capital, and if the company were to guarantee to return the value of these shares to their owners, this would contravene the basic precept of the company, as they, in the event of loss, would receive the value of others' shares, which is contrary to justice, is prejudicial to the other partners, and is not religiously permissible.²⁷³

3.7.2 Redeemable Shares

Equity shares are those whose value cannot be paid back to the holder before the end of the company or after paying its creditors; thus, a shareholder remains a partner in the company as long as it exists. However, redeemable shares can be issued by the company (as this is one of its rights), and these shares can be issued as ordinary or preferred shares; they constitute part of the capital, which then can be disposed of during the life of the company.²⁷⁴ Issuing redeemable shares is subject to the company's articles.

The company may be forced to issue such shares if it fears losing its assets at the end (as in the case of mines and quarries, which end after a certain period, or in the case of the company receiving

²⁷³ Mubark Al-Fawaz. *Financial markets from an Islamic perspective*. King Abdulaziz University Press. KSA. 2010

²⁷⁴ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011, p. 539

governmental privilege, where the company and its assets are vested in the government at the end of the agreed period, such as in electricity, water and transport companies).²⁷⁵ The Saudi legislature details certain conditions that must be met for the consumption of shares to be valid; the company's articles must provide that it is possible to redeem shares during the life of the company (otherwise, it requires that an EGM be convened to amend the company's articles in order to allow the shares to be redeemed).²⁷⁶

Another condition is that the redeeming of shares is a project that gradually perishes, or is based on temporary rights; the latter condition is that any shares redeemed shall be taken from the profits or reserves (which may be disposed of). According to SCL 1965, shares are consumed through an annual draw or in any other way that achieves equality between shareholders. The holders of these share have fewer rights than those of the shareholder whose shares have not yet been redeemed, such as their right to profits and to attend the GM, and their right in the liquidation surplus; thus, the owner of the these shares still retains his capacity as a partner in the company, where he is given all the rights granted to owners of ordinary shares except for redeeming the share's nominal value upon liquidation of the company, due to the fact that they have already redeemed the nominal value of their shares.²⁷⁷

3.7.3 Classifying Shares According to the Way in they Are Traded

There are two basic types of shares issued by JSCs, which are the most common and most requested by shareholders: nominal shares and bearer shares. The nominal ones are those in whose certificate the name of the share owner is mentioned, and their property can be transferred to another person, where this transfer must be registered in the shareholders' register at the company or in the stock exchange. The transfer of property shall be carried out through certain mechanisms, as stated by CL, wherein the buyer replaces the seller, and this is registered in the company records. On the other hand, bearer shares do not carry the name of the owner, and are known only by their number; they are movable properties subject to the rule of tenure in movable property, i.e. they are ownership

²⁷⁵ Saudi Company Law 1965 Article 104

²⁷⁶ Ibid

²⁷⁷ Sameha, Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, 1993, p. 356

documents, and are transferred by handing or delivery.²⁷⁸ SCL 1965 stipulates that a JSC's capital is divided into cash or in kind shares, and that shares remain nominal until their value is fulfilled.²⁷⁹

3.8 Definition of Shareholder

SCL 1965 and the majority of Arabic legislations do not contain a precise definition of a shareholder,²⁸⁰ in general, shareholder as any natural or legal person who owns one or more shares of the shares of the company, whether he received them through subscription when the company was started, or as the outcome of ownership after it was founded. In either case, the holder acquires property,²⁸¹ and consequently, a shareholder is entitled to a range of rights and obligations.²⁸² Both 'partner' and 'member' in the context of JSCs refer to a shareholder; shareholders are partners in the company which is a separate legal entity, and in a JSC, they are not responsible for the debts of the company (only in so far as they share in the capital).²⁸³

Generally speaking, shareholders are classified into individual investors and institutional investors. Individual shareholders are natural persons investing their own money, while institutional investors are organizations investing other people's money in a variety of securities. The institutional investors are considered the largest investors in global financial markets; for example, in the UL, the institutional investors constitute more than 70 percent of investors in securities, and have a significant effect on JSCs.²⁸⁴ Some examples of institutional investors are endowment funds, investment companies, mutual funds, brokerage firms, investment banks, pension funds and insurance companies.²⁸⁵ This is the opposite situation in KSA, where individual investors constitute the bulk of investors in the

²⁷⁸ Saudi Company Law 1965 Article 102

²⁷⁹ Saudi Company Law 1965 Article 99. However, bearer shares do not carry the names of their owners, and any person carrying these documents is considered a shareholder in the company. According to this concept, Islamic law does not permit issuing such shares by the company because the owner is indefinite; that will lead to conflict, antagonism and a waste of rights. If the document is stolen, captured, lost or taken by another person, he will be the owner of the share by virtue of the law.

²⁸⁰ However, in Kuwait Company Law, Article 130 provides a clear definition of a shareholder in a JSC; this article provides, "The promoters who have subscribed to the company Memorandum and Article of Association, as well as subscribers who have subscribed for its shares, shall be deemed to be members of the company and shall have equal rights and be subject to the same obligations, with due observance of the provision of the law".

²⁸¹ Ali AlMazaini. *Osul Alqanon Altjari*. Egyptian Alnahdah Publishing, p. 26

²⁸² Saudi Company Law 1965 Article 96

²⁸³ Pamer in *Company Law* stated the nature of a share in a company thus, "The shareholder is the proportionate owner of the company but he does not own the company's assets which belong to the company as a separate and independent legal entity." Cited from *Whittome v Whittome* (No. 1). [1994] S.L.T. 114

²⁸⁴ Brian Cheffins, *Company Law: Theory, Structure and Operation*, Oxford University Press, 1997.

²⁸⁵ See <www.investorsuk.co.uk/institutional-investors.php> accessed 17 February January 2012.

Tadawul, while institutional investors do not constitute more than 30 percent of investors.²⁸⁶

Shareholders can also be divided according to their amount of shares in the capital; there are a majority and a minority. The majority does not mean that they constitute the largest number in the company, but rather they have a controlling stake the company; they may be one person or more, but they have significant influence over the company's affairs. For example, they have influential voting power at the GM, and they can form the board of directors according to their interests.

On the other hand, small shareholders constitute the minority, and they are usually dominated by the majority shareholders; their influence is so weak that they do not seem to be included in the company's activities, with minimal control over the company²⁸⁷. At the time of writing, there is no clear definition for minority shareholders in SCL 1965, but it is indicated in some of the provisions; the SCGRs define them as "shareholders who represent a class not in control of the company in so far as they are unable to influence it"²⁸⁸.

3.8.1 Terms of Membership in a JSC

A shareholder in a JSC may be an individual or a group, a natural person or a legal entity; if there is a group of shareholders who have a number of shares, there shall be a representative for them in the company.²⁸⁹ A company can also be a shareholder in another company if this is provided in company's bylaws, so it too shall have a representative on its behalf in the company. In case a shareholder dies, his shares are transferred to his legal heir; if the heir is more than one person, one of them shall represent them in the company, and the full right to exercise the rights granted to the deceased shareholder shall be transferred to him, such as the right to transfer shares, attend and vote at

²⁸⁶ See: World Bank Group and The Institute of Corporate Governance. *Corporate Governance Survey of Listed Companies and Banks across the Middle East and North Africa*, International Finance Corporation. 2008, p. 22.

²⁸⁷ Cheng, Yong. *On the Protection of the Rights and Interests of Minority Shareholders in Listed Companies*. International Journal of Business Administration 3.2 (2012), p. 54.

²⁸⁸ Corporate Governance Regulation of Saudi Arabia. Article 2 (B) of the SCGRs. The definition of shareholders under CA 2006 UK is clearer than in SCL 1965, S. 112 states, "The subscribers agree to become members of the company, and they have to be entered in its register of members; any other person is a member of the company if s/he agrees to become a member, and whose name is entered in its register". Generally speaking, there are certain ways for somebody to become a shareholder in a JSC: to subscribe to the memorandum of association of the company; to buy a number of shares in the company; to receive shares transferred from a member already existing in the company; to obtain shares through transmission as a result of death or bankruptcy of a member. Cited from: Brenda Hannigan. *Company Law*. Oxford: Oxford University Press. Third Edition. 2009, p. 304

²⁸⁹ 98 Saudi Company Law 1965 Article

shareholder meetings, and receive profits; he shall also bear the obligations entailed in the share.²⁹⁰

There is nothing in SCL 1965 or in exchange law that refers to a shareholder's capacity in JSCs, but it can be said that the general rules of Islamic Law apply; a person who is a minor can be a shareholder in a JSC,²⁹¹ unless the company's articles provide that a shareholder must be an adult, or that a minor must have a guardian who is then the legal representative of that minor in the company.

According to SCL 1965, all JSCs established in KSA are of Saudi nationality,²⁹² and their headquarters are in KSA; all Saudi and Arabian Gulf State citizens are entitled to contribute²⁹³ and to practice commercial activities within these countries in accordance with the agreements signed by their respective governments.²⁹⁴ One such activity is owning shares in companies listed on the capital markets, and therefore anyone can become a member of a JSC unless the CL or the company's articles state otherwise. According to SCL 1965, residents of KSA are also entitled to be shareholders in JSCs but they are only entitled to subscribe in any capital increase; new JSCs are limited in subscription to the citizens of KSA and the Gulf States, unless the company's articles provide otherwise.

In fact, both institutional and individual foreign investors are allowed to buy swaps to invest in the Tadawul;²⁹⁵ this was decided on 18 August, 2008 by the CMA.²⁹⁶ However, the investment is actually indirect and known as a Swap Agreement; this process is expedited through a brokerage firm licensed and certified by the CMA, and the legal ownership of the shares belongs to the brokerage firm. These

²⁹⁰ S. 774 of CA 2006 UK

²⁹¹ A minor person is under 18

²⁹² Article 11 of the Listing Rules provides, "A. The issuer must be a Saudi joint stock company, except where the provisions of Article 14 of these Rules apply".

²⁹³ It is intended by the citizens of GCC Gulf the natural persons who have the nationality of one of the Gulf Cooperation Council countries, and legal persons whose most of their capital is owned by citizens of the GCC countries or their governments, and has the nationality of a country of the Council, in accordance with the definition contained in the decision of the Supreme Council for the Cooperation Council for the Arab Gulf States which was issued at its fifteenth meeting, and was approved by the decision of the Council of Ministers No. (16), dated 27 May 1997.

²⁹⁴ Council of CMA decided to apply full equality between the citizens of the Gulf Cooperation Council (GCC) and Saudi citizens in the areas of Securities and trading, as in implementation of the Cabinet decision No. (267), dated 2008 regarding the application of full equality between the citizens of the GCC countries in the field of owning and trading listed shares.

²⁹⁵ Gordon Platt. *Saudi Market Opens to Foreign Investors*. *Global Finance*, 22(9). 2008, pp. 20-20. Available at <<http://search.proquest.com/docview/198766672/abstract?accountid=14494>> accessed 25 February January 2012.

²⁹⁶ Circular issued by CMA No. 2/28/2008

agreements are of various types, such as currency swaps, commodity swaps, interest swaps, equity swaps and credit default swaps; equity swaps are the most common type in KSA.²⁹⁷

A foreign investor is entitled only to the profits of shares, to gifts in any increase in capital, and to subscribe in the capital increase of JSCs. Exercising the rights related to shares, such as attending and voting in GMs, running for election on the board of directors as well as other rights are for the brokerage firm only.²⁹⁸

KSA recently joined the WTO; in order to keep pace with global developments in the field of business, the government has decided to open its doors to foreign investment and expertise, and they are now allowed to directly invest in the capital market. There may be some state restrictions on foreign investment but they are generally designed to ensure that economic development in the Kingdom is appropriate to its needs and/or culture. Perhaps, the most prominent advantage of opening the door to foreign investment is that it makes KSA an attractive investment destination for large multinational corporations, which will contribute to the development of the country's economic growth, provide liquidity and enhance the effectiveness of the market, as well as promoting levels of disclosure and transparency in the market.²⁹⁹

3.8.2 Register of Members

Under the law, all companies, particularly JSCs, must keep a special register of shareholders, which shall include the names of the members, their addresses, the number of shares held by each, the amount paid for each share, the date of registration of each member, and the date on which any member left (including the manner in which he left). This register shall be kept in the head office of the company, or in another place stipulated in the company's articles; all shareholders in the company shall be allowed to view it for free, as well as anyone from outside the company in return for a reasonable fee. This register is an important tool in determining the status, rights and obligations of each shareholder in the company; this is referred to in SCL 1965.³⁰⁰

²⁹⁷ Research Department. *The Financing Role of the Saudi Capital Market. Promising Prospects*. Economic Reports. Aljazira Capital Company. worldbank.org/ifa/rosc_cg_saudia

²⁹⁸ Ibid

²⁹⁹ Research Department. *The Financing Role of the Saudi Capital Market. Promising Prospects*. Economic Reports. Aljazira Capital Company. 2010, p. 32. Available at <www.aljaziracapital.com.sa/jaziracapital/report_file/ess/ECO-4.pdf> accessed 18 February January 2012.

³⁰⁰ Saudi Company Law 1965 Article 102(1)

Unfortunately, SCL 1965 does not cover all the issues relating to the register of shareholders, such as what legal provision there may be in the case of a company preventing a shareholder (or others) in gaining access to a copy; nor does it address under what conditions the law can prevent a shareholder from browsing the register. It also does not consider the legal ramifications of a company changing the register or deleting somebody without justification. On the other hand, CA 2006 UK regulates (in Section 2) the provisions of the shareholders' register in detail, covering many of the issues that may arise, and states the appropriate punishment in the case of any violation of the provisions of these materials; for example: every company must keep a register of its members;³⁰¹ if it has more than 50 members, it must keep an index of the names of the members of the company;³⁰² the index and register must be at all times kept available for inspection at the same place, or at a place specified in the regulations under Section 1136, within working hours.³⁰³

3.8.3 Termination of Shareholder Membership

A shareholder in a JSC ceases to be a member when his name is removed legally from the register of shareholders in the company; this happens for several reasons as stipulated in the CL or in the company's articles, but the most important of which is when a shareholder leaves the company. When the shareholder transfers the ownership of his shares, whether to another shareholder or to the company, he leaves the company, and a new owner replaces him.

Membership also ceases when the shareholder's shares are confiscated by virtue of law or by court, or upon the death of the shareholder; he then loses the status of being a partner, and his shares are transferred to the legal heirs, and thus they become new partners in the company, with the same rights and obligations of the shares. If there is more than one heir, one of them shall represent them in the company. In addition, membership ends when the company is dissolved and enters liquidation; it also ends when the shareholder retrieves the value of his shares in the capital of the company in the case of a merger with another company (or in some other manner of acquisition).

3.9 Conclusion

As we have seen in this section, a JSC is not entirely based on contractual theory, nor is it an organization created by the state. The parties who sign the constitution of the company are not the

³⁰¹ S. 113 of the CA 2006 UK

³⁰² S. 115 of the CA 2006 UK

³⁰³ S. 116 of the CA 2006 UK

owners of the company; rather, they are the providers of capital, according to establishment theory. Thus, shareholders are considered owners of shares in the capital of the company, and they bear the company's debts in accordance with their ratio in the capital. This means that a JSC is a mixture of the two theories, and it is clear here that the company is a legal person entirely separate from its shareholders, having its own possessions. Therefore, it cannot be said that the Saudi legislature has adopted either of the two theories; rather, the legislature stresses the importance of the contract and its significant role in the formation and management of companies. Nevertheless, in listed companies, the legislature plays a major role in the establishment and control of the company; state intervention here is represented by the Ministry of Commerce and the Capital Market Authority. It could be argued that a JSC, in accordance with SCL 1965, is a combination of the two theories. The company is managed in accordance with the contract signed among the shareholders in the company, and this contract, for example, gives each shareholder a number of rights and responsibilities. State intervention in the organization of these companies is for various reasons, including protecting the country's economy against manipulation, preserving the shareholders' money, and preventing corruption or illegal acts by the company's management.

This right is made clear in the final judgment of Appeal Committee for the Resolution of Securities Conflicts (referred to as ACRSC)³⁰⁴ issued on 23/06/2009 against a registered company, through ratifying the validity of the decision of CMA forcing that listed company to cease trading its shares because of financial instability. The CMA thus has the authority, under the laws governing the financial market, for example, to prevent trading in securities in the market, or to suspend their release if the Authority deems it necessary; this is stated in Article 21 of the Listing and Registering Rules, which give it the right to suspend or cancel the listing at any time as they deem appropriate in the cases identified by this article.³⁰⁵

Due to the above, the shareholder is in a distinctive position in the company, compared with other stakeholders, where he has a set of rights and bears certain obligations; and the source of these rights is the company's articles and the memorandum of association. On the other hand, shareholders are considered the source of legislation for the company and the activities entailed are implemented by the board of directors, which means that a balance is created between them in order to achieve the goals of

³⁰⁴ Appeal Committee for the Resolution of Securities Conflicts (ACRSC). Issued by the Council of Ministers, Resolution No. 222 dated 26/09/2005.

³⁰⁵ Decision issued by ACRSC, No. 437/L.S/2012

the company. However, if the shareholders do not fare well in the company, this will negatively affect their interests but the company's management still has the freedom to manage as it sees fit; thus, the role of shareholders in reality may be in contradiction to its theory. Actually, this case vis-à-vis the role of shareholders is now apparent in many Saudi listed companies, where the role of shareholders in controlling and directing the company's management is ineffective, and needs further clarification.

In this section, we also dealt with the definitions of shareholder and share; however, there is some criticism directed at SCL 1965 because it lacks these definitions. The rules concerning shares are very few, and the details are insufficiently adequate. SCL1965 includes many ambiguities, and needs a complete overhaul if it is to comply with the current era. In general, a person becomes a shareholder in the company when he acquires shares, and he may pay for them in cash or in kind. There are two types of share in accordance with Saudi law, which are ordinary shares and preference shares; the Saudi stock market is considered one of the biggest in the Middle East, where the majority of its contributors are individual shareholders, and the proportion of financial institutions is relatively small. So far, there have been no academic studies on financial institutions in the Saudi market, which is contrary to what exists in the UK, where such establishments constitute more than 70% of shareholders in the market, and play a major role in the management and control of the company.

Also in this section, we discussed the importance and characteristics of shares, including the fact that they are tradable, and that the shareholder cannot be prevented from trading shares except within very narrow limits; otherwise, any prevention will be void and null. This property attracts many people to invest in such companies. When a company does not achieve the goals of its shareholders, they simply withdraw from the company and reinvest in another company that would appear to achieve their ambitions.

In addition, other characteristics of shares are: they cannot be fragmented, the shareholder's responsibility is limited (where a shareholder is only responsible for the company's debts as far as his portion in the capital, i.e. not extending to his own property), and any decision that adds financial commitments to the shareholder shall be void and null. On the other hand, these properties may explain the lack of attention paid on the part of many shareholders to the company's affairs, resulting in their not exercising their role within the company in terms of control and direction; their primary goal is financial benefit at the end of each fiscal year. Thus, in the next chapter, we will discuss the

financial rights of shareholders within the company, which are considered as the main motivation to invest in JSCs.

Chapter 4: Financial Rights of Shareholders in JSCs

4.1 Introduction

Shareholders are considered to be an important source of finance for listed companies; therefore, they are a vital element of the company in addition to the board of directors. In general, shareholders invest in company capital in order to obtain some financial benefit; however, holding a share in a JSC means that they are partners, and thus are entitled to a set of rights. Normally, each shareholder in a JSC is entitled to all rights related to the ownership of the share, some of which are managerial rights, which will be discussed in the next chapter (Ch. 5); others include the many different financial rights, which will be discussed in this chapter. Shareholders' rights, more particularly financial rights, must be protected by both Company Law and the company's constitution. Therefore, the following questions are addressed in this chapter: Among the rights to which a shareholder is entitled, what are the financial ones? What obstacles face them in practising such rights? Are shareholders granted those rights by Saudi Law?

Shareholders have many important financial rights in JSCs; the first of these is the right to transfer shares, which is considered to be one of the most important financial rights for all shareholders. This right is one of the main reasons why many people prefer to invest their money in publically listed companies rather than in any other types of companies; this right gives the shareholder the right to complete freedom in selling or transferring his/her shares at any time as a sale, a gift or a pledge. The second financial right is known as the pre-emption rights; this right gives existing shareholders in the company the right to purchase any shares that are newly offered before offering them to external parties. The third significant right is the right of shareholders to receive profits at the end of each fiscal year. The shareholder's primary reason for purchasing shares is to make profit; the company's constitution clearly states that all shareholders in the company have the right to receive profits, which are distributed at the end of each fiscal year. In addition, shareholders have right to have the value of their shares reimbursed when their company goes into liquidation, in the form of a company debt settlement, and only in the case of the company having surplus assets. This right is enjoyed by each shareholder, as provided in the company's articles and the law. All of these rights and other related topics under SCL 1965 are discussed in this chapter.

4.2 The Right of a Shareholder to Transfer Shares

As indicated earlier, shares can be transferred through commercial means between the shareholders very easily; this is one of the most significant features relating to owning shares in JSCs, where shareholders can fully transfer their shares as a sale, a gift, a pledge, etc. No doubt, this right and other associated share rights are the factors that motivate many people to invest their money in such companies. The transferability of the share is considered a personal right on a par with the right to dispose of property;³⁰⁶ therefore, it is not possible to restrict the shareholder from transferring his shares permanently to other parties. Clearly, this lack of restriction or prohibition is in the public interest as well as benefitting the company and its shareholders.³⁰⁷ In SCL 1965, this right is clearly stated: “The capital of a corporation shall be divided into negotiable shares of equal value”.³⁰⁸

In general, these shares are transferable in the capital market after the approval of the CMA and after listing them in the Securities Depository Center.³⁰⁹ However, SCL 1965 imposes a number of restrictions on the transfer of shareholders’ shares; some restrictions may be agreed upon and included in the company’s articles, as described later in this chapter.

Nevertheless, a shareholder’s shares in the company are transferable; that is, they can be transferred by commercial means, according to certain simple procedures in order to facilitate a speedy transfer from the original owner to another, without the need to obtain prior consent from other shareholders in the company. If the shares are bearer shares, these can be traded through handling, but if the shares are nominal shares, then they are transferred to another through registration in the company register.³¹⁰

³⁰⁶ Article 541 of CA 2006 of the UK explains that the shares or other interests of a member in a company are personal property (or, in Scotland, moveable property) and are not in the nature of real estate (or heritage).

³⁰⁷ See: *Moffatt v Farquhar*. [1977-78] L.R. 7. Ch. D. 591

³⁰⁸ Saudi Company Law, 1965. Article 48

³⁰⁹ Article 26 of Saudi Capital Markets Law provides, “a. The Board of Directors of the Exchange shall establish a department to be known as the “Securities Depository Center” which shall be the sole entity in the Kingdom authorized to practice the operations of deposit, transfer, settlement, clearing and registering ownership of Saudi Securities traded on the Exchange. The Exchange’s Board of Directors may convert the Securities Depository Center into a company after obtaining the approval of the Authority’s Board for the conversion. The Board may give its approval indicating the requirements of the company’s structure and its operations, as it deems appropriate and necessary for the safety of the market and the protection of investors”.

³¹⁰ Sameha Alkalyouby, *Commercial Companies*, Third Edition. 1993. Egypt, Dar Alnahdah Al-Arabi Publishing. 1993. Article 102 of SCL 1965 provides, “Registered shares shall be transferred by means of an entry in the shareholders register kept by the company, which contains the shareholders’ name, nationalities, residence addresses, and occupations, the (serial) number of the shares (held by them); and the amount paid up on such shares. An annotation shall be made on the share warrant to the effect that such entry was made. A

Article 27 of CML states, “A) the registration of ownership of Securities traded on the Exchange and the settlement and clearance of Securities shall be made by entries in the Depository Center’s records. Ownership of Securities traded on the Exchange must be registered with the Securities Depository Center in order to be protected against third party claims. The Depository Center’s records will also report pledges or other claims related to the Securities traded on the Exchange. B) The Depository Center shall be the sole entity to register all property rights in Securities traded on the Exchange. The final mentions reported in the records of the Depository Center shall serve as conclusive evidence and proof of ownership of the Securities indicated therein together with the encumbrances and rights associated therewith, subject to the provisions of paragraph (d) of this Article”.

In general, in order that a shareholder can trade his/her shares in the capital market, certain requirements and conditions provided by the Saudi system must be fulfilled.³¹¹ In the UK, shares in public companies are transferable, according to CA 2006 and to the company’s articles. According to the case of *Smith, Knight & Weston*, shareholders have a prima facie right to transfer their shares; directors have no discretionary powers, independent of any powers given to them by the above article, and thus cannot refuse to register a transfer.³¹² The transferee becomes a member of the company when he allows his name to be entered on the register of members.³¹³

A share is considered to be the proprietary right of the holder; every shareholder has the right to protect that property from being interfered with, ultimately through filing a lawsuit.³¹⁴ S 544 of CA 2006 states, “(1) the shares or other interest of any member in a company are transferable in accordance with the company’s articles. (2) This is subject to (a) the Stock Transfer Act 1963 (c. 18) or the Stock Transfer Act (Northern Ireland) 1963 (c.24 (N.I.)) (which enables securities of certain descriptions to be transferred by a simplified process), and (b) regulations under Chapter 2 of Part 21 of this Act (which enable title to securities to be evidenced and transferred without a written instrument)”.

transfer of title to any registered share shall be effective as far as the company or third parties are concerned only from the date of its entry in the said register. Shares to bearer are transferable by mere delivery”.

³¹¹ Article 2(B) of the Listing Rules, Issued by the Board of the Capital Market Authority Pursuant to its Resolution Number 3-11-2004, dated 4/10/2004G, based on the Capital Market Law issued by Royal Decree No. M/30 dated 2004, amended by Resolution of the Board of the Capital Market Authority Number 1-36-2012, dated 25/11/2012G. Available at < <http://www.cma.org.sa/En/Documents/Listing%20rules.pdf> > accessed 20 February January 2012.

³¹² [1968] 4 Ch App 20, Cited from Brenda Hannigan, *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 317

³¹³ Article 112 (2) of CA 2006 of the UK

³¹⁴ *Moffatt v Farquhar* [1878] 7 Ch. D. 591

4.3 General Rules that Govern Share Trading

Firstly, for trading JSC shares in the Tadawul, a licence must be obtained from the relevant governmental authority; the CML states that no JSC share trading is possible without the approval of the CMA.³¹⁵ Article 20 of the CML provides, “A) A market shall be established in the Kingdom for the trading in Securities which shall be known as the “Saudi Stock Exchange”, and will have the legal status of a joint stock company in accordance with the provisions of this Law. This Exchange shall be the sole entity authorized to carry out trading in Securities in the Kingdom”.

The Tadawul, in accordance with Article 20 of the CML, is the sole body authorized to perform the trading of securities in the Kingdom. The Tadawul is a Saudi JSC that is wholly owned by the Saudi Public Investment Fund (PIF). It deals with the executive and operational functions of the market, and is the only body licensed to perform the task of managing the stock market.³¹⁶ The above law gives the Tadawul management the right to collect any information about the shares traded in the market; this is believed to be necessary for investors, and it has the right to make this information available to all traders.

Under this law, it is essential to register the ownership of any shares traded in the market, when they are circulated from one shareholder to another, in the records of the Securities Depository Center.³¹⁷ In general, the centre is the only body to record all ownership rights of securities traded in the market. The final entries in the SDC records provide evidence and conclusive proof of ownership of shares, and set forth therein are the burdens and rights relating to them.³¹⁸ Shares can be traded from Saturday to Wednesday, from 11.00 am to 3.30 pm, i.e. about four hours.³¹⁹ The number of trading days in 2011 was 248.

The second article of SCL 1965 states that all shares or JSC securities that are traded in the capital market, together with the source of each one, must be registered in the Security Deposit Centre,³²⁰ in accordance with the instructions issued by the Tadawul. However, the following transactions are not

³¹⁵ Article 6 (3) Saudi Capital Market Law

³¹⁶ See < <http://www.tadawul.com.sa> > accessed 21 February January 2012.

³¹⁷ Saudi Capital Market Law, Article 27

³¹⁸ Saudi Capital Market Law, Article 27(B)

³¹⁹ Annual report of the Saudi capital market, 2011. P. 41, available

at < www.cma.org.sa/Ar/Publicationsreports/DocLib/CMA%20Arabic%202011%20Fini.pdf > accessed 21 February January 2012.

³²⁰ Saudi Capital Market Law, Article 20 to 27

considered securities: commercial bills such as cheques, bills of exchange, order notes, documentary credits, money transfers, as well as the instruments exclusively traded by the banks among themselves, and insurance policies.³²¹

Another noteworthy point is that many minority shareholders who trade in the market (and who represent the largest shareholder class in it) consider that the trading period is not appropriate. This is due to various reasons, for instance, the inconvenient opening hours; Saudi Arabia has customs and traditions, for example, 30 minutes after opening time is the noon prayer³²² (there is no trading at all during this time). This is also the time to collect children from school, as well as having lunch at home with family members and taking a nap; therefore, the actual trading time is very short compared with other countries. For instance, the regular trading sessions at the London Stock Exchange operate from 8:00 until 16:30 every day of the week, except weekends and holidays declared by the exchange provider. Moreover, global stock markets can be accessed around the clock.³²³

Accordingly, the CMA should open the capital market such that is available for direct foreign investment (individual and institutional), while taking the necessary measures to protect the market from the phenomenon of 'Hot Money'.³²⁴ No doubt, foreign investors will return to the market as the confidence that was lost during the crisis of February 2006 slowly grows, but this must be facilitated. Also, the entry of foreigner investors will enhance transparency and disclosure in the market, and this will raise its profile and reputation around the world.³²⁵ The injection of foreign cash reserves will support the future of the Tadawul, through learning from the experiences of foreign investment cultures, which in turn will increase the level of buying and selling in the market, as well as reducing the control of a small number of powerful individuals in the market. All of these factors will contribute to strengthening the Saudi economy and increasing confidence in it; foreign investors tend to focus on

³²¹ Article 3 of the Market Conduct Regulations, Issued by the Board of the Capital Market Authority, pursuant to its Resolution Number 1-11-2004, dated 4/10/2004G, based on the Capital Market Law issued by Royal Decree No. M/30 dated 2004. Available at<www.cma.org.sa/En/Documents/Market%20Conduct%20Regulation-26-8-009.pdf> accessed 22 January 2012.

³²² All business activities are stopped during prayer time, for around half an hour.

³²³ See< <http://www.londonstockexchange.com>> accessed 28 January 2012.

³²⁴ The term of Hot Money can be described as a "Holdings of very liquid assets, which may be sold or cashed on short notice and then removed from a country, often in response to expectations of devaluation or other financial crisis". Cited from<www-personal.umich.edu/~alandear/glossary/h.html#HotMoney> accessed 23 January 2012.

³²⁵ Baamir, Abdulrahman Y. *Issues of Transparency and Disclosure in the Saudi Stock Market. Arab LQ*, 22 (2008). P. 78

a number of major sectors in KSA, which include petrochemicals, banking, telecommunications, construction and real estate.³²⁶

3.2.1 Transferring Shares should be conducted by Licensed Stockbrokers

Licensed brokers act as mediators in the Tadawul, and represent the only facility to play this role. It is intended that these brokers implement the buying and selling of shares on behalf of the investor in the stock market, and that they do so in accordance with the CML; otherwise the transaction will be invalid. The CML stipulates the requirements necessary for obtaining a licence to engage in brokerage prior to performing any stock transactions.³²⁷

In the vein, The CRSD has adjudicated in favour of CMA against persons accused of practising securities business without having obtained a licence from the CMA, and has announced such activities to the public through an electronic newspaper; this is done in order to give confidence to investors and to attract the largest possible number of investors, as well as ensuring that everyone knows that such practices are against the law.³²⁸ The CRSD considers that practising brokerage without legal authorization by the CMA is contrary to the provisions of Article 31 of the CML, as well as to the provisions of Article 5 (5) & 17 (6) of the Securities Business Regulations; the CRSD states that the CMA has the right to regulate the financial market in order to protect investors from fraud and manipulation, and that any person found guilty will be punished with a minimum fine of 10,000 riyals.³²⁹

Saudi banks represent the majority of brokerage firms; among the most important tasks that they carry out are: opening an investment case that enables the agent or investor to make deals in the market,

³²⁶ See <www.indexsignal.com/community/index.php?threads/275721/> accessed 23 February January 2012.

³²⁷ Article 31 of the CML provides, “Brokerage business is restricted to a person holding a valid license and who is an agent of a joint stock company that is licensed to perform brokerage activities”.

³²⁸ Issued Decision by CRSD No. 883/L/D1/2011 dated 04/06/2011

³²⁹ This article provides, “A person must not carry on securities business in the Kingdom unless he is: 1) an authorised person authorised by the Authority; or 2) an exempt person as specified in Annex 1 to these Regulations”. Article 17 states, “A person must not make or communicate any securities advertisement to a person in the Kingdom unless: 1) the person making the advertisement is an authorised person; or 2) the contents of the securities advertisement have been approved for the purpose of this Part by an authorised person”.

acquiring securities or identifying their source, and providing the necessary funding and facilities for customers to trade shares.³³⁰

When an investor wishes to trade in the stock market, he shall take the following steps: open an investment account with one of the brokers who are authorized to engage in securities business in the Tadawul, and fill in the specified forms when the investor desires to buy or sell a particular share through a broker. Most brokers offer the services of purchasing or selling shares through the Tadawul electronic system; this can be done on the phone without the need for the investor to attend the Tadawul in person. The shareholder determines the order type (to buy or sell), and when filling out the form, he must take care to choose the appropriate order.³³¹ Shares ownership is recorded electronically by the SDC in the capital market; the SDC then sends all the transaction data made on their shares directly to the listed company during the trading period. Subsequently, the company must register the ownership of the shares in the name of the new buyer in its books immediately it is notified by the SDC; otherwise, it will be liable to punishment.³³²

Significantly, minority shareholders represent the largest sector in the Tadawul; they prefer to trade shares on an individual basis and do not tend to place their investments with financial firms; most of them are interested in short-term profits and the nature of their investment is speculative, lacking financial or accounting expertise. Thus, many of the shareholders in the Tadawul are classified as speculators rather than investors. Unfortunately, many lose a large part of their investments due to their lack of knowledge of the rules of investing in the capital markets. In 2011, individual shareholders represented almost 80% of all transactions conducted on the stock exchange; the remaining percentage was conducted by companies and investment funds.³³³

A statistical study of the Arab capital markets found that approximately 65-70% of the shareholders in the exchanges are individuals and the rest are institutions, whereas in Western stock exchanges, it is

³³⁰ Article 32(A) of the CML.

³³¹ Mohammad Alsohbani, *Workshop on speculation in the financial markets*, placed in the Aleqtisadiyah Newspaper, Riyadh, 6 April 2007. P. 9

³³² Article 3 of the Authorised Persons Regulations states, “A. An authorised person and a registered person must comply with the Regulations and Rules applicable to them and must provide to the Authority without delay any information, records or documents that the Authority may require for the purpose of administration of the CML and its Implementing Regulations”.

³³³ Tadawul, free monthly magazine published by the Capital Market Company Saudi Arabia, Feb. No. 73, 2012, P. 63

completely the opposite, i.e. 65-70% are of transactions are conducted by financial establishments and only 30-35% by individuals.³³⁴ It is a condition that the trader be a citizen the Gulf Cooperation Council (GCC) states, or a resident. Individual have been allowed to trade directly in the stock market since 2006; hitherto, all persons had to members of investment funds.³³⁵ Shareholders must pay a commission to brokers;³³⁶ the maximum commission during share sale or purchase is based on the following: If the amount is 10 thousand SAR or less, the minimum commission is 12 SAR; whereas if the amount is more than 10 thousand SAR, the commission is 0.0012% of the value of the shares per deal.³³⁷

4.3.2 Restrictions on the Transfer Right of Shares

Article 48 of SCL 1965 demonstrates that JSCs are characterized by tradable shares; the advantage of owning shares in JSCs is that the shareholder has complete freedom to dispose of his/her shares by various means; furthermore, this right is a property right, which is subject to certain legal or conventional restrictions contained in the memorandum of association of the company or its articles. In general, these restrictions are limited to a specific period of time and are not permanent, and thereby they aim to regulate the right to dispose of stock through trading (but a trade cannot be cancelled). The restriction can be divided into two categories, namely: legal restrictions and contravention restrictions.³³⁸ The legal restrictions will be discussed in the following section.

³³⁴ Hassam Abotamah. *The role of disclosure toward minority shareholders in Saudi capital markets*. King Khaled University Press. Case study. P. 8

³³⁵ See <http://cma.gov.sa/Ar/News/Pages/CMA_N193.aspx> accessed 23 January 2013.

³³⁶ Article 46 of Authorised Persons Regulations provides, “Fees and commission charged by an authorised person to its clients must be fully disclosed in advance of providing any services”.

³³⁷ See < www.tadawul.com.sa/static/pages/ar/.../FAQ.html> accessed 26 February January 2012.

³³⁸ Certain conventional restrictions within the company’s articles may be imposed on share trading, which are aimed to forbid the disposal of the shares of the company to others for a variety of reasons but chiefly in order to give existing shareholders the opportunity to purchase shares before outsiders, or, in order to prevent shareholders who are considered a danger to the company from gaining entry into the company, or to avoid shareholders from entering the company who may affect the balance of power in voting. Such conventional restrictions do not prevent, in any way, the shareholder from the right to dispose of his shares absolutely; otherwise, they are void by virtue of the law, as this violates a fundamental right of the shareholders. Article 101 of the SCL 1965 states that the company’s articles can provide certain impositions regarding the negotiability of shares on condition that they shall not prohibit such trading; according to Article 9 of the CML, the company shall obtain approval from the CMA in advance prior to imposing any restrictions. See: Aziz Al-akali, *Commercial Companies*, Jordan, Amman, Maktabat Dar Althkafah Publishing, 2010. P: 24 . Saudi Company Law, 1965. Article 101 & Article 12 of CML which stated that, “b. The securities must be freely transferable and tradable. Any restriction on transferability must be approved by the Authority and all investors must be

4.3.2.1 Legal Restrictions on Share Transfer

The Saudi legislature cites a range of restrictions on the transfer of shares, including what is mentioned in SCL 1965, such as preventing the company founders from disposing of their shares, as well as preventing the disposal of guarantee shares by members of the board of directors. Other restrictions are mentioned in various laws, such as the CML; details of these restrictions are as follows:

4.3.2.1.1 In the first restriction, the disposal of founders' shares is prohibited; Article 100 of SCL 1965 states, "A - Cash shares subscribed for by the founders and shares for contribution in kind, as well as founders' shares, shall not be negotiable before the publication of the balance sheet and the profit and loss statement for two completed financial years, each consisting of at least twelve months as from the date of incorporation of the company, indicating their class, the date of incorporation of the company, and the period during which their negotiable shall be suspended".

According to SCL 1965, the founder is any person involved directly or indirectly in the establishment of the company.³³⁹ The founders are not those who agree on the idea of establishing the company and the signing of the contract for this, rather, the circle of founders includes each person having a role in the establishment of the company; it is not permissible for them to dispose of their cash shares, in-kind shares or and founding shares before publication of the budget and the profit and loss accounts for the first two years of the fiscal life of the company, where each year shall not be less than 12 full months.³⁴⁰

The purpose of this restriction is to keep the founders linked to the company for a sufficient length of time to ensure the stability of the company and to clarify the company's financial position for those who may wish to invest in it. The other aim is to ensure that the founders are serious in establishing the

provided with appropriate information to enable dealings in such securities to take place on an open and fair basis".

³³⁹ SCL1965 defined the founder of corporation in the article 53 thus, "A founder of a corporation shall be any person who has signed its memorandum of association, or applied for authorization to incorporate it, or offered a contribution in kind upon its organization, or actually participated in its organization".

³⁴⁰ This provision exists in most of Arabian Gulf states, and the duration of the ban is two years from the date of company establishment; the Bahraini Company Law reduced it to one year.

corporation, and to disallow the establishment of false companies; it is also to avert any overestimation of the success of the company, where misleading propaganda campaigns often accompany the formation of JSCs in order to attract the largest possible number of shareholders. In such a case, the founders may then sell their shares at an inflated price, after which, the value plummets when the actual financial position of the company, and the real value of its shares are made known. This restriction exists to ensure the protection of the shareholders, particularly the minority shareholders, from the possibility of any such fraud, manipulation, or exploitation by the founders.³⁴¹ The restrictions in this article include all actions conducted by the founders in terms of their founding shares, whether the action is to transfer of ownership by means of sale, gift, or custody, or whether it is a right claimed on the share such as mortgage.³⁴²

In the event of the founders disposing of their shares contrary to this restriction, the act is then considered void, and any shareholder with an interest has the right to use this invalidity in court; indeed, the court itself can decide on invalidity, because such an action violates the rules of the public order.³⁴³ The violating founder shall be liable to a punishment as set out in Article 229, which stipulates the punishment for each official in the company who violates the provisions of SCL 1965,³⁴⁴ either by imprisonment from 3 months to a year, or by a fine ranging from 5,000 to 10,000 SAR, or both. Clearly, such a penalty is ineffective and does not reflect the offence; therefore, both the term of imprisonment and the fine must be considerably increased if this is to have any real effect. However, it must be pointed out that this restriction excludes the possibility that the founders can dispose of their shares in the company among themselves, or from the heirs of the founder to others, or through the transmission of shares to a member of the board of directors to be allocated as a guarantee for the administration.³⁴⁵

³⁴¹ Sameha Alkalyouby, *Commercial Companies*, Third Edition. Egypt, Dar Alnahdah Al-Arabi Publishing. 1993, P. 250

³⁴² Toumah Alahamari, *Alqanoon Altjari Alkuaiti*. Kuwait, Dar Alketab Publishing. P: 350

³⁴³ Aziz Al-akali, *Commercial Companies*, Jordan, Amman, Maktabat Dar Althkafah Publishing, 2010. P: 247

³⁴⁴ Saudi Capital Market Law, Article 229(8)

³⁴⁵ Saudi Capital Market Law, Article 100

4.3.2.1.2 The second restriction is imposed on the shares owned by the company board members. SCL 1965 states that each member of the board of directors should offer guarantee shares (cash or in kind) for not less than 10,000 SAR (1654.87 GBP) to be offered within 30 days from the date of the decision of accepting a new member on the board, and shall be deposited in a bank specified by the Minister of the MOCI; the law provides that the deposit of such shares shall be made at a licensed bank in KSA.³⁴⁶

Regarding the criterion for assessing the value of guarantee shares, the law does not set specific standards regarding whether the legislature means the nominal value of the shares or the commercial value. If we assume that the legislature means the commercial value, this criterion is not suitable as an accurate standard because the value of shares changes from time to time; whereas if we assume that the standard is the nominal value of shares, then it is more accurate because the company's capital consists of the nominal value, which is considered the general guarantor for creditors. In Bahraini Company Law³⁴⁷ a member of the board of directors shall have a number of shares whose nominal value shall not be less than 10 thousand Bahraini Dinars (BD).³⁴⁸

It can be argued that guarantee shares are not tradable until the end of the period specified for hearing a case of liability, as provided for in Article 77, or until any judgment in the lawsuit. The purpose of this restriction is to ensure the proper management of a member of the acts ascribed to him, i.e. not to abuse company funds, and to not to put personal interest before company interests. The defect in this article is the amount of shares required by the member, equivalent to 10,000 SAR, which is very little if compared with the capital, as well as being considerably less than the amounts earned by a member of the board of directors from awards and incentives.³⁴⁹

For example, the total value of salaries and bonuses obtained by the Big Five directors in JSC amounts to almost 10 percent of net profits, and to approximately 18 percent of the distributed profits, i.e. they

³⁴⁶ Saudi Capital Market Law, Article 68

³⁴⁷ Bahrain Commercial Companies Law No. (21) 2001, Article (173) "The member of the board shall fulfill the following conditions...iii- He must personally own a number of shares the nominal value of which shall be at least ten thousand Bahraini dinars ... unless the company's articles of association provide for a higher amount".

³⁴⁸ Which equals £ 17,406

³⁴⁹ Saudi Company Law 1965 Article 74 shows that the company's articles shall specify the manner for remunerating the directors; it can be consist of a specified salary, or of an attendance fee for the meeting, or of material benefit, or of a certain percentage of the profit, or of a combination of two or more of these benefits.

receive one fifth of the distributed profits, whilst thousands of share owners only share in the remainder.³⁵⁰ Clearly, it is the duty of the legislature to provide a certain percentage (between 2% and 5%) of share ownership in the company; this would be more stringent and effective against the members being inordinately greedy. Also, the legislature should demand that the company's articles include the right to request a certain percentage not less than the percentage set by law.³⁵¹ For instance, Kuwaiti Company Law requires every director to have a number of shares constituting not less than one percent of the company capital; however, it is sufficient for a director to hold a number of shares, the nominal value of which is equal to ten thousand Kuwaiti Dinars unless the company's articles provide otherwise.³⁵²

4.3.2.1.3 According to the CML, the third restriction imposed on every person or group of persons, specified in the prospectus for owning shares in the JSC, is, at the date of the prospectus, shares must not be disposed of during a period of six months from the date when trading in those shares first commences in the Tadawul. However, the CMA may require that any person or group of persons, specified in the prospectus as owning shares, from the date of the prospectus shall comply for a period longer than six months; it considers that this is for the protection of investors.³⁵³ In this case, the company needs to increase its capital, and the main purpose of this restriction is to ensure non-manipulation of the shares of the company by majority shareholders, as this would have a negative impact on the company and its minority shareholders.

³⁵⁰ Abdulmajad Alfayaz. *Salaries and bonuses of senior executives in Saudi Listed Companies*. Aleqtisadiah Newspaper. Marsh 2009. Available at <http://www.aleqt.com/2009/03/09/article_202807.html?related> accessed 6 March January 2012.

³⁵¹ Article 95 of the French Companies Act requires the board member of a JSC to own a number of shares determined by the company's articles. These shares are dedicated to guarantee the actions taken by the board of directors, regardless of which member commits a violation; that is to say they do not guarantee individual member liability, but as a guarantee for the board as a whole against their violations.

³⁵² Article 139 of the Kuwait Company Law No. 15/1960 . In the UK, qualification shares are subject to the company's articles; thus, qualification shares are not mentioned in CA 2006. Therefore, if this is a requirement of the company's articles, then the directors must obtain them within the specified time.

³⁵³ Article 49 of the Listing Rules

4.3.2.1.4 The fourth restriction in the CML is that the Saudi legislature prevents the directors of the board, executives and anyone related to them from trading their shares, whether this be sale or purchase, based on insider information in order to achieve personal interests. This restriction is not provided in SCL 1965 but it is stated in the CML; Article 50 provides, “A) Any person who obtains, through family, business or contractual relationship, inside information (referred to as an “insider”) is prohibited from directly or indirectly trading in the Security related to such information, or to disclose such information to another person with the expectation that such person will trade in such Security”.

Insider trading can be defined as: the illegal dealing in shares by people who, because of their privileged position, have information, which materially impacts on the value of the shares, before that information has been made public.³⁵⁴ When an insider purchases or sells shares, they do this depending on the information obtained by virtue of their position; they know whether or not the company is profitable and therefore, an insider can trade his shares at an unfair advantage. Therefore, all persons knowledgeable about the company, or those who are in any relationship with them, are prohibited from buying or selling the company’s shares. Insider trading cause share values to rise or to fall, and this information is obtained it by virtue of their position for personal benefit (for themselves or others).

The following question arises here: Who is an insider person according to SCL 1965? In fact, SCL 1965 targets only members of the board of directors, whereas the CMA includes a larger group of people, stating³⁵⁵ that an insider person is a member of the board of directors, a executive officer, or

³⁵⁴ See<<https://securities.standardbank.co.za/ost/nsp/FrontOfficePublic/Legacy/Glossary/glossary.asp>> accessed 16 March January 2012.. In the UK, insider dealing receives a great deal of attention due to its danger; actually, it has been considered a criminal offence since 1980, which is now set out under the Part IV of the Criminal Justice Act 1993(CJA). However, the subject of insider dealing is also regulated in more detail in Financial Services and Markets Act 2000 (FSMA), which explains who an insider is, and defines insider information. Most provisions and regulations of insider dealing in KSA have been derived from the UK.

³⁵⁵ Article 4 of the Market Conduct Regulations provides, “b) For greater certainty, insider means any of the following: 1) a director, a senior executive or an employee of the issuer of a security related to inside information; 2) a person who obtains inside information through a family relationship, including from any person related to the person who obtains the information; 3) a person who obtains inside information through a business relationship, including obtaining the information: from the issuer of a security related to inside information; from any person who has a business relationship with the person who obtains the information; or from any person who is a business associate of the person who obtains the information; 4) a person who obtains inside information through a contractual relationship, including obtaining the information: from the issuer of a security related to inside information; or from any person who has a contractual relationship with the person who obtains the information”.

any employee in the company who has easy access to internal company information. This article has expanded its definition of the insider to include every person who can obtain such information through family relationships, business relationships, or a special relationship with the staff of the company.

Another important question here is: What is insider information for exploitation according to the Saudi system? SCL 1965 uses general terms to define insider information, whereas the CML and the Implementing Regulations that support the CL significantly cover this subject. Article 50 (A) of the CML defines what is meant by insider information stating, “Insider information means information obtained by the insider and which is not available to the general public, has not been disclosed, and such information is of the type that a normal person would realize that in view of the nature and content of this information, its release and availability would have a material effect on the price or value of a Security related to such information, and the insider knows that such information is not generally available and that, if it were available, it would have a material effect on the price or value of such Security”.

The first property of the information is confidentiality; confidential information is information concerning the source of securities, whether this is focused on its activities or transactions made, financial or economic positions, or perceptions of future development, where this information was not made public, and that publication will directly or indirectly affect the price of the shares in circulation. Therefore, such information must remain confidential and trusted by the trustee, and shall not be known by the public. It is considered confidential information even if it is in the possession of a number of people, such as the managers of the company, and it does not lose its confidentiality until it is broadcast to the public.

The second property is that the information is sufficiently specific, as non-specific information can be merely an assumption or a rumour; for example, to say that the company is facing some difficulties, or that the company is at the height of its prosperity, cannot be deemed specific, distinctive and fundamental information.

The third property is that such information influences the share price; Saudi legislation clearly states this property in the above provisions, thus, the information shall influence the share price upwards and downwards. Article 50 (A) states that the information shall influence the price of the securities; however, this is insufficient, and it is advised that the legislature mention the possibility of this effect,

even if it has not actually happened. Clearly, not every piece of information that remains unknown to the public is considered to be secret, unique or essential information; similarly, information that does not affect the share price is not considered to be significant or serious information.

In the case of the CMA against the Chief Executive Officer (CEO) of SADAF Co, the ACRSC confirmed³⁵⁶ the verdict of the CRSD,³⁵⁷ which cancelled the decision of CMA issued against the Chief Executive Officer. The CMA had issued a fine when the CEO disclosed to Reuters confidential information about the company concerning the net profit of 200% that the company had made in the first half-year, before informing the CMA, which was considered to violate Article 1(5) of Market Conduct and Article 50 (c) of the CML, as this disclosure was considered significant information that could affect the value of the shares. However, the CRSD accepted the appeal of the CEO and cancelled the decision of the CMA, referring to Article 50 of the CML, which requires (for violation) that the person should have prior knowledge, or that he expects the addressee to trade in securities based on that information; this was not the case with the addressee.

Therefore, the Articles above do not apply; this means that there must be some benefit from such disclosure for the addressee (in this case, the Reuters employee), who shall make material use of that information, which did not happen here. On the other hand, Article 45 stipulates that the prohibition to disclose such information only applies to the issuer of the shares, and based on this, the text does not apply to the CEO.

Nevertheless, in my opinion, the court's decision was wrong, as the decision was made on certain provisions that did not consider other wider provisions. The CML and Implementing Regulations complement each other, and are designed to protect the market and its investors, and to impose order. The decision of the CMA against the CEO was the correct one because he was the person who disclosed the information; therefore it is unfair to burden the company and its shareholders with the mistakes of others. In accordance with Article 4(1/ b) concerning market conduct, the CEO is considered a person familiar with the company's business, and the information that he announced at the press meeting was not a conclusion or expectation but a confirmed fact that he had obtained by virtue of his position within the company. Therefore, the CEO must have been fully aware of the

³⁵⁶ Issued Decision by Appeal Committee for the Resolution of Securities Conflicts (ACRSC) No. 424/L.S dated 14/01/2012

³⁵⁷ Decision issued by the Committee for the Resolution of Securities Disputes (CRSD) No. 888/L.S dated 18/06/2012

confidentiality and sensitivity of the information that he had disclosed, and in full knowledge that any such information could affect the share price, as he is the company's representative.

Regarding the necessity for gaining benefit from disclosure of the information, this is an invalid criterion. Article 59/A indicates that gaining benefit getting a fruit (or not) is not a condition for the violation. In the above case, the Commission also did not explain how it had concluded that the addressee had not gained any advantage from the confidential company information, and depended on this in finding that there had been no violation. It is clear from the above that this decision is a deviation from the goal set by the regulator, and it will contribute to an increase in the number of offences committed in the market. Furthermore, it opens the door for the corporate administrators of JSCs not to commit themselves to the legal provisions that prohibit them from disclosing confidential company information to the public before providing it to the CMA.

Observers of the Saudi Stock Market can see that the number of cases in which the CMA awards punishments regarding insider trading is very small when compared with the frequent penalties meted out to companies and individuals for other violations. This may be because insider trading is a highly sensitive issue, and also due to the difficulties surrounding investigating and prosecuting such financial crimes, in terms of obtaining proof, whereas it is much simpler for the CMA to monitor violations of a company that do not include the names of members of the Nominations Committee in their annual report for example. Another reason may be the power and influence of large investors who exercise such operations, or due to lack of experience in the detection of such crimes. So far, the CMA has announced only three cases that have been discovered against members of a company's board of directors; however, in all cases no precise details other than the name of the accused and the punishment (being fines) were given. It is however not reasonable that only those three cases exist. Unfortunately, to date, no academic studies have been conducted on the subject of insider trading in the Saudi market.

The small number of cases that have been brought to court for insider trading may be due to a number of reasons, such as the Saudi market still being in its start-up phase; it is an emerging market, which still has weaknesses in the legal and financial foundations for dealing in such subjects.³⁵⁸ Therefore, greater attention must be paid to the risks of insider trading, such as enhanced disclosure and

³⁵⁸ Nina Cankar, *Transition Economies and Corporate Governance Codes: Can Self-Regulation of Corporate Governance Really Work?* *Journal of Corporate Law Studies*, Vol. 5, Part 2, 2005. P. 294

transparency, and improvements to corporate governance rules. Other possible reasons include weakness in the application of the financial or legal regulations in the financial market, and, perhaps the most important, the lack of firm application of the existing laws. Concerning this point, Gugler states that one of the main advantages of strongly implementing legislation in capital markets is to secure the benefits of large numbers of investors, especially minority shareholders; it also acts as an effective monitoring mechanism on corporations and their directors' actions and, at the same time, prevents manipulators from taking illegal benefits.³⁵⁹

In general, it can be said that the development of the Saudi Stock Market is similar to that of many modern financial markets, which are also still face considerable difficulties. These difficulties can be summarized as: self-interest before company interest, where managers in JSCs focus on their own special interests at the expense of the company and other shareholders. This impacts negatively on the minority shareholders; here, they become the weakest party in the company, and the board of directors becomes the controller of company affairs. This contributes to the majority shareholders playing a bigger role in the financial market due to their strong links with the management of the company, the ease in accessing essential information before other shareholders, and the ability to exploit such information for personal gain.³⁶⁰ This is known as "crony capitalism" and, sadly, exists in abundance in emerging markets.³⁶¹

This can be seen in the listed companies in KSA, which have larger single family shares in the capital of the company; these quotas are normally divided between themselves, affording them a strong influence on decision-making, particularly in the company's board of directors. A recent study shows that more than 62% of directors and managers of JSCs have used insider information for their own benefit, demonstrating an important gap between the law and actual practice; furthermore, they generally fail to avoid conflict of interest situations.³⁶²

³⁵⁹ Klaus Gugler. *Corporate Governance and Economic Performance*. Oxford: Oxford University Press. 2001, P. 202

³⁶⁰ Baamir, Abdulrahman Y. *Issues of Transparency and Disclosure in the Saudi Stock Market*. Arab LQ 22 (2008). P. 73.

³⁶¹ The term "crony capitalism" is used to describe a capitalist economy in which the government or corporate officials and insiders provide lucrative opportunities for their friends and relatives. The term became popular during the Asian Crisis to describe some of the victim countries, but it is now often used elsewhere as well. See <www-personal.umich.edu/~alandear/> accessed 7 March January 2012.

³⁶² World Bank. *A Corporate Governance Survey of Listed Companies and Banks across the Middle East and North Africa*. International Finance Corporation, World Bank Group and the Institute of Corporate Governance. 2008. P.7

4.3.2.1.5 In the final restriction, the CMA has the power to suspend the right of a shareholder to trade shares in certain cases, as stipulated by the law of the CML. Article 59 of the CML states that if the CMA finds that a shareholder has participated, is participating, or has engaged in actions or practices that are considered violations of any provision of this law, or the Implementing Regulations, then the CMA is entitled to bring an action against the person concerned before the CRSD to adopt a resolution of appropriate punishment. This was confirmed by the judgement of the ACRSC against a shareholder who violated the provisions of Article 49 of the CML while shares were being traded during the period from 1/7/2007 to 12/9/2007. The shareholder was subsequently sentenced as follows: the return of all payments made due to illegal trading; a fine; and a ban on trading in the shares of listed companies for three years from the date of judgement.³⁶³

4.4 Shareholders' Rights of Pre-emption to obtain New Shares

Increasing the company's capital is one means of financing available to it when facing particular economic circumstances;³⁶⁴ these include: for the purpose of capital expansion because of the increase in demand for the company's products, or to address a financial crisis facing the company. It is a fundamental right of shareholders to participate in this increase through what is known as the pre-emption rights to subscribe to the capital increase.³⁶⁵ This is intended, "to protect shareholders from dilution, whereby shares are issued to favored investors at below market prices".³⁶⁶ pre-emption rights

³⁶³ Decision issued by ACRSC No. 361/L.S/2011 dated on 21/06/2011

³⁶⁴ Saudi Company Law, 1965 Article 135

³⁶⁵ The rights of pre-emption has been known in Islamic law since the advent of Islam by Prophet Muhammad, peace be upon Him; the beginning of the application of this rule was on the relationship between neighbours' real estate upon waiver of housing, and has been applied to houses and farms. Thus, the owner of pre-emption rights could claim or leave this right. Pre-emption is defined in Shari'ah as the right of the partner to buy his partner's share when it is divisible, so that it causes no harm to the partner. If there are many partners who are all involved in this right, it is not permissible to sell to one of them only without the rest. Prophet Mohamed, peace be upon Him, confirms this as saying: "The neighbour in housing has priority to get the house"; therefore, if there are two neighbors who have the rights of pre-emption, priority shall be given to the one whose door is closer to the door of the seller; over time, the application of the rule expanded to include commercial companies and their shareholders.

³⁶⁶ La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., *Law and Finance, Journal of Political Economy*, Vol. 106. 1998. P.16

allow a shareholder to maintain a proportionate share of the ownership of a corporation when it issues new shares.³⁶⁷

This right is considered one of the financial rights related to shares; here, shareholders are given priority to prevent outsiders from entering the company, which could reduce their influence within the company; however, this right does not extend to giving the shareholder in the JSC the right to purchase the shares of shareholders who wish to leave the company, as in the case of closed JSCs or a limited private company.

The Saudi system grants the shareholders the right to obtain new shares amounting to as much as their share in the company's capital during a limited period. SCL 1965 mentions this right in Article 136, thereby affording existing shareholders an advantage of subscription over outsiders.³⁶⁸ Therefore, SCL 1965 gives shareholders a pre-emption rights are order to protect against share dilution and expropriation through capital increases.³⁶⁹ This does not mean that the shareholder is obliged to accept; he is fully free to reject or accept the purchase of some part of the new capital. However, shareholders can be waived by the government in the case of companies under state ownership, and the company's articles.³⁷⁰

The company informs the shareholders about new shares and the decision to increase the capital (and conditions of subscription) by publication in a daily newspaper; however, SCL 1965 states that it is enough to notify shareholders via registered letters if all the shares of the company are nominal. Each shareholder has the option to use his right of pre-emption; he/she must notify the company in a written letter within fifteen days from the date of publication or notification referred to in the preceding paragraph. Subscription to the new shares must only be as much as his proportion in the capital.³⁷¹

³⁶⁷ World Bank. *A Corporate Governance Survey of Listed Companies and Banks across the Middle East and North Africa*. International Finance Corporation, World Bank Group and the Institute of Corporate Governance. 2008. P. 60

³⁶⁸ Saudi Company Law, 1965. Article 136 provides, "1- Shareholders shall have a pre-emption rights to subscribe for new cash shares, unless the company's bylaws provide for their waiver of this right or for restriction".

³⁶⁹ World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. pp. 31. Available at <www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf. /> accessed 5 March January 2012.

³⁷⁰ Ibid

³⁷¹ Saudi Company Law, 1965 Article 136 (6)

SCL 1965 has a set of conditions to be met by the shareholder for them to be entitled to exercise this right; the shareholder must be registered in the company records on the day of the EGM³⁷² that made the decision to issue new shares. In general, the shareholder has the right to request more than his share if there are any shares left without subscription on condition that the number of new shares shall not exceed the number requested in the first instance. If other shares are unsold, they will be offered for public subscription.³⁷³

Article 136 of SCL 1965 raises a very important issue, which is that the board of directors has the right to place restrictions on the rights of pre-emption; the board of the company, which often holds the majority of the shares and has significant influence on the decisions inside the GM, can cancel this right or restrict it at will through a resolution approved by GM. Moreover, this article does not clarify when the board of directors is entitled to do so; they may seek so to do in order to secure the interests of the company through converting the allocation of shares to the creditors of the company in order to convert debt into equity, or through allocating a certain percentage of new shares, such as 30%, to the employees in the company.³⁷⁴

It is the duty of the Saudi legislature to compel the board of directors and auditors to submit a report on the reasons and rationale for waiving the right of pre-emption of new shares; i.e. there must be acceptable reasons, such as protecting the interests of the company and its shareholders. Indirectly, this article gives the board of the company the right to issue new shares to non-shareholders, who may or may not be in a relationship with the board, in order to shift the balance of voting power within the company. The above article does not commit the company directors (upon the issuance of any restrictions on the right of pre-emption) to assert that they are acting in the interests of the company and not for personal purposes/interests.

It is true that SCL 1965 gives the shareholder the right of pre-emption, but this right is need reform, obviously, it is controlled by the board of directors, and consequently the board has the right to approve or cancel it. Actually, there is a defect in the above article where the Saudi legislature should

³⁷² Saudi Company Law, 1965 Article 134

³⁷³ Ibid

³⁷⁴ Aziz Al-akali, *Commercial Companies*, Jordan, Amman, Maktabat Dar Althkafah Publishing, 2010. P. 274

have been more explicit in stating the rights of shareholders, and should not have added any legal subsidiary paragraphs that may allow cancelling, or contradicting the right referred to.

Rights of pre-emption under CA 2006 in the UK are more detailed and more accurate than in the current law in KSA; such provisions should be utilized in KSA to improve shareholders' rights regarding in this issue. However, in the UK, the pre-emption rights can arise from the provision of CA 2006,³⁷⁵ or from the company's articles,³⁷⁶ or from a shareholders' agreement.³⁷⁷ A company must not allot shares to a person on any terms unless it has made an offer to each existing shareholder to allot to him on the same or more favourable terms a proportion of those shares.³⁷⁸ The offer must be in writing and the company must allow at least 21 days for the shareholder to take up the offer.³⁷⁹ The pre-emption rights does not apply in relation to the allotment of bonus shares;³⁸⁰ also, it does not apply to a particular allotment of shares if these are, or are to be, wholly or partly paid up otherwise than in cash.³⁸¹ Furthermore, it does not apply to the allotment of shares that would, apart from any renunciation or assignment of the right to their allotment, be held under an employees' share scheme.³⁸²

The following question arises: if the company does not offer any new shares to existing shareholders, what is the legal status? In SCL 1965, there is no article dealing with this matter, and therefore, the shareholders may not be able to do anything with regard to not being notified, or being prevented from exercising that right. It is the same case when the company invites certain class of shareholders and not all of them. This explains the reluctance of many shareholders for not using the right of pre-emption in the purchase of new shares. This was indicated in a study conducted by the CMA on a number of listed companies that had increased their capital in the last two years; the CMA concluded that more than 76% of the total shareholders did not exercise their legal right to subscribe to the capital increase. This

³⁷⁵ CA 2006, Part 17, Chapter 3 S. 561 to S.577.

³⁷⁶ CA 2006, Part 17, Chapter 3 S. 561 to S.577.

³⁷⁷ See <www.companylawclub.co.uk/topics/issuing_shares.shtml#pre> accessed 8 March January 2012.

³⁷⁸ S. 561 of CA 2006 UK

³⁷⁹ S. 562 of CA 2006 UK

³⁸⁰ S. 564 of CA 2006 UK

³⁸¹ S. 565 of CA 2006 UK

³⁸² S. 566 of CA 2006 UK. In addition, shareholders can be excluded from statutory rights of pre-emption either by the company's articles, or by passing a special resolution; in such a resolution, the company's directors must make a written statement setting out (a) their reasons for making the recommendation, (b) the amount to be paid to the company in respect of the shares to be allotted, and (c) the directors' justification of that amount. The directors' statement must, (a) if the resolution is proposed as a written resolution, be sent or submitted to every eligible member at or before the time at which the proposed resolution is sent or submitted to him, or (b) if the resolution is proposed at a GM, it be circulated to the members entitled to notice of the meeting with that notice. See: S. 571(6&7) of CA 2006 UK.

was for various reasons; the CMA mentioned the first reason as being the lack of information about the increase in capital available to shareholders in the company; the communication between them and their company is insufficiently effective; the second reason is the lack of money immediately available to the shareholder; and the third main reason is the lack of justification for the decision for a capital increase.³⁸³

In the contrast, in the UK, the company and every officer of it who knowingly authorized or permitted such a capital increase that was in contravention with the regulations are jointly liable to compensate any person to whom an offer should have been made, in accordance with the provisions for any loss, damage, costs or expenses that the person has sustained or incurred by reason of the contravention.³⁸⁴ The minority shareholders can bring a claim on the ground of ‘unequal treatment’.³⁸⁵ However, no proceedings to recover any such loss, damage, costs or expenses shall be commenced after the expiration of two years from the delivery to the registrar of companies of the return of allotment, or where equity securities other than shares are granted, from the date of the grant.³⁸⁶

Undoubtedly, the eligible shareholders who do not subscribe to the new shares will be liable to a low percentage of total values of the shares they own. In order to resolve this problem, the CMA has recently developed a new mechanism for the inclusion of priority rights from the beginning of 2013, and it gives the shareholder the right to sell his right to an IPO to a third party, where those eligible shareholders who do not participate in whole or in part in the IPO are compensated for priority rights by granting them a compensation, if any, that is calculated by a specific mechanism.

If the sale price of unsubscribed shares were higher than the IPO price, the difference (if any), shall be distributed after deducting the amounts and expenses of the IPO, as a compensation for the owners of priority rights who do not exercise their right to either subscribe or sell rights as the ratio of what they own; the issuance bulletin will determine the period of subscribing to the shares that have not been

³⁸³ See <www.aleqt.com/2008/03/08/article_131822.html> accessed 18 March January 2012.

³⁸⁴ S. 563(2) of the CA 2006 UK

³⁸⁵ Nguyen Hoang, *Minority Shareholder Protection in Shareholding Companies; a Comparison between Vietnamese Enterprise Law and the United Kingdom Company Law*. Joint Swedish-Vietnamese Master’s Programme. Master’s Thesis. P. 45

³⁸⁶ S. 563(3) of CA 2006 UK. In the case *Re Thundercrest Lid* (1994) B.C.C. 857, the Judge Paul cancelled the allotment of shares to two members of the company because the allotment letter was defective in that it required an acceptance in less than 21 days contrary to the provisions of s.90 of the Companies Act 1985. In addition, the complainant had not in fact received the provisional allotment letter sent to him and that he wished to take up the shares allotted to him. Cited from: <https://westlaw.co.uk/> *Re Thundercrest Lid*, (1994) B.C.C. 857

subscribed for, and the period of allocation of shares to subscribers, as well as the date of transferring the amounts of compensation.³⁸⁷

Undoubtedly, the CMA new mechanism involves a number of goals, and it could be said that the most notable include the following:

1. Protecting the investor through compensating him/her for the decline in the value of their shares as a result of the amendment of the share price after the approval of the EGM on the capital increase. This compensation is made through the deposit of priority rights as securities in the portfolios of investors enrolled in the company's records at the end of the day of the extraordinary GM, as the value of the rights of priority deposited directly into the accounts of shareholders after the EGM will be equivalent to the decline in the value of their shares.
2. Increasing flexibility to the investor by giving him/her a greater number of options for the use of priority rights. Through the new mechanism, the investor will have choice to sell the full rights of priority accorded to him, or full subscription of these rights, or to sell part of them and obtain the necessary liquidity to subscribe to the other part.
3. Protecting priority rights holders who do not exercise their right to subscribe by introducing the remaining shares after the end of the trading of rights and subscription periods; the IPO returns will be distributed after deducting the amounts and expenses of subscription to the remaining holders of priority rights according to the ratio of rights they own.

4.5 Protection of the Shareholder during Shares Trading

When considering the advantages of JSCs, the key one is that their shares are transferable; the shareholders are free to purchase and sell the shares of the listed companies at a time that they deem most appropriate to them and that meets their aim. The process of buying and selling usually proceeds easily and quickly. In order to keep the financial market free from untoward practices and behaviours,

³⁸⁷ See <http://cma.org.sa/Ar/News/Pages/CMA_N_1228.aspx> accessed 28 March January 2012.

which would affect generally the shareholders and the country's economy, the Saudi legislature has put forth a set of new provisions relating to the capital market through the CMA.³⁸⁸ This was following the heavy losses suffered by shareholders in the capital market in 2006, which were estimated at about \$ 500 billion,³⁸⁹ and were an attempt to fill the gaps in the provisions within SLC1965.

For example, the shareholder has the right to obtain information from the company within an appropriate time, and the right to obtain information and data on the performance of the company, as well as the right to complain to the competent administrative bodies.³⁹⁰ In addition, listed companies must disclose all primary actions before the end of their fiscal year, as well as announcing or declaring immediately any significant matters or events that may affect the position of the company.³⁹¹ In this context, CAM imposed a fine against the *SAMBA* Group when it announced its annual financial statements before 23 days of convening its AGM³⁹²; it must declare not less than 25 days before the date of convening the AGM.³⁹³

Article 49 of the CML provides, “a. Any person shall be considered in violation of this Law if he intentionally does any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security”. This refers to any acts or practices that involve manipulation or that are misleading (known as market

³⁸⁸ The CMA has been given the power to set the rules that determine unlawful conduct, and to develop appropriate penalties. On this basis, the CMA has issued a set of regulations, such as the Market Conduct (which seek to prevent market manipulation, trading based on insider information, and dissemination of incorrect data). The Resolution of Securities Disputes Proceedings Regulations, Anti-Money Laundering , Counter-Terrorist Financing Rules, Merger and Acquisition Regulations, Investment Funds Regulations, Corporate Governance Regulations, Real Estate Investment Funds Regulations, Securities Business Regulations, Authorised Persons Regulations, Offers of Securities Regulations and Listing Rules. For more information see<www.cma.gov.sa> accessed 18 March January 2012. Also; Samba Financial Group, the Saudi Stock Market: Structural Issues, Recent Performance and Outlook, 2009. Available at<www.samba.com/.../Saudi_Stock_Market_Eng.pdf> accessed 20 March January 2012.

³⁸⁹ Samba Financial Group, the Saudi Stock Market: Structural Issues, Recent Performance and Outlook, 2009. Available at<www.samba.com/.../Saudi_Stock_Market_Eng.pdf> accessed 20 March January 2012.

³⁹⁰ Such as CRSD, in the situations referred to in the CML. See<www.crsd.org.sa/En/Pages/home.aspx> accessed 20 March January 2012.

³⁹¹ For example, Article 40 of the Listing Rules stipulates that JSCs must disclose to the public any information or significant event at least two hours before the beginning of the trading period.

³⁹² See<www.cma.org.sa/Ar/News/Pages/CMA_N_782.aspx> accessed 23 March January 2012.

³⁹³ This charge was based on the Article 42 (E) of Listed Rules.

See<www.cma.org.sa/En/Documents/Listing%20rules.pdf> accessed 25 March January 2012.

manipulation). Here, the offence is usually due to speculators who aim to gain by harming others through manipulation, conducted by themselves or in participation with others, or by fabricating rumours and promoting recommendations without the correct reliable information; all are illegal. For instance, the Saudi legislature has detailed a set of behaviours that are considered crimes of market manipulation, including conducting fake trades, transactions that do not involve real change of ownership, making operations in order to give false or misleading impressions of the existence of trading activity in shares or interest in buying them, or for the purpose of forming false requests or offers of tradable shares.³⁹⁴

In this respect, the CRSD sentenced a shareholder for violating Article 49 because he committed several offenses, including entering a series of orders to sell the shares of one company without any intention to implement them, and was obliged to pay the amounts he achieved from this manipulation, and a fine of 100 thousand SAR.³⁹⁵ Article 49 of the CML confirms that any person who participates intentionally, alone or with others, in any action creating false or misleading impressions on the market value of any shares, or induces others to purchase, sell or subscribe to those shares, or to refrain from that, or urges them to exercise the rights granted by such shares, or to refrain from exercising them, is violating the law. Thus, violation can be through practicing or refraining from doing the act; it may be negative or positive.³⁹⁶

³⁹⁴ Article 29 states, “c. The following acts and practices shall be among those which shall be considered types of manipulation that are prohibited by paragraph (a) of this Article: 1. To perform any act or practice aiming at creating a false or misleading impression of an existing active trading in a Security as may be contrary to the reality. These acts and practices shall include, but not be limited to the following: a. undertaking transactions in Securities which do not involve a true transfer of ownership thereof. b. Entering an order or orders for the purchase of a particular Security with prior knowledge that an order or orders of substantially the same size, price and timing for the sale of the same Security has been or will be entered by a different party or parties. c. Entering an order or orders for the sale of a particular Security with prior knowledge that an order or orders of substantially the same size, price and timing for the purchase of the same Security has been or will be entered by the same party or different parties”.

³⁹⁵ Resolution No. 9/L/D/2005 Case No. 29/26 issued by the Committee for the Resolution of Securities Disputes (CRSD)

³⁹⁶ According to CML, Participation in manipulation has three forms: participation through agreement with the offender(s) to do one of the prohibited acts, or participate in inciting such as spreading rumours or recommendations and other things to influence the shares price; or to participate through help, through what is known as circulation among the cases; or dealing while depending on incorrect information that is not taken from its main sources and is promoted by the violators to affect the shares either for the sake of personal benefit for himself or for others illegally, such as promoting influential speculators, and dealing according to the information they have from the same sources or from certain non-official sources (such a chat rooms), paid sites (such as Reuters and newspapers via writers who collaborate with them), as well as information on the Internet amongst others.

As an application of the above, the CRSD issued three verdicts against three traders in the Tadawul, who had violated Article 49 of the financial market system and Article 3 of the Market Conduct Regulations³⁹⁷ while they were trading in the shares of a group of listed companies in the Tadawul. The verdicts prevented them from working in listed companies, and being a member of a board of directors for three years; the first trader was also fined 146,666 SAR, and the second one 17,172 SAR.

The Saudi legislature also demands the disclosure of important information and data in any emergency circumstances. There is no doubt that non-disclosure of such data and information would constitute a hindrance to the performance of the shares market, and would provide a suitable climate for illegal practices; that is why various legislations have sought to oblige companies who trade in shares to disclose and notify the monitoring bodies with any relevant data and information on a regular periodical basis;³⁹⁸ however, if the legislature had not specified this, disclosure would have been subject to the discretion of the competent court, which usually means as soon as practically possible.

The Saudi legislature stipulated in Article 46³⁹⁹ of the CML that JSCs must inform the CMA in writing when becoming aware of any substantial developments that may affect the prices of shares traded in the market; it is mandatory to inform the market of such developments. However, the capital law does not specify any particular manner in which the company shall report the existence of emergency circumstances. The goal of this disclosure is to inform shareholders and customers about the emergency circumstances facing the company, and to enable the monitoring bodies to extend their control over these exceptional cases and to investigate what they are and what their causes were.

³⁹⁷ Article 3 provides, “ A- The following actions shall be among those considered as manipulative or deceptive acts or practices: 1) making a fictitious trade; or 2) effecting a trade in a security that involves no change in its beneficial ownership. b. The following acts shall be among those considered as manipulative or deceptive acts or practices when committed for the purpose of creating a false or misleading impression of trading activity in a security or interest in the purchase or sale of the security, or for the purpose of creating an artificial bid price, ask price or trade price for a security: 1) entering an order or orders for the purchase of a security with the prior knowledge that an order or orders of substantially the same size, time and price for the sale of that security, has been or will be entered; 2) entering an order or orders for the sale of a security with the prior knowledge that an order or orders of substantially the same size, time and price for the purchase of that security, has been or will be entered”.

³⁹⁸ Saleh Albaryri, *Illegal practices in the Stock Exchange*, 2001, Cairo, Almsandah Center Publishing, P. 18.

³⁹⁹ Article 46 of the CML provides, “A. A party who issues Securities must inform the Authority in writing upon becoming aware of any material developments which may affect the prices of the Securities issued by such party. If such party has a Security traded on the Exchange, the Exchange must be informed of such developments in writing”.

These circumstances might be financial, such as a serious loss influencing the financial position of the company, or structural, such as the integration of the company with another company, or legal, such as amending the articles of association (substantial amendments or the entry or exit of a strategic investor from the company), or natural, such as a disaster that badly affects the company's activities, causing heavy losses. In this respect, *the Saudi Arabian Amiantit Company* (Amiantit)⁴⁰⁰ was late in its announcement to the public about the signing of a contract pertaining to the sale of 50% of its share in Chong Koenig Poly Co. on 25/4/2008 to the tune of 169 million SAR, but did not announce it until 3/5/2008.⁴⁰¹ The CMA imposed a fine on the company amounting one hundred thousand SAR⁴⁰² on the grounds that the act was a violation of the provisions of law, and represented damage to beneficiaries such as shareholders.

In consideration of the Saudi experience, it is easy to determine what is meant by acts or practices that involve market manipulation, but the difficulty lies in application; more precisely, it is difficult to prove the occurrence of a violation before the courts. This is clear due to the lack of convictions against traders for committing violations of the CML and Implementing Regulations, despite the large number of suspected cases. From 2004 to 2006, the CMA referred to the Investigation Department⁴⁰³ 123 cases of violation, and analysed a further 203 investment cases. The CRSD issued 7 condemning verdicts, while the CMA issued 28 decisions for cases of violation of the CML and Implementing Regulations.⁴⁰⁴ It is worth mentioning that such verdicts take a long time; indeed, some exceed one year. It was intended that such cases be expedited immediately or within a short period of time in order to emphasize the integrity of the market and to deter others.

4.6 Disposition of Non-Paid-up Shares

Under Article 99 of SCL 1965, the legislature allowed purchasers to pay the value of their shares in instalments, and required that the shares be nominal until full payment of their value; the shareholder should pay the full value within the period agreed upon,⁴⁰⁵ and in the case of non-completion of

⁴⁰⁰ See <www.amiantit.com/ar/default.php> accessed 25 March January 2012.

⁴⁰¹ See <www.jazan.org/vb/showthread.php?t=122561> accessed 25 March January 2012.

⁴⁰² See <www.tadawul.com.sa> accessed 25 March January 2012.

⁴⁰³ See <www.cma.org.sa/en/AboutCMA/CMA_Department/Pages/Enforcement.aspx> accessed 25 March January 2012.

⁴⁰⁴ Mohammad Alsohbani, *Workshop on speculation in the financial markets*, placed in the Aleqtisadiah Newspaper, Riyadh, 6 April 2007. P. 9

⁴⁰⁵ Saudi Company Law, 1965 Article 110 provides, "1- A shareholder is obligated to pay the value of (his) share on the sates set for such payment... 2- If a shareholders defaults in payments(of a call) when it becomes due the board of directors may, after giving him notice, by registered letter, sell the share at a public auction...".

payment, the company's board then has the right to ban the share or to sell it at auction after informing the shareholder. The company is entitled to priority in the reimbursement of its right, expenses and interests against all creditors, and any remaining amount is to be returned to the shareholder.⁴⁰⁶

In this vein, the verdict of the Board of Grievances was that the plaintiff shareholder has right to recovery his shares and their dividends, i.e. those that have been sold by the defendant company, which must be sent to his correct registered address; the verdict is based on Article 110 of SCL 1965⁴⁰⁷.

However, if the sale of the share does not cover the debt, the company is entitled to require recompense from the shareholder's property according to the general rules. The question that arises here is: is it possible to dispose of non-paid shares? In other words, is the shareholder entitled to sell the share whose value was partly paid in accordance with the Saudi system? If the answer is 'yes', who shall pay the rest of share's value (the transferor or the transferee).

There are not enough provisions under SCL 1965 to cover all the important points relating to this subject; the Saudi legislature has not regulated these issues, and has left answered many questions relating to many legal gaps in the company law. Such issues have been regulated in many Arab and western legislations; for example, the Egyptian system refers regulating this matter to the Implementing Regulations of its Company Law in Article 142.⁴⁰⁸

Practically speaking, it is noted that such actions among shareholders are generally considered correct; thus, the buyer, the owner of the new share, becomes responsible before the company to pay the rest of share's value. This matter is normal because the new owner of the share bought it at a value less than its true value if it were paid-up. On the other hand, obliging the seller to pay the remaining funds of the share is illogical because his/her relation to the share was cut off once the share was sold and

⁴⁰⁶ Saudi Company Law, 1965. Article 100 (C)

⁴⁰⁷ Case No.3441/1/1426 issued by Commercial Court under the Board of Grievances.

⁴⁰⁸ The Article states that the shares whose values have not been paid fully have all the rights allocated to those whose values have been paid fully, within the limits provided by company's bylaw, with the exception of the profits, which are distributed according to the percentage that was paid out of their nominal value. The Company shall be entitled to set some conditions on the shares whose values have not been paid fully, such as depriving their owners until they pay the full value of the share, so as to return all the allocated rights of the share and pay the profits earned.

registered in the records of the company, and the new shareholder replaced him, meaning that a new relationship arises between him and the company.⁴⁰⁹

4.7 Shareholders' Right to Dividends

A shareholder is entitled a set of rights once he subscribes to shares in a JSC, and they remain associated with them, and shall not be compromised.⁴¹⁰ These rights are either financial or administrative. The most prominent of those rights may be the shareholder's right to profit; thus, making a financial profit is one of the main reasons encouraging shareholders to participate in JSCs; they wait until the end of the financial year of the company to receive financial profits in return for the sums they invested in the company. Therefore, profit is a key factor in establishing commercial firms, especially JSCs. Accordingly, the right of shareholders to profit is always mentioned in the corporate laws and the company's articles; consequently, it represents the most prominent right for shareholders in these companies, as a fundamental right that they shall not be deprived of or that shall not be limited by any conditions; even though there are some restrictions, they are just regulatory restrictions that do not prevent them from exercising their right to profit.

SCL 1965 gives the shareholder a set of rights within JSCs, which are stipulated in Article 108; the shareholder's right to obtain profit is first among these rights: "A shareholder shall be vested with all the rights attached to shares, specifically the rights to obtain equity in the company a share in the profits declared for distribution". Article 7 of the SCGRs confirms this right and its importance.

The company's articles detail the percentage that must be distributed out of the net profits after setting aside the legal and conventional reserve, provided that the percentage mentioned shall not be less than 5% of profits;⁴¹¹ if the percentage is not mentioned in the company's articles, then the AGM shall determine it.⁴¹²

⁴⁰⁹ Lebanon Company Law, Article 119, French Company Law Article 282, and Morocco Company Law Article 277.

⁴¹⁰ Saudi Company Law, 1965. Article 125

⁴¹¹ Saudi Company Law, 1965 Article 127

⁴¹² Saudi Company Law, 1965. Article 123

The question that arises here is: what is the concept of net profit referred to by the Saudi legislature within SCL 1965? SCL 1965 does not define net profits accurately, as some comparative legislations do, such as the Egyptian law which stipulates in Article 40 that the net profits are “those realised from operations exercised by the company after deduction of all expenses needed for their realisation, and after accounting for all consumptions and allocations, which the accountancy rules impose and putting them aside before proceeding on any distribution in whatever way”. Consequently, the shareholders can expect their profits at the end of the year, and one can know what is considered a net profit (or not) through this definition. Thus, net profits distributable to shareholders represent the difference between the company’s assets after excluding deductions regulated by the law and the articles of association. On the other hand, to say that there are profits made by the company and available for distribution does not necessarily mean they must be in the form of cash; logically, they can be profits in kind. The state of having cash is not even required in the profits, and could be in any other form, such as in shares, which would then be distributed to shareholders, after verifying the activities for the previous fiscal year.⁴¹³

4.7.1 When Does the Shareholder own the Dividend?

Law academics are unanimous that the right of shareholders to the company’s profits is a probabilistic right, and the shareholder, here, is essentially the owner of a probabilistic right as a partner, because the profit is uncertain. At the end of each fiscal year, after doing the annual inventory and budget preparation, and calculating profit and loss, the final outcome of the company’s business is determined (whether it has made profits or losses).⁴¹⁴ If it makes profits, they must be distributed to shareholders after making the deductions stipulated in the law or in the company’s articles, such as expenses and satisfying the statutory reserve or contractual reserve as well as other reserves; the proportion of the profits that are to be distributed to the shareholders is determined by the GM upon the suggestion of the company’s board. Clearly, the resolution to distribute dividends to shareholders does not create a right for shareholders to the profits, but a revealing of this right; this resolution makes this right certain after being probabilistic, and so this right exists as long as the company has achieved profits (whether or not announced), and the power to declare dividends is granted exclusively to the board (no

⁴¹³ See: Hunkar Ozyasar. *Can a Shareholder Force a Corporation to Pay a Dividend?* Available at<<http://smallbusiness.chron.com/can-shareholder-force-corporation-pay-dividend-61506.html>> accessed 25 April January 2012.

⁴¹⁴ Saudi Company Law, 1965 Article 89

shareholder approval is required).⁴¹⁵

Article 127 of the SCL 1965 stipulates that a shareholders deserves their share of the profits from the date of issuance of the GM's decision on distribution. Consequently, this date marks the adoption of the shareholder's right to profit, and then the company owes him as much as his portion of the capital; the shareholder, here, becomes a creditor of the company, and may follow all legal means to claim the right to profit if the company delays payment contrary to any agreement.

The profit may become a loan with interest to the company if not distributed within the period stipulated by the law or as provided for in the articles of association; if the profit is not distributed within that period, it turns into a loan with interest, i.e. the company owes the shareholder.⁴¹⁶ If the liquidation of the company is announced before any distributions/dividends have been done, then the shareholder can claim his share of the profit together with the company's creditors; here, he is as a creditor, not a shareholder.⁴¹⁷ Each shareholder has the right to capture profits immediately as soon as the decision is taken at the GM to distribute dividends to shareholders.

However, the important question raised here is: when shall a company distribute the announced profits? Unfortunately, in SCL 1965 there is no clear mechanism for scheduling the dates for distributing profits to shareholders, or for when a company must publicize that there are profits to be distributed to shareholders; it leaves this matter to the board of directors, which has complete freedom in determining the appropriate time for the distribution of profits. Due to this lack, the board of directors has the right to postpone the payment of dividends to shareholders until a time of their choosing.⁴¹⁸

The second paragraph of Article 127 stipulates, "2- A shareholder shall be entitled to his shares in the profits (i.e. dividends) as soon as the general meeting adopts a resolution on the allocation (of profit)".

⁴¹⁵ Mentioned in Delaware General Corporation Law, § 170. Cited from: Bebchuk, Lucian. *The case for increasing shareholder power*. 2003. P. 16

⁴¹⁶ Ferran, Eilís. *Corporate Finance Law*. Oxford University Press, USA, 2008. P. 53

⁴¹⁷ Jamal Aldain. *Alshrkāt Altajarih*. Cairo. Dar Alnahdah. P: 235

⁴¹⁸ The shareholder deserves his share of the profit as soon as the decision to the General Assembly is taken to distribute the profits; and the Board of Directors distribute these profits to shareholders and employees within utmost one month from the date of the issuance of the decision. This is stated by both the Jordanian legislator in Article 191 and the Emirati one in Article 194.

On this point, the Saudi legislature needs to be more accurate and clear, and bind the board of directors to pay shareholders their dividends within a certain period from the date of the declaration of dividend distribution by the GM, in order to protect shareholders from fraud on the part of the board of directors. A good example for solving this problem is in Egyptian Companies Law, which provides in Article 44 (2), “the administrative board should precede to the execution of the decision of the general assembly for distribution of profits to shareholders and workers, within one month at most from the date of issue of the decision”.

As an historical example that illustrates the seriousness of this point, the directors of board of *Sipchem*⁴¹⁹ announced on 20/07/2008 that they would start distributing dividends to shareholders for the year 2007, amounting to 10% of the profits, and that the legitimacy of the dividends should be for each shareholder already registered in the official company registers on 7/5/2008. In fact, the timing of the declaration came as a surprise to investors in general and the company’s shareholders in particular, because the recommendation was for distribution after about six months from the end of fiscal year 2007,⁴²⁰ and the date of the GM to approve these distributions was after about seven months from the end of the fiscal year; the strange aspect was that the company had held its AGM only about four months before the date of that second GM (specifically on 15 March 2008), without including in the agenda at that time a recommendation for any cash dividends. This means that the shareholders had no knowledge of and no intention to recommend any dividends for the fiscal year 2007; then, the board of directors, after only about three months, suddenly recommended cash dividends, and called for a second GM to approve this recommendation.

Here, we must wonder: why were these cash distributions not recommended along with the call for, and in the agenda of, the AGM? Why were the shareholders subject to such a delay by the company in releasing their cash dividends? What is the status of those shareholders who sold their shares on the basis that the company had no intention of granting dividends (based on the AGM agenda)? Who is responsible for these? Then, how can we prevent what happened from happening again? All these questions need to be answered clearly in order to protect shareholders, especially minority shareholders; it is not fair that the board of directors can schedule the distribution of dividends in order to achieve its own interests and not for the sake of the company’s interests.

⁴¹⁹ Established in 1999, Saudi International Petrochemical Company (Sipchem) manufactures and markets methanol, butanediol, tetrahydrofuran, acetic acid, acetic anhydride, vinyl acetate monomer, as well as carbon monoxide through its various affiliates. It has been listed on Saudi Stock Market since 2006.

See <www.sipchem.com> accessed 5 April January 2012.

⁴²⁰ See <www.aleqt.com/2008/06/18/article_12702.html> accessed 5 April January 2012.

In the UK, statutory rules for distribution are detailed and set out in Sections 829 to 853 of CA 2006, and in the company's articles. Distribution is defined as “every description of distribution of a company's assets to its members, whether in cash or otherwise”.⁴²¹ A company cannot pay its shareholders out of its capital; it should have profits available to distribute dividends,⁴²² which are often referred to as distributable profits or distributable reserves.⁴²³ The company's articles of association describe the method for paying the dividends to its shareholders, according to their portion held in the company.

Article 830 of CA 2006 illustrates the basic rule, which is that a company's profits available for distribution are its “accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made”. The directors of a company must prepare a directors' report for each fiscal year of the company.⁴²⁴ The report must state the amount (if any) that the directors recommend should be paid by way of dividend.⁴²⁵ The company may by ordinary resolution declare dividends, and the dividend must not be declared unless the directors have made a recommendation as to its amount; such a dividend must not exceed the amount recommended by the board of directors.⁴²⁶

⁴²¹ S. 829 of CA 2006 UK

⁴²² S. 830 of CA 2006 UK, “(1) A company may only make a distribution out of profits available for the Purpose”. *Exchange Banking co. v. Filtcofts* (1882). 21 Ch D 519

⁴²³ S. 830(1) of CA 2006 UK

⁴²⁴ S. 415 of CA 2006 UK

⁴²⁵ S. 416 of CA 2006 UK

⁴²⁶ The Companies (Model Articles) Regulations 2008. Article 30 (1 & 2). In this respect, there are three important dates regarding dividends; the first is the declaration date, which is the day when the company's board announces its intention to pay a dividend. Accordingly, the company creates a liability for its books; it now owes the money to its shareholders. The second date is the date of record, called the ex-dividend date; it is the day upon which only the shareholders of record are entitled to the upcoming dividend payment. In other words, only the owners of the shares on or before that date will receive the dividend. The third date is the actual payment date; this is the date on which the dividend will actually be given to the shareholders of the company. Once a final dividend has been approved by shareholders, it becomes a debt due and payable to the shareholders. However, no dividend may be declared or paid unless it is in accordance with the shareholders' respective rights. Dividends must be paid in cash, unless the company's articles allow otherwise. See: The Companies (Model Articles) Regulations 2008. Article 30 (3). & the Companies (Model Articles) Regulations 2008. Article 34(1) Subject to the terms of issue of the share in question, the company may, by ordinary resolution on the recommendation of the directors, decide to pay all or part of a dividend or other distribution payable in respect of a share by transferring non-cash assets of equivalent value (including, without limitation, shares or other securities in any company).

4.7.2 Company Policy in the Distribution of Dividends

JSCs follow various policies in the way they distribute profits at the end of each fiscal year; these vary from one company to another, and a company may decide to deport part of the profits and distribute the rest, or deport all the profits to a future year; it may decide to exploit optional reserves to cover specific targets. Nevertheless, there is a common policy pursued by companies provided by law on how to distribute profits, if not provided for in the articles of association.⁴²⁷

A specified percentage of the net profits of the company are deducted each year; this amount is taken as reserve in order to maintain the financial status of the company against losses or unexpected expenses, or probable future losses. Therefore, it is considered as a collateral financial guarantee for the company, to be used when needed; in general, company reserves are only taken only from the net profits realized by the company.⁴²⁸

Shareholder dividends shall be only from net profits; the company's bylaws detail the percentage that must be distributed to shareholders after deducting reserves. SCL 1965 requires that dividends shall not be less than 5% of the profits.⁴²⁹ The distribution of dividends to shareholders is not conditioned on achieving profits during the fiscal year; the company can distribute dividends to shareholders even though it does not achieve profits through cutting off part of the reserves to be distributed among the shareholders as profits. However, there are reserves that the GM is not entitled to decide to take profits from; for example, the statutory reserve of the company, which is complementary to the capital,⁴³⁰ and its goal is to protect the company against risks it may encounter in the future; it is a guarantee for the company's creditors.⁴³¹

⁴²⁷ The English legislature does not require companies to make a legal reserve; this is left to the Board of Directors as stated in S.110; also, Article 264/(2) prohibits the distribution of dividends from out of certain reserves in certain cases.

⁴²⁸ Saudi Company Law, 1965 Article 125

⁴²⁹ Saudi Company Law, 1965 Article 127

⁴³⁰ Mahmoud, Aisharkawi, *Commercial Companies in Egyptian Law*, Cairo: Dar Alnandah Publishing (1986), p. 238.

⁴³¹ Ellis Ferran, *Company Law and Corporate Finance*, Oxford: Oxford University Press, 1999, p. 418.

As described earlier, if the company has not made net profits during the fiscal year and deducts part of the reserves to be distributed as dividends to shareholders, then the company must declare this and explain the source of the dividends, in order not to give an impression contrary to the truthful financial status of the company. To do otherwise would be to give inaccurate information to shareholders and others about the company, and to claim that it had made profits, while the truth would be that those profits are actually from taken the company's reserves.⁴³² If the company fails in the declaration of the source of those dividends, the GM resolution for distributing dividends to shareholders shall be null and revocable; moreover, the board of directors shall be subject to legal questioning on the basis that such an action falls within its duties.

No doubt, such an act by the board would be considered as misleading the shareholders, and would create an impression for others that the company was achieving profits; this would be contrary to the truth.

In brief, we can say that such a disclosure of any deductibles from reserves is a basic guarantee for the shareholders of the company; it is the right of every shareholder to know the status and financial position of the company, and to find that there is a match between what exists in the financial lists of the company and its financial position. That is why such disclosure reveals the factual financial status of the company to shareholders and others, and acts as confirmation that the company is committed to pursuing a policy based on truthful disclosure and transparency.

Disclosure will also reveal the company's management policy in terms of the shareholders' money is managed in the company; this forces the board to perform its duties with diligence. In addition, it enhances the status of shareholders by increasing their oversight over the company's performance and their ability to monitor its activities. In spite of the importance of this issue, SCL 1965 fails to identify such a guarantee, to oblige the company's board to disclose it acting immediately.

⁴³² Sameha Alkalyouby, *Commercial Companies*, Third Edition. 1993. Egypt, Dar Alnahdah Al-Arabi Publishing. 1993 p. 145

4.7.3 Distribution of Dividends under SCL 1965

When JSCs achieve profits, this does not mean that shareholders are entitled to the full profit realized; there are restrictions on those profits, mentioned in the company's bylaws or in the articles of association. The first deduction from the annual profits is the 10% for the statutory reserves;⁴³³ after that, not less than 5% (or more, as provided for in the company's bylaws) shall be distributed to shareholders as dividends; also, company may deduct for contractual reserve if mentioned in the company's bylaws. In addition, a ratio of not more than 10% of the net profits will be deducted for founders' shares;⁴³⁴ as well as allocating a ratio of these earnings (not more than 10%) as rewards to members of the board of directors,⁴³⁵ and if an amount remained as surplus from the net profits, it shall be distributed again to the shareholders as additional quotas.

In any case, it should be noted that profits cannot be distributed to shareholders before the company fulfils its obligations in a timely manner. If the company distributes dividends before fulfilling all its obligations, the company's creditors are entitled to sue the board of directors, and any such dividends are considered a sham; if the company profits are covered by the debts, then the shareholder has no right to claim that dividends.⁴³⁶

According to SCL 1965, there are two types of financial reserves; the first is called the statutory reserve, which all JSCs are obliged to establish, and the other is called the contractual reserve, which is an optional one that might be stipulated in the articles of association. There is also the possibility for companies to form other reserves as needed. The obligatory statutory reserve is a ratio of net profits; most legislation oblige JSCs to build a statutory reserve but they differ in the percentage to be

⁴³³ Saudi Company Law, 1965. Article 125 provides, "(1) The board of directors ... set aside 10% of the net profits to build up a reserve fund to be called the statutory reserve".

⁴³⁴ Saudi Company Law, 1965. Article 114 states, "(1) The company's bylaws or the general meeting's resolution creating founder's shares shall specify the rights attached thereto. Such shares may be granted a proportion of the net profits not exceeding 10% after distribution of a dividend of net less than 5% of the paid-in capital to stock holders".

⁴³⁵ Saudi Company Law, 1965 Article 74 (2)

⁴³⁶ Sameha Alkalyouby, *Commercial Companies*, Third Edition. 1993. Egypt, Dar Alnahdah Al-Arabi Publishing. 1993 P. 685

deducted from profits for the reserve.⁴³⁷ Article 125 of SCL 1965 demands a deduction of 10% from the company's annual net profits unless the company's bylaws provide a higher rate.

It can be argued that determining a percentage higher than 10% of the net profit for the statutory reserve would affect the shareholders' right to earnings, and reduce their share of the profits, which may lead to reluctance on the part of individuals wishing to invest in such companies; an inordinately high percentage would make returns on investment inadequate and therefore not commercially feasible. In fact, a deduction of more than 10% is considered as prejudicial to minority shareholders, remembering also that there are other reserves that the company can make if it wishes to do so, as we shall see later.

It is not possible to distribute any dividends to shareholders before making this deduction; that is why it is not allowed to distribute statutory reserve as dividends to shareholders. The reason behind that is that this reserve is treated as capital because it is used either to cover any shortfall in the capital resulting from losses suffered by the company, or to increase the capital should the AGM decide so.⁴³⁸

It is important to mention that SCL 1965 does not specify when deductions for reserves shall be halted, i.e. if it reaches a certain percentage; however, it gives the AGM the right to halt a deduction for the statutory reserve if that reserve has reached half of the capital. Thus, there is no obligation on the company to halt making deductions in any way, and SCL 1965 should have stated a certain percentage whereupon the deduction for the statutory reserve must be halted; the Egyptian law stipulates such a limit, where Article 40 states that the percentage shall not exceed 50% of the capital.⁴³⁹

The other reserve is contractual, and SCL 1965 allows the company's articles to stipulate setting aside a certain percentage of the net profits to build this reserve. The company may decide not to exploit this reserve for any purposes other than those defined by the company's articles (except through a GM resolution).⁴⁴⁰ If the company's articles do not mention the company's purpose for the reserve, then the

⁴³⁷ French Company Law Article 345, Egypt Company Law 40

⁴³⁸ Saudi Company Law, 1965 Article 126

⁴³⁹ Egypt Company Law Article 40

⁴⁴⁰ Saudi Company Law, 1965 Article 126

GM may decide to exploit it in a way that will benefit the company at the suggestion of the board of directors. The Saudi legislature does not determine the deduction percentage for this reserve, leaving it to the discretion of the company's board; the Saudi legislature should stipulate a maximum for the deduction, as the Jordanian Companies Act does, which states a percentage of not more than 20% of the net profits of the fiscal year.⁴⁴¹

In addition, in Article 127 of SCL 1965, there is the so-called 'optional' or 'free' reserve; this type of reserve is not demanded by the law or the company's articles, i.e. this reserve is made at the discretion of the company. Should a GM decide to build such a reserve, it must be for the benefit of the company as a whole, or to facilitate distributing fixed dividends to shareholders.

SCC 1965 does not specify any particular maximum percentage for deductions from net profits, leaving this matter to the board of directors. Here, it is important for the Saudi legislature to intervene and to determine a certain percentage for the reserve because not identifying such a percentage gives an excuse for the board of directors to determine a percentage according to their wishes, which may leave no profits for shareholders at the end, or result in the distribution of dividends that do not meet their expectations.

4.7.4 The Effect of the Company's Reserves on the Shareholder's Right to Dividends

When the company makes profits at the end of its financial year, but then decides not to distribute those profits to shareholders on the basis that is for the good of the company (to fund expansion, for example), the shareholders may argue that this decision is against their interests because the purpose of investing in a company is to reap the profits. This raises an important question: how can the respective interests of the shareholders and the company be reconciled in the use of profits? A shareholder wishes to obtain a fair proportion of any profits generated; on the other hand, the company deducts part of the profits to build its reserves in order to be able to finance new projects and to invest in the future, or to protect itself from risk and maintain its financial position; this may necessitate creating new reserves.

⁴⁴¹ The Companies Law No. 22 of 1997, Article (187) states, "a) The General Assembly of a Public Shareholding Company may upon the suggestion of its Board of Directors, decide to annually deduct 20% of its annual net profits for the account of the voluntary reserve".

Any expansion in the number of reserves should not be at the expense of the right of shareholders to profits. Deducting funds from profits for the statutory and contractual reserves does not represent a problem for shareholders because they are well informed of this. The problem starts when the company takes a certain percentage of annual profits to create other reserves for which the company has no particular need. It may create one to collect new funds in order to increase its capital, which may then be frozen; this is regarded as an assault on the interests of shareholders, whose financial returns will be reduced accordingly. Such an action should have legitimate justification; otherwise, the GM's decision to create such a reserve is considered invalid.

Nonetheless, the company's shareholders may be affected by sacrificing part of their profits, although they may benefit in the long term.⁴⁴² The company may decide to make new investments in order to expand and grow, and the company must have the necessary funds to assist in the completion of that goal; here, the company captures the annual profits (or part of them) to solve the problem of funding its business, and this type of funding is known as self-financing. This avoids the company having to engage in financing operations that might harm the company, such as borrowing from banks that impose commercial rates of interest, or interfering in company policy by converting a proportion of the loan into shares.

Similarly, the company may increase its capital by issuing new shares but this may have negative consequences for the company; this would reduce the shareholder's opportunity to obtain higher rates of profit due to the increase in the number of shareholders. On the other hand, this could lead to different policies being forwarded by the board of directors because the new shareholders may hold views that are contrary to those of the board.

Therefore, self-financing is the solution best suited for a company when it wants to expand and grow; it maintains the independence of the company and averts the financial burden of borrowing from others. Significantly, company laws generally encourage companies to follow a policy of self-financing, through the formation of obligatory reserves (with legal obligations), or optional ones in order to protect the company against risk and to maintain its independence at a time of crisis. Self-

⁴⁴² Faccio, Mara, Larry HP Lang and Leslie Young. Dividends and expropriation. *American Economic Review* (2001) Vol. 91 No. 1: 62.

financing also helps to protect the creditors of the company, which provides the company with safety and stability; this will certainly be reflected positively in the reputation of the company before its investors and shareholders.

On the other hand, any expansion in the policy of deducting funds from the profits to configure other reserves for the process of self-financing may have adverse effects on the financial rights of shareholders, and may lead to preventing them from receiving anything at all in some years; shareholders may receive minimal dividends, which could be seen as merely a reward for contributing to the company's capital.⁴⁴³ Such small amounts paid to shareholders will reduce the value of the shares when traded, and this action by the company might force shareholders to sell their shares and search for companies offering better deals. Therefore, the company should not expand a reserve or create a new one for self-financing because the shareholder also has the right to obtain a fair share of the profits, and the company must not exceed its authority in forming reserves that are not fully justified.

There should be a balance between the respective interests of the company and its shareholders; the interests of the company should not surpass those of the shareholders. Here, the board of directors plays an important role in the process of balancing the interest of the company against the interests of the shareholders in the use of annual profits; it is the directors' duty to ensure that there is no conflict between the two parties when distributing profits, and to achieve the interests of both to the satisfaction of both.

Generally, shareholders expect the company's management to work on maximizing their funds and making them realize the maximum possible profits; the problem begins when the members of the board of directors are the owners of large quotas in the company, and thus tend to pursue the company's (i.e. their own) interests at the expense of the shareholders' interests. The members control the decisions of the GM and will defeat those voices in opposition to the composition of such reserves. So, the company's decision to make deductions must be in the interests of the company, and must not affect the rights of minority shareholders to the profits.

⁴⁴³ Faccio, Mara, Larry HP Lang and Leslie Young. *Dividends and expropriation*. *American Economic Review* (2001) Vol. 91, No. 1: 62.

4.8 The Right of the Shareholder to the Company's Assets upon Liquidation

As a general principle, shareholders are not entitled to claim their share as long as the company exists. Thus, if they wish to leave the company, they dispose of their share to other shareholders who then replace them. However, in the case of the company going into liquidation, the shareholders here have the right to claim the value of their shares as soon as the liquidation process is finished.

The right of shareholders to the company's assets after liquidation is one of their acquired rights, which cannot be waived without their personal consent; this is a basic right relating to share ownership.⁴⁴⁴ The right to preference in the distribution of the assets of the company may be granted to some of the shareholders (at the time of asset division) and not to others, such as to those who have shares with pre-emption (preferred shares, which give their owners priority in claiming their shares before the ordinary shares).⁴⁴⁵

In general, shareholders have the right to recover their share after the liquidation as much as their proportion in the capital of the company. Liquidation is a completely separate process from that of dividing the assets of the company among its shareholders; the liquidator cannot divide the company's assets before the liquidation of the company because it is contrary to the provisions of the law.⁴⁴⁶ Therefore, liquidators are responsible for determining the share of each shareholder in the company's assets, and for the distribution of the company's remaining properties among the shareholders; in the Saudi system, this is an easy process because there are only two types of shares, ordinary shares and premium ones.⁴⁴⁷

JSCs end for a number of reasons, as set out in SCL 1965; the consequences are great, the most important of which is the liquidation of company's properties and distributing the company's remaining properties to the shareholders after fulfilling the debts of the company's creditors. The liquidation stage starts as soon as the JSC ceases to exist.⁴⁴⁸ In general, the liquidation of the company

⁴⁴⁴ Saudi Company Law, 1965 Article 108

⁴⁴⁵ Saudi Company Law, 1965 Article 103. Also, Article 3 of the SCGRs.

⁴⁴⁶ Geoffrey Morse. *Charitiesworth's Company Law*. London, Thomson Reuters. P. 617

⁴⁴⁷ In fact, according to the SCL 1965 all listed companies have the right to issue two types of shares (ordinary & preferred), but in reality few companies issue the preferred shares; according to Alnasri, such shares are not commonly traded in the Tadawul. However, it can be said that there is one principle: all shareholders must have equal treatment.

⁴⁴⁸ Saudi Company Law, 1965 Article 15

is either voluntary (upon the decision of the EGM),⁴⁴⁹ or compulsory (upon the decision of the competent court).⁴⁵⁰ In the case of voluntary liquidation, the EGM, when taking its decision to liquidate the company, shall appoint a liquidator (or more); if it does not appoint a liquidator, then the GAFC shall appoint one and determine his fees.⁴⁵¹

Before dividing the company's assets among the partners, certain procedures must be followed, such as appointing a liquidator to perform the operations necessary for determining the net funds, paying outstanding debts, and selling remaining assets to be converted into cash.⁴⁵² Therefore, the liquidator shall pay the debts of the company if they are due, or keep the money if they are not due or are disputed; the debts arising from the liquidation itself have priority over other debts;⁴⁵³ fees, costs and related expenses, such as the liquidator's remuneration, shall be paid.

The general rule here is that the shareholders have the right to demand their share of the divided properties as soon as the liquidation is approved and the debts of the company are paid. According to SCL 1965, the liquidator shall then distribute the value of the shares of the shareholders depending on their priority in the company's capital, following settlement of all obligations relating to the company finances.

Following the liquidation of the company, there are three possibilities. In the first, the liquidation outcome is equal to the sum of capital; this happens when the company did not achieve any profit or loss, and so there are no profits or losses for the partners. The second possibility is that the liquidation outcome is greater than the total sum of the partner's shares; here, each shareholder takes his full share together with profits according to his share in the capital. The last possibility is that the remaining assets are less than the total sum of the partners' shares; here, each shareholder takes his share incompletely. Of course, if nothing is left after the payment of expenses and debts mentioned above,

⁴⁴⁹ Saudi Company Law, 1965 states the cases where the liquidation of the company is optional; they are the following cases: the end of the period assigned to the company, unless the GM decides on an extension; the completion or lack of purpose for which the company was founded, or the impossibility of the completion of this purpose; and the GM of the company decides the end or liquidation of it. In the other cases provided for in the company's articles: the transfer of all shares to one shareholder; and the integration of the company in another company.

⁴⁵⁰ According to Saudi Company Law 1965 Article 48, all JSC shall carry out compulsory liquidation in the following cases: if the company fails to meet its obligations; if its activities stop for a period of one year for no legal or justified reason; and when the total losses of the company rise to 75% of its subscribed capital unless the GM decides to increase the capital.

⁴⁵¹ Saudi Company Law, 1965 Article 218

⁴⁵² Saudi Company Law, 1965 Article 220

⁴⁵³ Saudi Company Law, 1965 Article 222

the partners do not take anything. If there is a surplus in the liquidation, it shall be distributed according to the provisions of the company's articles; if the articles do not include provisions in this regard, the surplus shall be distributed to the partners according to their portions in the capital.⁴⁵⁴ SCL 1965 does not provide any further details on this point.

4.9 Conclusion

When people buy shares in a listed company, they directly join the company's shareholders, and acquire a set of rights within the company. It can be said that the most important of these rights is the right to profit, which is the primary motivator encouraging shareholders to participate in the company; then, they become entitled to the right to participate in and to learn of the company affairs, and to make sure that their company is moving towards achieving their interests. Here, the shareholder is an owner of a portion in the capital, and bears any loss of the company, according to his share, and upon liquidation of the company, he may be reimbursed for the sum he had paid but only after other stakeholders.

In fact, making profits for shareholders is not the only goal of listed companies; there are other goals. Companies have a web of contracts, where there are many stakeholders, and each has a certain goal, but as the topic of research is shareholders' rights, we will focus only on those rights. The position of shareholders in listed companies differs from other stakeholders, as they have rights that other stakeholders do not.

The financial rights of shareholders in a JSC, as we have seen, are many but the most important is the right to dividends when the company achieves annual profits, to be distributed to shareholders after deducting any monies due as stipulated by law or the company's articles; however, SCL 1965 does not define the term annual profits in spite of its importance.

As referred to in SCL 1965 Article 127, the shareholder is entitled to his share of the profits as soon as the GM has decided to make a distribution, but the question that arises here is: in what timeframe should those profits be sent to their owners, or is this matter left to the board of directors to determine? This is regarded as serious legislative lack; the board of directors should not be given the power to determine the date for the distribution of profits. This is a matter that should be specified by law, and in the case of any delay in the payment of quotas, the board of directors shall be punished.

⁴⁵⁴ Saudi Company Law, 1965 Article 222(3)

As for the company's financial reserves, the law allows the board of directors in JSCs to create optional reserves at any time. In this chapter we also discussed the types of reserves and their importance in terms of company financing, as well as in terms of the company's ability to defend itself against future challenges. Certainly, creating new reserves exposes the stakeholders' interests to risk, as there is the possibility of the board of directors seeking to achieve their interests at the expense of other shareholders. It is the duty of the legislature to explain this issue in detail, in order to protect the weaker parties in the company.

In addition, we discussed in this chapter another financial right, as stipulated in SCL 1965 for all shareholders enrolled in the company, which is the priority right to subscribe to shares before any third party, and to have any new shares offered to them before others. This right is stipulated in Article 136 explicitly; unfortunately, in the same article, it also states that the company's articles may provide that the shareholders could have this right waived or restricted. This means that the board of directors may issue new shares without offering them to the shareholders. SCL 1965 needs to be more accurate and precise in this matter in order not to prevent shareholders from having this right taken from them in any way unless the shareholder himself rejects the subscription.

In conclusion, a JSC is considered as a legal person with its own property, but once it is dissolved, its properties are transferred to its stakeholders, including shareholders. The shareholders must not be deprived of their rights to the assets upon liquidation, and the company's assets must be distributed according to priority, where the creditors take their share before other parties, and then the shareholders take theirs as much as their portion in the company's capital.

Having addressed the financial rights of shareholders, there are other fundamental rights beside these financial ones. They also enjoy important managerial rights, the purpose of are to monitor the company through the GM; further, they have the right to participate in the GM, and to know what is happening inside the company. All these and other related research topics will be discussed in the next chapter.

Chapter 5: Shareholders' Rights in General Shareholders Meeting

5.1 Introduction

JSCs are controlled by two main organs: the board of directors, and GM.⁴⁵⁵ The GM is considered the supreme authority of the company, its powers stem from the CL and from the constitution of the company; therefore, resolutions of the GM should be compatible with the provisions of CL and constitution of the company; otherwise, the resolutions shall be subject to being deemed null and void. The same applies to the board of directors, which is considered similar to the executive power of the state and has specific terms of reference; thus GM cannot interfere in the work of the board of directors and vice versa.

In this vein, these two organs depend entirely on each other working together to achieve the same objectives, and therefore, balance must be struck between them. Such balance is indicated in the definition of corporate governance by the Cadbury Committee: “Corporate Governance is the system by which companies are run. At the centre of the system is the board of directors whose actions are subject to law, regulations and the shareholders in a GM. The shareholders in turn are responsible for appointing the directors and the auditors and it is to them that the board reports on its stewardship at the AGM”.⁴⁵⁶

In this context, the question as to whether the highest organ in the company is the GM or the board of directors must be addressed. This has been reconciled by Gower, who stated, “there is no doubt that the shareholders are supposed to be the supreme organ in the company as they are supposed to raise the necessary capital of the company, they are involved in the initiation, formation and direction of policy and they have a duty or role to protect their investment in the company, and in such a situation,

⁴⁵⁵ Charles Zhen Qu. *Some Reflections on the General Meeting's Power to Control Corporate Proceedings*. Common Law World Review. Vol: 231. 2007, p. 231. The Pettet defined the GM as “meeting of ordinary shareholders together with any other shareholders who are entitled to attend”. See: Ben Pettet. *Pettet's Company Law: Company and Capital Markets Law*. Third Edition. England. Pearson Education Limited. 2009. p. 144.

⁴⁵⁶ Cadbury Committee, *Report on the Financial Aspects of Corporate Governance*. Gee, London, July 1992.

no doubt that shareholders constitute the governing force in the company and the law is emphatic on this where it says that the general meeting is the company, directors are subordinates”.⁴⁵⁷

Accordingly, the GM and board of directors have a contractual relationship issued from the provisions of CL and company constitution. Greer L.J. in the case *John Shaw & Son Ltd v. Shaw* held, “A company is an entity distinct from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors; certain other powers may be reserved for the shareholders in GM. If powers of management are vested in the directors, they and they alone can exercise these powers”.⁴⁵⁸

Therefore, the main functions of GM are that:⁴⁵⁹ The shareholders should know about the financial situation of the company, in addition to the serious resolutions taken by the company management; this is the first function. The second concerns the case when the board of directors need to make decisions outside of its capacity, it seeks the approval of the shareholders; the third function is to hold meetings for discussions between the shareholders and directors concerning the plans, policies, and performance of the company, whether these be in the past or the future.⁴⁶⁰

Generally speaking, the GM is viewed as the parliament in a democratic state; all members of the company meet for issues of interest to the company. It has, for example, the right to make decisions, to monitor the performance of the company, manage the funds of the company and its interests, as well as the interests of shareholders in general (i.e. not the interests of a specific group of shareholders). GM consists of all its shareholders regardless of their number, or the number of shares they own.⁴⁶¹ Thus, the GM debates topics and issues that of concern to the company and that require the approval of the shareholders; it then adopts resolutions on those issues. Therefore, the presence of shareholders and

⁴⁵⁷ Daniel, Angualia. *Balance of Power between Shareholders and the Board in Corporate Governance*. 2010. the Corporation. *Duke Law Journal*, Vol

⁴⁵⁸ [1935] 2 K.B. 113. “The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.”

⁴⁵⁹ Electronic Corporate Governance: Online and Virtual Shareholder Meetings and Shareholder Participation in Switzerland and Germany. p. 15

⁴⁶⁰ Startling, R. *General Meetings: A dispensable tool for corporate governance of listed companies*. *Corporate Governance: An International Review*, 11, 2003. pp. 74–82.

⁴⁶¹ Yvon Dreano, Jeantet Associates. Shareholders' Rights, the European Lawyer, Mar 2011. Available at <www.europeanlawyer.co.uk/referencebooks_27_519.html> accessed 8 April January 2012.

their active participation at the GM plays an important role in the company in terms of monitoring and controlling the company's performance and managing its interests and the interests of the shareholders.⁴⁶²

Thus shareholders in JSCs have significant rights at a GM, such as attending the meeting, voting on resolutions, objecting to them, asking questions of the board, etc.⁴⁶³ these may be done in person or by proxy.⁴⁶⁴ GMs are held in order to take resolutions that are in the interests of the company, and they can be held on a regular basis or occasionally. Shareholder meetings vary but there are several particular types: the AGM, which takes place shortly after the end of the company's fiscal year (but ordinary GM may be held whenever the need arises); class meetings, which are for certain groups of shareholders; and the EGM, which is arguably the most serious type of meeting, as it is held to consider important and pressing affairs in the life of the company. The law requires a legal quorum for shareholder meetings to be held.

However, most of the legislation gives shareholders the right to request a GM, as this is a precautionary measure against the failure, negligence or stubbornness of the board to invite shareholders to the GMs, more especially if serious developments or events arise, such as the loss of a large part of the company's capital. It is believed that this procedure safeguards minority shareholders from the domination of the controlling shareholders of the company, and establishes a balance between the interests of the minority shareholders and those of the majority shareholders.⁴⁶⁵

The managerial rights will be discussed in this chapter, more specifically in relation to the GM. When shareholders own shares, they contribute to its capital; this, in turn, affords them a set of rights at the

⁴⁶² Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, Saudi Arabia. 1996. p. 335.

⁴⁶³ The main shareholder rights under the OECD are: 1. ensuring adequate methods of ownership registration, 2. conveying or transferring shares, participating in the company's profits, 3. obtaining information on a timely basis, 4. participating and voting in general shareholder meetings. OECD Principles of Corporate Governance, OECD, Paris. 2004. available at <www.oecd.org/document/49/0,3343,en_2649_34813_31530865_1_1_1_1,00.html> accessed 11 April January 2012.

⁴⁶⁴ Saudi Company Law, 1965 Article 83

⁴⁶⁵ It is assumed that the GM is the place where the company's shareholders (who are its partners) can view its operational and financial accounts, and where the company directors can be questioned and held to account; it is also the place where financial statements are presented, and where the resolutions that the board of directors cannot issue without the consent of shareholders can be passed. These resolutions include the appointment of the auditor, amending the company's statutes, the appointment of the audit committee and other administrative matters.

GMs. Examples of such rights include the right to be called to attend the GM, which is considered the foremost right granted to shareholders (and shall be practised); another is that it is acceptable that shareholders can appoint a proxy to attend the GM if the latter is unable to attend in person. When the shareholders attend the GM, they can exercise a number of rights, such as the right to debate issues, vote, and enquire about any area or function of the company. Prior to discussing shareholders' rights in meetings it is important to clarify a number of points, such as the different types of GM, the resolutions taken at GMs and their validity, the requirements of GMs, reasons why shareholders fail to attend GMs, and suggestions for increasing shareholder participation in GMs.

5.2 General Meeting Procedures

In accordance with SCL 1965, the call to convene a GM by the company's board shall be through the publication of a notice in the Official Gazette and in a daily newspaper distributed within the head office of the company at least 25 days prior to the meeting. Nevertheless, the notice of the meeting may be sent by registered mail to all shareholders who have nominative shares.⁴⁶⁶ It should be noted here that the SCGRs has demanded the JSCs make the announcement of the GM be through the company's website, and the Tadawul website, in addition to two daily national newspapers 20 days prior to the meeting.⁴⁶⁷ All JSCs must consult with the GAFC regarding the wording of the announcement and the content of the agenda prior to publication.⁴⁶⁸

However, today, most JSCs in KSA apply the provisions of the SCGRs and leave the mandatory provisions of SCL 1965; the reason for this is the ease of announcing the GM through the websites. Nevertheless, the CMA has to mitigate any discrepancy between the SCGRs and SCL 1965, such as the GM notice, where the SCMA states 20 days before the determined date but SCL 1965 states that this should be at least 25 days. Furthermore, SCL 1965 is issued by the supreme legislative authority; thus, the CMA has to take this into account when exercising their regulatory powers. It is clear that some form of coordination and cooperation should take place between the CMA and all relevant

⁴⁶⁶ Saudi Company Law, 1965 Article 88, "Notice of general meeting shall be published in the Official Gazette in a daily newspaper distributed in the locality of the head offices of the company, at least twenty five days prior to the date set for the meeting". Article 88 (2) "If all stock of the company is registered (nominative), a notice sent by registered mail at least twenty five days before the date of the meeting shall suffice."

⁴⁶⁷ Corporate Governance Regulations of Saudi Arabia. Article 5, "(c) Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date the meeting; invitation for the meeting shall be published in the Exchange' website, the company's website and in two newspapers of voluminous distribution in the Kingdom".

⁴⁶⁸ Ministerial Decree issued from Minster of Commercial and Industry No. 959, Dated on 6 August 2006.

bodies related to the JSCs prior to the preparation of any law or regulations for such companies.

In general, the board of directors in JSCs generally propose or support a call to convene a GM,⁴⁶⁹ whether requested by directors, shareholders or the auditor. SCL 1965 states that when requesting a GM, the application shall be addressed to the board of directors ;⁴⁷⁰ therefore, shareholders are not allowed to initiate the GM by themselves. In any case, SCL 1965 does not hold shareholders to account for requesting a GM; it is a matter for the company's board of directors to judge the seriousness of the reasons for the request and respond accordingly. It should be noted here that the SCL 1965 does not include explicit provisions for many of the issues that may arise after the submission of the mentioned application. Such issues include: What is the legal situation if the board of directors refuses the application? Is it possible to appeal against the board's refusal? Is the board's rejection contrary to the provisions of the law and its responsibilities? These questions, together with many others, need clear statutory definition to determine the procedure to be followed, thereby filling such legal gaps. For example, Article 131 of SCL 1965 states that the auditor has a right to request a GM if he encounters any difficulty in performing his duties and has not received any assistance from the board of directors; here, the auditor is entitled to request a GM. However, the article does not mention the authorized entity to which the auditor must apply to request the meeting.⁴⁷¹ The fact remains that neither a shareholder nor the auditor is entitled to call for a GM by themselves in any way or make a request to the court.

On the other hand, when requesting a GM, the SCL 1965 requires the request be addressed to the board of directors, which is the authorized body; thus, no other entity, such as the MOCI, the CMA or the courts can be approached to convene a GM. Therefore, it is the duty of Saudi legislators to regulate this matter in order to protect minority shareholders from potential abuse by the board of

⁴⁶⁹ Ben Pettet. *Pettet's Company Law: Company and Capital Markets Law*. Third Edition. England. Pearson Education Limited. 2009. p. 146

⁴⁷⁰ The Jordanian Company Law is more detailed on this issue, Article (172) "Invitation of the General Assembly to an Extraordinary Meeting. A) The General Assembly of a Public Shareholding Company shall hold an extraordinary meeting inside the Kingdom upon the invitation of the Board of Directors, or upon a written request submitted to the Board from shareholders holding not less than one-quarter of the Company subscribed shares, or upon a written request submitted by the Company auditors or the Controller, should shareholders holding in person not less than 15% of the Company subscribed shares request such a meeting".

⁴⁷¹ Saudi Company Law, 1965. Article 131 "3- if the auditor encounters any difficulty in this respect, he shall state that fact in a report to be submitted to the board of directors, if the board fail to facilitate his task, the auditors must call a regular general meeting to look into the matter".

directors, should those minority shareholders request convening a GM, particularly where the board of directors is composed of the majority and holds the company's capital.

From the above, this study suggests expanding the opportunity of the right to request a GM, and that the SCL 1965 should provide clear guidelines regarding requesting a GM by a neutral body in order that the GM can proceed in spite of the board of directors refusal. Moreover, currently, there are no clear provisions in the current SCL 1965 nor in the CGRS that explain when the board has to call the GM if requested by the shareholders or the auditor; consequently, allowing a GM remains a matter of assessment by the board directors, as they have the right to approve or reject an application without giving a reason at present. This is certainly a major statutory omission that requires urgent legislature in KSA.⁴⁷²

According to the CA 2006 UK, when the board of directors receives a request for a GM from shareholders representing at least 5% of the capital, it is the board's duty to call the meeting.⁴⁷³ Any request should clarify the subject matter to be discussed at the meeting, and should provide the text on which a decision is to be taken at the meeting.⁴⁷⁴

Normally, a resolution may be passed at a meeting, but in some cases it may not; for example, in instances when it is contrary to the company's constitution or other articles, or if it is deemed defamatory, or is considered to be spurious in content.⁴⁷⁵ Furthermore, the request should be documented and authenticated by the person/s that made it,⁴⁷⁶ and, it may be submitted in either an electronic or hard form. Calls for a GM shall be made by the directors within 21 days of the date they

⁴⁷² In this respect, SCL1965 may adopt the Article 125 of Qatar Commercial Company Law, which regulated this more specifically; Article 125 Considering the provisions of the articles (88) and (124) of this Law, the Ministry will invite for the meeting of the general assembly in the following cases: If thirty days pass on the time fixed in the article (122) of this Law, without having invited the general assembly for meeting. If the number of board of directors becomes less than the minimum limit prescribed in the article (100) of this Law, without having invited the general assembly to hold. If seen at any time that there are violations to the Law or the statute of the Company or any great mistake in its management. In this case all the procedures prescribed for holding the meeting of the general assemble will be followed and the company will bear the expenses.”

⁴⁷³ S. 302 & 303 of the UK CA 2006. It was 10% but reduced to 5% to follow the Shareholders Rights Directive.

⁴⁷⁴ S. 303 (4) of the UK CA 2006

⁴⁷⁵ S. 303 (5) of the UK CA 2006

⁴⁷⁶ S. 303 (6) of the UK CA 2006

receive the request; and the GM must be held within a maximum of 28 days from the date of the notice.⁴⁷⁷

Moreover, if the directors have to call a meeting according to the Act, then shareholders have the right to call a GM at company's expense, but if not, then the members who requested the meeting may call a GM.⁴⁷⁸ A meeting may be called by the court upon an order from those who have the right to attend and vote at the meeting, whether they be directors or shareholders.⁴⁷⁹ In *Re El Sombrero Ltd*, the court held: "Examine the circumstances of the particular case and answer the question whether, as a practical matter, the desired meeting of the company can be conducted, there being no doubt, of course, that it can be convened and held".⁴⁸⁰

Article 88 of the SCL 1965⁴⁸¹ stipulates that the notice to attend the meetings must include an agenda, essentially a statement that includes the issues to be discussed by the shareholders at the meeting, as well as notification of the place and time of the meeting. In general, the board prepares the agenda, which is the core of its duty; however, the shareholders who have the right to request a GM, also have the right to include issues in their requested meeting, as well as the auditor's right to call a meeting to discuss certain issues.

In general, topics that are not listed on the agenda (which is drawn up prior to the GM) are not allowed in the meeting in order to focus on the reasons for calling the meeting. Therefore, other issues cannot be raised to the board of directors or the auditor during the meeting, as they would not be adequately prepared to answer and because the shareholders may be distracted from the real issues on the agenda and the reason for the meeting.

However, shareholders do have the right to deliberate on any serious issue that may arise during the meeting, or on matters that deviate from the main topics on the agenda. For example, while considering the report of the board of directors, the existence of serious faults made by an officer of the company, is discovered, the GM may take a decision to isolate him even if the issue of isolation was not listed in the agenda. Although no article in the SCL 1965 refers to this point; the GM has the

⁴⁷⁷ S. 304 (1) of the UK CA 2006

⁴⁷⁸ S. 305 (1) of the UK CA 2006

⁴⁷⁹ S. 306 (2) of the UK CA 2006

⁴⁸⁰ [1958] Ch. 900

⁴⁸¹ Saudi Company Law, 1965. Article 88

right to decide on a course of action, depending on the shareholders attending the meeting; whereas the SCGRs stipulates that the rights of shareholders that represent 5% or more of the company's capital are allowed to add one or more subjects to the meeting's agenda during its preparation but not during the actual meeting.⁴⁸² However, it is not forbidden to raise an issue during the meeting as long as it is related to the agenda, on condition that it receives the approval of a given number of the shareholders attending the meeting and that own 5% of the capital⁴⁸³, (or a group of shareholders containing not less than 100 people).

Every shareholder, according to French company law, may submit I any enquiry to the company's board in writing, prior to the date of the GM; the text of the response then has to be read out during the meeting.⁴⁸⁴ This is supposed to be undertaken by the board according to the legislation.

Prior to the GM, shareholders must register their names in the record that the company has prepared prior to the meeting date.⁴⁸⁵ The record contains the names of shareholders, the number of shares owned or represented, and the names of their original owners. The shareholder is then given an invitation to attend. This record must be available to anyone who wishes to see it in order to verify the validity of representation at the GM. This method should be updated to allow for developments in technology to enable the shareholders to register in the record by telephone or email; using such means

⁴⁸² Corporate Governance Regulations of Saudi Arabia. Articles 5 states, “f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda upon its preparation”.

⁴⁸³ Jordan Companies Law No. 22 of 1997. The Article 171 “9- Any other matter which the General Assembly proposes to include in the agenda, and are within the work scope of the General Assembly in its ordinary meetings, provided that such a proposal is approved by shareholders representing not less than 10% of the shares represented in the meeting”.

⁴⁸⁴ Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years On*. Oxford University Press, Oxford, 2005. p. 210

⁴⁸⁵ In France, a shareholder is required to register in the company's record up to three days prior to the date of the GM.

Cited from: Yvon Dreano, Jeantet Associates. *Shareholders' Rights, the European Lawyer*, Mar 2011. available at <www.europeanlawyer.co.uk/referencebooks_27_519.html> accessed 13 April January 2012.

will help improve the relationship between the board of directors and the shareholders,⁴⁸⁶ and increase the shareholders' value within the company.⁴⁸⁷

In addition, essential information shall be included in the notice, such as the date, time, and place of the GM, as well as including the subject matter of the business to be considered, in accordance with the articles of the company.⁴⁸⁸ Furthermore, any notice shall clearly state that it is possible for company members to appoint a proxy to attend the meeting and to exercise some or all of their rights, such as speaking, asking questions and voting in the resolutions.⁴⁸⁹ Moreover, when drawing up a notice for an AGM, it must clearly state that the meeting is an AGM⁴⁹⁰.

It is possible to inform shareholders of the notice of a GM in various ways; for example, as a hard copy form, electronic form or through the company website⁴⁹¹. However, if a resolution that is seeking approval is not listed on the agenda of the meeting, then it cannot be approved or validated. In this respect, Lord Cozens stated in *Bailey v. Oriental Telephone and Electric Company Ltd*: "I feel no difficulty in saying that special resolutions obtained by means of a notice which did not substantially put the shareholders in the position to know what they were voting about cannot be supported, and in so far as these special resolutions were passed on the faith and footing of such a notice the defendants cannot act upon them".⁴⁹²

In accordance with the CA 2006, shareholders who represent at least 5% of the total voting rights, or at least 100 members who hold shares on which an average sum of at least £100 per shareholder has been paid may require the company to give notice, of a resolution to be approved at a meeting, to shareholders who have the right to receive notice of a GM. The written notice can contain a maximum

⁴⁸⁶ Louis Corrigan, *Annual Shareholder Meetings go Online, the motley fool*, 1997. Available at <www.fool.com/rogue/1997/rogue970822.htm> accessed 15 April January 2012.

. However, in the UK a company and an individual shareholder can communicate through phone text message.

⁴⁸⁷ Bengt Holmstrom and Steven N. Kaplan. *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s, Journal of Economic Perspectives*, Vol. 15, No. 2. 2001. p. 122. In the UK, a suitable notice shall be sent to every shareholder entitled to attend the GM and vote, that's to attend the meetings of shareholders; all shareholders and directors in the company have to receive such notice, The notice has to be sent at least 21 days in the case of AGM and for GM at least 14 days prior to the date of convening.

See: S. 310 (2) & 307(1) of the UK CA 2006

⁴⁸⁸ S. 311 (1)(2) of the UK CA 2006

⁴⁸⁹ S. 325 of the UK CA 2006

⁴⁹⁰ S. 337 (1) of the UK CA 2006

⁴⁹¹ S. 308 of the UK CA 2006

⁴⁹² [19151] 1 Ch. 503

of 1000 words concerning any relevant matter to be considered at that meeting; or any other subject matter shall be argued at that meeting;⁴⁹³ otherwise, the shareholder who requested the meeting must cover the expenses upon the request of the company and deposit the payment before the circulation the notice.⁴⁹⁴ In fact, the notice of the meeting should contain the following information: the website address, where anyone can find the necessary information about the meeting; a text stating that registered members only are entitled to vote at the meeting, the time of the meeting; information about the forms that can be used in case of appointing a proxy; a statement about the facility the company offers for members to vote in advance or by electronic means; and to mention the right of members to ask questions.⁴⁹⁵

In addition, there is no article in SCL 1965 that explains who should chair the GM, it is subject to the company's articles that identify the persons authorized to do so,⁴⁹⁶ therefore, the chairmanship of the meeting may be taken by chairman of the board of directors, his deputy, or whoever is assigned by the board of directors;⁴⁹⁷ in the event of the absence of those mentioned above, one of the shareholders will be appointed to act as chairman of the meeting. The function of the chairman is to conduct the meeting properly and fairly in accordance with the provisions of CL, the company's articles and in accordance with the interests of the company and its shareholders.⁴⁹⁸

⁴⁹³ S. 314 of the UK CA 2006

⁴⁹⁴ S. 316 of the UK CA 2006

⁴⁹⁵ See <www.bis.gov.uk/policies/business-law/company-and-partnership-law/company-law/company-law-faqs/shareholder-rights> accessed 10 May January 2010.

⁴⁹⁶ Article 22 of the Articles of Association OF Etihad Etisalat Companies stated that "From among its members, the Board of Directors shall appoint a Chairman and a Managing Director. One member may hold both Chairman and Managing Director positions. The Chairman shall be nominated by and selected from amongst the Board Members other than Etisalat Board Members. The functions and responsibilities of the Chairman shall be: (a) to preside over meetings of the Board of Directors and the shareholders General Meetings and to represent the Company before all government authorities and the judiciary". And in the UK, S.319 CA 2006 provides that; Chairman of GM "(1) a member may be elected to be the chairman of a general meeting by a resolution of the company passed at the meeting. (2) Subsection (1) is subject to any provision of the company's articles that states that who may or may not be chairman". S.328 (1) of CA 2006 provides that the proxy can be the chairman of a GM by resolution passed at the meeting.

⁴⁹⁷ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011. p. 583.

⁴⁹⁸ *John v Rees and Others* [1970] Ch. 345. The most prominent functions of the chairman include: opening the meeting, announcing the number of shares represented and the attendance percentage, clarifying the procedures and the voting mechanism for shareholders, making a declaration of a quorum for the convening GM, in addition to the declaration of reaching the required quorum or not, obtaining shareholders' approval for the nomination of the secretary of the meeting and the committee for counting the votes, reciting the agenda of the GM, briefly reviewing certain items on the agenda, such as: the board of directors' report, dealing with shareholders' questions, inviting shareholders to vote on items of the agenda, requesting the votes collector to collect ballots and sort them, and reading the results of the vote and adopting the minutes of the GM; minutes are written on a regular basis after each meeting, which are signed by the chairman, the secretary, and the votes

Normally, the chairman nominates the secretary of the meeting and the screening committee, and any shareholder has the right to nominate him/herself as the secretary of the meeting or a member of the screening committee.⁴⁹⁹ Furthermore, SCL 1965 does not require the presence of the directors at the GM with the necessary quorum needed as a condition for convening its meeting; however, the CL in certain countries does require the presence of directors at meetings, or at least some of them, as they manage the company, and are required to answer the shareholders' questions or those of other relevant persons such as the auditor or the representative of the MOCI.

Article 60 of the Egyptian Company Act is a notable example that SCL 1965 can benefit from; it states that the company's directors should be present at GMs in a number not less than the quorum needed to convene the board meeting. However, non-attendance at meetings for a valid reason is acceptable; and in any case, the meeting is not considered void if it is attended by at least three members of the board, on condition that the head of the board of directors, his deputy, or one of the members assigned to management, should attend the meeting, assuming all other conditions required by law have been met. If the quorum of the meeting of shareholders is legally correct, but the quorum of board of directors is not, in this case, GMs may consider punishing those directors who did not attend without an acceptable excuse, with a fine; and in the case of frequent absences, GMs may consider isolating them and electing others.⁵⁰⁰

However, arguably SCL 1965 does not indicate the procedures to be followed in the matter of adjourning a GM or who has the right to decide to adjourn the meeting. Therefore, this could lead to a situation in which the company's board carries the resolution, thereby preventing absent shareholders

collector. Cited from: Shareholders Guide in General Meeting in Joint Stock companies on the Saudi Capital Market. 2011. Available at <www.bakheetgroup.com/pdf/Ebooks/Book_14.pdf. P:9> accessed 15 April January 2011.

⁴⁹⁹ Some of the functions of secretary of the meeting and the committee of screening are the followings: writing down the discussion rolling in the meeting in the minutes of the meeting; and the screening committee to collect ballots, sort them out, and make verify the ownership of shares based on the attendance record.

⁵⁰⁰ Also the Jordan Company Law No. 22 of 1997 provides that in the Article (177) "Presidency of the General Assembly Meeting and Attendance of the Chairman and Members of the Board of Directors: a) The ordinary meeting of the General Assembly of a Public Shareholding Company shall be presided over by the chairman of the Board or his deputy, in case of the chairman's absence, or the person delegated by the Board if both the chairman and his deputy are absent. b) The number of the members of the Board of Directors attending meetings of the General Assembly must not be less than the number needed for constituting a quorum required for convening Board meetings. Board members must not be absent from the meetings without a justifiable cause."

from taking part in making decisions, which will result in weakening the position of the minority shareholders in the company.

In the UK, this point is very well detailed. The chairman must adjourn the meeting when directed to do so by the meeting, or when the quorum does not collect within half an hour before the start of the meeting, or if at any time during a meeting a quorum ceases to be present.⁵⁰¹ In addition, there are certain cases in which the chairman could postpone the meeting even when a quorum is available: members at the meeting accepting a postponement, or when the chairman decides to postpone the meeting due to some threat, e.g. should an unauthorized person attempt to attending; these measure are merely designed to ensure that the activities of the meeting proceed smoothly and properly.⁵⁰²

The decision to postpone the meeting is invalid if the chairman does not take it in a bona fide manner, or if he/she takes into account irrelevant factors, or ignores relevant factors. Such a decision should be acceptable to all parties.⁵⁰³ In *Byng v London Life Association Ltd*, the Court of Appeal found that overcrowding is no justification for the chairman adjourning the time and place of the meeting.⁵⁰⁴ In any case, the company must give at least 7 clear days' notice if the adjourned meeting is to take place more than 14 days after it was adjourned; it must do so to the same attending shareholders and with the same information.⁵⁰⁵

5.3 Kinds of Shareholders Meetings

Under the SCL 1965, there are three main types of GM, and they are: AGM, EGM and Class Meeting (when the company has more than one shares class).⁵⁰⁶ SCL 1965 identifies the competence of each type, and states the procedures to be followed; these are mentioned in Articles 83 to 97. GMs differ from each other in terms of the topic of the resolution to be discussed at the meeting; a quorum must be reached to hold the meeting and to issue such a decision.

⁵⁰¹ The Companies (Model Articles) Regulations 2008, No. 3229. Part 4. Article 33(1)

⁵⁰² The Companies (Model Articles) Regulations 2008, No. 3229. Part 4. Article 33(2)

⁵⁰³ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. p. 376

⁵⁰⁴ (1989) BCLC 400

⁵⁰⁵ The Companies (Model Articles) Regulations 2008, No. 3229. Part 4. Article 33(5)

⁵⁰⁶ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011. p. 584.

However, EGMs are distinct from the others as it can discuss all matters that fall within the competence of a GM.⁵⁰⁷ Class meetings convene to discuss matters related to a particular class of shareholders, i.e. those who have a special type of share or bond in the company; such meetings are held for the approval or rejection of a resolution taken at a GM regarding alteration of their rights, and therefore, the resolution shall not be enforced unless all relevant shareholders approve it.⁵⁰⁸ For example, if the company has preferred shares, it is not allowed to issue new shares with priority conferred without the approval of a special meeting composed of all shareholders who have preferred shares.⁵⁰⁹

The powers of GMs are wide but a GM may be prevented by the provisions of law from considering certain issues that may affect the interests of the company or its shareholders; this prevention is designed to protect the company and its shareholders. Examples of this are: no meeting is entitled to modify the purpose of the company for which the company was established, or to amend the nationality of the company, or to increase the financial obligations of a shareholder, and to ask him to pay additional sums.⁵¹⁰ Article 85 of SCL 1965 stipulates, “the extraordinary general meeting shall be competent to alter the bylaws of the company except in respect of: 1- Alteration of nature to deprive a shareholder of his fundamental rights in his capacity as a members of the company, deprived from the provisions of these Law or from the bylaws of the company, which rights are set forth in Articles 107 and 108. 2- Alteration of nature to increase the financial liabilities of shareholders. 3- Alteration of the object of the company. 4- Transferring to a foreign country the head office of a company incorporated in the Kingdom. 5- Changing the nationality of the company.”

According to the above, a GM is prevented from making amendments to any company’s articles that may deprive the shareholder from his basic rights as a partner in the company, such as to prevent the

⁵⁰⁷ In the CA2006 of UK states in S.282 (5) that “Anything that may be done by ordinary resolution may also be done by special resolution”.

⁵⁰⁸ The Saudi Company Law, No.1965. Article 68 “1- if a resolution adopted by a general meeting entails the alternation of the rights of a certain class of shareholders.”

⁵⁰⁹ The Saudi Company Law, No.1965. Article 103,113,115 & 122. SCL1965 provides that “2- such resolution shall be valid unless it is approved by those entitled to vote from among the shareholders of that class, at a special meeting of such shareholders convened in accordance with the rule prescribed for extraordinary general meeting”.

⁵¹⁰ In the UK, CA 2006. Article 25 states that shareholder is not bound by an alteration to the articles after the date on which he became a member, if and so far as the alteration requires him to take or subscribe for more shares than the number held by him at the date on which the alteration is made, or in any way increases his liability as at that date to contribute to the company’s share capital or otherwise to pay money to the company. However, the financial obligations of the shareholders could be increased if they agree in writing.

shareholder from attending the GMs, or to participate in voting on resolutions. Also, a GM is not entitled to deprive the shareholder from his share in dividends, to reduce them, or to prevent shareholders from seeing the books or other company documents. On the other hand, GMs cannot move the centre of the company from KSA to any foreign state; this is in order to protect the shareholders' money. In addition, GMs cannot prevent any shareholder from filing a lawsuit against the directors of board, or any one of its members. Consequently, any resolution issued that conflicts with the above is considered void under the law, and thus unenforceable against third parties.

Attending a GM is a right for all shareholders, without exception, and this is clearly stated in SCL 1965: every shareholder who has 20 shares or more in a company has the right to attend and participate in the meeting and vote on resolutions.⁵¹¹ If the company's articles include anything contrary to this, then it is considered void;⁵¹² however, it is the right of the company's articles to state a rate of less than 20 shares (but not more than twenty shares). Also, everyone who has an interest has the right to attend meetings, such as the representative of the MOCI.⁵¹³

It is believed that stipulating a condition prescribing a certain quorum needed to attend GMs does not mean compromising the basic rights of minority shareholders, the most important of which is the right to attend and vote. Therefore, a shareholder who does not have 20 shares can associate with other shareholders in order to reach the required quorum for a GM.⁵¹⁴ However, this view is impractical (indeed, almost impossible) because shareholders usually do not know each other beforehand, and there is no independent authority or association for taking care of shareholders' rights in listed companies (as there is in some countries). Thus, demanding such a quorum to attend is a prejudicial to the rights of minority shareholders, implicitly keeping them away from active participation within GMs.

The board of directors must invite all shareholders to attend the GMs as well as the auditor and the representative of the MOCI; the invitation must include the agenda.⁵¹⁵ The representative of the MOCI has the right to decide whether or not to attend the meeting; the company law of some

⁵¹¹ Saudi Company Law, 1965. Article 83

⁵¹² Christopher Scott Maravilla, *Shareholder Voting Rights*, Texas International Law Journal, vol. 39:163, 1999. p. 166

⁵¹³ Saudi Company Law, 1965. Article 83

⁵¹⁴ Mohamed alArini. *Commercial Law*, Egypt, Alexandria, Dar Al-matbat Al-jamiyah Publishing, 2002. p. 404

⁵¹⁵ Saudi Company Law, 1965. Article 88

neighbouring countries, such as Jordan, state that a GM is invalid if it is not attended by a representative of the MOCI, in order to ensure the functioning of the GM procedures in accordance with the law and the company's bylaws.⁵¹⁶

In the UK, resolutions must be passed at shareholder's meetings.⁵¹⁷ The AGM must be held in public companies every six months starting from its reference date; this is regardless of any meetings held during that period, and another meeting will call the GM.⁵¹⁸ According to CA 2006, it is necessary that the notice calling an AGM be given at least 21 days beforehand or at least 14 days beforehand if issued in another GM.⁵¹⁹ It can happen that the period of notice differs between what is stated in the Act and what is stipulated in the company's articles,⁵²⁰ shorter or longer. This is if the majority of shareholders (at least 95 per cent) who are entitled to attend and vote at the meeting agree;⁵²¹ therefore, the GM can be convened after 14 days if the following conditions are met:⁵²² the meeting is not an AGM, the shareholders are enabled by the company to vote by electronic means (accessible to all members who have shares and who carry the right to vote at a GM), the period of notice has been reduced to not less than 14 days, or a certain decision has been taken at the previous AGM (or at some GM held since that AGM).

Ordinary resolutions and special resolutions are the two main types of resolution to be considered at a GM. The first is used for conducting most types of business,⁵²³ and are passed by simple majority (needing more than half of the shareholders who have the right to attend and vote at the GM in person or by proxy).⁵²⁴

⁵¹⁶ Jordan Company Law, No. 22 of 1997, Article (182), "The Board of Directors shall invite the Controller, Securities Commission and the Company auditors to the meeting of the General Assembly at least fifteen days prior to the date set for the meeting's convention. The auditor shall attend or delegate a person to represent him, failing which he shall be held responsible. The invitation shall be accompanied with the meeting's agenda and all the data and enclosures whose attachment to the invitation sent to shareholders have been stipulated. Any meeting of the General Assembly not attended by the Controller, or any of the Directorate employees delegated by him in writing shall be considered null and void".

⁵¹⁷ S. 281(2) of the UK CA 2006

⁵¹⁸ S. 336 of the UK CA 2006

⁵¹⁹ S. 307(2) of the UK CA 2006

⁵²⁰ S. 307(3) of the UK CA 2006

⁵²¹ S. 282(1) of the UK CA 2006

⁵²² S. 307 A. of the UK CA 2006

⁵²³ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011. p. 587

⁵²⁴ S. 324 (1) of the UK CA 2006

Special resolutions are used for effecting major changes;⁵²⁵ these are passed by a majority of not less than 75% of the shareholders (present in person or by proxy) at a GM. The main purpose of these resolutions is to discuss more serious company affairs, such as the company's articles,⁵²⁶ increasing or reducing the company's capital,⁵²⁷ or changing the name of the company.⁵²⁸ The notice for the meeting should provide the text of the resolution, and clarify it as being special in order for it to be considered and passed as a special resolution.⁵²⁹

Certain actions are required under SCL 1965: at the end of the meeting, the minutes shall be written down, containing the names of the shareholders (present or represented), the number of shares in possession (in person or agency), the number of decisions taken, the number of votes accepting or rejecting them, and a compendium of the discussions at the meeting as well as any matters asked for by shareholders.⁵³⁰ The minutes shall be written down on a regular basis after each meeting in a special record, signed by the chairman of the meeting, the secretary, and the collector of votes.⁵³¹

In the UK, every JSC is requested to keep minutes of GMs⁵³² as well as minutes of the proceedings of directors' meetings.⁵³³ The minutes of GM proceedings, if purporting to be signed by the chairman of that GM or the next GM, are evidence of the proceedings at the meeting.⁵³⁴ Such minutes must be kept for 10 years at least, and be available for inspection by any member of the company free of charge; they also have the right to order a copy for a nominal fee (otherwise, the company may be punished).⁵³⁵ Such provisions do not exist in SCL 1965, and thus the minority shareholders may not be

⁵²⁵ Lucy Jones. *Introduction to Business Law*. Oxford. Oxford University Press. 2011. p. 587

⁵²⁶ S. 21 states that "(1) A company may amend its articles by special resolution".

⁵²⁷ S. 641(1)(A) of the UK CA 2006

⁵²⁸ S. 77 states that "(1) A company may change its name (a) by special resolution, or (b) by other means provided for by the company's articles".

⁵²⁹ S. 283(6) of the UK CA 2006

⁵³⁰ Saudi Company Law, 1965. Article 97

⁵³¹ Saudi Company Law, 1965. Article 95. SCL1965 does not refer to binding the company to send a copy of the minutes to the GAfC, whereas SCGRs necessitates the company to provide the CMA with a copy of the minutes of meeting within 10 days from the date of the meeting. See: Corporate Governance Regulations of Saudi Arabia. Article 5 states that "I) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting. j) The Exchange shall be immediately informed of the results of the General Assembly".

⁵³² S. 355(1)(b) of the UK CA2006

⁵³³ S. 248 of the UK CA2006

⁵³⁴ S. 356(4) of the UK CA2006

⁵³⁵ S. 356 of the UK CA2006

able to acquire a copy of the minutes from GMs or directors' meeting, as this is not regulated under the CL.

5.3.1 Annual General Meeting

The AGM shall consider all matters relating to the company except those matters that are specific to an EGM, as provided for in SCL 1965 or the company's bylaws.⁵³⁶ Examples of these competences, but not limited to, are: appointment of members of the board of directors; isolating them or some of them; the appointment of vacant positions;⁵³⁷ the AGM's approval of the report of board of directors; calculating the budget and the profit and loss statements; assessing the auditor's report; the appointment of auditors or isolating them;⁵³⁸ discussing the report of a liability lawsuit against the members of board of directors (or some of them);⁵³⁹ the issuance of bonds;⁵⁴⁰ permitting one member of the company's board (for a renewable period of one year) to participate in the work of a competitor to the company, or trafficking in one of the branches of activity practiced by it;⁵⁴¹ and permitting the board of directors to determine the loans that the company takes and their conditions.⁵⁴²

In SCL 1965, the AGM is held at least once a year during the six months following the end of the financial year for the company, and it may be called for another meeting whenever the need arises. The company's board has the right to call a GM to convene whenever the need arises; it has the discretion to request to convene meeting but there are some cases in which it becomes necessary under the law to call shareholder meeting, and these cases are:

- 1 - If requested by shareholders representing at least 5% of the company's capital; this right is one of the guarantees granted by the law for minority shareholders.⁵⁴³
- 2 - If requested by the GAFC upon the request of a number of shareholders representing 2% of the capital at least, or upon the decision of the MOCI to call a GM if one month has passed after the date set for the meeting without it being called to convene.⁵⁴⁴
- 3 - If the auditor requests the meeting to convene when he faces difficulty in the performance

⁵³⁶ Saudi Company Law, 1965. Article 84 "except for matters falling within the jurisdiction of the extraordinary general meeting, the regular meeting shall be competent in all matters related to the company".

⁵³⁷ Saudi Company Law, 1965. Article 66 and 67

⁵³⁸ Saudi Company Law, 1965. Article 130

⁵³⁹ Saudi Company Law, 1965. Article 77

⁵⁴⁰ Saudi Company Law, 1965. Article 117

⁵⁴¹ Saudi Company Law, 1965. Article 70

⁵⁴² Saudi Company Law, 1965. Article 118

⁵⁴³ Saudi Company Law, 1965. Article 87

⁵⁴⁴ Ibid.

of his work;⁵⁴⁵ if the board of directors does not respond, he shall be entitled to call a GM to convene directly. At this point, SCL 1965 does not clarify how the auditor invites the shareholders to a GM, something that is regarded as a lack in the legislation and that requires reconsideration; the board of directors may not respond, and may even reject the call for a GM.

4 - If the number of the members of the board of directors falls below the number stated by law.

5 - If requested by a court after an inspection on the company (instigated by shareholders representing 5% of the capital of the company) unveils violations attributed to a director or the auditor.⁵⁴⁶

The board must prepare for each fiscal year a budget for the company, a profit and loss account, a report on the activities of the company, its financial position, and the manner proposed for the distribution of net profits; this should be at least 60 days before the AGM. The chairman of the board of directors shall sign all such documents, and they shall be deposited in the headquarters of the company at the disposal of the shareholders 25 days at least before the meeting.⁵⁴⁷

As provided in Article 91 of SCL 1965, a GM is not considered legal unless attended by shareholders representing at least 50% of the capital, unless the company's articles provides for a higher percentage; if there was no quorum at the first meeting, the call shall be made for a second meeting to be held within 30 days subsequent to the first meeting. The announcement for this shall be in the same way provided for in SCL 1965, and the second meeting will be legal whatever the number of shares represented, and the resolutions of that GM are passed by an absolute majority of the shares represented at the meeting, unless the company's articles provides a higher percentage.⁵⁴⁸

In case of any board default vis-à-vis calling a meeting, the board will be found acting contrary to the law, and will then be subject to the penalties provided in SCL 1965;⁵⁴⁹ and as example, the commercial court issued a judicial resolution against one JSC that did not call for the AGM within six months

⁵⁴⁵ Saudi Company Law, 1965. Article 131

⁵⁴⁶ Saudi Company Law, 1965. Article 109

⁵⁴⁷ Saudi Company Law, 1965. Article 89. Also see: World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. p. 25. Available at <www.fool.com/rogue/1997/rogue970822.htm> accessed 15 April January 2012. The company has to publish in a newspaper, distributed in the head office of the company, the budget, profit and loss account, a compendium of the report of board of directors, the full text of the auditor's report, and send a copy of these documents and the agenda to the GAFC 25 days at least before the AGM.

⁵⁴⁸ Saudi Company Law, 1965. Article 91

⁵⁴⁹ Saudi Company Law, 1965. Article 229 (8)

following the end of the fiscal year, and the court imposed a fine on the board of directors to be paid to the MOCI.⁵⁵⁰

In order to fill the gaps in the statutory provisions that regulate the convening of a GM, it is suggested that the CMA be given the right to call meeting to bring the company to account⁵⁵¹ if the board of directors have failed to call a GM within 15 days of any request made by shareholders who represent at least 5% of company' capital, or made by the auditors. In addition, the CMA should have the right to call a GM if such a meeting is not convened within 30 days of the date set. Therefore, if the number of the board of directors falls below the number prescribed in the CL and if it does not call for a GM to consider this issue, and if the CMA thinks that at any time the company has acted contrary to the provisions of the law or the company's bylaws, or if the board has failed to protect the company and its interests, then a GM can be called.

5.3.2 Extraordinary General Meeting

An EGM has a broad range of powers; it can consider matters of great importance and gravity in the life of the company, and it is held at any time during the year, whenever the need arises.⁵⁵² The purpose of calling an EGM is to modify the company's articles, such as modifying the duration of the company (making it longer or dissolving it before the end of its duration); increasing or reducing its capital; merging with another company; and modifying the manner in which profits are distributed. Such meetings are held under certain and very particular conditions, which are more stringent than the requirements prescribed for a GM.

The company's board has the right to request an EGM at any time in accordance with the conditions provided in SCL 1965 and in the company's bylaws;⁵⁵³ in addition, SCL 1965 gives the GAFC (at the request of a number of shareholders representing 2% of the capital at least, or upon a decision of the Minster of MOCI) the right to call an EGM if a period of one month has passed after the date set for a meeting without it being called.

⁵⁵⁰ The Board of Grievances - Case number 1044/256. On 8 July 2002

⁵⁵¹ These suggestions adopted from the Company Law of the Qatar state, No. (5) Of 2002, Article 125.

⁵⁵² The terms "extraordinary general meeting" and "EGM" are no longer used in the 2006 Act. All meetings that are not AGSM s are called "general meetings". Extraordinary resolutions: any resolution that needed to be passed as an extraordinary resolution under the Companies Act 2005 can now be passed as a special resolution under the 2006 Act.

⁵⁵³ Saudi Company Law, 1965. Article 87

It should be noted that the current version of SCL 1965 does not mention the right of the shareholders or auditor to request an EGM, which is regarded as a great failure in protecting the rights of the shareholders. However, the SCGRs have attempted to mend this situation, giving such a right to the auditor and shareholders who own 5% of the capital of the company.⁵⁵⁴ Furthermore, the company board is not obliged to call an EGM because most of the SCGRs are for guidance only and are not compulsory, and the board may find pretext in that.

It is important to highlight one essential point, which is that the board of directors is obliged to call an EGM if the company losses reach three-quarters of its capital.⁵⁵⁵ This measure is logical but needs modification; even if we assume that the company has lost half of its capital, according to the provision, there is no need to call an EGM. It is accordingly suggested that the Saudi legislature adopt the phrase ‘significant losses’ rather than ‘three-quarters’ of the capital because losing such a proportion of the capital is considered serious and in need to being dealt with urgently; such losses touch everyone but the greatest impact will be on the minority shareholders.

In this respect, under CA 2006 UK, the directors must call an EGM if the company faces a serious loss in capital; thus, if the net assets of the company fall to half (or less) of its called-up share capital, the meeting should be convened not later than 28 days from the earliest day on which that fact was known to a director, and not later than 56 days from that day. Such a meeting shall consider the actions that should be taken to deal with the situation; the directors will be liable to a penalty if they fail to convene this meeting, as required by CA 2006.⁵⁵⁶

The EGM is not considered legal unless attended by shareholders representing half of the capital at least; the company’s articles could provide a higher percentage. If this quorum is not present at the first meeting, an invitation shall be made to a second meeting, to be held within thirty days following the previous meeting, under the same conditions stipulated for holding the first EGM; this second

⁵⁵⁴ Corporate Governance Regulations of Saudi Arabia. Article 5 “b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital”

⁵⁵⁵ The Saudi Company Law, No.1965. Article 148 “1- if the losses of a corporation total three quarters of its capital, the directors must call an extraordinary general meeting to consider whether the company shall continue(to operate) or be dissolved before the expiry of the term specified in its bylaws”

⁵⁵⁶ S. 656 of the UK CA2006

meeting will be valid if attended by shareholders representing one quarter of the capital at least.⁵⁵⁷

Saudi legislation has set this percentage in order to protect the company and shareholders due to the seriousness of the decisions that will be taken at the meeting.

EGM resolutions are taken by two-thirds majority (of the shares represented at the meeting), and SCL 1965 requires the consent of a majority not less than 75% of the shares represented at the meeting in the following cases:⁵⁵⁸

- 1 - If the resolutions are concerned with increasing or reducing the company's capital;
- 2 - or are related to an extension of the term of the company;
- 3 - or to the dissolution of the company before the expiry of the period specified in its bylaws;
- 4 - or to a merger of the company with another company or firm.

The reason behind requiring high quorum in an EGM is to prevent the normal majority from conducting such substantive amendments, i.e. amendments that may conflict with the interests of all shareholders in the company. If an EGM issues a resolution to amend the company's articles, the company must announce so in the Official Gazette in a daily national newspaper and in the main centre of the company; in order that the resolutions be legal, SCL 1965 require the company to register this in the Commercial Register,⁵⁵⁹ and at the CMA as well.⁵⁶⁰

5.4 Invalidity the Resolutions at GMs

It is worth mentioning that subscribing to or owning shares means that the shareholder accepts the company's articles, and commits to the resolutions issued by the GMs, in accordance with the provisions of CL and the articles of association, whether he is present or absent, and whether he agrees to or rejects these resolutions.⁵⁶¹

SCL 1965 states that GM resolutions (issued within the limits set by law or by the company's articles)

⁵⁵⁷ Saudi Company Law, 1965. Article 92

⁵⁵⁸ Saudi Company Law, 1965. Article 93

⁵⁵⁹ In accordance with the provisions of the regulations of Commercial Register, article 4. Director of board must register at any alternation in the company's articles within thirty days of the resolution in the Register Commercial Office.

⁵⁶⁰ Article 51 of the Listing Rules provide that "Provision of documents to the Authority The issuer must send copies to the Authority of the circulars sent to shareholders and all documents relating to acquisitions, mergers and offers, notices of meetings, reports, announcements or other similar documents, promptly after they are issued".

⁵⁶¹ Saudi Company Law, 1965. Article 96

are obligatory for the board as well as the shareholders, regardless of whether or not they attend the meeting or agree with the decision.⁵⁶²

Article 97 of SCL 1965 states, “1- Without prejudice to the rights of any bone fide third party, all resolutions adopted by the shareholders’ meeting contrary to the provisions of these Regulations or of the company’s bylaws shall be considered null and void. 2- The GAfC and any shareholder who has recorded his name in objection to the resolution in the minutes of the meeting or who was absent from the meeting for any acceptable reason, may request to invalidate a resolution. 3- Nevertheless, an action of invalidation (of a resolution) shall be barred after the lapse of one year from the date of such resolution.”

SCL 1965 in Article 97 accords each shareholder in the company the right to request an invalidation of a resolutions if it is contrary to the provisions of the law or the company’s bylaws, provided that the shareholder attends the meeting when the resolution was issued and the objection is recorded in the minutes of the meeting; however, if he was absent from the meeting, he must have an acceptable excuse.

It is argued that restricting the right to object to this condition represents a significant prejudice to minority shareholders. If a GM resolutions has been issued through abuse of power, or is done craftily or by cheating, or is conducted through controlling the shareholders, the shareholder is not entitled to object unless he attended the meeting and objected to it; if he was absent from the meeting, he must bring an acceptable excuse. However, there is no explanation in the law of what constitutes an acceptable excuse. It can therefore be said that it is unreasonable to prevent the shareholder from objecting on the grounds that he agreed to the resolution because he may have agreed under some form of duress, or they were absent from the meeting because he may have a reasonable excuse; this can be regarded as a violation of the rights of minority shareholders, allowing the controlling shareholders to act in accordance with their interests.

⁵⁶² Ibid, However, SCL1965 doesn't show clearly when the resolutions of GM are invalid. However, it can be said that the resolutions issued by a non-competent authority is void; if a resolution is issued by the GM which is the jurisdiction of the EGM, it is considered null by law. Also, the resolution is void if it was suspected of arbitrary change by the controlling shareholders in the company, and the resolution was issued for their own interests, or to issue a decision without a quorum required for meeting.

The proof that a GM resolution is invalid shall be made by the aggrieved party in person; in practice, proving such a case is no easy task for the shareholder, and this is due to a number of reasons;⁵⁶³ firstly, the majority shareholders can defend themselves by arguing that they have exercised the authority conferred upon them by law or the company's articles. Secondly, it is difficult to prove any deviation on the part of the majority, especially if the resolution in question satisfies the conditions of all formal and substantive terms; in this case, the majority can defend themselves by arguing that they are authorized to determine the suitability of the resolution as being in the interests of the company. Finally, not many shareholders have the administrative, legal or technical expertise to determine whether the decision is void or legal.⁵⁶⁴

A court judgment may regard the resolution in question as being taken not for the benefit of all shareholders and therefore invalid, but any ensuing lawsuit to declare that resolution null and void cannot be considered after one year has elapsed following the date of issuance of that resolution.⁵⁶⁵ Any challenge to such a resolution does not halt its implementation unless the courts decide otherwise; however, such a procedure is not provided under SCL 1965.⁵⁶⁶

This problem can be solved by granting the shareholders holding 15% of company's capital the right to vote against the resolution and to prove that it is unfair and against their interests; this can be done through applying to the court within 30 days of the issue of the resolution.⁵⁶⁷ However, the court has the power to uphold, modify, overrule or defer the implementation of the resolution. The settlement by the court may be achieved by buying the shares of the objectors, or through any other possible manner.

⁵⁶³ Mohamed alArini. *Commercial Law*. Egypt, Alexandria, Dar Al-matbat Al-jamiyah Publishing, 2002. p. 310

⁵⁶⁴ Lazarides, Themistokles G., *Minority Shareholder Choices and Rights in the New Market Environment* (July 10, 2009). p. 4. Available at <SSRN: <http://ssrn.com/abstract=1432672>> or <<http://dx.doi.org/10.2139/ssrn.1432672> accessed 27 April January 2012

⁵⁶⁵ Saudi Company Law, 1965. Article 97

⁵⁶⁶ The Jordan Companies Law No. 22 of 1997. Article (183) "B- The Court shall have jurisdiction to look into and settle any case that may be presented for the purpose of contesting the legality of any of the meetings of the General Assembly, or contesting the decisions issued at any one of these meetings. Such contesting shall not halt the implementation of any decision of the General Assembly unless the Court decides otherwise. Such a case shall not be entertained after the lapse of three months from the date of the meeting"

⁵⁶⁷ See: The Kuwaiti Companies Law. No. 15/1960. Article 136

5.5 Absent Shareholders from GMs

Shareholder meetings suffer from the phenomenon of absent shareholders. Many of them, especially minority shareholders, do not care to attend meetings, and this absence may lead to shareholders giving up their rights at the GM; also, it can allow the board of directors to dominate the company and become the sovereign and supreme power within the company. Thus, the role of the shareholder in the company may become different in practice to what is stated in the law. It has been argued that GMs have lost their core task and have become a rump parliament for shareholders, wherein a small group of shareholders, whose shares may not exceed 40% the capital, controls the greater part of the capital of the company.⁵⁶⁸

In fact, various reasons contribute to the absence of shareholders at GMs; some are related to the shareholders themselves and the others are due to the laws governing these meetings. It could be said that the first reason for the absence of shareholders at a GM is the large number of shareholders in the company; the shares may have been offered for public subscription, and not limited to a certain number of shareholders in a certain region of the State. Many listed companies, especially large ones, have thousands of shareholders, and it is difficult to gather them in one place. Many of them may not care to attend, particularly those who own only a small portion,⁵⁶⁹ and think that they will not represent an effective voice in the presence of shareholders having large a stake in the company's capital.

Most shareholders are distributed widely across the country, living far from the main centre of the company⁵⁷⁰ but most JSCs are located in major cities.⁵⁷¹ It is therefore not logical to expect all shareholders to travel sometimes great distances to attend a meeting that may merely be adjourned for lack of quorum; this may also result in costs higher than the amounts earned from the profit generated. It must be remembered that attending a GM can be costly and time consuming for some shareholders.⁵⁷²

⁵⁶⁸ Cheng, Yong. "On Protection of Rights and Interests of Minority Shareholders in Listed Company." *International Journal of Business Administration* 3.2 (2012): p. 56

⁵⁶⁹ Sjostrom, William K. and Kim, Young Sang, Majority Voting for the Electronic of Directors (February 24, 2007). *Connecticut Law Review*, Vol. 40, No. 2, December 2007.

⁵⁷⁰ Mayson, Stephen, French D. and Ryan, C., *Company Law*, 21st Edn, Oxford. Oxford University Press. 2005. p. 406

⁵⁷¹ Boros, Elizabeth J., Virtual Shareholder Meetings: Who Decides How Companies Make Decisions? *Melbourne University Law Review*, Vol. 28, No. 2, pp. 265-289, 2004.

⁵⁷² Louis Corrigan, Annual Shareholder Meetings Go Online, *The Motley Fool*, 1997, available at <www.fool.com/Rogue/1997/Rogue970822.htm> accessed 16 April January 2012.

Another reason is lack of knowledge on the part of some of shareholders in relation to their rights within the company, particularly their rights at GMs, and too many shareholders believe that GMs deliver resolutions that have already been agreed upon,⁵⁷³ serving only the interests of the controlling shareholders in the company.⁵⁷⁴

A simple example explains the reluctance of shareholders to attend GMs; that of Herfy Co.⁵⁷⁵ In April 2012, the company held its AGM to discuss a range of topics; firstly, the strange thing to notice is to the use of the phrase ‘ratification and approval’ of the resolution instead of ‘discussion’; the latter indicates an exchange of views, with shareholders making suggestions on the issues in the agenda. On the other hand, the former calls for the meeting to agree to the company renting land and two residential buildings,⁵⁷⁶ to agree to the company renting land and shops,⁵⁷⁷ and to agree to the company leasing a fully furnished building from the Qitaf company.⁵⁷⁸ The last statement in the notice came as follows: the quorum for the meeting will be satisfied by shareholders representing 50% of the company’s capital attending the meeting, which can be met through only two of the owners attending (who already agree); this sends a clear message to shareholders: the quorum is already reached whether you come or not, and therefore your attendance is only to approve the agenda.⁵⁷⁹

⁵⁷³ Mayson, Stephen, French D. and Ryan, C., *Company Law*, 21st Edn, Oxford. Oxford University Press. 2005. p. 406

⁵⁷⁴ Eddy Wymeersch. *Some recent trends and developments in company law*. 2001. p. 8

⁵⁷⁵ The company was founded in 1981, and in 2008 was transformed from a limited liability company to close JSC, and in 2010 was converted into a JSC. The major owners of it are Mr. Al-Sayed with 20.3% of the capital, and Savola Group Co. with 47.6%; so, half of the capital of the company is already owned by two people only, and 30% had been put to public shareholding, still 2.1% left, not clear who are the owners of it. See <<http://www.tadawul.com.sa>> accessed 20 April January 2012. Also see <www.herfy.com/index.php?option=com_content&view=article&id=64&Itemid=72&lang=ar> accessed 21 April January 2012.

⁵⁷⁶ It is worth an annual rental rate of 580 thousand SAR, owned by Mr. Al- Sayed, who has more 20% of the capital, occupying the post of CEO and member of the board of directors.

⁵⁷⁷ An annual rental value of 920 thousand SAR, the land and stores owned by the son of CEO, who occupies the post of general manager of investment management and member of the board of directors as well.

⁵⁷⁸ with an annual rental value of 400 thousand SAR, which is owned by the CEO and his son; the approval of the insurance contract on the property of the company with the Arabian Shield Insurance Co. of SR 1.1 million SAR, one of its members of board of directors is Mr. Khudairi, who is basically the head of the board of directors in Herfy Company.

⁵⁷⁹ It is assumed that the board of directors holds shareholder meetings to raise and discuss issues related to the affairs of the company, exchange views, make suggestions, listen to their views as well as to determine the company’s position and its future challenges. Therefore, effective shareholder participation would serve to integrate and strengthen the relationship between the company management and its owners, and all shareholder parties.

The example above explains in a simple way why minority shareholders often do not care to attend GMs. Most of them have the conviction that the GM resolutions are ready for approval and do not need any discussion;⁵⁸⁰ consequently, any opposition to the interests of the controlling shareholders will be unsuccessful.

The general principle here is: whoever has the largest number of shares, has the greatest influence within the company. Often, minority shareholders in the company have a limited number of shares, and so they do not care deeply about the company's future; this is contrary to those who own more shares and are keen to follow the company on an ongoing basis, in order to protect the money they invested in the company.

In light of the above, it is believed that many shareholders do not really attend to their role as members, and do not attend GMs regularly, caring only about the annual dividends of the shares or any rise in their market value in order to sell them. Many do not even care who runs the affairs of the company. Unfortunately, at the end of each meeting, minority investors, who may number in the tens of thousands, are shocked to find that one person or a few persons owning a large proportion of the shares support the proposal of the board of directors, rejecting all discussion and destroying the aspirations of all shareholders. This can cool the relationship between the minority shareholders and the board of directors, resulting in the minority shareholders selling their shares and investing in another company.

Another reason behind the absence of shareholders at GMs is their not knowing the date of the meeting, despite its publication in newspapers and on websites. In KSA, the invitations are not sent to the shareholders directly via registered mail, as most shareholders do not have a postal address; this makes it difficult for shareholders to learn of the company's meetings. However, companies could use modern technology such as e-mail and mobile phone text messages to notify as many shareholders as possible; this would not cost the company much. Indeed, it would be more practical nowadays to use modern technology to send the invitations, in particular via email, and especially for individual

⁵⁸⁰Mayson, Stephen, French D. and Ryan, C., *Company Law*, 21st Edn, Oxford. Oxford University Press. 2005. P:406

investors; this becomes necessary if the meeting is to be convened in the very near future.⁵⁸¹ It is believed that distant shareholders could also make use of the company's website, where they should be able to find all the information they need.⁵⁸²

A yet further reason for the absence of shareholders is when a GM is held at an inconvenient time, such as on weekdays during business hours, which makes it difficult for shareholders to attend because most of them are working.⁵⁸³ Most listed companies hold their AGM in January; the fiscal year usually starts from the beginning of January and ends at the end of December. JSC meetings are therefore often held on similar dates or even on the same days, and so the shareholders who invest their money in more than one company may not be able to follow all the meetings of all the companies that they have shares in, or they may prefer to attend the meeting of one company over another.

Lack of technical, administrative or legal expertise on the part of shareholders represents another reason for their absence; many of them do not know how to analyse the auditor's report, or the report of the board of directors, and most of them have little experience in how to monitor the actions of the company's board, which requires a certain level of expertise.⁵⁸⁴ Therefore, they feel unable to oppose the board of directors, or protest against a particular issue. For example, most shareholders are not able to distinguish whether a decision is legal or void. It has been found that many shareholders suffer from lack of investment culture, which is the responsibility of government agencies, universities and JSCs; they should contribute to raising the level of investment awareness among shareholders.

Moreover, there is sometimes a lack of seriousness on the part of the company's board in terms of the participation of shareholders at GMs. It is argued that the law has granted shareholders the right to ask

⁵⁸¹ Richard Alcock, Andrew Daly and Caspar Conde, *Electronic Proxy Voting in Australia*, Allens Arthur Robinson, 2006. Available at <www.agilentia.ch/.../Agilentia_Electronic_Proxy_Voting_in_Australia> accessed 25 April January 2012.

⁵⁸² Serenella Rossi. *Giving good meeting*, European Lawyer, Legislative Comment. 2010. In the UK, the shareholder has to accept to communicate with the company electronically through the company website or email than to communicate with it via hard copies. This also applies to communication of documents, either for general communication or for specific class. However, the shareholder is entitled to ask for a hard copy of any document or information sent to him electronically from the company See: Paul Davies, *Principles of Modern Company Law*, 8th ed, London: Sweet & Maxwell Publishing, 2008, P: 471. Also, S.333 and S. 1145 CA 2006 of the UK

⁵⁸³ Boros, Elizabeth J., Virtual Shareholder Meetings: *Who Decides How Companies Make Decisions?* *Melbourne University Law Review*, Vol. 28, No. 2, pp. 265-289, 2004.

⁵⁸⁴ Lazarides, Themistokles G., *Minority Shareholder Choices and Rights in the New Market Environment* (July 10, 2009). P:4. Available at: <<http://ssrn.com/abstract=1432672>>accessed 15 February January 2012.

questions of the directors or auditor, but in fact they are not obliged to answer all questions; indeed, the board can refuse to answer questions or to discuss certain points. It can be said that the reason behind refusing to answer a question may be: to safeguard commercial confidentiality; the time available is too short and it is not possible to explain everything; the response is made diplomatically or very briefly, and thus does not answer the question adequately; or they merely direct the shareholder to refer to the company reports.

Consequently, the easiest way to evade a question is to assert that the required information is commercially sensitive and therefore confidential and cannot be disclosed. This will result in the shareholders being reluctant to attend meetings. However, the final decision as to whether or not to answer a shareholder's question belongs to the chairman of the meeting, who has the final decision in this respect and his decision should be in good faith and in the best interests of the company. Nonetheless, SCL 1965 has been criticized for not explaining when the information is harmful to the interests of the company; the auditor may reasonably argue not to answer the questions of shareholders because the disclosure of certain information would harm the company. However, this point opens the door to the board of directors and the auditor to evade answering the shareholders' questions.⁵⁸⁵

In brief, the CMA has stated the most common mistakes made by listed companies in this regard,⁵⁸⁶ namely: the delay of some companies in calling for a GM (they sometimes call for meeting to be held in less than 25 days); the lack of adequate information about the meeting's agenda, which could affect the decisions of the shareholders,⁵⁸⁷; not choosing a suitable time or place so that the shareholders can

⁵⁸⁵ According to OECD principles, all shareholders should have the opportunity to discuss issues and to put questions to the directors and auditors at the GM; however, such rights should be subjected to reasonable limitations. In the UK, this issue is clearer than in the Saudi system; the board must answer any question relating to the business being dealt with at the meeting and put by the shareholders who attend the GM. However, the company may refuse to answer a question if to do so would interfere unduly with the preparation or proceedings of the meeting, or involve the disclosure of confidential information, or if the answer has already been given on a website (in the form of an answer to a question), or if it is undesirable in the interests of the company or the good order of the meeting that the question be answered. See: The Companies (Shareholders' Rights) Regulations 2009, No. 1632. Article 12. Also; ICSA Guidance on the Implementation of the Shareholder Rights Directive. Available at <www.icsa.org.uk/assets/files/pdfs/guidance/090729%20Implementation%20of%20the%20Shareholder%20Rights%20Directive%20-Amendment.pdf> accessed 5 May 2012. Also, see: Organisation for Economic Co-Operation and Development, OECD Principles of Corporate Governance. 2004. p. 35.

⁵⁸⁶ Shareholders Guide in General Meeting in Joint Stock companies on the Saudi Capital Market. 2011. Available at <www.bakheetgroup.com/pdf/Ebooks/Book_14.pdf> accessed 5 May 2012.

⁵⁸⁷ Corporate Governance Regulations of Saudi Arabia. Article 5 "h) Matters presented to the General Assembly shall be accompanied by sufficient information to enable shareholders to make decisions".

attend and participate at their convenience; not discussing all the items before the shareholders; and discussing only what is stated on the ballot papers.

Moreover, the chairman may request an adjournment of any discussion of the agenda until after the ballot, which means that shareholders may be making decisions based on incomplete or incorrect information because they have not been allowed to discuss each item on the agenda apart before they actually vote. Thus, the agendas are not reviewed sufficiently or adequately; the participation of members of the company's board in voting on an item discharges them from liability for the period of their management; not all items on the agenda are discussed; some companies demand the chartered accountant answer the questions of shareholders that are not related to the agenda.

5.6 Shareholders' Right to Attend the GM in Person or by Proxy

Each shareholder is entitled to attend a GM in person or by proxy, and it is a fundamental right for the shareholder, from which he shall not be deprived.⁵⁸⁸ Any action that deprives the shareholder from attending is considered void by virtue of law because it is one of the paramount rights inherent in the ownership of a share.⁵⁸⁹ This is in order to protect minority shareholders, not assist them in controlling the company's management and to thwart any domination of the company by majority shareholders.

SCL 1965 has regulated this right, enabling each shareholder who owns 20 shares or more to attend a GM; the company is not permitted to require a higher rate.⁵⁹⁰ This restriction means that if the number of shareholders is large, the attendance procedures must be well organized.⁵⁹¹ Minority shareholders are allowed to unite in order to provide a quorum and to elect a representative for the meeting. Should minority shareholders not be allowed to do this, they would be deprived of an important right; it is the duty of the Saudi legislature to allow each shareholder to attend a GM, regardless of the number of shares he has.⁵⁹²

⁵⁸⁸ Sameha alKalyouby, *Commercial Companies*, third edition. 1993. Egypt, Dar Alnahdah Al-Arabi Publishing, 1993, P: 450.

⁵⁸⁹ Saudi Company Law, 1965. Article 108 "A Shareholder shall be vested with all the rights attached to the share, specifically ...the right attend meetings and participation in the deliberations and vote on the resolutions (proposed) thereat "

⁵⁹⁰ Saudi Company Law, 1965. Article 83

⁵⁹¹ Safwat Behnsawi, *Saudi commercial system*, Egypt: Dar Al-nadah Publishing, 1970, p: 186.

⁵⁹² this is provided for in many modern legislations, According to the companies' laws of Qatar (Art.128), Egypt (Art.59), and Emirate (Art.127), Bahrain (Art.173)

This right includes all shareholders, regardless of the type of shares, except for the owners of preferred shares if they have no right to vote.⁵⁹³ This right also includes shareholders who have not paid the full value of their shares; it is not required for a person in becoming a shareholder in the company to pay the full value of the share. The company may not provide in its articles any limitation that deprives the shareholder of certain rights related to ownership, such not being given access to profits or not being allowed to attend and vote at GMs until completing the full value of the share.⁵⁹⁴

The natural person is the representative of the artificial person that owns a share in the company, even if the natural person is not a shareholder in the company. In addition, a guardian or custodian may attend on behalf of an incapacitated or legally incompetent person because attending GMs is considered a form of business administration of their client's money; this is included in their power as a guardian.⁵⁹⁵ If the shares are owned by more than one person, they must appoint a representative.⁵⁹⁶

It should be noted that if the shareholder's shares are mortgaged, then the right of attendance is for the debtor mortgagee, i.e. the shareholder, not the creditor mortgager; this is because the creditor here only possesses the share, and thus, the creditor mortgager may not benefit from the mortgaged shares at no charge to himself without the permission of the mortgager. If it is agreed that it is the right of the creditor to possess all the rights related to the share, such as the right to attend a GM, then he shall have all the rights that were nominated for the debtor.⁵⁹⁷

On the other hand, SCL 1965 does not require the shareholder to attend a GM by himself; he has the right to delegate someone else to attend the GM when unable to attend for some reason, but only under certain conditions; Article 83 of SCL 1965 stipulates, "1- The bylaws of the company shall specify the (class of) shareholders entitled to attend general meetings. Nevertheless, every shareholder who holds twenty shares shall have the right to attend, even if the bylaws of the company provide otherwise. 2-

⁵⁹³ Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. P: 22. Available at: www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf.

⁵⁹⁴ The Companies (Model Articles) Regulations 2008, No. 3229. Part 3. Article 41 "No voting rights attached to a share may be exercised at any general meeting, at any adjournment of it, or on any poll called at or in relation to it, unless all amounts payable to the company in respect of that share have been paid".

⁵⁹⁵ Aziz Al-akali, *Commercial Companies*: Jordan, Amman, Maktabat Dar Althkafah Publishing, 2010. P: 309.

⁵⁹⁶ Saudi Company Law, 1965. Article 89

⁵⁹⁷ Saudi Commercial Mortgage regulation. Article 14.

A shareholders may, in writing, give proxy to another shareholder other than a director to attend the general meeting on his behalf.”

The conditions for power of proxy must first be written and formally documented; the company often publishes a form for power of attorney within the agenda, requesting ratification from the Chamber of Commerce, a bank, the employer of the shareholder, or the courts. Secondly, the proxy should be a shareholder in the company in order to safeguard the secrets of the company, and not to reveal them to others. This condition does not exist in the legislation of many countries, giving the shareholder the right to authorize non-shareholders.⁵⁹⁸ Thirdly, the authorized proxy should not be a member of the board; the shareholders are those who monitor the work of board. Also, in order to prevent fraud when voting on the resolutions of the meeting, a member of board may be a shareholder in the company, and might purchase the votes of shareholders in order to dominate the decisions of the GM and to vote for his interests. The SCGRs have added a fourth condition: that the agent shall not be an employee in the company.⁵⁹⁹

Notwithstanding the significance of this matter, the above provision is the only one that refers to the question of proxy regarding the attendance of the shareholders at GMs. In the provisions of proxy vis-à-vis attendance under the current SCL 1965, there are deficiencies and comprehensive regulation is needed for minority shareholders to realize the benefits to be gained from participating in GMs, and from exercising their rights guaranteed to them by law. For example, SCL 1965 and SCGRs do not specify the number of shares represented by the shareholder as being in person or in proxy for others, as found in some legislations (such as in Syrian company law), which determine the ratio of the number of votes represented by the shareholder in person or in proxy on behalf of a shareholder to 5% of the capital of the company.⁶⁰⁰

However, the aim of this measure is to maintain a balance between the votes of all the shareholders, and not to limit the shares to a few people who may control the meeting. Also, other issues may arise: How long is the proxy? Is the power of attorney valid for all GMs or for one meeting only? Does it

⁵⁹⁸ S. 324 (1) of the UK CA 2006 states that “A member of a company is entitled to appoint another person as his proxy to exercise all or any of his rights to attend and to speak and vote at a meeting of the company”.

⁵⁹⁹ Corporate Governance Regulations of Saudi Arabia. Article 6 “c) A shareholder may, in writing, appoint any other shareholder who is not a board member and who is not an employee of the company to attend the General Assembly on his behalf”.

⁶⁰⁰ Syrian company Law. No. 29. 2011. Article 178(2).

include all kinds of meetings or only certain types? Also, can the company assign a certain shareholder to receive the agencies or not?

In this vein, CA 2006 contains more details regarding such issues.⁶⁰¹ The shareholders who have the right to attend the GM and vote can appoint another person to attend the meeting if they do not wish to attend in person, and this proxy may be a shareholder or not. In fact, some or all of the rights of the shareholder may be exercised by the proxy, such as attending, discussing and voting at a GM.⁶⁰² The shareholder is entitled to appoint one proxy (or more) for a meeting providing he holds different shares,⁶⁰³ and each proxy has a vote.⁶⁰⁴ Appointing proxies by shareholders can be processed in writing or in a way that the company approves.⁶⁰⁵ In the proxy form, it is usually mentioned that the chairman of the meeting acts as a proxy for the shareholders.⁶⁰⁶

Voting by proxies is done according to certain regulations and procedures as stated by the appointing shareholder. If a proxy does not vote in the manner stated in the instructions, this shall not result in the meeting being invalidated;⁶⁰⁷ legally, the situation would be that the proxy is subject to the common law as an agent.⁶⁰⁸

The notice calling a GM must stipulate clearly that the shareholders have right to appoint proxies. However, the validity of the GM or of anything done at the GM shall not be affected if the company fails to do this; this only can be considered as a fault that may lead to a fine for the company official involved.⁶⁰⁹ In the company's articles, a provision that requires the instrument appointing a proxy to be deposited two days prior to the day of the determined or postponed meeting is considered void provision.⁶¹⁰

⁶⁰¹ See Section 324 to 331.

⁶⁰² S. 324 (1) of the UK CA 2006

⁶⁰³ S. 324 (2) of the UK CA 2006

⁶⁰⁴ Saleem Sheikh, *A Guide to the Companies Act 2006*. Routledge –Cavendish. P:591

⁶⁰⁵ The Companies (Model Articles) Regulations 2008, No. 3229. Part 4. Article 38

⁶⁰⁶ Charkham J. et Simpson A. *Fair Shares: The Future of Shareholder Power and Responsibility*, Oxford University Press. 1999. P: 63

⁶⁰⁷ S. 324 A. of the UK CA 2006

⁶⁰⁸ ICSA Guidance on the Implementation of the Shareholder Rights Directive

www.icsa.org.uk/assets/files/pdfs/guidance/090729%20Implementation%20of%20the%20Shareholder%20Rights%20Directive%20-Amendment.pdf accessed 7 May 2012.

⁶⁰⁹ S. 325 (1) of the UK CA 2006

⁶¹⁰ S. 327 (2) of the UK CA 2006

It is stated clearly in S. 326 that in any invitation made by the company in relation to the appointment of specified person(s), all shareholders of the company, who have the right to vote, should receive a copy of the invitation; otherwise, the company becomes subject to a fine. This procedure guarantees the protection for shareholders against the directors who seek avocation in the voting.⁶¹¹ Any action made by proxies at a GM is considered valid on condition that the proxy is not given a notice of termination of his authority before starting the meeting.⁶¹²

5.7 Shareholder's Right to Discuss the Auditor's Report

Practically, it is difficult for the GM to be conducted and controlled effectively and continuously due to the phenomenon of the absence of shareholders; also, many shareholders do not have the culture or experience, particularly in accounting or law; these would qualify them for controlling and supervising the company's business effectively. Therefore, the legislation gives this task to one or more auditors, who are professional, competent, qualified and independent, and are appointed by the GM, in order to assist in controlling and supervising the board's business;⁶¹³ they are also charged with auditing and verifying the budget, and with calculating the profits and losses for the fiscal year to which they are assigned, as well as monitoring the application of the provisions of law and company's articles.

Auditors are usually recommended by the board, which determines their remuneration as well; in fact, the auditor is appointed indirectly through the board, based on the recommendation of the audit committee.⁶¹⁴ Thus, this contributes to maintaining a close relationship between the auditors and the board of directors, rather than as it is supposed to be, i.e. between the shareholders and the auditors; as

⁶¹¹ S. 326 (6) of the UK CA 2006

⁶¹² S. 330 of the UK CA 2006

⁶¹³ World Bank. *A Corporate Governance Survey of Listed Companies and Banks Across the Middle East and North Africa*. International Finance Corporation, World Bank Group and the Institute of Corporate Governance. 2008. P:45

⁶¹⁴ The Audit Committee is a committee derived from the Board of Directors, and its members are appointed from the board members and staff of the company, and may be independent persons from outside the company. This committee is mandatory for all joint stock companies, based on the decision of the Minister of Commerce No. 903, dated 14 January 1994. The responsibilities of the Audit Committee are summarized in reviewing the financial statements of the company, reviewing all accounting policies that the Company applies, verifying the internal control system of the company, preparing the recommendations for the selection of the auditor and determining his fees, emphasizing the independence of the auditor, working to solve the problems that may arise between the company's management and the auditor, preparing recommendations for the appointment of the head of the internal audit department and his assistants, and assessing the efficiency of management performance and effectiveness, to make sure that the management of the company is committed to implementing the rules of corporate governance. But, practically, this committee is strongly subject to the influence and domination of the board of directors.

a result, the auditor is not fully independent in his work, rather there will be interference by the company's board because of their power in terms of appointment reappointment or dismissal.⁶¹⁵ This normally results in a weak level of control on the part of the auditor, as an agent of the shareholders, over the work carried out by the company's board.

It is thus believed that the auditor's work is subject to the board and does not fully represent independent work.⁶¹⁶ A simple example of the seriousness of the control of directors over auditors is that the auditor could declare to the shareholders false or incomplete information, the auditor would not be in a position to tell the truth to the shareholders, as he is under the control of the board of directors and can have no influence over it.⁶¹⁷

In order to strengthen the principle of non-interference on the part of the board in the auditor selection process, the Egyptian legislature states in the Companies Act that the board of directors may not be authorized to appoint the auditor, or determine his fees without specifying a maximum.⁶¹⁸

However, this matter can be resolved by preventing the board from interfering in the selection of auditors and determining their remuneration; this could be done through the formation of an independent committee to be selected by the shareholders, and preferably by those who have experience in this field but not by the owners of large quotas in the company (in order not to create a conflict of interests between them and the auditors). After choosing a candidate as a potential auditor and determining his fees, their recommendations in this regard will be put to the vote;⁶¹⁹ this, undoubtedly, would ensure the integrity of the selection process for the auditor, and his independence from the company's board.

In the same vein, according to Article 130 of SCL 1965, auditors are appointed for a full fiscal year, and can be re-assigned more than once. All auditors should be independent of JSCs, and independent

⁶¹⁵ Abdulrahman A. M. Al-Twajiry, John A. Brierley and David R. Gwilliam, *An examination of the role of audit committees in the Saudi Arabian corporate sector*. *Corporate Governance: An International Review* 10, no. 4 (2002): 294.

⁶¹⁶ AlMelhem, Ahmed. *Kuwaiti Commercial Companies Law and the Comparative*. Kuwait University Press, Kuwait, 2009, pp. 346.

⁶¹⁷ O'Sullivan, Noel, *Auditors' Liability: Its Role in the Corporate Governance Debate*, 23 *Accounting and Business Res* (1993). pp: 415-6.

⁶¹⁸ Article 103 (2) of the Company Law no. 159/198.

⁶¹⁹ Sameha, Al Kalyoubi, *Commercial Companies*. Egypt: Dar Alnadah Publishing, (1993). pp: 489

of each other, as well as authorized by the CMA. Therefore, the process of appointing the auditor occurs indirectly through the board, and the effect of the board in re-electing the auditor is quite clear; thus, the auditors tend to agree with the policy of board, and overlook any irregularities they discover, otherwise they know that they will not be re-appointed, or even dismissed.

In general, the auditor's report is subject to elementary approval by the board. Unfortunately, the provision above gives the board considerable power to influence the independence of the auditor, where the auditor has a choice, either to respond to the dictations and conditions of the board of directors, or to reject their employ.⁶²⁰

It could be argued that determining a legal duration of the duty for the auditor of longer than a year would serve to address this shortcoming, and give the auditor greater stability and independence; then the board's influence over the auditor would be weakened. The maximum duration for the appointment of the auditor could be three years (or more) during which he would not be re-elected. This is actually what is stipulated in the Swiss Companies Act;⁶²¹ According to the French Companies Act,⁶²² the auditor shall be appointed for longer than a period of six continuous fiscal years, where any contrary agreement between the company and the auditor will be considered void; it may not be agreed in advance to extend the duration of the appointment for a period exceeding six financial years, nor shall this period be shortened to less than six continuous financial years.⁶²³

SCL 1965 gives JSC shareholders the right to discuss the auditor's report, and to ask him questions in order to understand his annual report; the auditor is obliged to answer shareholders' enquiries. The auditor is in charge of delivering any information he obtains to the shareholders clearly and accurately. In general, the auditor must preserve the interests of the company and its stakeholders by making sure that the deeds of the board are in conformity what is stated in the documents of the company.

⁶²⁰ See Farmer, T.A., Rittenberg, L.E., and Trompeter, G., M., *Investigation of the Impact of Economic and Organisational Factors on Auditor Independence*, Auditing, (1987) P: 1-14. the Spanish Companies Act stipulates that the duration shall be not less than 3 years and not more than nine years, but not re-elected after the end of the period cited from: Ahmed AlMelhem. *Kuwaiti Commercial Companies Law and the Comparative*. Kuwait University Press, Kuwait, 2009, P: 678.

⁶²¹ Cited from: Bruno Becchio and others, *Swiss Company Law* (2Ed, Kluwer Law International, 1996)

⁶²² Article 224 (1) of French Company Law.

⁶²³ So the task of the auditor at the company ends by the force of law with effect from the date of the AGM adopting the accounts of the sixth financial year, and if his contract is not renewed for a further period of six new financial years.

In the same vein, one of the drawbacks of SCL 1965 is that it does not give more details about auditor issues; we find only five articles that regulate the function of the auditor and they are very brief (Articles 129 to 133). The law does not expressly refer to the auditor's duties; detailing these duties is important as the shareholders need to know their rights and duties toward the auditor.

In the UK, it is quite different; CA 2006 considers the auditor to be of great importance, and the provisions relating therein appear more accurate and highly professional;⁶²⁴ Ss. 498 to 502 regulate the provisions relating to the duties and rights of auditors. It is hoped that the Saudi legislature, in the new CL, will give this matter due consideration and make the duties more detailed and clear, due to the auditor's importance in protecting the interests of the company and its shareholders against any violation. In order for the auditors do their job effectively, it is believed that the Saudi legislature should provide for the independence of auditors, fully from board of the company, and emphasize that auditors shall gain all the necessary academic qualifications; the final point to be stipulated is to give the auditor all the powers he needs to perform his work effectively.

5.8 Shareholder's Right to Vote at GMs

The shareholders have the right to vote in their interests, provided this does not damage the best interests of the company. This right is considered one of the rights of property inherent in the ownership of the share, and one of the basic tools that ensure the active participation of shareholders in determining the company's affairs and making decisions related to it.⁶²⁵ In *Carruth v ICI Ltd*, Lord Maugham said, "The shareholder's vote is a right of property, and prima facie may be exercised by a shareholder as he thinks fit in his own interest."⁶²⁶

Moreover, shareholder voting is a fundamental feature of a sound corporate governance system.⁶²⁷ The OECD emphasizes, "The corporate governance framework should protect and facilitate the

⁶²⁴ Part 16 of the CA 2006 of the UK.

⁶²⁵ Chris Mallin. *Institutional investors and voting practices: An international comparison*. Corporate Governance: An International Review, 9, 2001. pp: 119.

⁶²⁶ [1937] A.C. 707

⁶²⁷ Chris Mallin & Andrea Melis. *Shareholder rights, shareholder voting, and corporate performance*. Journal of Management & Governance. 2010.

exercise of shareholders' rights...4) participate and vote in general shareholder meetings".⁶²⁸

Furthermore, any resolution issued at a GMs or anything in the company's articles that prevents the shareholders from exercising their right to vote is invalid by law. SCL 1965 confirms this right,⁶²⁹ and the SCGRs provide that voting is a fundamental right for the shareholder and cannot be cancelled in any way. JSCs should avoid any action that may lead to hindering the right to vote, and should ease and facilitate exercising the shareholders right to vote.⁶³⁰ This right is deemed a principal feature in good corporate governance practice by the SCGRs.⁶³¹

The right to vote is given to each shareholder in the company whose name has been registered in the record of shareholders, which is prepared prior to convening a GM. Only shareholders are entitled to attend and vote, and a shareholder can vote in person or by proxy via another shareholder; therefore, company employees are not entitled to vote on the resolutions of meetings, neither are the creditors of the company because they are not partners and do not have shares in its capital. Non-shareholders are not entitled to vote on any GM resolutions, even if is stipulated in the company's bylaws (unless they are agents or representatives of a corporate body). Pursuant to SCL 1965, each shareholder who owns 20 shares in the company has the right to vote regardless of the type of shares, whether mortgaged, owned by a group of shareholders or legal persons, or owned by incapacitated people.

It should be pointed out that under the Saudi system, a shareholder only has the right to vote at a meeting in person or by proxy; other means of voting are not regulated by SCL 1965 or SCGRs; shareholders are not permitted to vote by telephone, post or electronic means.⁶³²

⁶²⁸ (OECD). *Principles of Corporate Governance*. Organization for Economic Co-Operation and Development, 2004. Paris. Available at<www.oecd.org/dataoecd/32/18/31557724.pdf> accessed 8 May 2012.

⁶²⁹ Article 108 of the SCL1965 "1) A Shareholder shall be vested with all the rights attached to shares; specifically ...the right attend meetings and participation in the deliberations and vote on the resolutions (proposed) thereat".

⁶³⁰ Corporate Governance Regulations of Saudi Arabia. Article 5 "a) Voting is deemed to be a fundamental right of a shareholder, which shall not, in any way, be denied. The company must avoid taking any action which might hamper the use of the voting right; a shareholder must be afforded all possible assistance as may facilitate the exercise of such right".

⁶³¹ Paces Alessio M. *Featuring Control Power: Corporate Law and Economics Revisited*. January 24, RePub, January. 2008 .

⁶³² World Bank. Report on the Observance of Standards and Codes (ROSC). *Corporate Governance Country Assessment Kingdom of Saudi Arabia*. 2009. pp: 22. Available at<[ww.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf](http://www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf)> accessed 11 May 2012.

5.8.1 Shareholder Agreements

The shareholders in JSCs can conclude agreements between each other designed to unite their opinion within the company, including determining how to vote according to a certain way or to abstain.⁶³³

Thus, minority shareholders conclude formal or informal agreements to enhance their influence inside the GM,⁶³⁴ and to maintain their presence and rights against the majority shareholders in the company.⁶³⁵

In general, voting agreements should not be prejudicial to the interests of the company or its shareholders, and not contrary to CL or the constitution of the company; otherwise, they will be deemed invalid.⁶³⁶ In the case of *Russell v Northern Bank Development Corporation Ltd*, Lord Jauncey held, “Shareholders may lawfully agree inter se to exercise their voting rights in a manner which, if it were dictated by the articles, and were thereby binding on the company, would be unlawful”.⁶³⁷

Unfortunately, as in many other issues, SCL 1965 does not provide clear provision on these issues, and it does not explain whether the shareholders have the right to engage in agreement with others to vote on a particular matter or not.⁶³⁸ This is usually left to the court, which has the authority to approve the legitimacy of the agreement or to cancel it. Usually, the agreement is valid as long as it does not deprive the shareholder of the right to vote, based on the fact that this right is a personal right that cannot be waived, i.e. it is not possible to restrict the freedom of the shareholder, or to prevent him from exercising his right. On the other hand, the agreement is void if it is designed to vote for a particular party in return for private gain.

⁶³³ Mayson, Stephen, French D. & Ryan, C., *Company Law*, 21st Edn, Oxford. Oxford University Press. 2005. pp: 439

⁶³⁴ Piesse, Jenifer, Roger Strange, & Fahad Toonsi. *Is there a distinctive MENA model of corporate governance? Journal of Management and Governance*. 2011. pp: 1-37.

⁶³⁵ Azer Ozturk & Dilara YUrekli. *Voting Agreements Under Turkish Law*, Mondaq Business Briefing. 2011. Also see: Len Sealy, *Cases and Materials in Company Law*, 9th Edn. Oxford; Oxford University Press. 2010. pp: 230

⁶³⁶ Ben Pettet. *Pettet's Company Law: Company and Capital Markets Law*. Third Edition. England. Pearson Education Limited. 2009. pp: 93

⁶³⁷ [1992] 1 W.L.R. 588

⁶³⁸ See: Survey on Corporate Governance Frameworks in the Middle East and North Africa, OECD, 2005. P. 12. Available at < www.oecd.org/dataoecd/4/62/49012924.pdf > accessed 15 May 2012.

The decision of the Court of Cassation in Lebanon asserts that the concerns of shareholders about the company's interests, including the election of the most effective members of board, requires prior deliberations among shareholders, inevitably leading to personal agreements before GMs in order to vote in favour of a particular candidate. The shareholders' agreement on one member to be a nominated is a legal agreement; often, the agreement is verbal but this does not matter.⁶³⁹

5.8.2 The Number of Votes is Equal to the Number of Shares

The general principle in the Saudi system is that the number of votes is equal to the number of shares; if the shareholder owns one share, then he has one vote.⁶⁴⁰ This is based on the fact that the shareholders own shares of nominal value, and therefore they are equal in the right to vote and there is no difference between them.⁶⁴¹ This principle is of the public order, which may not be violated; therefore, any statement in the company's articles this is contrary to this principle is considered void automatically.⁶⁴² Therefore, SCL 1965 prevents all JSCs from issuing shares having more votes.⁶⁴³

Some legislation allow listed companies to issue shares without voting rights, including SCL 1965, which allows a company to issue non-vote shares, and to call them preferred shares. This is according to certain criteria; their owners have, in addition to the net profits, priority in receiving a certain percentage of the profits, as well as priority to obtain the value of their shares of the capital in the company before the owners of other shares at liquidation, and to gain a certain percentage of the liquidation output; however, the owners of these shares are not entitled to vote on GM resolutions.⁶⁴⁴

To maintain the equality between shareholders, the Saudi legislature does not allow issuing shares with

⁶³⁹ Aziz Al-akali, *Commercial Companies*: Jordan, Amman, Maktabat Dar Althkafah Publishing, 2010. P: 297.

⁶⁴⁰ Saudi Company Law, 1965. Article 107 states "Any shareholders entitled to attend shareholders meetings shall at least one vote".

⁶⁴¹ See: Survey on Corporate Governance Frameworks in the Middle East and North Africa, OECD, 2005. P. 10. Available at < www.oecd.org/dataoecd/4/62/49012924.pdf > accessed 17 May 2012.

⁶⁴² Christopher Scott Maravilla, *Shareholder Voting Rights*, Texas International Law Journal, vol. 39:163,1999. P. 166

⁶⁴³ Saudi Company Law, 1965. Article 103

⁶⁴⁴ Saudi Company Law, 1965. Article 103 "1- shares shall carry equal rights and obligation. 2-Nevertheless, a general meeting may, in the absence of any restraining provision in the company's bylaws, resolve to issued preferred shares of stock or convert common shares to preferred shares of stock".

dual or multiple votes.⁶⁴⁵ In France, double voting of shares can exist along with higher dividends. Actually, this merit is granted for the purpose of strengthening the shareholders' loyalty, and it is usually offered to those who hold shares for two years at least; it can also serve to maintain family control over company, in addition to granting the members of the family higher interests and rewards.⁶⁴⁶

5.8.3 Restricting the Right to Vote

Initially, each shareholder has absolute freedom to vote on GM resolutions, and may abstain from voting; the shareholder is not obliged to vote in any way and thus the shareholders position in the JSC is different from that of the directors, who are in fiduciary position.⁶⁴⁷ They are fully free to vote on the resolution that is suited to their interests, but not contrary to law, or the company's bylaws, nor in any way that damages the company or other shareholders.

In general, the shareholder's freedom in casting his vote (or not) should not be taken lightly and he should interact with what is happening at the GM; shareholders are basically partners in the company, and at the very least, there is a moral obligation to vote in good faith, compatible with the interests of the company (otherwise, the decision can be challenged before the competent authorities). The right to vote is restricted in certain respects by Saudi legislation in order that GM resolutions are in the public interest of the company, and not in the interests of a certain class of shareholders.

One of these restrictions is that the shareholder who does not have 20 shares is not entitled to attend GMs or to vote on resolutions unless the company's articles state so.⁶⁴⁸ Members of the company's board are not permitted to vote on resolutions pertaining to their relief from liability for the

⁶⁴⁵ Ibid article.

⁶⁴⁶ Some countries allow JSCs to set the number of votes held by shareholders to be less than the number of shares actually owned; this is in order to reduce the dominance of the owners of major shares and to protect small shareholders. For example, the company may give one vote for every 5 shares or for every 10 shares, in proportion to the number of shares owned, such that for every five to one hundred shares owned there is one vote, but there is one vote for every ten shares above one hundred to one thousand shares, and so on. See: Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years On*. Oxford University Press, Oxford, 2005. Pg. 210. & David L. Ratner. *The Government of Business Corporation-Critical Reflection*. Cronell Law Review. Vol. 56. No. 1. 1970. Pg. 7-6

⁶⁴⁷ In the case of *Northern Counties Securities Ltd v Fackson and Steeple Ltd*. Walton J. held that "when a shareholder is voting for or against a particular resolution he is voting as a person owing no fiduciary duty to the company and who is exercising his own right of property to vote as he thinks fit... he is voting simply in exercise of his own property right." [1974] 1 WLR 1133

⁶⁴⁸ Saudi Company Law, 1965. Article 83

administration.⁶⁴⁹ This is considered an axiom that should be present in any legislation; it could be that a board member has shares that help him evade responsibility. Directors are also prevented from participating in a vote on GM resolutions that are GMs issued on business licensing or contracts that are conducted for the company, as they may have related benefits (whether directly or indirectly) in them.⁶⁵⁰

However, an additional defect in SCL 1965 is that it gives directors the right to vote in a GM resolution that benefits them, such as on bonuses and salaries; for example, 35 listed companies ended their fiscal year for 2011 with a loss, but 33 ones of them gave rewards and incentives to board members estimated at about 121 million Riyals;⁶⁵¹ the members of one board waived their rewards, while the other company did not give any rewards to the directors. One of these companies was founded more than 20 years ago and has not given any profits to its shareholders, but it still continues to give rewards to its board of directors.⁶⁵²

For instance, the CEO of Savola Co. received 15.65 million SAR in bonuses and salaries for the year 2011, while the CEO of Herfy Co. received about 5.9 million SAR during the year 2011 in salaries, bonuses and allowances, compared with 5.2 million SAR he obtained in 2010; in the same company, the General Manager of Investment (the son of the CEO) received more than one million SAR in salaries, compensations and rewards.⁶⁵³ It is believed that the Egyptian legislature avoids this problem; it states that directors are not entitled to vote on resolutions that determine their salaries and rewards, or that discharge them of their responsibility for the administration.⁶⁵⁴

Again, SCL 1965 gives directors the right to vote on GM resolutions that include special benefits for certain shareholders, such as those deciding their relative proportions of profits. Also, in the case of

⁶⁴⁹ Saudi Company Law, 1965. Article 94

⁶⁵⁰ Saudi Company Law, 1965. Article 69. And Corporate Governance Regulations of Saudi Arabia. Article states that “a) A Board member shall not, without a prior authorization from the General Assembly, to be renewed each year, have any interest (whether directly or indirectly) in the company’s business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company’s account.”

⁶⁵¹ One Saudi Riyal equals 0.17 GBP

⁶⁵² See<.alriyadh.com/2012/03/20/article720086.print> accessed 18 May 2012.

⁶⁵³ See<www.alyaum.com/News/art/45799.html> accessed 18 May 2012.

⁶⁵⁴ Egypt Companies Law No 159 of 1981. Article 74 “Members of the board of administration should not take part in voting on the decision of the general assembly concerning the fixation of their allocations or gratification or discharging their responsibilities on management”.

the formation of a nomination and remuneration committee, and audit committee within the JSC, which is often decided through the company's board, voting is usually done at GMs, where directors have the right to vote on the committee members, their term of office, and the committee's duties. This is regarded as contrary to the rules of fairness and transparency in the world of CG; such committees must be independent and subject to no influence from the members of the board.

It should be noted that SCL 1965 contains no explicit provision in the case a shareholder voting on a resolution that is of personal interest to him. If we assume that the company rents real estate from one of its shareholders (who does not work in the company), is that shareholder entitled to vote on the resolution? Lebanese law explains this question clearly; it stipulates that the shareholder shall not vote for himself or for whom he represents when the decision is of interest to him; it states, "The shareholder is precluded from voting in his personal name or as proxy, whenever the matter concerns vesting him with a specific advantage or that the meeting is required to take a decision in respect of a dispute between himself and the company".⁶⁵⁵

5.8.4 Cumulative Voting

This is a method of voting for selecting members of the board of directors, and gives each shareholder the ability to vote in accordance with the number of shares he owns, where he is entitled to use them to vote for one candidate or to distribute them to the selected candidates without a duplication of these votes.⁶⁵⁶ This method increases the chances of minority shareholders to gain greater representation on the board of directors by concentrating cumulative votes on one candidate.⁶⁵⁷ The main objective in such a method is to protect their interests against any overreaching by controlling shareholders,⁶⁵⁸ and to ease tensions between the board and minority shareholders.⁶⁵⁹ In fact, the greater the number of

⁶⁵⁵ Lebanon Code of Commerce No 304. 1942. Article 18

⁶⁵⁶ Dan S. Felsenthal. *Is cumulative voting really different from one-man, one-vote?* . *Electoral Studies*, Vol 4, Issue 2, August 1985, Pg.: 141. Available at<www.sciencedirect.com/science/article/pii/0261379485900058>accessed 18 May 2012. Corporate Governance Regulations of Saudi Arabia adopt the cumulative voting as optional style. Article 5 "B) in voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied".

⁶⁵⁷ Theodor Baums &. Johann Wolfgang. *General Meetings in Listed Companies: New Challenges and Opportunities*, Working Paper No. 103. Institute for Banking Law, Goethe University. 2000. P: 12.

⁶⁵⁸ Jeffrey N. Gordon. *Institutions as Relational Investors: a New Look at Cumulative Voting*. *Columbia Law Review*, Vol. 94, No.1. 1994. P: 142.

⁶⁵⁹ Aiwu Zhao, Alexander J. Brehm. *Cumulative voting and the conflicts between board and minority shareholders*. *Managerial Finance*, Vol. 37 Iss: 5, Pg. 465 – 473.

vacancies, the higher the possibility of minority shareholders securing some representation by focusing their multiple votes on the same one or few candidates.⁶⁶⁰

Cumulative voting is provided for the SCGRs but not in SCL 1965, which is not mandatory for the companies listed. As an illustrative example of this: if a company has three vacant seats on the board of directors on which to vote, and there are seven candidates, then each shareholder can vote as follows: shareholder A owns 350,000 shares and shareholder B owns 120,000 shares; shareholder A can distribute his shares as follows: 120,000 shares to the first, third and fourth candidates, while the shareholder B can give all his shares to the seventh candidate.

In contrast, in most corporations, board directors are elected through 'straight' voting, which means that each shareholder is entitled to cast votes equal to the number of shares held for each nominee position.⁶⁶¹ The consequence of this is that a majority shareholder with 51% of the company's voting shares could fill every director position, while a single minority shareholder with as much as 49% of the voting shares would be unable to elect even one nominee to the board.⁶⁶²

The MOCI and the CMA encourage all JSCs to apply cumulative voting in the election of members of the board, in order to give minority shareholders the largest possible participation in the company's board.⁶⁶³ In 2011, the number of companies that applied this method was 20 out of the 163 companies in the Tadawul;⁶⁶⁴ many JSCs have rejected this application. Their arguments regarding the disadvantages of cumulative voting usually include:⁶⁶⁵ a good board should not be captured by any special interest group; the board should possess mutual confidence and respect; disharmony could harm the energy of management; confidential information could be leaked; and shareholders with narrow, selfish interests could abuse cumulative voting.

⁶⁶⁰ Theodor Baums & Johann Wolfgang. *General Meetings in Listed Companies: New Challenges and Opportunities*, Working Paper No. 103. Institute for Banking Law, Goethe University. 2000. P: 12.

⁶⁶¹ Bhagat, Sanjai, Brickley, James A, Cumulative Voting: The Value of Minority Shareholder Voting Rights. *Journal of Law & Economics*, vol. XXVII. 1984. Pg. 339

⁶⁶² June A Striegel. Cumulative Voting, Yesterday and Today: the July, 1986 Amendments to Ohio's General corporation Law. *Cincinnati Law Review*, 55 U. Cin. L. Rev. 1266 (1986-1987). P:1266

⁶⁶³ World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. P: 19. Available at: www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf.

⁶⁶⁴ Such as Mobily, Tabuk Agriculture Development, Ace Insurance, Almarai, Jarir Bookstore, Nama Chemicals, Petro Rabigh, Saudi Groups, Saudi Arabian Cooperative Insurance, Al Jouf Cement.

⁶⁶⁵ Aiwu Zhao, Alexander J. Brehm. Cumulative voting and the conflicts between board and minority shareholders. *Managerial Finance*, Vol. 37 Iss: 5, P: 465 – 473.

Nevertheless, there is no deterrent hindering the MOCI and the CMA from requiring companies to apply this method. For example, the shareholders in the *National Industrialization Company*, at an AGM in 2011, voted not to approve the adoption of cumulative voting for electing directors. The refusal of the company shareholders' attending the meeting was by a majority of 75% (who did not agree on the mechanism of cumulative voting) against 25% (who voted for approval); the total attendance was about 60% of the shares of the company.⁶⁶⁶ The reason given for rejecting this application of cumulative voting was that voting to choose the directors should be conducted in accordance the company's articles and that the traditional method is compatible with the law.⁶⁶⁷ It is noted that this company consists of 5 family companies and a government investor that make up more than half of the capital, and they are the ones who manage the company;⁶⁶⁸ therefore, the application of such a voting would lessen their opportunity to be members of the board of directors, something that might be a danger to their interests.

Consequently, the main reason for rejecting the application of this technique is that the selection of directors is mainly based on the criterion of ownership of shares, where most members of the board have large portions of the shares in this company. Also, most JSCs do not prefer the application of cumulative voting; the justifications given differ from one company to another. Some of them argue that nothing in the company's articles requires the application of cumulative voting in selecting directors at GMs, it is not stipulated in SCL 1965, and whenever it is stipulated by the competent authorities, it is applied immediately. Some companies say that the application of this method is still under study and it needs time to prove its success.⁶⁶⁹

In summary, the Saudi legislature must adopt cumulative voting as a compulsory method for many reasons but chiefly: the level of protection of minority shareholders under SCL 1965 in general is weak, and remedies against oppressive actions do not exist. It is believed that in the current circumstances, applying this method would give a voice to minority shareholders inside the company and would improve their level of protection in general.⁶⁷⁰

⁶⁶⁶ See <www.tadawul.com.sa> accessed 5 May 2012.

⁶⁶⁷ See <www.tasnee.com/Investor-Relation/Governance.aspx?lang=en-US> accessed 19 May 2012.

⁶⁶⁸ See <www.tadawul.com.sa> accessed 21 May 2012.

⁶⁶⁹ See <alphabet.argaam.com/?p=20227> accessed 19 May 2012.

⁶⁷⁰ However, cumulative voting could be upon the request of a certain number of shareholders, or according to the articles of the company like in Brazil. See: Andreas Grimminger, Daniel Blume. *Board Processes in Latin*

5.8.4 Electronic Voting

Electronic voting is an Internet-based system, through which shareholders can log in and register their votes on company resolutions.⁶⁷¹ Nowadays, in many developed countries, distance voting has become very common, such as in the USA, the UK, Japan, Australia and South Korea.⁶⁷² Many corporations have tried to shift from the traditional form to electronic shareholder meeting, especially at the AGM.⁶⁷³ There are certain benefits to electronic voting at GMs for both company and shareholders: it is fast, easy and cheap.⁶⁷⁴ It reduces the cost of convening a GM, and maximizes the number of shareholders having the opportunity to exercise their rights, to participate in deliberations and to make important decisions at GMs. Shareholders have many ways to vote electronically but they should all be considered as enabling the shareholder to be present at the GM for the purposes of quorum and determining a majority vote.

In the context KSA, too few shareholders are willing to physically attend GMs, due to the reasons mentioned earlier in this chapter.⁶⁷⁵ In order to solve this problem and as part of the process of improving the protection of shareholders, the CMA has applied a new mechanism, which is considered as a step forward in activating the role of shareholders at GMs, as it enables them to vote on GM resolutions without being physically in attendance.

On 17 March, 2011,⁶⁷⁶ the Tadawul, with the approval of the CMA and the MOCI, and in cooperation with brokerage firms, built an electronic system to facilitate voting at GMs for listed companies; it is called Tadawulaty.⁶⁷⁷ It is an advanced service that is available for use by registration on the Tadawul

America ,Board Nomination, Selection and Handling of Conflicts of Interest, External Frameworks and Internal Practices in Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama and Peru. 2011. P: 5.

⁶⁷¹ The electronic voting technology and platform may include punch cards, optical scan voting systems, and specialised voting kiosks, telephone, SMS, etc. see: Joffy George Chalakkal & K. Sasikumar. E-Voting Revolution—In Pusuit of better. *The Management Accountant*. November. 2010. P: 937

⁶⁷² Andreas Grimminger, Corporate Governance in Asia: Progress and Challenges. Standards Forum – Financial Standards Foundation, Asian Roundtable on Corporate Governance, Shanghai, December. 2010. Pg. 5.

⁶⁷³ Jesse A. Finkelstein. *Annual meetings: Shareholder meetings in cyberspace: Will your next meeting location be a web site?* Insights; the Corporate & Securities Law Advisor, 14(6), 13-13. 2000. Available at<<http://search.proquest.com.v-ezproxy.brunel.ac.uk:2048/docview/224827070?accountid=14494>> accessed 15 March 2012.

⁶⁷⁴ Adrienne Baker, E-lections, ADP Investor Communications Services, 1 Sep, 2000. Available at<www.insideinvestorrelations.com/contact/> accessed 25 May 2012.

⁶⁷⁵ See: 5.5

⁶⁷⁶ See<tadawulaty.tadawul.com.sa/tadawulaty/ar/news.htm> accessed 5 March 2012.

⁶⁷⁷ Saudi Stock Market. See<[www. Tadawul.com.sa](http://www.Tadawul.com.sa)> Accessed 5 March 2012.

website, on the websites of brokerage firms, or through attending in person. In fact, this service is not compulsory for JSCs at the moment but, according to Tadawul, 20 meetings have utilized electronic voting in 2011, and the number has since increased to 42.⁶⁷⁸

The shareholder can cast distance votes on all GM resolutions through the company website, which therefore may be considered a variant of traditional voting.⁶⁷⁹ Voting is open for the shareholders to cast their vote before actual meeting (for a specified period of time). The shareholder who practises electronic voting has the right to attend GMs, change his previous vote, cancel it, and vote again. The number of voters and the total number of shares they own will be added to the number of people attending the GMs in order to determine the attendance percentage and the quorum for convening the meeting.

The first trial was applied on *The National Shipping Company of Saudi Arabia (Bahri)*,⁶⁸⁰ on 29 March 2011; it was a successful experiment. 200 shareholders owning at least 12% of the capital of the company cast distance votes on the GM items; it experiment helped in reaching the quorum for the GM from the first time, where the quorum was more than 60% of the capital of the company.⁶⁸¹

Thus, this method aims to facilitate the participation of shareholders at GMs, to raise the efficiency and effectiveness of these meetings, and to reduce the chances of a GM not being convened for lack of quorum. This mechanism helps to overcome the obstacles that may prevent the participation of shareholders in GMs; it frees the shareholder from having to travel. Also, it maintains the secrecy of the votes, and helps to prevent disclose of the results to any member of the administration or other shareholders before the end of voting, thereby circumventing any influence on their behaviour during the voting process.⁶⁸²

It should be pointed out that this type of voting is not regulated by SCL 1965 or by the SCGRs;

⁶⁷⁸ See <www.tadawul.com> accessed 5 March 2012.

⁶⁷⁹ Eddy Wymeersch. "Some recent trends and developments in company law." (2001). Pg. 10

⁶⁸⁰ The National Shipping Company of Saudi Arabia (Bahri) was founded by a Royal Decree in 1979 as a Public Company, 28 per cent ownership held by the Public Investment Fund "PIF" of the Government of Saudi and the remaining is widely held in public shares by Nationals investors. More information at <www.bahri.sa/about-us> accessed >29 May 2012.

⁶⁸¹ See <tadawulaty.tadawul.com.sa/tadawulaty/ar/news_5.htm> accessed 25 May 2012.

⁶⁸² Albert Birkner, *Power to the people*, European Lawyer, Legislative Comment, 2009.

however, JSCs are not obliged to apply online voting.⁶⁸³ According to some press releases, there have been attempts by some senior members of JSCs to hinder the success of electronic voting in their company, in order to neutralize the power of minority shareholders in making decisions and participating in determining any future direction for the company.⁶⁸⁴ They argue that the electronic voting is not effective and is costly for the company, which will have to pay the Tadawul 40 SAR (£6737.42) per year; thus the participation of shareholders is still weak.

It is the duty of the Saudi legislature to compel listed companies to apply this method, as it is important in the protection of minority shareholders; there is no impediment to applying it and it will serve to solve many of the problems in JSCs, such as the absence of shareholders from GMs, which often leads to adjournment; the dominance of the controlling shareholders in the company; and the lack of an effective role of shareholders at GMs like, such as controlling the board and bringing them to account when they make a mistake that affects the interests of the company.⁶⁸⁵ Providing such a voting facility through the Internet will help shareholders to participate in the activities and affairs of the company more effectively, as this will save them time and money in terms of travel and accommodation costs for the sake of attending a GM.⁶⁸⁶ Therefore, minority shareholders will be able to participate more strongly in the life and the affairs of the company through employing this facility.⁶⁸⁷ However, until now there have been no reliable statistics to demonstrate the success (or otherwise) of distance voting.

5.9 Conclusion

As we have seen, the GM is considered the most important part of any JSC; it is the highest authority, where the major plans of the company are made, and where their implementation is monitored. The shareholders of the company are the main component of GMs; they play an important role in the life of

⁶⁸³ Article 8 of the European Shareholders' Rights Directive requires JSCs to offer electronic participation in the GM, such as electronic voting. On 28th August 2012, Istanbul Stock Exchange requires from all company listed to adopting an electronic voting, and enables shareholders to participate and vote electronically in GM with immediate effect. Cited from: Noam Noked. Istanbul Stock Exchange Moves First on Mandatory Electronic Voting. HLS Forum on Corporate Governance and Financial Regulation. 2012. see<blogs.law.harvard.edu/corpgov/2012/11/06/istanbul-stock-exchange-moves-first-on-mandatory-electronic-voting/#> accessed 24 May 2012.

⁶⁸⁴ See<www.aleqt.com/2012/02/18/article_627600.html> accessed 26 May 2012.

⁶⁸⁵ See<www.aleqt.com/2012/10/10/article_700261.html> accessed 26 May 2012.

⁶⁸⁶ Daniel Adam Birnhak, Online Shareholder Meetings: Corporate Law Anomalies or the Future of Governance? *Rutgers Computer & Tech. L. J.* 2003. P: 445.

⁶⁸⁷ Fairfax, Lisa M. The Future of Shareholder Democracy, *Indiana Law Journal*: Vol. 84: Iss. 4, Article 6. 2009. P: 1301.

the company. They have a wide range of rights within the GM, which allow them to monitor the performance of the company and follow-up the members of the board and the auditors, making sure that they fulfil their duties towards the company, such as appointing directors or isolating them; this is all in order to achieve the interests of the company.

The law and the constitution of the company grant the shareholders a set of rights and responsibilities both inside and outside the GM on the basis that they own company shares; thus, it is they who mainly generate the capital. As a result, the GM is the most suitable body for monitoring the commitment of the board of directors and the auditors towards the company and its shareholders. The shareholders' rights in the GM cannot be exercised in full without attending the first meeting; therefore, the right of the shareholder in terms of attendance is one of the most important rights, as it is the gateway to exercising other related rights, such as discussing company officers, adding items to the agenda and voting, amongst others.

Minority shareholders must have a strong belief that attending a GM is necessary to protect their interests and the interests of their company in general. Participation in the GM delivers their voice to the company's management effectively. Thus, we must remove all obstacles that prevent them from attending and participating in an effective and influential way. The door should not be left open for the board to do everything it wants in the company without any real control preventing it from doing so.

It is clear that the role of minority shareholders in KSA is weak; it is true that they are so large in number that they cannot be ignored but their influence is minimal. Therefore, the competent authorities should seriously consider this matter in order to activate the role of minority shareholders, and should develop legal rules that are more effective and clear. For example, the shareholders should have the right to call for a GM to convene through the courts or the competent authorities in the case of the board not responding to their request for a GM. Also, all JSCs should be in contact with their shareholders through modern technology, such as by email or mobile phone SMS, and the shareholders should have the right to make agreements among themselves to vote in a certain manner.

Shareholders should have the right to make decisions at all times; the Saudi legislature should allow them to vote by post, telephone or the Internet, and all JSCs should facilitate the voting process for the

benefit of shareholders. Such tools will help to reduce the absence of shareholders at GMs, and reduce the domination of the company board on resolutions, allowing the minority shareholder to participate in building company policy. The greater the role of shareholders in GMs, the more effective, credible and more attractive the company becomes to local and foreign investors. Finally, educational bodies need to be established to spread investment culture among shareholders and defend their interests.

So far, it should be noted that this study has detailed the fundamental rights of shareholders in JSCs, either financial or managerial rights. When they exercise their rights in the appropriate manner, they protect their interests. The main aim of these rights is to protect the interests of the company and its shareholders. However, this raises certain questions: if the company or its shareholders face harm or damage caused by a mistake by the company's board or by a third party, what is the role of the GM or board of the company in terms of compensation? In this context, given the shortcomings of the GM, how can shareholders protect the company from damage or potential damage? In addition, what is the function of company law in protecting the interests of the company and its shareholders, particularly the minority shareholders who stand in a weak position against the majority shareholders who control and run the company?

Chapter 6: Remedies of Shareholders under the SCL1965

6.1 Introduction

JSCs are considered a legal entity with a legal personality; they must have a normal person to represent them when dealing with third parties,⁶⁸⁸ and have the right to bring a claim against the board of directors, one of its members, or a third party, if the damages caused to them were due to a fault or action made by them.⁶⁸⁹ In addition, company shareholders have the right to bring a claim against the directors or third parties that have committed a wrongful act under the name of the company or under their own name. In fact, the company directors can incur three principal types of liability: to the company, to the company creditors, and to individual shareholders or third parties who have suffered harm as a result of a wrongful act committed by the directors.⁶⁹⁰

The company aims to raise the lawsuit to seek compensation for the harm caused to them and the interests of all the shareholders as well. Nevertheless, when the damage is personal, or has affected individual shareholders or minority shareholders, they have the right to commence their individual or personal claim according to their vested rights and interests.

However, there are many differences between the company action and the individual shareholder claim. The most notable distinction is derived from its purpose: in the company action, the purpose is to protect and defend its rights and the rights of all company's members; this action could be commenced by company's officers or by its shareholders, the indemnity for the damages sustained is for the company. On the other hand, the purpose of a shareholder action is the protection of his/her personal rights, which are not related to the company, and therefore, the damage affects the shareholders in person.

Against the background of this chapter, the main question is whether and to what extent the current statutory remedies and means under SCL 1965 are effective in protecting the minority shareholders' rights and their role in listed companies. To address this, the remedies and means available under SCL

⁶⁸⁸ Ahmed Al-Melhem. *Kuwaiti Commercial Companies Law and Comparatisons*. Kuwait, Kuwait University Press, 2009, P: 1088.

⁶⁸⁹ Most provisions relating to listed companies come either from SCL 1965 or from the CML and its Implementing Regulations. There are two court authorities: the Commercial Court (under the Board of Grievances) which considers claims relating to the CL, and the Committee for the Resolution of Securities Disputes (CRSD), which has jurisdiction over claims relating to issues in the capital market.

⁶⁹⁰ Christian Campbell. *International Liability of Corporate Directors*, Yorkhill Law Publishing, 2007. P: 102.

1965 to protect the minority shareholders from the controlling shareholders (who look after their own personal benefits, regardless the minority's opinion) will be analysed. Furthermore, this chapter examines how minority shareholders can enforce their rights inside and outside the company. This chapter argues that the statutory remedies and means under SCL 1965 are not sufficiently effective in defending and protecting minority shareholders in listed companies, and consequently, it suggests reforms to those provisions.

The chapter six is divided into four main sections: the first section concerns company action (which can be initiated by the company or by its shareholders), and will cover company action and derivative action. The second section concerns the personal suit; the third section will concentrate on the statutory remedies available to shareholders that can be used without litigation, and the final section will cover the penalties under the SCL 1965.

6.2 Company Action

It has been said that company action is a claim concerned with the protection of its rights and its interests, and has nothing to do with the specific harms caused to one shareholder or more; it mainly aims to indemnify all the shareholders for the harm done, and results in a waste of company resources and may be prejudicial to the financial assets of company.⁶⁹¹

The company has a legal representative who is a separate legal entity from the shareholders. Thus, he has the right to initiate the claim through the company's representatives or shareholders but only under specific circumstances. The objective of the company action is to protect its rights and interests from any harm that may affect its business affairs.

Such harm takes several forms including damage caused to the company's financial status because of gross negligence in the administration, abuse of power, engaging in losing bids, or obtaining a loan from the banks with high interest rates, and distributing sham profits to shareholders.⁶⁹² Therefore, the liabilities of the company's directors towards such harms exists under Article 76 of the SCL 1965, which states, "1- Directors shall be jointly responsible for damages to the company, or the shareholders, or third parties, arising from their maladministration of the affairs of the company, on

⁶⁹¹ Ali Hassan Younes, *Commercial Companies*. Dar-Al-faker Al-Arabi Publishing. Egypt. 1991. P: 429.

⁶⁹² Mohammed Al-Jabr. *Saudi Commercial Law*. King Fahad National Library, KSA. 1996. P: 341.

their violation of the provisions of these laws or of the company's bylaws. Any stipulation contrary to this provision shall be considered non-existent".⁶⁹³

Generally speaking, the board of directors represent all shareholders of the company;⁶⁹⁴ therefore, directors should perform their duties in a bona fide way and act in a responsible manner for the good of the company.⁶⁹⁵ As a general rule, the resolutions of the board should be issued within the authorities of the board for the benefit of the company and in good faith.⁶⁹⁶

It should be noted that the Saudi courts have not yet developed any consistent criterion for assessing whether the actions of the board of directors are a form of maladministration or not; it could be argue that resolutions of the board should be in accordance with the 'prudent man rule'⁶⁹⁷ otherwise it may be considered maladministration, In addition, gross negligence could be a solid ground for a legal claim against the board of directors.⁶⁹⁸ However, such criterion depends solely on the discretion of the judge.

According to SCL 1965, a corporate is considered a legal personality⁶⁹⁹ starting from the date it was founded in the manner prescribed under Company Law, and must complete the procedures for

⁶⁹³ Saudi Company Law, 1965 Article 76.

⁶⁹⁴ Corporate Governance Regulations of KSA. Article 11: Responsibilities of the Board. "d) A member of the Board of Directors represents all shareholders; he undertakes to carry out whatever may be in the general interest of the company, but not the interests of the group he represents or that which voted in favour of his appointment to the Board of Directors".

⁶⁹⁵ Corporate Governance Regulations of KSA. Article 11: Responsibilities of the Board. "c) The Board of Directors must carry out its duties in a responsible manner, in good faith and with due diligence. Its decisions should be based on sufficient information from the executive management, or from any other reliable source".

⁶⁹⁶ Ahmed AlMelhem. *Kuwaiti Commercial Companies Law and the Comparative*. Kuwait University Press, Kuwait, 2009, P: 1086. The Company Act in the UK sets out the general duties of directors which are: "1- duty to act within powers; 2- duty to promote the success of the company; 3- duty to exercise independent judgement; 4- duty to use reasonable care, skill and diligence; 5- duty to avoid conflicts of interest; 6- duty not to accept benefits from third parties; and 7- duty to declare an interest in a proposed transaction or arrangement with the company". For more details, see: Part 10 of CA 2006.

⁶⁹⁷ The term of Prudent Man Rule is defined as a legal rule requiring investment advisers to only make investments for their clients' discretionary accounts that a "prudent person" would make; it is the basic standard, a fiduciary, which is responsible for other people's money, must meet. The rule has its origins in an 1830 court decision in Massachusetts, "Those with responsibility to invest money for others should act with prudence, discretion, intelligence, and regard for the safety of capital as well as income."

See<<http://financial-dictionary.thefreedictionary.com/Prudent+Man+Rule>> accessed 26 October 2012.

⁶⁹⁸ Mohammed Al-Jabr, *Saudi Commercial Law*. King Fahd National Library, Saudi Arabia.1996. P: 135. Cited in: Fahd Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. P: 240.

⁶⁹⁹ Saudi Company Law, 1965 Article 40 defined the Joint Venture as "an association of which third parties are not aware and which neither enjoys a juristic personality nor is subject to the publication formalities".

publication in the Official Gazette.⁷⁰⁰ It is not possible for a third party to object to the legal personality if the Minister of the MOCI takes a decision that the company has officially established, and has announced this to the public. At this time, the company becomes an artificial personality, independent from the partners and is entitled to acquire rights and assume obligations, i.e. has independent financial assets.⁷⁰¹

As discussed previously, the company is considered a legal personality represented by a normal person towards a third party, and also before the judiciary; furthermore, the company is obliged to the implement the work decided upon by the board of directors, within the limits of its jurisdiction, and therefore be asked for compensation for damages resulting from wrongful acts on the part of the board,⁷⁰² on the grounds that the board of company represents the company towards third parties.

Given that the board has wide-ranging powers in the management of the company and represents it toward third parties, and on the assumption that the chairman of the board is the one who represents the company towards third parties,⁷⁰³ the board thus acts on behalf of the company in any lawsuit.⁷⁰⁴

In fact, there is no article in the Saudi system that refers to this but we can understand, in light of Article 73, that “1- With due regard to the prerogative vested in the general meeting, the board of directors shall enjoy full powers in the administration of the company. It shall entitle, within the scope of its competence, to delegate one or more of its members or others to perform an act or certain acts”.⁷⁰⁵

However, there is no debate if the wrongful acts have been conducted by third parties; the company has the right to start the claim against them by its board or by shareholders in the GM. But, if the defendant is within the company itself, such as the board or its members, how is it possible to have the right to sue the wrongdoers, and how are the legal proceedings implemented?

⁷⁰⁰ Saudi Company Law, 1965 Article 53, “corporations may be incorporated only by authorization to be issued by the Minister of Commerce and published in the Official Gazette”.

⁷⁰¹ Mohammed Al-Jabr, *Saudi Commercial Law*. King Fahd National Library, Saudi Arabia. 1996. P: 135.

⁷⁰² Saudi Company Law, 1965 Article 75, “The Company shall be bound by (all) the acts performed by the board of directors within the limits of its competence, and shall be responsible for damages arising from the unlawful acts committed by directors in the administration of the company”.

⁷⁰³ Kuwaiti Law of Commercial Company states explicitly this point, Article (147) “The chairman of the Board of Directors shall be the president of the company and it is he who represents it vis-à-vis third parties; his signature shall be deemed vis-à-vis third parties to be that of the directors; he shall implement the resolutions and be bound by the recommendations of the Board of Directors. The deputy chairman shall act for the chairman during his absence”.

⁷⁰⁴ Egyptian Company law is clear; then The Saudi Company Law, which states in Article 85 (3), “the chairman of the board represents the company before the judicature...”

⁷⁰⁵ Saudi Company Law, 1965 Article 73 (1)

The legal basis for the company's action in the SCL 1965 is Article 77, which states, "1) The Company may institute an action against (its) directors for wrongful acts that prejudice to the body of shareholders, 2) The resolution to institute this action shall be made by regular general meeting, which shall appoint a person (or persons) to pursue the case on behalf of the company".

When filing litigation against the members of the board of directors or one of them, the company, represented by the GM, appoints a representative to proceed with the lawsuit before the competent court. The article above does not specify the person who would be deemed most appropriate to initiate the lawsuit; it could be the chairman of the board of directors, a director, a shareholder, or a lawyer. This person will be acting in accordance with the GM through the resolution adopted by the majority voting of the shareholders present or represented in the meeting.⁷⁰⁶

This article has been criticized because it does not indicate the appropriate person to represent the company in such a lawsuit. Therefore, it would be better that the Saudi legislator formulate the previous article in order to be clearer, and to determine the correct person to represent the company before the court.⁷⁰⁷ Moreover, the Saudi legislator mentions only wrongful acts that happened in the past or at a previous time, and does not demonstrate what the legal stance is regarding the misconduct or fault that may occur at the present time or in the future.⁷⁰⁸

However, if the lawsuit is brought against all directors of the board, the GM must appoint a representative who is not a member of the board. In the case of the lawsuit being brought against the chairman of the board, the GM dismisses him/her and appoints another one. However, if it was brought against all the members of the board, then the GM would dismiss them all, and would appoint a newly elected board.

⁷⁰⁶ Saudi Company Law, 1965 Article 80 (4)

⁷⁰⁷ Bahrain company law is clearer than Saudi in this situation. It provides in the Article 185(1). "The general meeting shall pass a resolution to file the action which shall be carried out by the chairman of the board. If the chairman of the board is among those litigated by the company, the general assembly shall appoint another board member to file the action. However, if the action was against all board members, the general assembly shall appoint a non-member to file the action."

⁷⁰⁸ Mansour, S. T. Al Anazi, *Minority shareholders: improving their protection to attract foreign Investment in the Kingdom of Saudi Arabia*, LLM. 2008. P: 52. However, S. 994 the UK CA 2006 allows minority shareholders to apply to the court on the ground "(a) that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or (b) that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial."

This is theoretically possible, however, in reality it is unlikely given the power of the majority shareholders, who often control the company; therefore, the general rule is that majority shareholders mean more dominate in the company. In addition, it is worth noting that some laws stipulate that the decision of the GM to initiate a lawsuit against the board of directors automatically leads, by law, to the removal of all the members of the board, or the one against whom the lawsuit of liability was filed.⁷⁰⁹

It is believed that the Saudi legislature should rule out the share of the member of the board of directors who is subject to dismissal when voting on the decision of the GM; hence, it is not rational to allow the defendant directors to vote in a decision related to the liability action against them, as, if they own a major portion of the shares, this could affect the resolution of a claim, or they could ally with other directors in order to make the decision fail.⁷¹⁰ According to the Italian Civil Code, “Directors can’t vote on decisions affecting their own liability”.⁷¹¹

Thus, the GM may not be able to litigate against the board of directors due to majority disapproval. The GM may however issue a decision to discharge the board of directors, and shall not prevent a lawsuit of liability that has been given consent by a GM in order to discharge the members of the board of directors; any lawsuit of liability must be considered within three years of the date of the discovery of harm.⁷¹²

It is interesting to note that, according to the Spanish Company Law, shareholders who hold shares without voting rights, as an exception on the general rule, have the right to fully participate in the initiation of the action, and also have rights to vote on it. It would be equitable and fair to permit all shareholders to protect their interests and rights in the company,⁷¹³ as such statutory provision would lead to increasing the protection of minority shareholders; furthermore, it would act as a tool for pressuring the directors of the company to be aware to their acts. However, in the Saudi context, such legal provision does not exist. The company files a litigation of liability against the board of directors, or one of its members, in order to preserve their interests and the interests of all its shareholders. In

⁷⁰⁹ Spanish Corporate Act 1989, Article 134 (2). Also, see, Christian Campbell, *International Liability of Corporate Directors*, Yorkhill Law Publishing, 2007. P.111.

⁷¹⁰ Mohammed Sadeq. *Board of Directors of the joint stock company in the Saudi law*. Al halabi Publishing. Lebanon. 2006. P: 160

⁷¹¹ Italian Civil Code, Section: Duties and Obligations of Company's Board of Directors. Article 2393. Cited in: Christian Campbell, *International Liability of Corporate Directors*, Yorkhill Law Publishing, 2007. P: 274

⁷¹³ Christian Campbell, *International Liability of Corporate Directors*, Yorkhill Law Publishing. 2007. P. 275.

order to make the GM resolution valid, it must be made by an absolute majority of the shares represented at the meeting.⁷¹⁴ Such matters can be discussed, even if they are not on the agenda of the meeting.⁷¹⁵

All members of the board of directors bear liability for damages if the resolution was made unanimously. However, if the resolution is passed by a majority, then the liability is borne by those who voted for the decision; however, a member of the board is not required to state whether he was absent from a meeting for legal reasons, and cannot object to it after learning the decision.⁷¹⁶ In addition, the company has the right to institute a liability action against the directors if they have resigned in an unreasonable length of time.⁷¹⁷ This provision does not specify what either inappropriate time or unacceptable reason means.⁷¹⁸

SCL 1965 does not indicate what the situation is if the company decided to stop pursuing the claim on the basis of settlement.⁷¹⁹ The general rule states that the company that commenced the suit may abandon or settle it providing that any indemnities for the settlement or waiver favour the company's interests.⁷²⁰

Generally speaking, in the Saudi context, the controlling majority holds the balance of power in the GM. They can ratify the claim of the directors, and can vote against the action resolution. According to the Report on the Observance of Standards and Codes (ROSC) concerning assessment of corporate governance in KSA, no legal suits had been filed against any board members before 2009; generally,

⁷¹⁴ Saudi Company Law, 1965 Article 92, "The regular general meeting shall be valid only if attended by shareholders representing at least one half of the company's capital, unless the bylaws of the company provide for a higher proportion ... The second meeting shall be considered valid, regardless of the number of shares represented thereat... Resolutions of the regular general meeting shall be adopted by absolute majority vote of the shares represented thereat, unless the bylaws of the company provide for a higher proportion".

⁷¹⁵ The Italian Civil Code, Article 2393, "The resolution regarding the ability of the directors can be passed on occasion of the discussion on the balance sheet, even if it is not indicated in the meeting agenda".

⁷¹⁶ Saudi Company Law, 1965 Article 76, "... In all cases, such action shall be barred after the lapse of three years from the date of discovery of the wrongful act".

⁷¹⁷ Saudi Company Law, 1965 Article 66 "... a director may resign, provided that such resignation is made at a proper time; otherwise, he shall be responsible to the company (for damage)".

⁷¹⁸ World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. P: 19. Available at: www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf.

⁷¹⁹ According to the Corporations Act in the article 134 (2) at any time the GM may compromise or waive the exercise of the claim, provided that there are unfavourable shareholders representing 5% of the capital shares. Available at <www2.gobiernodecanarias.org/educacion/17/WebC/Apdorta/ley/v0000207.htm> accessed 22 May 2012.

⁷²⁰ Christian Campbell, *International Liability of Corporate Directors*, Yorkhill Law Publishing, 2007. 112

policies of liability insurance are not applicable to them.⁷²¹ This means that majority shareholders control; therefore, no liability action can realistically be brought against them. Another reason could be the failure of shareholders to attend the GM; they choose not to practise their rights vested by the CL, unfortunately, most of the shareholders in JSCs in KSA elect to pursue short-term rather than long-term profits.⁷²²

However, this is unsurprising, as the majority of public companies in KSA are owned by families, or are state-owned.⁷²³ This means that the majority shareholders control the company and can therefore prevent a liability action from being brought against them. Consequently, their ability to pass any action resolution depends on ratification of the majority shareholders.

In fact, it is normal in listed companies, especially in KSA, for the directors who run and manage the company to hold major portions in the company, and they are in a position to ratify the acts that result in harm to the company. Lord Buckmaster LC stated that in the case of *Cook Appellant v G. S. Deeks and Other Respondents*: “Even supposing it be not ultra vires of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority”.⁷²⁴

6.3 Derivative Action

Majority shareholders may infringe, injure and override the interests of minority shareholders and their rights through the resolutions of the board of directors.⁷²⁵ Thus, the GM is unable to perform its duties fully and successfully, due to the control and domination that majority shareholders, often paralysing the GM in adopting a resolution to file a lawsuit of liability against the members of the board of directors. Therefore, the question that must be asked in this respect is: What is the role of company shareholders? Do they have the statutory right to institute action on behalf of the company to sue the defendant directors? If so: What is the starting point to make a claim under the name of the company? However, these points will be discussed below.

⁷²¹ The World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia. 2009. Available at <www.worldbank.org/ifa/rosc_cg_saudia_arabia.pdf> accessed 28 May 2012.

⁷²² Ibid.

⁷²³ One of the main problems to the minority shareholders in the listed companies in Saudi is the concentration of ownership.

⁷²⁴ [1916] 1 A.C. 554.

⁷²⁵ Khurram Raja. *Corporate governance and minority shareholders' rights and interests in Pakistan: a case for reform*. Journal: International Company and commercial law review. Volume: 23 Issue: 10. Page: 347. 2012

In reality, the controlling majority has wide power in the company; however, it is unfair to allow them to act as they please, i.e. acting in their own interest regardless of the minority shareholders.⁷²⁶ In this respect, if the company is unable to bring a claim against its directors of board or one of them for any reason, many laws exist that grant minority shareholders the right to commence a company claim aimed at the protection of the general interest of the company.⁷²⁷ It has been argued that an effective legal remedy exists that will protect minority shareholders against expropriation of the board directors, namely, a derivative action.⁷²⁸ This right is considered as an exceptional right when the company cannot defend its rights.⁷²⁹

A shareholders' derivative suit, claim or action, are interchangeable terms that have one meaning,⁷³⁰ which refers to the claim made by the shareholders on behalf of the company's name, "in order to protect the interests of the company and obtain a remedy on its behalf".⁷³¹ The suit is considered as a significant device of corporate governance to promote shareholder's rights and to protect their interests as well.⁷³² Knox J. defined the derivative action in the case *Smith and Others v Croft and Others* as: "...a form of pleading originally introduced on the ground of necessity alone in order to prevent a wrong going without redress".⁷³³ The shareholders or minority shareholders who have the right to claim, on a true analysis vested in the company, are considered in representative capacity for the company.⁷³⁴

⁷²⁶ Enriques, L. & Volpin, P. Corporate Governance Reforms in Continental Europe. *The Journal of Economic Perspectives*, 21(1), 3-140. 2007.

⁷²⁷ For examples: the UK, France, German, Spain, Australia, United States, Canada and Singapore.

⁷²⁸ Kirkbride, James, Steve Letza, and Clive Smallman. "Minority Shareholders and Corporate Governance." *International Journal of Law and Management* 51, no.4. 2009. Pg. 206.

⁷²⁹ [1985] 1 W.L.R. 370. See the case: *Nurcombe v Nurcombe and Another*. The Appeal Court said, "however, minority shareholder's action in form is nothing more than a procedural device for enabling the court to do justice to a company controlled by miscreant directors or shareholders, since the procedural device has evolved so that justice can be done for the benefit of the company".

⁷³⁰ Fahad Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective*. Ph.D. Thesis. 2008. P: 79.

⁷³¹ S. 265 (1) of the UK CA 2006. CA 2006 defined the derivative action as a proceeding that may be brought by a member of a company, in respect of a cause of action vested in the company, and for seeking relief on behalf of the company, after gaining permission from the court.⁷³¹ Shareholders, it can be bring a derivative action under the S. 260 or under S. 994 as the known proceedings for protecting members against unfair prejudice. See: S.260, 261 &262 of CA 2006.

⁷³² Ailbhe O'Neill, *Reforming the derivative suit*, *Journal of International Banking and Financial Law*, March 2007, Vol. 157, Issue 7263.

⁷³³ [1988] Ch. 114

⁷³⁴ [1997] BCC. 17

A derivative action in the UK is a statutory remedy created by the courts to allow the individual shareholder or minority shareholders to start suit proceedings against the wrongdoers under the name of the company, in other words, to redress the harm done to the company rather than to its shareholders personally; and moreover, to enable the courts to bring justice to a company that is controlled by directors or majority shareholders.⁷³⁵ It strengthens shareholders of the company by granting them the opportunity to bring an action on behalf of the company against company insiders for violations in circumstances where the company is either unable or unwilling to bring the action.⁷³⁶

Furthermore, derivative action has emerged from common law; it refers to the well-known and old principle that is commonly known as, “*the rule of Foss v Harbottle*”.⁷³⁷ The principle states that the individual shareholder or minority shareholders are not allowed to litigate or make a complaint for alleged damages. Consequently, the correct plaintiff to sue is the company itself, to enforce its rights; thus, courts are not allowed to interfere in the company’s internal affairs.⁷³⁸

In fact, the ability of a shareholder to commence derivative proceedings on behalf of the company under common law is obscure and complex; the procedure is considered lengthy and costly.⁷³⁹ It is important to note that these exceptions were developed by the courts to ensure that justice could be brought to cases when needed.⁷⁴⁰ However, these exceptions, according to the Law Commission, are rigid, out of date and unclear.⁷⁴¹

With the high growing realisation that corporate activity has become of more public concern, and the resulting trend towards greater recognition of individual shareholders’ rights, the derivative action became a statutory remedy under the CA 2006; it is now introduced under sections 260 to 264.⁷⁴² CA

⁷³⁵ Melissa Hofmann, *Statutory Derivative Action in Australia: An Empirical Review of its Use and Effectiveness in Australia in Comparison to the United States, Canada and Singapore*. Corporate Governance eJournal. pp: 4. Available at<<http://epublications.bond.edu.au/cgej/13>> accessed 15 May 2012.

⁷³⁶ *Ibid.* pp.5

⁷³⁷ [1843] 2 HARE 462

⁷³⁸ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. pp: 447

⁷³⁹ Law Commission Consultation Paper, *Shareholder Remedies: A Consultation Paper*, UK, 1996. P: 7. Available at<<http://lawcommission.justice.gov.uk/publications/shareholder-remedies.htm>> accessed 28 May 2012.

⁷⁴⁰ Mahmoud Al-Madani, *Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward?* Ph.D. Thesis. 2011. pp: 143.

⁷⁴¹ Law Commission Consultation Paper, *Shareholder Remedies: A Consultation Paper*, UK, 1996. P: 7. Available at< <http://lawcommission.justice.gov.uk/publications/shareholder-remedies.htm>> accessed 28 May 2012.

⁷⁴² Melissa Hofmann, *Statutory Derivative Action in Australia: An Empirical Review of its Use and Effectiveness in Australia in Comparison to the United States, Canada and Singapore*. *Corporate Governance eJournal*. Pp.29. Available at<<http://epublications.bond.edu.au/cgej/13>>accessed 26 May 2012.

2006 presented the new statutory remedy for minority shareholders to allow them to bring an action on behalf of the company more openly than in the common law, according to the recommendations of the Law Commission, in order to make,⁷⁴³ “[a] new derivative procedure with more modern, flexible and accessible criteria for determining if a shareholder can pursue an action”.⁷⁴⁴ It has been argued that the codification of derivative action will enhance the position of minority rights in the company, and will ensure their rights against the corporate officers; however, on the other hand, the procedures of commencing this claim are extremely rigorous and several hurdles must be overcome.⁷⁴⁵

Minority shareholders can bring a derivative suit, “only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company”.⁷⁴⁶ Under CA 2006, shareholders can initiate such an action, which will cover a more extensive range of conduct and circumstances than currently exist under common law.⁷⁴⁷ As such, a derivative proceeding can be brought in respect of an alleged breach of any of the directors’ general duties under Part 10, “A company’s directors” in the Act, which includes the duty to exercise reasonable care, skill and diligence; the inclusion of negligence means that any instance of a director’s breach of his duty of care and skill can be prima facie.⁷⁴⁸ In fact, a derivative action can be initiated against any director, including a former director or a shadow director, and may be against any company official.⁷⁴⁹ They can also claim against third parties implicated in any breach, in the company’s name, such as auditors.⁷⁵⁰

Furthermore, initiating the derivative action must be made by a member of the company at the time of the proceeding and no minimum number of shareholders is required.⁷⁵¹ A member of a company includes any person who is not a member but to whom shares in the company have been transferred or

⁷⁴³ The proposal of Commission of Law for a new derivative claim is in line with the developments around over the world and notably in Canada, Australia, Japan, Hong Kong, and in New Zealand.

⁷⁴⁴ Law Commission Consultation Paper, Shareholder Remedies: A Consultation Paper, UK, 1996. P: 7. Available at <<http://lawcommission.justice.gov.uk/publications/shareholder-remedies.htm>> accessed 28 May 2012.

⁷⁴⁵ See <www.herbertsmith.com/Publications/.../JIBFL_davies+final.htm?wbc> accessed 5 October 2012.

⁷⁴⁶ 260 (3) of the UK CA 2006

⁷⁴⁷ Dov Ohrenstein, *Derivative action*, Shareholders now have a statutory right to sue directors in derivative actions. Will they use it? *New Law Journal*. 2007.

⁷⁴⁸ Reisberg Arad, *Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?* Rationality in Company Law: Essays in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. P: 11.

⁷⁴⁹ S. 260 (3, 5) of the UK CA 2006.

⁷⁵⁰ See <www.freshfields.com/publications/pdfs/2007/sept26/19863.pdf> accessed 5 October 2012.

⁷⁵¹ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 448.

transmitted by operation of law.⁷⁵² An example of this is when a trustee in bankruptcy or a personal representative of a deceased member's estate acquires an interest of a share as a result of the bankruptcy or death of a member.⁷⁵³

There are no certain provisions under CA 2006 related to the cost of the derivative action;⁷⁵⁴ therefore, due to the derivative and representative nature of the derivative action, the indemnity will be directed to the company itself, and the claimant shareholder in a derivative action will not directly benefit from the action. If the claimant shareholder has to bear the costs, while at the same time not being able to benefit directly, he may not be willing to initiate a derivative action.⁷⁵⁵ Lord Denning, in the case *Wallersteiner v Moir*, indicated: "Minority shareholders, being an agent acting on behalf of the company, are entitled to be indemnified by the company against all costs and expenses reasonably incurred by him in the course of the action. This indemnity does not arise out of a contract explicit or implied, but it arises from the plainest principles of equity. But what if the action fails? He should himself be indemnified by the company in respect of his own costs even if the action fails".⁷⁵⁶

This means that it would be just and equitable to the plaintiff shareholders to have the right of indemnity for any costs paid under this action against the company, regardless of whether the action succeeded or failed, as long as the goal of the plaintiff shareholders is the company's interests and the enforcement of its rights, and not simply a personal interest. However, in this respect, discretion of the court plays a major role in this matter.⁷⁵⁷

In the new statutory framework, the applicant shareholder who wants to bring a derivative action has to apply to the court to obtain permission to continue with it.⁷⁵⁸ Furthermore, due to new reforms on the Act, petition to the court to initiate statutory derivative action has become easier now than in

⁷⁵² S. 260 (5c) of the UK CA 2006.

⁷⁵³ Reisberg Arad, *Derivative Claims Under the Companies Act 2006: Much Ado About Nothing? Rationality in Company Law: Essays in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. P: 11.*

⁷⁵⁴ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford. Oxford University Press. 2009. pg. 459.

⁷⁵⁵ Xiaoning Li, *A Comparative Study of Shareholders' Derivative Actions: England, the US, Germany and China*. Kluwer Publishing. 2007. P: 74.

⁷⁵⁶ [1975] QB 373

⁷⁵⁷ The law commission recommended respect of costs of indemnity orders "that the court's power to make costs indemnity orders in derivative actions should remain unchanged and this view received virtually unanimous support on consultation". Law Commission Consultation Paper, Shareholder Remedies: A Consultation Paper, UK, 1996. P: 7. Available at <<http://lawcommission.justice.gov.uk/publications/shareholder-remedies.htm>> accessed 28 May 2012.

⁷⁵⁸ S. 261(1) of the UK CA2006.

common law.⁷⁵⁹ Thus, the applicant is not required to prove that the directors engaged in wrongful acts dominate most of the shares.⁷⁶⁰ In fact, the court has wide discretionary powers for giving the plaintiff permission to continue the proceeding on such terms as it thinks fit; it can refuse permission and reject the application, or, it can adjourn the proceedings, and it can give direction as it thinks fit.⁷⁶¹

Furthermore, the court has to consider certain factors when deciding whether to give the permission such as: the shareholder is acting in good faith; the action is in the interests of the company; the shareholder seeks the success of the company; the company decides not to pursue the action.⁷⁶²

However, the court may consider any other relevant factors.⁷⁶³

6.4 What is the stance of the derivative suit under SCL 1965?

Generally speaking, the derivative claim is intended to protect the interests and rights of the corporate; in this respect, does the Saudi system grant the minority shareholders the right of suing the wrongdoers on behalf of corporate's name if their acts have caused damage to the company? Unfortunately, SCL 1965 does not provide a shareholder or minority shareholders the right of bringing a claim against the board of company or its members on behalf the company or third party,⁷⁶⁴ which is available in neighbouring countries, such as, Jordan, Egypt, and in developed countries, for example, the UK, the USA and Canada.⁷⁶⁵

⁷⁵⁹ Mahmoud Al-Madani, *Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward?* Ph.D. Thesis. 2011. P: 186. "Many difficult and complex requirements under common law restricted potential claims from benefiting from the derivative action and from achieving the purpose for which the action was originally designed. Initiating a derivative suit under the common law more difficult than now"

⁷⁶⁰ Gaining permission requires two stages; however, judicial controls have been put in place to ensure that the minority shareholders are serious about pursuing the proceeding, and that they have sufficient reasons to do so. At the first stage, the applicant shareholder has to make a prima facie case; otherwise, the court cancels the application, and the burden of cost is against the applicant shareholder. At the second stage, a number of factors have to be taken into account, some of which oblige the court to reject the claim. See: Lorraine Talbot. *Critical company law*. Routledge Publishing. UK. 2008. P: 215. Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 451.

See<www.withyking.co.uk/.../CDR_factsheet_Shareholder_Protection.pdf> accessed 8 October 2012.and <www.radcliffechambers.com/articleDocs/398.pdf> accessed 8October 2012.

⁷⁶¹ S. 261(2) of the UK CA 2006.

⁷⁶² S. 263 (34) of the UK CA 2006.

⁷⁶³ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 455.

⁷⁶⁴ The Statutory Derivative Action was enacted by various legislatures around the world to unveil corporate mismanagement and to alleviate the imbalance of power created by the separation of ownership and control.

⁷⁶⁵ For example, Egyptian Company Law provides the derivative action in Article 102/3, which states, "The competent administration authority and also every shareholder allowing the surrender of the lawsuit or depending it on a previous license of the General Assembly or adoption of any other measure will be null".

Also, in Article 160 of the Jordanian Companies Law declares that a shareholder has the right to file an action

SCL 1965 and especially article 77 does not indicate what the procedure is if the GM fails to issue a decision to sue the wrongdoers or whether the shareholders have the right to bring a derivative action on behalf of the company or not.⁷⁶⁶ In this respect, minority shareholders are not allowed to commence action on behalf of the company as an exceptional right for any circumstances.⁷⁶⁷ From a practical perspective, Al-Ibrahim stated that there are no liability claims that have been brought by minority shareholders under the name of company; they can only ask the MOCI to do investigation on the affairs of the company.⁷⁶⁸

Article 78 of SCL1965 states: "...A shareholder shall have the right to institute action against the directors a liability case determined for the company, if their fault causes him personal damageThe shareholder may institute such action only if the company's right to institute it is still valid. The shareholder must notify the company of his intention to file the case...Shareholder shall be adjudged (compensation) only to the extent of the damage caused to him".

In accordance with Article 78, damages caused to the shareholder is due to a fault of one or more of the board of directors, either because they violated the law or the company's articles; this article stipulates that the shareholder has the right to file a suit under the following conditions, namely:

1. The shareholder is entitled to raise his claim if the directors caused harm to his personal interests.
2. The shareholder cannot initiate the lawsuit unless the company has the right to litigation.
3. The shareholder must inform the company of its intention to raise the lawsuit.
4. The compensation shall be for the petitioner shareholder.

on behalf of the company; "The Controller, (General Controller of Companies - Companies Control Department) the Company and any shareholder therein shall have the right to file a case with the Court ...". See: Egyptian Company Law. No. 159/1981 Article 102 (3), & Jordanian Company Law No. 22 of 1997 Article 160.⁷⁶⁶ Article 77 states that "1) The Company may institute an action against (its) directors for wrongful acts that prejudice to the body of shareholders, 2) The resolution to institute this action shall be made by regular general meeting, which shall appoint a person (or persons) to pursue the case on behalf of the company".

⁷⁶⁷ Mansour S. T. Al Anazi, *Minority shareholders: improving their protection to attract foreign Investment in the Kingdom of Saudi Arabia*, LL.M. 2008. P: 49.

⁷⁶⁸ Tariq AL Ibrahim, *Claims of liability in Joint stock Companies*, Journal of Law, Dar Tariq AL Ibrahim for publication, 2010. P: 22.

However, there are a number of criticisms, ambiguities and uncertainties in the above Article, and there is considerable confusion between shareholder personal suits and derivative action.⁷⁶⁹ Furthermore, this Article does not clarify which type of lawsuits it addresses; is it an individual/personal or a derivative action? Consequently, it could be argued that Article 78 designates the right of shareholders to sue the directors of the board on behalf of the company.

However, it could be said that, in light of the wording of Article 78, this refers to the claim on behalf of the company, but in fact the Saudi Legislature did not intend to establish derivative action as it exists in other countries.⁷⁷⁰ Furthermore, the problem with this Article is that it could lead to the risk of multiple actions and vexatious actions, and it unreasonable for the law to give all shareholders the right to claim on behalf of the company at one time; such legal process should be regulated in detail. Moreover, it was not possible to find any articles regarding derivative action in Saudi academic literature. Moreover, many lawyers and legal lecturers at Saudi universities agree that there is no derivative action under SCL 1965.

Nevertheless, the lawsuit indicated in Article 78 aims to recover the damages done to the shareholder alone; furthermore, this article mentions that the compensation adjudged is for the petitioner shareholder, whereas the compensation in derivative action is for the company. However, the purpose of the legal suit in this article, and the indemnity of the damages are absolutely contrary to the objectives and purpose of the derivative suit.

It is believed that the Saudi legislature was unsuccessful in the formulation of Article 77 and 78 of SCL 1965, where the personal suit and the derivative action were combined; each lawsuit requires a separate legal provision, in order to avoid confusion between each suit, as well as to remove any ambiguity in the article, as this may be the cause of harm to shareholders or can lead to a loss of their interests because of a lack of clarity in the legal provision. It is advisable that minority shareholders should have the right of suing on behalf the company if the GM cannot initiate a liability action, thereby protecting the company's interests as well as its shareholders.⁷⁷¹

⁷⁶⁹ Ibid.

⁷⁷⁰ Mansour S. T. Al Anazi, *Minority shareholders: improving their protection to attract foreign investment in the Kingdom of Saudi Arabia*, LL.M. 2008, p. 48

⁷⁷¹ According to the Spanish Company Law, Minority shareholders who hold at least 5% of shares of the capital can bring the Derivative action, and they should request to call for general meeting to decide to initiation the liability action or not, the directors of the board are not allowed to vote, the GM could not commence the liability action. Cited in: Christian T. Campbell, *International liability of corporate directors*, Vol. 2. Yorkhill Law Publishing, 2007. P: 274.

The right of shareholders to use the derivative action should be stated in Article 108 in SCL 1965, which provides some of the rights of the shareholders in listed companies, such as the right to initiate a liability action against the wrongdoers, and the right of to nullify any resolution issued by the GM or the corporate board, that violates public order, CL, or the company's bylaws.

Shareholders under the Saudi legal system do not have the right to bring a derivative action against one or more of the company's officers or third party. Similarly, shareholders under SCL 1965 do not have the right to bring such an action against the founders of the company. If they commit any offence against their company or its interests before the first election of the company's board, the law gives the shareholders the right to sue the founders of the company under their names only.⁷⁷²

In addition, when a company goes into liquidation, Article 77 of SCL 1965 states that the liquidator has the legal power to initiate and commence lawsuits against the company's officers. If they have caused any damages that are the result of their mismanagement of the company, this is considered to be in violation of the provisions of this law or articles of association. The liquidator should obtain the approval of the GM to bring this action.⁷⁷³

Consequently, when a company is in the stages of liquidation, the derivative action can be brought by the liquidator, who is considered the legal person authorized to do so, on behalf of the company. Thereby, the liquidator has the statutory power to sue the wrongdoers under the name of the company in order to protect the company's assets and its interests. However, the question that should be presented here is: Do any shareholders under SCL 1965 have the right to bring an action under the name of the company if the liquidator(s) cannot commence the company action for any reason?

When the company goes into liquidation and the liquidator is unwilling to bring the action, the GM then has the right to sue the liquidator(s) if his action has caused any damage or harm to the company.⁷⁷⁴ However, unfortunately, under SCL 1965 there is no article that gives the shareholder the right to bring a derivative action under the name of the company when the liquidator is unwilling to do

⁷⁷² Saudi Company Law, 1965 Article 64

⁷⁷³ Saudi Company Law, 1965 Article 77, “3) If the company is adjudged bankrupt, the institution of this action shall rest with the receiver, and upon the dissolution of the company, the liquidator shall (institute and) pursue the case after obtaining the approval of the regular general meeting”.

⁷⁷⁴ Saudi Company Law, 1965 Article 219, “If two or more liquidators are appointed, they must act jointly, unless the authority that has appointed them permits them to act individually. They shall be jointly responsible for damages sustained by the company, the members, and the third parties as a result of their ultra vires acts, or of the errors committed by them in the performance of their duties.”

so. In spite of this, shareholders are still not allowed to bring a derivative action under any circumstances.

In the UK context, a derivative action cannot be brought by a minority if the company has been put into liquidation.⁷⁷⁵ If the liquidator is unwilling or refuses to commence the suit on behalf of the company, the shareholders have the right to pursue the derivative suit; moreover, they have the right to request a court to order and instruct the liquidator to initiate the shareholders' derivative suit against the corporate officers in the name of the company.⁷⁷⁶

On that point, it is strongly recommended that the Saudi legislature grants the shareholders the right to bring a derivative action, which will promote the position of the minority shareholders in the company, as well as contributing to increased oversight on the part of all shareholders over the affairs of the company; furthermore, it would remedy any irregularities that could cause harm to the company. On the other hand, granting the shareholders this right would result in various benefits; any employee in the company, such as, the founders and board members would be forced to protect the interests and funds of the company on the basis that the shareholders have the legal right to sue them if they breach their duties towards the company.

It has been argued that permitting the minority shareholders to litigate against the corporate officers under the name of the company will decrease the control of the majority of shareholders in the GM, which is currently controlled by the directors of the board; consequently, the shareholders can practise the derivative action without obtaining permission from the GM, which will give the shareholders a strong voice within the company.⁷⁷⁷

⁷⁷⁵ On the base that the liquidator is the proper person, and he should protect the assets of the company pursuant to the law, he will control and manage the company... "But once the company goes into liquidation the situation is completely changed, because one no longer has a board, or indeed a shareholders' meeting, which is in any sense in control of the activities of the company of any description, let alone its litigation . . . the liquidator is the person in whom that right is vested." Cited in: V. Joffe, QC, D. Drake, G. Richardson, D. Lightman & T. Collingwood, *Minority Shareholders: Law, Practice and Procedure*. Oxford University Press. 2008. Pages, 9-10. Also, see *Fargro Ltd v Godfroy* [1986] 1 WLR 1134.

⁷⁷⁶ Minority shareholders can ask the court to initiate the derivative action under the Insolvency Act 1986 (IA 1986), s112 (1) or s168 (5). Article 112. Para(1), "The liquidator or any contributory or creditor may apply to the court to determine any question arising in the winding up of a company, or to exercise, as respects the enforcing of calls or any other matter, all or any of the powers which the court might exercise if the company were being wound up by the court." Article 168, Para(5) "If any person is aggrieved by an act or decision of the liquidator, that person may apply to the court; and the court may confirm, reverse or modify the act or decision complained of, and make such order in the case as it thinks just."

⁷⁷⁷ The Saudi legislature should give minority shareholders this right by reforming Articles 77 and 78. To give an example; in order to grant effective protection for shareholders, *the Saudi Basic Industries Corporation*

As we have seen in the earlier context, individual shareholders or minority shareholders should have the right of entitlement of the derivative claim as an exception on behalf of the company. This will reflect positively on the company itself and its interests. Moreover, it will limit excesses on the part of the members of the board of directors and managers. In addition, the use of the action will increase closer monitoring of the company's performance by the minority shareholders, thereby preventing any abuses that may affect the interests of the company and its shareholders at the same time.

It is here submitted that offering a derivative action to minority shareholders will strengthen the position of the shareholders in the company, and will make their voices heard. Therefore, in order to enhance the protection of shareholders, Saudi Legislature should grant more legal means and mechanisms for shareholders to strike a balance between the interests of majority and minority shareholders. This does not mean that shareholders can exercise the derivative action in the broadest sense; however, using this right under particular conditions and on a restricted scale will ensure that its use is serious, effective, and far from any excessive litigation.

Nevertheless, it is argued that giving shareholders such a right could lead to disruption or instability within the company, and may result in multiple litigations, which would undoubtedly affect the business affairs and reputation of the company.⁷⁷⁸ It is worthy of mention that shareholders should be granted the derivative action within specific limits. The Saudi legislature can place a number of restrictions on its use when shareholders plan to sue the wrongdoers in the name of the company, in order to prevent this legal action being abused or damaging the company; for example:

Firstly, plaintiffs seeking to initiate the derivative claim should be members of the company. In addition, the relevant state departments may have this right in special circumstances.

Secondly, the right of shareholders to use this lawsuit is an exceptional right; therefore, they cannot practise this unless the GM or the company's board have failed or rejected issuing such a decision.

(SABIC),⁷⁷⁷ is a public shareholding company where the state owns more than 70% of the capital; therefore the Saudi Government has a great deal of influence on the decisions of the GM of the company. If we assume that the GM is unwilling to bring an action against the members of the board for any reason, then, the minority shareholders cannot bring the derivative action in any circumstances under the current provisions of CL, in the sense that, minority shareholders cannot protect the interests of the company and their interests as well. SCL 1965 should provide effective legal mechanisms such as this to shareholders when the GM is unable to sue the board of directors, and aim to rectify any act that could affect the company and its shareholders. For more information see Saudi Stock Exchange (Tadawul). See <www.tadawul.com.sa> accessed 8 October 2012.

⁷⁷⁸ Al-Melhem, Ahmed. *Kuwaiti Commercial Companies Law and Comparisons*. Kuwait University Press, Kuwait, 2009, p: 1105

Thirdly, the law should clearly identify the circumstances when shareholders can begin a derivative action, such as infringement, breach, oppression, abuse, fraud, misuse and expropriation.

Fourthly, the shareholders must notify the GM of the company about their intention to use the derivative claim, and must wait for a reply from the company, as it could be that the company wishes to initiate the lawsuit instead of the shareholder.

Finally, courts should have wide discretionary powers as to whether to accept the application or not; therefore, the courts would play a greater role in ensuring the validity of the claim, and that it is in the company's interest to do so.

6.5 The Personal Action

Shareholders in the listed company have right to defend their rights and interests; this right is derived from the shareholder agreement, company articles, or from statutes that should be provided to shareholders as an effective means to protect these rights.⁷⁷⁹ The personal claim right is also provided in SCL 1965 and the SCGRs,⁷⁸⁰ which is considered one of the most fundamental and important precautionary rights for shareholders in the company.⁷⁸¹

The board of directors, one of its members, or a group of company employees may cause damage to the interests of one or a group of shareholders; for example, if the wrongful act is contrary to the law, the company's bylaws, or is the result of an act of fraud or abuse of power. The shareholder is entitled to the right to raise a lawsuit based on omissive responsibility against the wrongdoer; thus he/she is entitled to file his/her personal suit when the shareholder's interests are directly caused by the members of the corporate, or he/she is deprived of a benefit, because of the direct effect of the committed fault;⁷⁸² such as, preventing the shareholder from voting in the GM; depriving one or a

⁷⁷⁹ Victor Joffe QC, David Drake, Giles Richardson & Daniel Lightman, *Minority Shareholders; Law, Practice and Procedure*, Third Edition. Oxford, Oxford University Press, 2009. P: 2.

⁷⁸⁰ Corporate Governance Regulations of Saudi Arabia. Article 3 provides, "A Shareholder shall be entitled to all rights attached to the share, in particular ...file responsibility claims against board members..."

⁷⁸¹ Saudi Company Law, 1965 Article 108 states that "A shareholder shall be vested with all the rights attached to the share, specifically ...to institute the action in liability against the directors, and contest the validity of the resolutions adopted at shareholder meetings".

⁷⁸² Sameha Alkalyouby, *Commercial Companies*, Third Edition. 1993. Egypt, Dar Alnahdah Al-Arabi Publishing. 1993, P: 479

group of shareholders from attending a GM and seeing the minutes of the meeting; or not giving a shareholder his/her share of the profits.⁷⁸³

This right is one of the fundamental rights that cannot be restricted, or prevent the shareholder from using it. If any conditions restricting this right exist in the company's articles, they are considered void by virtue of law. Thus, if a decision is made by the GM to prevent the shareholder from raising his personal claim, then it has no value, because the shareholder's right here is to claim compensation for personal damages caused to him, not to the company. It is worth noting that the responsibility of the members of the board of directors could be jointly or individually responsible.⁷⁸⁴ The period in which the suit can be heard is three years from the date of discovery of the harmful act.⁷⁸⁵

It has been argued that the goal of the personal lawsuit is to seek compensation for damages caused to a shareholder's personal interests in the company. Shareholders have the right to demand compensation for personal damages caused to them before the judicature; they file their claim in their own names, not in the company's name, based on omissive responsibility.⁷⁸⁶

However, it could be argued that Article 76 again puts the shareholder in a stronger position than he would be in the UK in taking action against a director. However, it is believed that such action in reality is often impractical; it is difficult to file a suit against specific member(s) of the company's board due that all the resolutions of the company issued under the name of the company, and the claimant shareholders must have strong evidence confirming that any damage sustained was a direct result of some act by the director. It can be said that Article 76 gives rise to the risk of multiple actions and vexatious litigation, and consequently such claims are not common in KSA.

6.6 Statutory Protection for Shareholders under the SCL 1965

⁷⁸³ Victor Joffe QC, David Drake, Giles Richardson & Daniel Lightman, *Minority Shareholders; Law, Practice and Procedure*, Third Edition. Oxford: Oxford University Press, 2009. P: 2.

⁷⁸⁴ Saudi Company Law, 1965 Article 76, "2- Joint liability shall be assumed by all directors if the wrongful act arise from a resolutions adopted by unanimous vote. But with respect to resolutions adopted by majority vote, dissenting directors shall not be liable if they have expressly recorded their objection in the minutes of the meeting. Absence from the meeting at which such resolution is adopted shall not constitute cause for relief from liability, unless it is established that the absence was not aware of the resolution, or, on becoming aware of it, was unable to object to it".

⁷⁸⁵ Saudi Company Law, 1965 Article 76 provides, "...In all case, such action shall be barred after the lapse of three years from the date of discovery of the wrongful act."

⁷⁸⁶ Alshemmri, Tammeh, *The Board of Directors of Joint Stock Companies: Comparative Study between Law of Kuwait and the Laws of USA*, 1st Ed, 1987, p 241.

The shareholder's GM is the supreme authority in JSCs, because of its broad powers of decision-making in the company's affairs; it enjoys this authority within the limits prescribed by law and the company's articles. If it acts against these, such decisions become violations of the provisions of the law and regulations, and may damage the interests of both the company and the interests of its shareholders, which leads to the infringement of the rights of shareholders. It has been argued that GM resolutions are often taken by dominant shareholders who own a large amount of shares, which allows them the right to many votes.⁷⁸⁷

The majority are not considered to have power over the other shareholders (opponents or absentees); the basis for this is that the majority has an ethical obligation towards the company and its shareholders and each one has an interest. The dominance of the majority within the company is not necessarily deleterious as long as their acts are motivated to be in the interests of the company and shareholders. However, there are cases in which the GM takes decisions that are contrary to the provisions of the company's articles and the law, or that the decisions are correct but marred by abuse on the part of the majority in order to achieve their own interests. The question to be raised here is: what are the statutory rights and remedies within SCL 1965 for the minority shareholders, which they can use at the GM (or outside) in order to prevent any oppression by the controlling majority?

Most legislations accord the shareholders in listed companies a set of rights and means to protect their interests, and to defend them and as a guarantee for them against the controlling shareholders, such as the right to request a GM to discuss important company affairs, to refuse to add any new commitments to the shareholders, to assert the invalidity of a GM decision, to request an inspection of the company by the competent authorities, and to seek the dissolution of the company amongst others. The OECD stresses, "Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress".⁷⁸⁸

In SCL 1965, there is certain set of statutory provisions designed to give legal protection to the shareholders' rights and interests, and therefore, this section discusses these provisions in order to

⁷⁸⁷ Cheng, Yong. *On the Protection of Rights and Interests of Minority Shareholders in a Listed Company*. International Journal of Business Administration, 3.2 (2012): Pg. 54

⁷⁸⁸ The OECD Principles of Corporate Governance. Available at the OECD website: <www.oecd.org> accessed 13 October 2012.

determine whether or not they are sufficient.

According to Article 87 of SC L1965, shareholders representing at least 5% of the capital may call for the GM.⁷⁸⁹ Also, a number of shareholders representing at least 2% of the capital may request the MOCI to take a decision obliging a GM to be convened if a period of one month has passed since the date designated for the session, without any call.

In addition, Article 94 of SCL 1965 states the right of shareholder to ask questions at the GMs of all members of the board of directors as well as auditors; the directors or auditors are obliged to answer the questions as long as they do not harm the company's interests, and if the shareholder is not satisfied with the answers, then he has the right to refer the matter to the GM, which may then decide on this.⁷⁹⁰ However, it is argued that the 'harm standard' is not clear; it can differ from one person's perspective to another. Consequently, the shareholder cannot do anything against the board or auditors because the law actually allows them not to answer the question.

The right to vote at a GM is one of the basic rights of the shareholder, and thus, this right should not be restricted by any condition.⁷⁹¹ The company must enable shareholders to exercise that right effectively, and any prior agreement that results in the shareholder being unable to vote will be considered null and void.⁷⁹²

SCL 1965 also states the minority's right to have access to the company's documents in order to assist him in making decisions relating to his share in the company; there is also the right of the shareholder, within 25 days prior to the ordinary AGM, to have access to the agenda of the meeting.⁷⁹³ The current form of SCL 1965 also gives the shareholders who own at least 5% of the shares in the company the

⁷⁸⁹ Corporate Governance Regulations of Saudi Arabia. Article 5 "b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital."

⁷⁹⁰ Article (94), Corporate Governance Regulations of Saudi Arabia. Article 5 "g) Shareholders shall be entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest."

⁷⁹¹ Corporate Governance Regulations of Saudi Arabia. Article 6 (A)

⁷⁹² Corporate Governance Regulations of Saudi Arabia. Article 5 (D)

⁷⁹³ Corporate Governance Regulations of Saudi Arabia. Article 5, and the Saudi Company Law, No.1965.

right to add one or more subjects to the agenda of the GM during its preparation.⁷⁹⁴ The rights of the shareholder, in accordance with Article 108 of SCL 1965, guarantee permanent access to the company's documents and books, which will inform him of the company's condition and which will enable him to take appropriate decisions.⁷⁹⁵

One of the fundamental legal means given by SCL 1965 for shareholders is the right to request an inspection of the company, which can be considered a form of external oversight.⁷⁹⁶ The aim of such a request would be to verify the commitment of the company officials to the law, and non-violation of the company's articles.

In accordance with Article 109 of SCL 1965, the shareholders representing at least 5% of the capital is entitled to request an investigation of the company; this may occur should they have suspicions over the behaviour of the members of the board of directors or the auditor. In such a case, they are entitled to apply to the Commercial Courts⁷⁹⁷ to conduct investigation into the company's affairs, and to identify violations on the part of members of the board of directors or auditors.⁷⁹⁸

The Courts has the right to request a bank guarantee form the applicants to ensure they are serious; this is not mandatory, but subject to the Court's discretion. The Courts will appoint an inspector with jurisdiction in such matters; he shall have broad powers, such as questioning the members of the board of directors and the auditor in private meetings, and being granted access to all documents and records relating to the company.

If the investigator is satisfied that the applicants' suspicions are well founded, the Courts can take the appropriate and necessary measures, such as seizing all company documents. In extreme cases, the Court has the right to call an EGM to discuss and take decisions on the matter, possibly resulting in a lawsuit against the members of the board of directors or the auditors; the EGM may decide to dismiss them and appoint a new director with specific tasks for a certain period.

⁷⁹⁴ Corporate Governance Regulations of Saudi Arabia. Articl.5 “ f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda. Upon its preparation”

⁷⁹⁵ Mohammed Sadeq. *Board of Directors of the joint stock company in the Saudi law*. ALhalabi Publishing. Lebnan. 2006. P: 160

⁷⁹⁶ Mohammed Sadeq. *Board of Directors of the joint stock company in the Saudi law*. Alhalabi Publishing. Lebnan. 2006. P: 163

⁷⁹⁷ The Commercial Courts which it now under the Board of Grievance.

⁷⁹⁸ The Saudi Company Law, No.1965. Article 109.

In this context, the Board of Grievance on 8th February, 2001 issued the first judgment stating the shareholder's right to request an inspection in accordance with the provisions of Article 109. This judgment also confirmed the shareholder's right to engage an accredited accountant to inspect the company's affairs and management expenses. However, it is noted that the period of litigation in this case lasted a great deal of time (over 8 months); such claims need to be expedited as quickly as possible because listed companies are financial institutions consisting of a great many shareholders who invested in it for profit, and any litigation is likely to result in some financial loss, which will reflect negatively on the interests of the shareholders and third parties.⁷⁹⁹

However, it could be said that the inspection right under the SCL 1965 is not a workable method for minority shareholders; indeed, it may be defective. This is for various reasons; first: the above article does not mention a few important points that should have been provided for in any inspection request, such as: 1) the right of the competent authorities to inspect the companies (such as the MOCI, CMA),⁸⁰⁰ 2) the need to mention the reasons for the inspection in the inspection request, and 3) the need to protect the shares of the applicants pending a ruling on the lawsuit.

Second: Article 109 has also been criticized for its requirement to provide a financial guarantee designed to ensure the credibility of the applicants; it is supposedly designed to protect the company, its activities and reputation from any unwarranted action. Additionally, this article is criticized for being loose and too broad in its statements pertaining to the concept of doubt or suspicion on the part of the applicants. It does not specify, for example, the situations in which a request may be filed; also, it does not clarify whether or not it is possible to re-elect any isolated board members or to re-appoint the auditors.

Third: in the case of a request failing, SCL 1965 does not mention any procedures to be followed, such as the right of the company to seek compensation if any damage has been caused to the company and its interests. However, it does provide for the rehabilitation of members of the board or auditors who had been accused, stating that the result of any inspection be published for the public's information through the media; everyone who is entitled to request compensation also has the right to do so. Moreover, the article does not clarify the legal status of the inspector should he commit any breach of his remit, which may affect the result of the inspection.

⁷⁹⁹ Asharq Alawsat Newspaper. 8 February. 2001. Issue 8108

⁸⁰⁰ A General Department in the Ministry of Commerce whose concern is to follow up the application of the provisions of Company Law in general, in all types of companies.

It has been concluded that, despite the importance of inspections for shareholders, they are not as practically effective as they could be because of the lack of clarity in the legal text under Article 109. There are also too few means of communication for the minority of shareholders who may need to discuss the affairs of the company and to prepare an inspection request; further, Article 109 states that they must do so through completion of the required quorum. Thus, the investigation method should be reformed to improve the position of shareholders and to enhance the protection of investors in listed companies in general.

The investigation method for companies in the UK is more detailed and comprehensive than in KSA; all investigations are conducted through the Companies Investigation Branch (CIB),⁸⁰¹ which has the power to assign an inspector (or more if needed) to investigate the company's affairs. However, there must be reasonable cause to suspect fraud, serious misconduct, material violations, or important irregularity in the affairs of the company to initiate an investigation.⁸⁰²

The CA 2006 also confers the Secretary of State the power of investigation of a company's affairs; and has right to appoint an inspector (s) (a barrister and an accountant)⁸⁰³, depending on the situation, and they will report the results of the investigation directly to the Secretary of State.⁸⁰⁴ Also, an investigation order may be requested by a number of company's members not less than 200, or by members who hold not less than one-tenth of the issued shares.⁸⁰⁵

The Secretary of State has the power under CA 2006 to investigate a company for a number of reasons, which are mentioned under this Act; the Secretary can appoint an investigator in the following situations:⁸⁰⁶ if anyone is suspected of intentionally working to defraud the company's creditors or the creditors of any other person, or for any illegal goal; if anyone is suspected of abusing the company's affairs in a way that is unfairly prejudicial to some of its members; when an action by the company is

⁸⁰¹ Through Companies Investigation Branch CIB which is part of the arm of the Department for Business, Innovation and Skills (BIS) and exercises the Secretary of State's powers of investigation under the Companies Acts. Previous to the foundation of BIS, it was part of the Department of Trade & Industry (DTI). For more information, see <www.webarchive.nationalarchives.gov.uk/+http://insolvency.gov.uk/cib/> accessed 18 October 2012.

<<http://webarchive.nationalarchives.gov.uk>>&<www.insolvency.gov.uk/howtocomplain/complainscib.htm>> accessed 19 October 2012.

⁸⁰² See <www.insolvency.gov.uk/insolvency/Companies/company-investigation/when-can-the-service-investigate> accessed 21 October 2012.

⁸⁰³ However, it should be noted that some of provisions of investigation are still retained in act 1968 instead of being incorporated into the act 2006S.

⁸⁰⁴ S. 431 (1) of the UK CA 1985

⁸⁰⁵ S. 431 (2) of the UK CA 1985

⁸⁰⁶ S. 432 (1) of the UK CA 1985.

considered prejudicial, or when the company was formed for an illegal purpose, or the concerned persons in the company's formation or its affairs have been guilty of fraud, or other misconduct towards it or its members; and when the company's members are not being supplied with all the information relating to its affairs that they may logically expect. The courts may also order an investigation.

To apply for an investigation, there needs to be some evidence; the Secretary of State may wish to establish that the applicant has good reason for requiring the investigation.⁸⁰⁷ Accordingly, any application should be supported by evidence submitted by the complainant shareholders, in order to confirm the validity of their complaint. This evidence should confirm there are some doubts or irregularities over the company's behaviour, and that there are reasonable grounds to suspect fraud, serious misconduct, materially wrongful behaviour or serious irregularity in the company's affairs. Furthermore, the inspections are confidential.⁸⁰⁸

Following this, the Secretary of State may decide that there are good reasons for the requested investigation and that it would be in the public interest; accordingly, the Secretary will appoint investigators or decide that there is insufficient basis for the investigation.⁸⁰⁹ When the investigation is decided by the Secretary of State, s/he will appoint one or more inspectors; they will perform their duties in accordance with the wide powers granted in the Act. Therefore, they have the authority to meet all officers and agents of the company, and all officers and agents of any other corporation to attend before the inspectors whenever they are required to do so; the inspectors have the right to place the interviewees under oath.⁸¹⁰ Also, officers in the company must show the inspectors all books and documents relating to the company.⁸¹¹ Further, the inspectors have the power under the Act to investigate a company's affairs even when the company is already under investigation by another body.⁸¹²

⁸⁰⁷ S. 431 (3) of the UK CA 1985.

⁸⁰⁸ Before starting the investigation, the Secretary of State may require the claimant to offer security, to an amount not exceeding £5,000, for payment of the costs of the investigation. See: S. 431(4) of the UK CA 1985.

⁸⁰⁹ The Secretary of State cannot normally investigate in the following points: unincorporated partnerships or sole traders; companies which do not carry on business in either England, Wales, Scotland or Northern Ireland; companies which have been dissolved; companies which are in compulsory liquidation; intervene in any disputes between a company and its shareholders; intervene in any dispute between the company's directors.

⁸¹⁰ S. 434 (1) (3) of the UK CA 1985. See also: [2002] All ER (D) 114 (Apr), *R (on the application of Clegg) v Secretary of State for Trade and Industry and others*.

⁸¹¹ S. 434(1) of the UK CA 1985.

⁸¹² S. 433(1) of the UK CA 1985.

In addition, under CA 2006 Section 1037, the Secretary of State may give investigators the power to gather information from a former investigator, who may have been appointed as an investigator but resigned, or whose appointment has been revoked.⁸¹³ Investigators can also ask any person involved in the company or any third party to provide documents, explanations of the documents, or any other information relating to the company; such questions can be of a wide range and those being asked the questions are obliged by law to provide answers, moreover, investigators have the power to enter and search the premises of the company, to look for any documents or books relating to the investigation.⁸¹⁴

However, if any corporate official or anyone involved in the investigation refuses to respond positively to their demands, the inspectors may apply to the courts, and the court may punish the offenders in an appropriate manner (as if he had been guilty of contempt of the court);⁸¹⁵ the punishment may be a fine or imprisonment or both.⁸¹⁶ The authorities of the Secretary of State in an investigation have been strengthened by the Audit, Investigation and Community Enterprise Act 2004.⁸¹⁷

At the end of an investigation, the results of the final report may lead the Secretary of State to do one of the followings: submit a petition to the courts to find a solution for the shareholders in the company on the basis of unfair prejudicial conduct;⁸¹⁸ apply to the courts to order a compulsory liquidation of the company in the public interest;⁸¹⁹ or present a petition to the courts to request disqualification of the directors or shadow directors of the company (directors can be disqualified for a period of up to 15 years).⁸²⁰

It has been argued that Common Law countries offer a good level of protection to shareholders; this can be seen in the UK, which provides a package of laws to protect minority shareholders.⁸²¹ The statutory protection under CA 2006 for individual and minority shareholders is broader and more

⁸¹³ S. 446 (E) of the UK CA 2006.

⁸¹⁴ S. 448 of the UK CA 2006.

⁸¹⁵ S. 436(1) of the UK CA 1985.

⁸¹⁶ See

<www.business.scotland.gov.uk/bdotg/action/detail?itemId=1084616834&site=202&type=RESOURCES> accessed 25 May 2013.

⁸¹⁷ Jon Rush, Michael Ottley. *Business Law*. Thomson Learning Publishing. London. UK. 2006. P: 272.

⁸¹⁸ S. 995 (2) of the UK CA2006.

⁸¹⁹ According to Insolvency Act 1986 124 (4)

⁸²⁰ See

<www.business.scotland.gov.uk/bdotg/action/detail?itemId=1084616885&site=202&type=RESOURCES> accessed 27 March 2012.

⁸²¹ R, La Porta and Others. Law and Finance, *Journal of Political Economy*. 1998, 106(6), P: 1129.

comprehensive; actually, it is more modern than SCL 1965 in terms of protection for shareholders. Any shareholder has the right to request from the company a copy of the company's articles, or a copy of the company's constitution.⁸²² In addition, shareholders have the right to receive from the company a copy of its annual accounts and reports for each financial year,⁸²³ and the company must send copies to the shareholders at least 21 days before the date of any relevant accounts meeting.⁸²⁴ Moreover, shareholders have the right to inspect and require copies of the register and index of members, without charge. The company has the right either to comply with such requests or to go to court to refuse a request within five working days.⁸²⁵ However, the court may order the company to comply (or otherwise) at its discretion.⁸²⁶

It is interesting to point out that shareholders have the power to require the company to publish on its website any material relating to the audit of the company's accounts, or any circumstances connected with an auditor of the company ceasing to hold office since the previous accounts meeting.⁸²⁷

Under the Section 314 of the UK CA 2006, members who represent at least 5% of the total voting rights have the right to request the company to circulate a statement regarding any matters related a proposed resolution or business affairs; this statement should not exceed 1,000 words. The company, on receiving such a request, must do so,⁸²⁸ as any proposal will be excluded if the statement is deemed ineffective, defamatory of any person, or frivolous or vexatious.⁸²⁹

On the other hand, with respect to statutory protection for shareholders, does SCL 1965 provide minority shareholders with the right of petition to the judiciary to wind up the company? Also, is the shareholder granted the right to demand the company be wound up in the case of the company's affairs

⁸²² S. 32 (1) of the UK CA 2006

⁸²³ S. 432 (1) of the UK CA 2006

⁸²⁴ S. 424 (3) of the UK CA 2006

⁸²⁵ S. 116 of the UK CA 2006.

⁸²⁶ S. 177 of the UK CA 2006.

⁸²⁷ S. 527 of the UK CA 2006.

⁸²⁸ S. 314 of the UK CA 2006.

⁸²⁹ S. 338 (2) of the UK CA 2006. Furthermore, the S. 303 gives the shareholders who represent at least 5% of the actual company's capital can demand the directors to call for a GM. Also S. 342 states that the minority shareholders in the company can ask the directors for an independent report on any poll taken, or to be taken, at a GM. In fact, the S. 633 (2) (4) of the CA 2006 states that the minority shareholders who own not less than 15% of issued shares of the class can object before the court not to change the class rights, on condition that they did not approve or vote in favour of a resolution enforcing this; applying to the court must be made within 21 days after the date on which the consent was given or the resolution was passed. Moreover, A number of shareholders who own not less than 5% of the issued share capital of the company, or by not less than 50 of the members of the company are entitled to cancel the a resolution in the court if any special resolution has been passed to re-register a public company as a private limited company; this request must be made within 28 days after the passing of the resolution. See: S. 633 (2) (4) of the UK CA 2006.

being, or have been conducted in an unfair prejudicial manner, against the interests of the company itself and its shareholders?

Actually, under SCL 1965, there is no provision granting minority shareholders the right to demand the winding up of the company by the court; thus, there is no legal right for the court to accept a request for the dissolution of the company, except in certain cases. These cases are, firstly, where the losses of the company reach three-quarters of the company's capital, and in this case, the board must call for EGM to consider the dissolution (or otherwise) of the company; and secondly, if the board neglects to call an EGM, or it has been impossible to issue a decision in this regard, then it is possible for everyone in the company who has an interest to appeal to the court to wind up the company.⁸³⁰

Based on the above, it has been argued that if the shareholder were given the right to wind up the company through due judicial process on the basis of harmful action, it would be considered one of the most important and fundamental rights ensuring the protection of his interests in the company. Unfortunately, there is no such right in SCL 1965; on this point, the judiciary has the power to accept or refuse an application, in order to avoid arbitrariness on the part of the shareholder, which could possibly harm the interests of the company or its reputation. This right to accept or refuse an application is subject to certain limitations, such as proof of a harmful act or the inability of the company to continue in business, and a financial guarantee must be provided until the completion of the lawsuit.

In the UK, minority shareholders have the right to present a petition to the court to wind up the company. This is a statutory remedy conferred under the Insolvent Act 1986, S. 122 (1) (g); any petition to the court must be on just and equitable grounds.⁸³¹ The winding up of the company can be decided by the court; however, the court can reject a winding up order when an alternative remedy is available to the petitioner (such as CA 2006, S. 994), or that there is some evidence of unreasonable behaviour behind this order, i.e. that there is an alternative remedy.⁸³² However, winding up the company as a statutory remedy will lead to the demise of a solvent company and result in the loss of jobs, and most minority shareholders will not profit from this.⁸³³

⁸³⁰ Saudi Company Law, 1965 Article 148

⁸³¹ Jon Rush, Michael Ottley. *Business Law*. Thomson Learning Publishing. 2006. P: 266.

⁸³² Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 467.

⁸³³ Jon Rush, Michael Ottley. *Business Law*. Thomson Learning Publishing. London. UK. 2006. P: 266.

It is argued that a winding-up order under the Saudi system would be effective and beneficial as a statutory remedy for the protection of minority shareholders; however, it is argued that such a remedy could be a powerful weapon, and certain parties may abuse it. Also, granting the minority this right could lead to disruption of the smooth running of many corporations.⁸³⁴

Thus, it is believed that the winding-up right could be too severe a remedy and that granting shareholders such a right could adversely affect the business affairs of the company. However, such concerns are largely unrealistic, given that this right would only be granted under the condition that a certain number of shareholders demand it. On this point, the court would have discretion in accepting or dismissing the winding-up application, and the court would only order the winding-up of the company as the only available remedy.

In fact, the most important statute remedy for shareholders under CA 2006 is the ability of members to petition the court for relief on the basis that the company's affairs have been conducted in a manner that is unfairly prejudicial to the interests of the shareholders in general or of some portion of them.⁸³⁵ To establish a claim under the S. 994, the aggrieved shareholders must demonstrate that: the affairs of the company in question have been conducted in a manner that is unfairly prejudicial to the interests of the petitioner.⁸³⁶ In order to present petitions for relief on the unfair prejudice ground, a petitioner must have the *locus standi* prescribed by S. 994; "The provisions of this Part apply to a person who is not a member of a company but to whom shares in the company have been transferred or transmitted by operation of law as they apply to a member of a company".⁸³⁷

⁸³⁴ Mahmoud Al-Madani, *Reforming minority shareholder protection in Saudi Arabia and UAE (Dubai): does English company law offer a way forward?* Ph.D. Thesis. 2011. P: 132.

⁸³⁵ Brenda Hannigan. *Company Law*. 2nd Ed. Oxford: Oxford University Press, 2009. P: 413. Section 994 provides, (1) "A member of a company may apply to the court by petition for an order under this part on the ground: That the company's affairs have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial".

⁸³⁶ Robin Hollington. *Shareholders' Rights*. Sweet & Maxwell Ltd. 2010. P: 158. However, unfair prejudicial conduct has many examples: exclusion from management, failure to consult the petitioner, misappropriation of corporate business or assets; mismanagement of the company's business, payment of excessive director's remuneration, failure to pay reasonable dividends to shareholders; and breach the provision of the act. Cited from: Victor Joffe QC, David Drake, Giles Richardson, Daniel Lightman, *Minority Shareholders; Law, Practice and Procedure*, Third Edition. Oxford, Oxford University Press, 2009. P: 176-177.

⁸³⁷ S. 994 (2) of the UK CA 2006. The member of the company, who is mentioned in the above provision defined under S.112, is the "subscribers to the memorandum of the association of the company; and every other person who agrees to become a member of a company, and whose name is entered in its register of members". Consequently, any person may have the right to present a request to the court if he is a subscriber to the memorandum of association, or has entered his name in the register of members of the company. In addition, according to the a provision of S. 994 (2), anyone whose shares have been officially transferred by operation of

The court should be satisfied that the petition is well founded, it may order any such remedy it thinks fit for giving relief regarding the matters complained of;⁸³⁸ it may order the conduct of the company's affairs to be regulated in the future; require the company not to do the act complained of; authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons, and on such terms as the court may direct; require the company not to make any specified alterations in its articles without the leave of the court; provide for the purchase of the shares of any members of the company by other members or by the company itself; and order the reduction of the company's capital accordingly if the company itself purchases.⁸³⁹

In general, the court is not prepared to grant a petitioner the permission to continue derivative proceedings where remedies under S. 994 still exist, such as purchasing the shares, where the shares purchase order almost invariably requires a majority to buy out a minority.⁸⁴⁰

On the other hand, do the minority shareholders under SCL 1965 have the right to prevent or nullify decisions taken at the GM that are marred by abuse of power or are deemed oppressive through the actions or decisions of the controlling majority within the board of directors or in the GM? Article 97 SCL 1965 regulated the provisions for objection; "... all resolutions adopted by the shareholders' meeting contrary to the provisions of these Regulations or of the company's bylaws shall be considered null and void. The GAFC and any shareholder who has recorded his name in objection to the resolution in the minutes of the meeting or who was absent from the meeting for an acceptable reason, may request to invalidate a resolution... Nevertheless an action of invalidation (of the resolution) shall be barred after the lapse of one year from the date of such resolution".⁸⁴¹

According to the provision, the shareholder is entitled the right to object to the resolutions of the GMs if they contrary to the law or the articles of association, on condition that the shareholder attends the meeting and object in the minutes of the meeting. If the shareholder does not attend the meeting, he/she shall not be entitled to object unless there is an acceptable reason preventing his/her attendance. It is argued that the objection is criticized because it does not give effective guarantees to minority

law, and if the company or its directors have refused to enter their name in the company's register, is qualified to be a *locus standi* to apply for a petition on the ground of unfair prejudice. Cited from: Robin Hollington. *Shareholders' Rights*. Sweet & Maxwell Ltd. 2010. P: 326

⁸³⁸ S. 996 (1) of the UK CA 2006.

⁸³⁹ S. 996 (2) of the UK CA 2006.

⁸⁴⁰ Ben Pettet's, John Lowry & Arad Reisber, *Pettet's Company Law: Company and Capital Markets Law*. Pearson Education Limited. 2009. P: 261.

⁸⁴¹ Saudi Company Law, 1965 Article 97

shareholders. An example of this is: the shareholder who has agreed to the resolution and then found out later that it was null for some reason; in this case, the above text does not explain if he/she is allowed to object to the resolution or not; also, it does not explain if it is necessary for the shareholder in order to object to the resolution to attend the meeting, which is practically impossible due to the large number of shareholders in JSCs. Also, the above article does not explain the case of shareholders who did not attend the meeting because they had received an invitation from the company, or their name had been dropped from the invitation list by mistake.⁸⁴² However, such objection shall not be heard a year after the date of the resolution.⁸⁴³ In addition, if the resolution is adjudged invalid, it will benefit all shareholders, regardless of the resolution being passed or not.⁸⁴⁴

Unfortunately, in either SCL 1965 or in the SCGRs, there is no provision that regulates the right of minority shareholders in objecting to the resolutions issued by the GM on the basis of oppression by the majority, discriminatory behaviour, abuse of power or unfair prejudice. In fact, most shareholders are unable to determine whether or not the resolution is true or void.

However, it has already been mentioned that most resolutions are made by the majority that controls the company's management, and their interests are usually above or at the expense of the minority. A further criticism that is directed at SCL 1965 is that it does not assign any role to the minority within GMs; indeed, it does not give this subject any attention. It could be suggested that SCL 1965 should add a new set of rights for minority shareholders, in order to protect their interests as well as the interests of the company.

To sum up this section, redress mechanisms for individual shareholders are present in SCL 1965 to allow for filing a liability action against the company; however, no particular regime is specified in the law or the regulations for minority shareholders.⁸⁴⁵ As well, SCGRs, which were issued in 2006, do not cover the problems that the minority shareholders suffer from directors; however, they should serve to empower their position against oppression of majority. SCL 1965 and more particularly

⁸⁴² World Bank. Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country assessment Kingdom of Saudi Arabia. 2009. P: 26. Available at <www.worldbank.org/ifa/ros_cg_saudia_arabia.pdf> accessed 28 October 2013.

⁸⁴³ Saudi Company Law, 1965 Article 147

⁸⁴⁴ Saudi Company Law, 1965 Article 97 provides, "2- A resolution adjudged invalid shall be considered nonexistent as far as all shareholders are concerned".

⁸⁴⁵ The World Bank. *Report on the Observance of Standards and Codes (ROSC). Corporate Governance Country Assessment Kingdom of Saudi Arabia*. 2009. P: 32. Available at <www.worldbank.org/ifa/ros_cg_saudia_arabia.pdf> accessed 28 October 2013.

Article 76 & 78 do not provide efficient protection to minority shareholders against abuse or oppression by the controlling shareholders. Moreover, most provisions of SCL 1965 need comprehensive amendment to give minority shareholders extensive protection, as they are not protected because of deficiencies in the current law.

6.7 Punishments as Additional Protection of Shareholder

In order to be respected and followed by others, the law has to include a range of penalties which apply to any person who contravenes the provisions of law. Such punishments are considered, in the world of listed companies, as a kind of protection for shareholders, partners, and all of those who have interest in the company. It aims to not violate relevant laws of companies, and thus will force every officer in the company (founders, members of the board of directors, the auditor ...) to comply with the law in order to protect the interests of shareholders and the interests of other groups in the company; in addition to contributing to the prevention of assaults against the company and minimize them.

There are only two articles describing punishments (229 & 230), and unfortunately they overlook many important breaches. SCL 1965 regulates (in the two articles) a limited range of punishments; they require imprisonment from three months up to one year, or a fine of 1,000 SAR up to 20,000 SAR,⁸⁴⁶ or a combination of both, with no violation of the provisions of Islamic law. It can be said that the punishments provided in the current SCL 1965 are very lenient and are not rigid, and certainly there is no fit between them and the gross faults caused to the company and its shareholders. As a result, the aim of these punishments will not be achieved. Also, when the offence is repeated by the same person, the punishment is doubled.⁸⁴⁷

Article 229 of SCL 1965 criminalizes with imprisonment from 3 months up to a year, or a fine of 5,000 up to 20.000 SAR, or a combination of both:

- 1- Any person who deliberately enters false information, or violates the provisions of the law in the documents of the company, such as the constitution of the company, or the prospectus, or in the application for authorization to incorporate it, and the one who signed in such a manner shall be also punished (this also applies to anyone who was involved in distribution if they

⁸⁴⁶ 1 Saudi Riyal equals approximately £0.17.

⁸⁴⁷ Ibid. 1965 Article 231

knew about it).⁸⁴⁸ In addition, the article criminalizes anyone who arranges for the public subscription of shares or bonds if it is done so contrary to the provisions of SLC 1965.⁸⁴⁹

- 2- Any person who offers shares, or who evaluates the in-kind shares exaggeratedly and unfairly.⁸⁵⁰
- 3- Any director of the company, or a member of board of directors if he acquired sham profits or distributed them to the partners.⁸⁵¹
- 4- Any person who willfully gives false statements in the company's budget or the accounts for profit and loss, or in reports of the GM or its partners, or anyone who conceals the company's financial condition by hiding any such false statements in the reports (whether directors, managers, auditor or liquidator).⁸⁵²
- 5- Any person who discloses the company's secrets to others by virtue of his work.
- 6- Any officer in the company who does not apply the binding rules according to the regulations and decisions of the competent authorities; also, anyone who is deemed to be in non-compliance with the instructions of the MOCI, with respect to the obligations of the company in allowing the MOCI delegate to access the company's documents.

The fines for any breaches by the board members are collected from their remuneration; in fact, it can be noted that the fines tend to be small, as the members of the board of directors enjoys large bonuses and allowances. Therefore, the violation is not commensurate with the punishment.

Article 230 of SCL 1965 awards some punishments through fines only, from 1,000 SAR up to 5,000 SAR for each perpetrator of the following;

- 1- Any person who contravenes the provisions of Article 12,⁸⁵³ which stipulates that it is imperative to issue company papers in a manner that indicates their character, such as in terms of name, type and central office; if the company is under liquidation, this too shall be indicated.⁸⁵⁴

⁸⁴⁸ Ibid. 1965 Article 229 (1)

⁸⁴⁹ Ibid. 1965 Article 229 (2)

⁸⁵⁰ Ibid. Article 229 (3)

⁸⁵¹ Saudi Company Law, 1965 Article 229 (4).

⁸⁵² Saudi Company Law, 1965 Article 229 (5).

⁸⁵³ Saudi Company Law, 1965 Article 12, "All contracts, receipts, notices and other documents issued by the company must bear its name and state its kind and (the location of) its head offices... Furthermore, upon dissolution of the company, there must be stated in such document that the company is under liquidation".

⁸⁵⁴ Saudi Company Law, 1965 Article 230 (1)

- 2- Any person who issues shares, debentures, subscription receipts or interim certificates, or who offers them for circulation, is considered contrary to the provisions of SCL 1965.⁸⁵⁵
- 3- Any member of the board of directors, or director, who neglected to send documents as stipulated in SCL 1965 to the GAFC as well as anyone who hampered the work of the auditor.⁸⁵⁶

In contrast, in the UK, CA 2006 contains a remarkably large number of criminal offences; most of them are designed to punish misconduct by companies and directors but some address the conduct of shareholders and even third parties; the offences are spread across a wide range of provisions.⁸⁵⁷ The offences in CA 2006 are comprehensive and more modern; they consist of fines and terms of imprisonment, or both of; for example:

- 1- The directors of a company must not exercise any power of the company to allot shares in the company, except in accordance with authorization by that company;⁸⁵⁸ any director who knowingly contravenes, or permits or authorizes a contravention commits an offence;⁸⁵⁹ a director guilty of an offence shall be liable, on conviction or indictment, to a fine.⁸⁶⁰
- 2- The company and its officers guilty of an offence shall be liable to a fine of no more than £1,000 if they:
 - I. Failed to send a copy of amended articles to the registrar not later than 15 days after the amendment takes effect.⁸⁶¹
 - II. Failed to forward the resolutions or agreements to the registrar within 15 days after they have been passed or made.⁸⁶²
 - III. Failed to give the registrar notice of changes made to the company's constitution by court order, not later than 15 days after the enactment comes into force.⁸⁶³

⁸⁵⁵ Saudi Company Law, 1965 Article 230 (2)

⁸⁵⁶ Saudi Company Law, 1965 Article 230 (3) (4).

⁸⁵⁷ Hogan Lovells & Nigel Banerjee, *Company law made easy - criminal offences under the Companies Act 2006, United Kingdom*, 2010. Available at <<http://www.lexology.com/library/detail.aspx?g=e49e0bcd-2d73-4238-8b89-c0ea9843717e>> accessed 30 May 2013.

⁸⁵⁸ S. 549 (1) of the UK CA 2006.

⁸⁵⁹ S. 549 (4) of the UK CA 2006.

⁸⁶⁰ S. 549 (5) of the UK CA 2006.

⁸⁶¹ S. 26 of the UK CA 2006.

⁸⁶² S. 30 of the UK CA 2006 (including the liquidators)

⁸⁶³ S. 34 of the UK CA 2006.

- 3- The company and its officers guilty of an offence will be liable to a fine of less than £5,000 if they fail to comply with the directions of the Secretary of State regarding the requirements pertaining to the appointment of directors.⁸⁶⁴
- 4- The register of directors must be available for inspection; otherwise, the company and its officers (including the shadow director) will be liable for a fine of no more than £1,000.⁸⁶⁵
- 5- If the company and any officers fail to send the annual accounts and reports for each financial year to every person who is entitled to receive one, they will be liable to a fine.⁸⁶⁶
- 6- Where a director of a company is in any way, directly or indirectly, interested in a transaction or arrangement that has been entered into by the company, he must declare the nature and extent of that interest to the other directors.⁸⁶⁷ Any director who fails to comply with this commits an offence, and will be liable to a £5,000 fine.⁸⁶⁸
- 7- If a company or/and its officers fail to comply with the duty to keep accounting records, they will be liable to a fine or to imprisonment for a term not exceeding two years, or both.⁸⁶⁹
- 8- Any director who gives false information about himself to the company as required by the Secretary of State, or who fails to give such information, is liable to a fine or imprisonment, or both.⁸⁷⁰
- 9- Every company must keep recorded minutes of all proceedings at the meetings of its directors. If a company fails to comply with this, an offence is committed by every officer of the company. A person guilty of such an offence is liable to a fine.⁸⁷¹
- 10- Company's members have the right to circulate a note for the next general meeting; if any officers in the company fail to do that, they may be liable to a fine.⁸⁷²
- 11- The company's officers are guilty and will be liable to fine if they prevent the company from publishing any poll taken at a GM on its website.⁸⁷³

It could be said that the main objective of these punishments (financial, imprisonment or both) is not just to inflict punishment on the offender or violator; rather, it reaches beyond that, as the punishments

⁸⁶⁴ S. 156 (5.6.7) of the UK CA2006.

⁸⁶⁵ S. 162 (6) of the UK CA2006.

⁸⁶⁶ S. 425 of the UK CA 2006.

⁸⁶⁷ S. 182 (1) of the UK CA 2006.

⁸⁶⁸ S. 183 of the UK CA 2006.

⁸⁶⁹ S. 387 of the UK CA 2006.

⁸⁷⁰ S. 989 of the UK CA 2006.

⁸⁷¹ S. 428 of the UK CA 2006.

⁸⁷² S. 314 of the UK CA 2006.

⁸⁷³ S. 341 of the UK CA 2006.

are intended to deter anyone from attempting to commit such offences in the future, or any offence that damages the company's reputation or the interests of its shareholders. Unfortunately, such an objective is apparent in the current SCL 1965, which includes only a limited set of offences with relatively weak punishments; the punishments have no practical effect on the violator, and they need to be reviewed with urgency.

In fact, a great deal of criticism has been levelled at the punishments mentioned in SCL 1965 on the grounds that they are too few and too lenient, and that the law does not include other important violations. The punishments are not commensurate with the violations; in addition, these punishments need, from time to time, to be updated (or cancelled) in line with reality.

It is proposed that these two articles be amended to increase the fines and imprisonment periods, in order to make them more of a deterrent; also, a set of serious violations (not mentioned in the current SCL 1965) should be added, and these violations should be phrased as examples. To regulate such violations, a comprehensive study should be conducted by a specialized team. The goal of these amendments and additions should be to ensure the protection of the interests of the company, the shareholders and all of those who have interests in it. It could be said that such protection needs strong punishments, ones that make the offender think before committing such offences.

Thus, this study proposes amendments and the addition of other offences that need to be mentioned in law. Offenders should be punished with imprisonment for not less than 1 year and up to 5 years, or with a fine of not less than 100,000 SAR and up to 3 million SAR, or both, as follows:

- 1- Every officer or member of the board (or manager using company funds) who knows that it is against the interests of the company, whether directly or indirectly.
- 2- Every officer or member of the board (or former employee) using the powers granted to him by law or the constitution of company, with the knowledge that it is against the interests of the company, in order to achieve personal benefits, whether directly or indirectly.
- 3- Every officer, member of the board or auditor (or former employee) who does not inform the GM of the company or shareholders, upon becoming aware of the company's losses reaching 50% of its capital, or does not announce such a loss to the public.

- 4- The use of funds of the company, its assets and its rights to third parties by the auditor knowing that it is contrary to the general interests of the company, or might intentionally cause harm to the creditors or partners, in order to achieve personal benefits, directly or indirectly.
- 5- Any person appointed to investigate the company who intentionally makes false reports of the events, or intentionally omits core facts that influence the result of the investigation; and all those who intentionally include false statements or ones contrary to the law, in the constitution of company, in the other documents of the company, in the application for a license for establishing the company, or in the documents accompanying the application of establishment, and anyone who signed or distributed those documents, with knowledge of it.
- 6- Any person who impersonates a shareholder or partner, and who then votes at a GM for shareholders or partners, whether personally or through another person.
- 7- Any director who causes deliberately to disable the call for a GM to be held or not be held.
- 8- Any person who neglects to perform his duty in inviting the GM of shareholders or partners to convene within the prescribed period in accordance with the law.
- 9- Anyone who intentionally prevents a shareholder or partner from participating in a GM for shareholders or partners, or prevents him from enjoying the right to vote in accordance with his shares or quota, or as a partner, contrary to the law.
- 10- Anyone who so charged does and write down the minutes of the meetings in accordance with the law.
- 11- Anyone who accepts to undertake the task of auditor, or who continues doing this, knowing that there are reasons preventing him from performing those tasks in accordance with the law.
- 12- Anyone who accepts appointment as a member of the board of directors in the company, or a member named to manage it, or still enjoys its membership contrary to the provisions prescribed herein, and each member of the board of company that witnesses these offences if he knew about them.
- 13- Each member of the board of directors who receives a guarantee or loan from the company in contrary with the provisions of law, as well as the chairman of the board of directors if he knows about such violations.
- 14- Anyone who does not make all of the necessary documents available to the shareholders or partners in accordance with the law.

- 15- Anyone who deliberately hinders those who have the right to inspect the company's papers and documents, accounts and books, by the virtue of the law and constitution of the company; or anyone who causes such hindrance.
- 16- Anyone who gains personal benefit in return for voting in a particular direction, or not participate in the vote, as well as the one who offers that benefit.

6.8 Conclusion

Chapter Six has focused on the protection of shareholders' rights in terms of jurisprudence; this chapter has highlighted the rights of shareholders in seeking to defend their interests and the interests of the company, and to protect them from harmful acts committed by third parties or employees of the company, through the legal means and remedies available in SCL 1965. As already discussed, the greater bulk of the shareholders in listed companies in KSA are small shareholders. This minority should have the right to preserve the interests of the company against any assault that may affect their interests and the company as well.

Unfortunately, in accordance with SCL 1965, the company is entitled to maintain its interests and the interests of shareholders against any detrimental act, whether from within the company or from without; if the company does not file a liability suit against the aggressor through the GM, the shareholders have no right to file a liability claim on behalf of the company and for the company itself. This is considered a violation of the rights of shareholders, and it weakens their position in the company; further, it enables the majority shareholders to control the process of making important decisions in the company.

It was found that there is a flaw in the Saudi system, where the Saudi legislature has clearly combined company suits and individual shareholder suits, despite the differences in their relative positions and in the effects of such suits; it is hoped that the Saudi legislature will reconsider its approach in this regard. SCL 1965 does not give a shareholder the right to file a lawsuit on behalf of the company in

the event of a GM objecting to raise any case in question. It is also hoped that the Saudi legislature will provide clear provisions on a shareholder's right to file a suit on behalf of the company, in order to defend the company and its interests; this would definitely raise the level of protection for all shareholders.

Meanwhile, SCL 1965 gives the shareholder who owns 5% or more of the capital of the company the right to request the MOCI for an inspection of the company's affairs if he has suspicions of fraud or incompetence. This right is an important guarantee for the protection of shareholders; however, it is suggested that the inspection system needs to be amended in its legal provisions to grant more than 200 shareholders the right to request an inspection when they have strong evidence of the existence of fraud within the company; certainly, it would remain the court's power to accept or reject the application. Furthermore, it is believed that it is the duty of the Saudi legislature to provide for this right at all times, and to give the investigators all necessary powers to run the investigation as they see fit in order to prove a case or reject it, to determine the truth of the matter, and to report to the MOCI to decide on any appropriate action within its remit.

Generally, a GM will object to a shareholder filing a suit if it is deemed to threaten the influence of the controlling shareholders who, de facto, manage the company. The current law does not provide any guarantees for minority shareholders against any excessive behaviour on the part of the major shareholders in the company, or against their being prevented from exercising their rights. For example, minority shareholders cannot file to liquidate the company before the courts should they find that the company is being managed only to achieve the interests of a particular class. In this context, the competent court should be given full authority to consider or refuse the case from the beginning. The court must have a greater role in protecting the rights of shareholders, such as the right to modify the memorandum of association, to order the company to purchase the shares of disgruntled shareholders at a fair price, and to dissolve the company should it see fit, amongst others. Again, the Saudi legislature clearly mingles company suits with individual shareholder suits in spite of their clear differences. Accordingly, this study suggests that the Saudi legislature reconsider its approach in this regard in order to allow shareholders the right to protect the company on its behalf in certain cases. Moreover, minority shareholders play only a limited role within the GM, and are largely unable to prosecute the members of the board of directors on the basis of abuse or misuse of power; this matter

is not mentioned in SCL 1965. This is one of the disadvantages of the company law, which has failed to protect minority shareholders. It urgently needs to be rewritten in order to keep pace with the modern commercial era.

Chapter 7: Conclusion and Recommendations

7.1 Conclusion

This study has focused on shareholders' rights in JSCs under SCL 1965. It is one of the few studies dealing with equity within JSCs in KSA in a comprehensive manner; in fact, one of the main reasons for choosing this topic is the importance of highlighting the rights of shareholders, particularly minority shareholders, of protecting them, and of contributing to the dissemination of an investment culture among shareholders.

As we have seen, the shareholders are the owners of the company's shares; the company is a legal entity that is entirely separate from them. The company is the original owner of its assets, and once a person receives shares in the company, he is accorded a set of rights and obligations, which are directly associated with the ownership of those shares, and when he rid himself of them, he frees himself of those rights and obligations.

The shareholders in the company are considered a source of finance in generating the company's capital. Therefore, they deserve profit but must bear loss in proportion to their ownership of the capital. Also, shareholders are entitled to participate in the management of the company as well as in the general policies of the company; these are effected through GMs. GMs are considered one of the most important organs of the company along with the board of directors; each of them has a specific set of authorities as per law or the company's articles, and their goal is to achieve the company's interests, including the interests of shareholders. If the company is liquidated, the shareholders have rights to the assets of the company as a percentage of their ownership. Thus, shareholder's rights exist from the establishment stage of the company until its dissolution stage.

Moreover, this study has identified the shareholders' rights in JSCs that they should enjoy in accordance with the provisions of SCL 1965. In this study, we tackled the provisions of company law in a comparative manner; the most important comparison was made with CA 2006 of the UK. We did this in order to assess the coverage and the existing legislative shortcomings within SCL 1965, and to find appropriate solutions to the problems relating to the rights of shareholders.

In this conclusion, we focus on the most important points that we have discussed in this study in relation to the rights of shareholders, and make some appropriate recommendations in order to promote the protection of shareholders' rights within JSCs vis-à-vis SCL 1965.

In the second chapter, the research described the Saudi State, and mentioned how KSA's legal system functions; this necessitated describing the purposes and mechanisms of the three authorities of state. It found that there are, alongside these authorities, additional powers, principally the authority of the Royal Order. It also showed how some legislations are issued by the Council of Ministers, which has both executive and legislative authority at the same time; this authority in the state is second only to the King. In addition, SCL 1965 was tackled, describing how it was drafted, its position with respect to the legal protection of shareholders in JSCs, and the importance of protecting shareholders and investors within JSCs. Then, it explained how a JSC is established according to the Saudi system, the most important bodies in this, the roles of the board of directors and GMs, and finally how companies are liquidated.

Moreover, in this chapter we reviewed the experience of modern corporate governance regulations in KSA, and found that they have not generally achieved the desired aims. Actually, the SCGRs have been criticized a great deal, and the most important point is they sometimes conflict with the provisions of SCL 1965. On the other hand, many of its provisions are intended as guidelines only, although some of them have been issued in the form of orders/decrees. As for protecting the rights of shareholders, the SCGRs did not introduce anything new, as many of the rules were copied from SCL 1965. Thus, we would encourage the Saudi legislature to reconsider the SCGRs, and to address the shortcomings of SCL 1965, in order to make the protection of shareholders' rights more powerful and effective than it currently is.

On the other hand, many shareholders are unfamiliar with the term CG; there is a general weakness in spreading the concept of CG, and the functions of the CMA in terms of educating investors are limited. Also, there is a need to include other organizations in the dissemination CG; for example, public and private universities in KSA should adopt teaching CG, as the number of academic studies on this subject is very low. This interest in the subject of CG is found in many countries around the world, for example in the UK, where we find many universities teaching CG, emphasizing its importance and the benefits that can flow for the national economy; many academic studies are published every year in these countries, adding new information to benefit their business communities.

Such attempts would definitely contribute to the dissemination of investment culture among

shareholders, and increase knowledge of their rights within the company, which would then result in the exercise of those rights in an efficacious manner. Their observation of the deeds of board of directors would also increase and, in general, this would contribute to improving the legal and commercial environment in KSA.

The aim of this chapter was to give the reader a comprehensive overview of KSA, as every country is different in terms of establishing companies, the legal system of the state, and how the state authorities function. All of these are directly or indirectly relevant to the subject of this study.

The third chapter included a discussion on the various company theories; it sought to determine whether a company is based on contractual theory or institutional theory. The importance of this point is that it relates the position of shareholders and their role within JSCs; however, it was found that there is no easy answer.

Contractual theory believes that a company is merely a contract organized by certain parties, between multiple people who have the freedom to create it; it argues that a company is a private contract and that the state is not entitled to interfere, except in terms of certain organizational aspects. This is why those people are the actual owners of the JSC.

On the other hand, institutional theory considers a company to be a project established in accordance with a resolution by the relevant governmental authority (through certain procedures); i.e. the state has a great role in the establishment and functioning of the company. The role of state in JSCs thus increases under this theory, and shareholders are merely the suppliers of capital.

However, it can be said that a company is not solely a contract, giving the contracting parties complete freedom in organizing it without having to follow the rules established by law. Thus, a JSC cannot be solely a private contract; that is to say, the contracting parties should take into account the rules laid down by the legislature, and cannot ignore the rules of common law, which are mandatory; such rules are found in all legislations due to their importance of regulating the activities of companies (especially JSCs) within the state.

A company is actually a set of contracts between it and its stakeholders; the concept of contractual theory completely disappears in a corporation. A corporation operates according to multiple contracts with several parties, such as creditors, customers, employees, shareholders, suppliers and others. This

is found clearly in the first article of SCL 1965, which stipulates that a company is a contract whereby two or more people commit in a project to provide a share in cash or in kind in order to generate profits, and to distribute those profits and to bear any losses resulting from the project.

We find a clear example of state intervention in the establishment of a company under Article 52, which stipulates that it is not permissible to establish a JSC without a license issued by the MOCI. As we have seen, protection is the demand of all stakeholders (not just shareholders) in a company, and in fact, the legislature interferes in the activities of a company (through mandatory provisions) in order to protect investors and the wider community. JSCs also have minority shareholders, and severe damage could be done to the country's economy as well as individual shareholders if a company is not established and operated in accordance with the law. On this point, the legislature may intervene heavily in order to protect the public interest as well as individuals in JSCs. We find such intervention on the part of the Saudi legislature through several legal provisions in SCL 1965 and in the CML and implementing regulations; these give the MOCI and the CMA a major role to play in the formation and dissolution of JSCs.

Once the license to establish a JSC has been issued, the company becomes a legal person independent from the shareholders, and be the actual owner of its assets; the shareholders are owners of shares in the capital of the company only, and are not owners of the company. In obtaining a share, the owner becomes entitled to a set of rights and obligations associated with the share. However, possession of the company's assets may only be transferred to the shareholders following the liquidation of the company and the fulfilment of all its obligations and debts. After that, the shareholder has the right to retrieve his portion in accordance with his share in the capital of the company.

Also in this chapter, we defined shareholder and share as well as its features. The ownership of a share means ownership of the rights associated with it; the legislature has divided shares into two types only: ordinary shares and premium ones. The shareholder shall exercise those rights within the company under the law and the company's bylaws. A shareholder shall not be prevented in any way from exercising the rights relating to the share, but those can be restricted in certain circumstances. SCL 1965 does not give any definition for share or shareholder, or even for JSC, even though such definitions are important for removing any confusion that may appear. No detailed provisions are available for premium shares; they are only mentioned briefly. This criticism is in addition to others levelled at SCL 1965, one of which is with regard to the article 68 that stipulates that a member of the

board who is also a shareholder in the company is required to provide shares to ensure the performance in the company; and it is a fault that the legal article stipulates that the value of share is very low because it can't deter the member in case of violation. However, there should be a balance between the punishment and the offending act.

The fourth chapter was on the theme of shareholders' financial rights, including the right to dispose of the share (sale, gift, mortgage, etc.), the right to profits, priority in subscribing for new shares, and the right to the company's assets upon liquidation. The shareholder's right is considered an inherent right that cannot be, in any way, prevented from being exercised; the company has no power to prevent the shareholder from disposing of his shares, but some restrictions may be imposed to prevent the disposition of shares for a temporary period.

Having said that, SCL 1965 imposes a set of restrictions in the public interest as well as in the interest of shareholders; also, the company has no right to provide that the shareholder shall not dispose of their shares absolutely. Financial rights are the main reasons for people investing in these companies. Another criticism levelled at SCL 1965 is that it allows Company's board to put new restrictions without stipulating any particular regulations on this matter, which could be extremely dangerous to minority shareholders' rights, on the grounds that this could constitute a motive for controlling shareholders and the board of directors to include such restrictions in the company's articles without criteria controlling their powers. This is on the one hand, and on the other, these restrictions in SCL 1965 undermine the foundations upon which JSCs in particular are based; the most distinctive feature of JSCs is the freedom to trade shares.

We also discussed in this chapter one of the more important financial rights for shareholders, as stipulated in SCL 1965, which is the right of priority in subscribing to shares in the new company before third parties. The company must offer any new shares to shareholders before any other party in order to maintain the balance of power within the company. This right is explicitly stipulated in Article 136 but unfortunately, in the same article, it stipulates that the company's articles may waive or restrict this shareholder right; i.e., the board of directors are entitled to issue new shares without offering them to current shareholders first. Actually, SCL 1965 should have been striven to guarantee this shareholder right unless the shareholder himself surrenders it on his own accord.

As for the company's financial reserves, SCL 1965 permits the board of directors in a JSC to create optional reserves at any time it sees fit; we explained in this chapter the types of reserves and their

importance in the company's financing, as well as in the company's defence against future challenges. Expansion in creating other reserves could result in the board of directors expanding and achieving its interests at the expense of other shareholders, which may then endanger shareholders' interests in the company; it is the duty of the legislature to clarify this matter in order to protect the weaker parties in the company.

Following this, we discussed in this chapter the most important rights relating to the ownership of a share, which is the shareholder's right to annual profits, and we defined the term profit. However, SCL 1965 has been criticized for not defining the term profit clearly in spite of its importance. The annual profits are divided according to the provisions of the law and company's articles; the board of directors recommends the pro rata distribution of profits to the shareholders, which is then approved or rejected at the GM (shareholders may demand an increase).

As indicated in Article 127 of SCL 1965, the shareholder shall receive his share of the profits as soon as the decision regarding the distribution has been issued at the GM; however, a question arises here, which is: what timeframe is acceptable for sending dividends to their rightful owners? The board of directors has the power to determine the date for the distribution of dividends to shareholders but it may delay that distribution for any reason that it sees fit without consulting the shareholders. This is regarded as a serious legislative shortcoming, which needs addressing; the board of directors should not be given the authority to determine the date for the distribution of profits to suit its own purposes. Rather, a specific timeframe should set in the law, to which the board must refer, and in the case of any delay, the board will be liable to legal accountability.

In relation to the illegal distribution of dividends, we discussed the attitude of SCL 1965 towards the question of distributing 'false' profits to shareholders, wherein the board of directors recommends the distribution of a ratio of profits to shareholders, and then deliberately distribute dividends to shareholders even though the company has not achieved any real profits in the fiscal year in question. Such monies are actually taken from the capital of the company, which represents considerable damage the interests of all stakeholders. On this issue, SCL 1965 needs to give more detail; there is only one article, which is No. 8, and the stated penalty for the distribution of illegal profits is weak and is not commensurate with the violation, i.e., it needs to be reformulated.

As for the auditor, he is considered one of the major parts of a company, and plays a significant role in protecting its interests and its shareholders; that is why he must be independent in his work. He must not be subjected to any pressure from within the company, in particular from the members of the board of directors who may be seeking to recommend a certain distribution of profits to shareholders, which they know will be approved or rejected at the GM on the basis of the auditor's report (indeed, the shareholders may demand an increase). The Saudi legislature has emphasized in CL the importance of the auditor and his functions; unfortunately, it gives authority over recommending the distribution of profits to the board of directors. The board of directors has extensive powers at its disposal in selecting or isolating the auditor, and thus he is under the influence of the administration. Therefore, the provisions relating to auditors must be reconsidered in detail, in order to enhance the independence and effectiveness of the auditor.

The last question reviewed in this chapter is the right of the shareholder to the company's assets upon dissolution or liquidation of the company. The JSC is a legal person that has its own property, but as soon as it enters the liquidation phase, its possessions are transferred to its stakeholders, including shareholders. Therefore, a shareholder shall not be deprived from his right to the assets upon liquidation. Also, the company's assets are distributed according to priority; creditors take their shares before any third party, and then the shareholders, who receive monies in accordance with their stake in the capital (if any funds remain).

In the chapter 5, we focused on the position of shareholders and their rights at the GM, and the importance of shareholders exercising their rights. In attending GMs, they exercise the right of supervision and control over the actions of the board, the right to participate in the development of company policy, and the right to vote and object. Undoubtedly, the attendance of shareholders at GMs is a significant issue, as it is only through these meetings that the voice of the shareholders is heard within the company; they can meet the members of the board, question them, and vote for or against their resolutions, as well as object to any other decisions that may affect their interests. The current form of SCL 1965 is criticized for stating the condition that a shareholder shall have at least 20 shares to attend the GMs; it would be better to give each shareholder the right to attend even if he has only one share. The law gives the shareholder the right to attorney, and if he is unable to attend, he may delegate another person, provided that the representative shall be a shareholder but neither an employee of the company nor a member of its management. Actually, the requirement that the

representative shall be a shareholder is onerous and problematic, as the shareholder may not know anyone else in the company.

Many shareholders do not attend their GMs, and most shareholders have little enthusiasm when they do attend; this undoubtedly leaves the door open to the board of directors to manage the company as it deems appropriate, and where there is poor supervision by the GM, the weaker the GM, the stronger the board of directors.

Most studies in this regard indicate that the absence of a shareholder is attributable to various factors, but the main reason is that shareholders find it useless to attend. This is largely due to the acquisition by a small group of shareholders of a large portion of the company, giving them a strong influence at the GMs, resulting in the votes of minority shareholders being ineffective. Another reason is the large number of shareholders who, for quite simple logistical reasons, are unable to attend the GM on a certain date or at a particular time. In addition, attendance can cost the shareholder significant amounts of money and time. This should engender the use of modern technology in order to facilitate the participation of greater numbers of shareholders, through the use of the Internet. However, listed companies in KSA have largely rejected the application of remote voting systems, and they have done so because there is no provision for remote voting in the law. Therefore, SCL 1965 should stipulate some provision for the application of remote voting; however, the truth is that many dominant shareholders inside the companies evade the application of remote voting to continue managing the company as they want.

It could be said that one of the best solutions to the problem of shareholder absenteeism is to spread investment education among shareholders, and to establish bodies especially for shareholders where they can take care of their affairs and communicate with others. In this regard, the company should facilitate the establishment of shareholder groups so that they can, through acting together, represent a force within the company.

Moreover, SCL 1965 stipulates the right of shareholders to question the members of the board and the auditors, and to discuss any issues of concern. Therefore, according to the law, a member of board and the auditor is obliged to answer questions put to them directly, and to support their answers with adequate and convincing evidence. Their annual reports might be issued in ambiguous terms, necessitating clarification for the shareholders during the AGM. In fact, SCL 1965 does not provide

much detail on this point, in particular when directors or the auditor refuse to answer on the grounds of the confidentiality or commercial sensitivity of the information. On the other hand, it is the duty of SCL 1965 to give shareholders the right to send their questions and queries to the company prior to any GM, to be included in the meeting and to be answered in an orderly fashion; this is intended not to waste time at the meeting with repeated questions, or in engaging in irrelevant discussions.

The right to vote is an important shareholder right; when a person owns a share, he is entitled to vote at GMs. All key decisions pertaining to the company are taken through shareholder voting, and as the company cannot prevent a shareholder from exercising his right to vote, any shareholder may file a suit against the company. Also, shareholders are entitled to make conventions among themselves in order to vote in an agreed direction on a specific resolution. Such agreements are important to shareholders; they unite their votes and make them more effective in achieving their interests, which in the long run are the company's interests. On this point, SCL 1965 does not make any reference to shareholders' rights in making such agreements; provisions should be regulating this case to achieve the interests of the company and all of its shareholders. A strong regulatory framework would act as a barrier against any undue pressure being applied by the directors, who may seek to exploit any weakness on the part of minority shareholders; the votes of the latter party would have little effect unless there were some form of cooperation and coordination among them.

As for disclosure of information, this is considered an important right for shareholders and stakeholders. SCL 1965 gives shareholders the right to obtain copies of the reports of the board and of the auditor, and to receive an invitation to a GM together with its agenda; these are briefly described. Unfortunately, SCL1965 does not provide a mechanism for ensuring that the information the shareholder receives is a true and accurate reflection of the real status of the company. Shareholders cannot be expected to play their part in the company's affairs effectively if they are not given the whole and true picture. Accordingly, this matter should be reconsidered within SCL 1965 and the right of shareholders to access all reports and any other information should be reaffirmed, as long as such information does not harm the company; this right should also be free of charge.

In the Chapter Six has focused on the protection of shareholders' rights in terms of jurisprudence; this chapter has highlighted the rights of shareholders in seeking to defend their interests and the interests of the company, and to protect them from harmful acts committed by third parties or employees of the company, through the legal means and remedies available in SCL 1965. As already discussed, the greater bulk of the shareholders in listed companies in KSA are small shareholders. This minority should have the right to preserve the interests of the company against any assault that may affect their interests and the company as well.

Unfortunately, in accordance with SCL 1965, the company is entitled to maintain its interests and the interests of shareholders against any detrimental act, whether from within the company or from without; if the company does not file a liability suit against the aggressor through the GM, the shareholders have no right to file a liability claim on behalf of the company and for the company itself. This is considered a violation of the rights of shareholders, and it weakens their position in the company; further, it enables the majority shareholders to control the process of making important decisions in the company.

It was found that there is a flaw in the Saudi system, where the Saudi legislature has clearly combined company suits and individual shareholder suits, despite the differences in their relative positions and in the effects of such suits; it is hoped that the Saudi legislature will reconsider its approach in this regard. SCL 1965 does not give a shareholder the right to file a lawsuit on behalf of the company in the event of a GM objecting to raise any case in question. It is also hoped that the Saudi legislature will provide clear provisions on a shareholder's right to file a suit on behalf of the company, in order to defend the company and its interests; this would definitely raise the level of protection for all shareholders.

Meanwhile, SCL 1965 gives the shareholder who owns 5% or more of the capital of the company the right to request the MOCI for an inspection of the company's affairs if he has suspicions of fraud or incompetence. This right is an important guarantee for the protection of shareholders; however, it is suggested that the inspection system needs to be amended in its legal provisions to grant more than 200 shareholders the right to request an inspection when they have strong evidence of the existence of

fraud within the company; certainly, it would remain the court's power to accept or reject the application. Furthermore, it is believed that it is the duty of the Saudi legislature to provide for this right at all times, and to give the investigators all necessary powers to run the investigation as they see fit in order to prove a case or reject it, to determine the truth of the matter, and to report to the MOCI to decide on any appropriate action within its remit.

Generally, a GM will object to a shareholder filing a suit if it is deemed to threaten the influence of the controlling shareholders who, de facto, manage the company. The current law does not provide any guarantees for minority shareholders against any excessive behaviour on the part of the major shareholders in the company, or against their being prevented from exercising their rights. For example, minority shareholders cannot file to liquidate the company before the courts should they find that the company is being managed only to achieve the interests of a particular class. In this context, the competent court should be given full authority to consider or refuse the case from the beginning. The court must have a greater role in protecting the rights of shareholders, such as the right to modify the memorandum of association, to order the company to purchase the shares of disgruntled shareholders at a fair price, and to dissolve the company should it see fit, amongst others. Again, the Saudi legislature clearly mingles company suits with individual shareholder suits in spite of their clear differences. Accordingly, this study suggests that the Saudi legislature reconsider its approach in this regard in order to allow shareholders the right to protect the company on its behalf in certain cases. Moreover, minority shareholders play only a limited role within the GM, and are largely unable to prosecute the members of the board of directors on the basis of abuse or misuse of power; this matter is not mentioned in SCL 1965. This is one of the disadvantages of the company law, which has failed to protect minority shareholders. It urgently needs to be rewritten in order to keep pace with the modern commercial era.

In conclusion, this study has found that the rights of shareholders, even in accordance with SCL 1965, are weak; this law does not provide shareholders with all the rights that they should enjoy. Thus, minority shareholders are often subject to the control of majority shareholders, who are generally in charge of the company's management. As a result this, shareholders either do not exercise or do not enjoy certain rights, and they therefore forfeit their natural and intended role, which is to control the activities of the board of the company, and defend their interests. Despite the Saudi government intending to conduct a range of reforms, particularly in the field of trade, SCL 1965 has not been

modified to any significant degree; it is still not sufficiently effective, and does not address many important points relating to shareholders' rights in listed companies. Therefore, there is a need to develop a new company law, one that is modern and compatible with the present era.

This study has focused on the rights of shareholders in listed companies in accordance with SCL 1965; it is hoped that the new law (still under development) will consider the following set of recommendations, which address issues that are lacking in the current form of the law:

- **Recommendations for CL bill**

The new company law must be comprehensive, and covers all details however minor; the best example is CA 2006 of the UK. All relevant persons, governmental departments, shareholders, the business community, competent courts, university professors, lawyers and others must be invited to participate in its development.

- **Recommendations on Saudi Corporate Governance Regulation**

It has been said that the objective of the Corporate Governance framework is to provide a general guideline of best practice for listed companies and their shareholders; this was meant to increase the level of protection for all shareholders, especially the minority ones, and it should serve to empower their position against oppression of majority.

In fact, it has been argued that reforming the laws concerned with investor protection and improving judicial quality are quite difficult, lengthy, and require the support of politicians and relevant bodies; especially on KSA. However, improving corporate governance at the firm-level seems to be a feasible goal. In this context, Saudi legislature have to reconsider the SCGRs, and to address the shortcomings of SCL 1965, in order to make the protection of shareholders' rights more powerful and effective than it currently is.

Therefore, CMA has the greatest opportunity to adjust the SCGRs and to change its status from being 'comply or explain' to being obligatory, particularly given that reforming the CL has taken longer than expected. Such attempts would definitely contribute to the dissemination of investment culture among shareholders, and increase knowledge of their rights within the company, which would then result in

the exercise of those rights in an efficacious manner. Their observation of the deeds of board of directors would also increase and, in general, this would contribute to improving the legal and commercial environment in KSA.

- **Recommendations for MOCI & CMA**

There must be an active and significant role for the MOCI and CMA through monitoring listed companies, inspecting their administrative aspects and financial reports, and addressing any errors or violations of the law or the company's articles; this last responsibility is particularly important as violations may harm stakeholders, especially should the company be passing through bad financial or administrative conditions, or suffering from heavy losses. The primary goal of such oversight would be to improve the level of protection for shareholders within listed companies. There should also be a role for governmental bodies to disseminate knowledge of shareholder's rights within companies, through seminars, courses and advertising.

- **Recommendations on Shareholders General Meetings**

SCL 1965 should be included an explicit provisions for many GM's issues. Such as the legal situation if the board of directors refuses shareholders application to request convening GM. Therefore, shareholders should have right and allowed them to initiate the GM by themselves, or by order of the court, and CL should be regulated this matter in order to protect minority shareholders from potential abuse by the board of directors.

According to SCL 1965, the board of directors is obliged to call an EGM if the company losses reach three-quarters of its capital. This measure is logical but needs modification; even if we assume that the company has lost half of its capital, according to the law, there is no need to call an EGM. It is accordingly suggested that the Saudi legislature adopt the phrase 'significant losses' rather than 'three-quarters' of the capital because losing such a proportion of the capital is considered serious and in need to being dealt with urgently; such losses touch everyone but the greatest impact will be on the minority shareholders.

Moreover, SCL1965 should be required all listed companies to use the modern technology in order to facilitate the participation of greater numbers of shareholders in GMs, through the use of the Internet, Telephone, and Fax. However, it has been argued that distant voting and cumulative voting will enhance participation shareholders on making decisions inside corporations. As well, shareholders should have the right to make agreements among themselves to vote in a certain manner.

In additional, every company must keep recorded minutes of all proceedings at the meetings of its shareholders and directors at least 10 years like to the CA 2006, however, such keeping will be helpful for evidence in any disputes.

Furthermore, the SCL 1965 should amend Article 108, and clearly shows when directors and auditors must to answer the shareholder's question arising during GMs. As well what are the cases that they are entitled to refuse to answers the questions if will damage the company's interests.

- **Recommendations to Establish an Independent Association for Shareholders**

It is believed that shareholders should have their own independent associations that take care of their affairs and that defend their rights. The existence of such associations is necessary, especially for shareholders in KSA, because it ends to be the case that only a few shareholders own a major part of the company, and those major shareholders are usually the ones who manage the company. Many shareholders do not have sufficient knowledge of all their rights relating to ownership; for example, the term corporate governance is known only to a few and is only fully comprehended by professionals in the field.

It is believed that such associations would contribute to providing the necessary means vis-à-vis the exercise of shareholders' rights within the company; they would make them aware of their rights, and serve to disseminate investment culture among them. This could be achieved through training courses; shareholders could have their rights explained to them and be shown how to exercise them, and other important issues facing shareholders could be addressed, such as attending GMs, conducting discussions with company officials, voting on decisions, taking legal action should they uncover violations on the part of board, and other related subjects.

This certainly will also contribute to improving the practice of rights by shareholders within the

company, and the legal defending of his interests; the more knowledge a shareholder has about his rights, the more effectively they are exercised, which will be positively reflected in an increase in the level of protection for the rights of shareholders. Then, the board of directors will take into account the existence of shareholders exercising their rights in practice, including taking control over the work of the board, and questioning them for any violations. The shareholders association concept is available in many legal systems around the world, an example of which is the shareholder associations of the UK.

- **Recommendations on the Members of the Company's Board**

One of the rights of shareholders is that the person(s) who run their company shall be highly qualified; the law must provide certain requirements of persons who wish to join the board of the company, and give the shareholders the right to choose the directors by inspecting the CV of each candidate for membership. Such information should be published on company's websites.

Guarantee shares are provided by the members of the board of directors currently estimated at ten thousand SAR; this is ineffective. The amount must be increased, or a certain number of shares must be stipulated because the currently stipulated amount is insufficient and does not achieve the desired goal of warranty shares.

Furthermore, SCL 1965 does not require the presence of the directors at the GM with the necessary quorum needed as a condition for convening its meeting; however, the CL in certain countries does require the presence of directors at meetings, or at least some of them, as they manage the company, and are required to answer the shareholders' questions or those of other relevant persons such as the auditor or the representative of the MOCI.

- **Recommendations on Auditors**

It could be argued that determining a legal duration of the duty for the auditor of longer than a year would serve to address this shortcoming, and give the auditor greater stability and independence; then the board's influence over the auditor would be weakened. The maximum duration for the appointment of the auditor could be three years (or more) during which he would not be re-elected.

- **Recommendation on Shareholder's Financial Rights**

The Policy of dividends distribution under SCL 1965 is not clear and should be regulated again to avoid any harm to shareholders and any abuse from company's board.

In this context, SCL 1965 does not specify any particular maximum percentages for deductions to Company's Reserves, leaving this matter to the board of directors. At this point, it is important for the Saudi legislature to intervene and to determine a certain percentage for the reserves because not identifying such a percentage gives an excuse for the board to determine a percentage according to their wishes, which may leave no profits for shareholders at the end, or result in the distribution of dividends that do not meet their expectations.

It is true that Article 136 of the SCL 1965 gives the shareholder the right of pre-emption, but this right is need reform, obviously, it is controlled by the board of directors, and consequently the board has the right to approve or cancel it. Actually, there is a defect in the above article where the Saudi legislature should have been more explicit in stating the rights of shareholders, and should not have added any legal subsidiary paragraphs that may allow cancelling, or contradicting the right referred to.

- **Recommendations on the Penalties**

As for sanctions against violating the provisions of the law, whether by members of the board, the auditors, or the employees of the company, they need to be reconsidered. The sanctions are very weak and do not achieve the required goal; they are not considered as a sufficient deterrent to potential offenders, and do not help protect the interests of shareholders. The punishment should be commensurate with the violation.

- **Recommendations on Shareholders Remedy**

All shareholders must be given the right to defend the company's interests on its behalf, which is a fair means of redress, through which minority shareholders have the right to file a liability lawsuit against the aggressor when the GM has not fulfilled its duties in this regard. Obviously, this is considered an exceptional right, which is only enabled in particular circumstances; nevertheless, minority shareholders are entitled to file a suit when the company fails to defend their rights because of the intransigence of majority shareholders in ratifying the filing of a suit. Such a claim must be for the benefit of the company and not for the interests of shareholders; certainly, the Saudi courts should play

an important role in granting the shareholder the right to continue the action or to cease it. The courts should have discretion in accepting or rejecting the lawsuit, without the need to obtain permission from the company. However, it is believed that the derivative action must be organized in great detail.

However, at the end of this research, the question still remains: for the minority shareholders in the current SCL 1965, is there adequate protection that preserves their rights from domination on the part of the controlling shareholders? In other words, do the minority shareholders in listed companies have sufficient and effective rights?

It could be said that the minority shareholders, in the light of SCL 1965 and SCGRs, do not have a set of minimum of rights and safeguards to ensure that they can protect their interests in the company, and that deter members of the board of directors and major shareholders in the company from prejudicial acts.

It has been believed that the position of minority shareholders against majority shareholders is very weak; the majority shareholders still control the company as it thinks right, regardless of the opinion of minority shareholders. It is hoped that the new law, prepared since 2007, will meet the aspirations of all shareholders, but particularly the minority ones, and will help to create a healthy environment for investment, thereby contributing to the generation of financial rewards for all.

7.2 The Contributions of the Study:

Generally, this study aims to improve the level of protection for shareholders in Saudi listed companies, and to emphasize the importance of shareholders having sufficient protection against any encroachment on their interests within the corporation; hence, it aims to recast the provisions relating to shareholders, however, the main contributions of this study are its assistance to fill the gap in the literature concerning current practices of minority shareholders rights in Saudi Arabia through the legal perspective. In addition, to amend and reform the current Saudi company law to support the position of minority shareholders to bring into line with the international standards. The final contribution is to improve corporate governance practice within the listed companies in KSA.

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