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The enforcement of directors' duties in the context of shareholders' rights protection

A comparative study between UK and Saudi law

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LL.B Al-Imam Mohammed Ibn Saud University 2008

LL.M Higher Institute for Judiciary 2011

November 2016

A thesis Submitted for the Degree of Doctor of Philosophy in Law

Declaration

I confirm that the thesis is my own work; that it has not been submitted in substantially the same form for the award of a higher degree elsewhere; and that all quotations have been distinguished and the sources of identification specifically acknowledged.

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Abstract

Corporate governance has been the topic of intense research and policy debates over the past two decades. Clearly, the duties that directors owe to their company are a key component of corporate governance. These duties were introduced in an attempt to create a fair and balanced relationship between shareholders and directors. This balance is needed to regulate tensions between ownership and control of companies. Nonetheless, if directors' duties are not enforced effectively then these obligations will probably have no real impact on corporate management.

The key objective of the current thesis is to analyse and assess the enforcement actions under Saudi law that can be taken against directors in breach of their duties compare to their counterparts in UK. This is done in the hope of benefiting from other countries' more advanced political, financial and legal institutions and avoiding any shortcomings identified in existing legal systems. The newly enacted Companies Law 2015 substantially reformed and modernised company law in the country, yet it has not made any significant inroads in regards to enforcing the duties of directors. It was found that the new legislation requires further amendment and revision.

The study found that the text stipulating the duties of directors in Saudi law that directors' substantive responsibilities are observed, though certain aspects are clearly ignored or neglected. What is required henceforth is for directors under Saudi law to have a broader way of covering director actions and behaviour. Also, it was argued that if directors are in breach of their duty in Saudi Arabia then there is no effective legal course by which private actions can be initiated to punish or reprimand the wrongdoers. On the other hand, the author found that public enforcement actions are not only sufficient but more efficacious compared to private actions and enforcement. Therefore, this study proposes to a number of changes to existing Saudi Law and argues that the legal system in Saudi Arabia would benefit as a result.

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CHAPTER 1. Introductory

1.1 Brief background

The concept of corporate governance has acquired significant interest over the past two decades as both Western and less developed economies have suffered on account of financial crises, economic downturns and corporate scandals. For instance, the Enron and WorldCom scandals highlighted the need for corporate governance provisions to monitor and regulate the activity of multinational corporations on an international scale. As these companies, along with many others, reached bankruptcy on account of investor distrust and financial fraud, the need for a regimented corporate governance framework to ensure greater transparency and protection for the public has been acknowledged[1]. In addition, corporate governance contributes mainly towards protecting shareholders' rights, which includes maximising their profits; participating in general meetings, and being informed when needed, thereby creating an appropriate atmosphere to attract transnational commerce as well as guarantee the economic stability [2].

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[1] Simon Ho and Kar Wong, "A Study of the Relationship Between Corporate Governance Structures and the Extent of Voluntary Disclosure", Journal of International Accounting, Auditing and Taxation, 2001, 10, 139.

[2] See Ruth V. Aguilera, Luiz Ricardo Kabbach-Castro, Jun Ho Lee and Jihae You, "Corporate Governance in Emerging Markets" March 12, 2012, available at SSRN: http://ssrn.com/abstract=1806525 , and also, see David Milman, *National Corporate Law in A Globalized Market*, Edward Elgar, 2009, p28.

Since the late 20th century, several bodies, such as the World Bank and the Organization for Economic Co-operation and Development (OECD), have realised the significant importance of corporate governance. Therefore, they have contributed effectively in this area by creating or developing programs[3]. The Organization for Economic Co-operation and Development (OECD) has played the most significant role in improving the concept of corporate governance as it has established basic principles of corporate governance, which are: shareholders' rights, equitable treatment of shareholders, stakeholders' role, board responsibilities and disclosure and transparency[4], before adding the sixth principles which is ensuring the basis for an effective corporate governance framework[5]. In fact, all the above mentioned principles cannot be applied without the board of directors, so the directors' responsibilities, or in other words the directors' duties, are central to the aforesaid principles.

In this respect, the role of government is to adopt effective principles through binding rules which are enforced by the firms in order to govern any wrongful behaviour, as well as playing a fundamental role whereby a sound framework is

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[3] See John D Sullivan, "Building Sound Corporate Governance for Global Competitiveness" Presentation to the Colombian Confederation of Chambers of Commerce, Cartagena, Colombia, 2000.

[4] OECD Principles of Corporate Governance, by Organization of Economic Co-Operation & Development, 1999.

[5] OECD Principles of Corporate Governance, by Organization of Economic Co-Operation & Development, 2004.

set up for a market economy; otherwise, anarchy would be the result[6]. For example, in the UK, a complicated network of statutory law questions possible misconduct and stipulate director duties. These laws have been created in an effort to right the balance between directors and shareholders[7].

It is indisputable that directors' duties to their company are an important element of corporate governance in particular, and company law on the whole[8]. However, although it is very often that the corporate law in each jurisdictions -including UK Saudi laws- provide an elegant set of rules on the duties owed by directors, this is only one side of the issue. It is essential to have an effective and adequate enforcement scheme, in case of a breach of their duties[9], otherwise, these duties are unlikely to make any real difference to corporate management.

This thesis will examine the ways in which enforcement actions with regard to the directors' duties can be taken, which should lead to good corporate governance, better shareholders' protection, and therefore a successful business for shareholders and the community at large.

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[6] See John D Sullivan, "Building Sound Corporate Governance for Global Competitiveness" Presentation to the Colombian Confederation of Chambers of Commerce, Cartagena, Colombia, 2000.
[7] Shuangge Wen, *Shareholder primacy and corporate governance: legal aspects, practices and future directions,* Routledge, 2013, p.74.
[8] Andrew Keay, "The Public Enforcement of Directors' Duties" January 16, 2013. Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.
[9] *Ibid.*

1.2. The importance of the topic

In terms of the significance of the topic, this stems mainly from the importance of corporate governance itself, as mentioned above. In other words, the importance of the enforcement of directors' duties, based on the fact that this is considered a critical point in corporate governance topics.

However, one may ask: why are the directors' duties so important? The answer to that question is due to the fact that a company is a separate legal entity[10], but without a brain, so it cannot run or act save only through its directors, relying on their stewardship[11]. In other words, being an artificial legal person, the company needs a natural person to act on its behalf. There are two means in which the company can act which involve stockholders in general meetings and the directors. Having said that, the power to institute litigation on a company's behalf, tends to be vested by the articles of association, according to the board of directors. Therefore, when litigation is triggered, since one or more members of the board of directors breach their duties, then the director(s) will encounter a major conflict of interest. This poses a major obstacles in the way of enforcing the directors' duties which have been provided by the law[12]. Hence, it is necessary

[10] The establishment that companies are separate legal entity refers to *Salomon v Salomon & Co Ltd* [1896] UKHL 1.
[11] See Philip Lawton and Yung, Boyce, "Corporate political connection as a determinant of corporate governance in Hong Kong" Northern Ireland Legal Quarterly, 2012, 63, 449.
[12] Hans C. Hirt, *The enforcement of directors' duties in Britain and Germany: a comparative study with particular reference to large companies*. Peter Lang, 2004, p.17.

to find a legal solution for the shareholders, in order to protect their rights and the company's right not to be subject to wrongful practices by the directors.

Also, the importance of the topic can be seen clearly in the way that it is an attempt to deal with the most important elements of corporate governance. Hence, the Kingdom of Saudi Arabia has tended to develop its laws and regulations to cope with global market needs, especially since its accession to the World Trade Organization (WTO) in 2005.

Notable efforts have been made by the government of Saudi Arabia to introduce a stable and strong legal system to structure governance and ensure that the function of human resource management is properly applied all through the country[13]. Moreover, to better safeguard the interests of shareholders, the Saudi Stock Market has introduced a range of policies and guidelines for best practice. Several essential characteristics of the institutional framework for corporate governance in Saudi Arabia can be identified from the perspective of the Saudi Stock Market[14]. Since the start of the 21st century, the Saudi Stock Market has experienced significant development. During the period 2001-2005, there was a nine-fold increase in the market value of shares, from SR. 275 billion to SR. 2438 billion[15]. However, this promising growth was cut short by the market crash in

[13] See Kamel Mellahi,"The effect of regulations on HRM: private sector firms in Saudi Arabia" The International Journal of Human Resource Management 18.1, 2007, 85.
[14] Christopher Robertson, Sulaiman Al-AlSheikh and Ali Al-Kahtani "An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia" International Journal of Public Administration 35.6, 2012, 402.
[15] *Ibid.*

early 2006. The Capital Market Authority (CMA) reacted to this critical situation by publishing a detailed corporate governance regulation mandate with the purpose of informing Saudi state-owned companies about best governance practices[16]. Al-Abbas conducted an empirical research addressing the impact of the absence of corporate governance on earnings management behaviour and questioning whether regulations should be multiplied or minimised if governance rules are to facilitate and promote Saudi commercial development. The findings of this research suggested that there is a necessity to regulate the governance practices used by Saudi companies through the introduction of a monitoring programme[17].

In this regards, a new bill proposing amendments to the Companies Law was passed by the Consultative Council of Saudi Arabia (Shura Council) in 2011 for ratification by the Ministers Council,[18] which has just ratified the bill. Recently, a Royal Decree approving the long-awaited new Companies Law 1437H/2015G has been promulgated by the King.[19]. Section 227 of the new law states that it will come into force 150 days after its publication in the Official Gazette, which took place on 4 December 2015.[20] This means the CL 2015 came into force on 3

[16] See Mohammed Al-Abbas "Corporate governance and earnings management: An empirical study of the Saudi market" The Journal of American Academy of Business, 2009, 15, 301.
[17] *Ibid.*
[18] See Riyadh Newspaper, 21st February 2011, http://www.alriyadh.com/606824 .
[19] The Royal decree NO. 3 in 11/11/2015.
[20] Umm al-Qura Gazette, Companies Law, available at http://www.uqn.gov.sa/News/PDFVersion/UM-ALQURA.4595.pdf (Accessed on 27th December 2015).

May 2016. The Law represents a significant overhaul and modernisation of Saudi Company Law, aligning it closer with global trends and developments in corporate law and governance. For example, the concept of holding companies, the possibility of setting up single-shareholder companies, provision prevention the combination of the post of chairperson with executive positions (including that of CEO) and compulsory cumulative voting have been introduced. Nevertheless, as this thesis will address, the new law has made no major changes to minority shareholders' right to sue directors.

Although the CL 2015 substantially reformed and modernised company law in the country, it still needs to be revised and amended. It is possible to put forth recommendations to amend the CL 2015 according to fresh developments and requirements. The main aspects that demand attention are improvement of the structure of corporate governance, better enforcement of directors' duties, and consolidation of shareholder protection based on the efficiency of enforcement actions.

From this standpoint, the research will aim to contribute to this reform process by benefiting from the experiences of more developed countries in this field.

1.3. Aims and objectives

This thesis aims to analyse and provide a critique of the appropriate methods for the shareholders' protection in light of the enforcement of the duties of the company's board in Saudi and the UK's legal systems. This will contribute to the protection of the rights of shareholders, and enhance confidence and promote greater integrity in the market. To this end, the study addresses three main issues. First, it will clarify the duties of the board in each legal system. Furthermore, it will illustrate misconduct according to actions which are considered to be a breach of the duties, when a director(s) commits them.

Second, the study provides a critical analysis of each of the actions that can be taken, whether publicly or privately, to enforce the duties of the directors; taking into consideration any obstacles which could affect or prevent the establishment of such action.

Finally, it attempts to provide appropriate solutions by learning from other countries' regulations using methods that reveal proven success. This means that the study will try to identify the weaknesses in each legal system in an attempt to find possible solutions, taking into account the economic, political and social structures in each country.

1.4. Methodology

This study will use two research methods – one comparative and one critical – in performing this analysis. Firstly, the objectives of this research will be met using some aspects of comparative law approach. The study will be carried out between the Saudi and UK's jurisdictions in terms of dealing with the enforcement of directors' duties. This will help to clarify the similarities and differences between both laws. This will broaden the horizons for Saudi legislators and reformers which will contribute to improving the scope of laws. Secondly, as the study deals with the situation in the UK and Saudi Arabia, a review of both primary and secondary sources of literature will enable the critical analysis of current practice in each jurisdictions. First, primary resources such as company law, stock market regulations, public agencies' decisions, law cases and other relative laws and regulations will be important sources of information. Secondary resources, including books, journals and papers will be important too, to support the analytical approach of this study[21]. Also, due to the lack of research studies on the topic, this thesis will use some valuable PhD theses as sources where the work has not been published elsewhere.

The UK law has been chosen since it is considered among the most advanced jurisdictions in the area of corporate law, particularly in terms of how it deals with directors' duties and their enforcement. Based on its long experience in this field, this thesis will consider a number of sources of UK law. Court cases and legislation, particularly the Companies Act 2006, have comprehensively covered a number of directors' duties aspects. Even after the introduction of the new Saudi Companies Law 2015, there remain some essential points that have not yet been addressed. Hence, it will be useful to carefully consider relevant UK legislation, as it could significantly contribute to the development of the CL 2015.

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[21] The author has attended a workshop of "comparative research in commercial law-challenges and opportunities-" which took place in Durham University on 25th June 2013.

On this subject it is necessary to discuss the concept of legal transplantation. Legal transplantation has been defined as the transposition of a system of law or rule from one jurisdiction to another and is considered the most productive source of development of the law. Legal transplantation does not involve transplanting the essence of a legal system but rather borrowing substantive laws, legal structures, legal concepts and institutions. In other words, a legal rule originating in one jurisdiction can be transplanted to another verbatim, but will still not be the same legal rule[22]. Legrand maintained that although a rule is likely to understand in a certain manner, there must be certain sorts of epistemological assumptions behind the understanding of rule in particular aspects[23].

Correspondingly, a specific enforcement action may be successful in one legal context but may fail when moved to a different legal environment. That is, the specific conditions in which a legal instrument operates must be considered when any attempt is made to transplant this instrument. If conditions differ the instrument may not function as expected. In addition, reformers of legislation need to confirm that the new law is needed and demanded in a domestic context

[22] Alan Watson, *Legal Transplants*, Scottish Academic Press Ltd, Edinburgh, 1974, pp.19-21.
[23] Pierre Legrand, "The Impossibility of Legal Transplants", Maastricht Journal of European and Comparative Law 4, 1997, 111.

and can be delivered in a way that meets this need.[24] Indeed, too much legal reform can create uncertainty for and can lead to an unstable system.[25]

In particular, while the adoption of corporate notions and structures from other countries is commonplace, this does not mean that challenges do not arise[26]. Stout believes that the task of successfully transplanting the United States' corporate law can vary from only being slightly challenging to extremely difficult. She argues that to enhance the possibilities of effective transmission, we should employ the help of anthropologists, sociologists, historians, and even political scientists[27].

Nonetheless, legal transplantation is a valuable element in the creation and implementation of a new legal strategy and related literature. In order for a legal transplantation to be successful it is necessary for legislators to identify the potential opportunities that the adoption of a legal element can offer. This can be achieved by describing the reasons why the legal transplant is needed.[28] Put

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[24] Daniel Berkowitz Katharina Pistor and Jean-Francois Richard. "Economic development, legality, and the transplant effect" European Economic Review, 47.1, 2003, 165.
[25] See David, Milman, *National Corporate Law in A Globalized Market*, Edward Elgar, 2009, p.37.
[26] *Ibid*, p.24.
[27] Lynn A. Stout, "On the Export of U.S.-Style Corporate Fiduciary Duties to Other Cultures: Can a Transplant Take?" UCLA, School of Law Working Paper No. 02-11. Available at SSRN: http://ssrn.com/abstract=313679 . [Accessed 5 October 2016]. It is submitted that corporate regulations are less complicated to transmit compared to family legislation as they are not as likely to be dismissed by the new country during the transmission process. See Mathias Siems and David Cabrelli, *Comparative Company Law: A Case-based Approach*, Hart Publishing, 2013, p.10.
[28] María Paula Reyes Gaitán, *The challenges of legal transplants in a globalized context*, Diss. University of Warwick, 2014, p.48.

simply, law-makers need to adopt a foreign legal element that has been shown to be effective in its original context to maximise the chances that it will work in a new context[29].

The situation with regard to Companies Law (now 2015; formerly 1965) in Saudi Arabia is complex, given that its general structure was originally promulgated through French and Egyptian Law[30]. Seeking to introduce laws common in Western countries into Saudi Arabia could be problematic, given the country's under-pinning reliance on Shari'ah law. Providing there is no compromise to the principles of Shari'ah, research suggests that appropriate laws and regulations from foreign legal frameworks can be adopted into Shari'ah law[31]. The prevailing view that Islam, the demands of globalisation and the international markets, are mutually incompatible is incorrect, according to Miles and Goulding[32]. The authors concur that the mores attributed to Western capital markets do not necessarily compromise observant practice of the Islamic faith. Rather, the requirements of the international market and globalisation more generally are compatible with Islam.

[29] Mathias Siems, *Comparative Law*, Cambridge University Press.2014, p.190.
[30] Maren Hanson, "The Influence of French Law on the Legal Development of Saudi Arabia" Arab Law Quarterly, 1987, 272.
[31] For in depth see Ch 3, paras 3.1.1.2.
[32] Lilian Miles and Simon Goulding, "Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?" J.B.L. 2010, 2, 126.

1.5 Research question

The research question has been carefully selected to suggest reform to the current Saudi practice of directors' duties and the possible enforcement actions when these duties are breached. This thesis will mainly attempt to answer the following question: To what extent does UK legislation provide effective enforcement actions for directors' duties in comparison to Saudi law?

To this end, this question will be addressed and critically evaluated throughout chapters of the thesis.

1.6 The scope and limitations of the study

This research addresses a number of research questions and involves evaluating current practice in the area of the enforcement of directors' duties in Saudi Arabia with reference to more developed jurisdictions. This paper will discuss the enforcement of directors' duties to protect the rights of shareholders in Saudi Arabia and the UK, including directors' duties towards the company; directors' actions that are considered to be a breach of their duties; possible enforcement actions, and the difficulties that may be faced as regards enforcement. Hence, this study excludes the issue of the protection of non-shareholders, such as creditors and other stakeholders. Therefore, only enforcement actions against the directors of a solvent company with the purpose of safeguarding the rights of the shareholders are analysed here.

This research will primarily consider the situation according to UK and Saudi Arabian law. Nevertheless, it will make reference to other legal systems in developed countries such as Germany, Canada and Australia, when the researcher sees this as beneficial.

1.7 Research Structure

In order to answer the research questions in depth, this thesis is divided into six chapters. First of all, the introductory chapter will provide a brief background to the study, identifying the importance of the research, aims, methodology, questions, scope and limitations.

Chapter 2 will both define what a ‘director’ is and will explain what is required for a person to become a director. As the structure of boards of directors varies, it will then be discussed which structure is most effective to ensure the best possible operation and performance of a company. As a final point, the statutory responsibilities placed on formally appointed directors will be reviewed. Furthermore, as courts have repeatedly applied statutory and common law duties to those directors who are not formally appointed, the different director types acknowledged by both the courts and statute will also be explored.

Chapter 3 will examine UK law and Saudi Arabian and Shari’ah law as they relate to the responsibilities of directors. The responsibilities of directors have always been considered to be central to good corporative behaviour. Correspondingly, director misconduct has been blamed as the driving force behind explosive corporate scandals, Enron, for example. In the UK, the duties of directors and what constitutes a breach of these duties is laid out in the CA 2006 while in Saudi Arabia it is laid out in Companies Law 2015. Saudi Arabian law has the additional component of Shari'ah principles and standards which provide suggestions on how to confront fraud and misconduct and improve the regulatory response. It will be seen that there are a number of similarities in the basic features of the duties of directors in both countries as well as some considerable differences. This chapter will present an evaluation of the responsibilities of directors in both legal systems and will compare and contrast them.

In practice, directors' duties are unlikely to make any real difference to corporate management in any legal system if they are not efficiently enforced. Depending on whether the action is taken by a private party or a state official, enforcement is categorised as either private or public. Private and public enforcement will be examined in Chapter 4 and 5 respectively.

Chapter 4 will examine the efficiency of private enforcement actions. This chapter will be separated into five sections. The first section will address derivative claims under UK law, which can be taken up by minority shareholders on behalf of the company. It will also be discussed whether these actions are recognised by SCL 2015. The second section will concentrate on personal suits, while the third section will explore unfairly prejudicial conduct claims. The fourth section will discuss the additional measures that shareholders can resort to.

Finally, the fifth section will present the impediments to enforcement that arise from the pervasiveness of the principle of majority rule, as well as the drawbacks of an enforcement system underpinned by shareholder action. As regards the scope and limitations of this study, litigation against the directors of a solvent company as a means of safeguarding the rights of shareholders will be the only issue assessed.

Chapter 5 will be divided into three main sections in order to fully address public enforcement. In the first part, public enforcers will be discussed. This section outlines the public decision-making bodies that are authorised to penalise directors who have violated their responsibilities in the UK and Saudi Arabia. The second part of the chapter examines the various measures that can be utilised by state officials in the UK and Saudi Arabia to penalise a director who has violated civil or criminal law. These measures could be outcomes such as director disqualification, financial sanction or even punishment under criminal law. The final section will highlight the obstacles to public enforcement actions.

Finally, the concluding chapter will summarise the research findings. Also, it will provide some recommendations in the hope of contributing to Saudi Arabia's legal reform programmes which are aimed at improving current practice as regards the enforcement of directors' duties. In addition, future research will be suggested and this concluding chapter will identify the key contributions of the thesis.

CHAPTER 2. The nature of the Board of Directors

The everyday influence of boards of directors is not immediately apparent: so people often doubt their importance. However, their significance is clear when disaster strikes, as illustrated by the corporate scandals of Parmalat, Worldcom, Enron[33]. A substantial amount of academic research and a great deal of political debate about governance reform has centred on boards as a result of such corporate scandals and continuing apprehension about corporate governance[34]. Chapter 2 will both define what a 'director' is and will explain what is required for a person to become a director. As the structure of boards of directors varies, it will then be discussed which structure is most effective to ensure the best possible operation of a company. Also, the statutory responsibilities placed on formally appointed directors will be reviewed. However, as courts have repeatedly applied statutory and common law duties to directors who are not formally appointed to that position[35], the different director types acknowledged by both the courts and statute will also be explored. Finally, a summary will be provided.

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33 See Lynn A Stout, *The shareholder value myth: How putting shareholders first harms investors, corporations, and the public*, Berrett-Koehler Publishers, 2012, p.22.
34 See Renee Adams, Benjamin E. Hermalin, and Michael S. Weisbach "The role of boards of directors in corporate governance: A conceptual framework and survey", Working Paper 14486, National Bureau of Economic Research, 2008, available at: http://www.nber.org/papers/w14486.pdf .
35 See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p. 510.

2.1 The definition of a "Director"

The CA 2006 states that a 'director' includes any person occupying the position of director, by whatever name called[36]. Thus, shadow directors, de jure directors and de facto directors are all covered by this definition found in s.250 of the statute[37]. Nonetheless a distinct definition of a shadow director is given in s.251. Section 251 states that a shadow director is someone in accordance with whose directions or instructions the directors of the company are accustomed to act. Apparently, the law-makers evidently deemed it necessary to expand on the unique character of shadow directors.

In Saudi Arabia, no piece of legislation currently includes an explicit definition of 'director'. However, defining precisely what the directors are is vitally important and centres on the key concern of the question by whom the duties of directors are owed? In Saudi Arabian law, in order to be acknowledged as a director, an individual must be formally appointed to this role[38] and thus de facto and shadow directors are not recognised. It is recommended that, when introducing new amendments into the CL 2015, law-makers include a clear definition of 'director' to prevent uncertainty when enforcing the law.

[36] S.250 of the CA 2006.
[37] See Ch 2, para 2.4.
[38] S.66 of the CL 1965, s.68 of the CL 2015.

2.2 The requirements for directors

A director must be formally appointed in order to act on a firm's behalf. The CA 2006 covers what is needed to formally appoint a director in the United Kingdom[39]. The statute states that no one under the age of sixteen can be appointed a company director, although the Secretary of State is empowered to create special regulatory provisions that will allow someone under the age of sixteen to be made a director. These provisions must clarify the specific situations in which such an appointment can be made and any conditions that may apply in such a case[40]. In Australia the law is slightly different and a director of a company must be at least eighteen years of age[41].

No clauses within the CL 2015 make reference to what age an individual must be in order to be recognised as a director. However, the Commercial Court Law (CCL) 1931, s.4, does specify that an individual has the right to engage in any form of trade profession once they achieve the age of majority. The age of majority in Saudi Arabian is eighteen, as decided by the Shura Council (or the Consultative Assembly of Saudi Arabia) [42]. Therefore, to be recognised as a director in Saudi Arabia, one must be a minimum of eighteen-years-old[43]. Yet, it can be considered that the role of a director is not classed as a form of trade

[39] Ss.157-161 of the CA 2006.
[40] Ss. 157(1), 158 (1) and (2) of the CA 2006.
[41] S.201B of the Australian Corporations Act 2001.
[42] Shura Council Decree No: 114 in 1955.
[43] See Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in Saudi Law*, Alhalabi for legal publications, Lebanon, 2006, p. 132.

profession according to the CL 2015 and the CCL 1931. In addition, Saudi Arabian legislation relating to directors is completely silent in regards to how old an individual must be in order to be appointed to a board of directors. It has thus been argued that the CL 2015 should make specify a minimum age requirement for directors.

In UK, the CA 2006 also demands that public companies have a minimum of two directors whereas private companies can have only one[44]. Nonetheless, a minimum of one board member for every company (public or private) must be a natural person[45].

In July 2013, a paper entitled ‘Transparency and trust - enhancing the transparency of UK company ownership and increasing trust in UK business’ was published by the United Kingdom’s Business, Innovation and Skills Department. Following consultation on the paper, in April 2014 the UK government made public what actions it intended to take. The ‘Transparency and trust’ paper suggests that all directors should be individuals rather than corporate directors, and that companies in the UK should not be allowed to appoint corporate directors. The reason for this is that it is believed that the appointment of individuals as directors would improve accountability in regards to who is in

[44] S.154 of the CA 2006.
[45] S.155 of the CA 2006.

practical control of businesses in the United Kingdom[46]. The government, however, decided that a pragmatic approach in these matters was required. In certain sectors of the UK economy[47], corporate governance and transparency are considered to be less important issues and corporate directors are seen as valuable assets. The government is endeavouring to improve the UK's business environment, which includes not introducing onerous restrictions. A default prohibition is thus being implemented, with some exemptions to this prohibition being put in place. Thus, the majority of businesses will be prohibited from appointing corporate directors to their boards, but some businesses will still be able to do this. The goal here is to reduce the appointment of one company as a director of another except in cases where the appointment of corporate directors has less risk attached to it and greater potential value[48]. Following this, the Small Business, Enterprise and Employment Act 2015 was introduced. In this respect, after October 2016 when the S.87 of the Small Business, Enterprise and Employment Act 2015 comes into effect, it is possible that legal persons will no longer be eligible. This is based upon a change in the CA 2006 whereby only natural persons can be employed as a company director[49].

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[46] See "Transparency and Trust - Enhancing the transparency of UK company ownership and increasing trust in UK business –Government response-"published by the Department for Business, Innovation and Skills, April 2014, para.161.
[47] *Ibid*, para.168. The government response does not specify which sectors of the UK economy consider directors' duties more important.
[48] *Ibid*, paras.167-169.
[49] S.87 of the Small Business, Enterprise and Employment Act 2015, and the new s.156A (1) of CA 2006.

In Saudi Arabia, a few decades ago a number of practical problems had arisen in relation to legal persons being appointed to the boards of directors of joint stock companies.

As a response to this situation, in 1989 the then-Trade Minister announced what is referred to as Decision No. 432. This decision introduced a set of rules designed to control the appointment of legal persons to joint stock company boards. A number of limitations to such appointments were implemented. Firstly, a natural person must be appointed by a legal person to act on the legal person's behalf for an unlimited amount of time; secondly, no legal person can be on the boards of three joint stock companies simultaneously; thirdly, s.78 of the CL 2015 applies to the legal person (and the legal person's representative) making it possible for them to be held liable for a violation of a director's duty; and lastly, the legal person's representative can face criminal sanctions[50] if convicted of a crime under the CL 2015 specifically or Saudi Arabian law generally. These crimes include fraud, misuse of funds, distributing false dividends[51] and mismanagement[52].

[50] See Ch 5, para 5.2.
[51] When there is no profit, no dividends may be distributed to shareholders; when dividends are paid without the existence of profits, they are deemed fictitious.
[52] Ss. 229,230 of the CL 1965, ss.212, 213 of the CL 2015.

2.3 Board structures

2.3.1 A unitary or a supervisory board structure?

Inherent in corporate governance is the problematic issue of collective action. A board is one apparatus intended to help settle this issue. A board is responsible for the oversight of a company's actions and the appointment of managers. It also operates on shareholders' behalf in a monitoring capacity. There are **two** chief forms of board structure found in developed nations. The unitary (single) structure is made up of independent directors and managers and blends the monitoring and advisory responsibilities of the board together. In the two-tier (dual) structure the board's monitoring and advisory responsibilities are divided up. A management board oversees the company's operations and a distinct supervisory board, on which managers cannot sit, oversees a company's activities. In particular, a supervisory board oversees the appointment of managers and how they are monitored[53].

In Europe, the US and the UK, the majority of boards have a <u>unitary</u> structure. However, in some European nations, such as Finland and France, <u>two-tier</u> boards are often adopted and in some countries, Austria and Germany for example, a dual board structure is compulsory. A two-tier board will typically comprise a supervisory board and a managing board made up of the company's executives.

[53] See Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka,"Freedom of Choice between Unitary and Two-Tier Boards: An Empirical Analysis" October 1, 2013, Journal of Financial Economics (JFE), 112(3), 364.

Co-determination, that is, the representation of employees on a supervisory board, is also compulsory in Germany[54]. The internal organisation of European Companies, or SEs, is significantly benefitted by the Council Regulation on the Statute for a European Company (SE) 2157/2001 as this Regulation gives European Companies the freedom to determine their own management structure. As per Art.38 (b) of the SE Regulation, founding members of a European Company face no limitations when choosing whether to practice a unitary or two-tier board structure[55].

A unitary board is simpler than a two-tier structure and offers a more efficient decision-making process, quicker reaction times to key events and facilitates better communication between directors and managers. Empirical research has identified that when a CEO is part of the control group a unitary system is favoured. This indicates that control in such organisations is centralised[56]. Also, single board systems that are capital market oriented offer greater flexibility,

54 See Kevin Keasey, Steve Thompson and Michael Wright, *Corporate governance: accountability, enterprise and international comparisons,* John Wiley & Sons, 2005, p.256, and also see Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka, “Freedom of Choice between Unitary and Two-Tier Boards: An Empirical Analysis” October 1, 2013, Journal of Financial Economics (JFE), 112(3), 364.

55 See Jessica Schmidt “SE and SCE: two new European company forms - and more to come!” Comp. Law. 2006, 27(4), 99. For in depth see John Quinn “German codetermination and Ireland's convergence” Comp. Law. 2016, 37(11), 331.

56 See Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka,“Freedom of Choice between Unitary and Two-Tier Boards: An Empirical Analysis” October 1, 2013, Journal of Financial Economics (JFE), 112(3), 364.

slimmed down management structures and improved flow of information[57]. Subsidiaries and smaller companies (that do not have to abide by co-determination) are thus more likely to benefit from a unitary structure[58].

A unitary board of directors in a British company has two key functions which appear to be irreconcilable with each other. The board is the company's ultimate executive organ and is legally obliged to make sure that the actions of the business comply with company law and other relevant legal provisions and to produce and implement business tactics on the shareholders' behalf. The board's second role is to act as the key institutional apparatus through which shareholders are supposed to be able to hold the managers of their assets accountable for their actions as stewards[59]. In conventional single board structures, management and supervision are carried out by the one administrative organ. Yet, a unitary board will generally have wide-ranging discretionary powers to delegate authority as the needs of companies differ. A board may give non-board member managers considerable authority and thus only be responsible for overseeing the management of this authority. In the most permissive systems, the board is given complete control over delegating authority, except in the case of hiring and firing

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[57] See Paul Davies, "Board structure in the UK and Germany: convergence or continuing divergence?" 2001, Available at http://ssrn.com/abstract=262959.

[58] See Jessica Schmidt "SE and SCE: two new European company forms - and more to come!" Comp. Law. 2006, 27(4), 99.

[59] See Kevin Keasey, Steve Thompson and Michael Wright, *Corporate governance: accountability, enterprise and international comparisons,* John Wiley & Sons, 2005, p.104.

rights. This approach is prevalent in the UK where boards generally enjoy all the firm’s powers but are able to distribute these to non-board member managers[60].

In the 1990s, the unitary board structure of the UK came under fire when a number of businesses collapsed and instances of mismanagement were revealed. Analysts looked into the make-up and responsibilities of boards of directors concentrating on the part that non-executive directors played in both monitoring and reprimanding senior executives. It was established that hiring decisions regarding non-executive directors (NEDs) were taken in large part by CEOs. It was also found that boards that consisted of a number of independent members had greater freedom and more authority over CEOs. Companies with these boards performed better but it was postulated that managers may have lacked the motivation to make choices that carried higher risks and returns. Furthermore, it was also found that NEDs can have an effect on strategic decision-making and control but, as compared with CEOs, they may lack adequate information and proficiency. Lastly, it was highlighted by Ezzamel and Watson that requiring NEDs to both monitor executives and act as their equals on boards as managers of a firm did sometimes result in conflict[61].

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[60] See Paul Davies and Klaus Hopt "Boards in Europe–Accountability and convergence."Ecgi, Law Working Paper 205, 2013, 25.
[61] See Mahmoud Ezzamel and Robert Watson, *Wearing two hats: the conflicting control and management roles of non-executive directors,* Corporate governance, 1997, 54-79, and also see Kevin Keasey, Steve Thompson and Michael Wright, eds. *Corporate governance: accountability, enterprise and international comparisons,* John Wiley & Sons, 2005, p.10.

Certain analysts examined closely held companies[62] and established that a two-tier board structure is a helpful mechanism for delegating investment project decisions to qualified managers. Another benefit of the dual system is that creativity is left to the management organ. Qualified managers can do what they need to collect project data without running the risk that key shareholders' (who form part of the supervisory board) incentives in relation to monitoring will be impacted upon[63]. Moreover, it is more feasible that a meaningful division of management and supervisory activities can be achieved in a two-tier system. This division offers an improved balance of authority, more transparency, enhanced responsiveness to stakeholders and better relationships between managers. There are also a number of examples which, in reviewing the type of information passed on to stakeholders, are seen to illustrate that a two-tier system is a more modern business system compared with the unitary system. It was the position of the majority of companies that the chain of command remains the same but that a much-needed gap between directors and managers is created by transferring their existing independent directors to supervisory boards[64]. It has been claimed that, irrespective of the role given to a supervisory board, in Germany large

[62] A closely held corporation is any company that has only a limited number of shareholders; its share is publicly traded on occasion, not on a regular basis.
[63] See Clara Graziano and Annalisa Luporini, "Ownership concentration, monitoring, and optimal board structure." Economics Bulletin 32.4, 2012, 3333.
[64] See Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka,"Freedom of Choice between Unitary and Two-Tier Boards: An Empirical Analysis" October 1, 2013, Journal of Financial Economics (JFE), 112(3), 364.

shareholders can adequately monitor management, monitoring that also advantages minority shareholders. Moreover, a lesser focus on a supervisory board's role as monitor gives them the freedom to engage with the company's stakeholders and to network. The effectiveness of the German two-tier system explains why there has been little public debate in the country concerning the possibility of employing a unitary board structure[65].

In theory, a dual board of directors' structure avoids conflicts of interest in regards to lawsuits. Germany's two-tier system includes the Aufsichtsrat (supervisory board) and the Vorstand (management board). The Aufsichtsrat represents the business's claims against the Vorstand while the Vorstand can bring a claim against Aufsichtsrat members. This arrangement naturally requires that one must be a member of either the Vorstand or the Aufsichtsrat and definitely not both[66]. This kind of set-up has a lot to recommend it on a theoretical basis, however, it is claimed that it does not prove effective in reality[67].

A dual board structure also provides the potential for litigation to be brought by shareholders and the supervisory board (as a collective or separately) against management. Yet, the supervisory board has strong motivation to avoid bringing

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[65] See Paul Davies, "Board structure in the UK and Germany: convergence or continuing divergence? 2001, Available at http://ssrn.com/abstract=262959.
[66] S.90 of the German Stock Corporation Act 2010.
[67] See Hans C. Hirt, *"The enforcement of directors' duties in Britain and Germany : a comparative study with particular reference to large companies"*Peter Lang AG, Euroean Academic Publisher, 2004, p.262.

claims against management as such a claim can appear to indicate that the supervisory organ itself has not carried out its duties effectively. The Bundesgerichtshof's decision in the ARAG/Garmenbeck[68] case is of note here. The decision in this case reflected that the supervisory board, who had decided not to sue, could not rely on the protection of the business judgement rule and thus a higher level of judicial inspection was applied to the supervisory board. Nonetheless, a supervisory board can still exercise a certain level of discretion when it comes to considering the business interests of a company when assessing whether to bring a claim. Unsurprisingly, after the ARAG/Garmenbeck decision, the amount of claims brought against management by supervisory boards went up, especially in the wake of the 2008/9 financial crisis. However, it is still difficult to obtain the necessary empirical data to prove a claim as typically only anecdotal evidence and financial statements are available. Thus, the rate of litigation brought by supervisory boards concerning the liability of directors remains low[69].

Dual and single board structures have one essential difference. In a unitary system monitoring of senior executives is carried out by the board itself whereas in a two-tier system a distinct supervisory board is created to fulfil this function. This essential variation has given rise to a continuing discussion about appropriate

[68] Judgement dated 21 April 2007 – II ZR 175/95.
[69] See Paul Davies and Klaus Hopt, "Boards in Europe–Accountability and convergence."Ecgi, Law Working Paper 205, 2013, 25.

director compensation in a two-tier board structure context[70]. It is claimed by some analysts that directors in a two-tier system are more effective administrators of a company's assets than other agents and have greater disciplinary powers[71]. From this perspective incentive schemes for directors are only of marginal value. However, a contrasting viewpoint holds that information asymmetry is likely to be greater in a two-tier system[72]. This makes monitoring more challenging and thus incentive regimes for directors take on greater importance[73].

Company directors are under a legal duty (s.173 of the CA 2006) to independently evaluate situations. In an attempt to ensure this occurs, the Cadbury Report presented a number of recommendations. The Cadbury Report stated that all boards of directors should include a minimum of three NEDs, one of which can be a chairman of the firm and the minority of which should be from within the firm. Most NEDs should thus be outsiders[74]. The United Kingdom Governance Combined Code has backed this suggestion and argues that boards of directors should have a healthy mix of executive director and NEDs. It is hoped that this

[70] See Jörn M. Andreas, Marc Steffen Rapp and Michael Wolff, "Determinants of director compensation in two-tier systems: evidence from German panel data", Review of managerial science 6.1, 2012, 33.
[71] See Pieter W. Moerland "Alternative disciplinary mechanisms in different corporate systems." Journal of Economic Behavior & Organization 26.1, 1995, 17.
[72] See Martin J. Conyon and Joachim Schwalbach, "Executive compensation: evidence from the UK and Germany." Long Range Planning 33.4, 2000, 504.
[73] See Jörn M. Andreas, Marc Steffen Rapp and Michael Wolff, "Determinants of director compensation in two-tier systems: evidence from German panel data."Review of managerial science 6.1, 2012, 33.
[74] See Adrian Cadbury, et al. *Committee on the Financial Aspects of Corporate Governance*, Gee, London, 1992.

will prevent any one group from taking control of the decision-making process. The Code asserts that independent NEDs should make up a minimum of 50% of a board. So, in a board of nine, four independent NEDs are needed to match the four executive directors (the final board member being the company's chairman) [75]. It can be argued, however, that the Cadbury Report did not go far enough. Safeguarding the independence of NEDs requires more significant efforts such as amending UK company law. If the law were changed so that NEDs had no executive duties but were limited to sitting on supervisory boards and to fulfilling a monitoring function, or the function of introducing a dual system to a company, they could finally be said to be genuinely independent[76].

It is believed that a dual board structure can offer more accountability than a single system can. Additionally, it is not believed that enhanced accountability will compromise a business's performance. If performance was found to suffer this would signify that greater accountability enforces certain costs on at least one of the elements of the business but would not have an impact on the accountability features of the board structure. While relevant features of Germany's two-tier system, it is regularly claimed that delayed reaction to external changes, poor information flow to the supervisory board and ineffective meetings of the supervisory board and overly entrenched staff can all be blamed on a dual board

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[75] S.B1 of the GCC 2010.

[76] See Kevin Keasey, Steve Thompson and Michael Wright, *Corporate governance: accountability, enterprise and international comparisons,* John Wiley & Sons, 2005, p105.

structure. However, these features are not inherent characteristics of the two-tier system[77]. It is acceptable to question who the supervisory board is responsible to, as opinions vary. It was suggested by Keay that because the employees and shareholders elect the board, people may suspect these are the primary groups the board is accountable to. This may be accurate as these groups are also able to prevent members re-joining the board[78].

Of note are the distinct structures of Japanese boards of directors. The first Japanese governance structure includes a board of directors and a supervisory organ (like the dual system). Boards of directors are primarily made up of internal directors and supervisory boards primarily comprise auditors. Japan's second governance system is the American structure which includes just the one board of directors but within which are a number of committees. Article 400 of the Japanese Corporations Act 2006 defines this board structure as a committee governance structure. Such a system requires the presence of audit divisions and all directors must be nominated and duly compensated. A company cannot adopt both board structure types. If a firm opts for the first type of Japanese governance system there is no obligation on the firm to include directors from outside the company[79]. Generally, the most up-to-date government policies on the structure

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77 *Ibid*, p113.

78 Andrew Keay, *Board Accountability in Corporate Governance*, Routledge, 2015, p.155.

79 See K.T. Fung, Z.Y. Gao, J. Gonzalez and K.L. Alex Lau "A study on the ineffectiveness of corporate governance in Japan" Comp. Law. 2014, 35(3), 83.

of boards of directors does promote the use of directors from outside the firm but does also give companies the freedom to determine whether they will adopt an American committee structure or the more conventional Japanese structure including a board of directors and a supervisory board[80].

A number of researchers have argued that as Saudi Arabian legislation does not promote, or even make reference to, the adoption of any particular structure for a board of directors, a unitary model is used by businesses in the country. There are no clauses in the CL 1965 –now CL 2015- restricting the adoption of any particular board structure type, whether it is for a small or large enterprise. Despite companies being given this freedom to choose, as yet no business on the Saudi Arabian stock market has opted for a non-unitary board structure[81].

What the CL 1965 –now CL 2015- does provide, however, is the right for shareholders of a limited liability company (LLC) to keep tabs on the activities of a board or directors and monitor them. If a group of shareholders numbers twenty or fewer people, each shareholder can advise the board directly and has access to relevant documents and accounts. Any agreement or practice that contravenes these rights is considered invalid[82]. If a group of shareholders of an

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[80] Masao Nakamura, "Adoption and policy implications of Japan's new corporate governance practices after the reform", Asia Pacific Journal of Management28.1, 2011, 187

[81] See Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective,* Hard copy, Unpublished PhD thesis in Manchester University, 2008, pp.193,194,245.

[82] S.171(3) of the CL 1965, s.173(3) of the CL 2015.

LLC numbers more than twenty, then a business's activities may be disrupted by their direct involvement[83]. As a result, the CL 1965 - now CL 2015- requires that a supervisory board be created. This board is made up of a minimum of three shareholders[84]. A supervisory board is entitled to oversee the business's actions. It can also make judgements in relation to issues that come before the board of directors and it must grant permission for certain actions to be carried out. Additionally, a supervisory board can call for a general assembly of the shareholders regarding the violation of a director's duty. At the close of each fiscal year, the board submits a paper on the outcomes of its oversight of the business's conduct to the general assembly. If a supervisory board does not call a general assembly despite knowing that directorial transgressions have occurred, then the supervisory board members may be found guilty of negligence[85]. A two-tier board structure, as previously discussed, is useful in regards to utilising qualified managers in closely held companies to make investment choices. The concentrated ownership found in the majority of Saudi Arabian businesses is consistent with the creation of supervisory boards[86].

A defining feature of Saudi banks is the Shari'ah supervisory board (SSB). In 2005, Al-Aljlan completed an empirical study which revealed that two thirds of

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[83] Mohammed Al-Jeber, *The Saudi Commercial Law,* King Fahad National Library, Riyadh, 2000, p.400.
[84] S. 170 of the CL 1965, s.172 of the CL 2015.
[85] Ss. 153 and 170 of the CL 1965, s.172 (5) of the CL 2015.
[86] Mohammed Soliman, "Ownership Structure, Board Composition, and Dividend Policies - Evidence from Saudi Arabia", April 2013, available at SSRN: http://ssrn.com/abstract=2258399.

the Saudi Arabian banks examined (nine in total) had an SSB made up of between two and five Shari'ah scholars, all of which were non-executive SSB members. The remaining third had one sole advisor on Shari'ah. The Al-Aljlan (2005) study examined the part played by SSBs in connection with the business strategies adopted by banks. The majority of directors involved in this research stated that their SSB played no part in deciding or creating their firm's business strategy. The primary function of SSBs is thus to provide opinions on the matters they are presented with[87]. As a result, an SSB is not, in fact, a true supervisory board as it does not oversee the actions of the board of directors nor does it have any direct effect on determining a company's actions. An SSB member is better described not as an overseer but simply as an advisor.

2.3.2. The CEO and the Chairman

Numerous corporate financial scandals have led to harsh criticism of certain board leadership structures, in particular the combining of the chairman and CEO positions. The amalgamation of these two positions in a corporate environment results in a power monopoly that can corrupt the goals of a business to ensure personal prosperity over the prosperity of the company. If the inaction of stakeholders and the board of directors allows personal benefit to be pursued unimpeded, stakeholder value will be misappropriated and legal problems will be

[87] Waleed Al-Ajlan, *Corporate Governance in Saudi Arabia: The Roles and Responsibilities of the Board of Directors in the Banking Industry*, Hard copy, A PhD thesis, University of Nottingham, 2005, p. 289-291.

created for the company. Ultimately, the value of the business will be compromised. This type of behaviour breeds a climate of corruption and self-interest that results stock viability being called into question and valuable employees, who could have assisted in the resurgence of the business, being lost[88].

However, some academics argue that these opinions concerning the dual CEO/chairman position are not supported or borne out in the literature. The contrasting argument is that companies decide on their board leadership structure based on an evaluation of the advantages and costs of various structures in their particular economic and business climate. To determine the impact of splitting or not splitting the chairman and CEO roles, negative performance outcomes in companies who adopt a dual role approach because of external factors has been recorded[89]. It has been found that for the majority of large companies there are more costs associated with splitting than there are advantages, some of which have been ignored by the supporters of dual leadership structures. Among these costs are: the expense of altering succession procedures, information costs, the cost of unpredictable decision-making and the agency costs associated with

[88] Sebastian A. Sora and Samuel M. Natale. "The ethical dilemma of merging the roles of CEO and chairman of the board" Corporate Governance, 2004, Vol. 4(2), 64.
[89] See Aiyesha Dey, Ellen Engel, and Xiaohui Liu. "CEO and board chair roles: To split or not to split?." Journal of Corporate Finance, 2011, Vol. 17(5), 1595.

managing a chairman's conduct. Certainly, the best board leadership structure for a business will be likely to change depending on the economic environment[90].

The vast majority of reports and guidelines on corporate governance released in the United Kingdom suggest that the role of CEO and chairman should be split[91]. The Corporate Governance Code (CGC) 2010 stipulates that the position of chief executive and chairman should not be held by the same person and that the separation of the duties of chairman and chief executive should be clearly defined in writing and with the board of directors' agreement[92]. Importantly, certain jurisdictions, for example Iraq (in 2004 amendments to the country's Companies Law 1997), prohibit members of a board of directors from holding both the position of chairman and CEO[93].

S.79 of the CL 1965 in Saudi Arabia provides that it is acceptable for a member of a board of directors to hold the position of chairman and CEO. Furthermore, the CL 1965 enables a board of directors to choose the chairman and CEO from among its members[94]. Yet, the Corporate Governance Code 2006 indicates that the merging of the position of chairman with another executive role, most notably that of CEO but also general manager or managing director, is not permitted.

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[90] See James A. Brickley, Jeffrey L. Coles and Gregg Jarrell, "Leadership structure: Separating the CEO and chairman of the board." Journal of corporate Finance, 1997, Vol. 3(3), 189.
[91] See Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years On*, Oxford University Press, Oxford, 2005, p.312.
[92] Article A.2.1of the UK CGC 2010.
[93] S. 121 (2) of the Iraqi CL 1997 with its amendments in 2004.
[94] S. 79 of Saudi CL 1965.

However, the CGC 2006 applies only to firms listed on the Saudi Arabian Stock Exchange and is guidance, not law. Nevertheless, s.81 of the new CL 2015 makes it illegal for a director to combine the post of chairperson with executive positions (including that of CEO).

An interesting feature of the configuration of Saudi Arabian boards of directors has been identified by scholars. This feature may be unique to the country. The CEOs of a significant number of firms listed on the stock market, for example, SADAFCO, SAMBA Bank, STC and the Saudi Electricity Company, are not members of their company's board of directors. While no Saudi Arabian legislation actually demands that a CEO of a company also be a member of its board of directors, if this is not the case it may call into question a board's effectiveness. A primary function of a board of directors is to keep track of the actions of the CEO and it is empowered as a supervisory mechanism to discipline senior members of staff. If a CEO is not present on a board it can be argued that the board is not able to effectively monitor an individual who forms the core of the firm's everyday activities[95].

2.3.3. Women directors

A review of the gender mix on boards is a necessary part of any thorough analysis of corporate board systems. In numerous countries, the small amount of women

[95] See Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, pp.193,194,245.

who act as directors on boards of directors has been the cause of much consternation. Some nations, such as France, Sweden and Norway and soon Italy, have utilised legally binding quotas to ensure that the gender balance in boardrooms is more equitable. In the recent past, boardrooms in the UK have shown a trend towards there being higher numbers of NEDs than executive directors and thus concern about gender inequality focuses on women securing NED positions[96]. A recent FTSE report reveals that in FTSE 100 firms, there were over 800 women acting as NEDs while less than 300 held executive director roles[97]. The Davies Review Annual Report 2014 reveals that the number of women on the board of directors of FTSE 100 companies has risen from 12.5% in 2011 to 20.7% in 2014 with two FTSE 100 firms still to welcome a woman onto their boards[98]. It was Lord Davies' recommendation in 2011 that by 2015 at least one quarter of the board members of FTSE 100 companies should be women[99]. The government endorsed the recommendations and the target has been achieved. In 2015 a report was published in which Lord Davies states that over a quarter of positions on FTSE100 boards are filled by women. The

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[96] See Mark McCann and Sally Wheeler, "Gender diversity in the FTSE 100: The business case claim explored", Journal of Law and Society 38.4, 2011, 542.

[97] According to FTSE, the FTSE 100 companies are those who have a bard with an average size of 11 member, see Susan Vinnicombe, Elena Doldor and Caroline Turner,"The Female FTSE Board Report 2014" Cranfield University, 2014.

[98] See Lord Davies, "Women on boards" in Davies Review Annual Report 2014, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/297519/bis-women-on-boards-2014.pdf.

[99] See Lord Davies, "Women on boards" in Davies Review Annual Report 2011, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31710/11-745-women-on-boards.pdf.

recommendation made in the report is for a new voluntary target: women should hold a third of positions on the boards of FTSE350 companies within five years[100].

Former UK Business Secretary Vince Cable praised the EC's decision to abandon compulsory quotas. He argued that the United Kingdom is dedicated to including more women on boards of directors in UK companies but states that any legislative measures are always best dealt with on a national rather than European level. Cable affirmed that the approach outlined in the Davies Review, that is, an approach led by businesses and subject to self-regulation, is the optimal method for the UK to adopt but reassures the EC that the UK will work alongside other Member States to review the EC's proposal and establish a Directive that enhances national initiatives to create more gender equality on boards[101].

The reviewed UK CGC was published in mid-2010. This amended CGC introduced Supporting Principle B.2 which acknowledges the benefits of boardroom diversity. This principle specifies that, when seeking candidates for a board, all interviews and appointments should be based on merit and guided by

[100] See Lord Davies, "Women on boards: 5 year summary" Davies Review, 2015, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482059/BIS-15-585-women-on-boards-davies-review-5-year-summary-october-2015.pdf.
[101] Legislative Comment, "Commission sets "objectives" for female non-executive directors of listed companies", Comp. Law. 2013, 34(2), 49.

objective requirements taking into account the value of having a board that is diverse, including gender diversity.

An alternative account of how gender categories inflect upon governing boards, relating to the enlightened shareholder value (ESV) principle[102], was offered by Valsan. He suggested that leading or authoritative traits are linked to more male characteristics, while conciliatory or collective ones are considered more female. Additionally, he states that ESV principles have affected attitudes towards the prevalence of interpersonal board relationships. Valsan notes that studies of the correlation between authority and gender has revealed women are better at interpersonal relationships than men. Consequently, when a board incorporates both authoritative and collective aspects, Valsan believes the board will be more successful in achieving overall managerial objectives[103].

Although at first women may be appointed to boards as a token gesture, they will nonetheless have the opportunity to participate in all of the activities of a board of directors. Industry type has a significant impact on whether women are appointed to boards. Physical and technical businesses have significantly less women on their boards than do firms from the consumer and economic industries[104]. The appointment of women to boards should not be done because it

[102]See Ch 3, para 3.3.3.2.
[103] Remus Valsan, "Board gender diversity and the enlightened shareholder value principle" Comp. Law. 2016, 37(6), 171.
[104] Mark McCann and Sally Wheeler, "Gender diversity in the FTSE 100: The business case claim explored", Journal of Law and Society 38.4, 2011, 542.

could be ‘good for business’. Women deserve a place on boards due to their economic participation and their justified calls for equality[105]. However, European nations such as Spain face a serious challenge in encouraging the appointment of women onto boards as their history and culture is steeped in the concept of male dominance, a concept that is so ingrained that it manages to continue without attracting any real censure in the country. Removing this entrenched cultural attitude will be hugely challenging[106].

According to statistics concerning the number of women on boards in the GCC, including Saudi Arabia, only 5% percent of directors on the boards of family companies are women[107]. The rights of women in Saudi Arabia have long been a highly contentious issue. However, substantial attitudinal shifts concerning women’s rights have occurred recently. For example, women can now be appointed to the Majlis al-Shura, or consultative council, and have been allowed to vote since 2015 municipal council elections[108]. These developments indicate that Saudi Arabian law-makers have become more mindful of women’s social, political and economic rights. As a natural progression of the rights of women in

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[105] *Ibid.*

[106] See Isabel Huerta Viesca “Women on the boards of major Spanish corporations after the entry into force of the Organic Equality Law 3/2007” Comp. Law. 2010, 31(7), 219.

[107] *Alhayah newspaper*, “5% is the percentage of women in GCC family companies’ boards”, 2014, available at: http://goo.gl/FyA7IZ.

[108] See Roel Meijer and Paul Aarts, *Saudi Arabia between Conservatism, Accommodation and Reform*, Netherlands Institute of International Relations, 2012, p.40.

the country, new legal provisions should be introduced compelling firms to appoint female board members.

Given its status as a Gulf country, it is interesting to note that the United Arab Emirates has recently implemented quotas associated with gender. As one of the initiatives of this scheme, legislation has been brought forward to motivate organisations to approach gender parity regarding directorial company boards, and, as stipulated by the Ministerial Resolution 225 of 2012, it is necessary for the board of directors in joint stock companies to have a minimum of one female member[109]. The underlying rationale for such a ruling is that having at least one female member on boards of this kind will serve to represent women equitably at the leadership level, thereby meaning that female interests will have some level of representation in the decision-making sphere[110].

As previously noted, female representation on directorial company boards in the United Kingdom rose above one quarter of all the positions held in FTSE 100 boards, and this took place even in the absence of pertinent legislation. In this way, in contrast to the United Arab Emirates, the method adopted in the UK is characteristic of the free market ethos of allowing companies themselves to

[109] Amending some provisions of the Ministerial Resolution 518 of 2009 concerning Governance Rules and Corporate Discipline Standards

[110] Sandeep Gopalan and Katherine Watson, "An Agency Theoretical Approach to Corporate Board Diversity" San Diego Law Review, 52(1), 2015, 1. Also, see PM HH Sheikh Mohammed, Twitter (Dec. 9, 2012, 3:36 AM), accessible at https://twitter.com/HHShkMohd/status/277738773746417664 [Accessed March 24, 2016].

determine the most viable course of action[111]. Many commentators suggest that this is a favourable avenue to take, primarily because legislating for the representation of women on directorial company boards could have the impact of leading to positive discrimination[112]. Furthermore, given that the degree to which boards are diverse in terms of gender constitutes a socially-informed responsibility, as determined by responsive theory[113], businesspeople who are motivated by social responsible conduct are likely to have their actions informed and directed by a self-regulatory framework[114].

Recently, the Growth and Emerging Markets Committee of the International Organization of Securities Commissions (IOSC)[115] indicated that board diversity, including gender, ethnic, age and level of expertise, should be encouraged through recommendations and guidelines. To incorporate these diverse elements into a homogenous whole, the IOSC proposes that a balance of appropriate skill-sets, experience and capability should be achieved[116].

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[111] *Ibid*.

[112] Aaron Dhir, *Challenging boardroom homogeneity: Corporate law, governance, and diversity*, Cambridge University Press, 2015, p.21.

[113] For in depth see Ch 5, paras 5.3.2.

[114] See Ian Ayres and John Braithwaite, *Responsive regulation: Transcending the deregulation debate*. Oxford University Press, 1992, p.24,25.

[115] Saudi Arabia is a member of IOSCO Board.

[116] The Growth and Emerging Markets Committee of the International Organization of Securities Commissions (IOSC), *Report on Corporate Governance*, October 2016, available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD544.pdf [Accessed October 30, 2016].

2.4 Types of directors

Formally appointed directors are subject to general statutory obligations. However, it has historically been the case that the courts apply common law as well as statutory duties to people who are not formally appointed as directors but appear to fulfil that role[117]. As previously stated, the definition of a director given in the CA 2006 includes anyone acting as a director regardless of the actual name their position carries[118]. A 'de jure director' is a director who has been formally appointed to that position. However, in certain cases natural or legal entities carry out the same tasks as formally appointed directors despite not being properly appointed to this role themselves. This type of director is legally treated as a de jure director but is known as a 'de facto director'[119]. In *Secretary of State for Trade and Industry v Hall and Nuttall*[120], it was held by Evans-Lombe J. that the definition of a de facto director as given in *Re Hydrodam Ltd*[121] by Millett J. demands that an individual takes some sort of positive action in order for it to be concluded that s/he was in reality behaving like a director of a company[122]. However, as will be explained below, in *Re Paycheck Services 3*

[117] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.510.
[118] S.250 of the CA 2006.
[119] See Evripides Hadjinestoros "Fear of the dark: banks as shadow directors" Comp. Law. 2013, 34(6), 169.
[120] [2006] EWHC 1995 (Ch).
[121] *Re Hydrodam (Corby) Ltd* [1994] B.C.C. 161.
[122] *Secretary of State for Trade and Industry v Hall and Nuttall* [2006] EWHC 1995 (Ch) at 30.

Ltd (HM Revenue and Customs Commissioners v Holland)[123], it was affirmed that this is not sufficient to make a one a de factor director of a company.

'Shadow director' was first defined in the Companies Act 1980 and then again in the Directors Disqualification Act (CDDA) 1986 and the CA 2006. According to these definitions a shadow director is someone whose instructions company directors habitually follow. Other advisers, such as solicitors, who offer directors guidance, which they may follow, in their capacity as a professional are not considered to be shadow directors[124]. However, if such an adviser steps outside the purview of her/his role as a professional then s/he may be deemed to have acted as a shadow director. It is argued by Morritt L.J. that a shadow director does not literally have to be relegated to the shadows. Even when an individual comes from inside a firm they can behave in such a way as to make them a shadow director[125].

For someone to be deemed a shadow director the majority of directors of a board must follow their instructions almost instinctively and without entering into any decision-making process, and this must become the habitual response to directions given by this person[126]. Millett J[127]. clarified that if directors use their own judgement in deciding whether to follow someone's instructions this

[123] [2010] UKSC 51.
[124] See S22 (5) of the CDDA 1986 and S251 of the CA 2006
[125] *Secretary of State v Deverell* [2001] Ch. 340 at 354–355.
[126] *Lord (Liquidator of Rosshill Properties Ltd (In Liq.)) v Sinai Securities Ltd* [2004] B.C.C. 986 per Hart J. at 27.
[127] *Re Hydrodam (Corby) Ltd* [1994] B.C.C. 161 per Millett J. at 163.

'someone' will not be considered to be acting as a shadow director[128]. To become a shadow director an individual may engage in widespread monitoring of a firm's actions, which can occur in a variety of ways, or may be actively involved in appointing staff and directors. It is typically stakeholders and blockholders (large shareholders) who bring about high levels of monitoring as they are eager to prevent directors from acting according to their own self-interests as much as possible[129].

According to English law a company may be a legal person (a corporate director) or a natural one. Before the CA 2006, it was allowed for a corporate director to be the sole director of any other business. A firm itself can behave as a de facto or shadow director of any other firm or can formally be appointed a de jure director of another firm[130]. It is possible that, in the scope of the internal management systems of a firm acting as a corporate director of a different firm, a director of the primary firm can be found to also act as a director of the secondary firm despite having never been properly appointed to this position within the secondary firm. This form of directorship would be a shadow or de facto directorship[131].

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[128] See Evripides Hadjinestoros "Fear of the dark: banks as shadow directors" Comp. Law. 2013, 34(6), 169.
[129] See Evripides Hadjinestoros "Stigmata of fiduciary duties in shadow directorship" Comp. Law. 2012, 33(11), 331.
[130] See e.g., *Re Hydrodam (Corby) Ltd* [1994] B.C.C. 161 Ch D.
[131] See Stephen Griffin, "Establishing the liability of a director of a corporate director: issues relevant to disturbing corporate personality", Comp. Law. 2013, 34(5), 135.

It has been held by Millett J. that, in this context, the director of the primary company will not be seen as a shadow director for the secondary company if it can be illustrated that all the director did was to engage in and possibly affect the activities of the secondary company. Millett J. clarified that personal liability to the company in which an individual is a director (or that company's creditors) may, in some rare cases, exist if a director of one company attends board meetings and votes with the board members of a secondary company. However, this fact alone will not make this individual a director of the secondary company[132]. It is Millett J.'s view that if the activities of a director consist simply of acting as a director for the final holding company then it is not the individual who is the shadow director but the holding company itself[133].

Consider a situation involving a director who is a director of the only corporate director of a different, second company. Can, and if so to what degree, this director be held liable for the mismanagement of the assets of the other company? This question was recently posed in *HM Revenue and Customs Commissioners v Holland*[134]. In the court of appeal, it was held by Rimer L.J. that, to be held liable, the questionable action/s concerning the affairs of the second company must be directed by the corporate director rather than the second company's own board of directors. It can be argued that this is quite a specialised distinction but it is still

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132 *Secretary of State for Trade and Industry v Hall and Nuttall* [2006] EWHC 1995 (Ch) at 30 at 184.
133 *Re Hydrodam (Corby) Ltd* [1994] B.C.C. 161 Ch D per Millett J. at 164.
134 [2009] EWCA Civ 625.

an important one in the context of company law where a separation between directors and the company itself is acknowledged[135].

Finally, in *Re Paycheck Services 3 Ltd (HM Revenue and Customs Commissioners v Holland)*[136] , by a majority of three to two, with Lord Walker and Lord Clarke dissenting, the Supreme Court upheld the previous decision of the Court of Appeal which had held that Mr Holland was not a de facto director of forty-two different firms. It was argued by Lord Hope in the Supreme Court that what Mr Holland had done was simply to carry out his duties as a director of the corporate director of the forty-two organisations. Lord Hope affirmed that these actions were not sufficient to make Mr Holland a de factor director of the firms[137].

In the context of the introduction of s.155 of the CA 2006, which requires that all firms have a minimum of one natural person as a director on their boards, it is suggested that the impact of the decision in this case is quite narrow[138]. However, of significance is the fact that it was not until *Re Paycheck Services 3 Ltd (HM Revenue and Customs Commissioners v Holland)* that the Supreme Court was faced with and debated the issue of shadow and de facto directors[139].

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[135] *HM Revenue and Customs Commissioners v Holland* [2009] EWCA Civ 625.
[136] [2010] UKSC 51.
[137] *Re Paycheck Services 3 Ltd (HM Revenue and Customs Commissioners v Holland)* [2010] UKSC 51.
[138] See Georgina Ball, "Case Comment: Holland v HMRC [2010] UKSC 51" UK Supreme Court Blog, January 2011, available at:http://ukscblog.com/holland-v-hmrc-2010-uksc-51/
[139] See Len Sealy, David Milman and Peter Bailey "*Sealy and Milman Annotated Guide to the Insolvency Legislation*" Sweet & Maxwell, (19th ed) 2016, vol.2, p.68.

However, S.251(3) of the CA 2006 states that in particular circumstances, corporate bodies can be excluded from being treated as shadow directors. This section states that, especially in regards to the general responsibilities of directors but also in relation to transactions that board members must approve and contracts with the sole member who is additionally a director, a corporate body will not be considered a shadow director of its subsidiaries because these secondary businesses are used to acting in a way that accords with the directions of the corporate body. However, after October 2016 when the S.87 of the Small Business, Enterprise and Employment Act 2015 comes into effect, it is possible that legal persons will no longer be eligible. This is based upon a change in the CA 2006 whereby only natural persons can be employed as a company director[140]. It is important here to question whether there is any meaningful difference between a de facto director and a shadow director. The courts have continually blurred the lines between these two types of directors in their unsuccessful hunt for those bodies or individuals with genuine influence over the affairs of a particular firm[141]. In *Re Paycheck Services 3 Ltd (HM Revenue and Customs Commissioners v Holland)*[142] it was confirmed that no one definition of a de facto director exists and there is no solid test for establishing that someone is a de facto director. The findings in this case established that it is in fact unnecessary for only

[140] S.87 of the Small Business, Enterprise and Employment Act 2015, and the new s.156A (1) of CA 2006.
[141] See Brenda Hannigan, *Company law*, Oxford University Press, 2016, p.168.
[142] [2010] UKSC 51.

one definition to exist and the term ‘de facto director’ can be applied to a range of situations[143]. Therefore, it is possible for someone to be a shadow director and then a de facto director (or vice versa) or even to be a shadow director and a de facto director at the same time. For example, an individual would be both types of director simultaneously if they assumed the tasks of a director in relation to one aspect of a firm’s business (de facto), e.g. marketing, and then instructed the board of directors in relation to another aspect (shadow), such as financial affairs[144].

Although the term ‘shadow director’ does not exist in Australian law, the idea of a shadow director does form part of the definition of a director given in s.9 of the Corporations Act 2011. This section provides that if an organisation habitually acts on the instructions of a particular individual then this individual will be deemed to be a director regardless of whether they have been properly appointed to this position[145]. In UK law, a separate definition for shadow director is provided, separating this form of directorship from the others, a separation that is not made in Australian law. In the UK shadow directors are referred to specifically and thus not all of the statutory regulations placed on directors apply to them. By contrast, in Australian law shadow directors come under same

[143] See Len Sealy, David Milman and Peter Bailey “*Sealy and Milman Annotated Guide to the Insolvency Legislation”* Sweet & Maxwell, (19th ed) 2016, vol.2, p.68. Brenda Hannigan, *Company law*, Oxford University Press, 2016, pp.161,162.
[144] *Re Mea Corporation Ltd; Secretary of State for Trade & Industry v Aviss* [2007] 1 B.C.L.C. 618.
[145] S.9 of the Australian Corporations Act 2001.

umbrella as any other director type and are therefore subject to all of the rules applied to the directors of a company[146].

In this respect, in order to distinguish a fiduciary within English legislation, the typical definition relies on whether or not a prior form of status or relationship-based fiduciary already exists. Additionally, and in contrast to de jure and de facto executives, the nature of the association between organisation and shadow executive is not pre-decided[147].

Beyond the accepted categories of fiduciary relationships, a fiduciary relationship will also arise when an individual makes an express or implied undertaking to act on behalf of another person (fact-based fiduciaries). This is the so-called "undertaking test". Although this form of assessment may be utilised to confirm the relationship of shadow executives in a fiduciary association with the organisation, it cannot be considered exhaustive[148]. The Canadian *Frame v Smith*[149] case, provided another precedent for this with the 'power and discretion' assessment, which has three primary features. These consist of whether or not the fiduciary can potentially perform an authoritative role or function (i.e. power), whether the fiduciary may actually perform that action in order to impact upon the lawful or concrete benefit of the recipient, or if the recipient will be dependent

[146] See George Forrai, Frederick Horsey and Diana Purdy-Tsang, "Hong Kong Shadow Directors: Patchwork Provisions or Blanket Protection." Comp. Law. 1997, 18(7), 202.
[147] Colin Moore, "Obligations in the shade: the application of fiduciary directors' duties to shadow directors" L.S. 2016, 36(2), 326.
[148] *Ibid*.
[149] [1987] 42 DLR (4th) 81.

upon the discretion or power of the fiduciary. Overall, the case discovered that when the power and discretion mode was applied, more precise findings may be gleaned from the investigation of specific relationships. Although the above method may be used to validate specific fiduciary relationships on a case-by-case basis, it may be considered objectionable as discrepancies will likely result. As an alternative, Moore suggested that in addition to the status-based fiduciary relationships, additional validation should occur through a combination of the power and discretion examination, and the undertaking assessment[150].

Over the past twenty years Saudi Arabia has been following the lead of Western nations in regards to its legislation, especially in relation to company law. However, as yet the Saudi Arabian legal system does not recognise 'shadow' or 'de facto' directors. If Saudi Arabian law-makers were to recognise these two forms of director, this would make firms and their directors more accountable for their conduct. It is thus recommended that new laws be introduced to ensure that the perpetrators of bad corporate conduct be held responsible for their actions.

The UK Governance Combined Code makes specific mention of non-executive directors[151] but no clear definition of NEDs is given. In fact, no legislation in the United Kingdom offers a definition of either an 'executive' or a 'non-executive' director. Typically, an executive director works full-time in this role and is given

[150] Colin Moore, "Obligations in the shade: the application of fiduciary directors' duties to shadow directors" L.S. 2016, 36(2), 326.
[151] S.B1 of the GCC 2010.

particular functions to carry out that are connected with the everyday business affairs of the firm. The CEO (chief executive officer) is one such executive director and is ultimately responsible for the management of the firm's business activities. A non-executive director, however, is employed by the company to work part-time, rather than full-time, as a director and is not allocated the job of supervising the firm's day-to-day activities[152]. However, a directorship is not a job, it is an office. Thus, a director is in fact continually on-duty throughout their directorship and is bound by their fiduciary responsibilities at all times[153].

The Saudi Arabian CGC recognises three types of director: executive, non-executive and independent. An executive directorship is defined in the CGC as a full-time corporate role that is remunerated by a monthly salary and involves administrative work[154]. A non-executive directorship is defined in the CGC as a part-time role for which the director does not receive a monthly salary and which does not concern administrative work[155]. As previously stated, the CGC is largely only guidance but as such it provides the framework for practice and certain of the provisions issued by the CMA Board, namely art.2.b, do create legally binding rules and regulations. In 2008, the CMA Board released the legally binding Decision No. 1-36-2008 which requires that all firms listed on the Saudi Arabian Stock Exchange act in compliance with art.12(c) of the CGC. This article

[152] See Andrew Keay, *Directors' Duties*, Jordan Publishing, Bristol, 2014, p.10.
[153] *Gwembe Valley Development Co. Ltd v Koshy* [1998] 2 BCLC 613.
[154] Article 2 of the CGC 2006.
[155] *Ibid*.

states that the majority of directors sitting on a board of directors should be non-executive directors[156].

An independent director is completely independent from the company on whose board they sit. Official rules stipulate when a director cannot be considered independent. Firstly, a director is not independent if they own a controlling interest in the firm or a subsidiary or have been senior executive for the firm/subsidiary for a period of two years. Secondly, a director is not independent if they own 5% or more of the firm or its group or is a representative of a legal person who owns such a stake. Thirdly, a director will not be considered independent if they are a director of a firm that falls within the body of the original company. Fourthly, a director is not independent if they have, for a period of two years, been an employee and partner of the firm or any other related firm (inclusive of senior suppliers and external auditors). Finally, a director will not be considered to be independent if they are a relative of a senior executive or other board member of the firm or any of the firm's subsidiary businesses[157].

Despite the CGC's role as a guiding instrument rather than a legal one, the CMA Board's issuance of Decision No. 1-36-2008 makes certain provisions legally binding. This decision demands that all firms listed on the Saudi Arabian Stock

[156] Article 12 of the CGC 2006.
[157] *Ibid*.

Exchange act in accordance with art.12(E) of the CGC. This article states that at least two seats on every board (or a third of seats, whichever is more) be held by independent directors[158].

A further type of director is the 'nominee director'. Nominee directors are appointed to be either executive directors or NEDs by outside stakeholders who have an interest in how the company is run. As such, nominee directors generally represent a key shareholder or group of shareholders on a board of directors or are a representative of the company's employees, an investor or a lender. In body corporates a holding company will typically have nominee directors sitting on the boards of its subsidiary companies[159]. The CA 2006, and indeed all other relevant UK legislation, provides no explicit legal provisions for nominee directors[160]. The term 'multiple director' refers to someone who acts as a director for a number of different firms[161]. This is entirely legal[162] and in *Gwembe Valley Development Co. Ltd v Koshy*[163] was referred to by Harman J. as being appropriate and even common[164]. Despite this, and a point that will be developed further on, it has been argued that the existence of multiple directors or nominee directors in competing

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[158] *Ibid*.
[159] Deirdre Ahern "'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy'" L.Q.R. 2011, 127(Jan), 118.
[160] It has been dealt with the nominee directors, duties under the Chapter (3) of this thesis.
[161] See Elizabeth Boros "The duties of nominee and multiple directors: Part 1" Comp. Law. 1989, 10(11), 211.
[162] See Robert Goddard, "Competing directorships" Comp. Law. 2004, 25(1), 23.
[163] [1998] 2 BCLC 613.
[164] *Gwembe Valley Development Co. Ltd v Koshy* [1998] 2 BCLC 613 at 621.

firms can result in conflicts of interest when the director's responsibility towards the parent firm or other firm is at odds with that owed to the firm[165].

There are no provisions in the CL 2015 that stipulate how many boards a director may be a member of at any one time. This oversight has been condemned by numerous different jurists as it allows the authority over several firms to reside in only a small number of investors. In turn, these investors may not have the capacity to encourage the profitability of the firms under their directorship[166]. Yet, s.66 of the CL 1965 does give the Council of Ministers the power to decide how many boards of directors a single person may be appointed to. In an attempt to reform this law, the Council of Ministers issued a decree stating that only state representatives or persons appointed by the government or stock companies are able to act as a director on two or more boards[167]. A further decree released by the Council of Ministers then allowed a person to participate in a number of boards of directors in various stock companies provided that these companies are not government-subsidised[168]. The amount of joint stock company boards of directors a single person can sit on has been set at a maximum of five by the CGC 2006, although, again, the CGC is only guidance[169]. The CL 2015 –again- does

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[165] See Elizabeth Boros "The duties of nominee and multiple directors: Part 2" Comp. Law. 1990, 11(1), 6.

[166] See Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p. 332, also see Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in* Saudi Law, Alhalabi for legal publications, Lebanon, 2006, p.126.

[167] Ministers Council Decree No: 17 in 1982.

[168] Ministers Council Decree No: 80 in 1985.

[169] Article 12 of the Saudi CGC 2006.

not specify how many boards a director may be a member of at any one time. Nevertheless, unlike the old CL 1965, the new statutory does not grant the Council of Ministers the power to regulate this area. Hence, there is a question whether the aforesaid Council of Ministers' decrees have been repealed.

Additionally, the articles of a firm can empower individual directors to appoint an 'alternate' to act as their representative if they cannot be present at meetings or are unable to fulfil any other of their directorial responsibilities[170]. However, the CA 1985 stated in s.308 that if an agreement between the people in a company is made to appoint an alternate or if a company's articles do allow for a manager or director to allocate their functions to someone else, then this agreement or article provision must be approved by a special resolution of the firm if it is to be legitimate. The use of alternate directors constitutes one of only a few exemptions to the common rule that the office of a director cannot be delegated or allocated to another.

There is no mention of alternate directors in the CA 2006, so it is believed that directors are not able to assign their office unless this is provided for in a firm's own articles[171]. If a firm's articles do allow alternates these alternates can attend meetings on behalf of a director or manager and generally fill their role. Section

[170] See John Davis, "A guide to directors' responsibilities under the Companies Act 2006" ACCA (the Association of Chartered Certified Accountants), July 2007, available at: http://www.accaglobal.org.uk/content/dam/acca/global/PDF-technical/business-law/tech-tp-cdd.pdf .
[171] *Ibid.*

250 of the CA 2006 provides a very broad description of the term ‘director’ and defines it as including anyone acting as a director regardless of what their title actually is. Overall, it is recognised that an alternate director is covered by this definition and thus all of the provisions applied to directors in general apply to alternates as well. The Companies (Model Articles) Regulations 2008[172] have dealt with the assigning of directorial powers to others, in both private and public firms[173]. Of particular note is the rule that certain documents must be signed by all directors. These documents include a solvency statement in the case of a private company reducing its share capital (as per art.2(c) of the Reduction of Share Capital Order (SI 2008/1915)) and the responsibility statement for a prospectus. As an alternate director is legally defined a director, as per s.205 of the CA 2006, both the assigning director and her/his alternate will thus need to sign the relevant documents.

The legislation of certain other jurisdictions has dealt more thoroughly with the activities of alternate directors, their appointment and the extent of their authority. Section 201K(1) of the Australian Corporations Act 2001 provides that a director can appoint an alternate if they obtain the approval of the other directors[174], and s.201D of the CA 2001 demands that the approval of the alternate her/himself

[172] The Secretary of State makes these Regulations in exercise of the powers conferred by section 19 of the CA 2006.
[173] S.5 of the schedule 1, 2 and 3 of the Companies (Model Articles) Regulations 2008.
[174] S.201K (1) of the ACA 2001.

must also be obtained in writing[175]. Section 205B(2) of the CA 2001 requires that the Australian Securities and Investments Commission (ASIC) be notified of the appointment within four weeks of the appointment taking place[176]. Specifically, ASIC must be given the personal details of the alternate director and the terms of their appointment, in particular, what functions the alternate is not allowed to undertake. It is stated in s.201K(3) of the Australian CA 2001 that an alternate has the same authority as a director when fulfilling the director's role. Precisely what alternates have the power to do should be plainly spelt out in the terms of the appointment[177]. For example, an alternate director may be empowered to attend meetings of the board of directors, vote, take receipt of documents and sign papers on the firm's behalf. Any limitations placed on the powers of the alternate should also be included in their appointment terms. However, it is not required that the timescale of the appointment be stated. Indeed, s.201K(4) of the Australian CA 2001 empowers the assigning director to cancel an alternate director's appointment whenever they see fit[178].

Applying the principle "Delegatus non potest delegare" the CL 2015 in Saudi Arabia makes it illegal for directors to assign their office to another director except in cases where the company's own articles allow this[179]. If the articles do

[175] S.201D of the ACA 2001.
[176] S.205B(2) of the ACA 2001.
[177] S.201K of the ACA 2001.
[178] S.201K(4) of the ACA 2001.
[179] S.80 of the CL 1965, s.83 of the CL 2015.

allow the use of alternate directors then these directors can participate in meetings on their nominator's behalf. However, four key limitations apply. Firstly, the alternate director, also a regular director of the board, is prohibited from acting as an alternate on more than one director's behalf at the one meeting. Secondly, there must be a written record of the assignment. Thirdly, the alternate director can only be assigned for a particular meeting. Finally, an alternate director can only vote for resolutions that the director on whose behalf they are acting is entitled to vote for[180].

2.5 Summary

In order to answer the research question regarding the nature of the board of directors, Chapter 2 has discussed this matter in a more wide-ranging way. It has dealt with foundational issues relating to the structure and composition of the board of directors. To be more precise, it examined the issue of how a 'director' can be defined and it explained what is required for an individual to become a director. In addition to this, it discussed which board structure is most effective to ensure optimal company operation. Finally, different director types acknowledged by both the courts and statute in a number of jurisdictions were explored. The evaluation of these subjects is vital as it contributes significantly to enhancing the efficiency of directorial boards, assisting directors in the fulfilment of their duties, and making directors more accountable. In so doing,

[180] Ministry of Commerce decision No: (3826/19362/222) in 1991.

this will improve the current practice of the enforcement of directors' duties. For example, determining by whom "directors" duties are owed is very important to clearly identify the person that can be held accountable for damages done to the company. As explored in this chapter, within the context of Saudi law, the role of shadow director is not officially recognized. Hence, the individual that has the capacity to influence a board to a considerable extent is not deemed to be a director. Therefore, this chapter sets out a series of suggested amendments to Saudi law that could serve to ensure that all directorial responsibilities are applicable to shadow directors and de facto directors. As a result of this, such individuals will assume greater liability for misconduct or bad decisions, thereby meaning that several enforcement procedures and mechanisms are attainable in the case of such a breach.

CHAPTER 3. Directors' Duties and Breaches of these Duties

The responsibilities of directors have always been considered to be central to good corporate behaviour and director misconduct has been blamed as the driving force behind explosive corporate disgraces, Enron, for example[181]. The duties of directors and what constitutes a breach of these duties is laid out in the CA 2006 in the UK, and Companies Law 2015 in Saudi Arabia. Saudi Arabian law has the additional component of Shari'ah principles and standards which give suggestions on how to confront fraud and misconduct and improve the regulatory response[182].

This chapter will examine UK, Saudi Arabian and Shari'ah law as they relate to the responsibilities of directors. It will be seen that there are a number of likenesses in the basic features of the duties of directors in both countries as well as some considerable differences. This chapter will present an evaluation of the responsibilities of directors according to each of these legal systems and will compare and contrast them. For the purposes of this chapter, directors' duties towards the rights of shareholders will be assessed. Finally, a summary will be given at the end of the chapter.

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[181] Mohammad Al Gamal, *Islamic finance: Law, economics, and practice*. Cambridge University Press, 2006, pp.171,172.
[182] *Ibid.*

3.1. Shari'ah Law and the Duties of Directors

Since the establishment of Saudi Arabia, Shari'ah law has been considered to be the foundation of the state. The government of Saudi Arabia explicitly introduced the Saudi Basic Law in 1992. This clarified the constitution of the country within the first chapter of the constitution. Chapter I, section 1 provides that Saudi Arabia's only "constitutions" are the Qur'an and the Sunnah, which are the deeds and teachings of the Prophet Mohammad - peace be upon him.

However, in order to know the position of Saudi law in terms of dealing with this topic, the Shari'ah perspective of directors' duties needs to be identified.

In addition, the wrongful actions of directors have been considered as the major reasons behind the massive corporations' scandals such as Enron. Therefore, Islamic scholars have discussed directors' duties in the light of Shari'ah principles and values to provide recommendations which can enhance the regulations' efficiency for tackling fraud and corruption[183].

This section aims to explain the nature of Shari'ah law within legislation and its position in dealing with the duties of directors.

[183] *Ibid.*

3.1.1 The nature of Shari'ah

This section provides an overall view about the nature of Shari'ah law. It will explore briefly the sources of Shari'ah law, its validity, as well as Shari'ah codification. Finally, a summary is provided.

3.1.1.1 Shari'ah law sources

Two major types of sources, primary and secondary, form the two main types that constitute the basis of Shari'ah law. The primary source consists of the Qur'an and the Sunnah. The Qur'an is the holy word, according to the Islamic faith, the scripture of God (Allah), which was revealed to the Prophet Muhammad, peace be upon him, who was to deliver it unchanged to people. Muslims believe that the Qur'an continues to be a protected primary source of Islamic law, which was revealed to regulate the people's lives, no matter when or where they live. Islamic doctrines are applicable at all times and in all places, and as established in Islamic literature[184].

The Sunnah is the second primary source of Shari'ah law, and its significance in Islamic law is based upon the belief that the Sunnah is intended to interpret the Qur'an and to elaborate upon its principles. The Sunnah plays an essential part in Islamic jurisdiction and regarded as a source of authority, second only to the Qur'an.[185]

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[184] See Abdul Qadir Odah, *Islamic Criminal Legislation*, Alkitab Alarabi, Beirut, 1981, p.65.
[185] *Ibid*, p 174.

There are **two** main sources within Shari'ah, which are Ijma and Qiyas. Ijma means the unanimous consensus of the Islamic jurists in a particular period, whilst Qiyas refers to the application in a new scenario of a divine law relating to a particular situation sharing features that are common[186]. A further source is Maslaha (public interest) and Urf (custom). Shari'ah secondary sources are tools that are used by Mujtahid (Islamic jurists) in order to interpret the primary sources, as well as giving an opinion about new contexts and the compatibility of Shari'ah principles[187].

3.1.1.2. Validity of Shari'ah law

Shari'ah is not only concerned with spiritual practices, but it exists to govern human affairs. The Islamic religion consists of **two** main parts: Firstly, worship provisions, such as Salat (prayers) and Haj (pilgrimage), which regulate Muslim's relations to Allah (God), which are unchangeable. Secondly, legal transactions that include inheritance, marriage, and commercial transactions, together with and all legal matters in both private and public law. Flexibility means that these

[186] See Siti Faridah Abdul Jabbar, "Financial crimes: Prohibition in Islam and prevention by the Shari' a Supervisory Board of Islamic financial institutions", Journal of Financial Crime, 17.3, 2010, 287.
[187] See Abdul Hamid Metwaly*, Sources of Constitutional Provisions of Shari'ah Law,* Egypt, 1975, p.208.

provisions are likely to be modified. Shari'ah law is a legal system operated by the courts, where punishments are given and not solely as a religion[188]. Unlike some societies where there is a separation between state and religion, where religion is considered to be a private matter, in Islamic society, Islam has an impact upon the decision making of its followers in all contexts, including business[189]. In Islamic law, the Shari'ah maintains sovereignty over all aspects of life, including social and ethical issues, encompassing criminal as well as civil jurisdiction[190].

The Shari'ah heritage highlights the differences in practice between Western and Islamic business. It is based upon man's contract with Allah, which is to adhere to the Shari'ah. Business activities are restricted to only those that are halal (permissible) and involvement in any haram (forbidden) activities is regarded as a sin. The reasons behind certain business activities being forbidden are that they are undesirable or harmful for human beings, as well as the ecosystem. Avoiding forbidden activities assists in fulfilling the contract with Allah and society, by channelling resources into activities that would be of benefit to society. The selection of business activities must meet the requirements of Shari'ah as well as

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[188] *Ibid*, pp.4, 5.

[189] See Zakaria Ali Aribi and Simon S. Gao, "Narrative disclosure of corporate social responsibility in Islamic financial institutions," Managerial Auditing Journal, 27.2, 2011, 203.

[190] See Mervyn K. Lewis, "Islamic corporate governance" Review of Islamic Economics 9.1,2005, 14.

influenced by Maslaha (greatest benefit to society or public welfare)[191]. Both welfare and success are tempered with ethical, moral and spiritual obligations with belief in accountability with Allah, who is the ultimate authority[192].

Shari'ah law has been criticised as being too immutable and too rigid a system of law, because any legislative authority cannot modify it. This is because changes in Shari'ah law ceased upon the death of the Prophet Mohammed - peace be upon him - [193] and because changes in Islamic law cannot be made, Islamic scholars fail to recognise the needs of current society[194].

It is claimed that this criticism is based upon misunderstandings of Shari'ah law. The belief that Shari'ah is immutable and rigid is based upon an incorrect understanding that Shari'ah law is only what is in the Qur'an and Sunnah, which are the primary sources. The law is not given 'ready-made' to people, to be passively received and applied. Instead, it is to be actively based upon the sacred texts that are its acknowledged sources[195]. Procedural details were not set out in

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191See Ros Haniffa Muhammad Hudaib, and Abdul Malik Mirza, "Accounting Policy Choice within the Shari'ah Islamiiah Framework" Discussion Papers In Accountancy and Finance, SOBE, University of Exeter, 2, 2004, 4.

192 See Abdussalam Abu-Tapanjeh, "Corporate governance from the Islamic perspective: A comparative analysis with OECD principles" Critical Perspectives on accounting, 2009, 20.5, 556.

193 See Noel J. Coulson, *A history of Islamic law*, Edinburgh University Pres, 2011, p: 2.

194Ibid, p.5.

195 See Bernard Weiss, "Interpretation in Islamic law: The theory of Ijtihad" Am. J. Comp. L. 26, 1977, 199.

either the Qur'an or the Prophet Mohammed - peace be upon him - for every single detail in people affairs. Islam only provides for the principle and the concept whilst details of procedure remain with Muslims to formulate and develop according to the circumstances and requirements of each generation[196]. Ibn Al-Qayyim[197] stated that Shari'ah law is based upon wisdom, justice and benefit[198], so it follows that Shari'ah law may be found wherever there is fairness and justice[199].

Shari'ah law is not only based upon what is specifically referred to in the Quran and Sunnah, but also upon areas where there is no conflict in ideas of wisdom and justice. Shari'ah law also includes regulations and laws from other legal systems, as long as they are not against the principles of Shari'ah. For example, in Saudi Arabia the Commercial Court Law 1931, the Commercial Register Law 1956 and the Chamber of Commerce and Industry Law 1980 have been transplanted from other legal systems such as those in France, which were not against the Shari'ah law principles[200]. The laws were often introduced after being revised by members of the senior Saudi scholars, in order to check their compatibility with Shari'ah

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[196] See Abdullah Alaroori, *The Understanding of Freedom*, Aldar Albaida, 1981, p.13.
[197] One of the most famous Islamic jurists (1292–1350 CE)
[198] See Ibn Al-Qayyim, Jawziyah, *I'lam Al-Muwaqqi'in 'an Rabb Al-Alamin*, Ibn Aljawzi, 2002, p.14.
[199] See Ibn Al-Qayyim, Jawziyah, *Alturuq Alhukmeyyah,* Almadany Press, 1978, p.14,15.
[200] See Mohammed Al-Jeber, *The Saudi Commercial Law,* King Fahad National Library, Riyadh, 2000, p.7.

law provisions[201]. The texts of Islamic law offer sufficient flexibility, which make Shari'ah rules relevant to society, able to satisfy their needs, to be closer to nature, as well as ensuring the security and contentment of the population.[202]

Miles' and Goulding's empirical research[203] disputes the traditional interpretation of the link between Islam and capitalism. While there is a commonly held belief that it is impossible for a Muslim to work within the conventions of the Western capital market without compromising aspects of their faith, the study argues that this is not actually the case. Rather, the requirements of the international market and globalisation more generally are compatible with Islam.

3.1.1.3 Codification of Shari'ah

The Prophet Mohammad - peace be upon him - established the Islamic state in the city of Almadenah in 619. Following the death of the Prophet Mohammad in 632 - peace be upon him - and the succession of the four Caliphs, the last of which was in 661, the Arab world was governed mainly by three dynasties: the Umayyad Caliphate 662-751, the Abbasid Caliphate 751-1517, and the Ottoman Caliphate 1517-1924. The Arab world was governed by 73 heads of state (Caliphs), which were all Arabs, from the seventh century until 1517[204].

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[201] *Ibid*, and also see Sa'ad Aloutaibi, "The monitoring of the constitutionality of laws", Nov 2012, available access at http://www.al-madina.com/node/412554?risala .

[202] See Abdul Qadir Odah, *Islamic Criminal Legislation,* Alkitab Alarabi, Beirut, 1981, p.65.

[203] Lilian Miles and Simon Goulding, "Corporate governance in Western (Anglo-American) and Islamic communities: prospects for convergence?" J.B.L. 2010, 2, 126.

[204] See Abdul Kareem Gharaybeh, *Recent History of the Arabs,* Al-Ahlyah for Publication and Distribution, Beirut 1984, pp. 28-32, and also see Abdul-Aziz Alduri, "Papers on Arab Islamic History", Centre for Arabic Unity Studies, Beirut, 2009, ", vol. 10, 218.

Shari'ah law governed the Islamic state during this period. However, there is a question whether Shari'ah law was codified during this period. It has usually been thought that the codification of the provisions of Shari'ah was carried out by the Ottomans, who were commonly known as Majallah, in 1876[205]. Sixteen books deal with some of the legal transactions, such as commerce, leases, transfer, companies, deposit, mortgage, agency, and the judiciary formed the Majallah[206.207]. It may also be argued that in earlier periods there were a number of attempts to codify Shari'ah principles and provisions. The author considers that the first codification Shari'ah law were 'legal maxims, the 'Alqwa'id Alfiqhiyyah'.

'Alqwa'id Alfiqhiyyah' is a used to describe general rules that apply to several provisions, and gathered as rules books held by Islamic jurists'[208]. Islamic jurists have classified the history of 'Alqwa'id Alfiqhiyyah' into three main stages, with the occurrence of the stages dependent upon the necessity for legal maxims.

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[205] See Heba A. Sewilam, *The Jurisprudential Problems of the Early Codification Movement in the Middle East*, Hard copy, PhD thesis at the University of California, 2011; p1.
[206] See Mohammed Albugha, "Codification in Majallah Alahkam Aladliyyah", Damascus University, Journal for Economic and Legal Sciences, 2009,vol 25, 743.
[207] Majallah has been thanked due to its role in facilitating access of Shari'ah civil law to practitioners of that time after being scattered in law books on different sources of Islamic jurisprudence.
[208] Ali Nadwi, *Alqwa'id Alfiqhiyyah,* (Legal maxims), Damascus Dar Alqalam, 1998, p.43.

The first stage is the establishment that began in the era of Prophet Mohammed - peace be upon him - and his companions. There were few maxims during this period because the primary sources of Islamic law were still in existence. One example of these maxims is that the Prophet - peace be upon him - says: “There should be neither harming (darar) nor reciprocating harm (diraar)”, which is a main principle for many of the Islamic provisions.

The second stage is the collection and writing of views and ideas that reflected the expansion of the Islamic state, together with a noticeable variation in the attitudes of Islamic jurists towards a number of provisions that were formulate into legal maxims. Imam Abu Zeid Aldbusi, who was followed by a number of Islamic jurists who began collecting provisions from the books of jurists. These provisions formed the basis of general rules ‘Alqwa’id Alfiqhiyyah’, such as one legal maxim, Al dharourat Tobeh Al Mahdhorat, which means illegal transactions that can be allowed in certain circumstances.

The third stage of ‘Alqwa’id Alfiqhiyyah’ relates to fixedness and organisation. Fixedness and organisation at this stage means that ‘Alqwa’id Alfiqhiyyah’ were in the early stages, scattered in different books of Islamic legal scholars and mixed with other Islamic sciences such as “the differences” and ‘Alqwa’id Alo’suliyyah’. Therefore, at this stage ‘Alqwa’id Alfiqhiyyah’ appeared in its final shape, which facilitated the access of Shari’ah law to judges and practitioners. ‘Alqwa’id Alfiqhiyyah’ is explained and clarified, with one example of Majallah by Ottomans 1876, which was mentioned earlier[209]. This resulted in ‘Alqwa’id Alfiqhiyyah’, which represented the first attempt at formulating Islamic jurisprudence into codified laws.

Following the establishment of the Kingdom of Saudi Arabia in 1932, efforts were made to codify the Shari’ah rules. However, these attempts were unsuccessful due to the resistance from senior Saudi religious scholars, which were so vociferous that policymakers were unable to challenge them[210].

It may be argued that there was little resistance to the introduction of any code. In 1927, the Saudi Judicial Authority[211], which consisted of a number of Islamic scholars, announced that Judgments should be based upon Ahmed Ibn Handbill schools, books, and legal maxims, unless judges saw benefits in other provisions that were greater[212]. One of the first laws in Saudi Arabia was the Commercial Court Law 1931[213]that regulates many aspects of commercial law in the country. This law did not face rejection from senior Saudi scholars, because it did not

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209 *Ibid*, pp.90-158.
210 See George N. Sfeir, "Saudi Approach to Law Reform”, The American Journal of Comparative Law, 36, 1988, 732.
211 At that time, it used be called the Kingdom of Nejd and Hejaz, 5 years before its call the Kingdom of Saudi Arabia, see Umm al-Qura Gazette, No. 405, issued on 16 September 1932.
212 See Ahmed, Dheff, “The first attempt of the codification in the kingdom”, 2006, available access at: http://www.okaz.com.sa/okaz/osf/20060608/Con2006060823750.htm.
213 By High Decree No. 32 in 1931.

conflict with the principles of Shari'ah. Saudi Arabia has regulated all legal areas, with the exception of the civil law and parts of criminal law.

Useful insights into reasons for not codifying all legal provisions in the Kingdom are given by Alhusayen[214]. For instance, Alhusayen commented that laws are a principle necessity for all societies everywhere, and that laws should be treated like antibiotics, and only used when essential. Failure to observe this will result in it becoming the basis of corruption and corruptors, and especially without effective mechanisms for enforcement[215].

3.1.1.4 Summary

This section has provided a clear understanding regarding the background of Shari'ah law. It has clarified, albeit briefly, the two major sources of Shari'ah law, namely, primary and secondary. It has explained that Shari'ah secondary sources are tools that are used by Islamic jurists in order to interpret the primary sources. Also, it has examined the validity of Shari'ah law and its applicability and flexibility at all times and in all places. Finally, it has answered the question whether Shari'ah law was codified in Islamic history.

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[214] One of the policymakers in Saudi Arabia since 1970.
[215] See Saleh Alhusayen, "the Extravagance of Codification: an influential factor in the presence of administrative corruption", Dec 2012, available access at: http://rowaq.org/?p=352 .

This will go towards identifying the Shari'ah position in terms of dealing with directors' duties.

3.1.2. The duties of directors in Shari'ah law

Several authors have highlighted the duties of directors in Shari'ah law, in order to develop Islamic corporate governance. Islamic corporate governance should be based upon the spirit of Islam and its teaching, with established corporate governance being considered in relation to contemporary corporate governance. These should then be tested against Islamic Shari'ah, with those that are consistent with Shari'ah law being accepted, whilst rejecting those that are not[216].

This section aims to explain the nature of directors' liability, general duties of directors, and finally the relief from liability from Shari'ah perspective.

3.1.2.1 Directors' liability

In the context of Shari'ah, contractual liability can be divided into **two** main parts that depend upon the type of legal transaction. Dhaman contracts are the first type that represent certain transactions, such as being in recipient of money or a commodity, and is held accountable under any circumstances, even with sufficient care, and which are usually commutative. Examples of this type of contract are loans and contracts of sales.

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[216] See Nabil Baydoun and Roger Willett, "Islam and Accounting: Ethical Issues in the Presentation of Financial Information", Accounting, Commerce and Finance: The Islamic Perspective, 1997, vol. 1(1), 1, also see Mervyn K. Lewis, "Islam and accounting" Accounting Forum. Blackwell Publishers Ltd, 2001, vol. 25. No. 2, 103.

The second type of contract is an Amanah contract, by which a recipient of money or a commodity is considered to be a trustee; for example, agencies and all kinds of companies[217]. This section refers to this type of contract.

There is an Islamic recognition of the principle of the fiduciary relationship/trust, which can be shown through different aspects. First of all, it is thought that the institution of Waqf[218] in Islamic law is the root of fiduciary duty, and that the former was imported to the UK in the 13th century[219] by returning crusaders who had witnessed the operation of the Waqf institution under Shari'ah law in the Middle East. It is thought that Walter de Merton, who was a government servant and clergyman, was in touch with crusaders and visitors to the Arabic states, in order to conduct some transactions with the Islamic world on behalf of the New Temple. As a result, it is thought that he would have been familiar with religious and charitable institutions, particularly, the institution of Waqf due to its significance in the Islamic world[220].

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[217] See Wahbah, Zuhayli, *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, 1967, p.580.
[218] The institution of Waqf will be clarified on the coming paragraphs.
[219] See Avisheh Avini, "Origins of the Modern English Trust Revisited", Tulane Law Review Association, 1995, vol 70, 1139. Also see James Hawley, Keith Johnson and Ed Waitzer. "Reclaiming fiduciary duty balance." Rotman International Journal of Pension Management 4.2. 2011, 4.
[220] See Ann Van Wynen Thomas, "Note on the Origin of Uses and Trusts-WAQFS", Southwestern Law Journal, 1949, vol.3, 162.

In 1264, after being appointed as “practically Regent of the Kingdom”, Walter de Merton issued the 1264 Statutes of Merton College. These statutes were reissued in order to confirm the establishment of the institution of trust. After analysing the elements of trust in these statutes, it is clear that they are similar to the elements of Waqf in Shari’ah law. Therefore, it is thought that Merton imported the concept of Waqf into the UK[221]. Finally, this can justify why the institutions of Waqf and the English trust are almost identical[222].

Secondly, Shari’ah law insists that a trustee must avoid conflict of interest[223], and also it prohibits insider trading[224]. The duty of loyalty - the core of fiduciary duty - is defined as the prevention of insider dealing and conflicts of interest[225]. As a consequence, Shari’ah law has recognised fiduciary duty.

Liability can fall on trustees for **two** main reasons, such as cases of **aggression** or **negligence**. The concept of negligence from the Shari’ah point of view means a lack of care in maintaining and protecting money or commodities placed in the

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221 See Monica M Gaudiosi, "The Influence of the Islamic Law of Waqf on the Development of the Trust in England: The Case of Merton College", University of Pennsylvania Law Review 136.4, 1988, 1231.

222 See Avisheh Avini, “Origins of the Modern English Trust Revisited”, Tulane Law Review Association, 1995, vol 70, 1139. Also see James Hawley, Keith Johnson and Ed Waitzer. "Reclaiming fiduciary duty balance." Rotman International Journal of Pension Management 4.2, 2011, 4.

223 This will be discussed that on the coming sub-section on “General duties’.

224 See Siti Faridah Abdul Jabbar, "Financial crimes: Prohibition in Islam and prevention by the Shari’ a Supervisory Board of Islamic financial institutions", Journal of Financial Crime, 17.3, 2010, 287.

225 See Norwood Beveridge, *The Corporate Directors’ Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, DePaul Law Review, 1991, 41, p.688.

care of a trustee[226]. The term ‘negligence’ also relates to breach of duties by a trustee(s). Islamic jurists have answered the question of what is sufficient care that is clarified as the normal diligence that experts consider is adequate under normal circumstances[227].

Aggression relates to direct or indirect damage to commodities or money[228]. Acting beyond powers[229], is also included within aggression in Shari’ah law, and is also known as *ultra vires* in common law[230].

The Prophet Mohammed - peace be upon him - also stated that whoever practices on people as a doctor, when he is not a doctor, will be held liable. The pretence of being skilled when he is not can be considered as aggression[231]. For instance, if an employee, who is unskilled, works in employment that requires certain skills, he will be held liable for damages created by his or her actions[232]. From the Shari’ah’ viewpoint, not only does duty of care concern loyalty and honesty, but it also includes competence.

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226 See Wahbah Zuhayli, *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, 1967, p.488.
227 See Mohammed Siraj, *liability of aggression in Islamic jurisprudence compare to tort liability in Law*, Dar Alddirasat Aljame’eiah, Beirut, 1993, pp.251-257.
228 See Wahbah, Zuhayli, *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, 1967, p.488.
229 See Abdullah, Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p.350, and also see Ali Abdul Hakim Net, *Liability in Islamic jurisprudence*, Najaf Press, Baghdad University Press, 1974, p.216.
230 More in depth, see Ben Pettet, *Company Law*, Pearson Education, England, 2005, p.114.
231 See Wael Asaf, *Civil Accountability for Doctors*, Hard copy, A Master’s dissertation in Alnajah University, Nablus, 2008, p.26. The author cite a MA as it is the only source to examine this topic.
232 See Ibn Al-Qayyim, Jawziyah, *Altteb Alnabawy*, Dar Ehyaa Alkutob, Egypt, 1957, p.105.

It is necessary to understand the position of company directors in the context of Shari'ah in order to determine the liability of directors in Islamic literature. Mudharabah is one form of company within the Shari'ah context, which is an arrangement whereby an investor or group of investors entrusts capital to an entrepreneur (Mudharib). The entrepreneur commences production or trade with this capital, and then gives investors a pre-agreed share of the resulting returns, together with their principal investment. The entrepreneur gains the remaining shares as a reward for his time and effort. The capital loss is borne entirely by the investors if the business fails, with the entrepreneur's loss being his labour and effort[233]. Muslim jurists are unanimous that profits are to be shared in previously mutually agreed proportions, with losses being shared in the same proportion as invested capital[234].

The board of directors are represented by Mudharib, and capital owners represent the shareholders[235], with Islamic jurists assuming that the directors (Mudharib) must act in accordance with the agreement between them and shareholders, and

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[233] See Walid Ghannouchi. *Banking productivity and economic growth in emerging countries*, PhD thesis at University of Rome Tor Vergata, 2010, p.44, available at https://art.torvergata.it/retrieve/handle/2108/1311/6442/Walid%20Ghannouchi%20-%20Doctorate%20Thesis.pdf [Accessed 27 March 2016] . Also see Abdul Rahim Abdul Rahman, "Issues in corporate accountability and governance: an Islamic perspective", American Journal of Islamic Social Sciences, 1998, 15.1, 55.

[234] See Abdullah Ibn Qudamah, *Almugni,* Dar Hajar, Egypt, 1989, vol 7, p.145.

[235] See Ali Alkhafif, *Companies in Islamic jurisprudence,* Dar Alnahdhah Alarabiyyah, Egypt, 1978, p.62.

as decided by the board of directors[236]. The reason is that in Islamic literature, the Mudharib is regarded merely as a type of agent.

There are a number of similarities and differences between normal agents and Mudharib. Usually, Mudharib has enhanced powers whilst normal agents must work in a particular manner. Although normal agents and Mudharib must act within certain powers, they are not held liable unless losses are the result of neglect or aggression[237]. In addition, they are not allowed to undertake actions or risks that are harmful to the people who trust them, and they must act in their interests[238]. In Shari'ah law, liability is mostly unlimited. Mudharibs are jointly responsible for any damages resulting from their aggression or negligence[239].

The concept of limited liability within modern commercial practice is a new concept, and there is no mention of it in original Islamic Fiqh sources, but limited liability can be found within the principles of Shari'ah[240]. The strong links between the existence of a separate legal entity and the concept of limited liability, Islamic authors have made considerable efforts to find precedents that

[236] See Abdullah Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p350
[237] See Sultan Alhashimy*, provisions of the agent's actions*, Dar Albuhooth Alislamiah, Dubai, 2002, pp.440-444, and also see Wahbah Zuhayli, *Islamic Jurisprudence in its new style,* Dar Alkitab, Damascus, 1967, p.580.
[238] See Mohammed Aldesoki, *Hashiat Aldesoki,* Dar Alfekir, Beirut, 1978, vol 3, p.380.
[239] See the related decision of Islamic Fiqh Council, the Muslim World League, in its fourteenth session, 1995.
[240] See Muhammad Taqi, Usmani, *An introduction to Islamic finance*, vol. 20, Brill, 2002, pp.154,155

can prove whether the concept of a separate legal entity is recognised within Shari'ah sources, with the most obvious precedent being the Waqf[241].

The Waqf is a legal and religious institution, whereby a person dedicates some of his property for charitable or religious purposes. Once the property has been declared as Waqf, it no longer remains in the donor's ownership. Whilst Waqf beneficiaries can benefit from the proceeds of the dedicated property, they are not its owners, as ownership has been given to Allah Almighty alone. If a property is purchased from the income of a Waqf, the purchased property cannot automatically become part of the Waqf. According to jurists, such property is to be treated as a property owned by the Waqf[242].

Muslim jurists consider Waqf as a separate legal entity, and have given it characteristics that are similar to those of a person relating to matters of ownership. Once ownership is established, it follows that it has its own budget, it can sell, purchase and own properties. It may become a debtor and a creditor and can sue and be sued. Accordingly, all the characteristics of a 'juridical person' can be given to it[243].

This view has been criticised for being not accurate. It is argued that assets purchased with the income of a Waqf do not become part of the original Waqf property, because in order to become Waqf, there has to be a human being who

[241] *Ibid*.
[242] *Ibid*, p155.
[243] *Ibid*.

dedicates the asset to Allah (God) as Waqf (a Waaqif). The Waaqif of the Waqf property specifically made the property Waqf in order to provide an income for the intended charitable cause. If the income of the Waqf automatically also becomes Waqf, the purpose of the Waqf will be destroyed; this is a dissenting view[244].

Whilst Waqf is only dedicated for religious or charitable purposes, Islamic scholars are unanimous that a property can be also be allocated as Waqf for private purposes. A property can be dedicated for a person's descendants or for posterity, as a posterity or family Waqf[245]. The institution of Waqf is not owned by the donor, or by the beneficiaries; it has its own independent financial statements and budget. Waqf is a separate legal entity, with a notion of limited liability.

If a company is formed as a Waqf, from the perspective of Shari'ah law, it follows that it has its own legal entity and the directors have limited liability. However, due to the flexibility and compatibility of Islam that is based upon the principles of 'urf' (custom) to suit the changing nature of trade and business in the modern

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[244] See Mujlisul Ulama of South Africa, "*The Concept of Limited Liability – Untenable in Shari'ah*", Young Men's Muslims Association, South Africa, 2007, available at http://books.themajlis.net/node/251, also see Zainal Zuryati, Mohamed Yusoff, and Ahmad Azrae,"Separate legal entity under Syariah law and its application on Islamic banking in Malaysia A note." International Journal of Banking and Finance, 2009, 8.

[245] See Sana Abdou, "posterity Waqf", knowledge Jornal, Egypt, 2009, 219, and also see Monzer Kahf, "The role of waqf in improving the ummah welfare", International Seminar on "Waqf as a Private Legal Body" organized by the Islamic University of North Sumatra, Indonesia. 2003, 6.

world[246], even if a company is not formed as Waqf it too can enjoy limited liability by referring to the following clause in its contracts, which is based on Sunnah:

"All the conditions agreed upon by Muslims are upheld, except a condition that allows what is prohibited or prohibits what is lawful"[247].

3.1.2.2 General duties

The recognised duties of directors within the Islamic context will be considered within this context and compared to duties within contemporary jurisdictions.

A number of authors consider that the Islamic view of directors' duties is based only upon transparency, accountability and trustworthiness. However, this is only half of the view of Shari'ah[248]. Such views only consider prescriptive duties, yet ignores proscriptive duties, which require action, whilst the latter require restraint[249]. The duty to promote a company's success is balanced with the duty not to accept benefits from third parties. This section will consider both types of duty.

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[246] See Zainal Zuryati, Mohamed Yusoff, and Ahmad Azrae, "Separate legal entity under Syariah law and its application on Islamic banking in Malaysia: A note." International Journal of Banking and Finance, 2009, 8.

[247] See Mohammed Altirmithy, *AL-Sunan*, Dar Alma'arif, 200, vol 1, p.253.

[248] See Esfandiar Malekian and Abbas Ali Daryaei, "Islamic values forward into better corporate governance systems", corporate integrity system in Malizia, available access at: http://cism.my/cismv2/modules.php?module=portfolio&do=portfolio&productname=Islamic-Values-Forward-Into-Better-Corporate-Governance-Systems. [Accessed 25 January 2014].

[249] More in depth about the difference between mentioned types of duties, see Rosemary Teele Langford, "The Duty of Directors to Act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared," Journal of Corporate Law Studies 11.1, 2011, 215.

3.1.2.2.1 The duty to act in good faith

Directors of companies in both the UK and Saudi Arabia have a duty and responsibility to act in good faith, honestly, fairly, and reasonably, and with due diligence in promoting the success of the company, as well as having a regard for the interests of stakeholders, including shareholders, in order to achieve the main objective of the company[250].

Shari'ah law has recognised stewardship from the beginning. Prophet Mohammed –peace be upon him - said **"All of you are guardians and responsible for your wards and the things under your care"[251]**. This statement means that when a director is appointed, he or she will have a responsibility and liability to act in its best interests. The realisation of profits for shareholders must be compatible with the principles of Shari'ah, such as, equitable distribution of wealth to all stakeholders and disadvantaged members in the form of Zakat (alms giving)[252] and the prohibition of interest 'usury'[253], insider dealing, fraud and

[250] S.172 and 1157 of the UK CA 2006, and s.55 of the Saudi CL 1965, s.65 of the CL 2015, and Article 11 of the Saudi CGC 2006.
[251] Translator: M. Muhsin Khan, "*Sahih Albukhari"*, Mika'il al-Almany, 2009, P209.
[252] See Abdussalam Abu-Tapanjeh, "Corporate governance from the Islamic perspective: A comparative analysis with OECD principles," Critical Perspectives on accounting, 2009, 20.5, 556.
[253] See Racha Ghayad, "Corporate governance and the global performance of Islamic banks" Humanomics, 2006, vol 24.3, 207.

money laundering[254]. The most important rule in business under Islam is honesty and fair dealing. The owner of a Muslim business should therefore be a person with high moral values, who would not seek to exploit or deceive others. Monopolies are also prohibited, because they harm the wider society[255].

The modern view of promoting the success of a company does not only mean maximizing the wealth of shareholders, but also taking into account stakeholders interests and long term issues[256].

Islamic texts and the viewpoints of jurists included this new approach. One form of company within the Shari'ah context is Mudharabah, whilst Mudharib represents the board of directors, and capital owners represent the shareholders[257]. Mudharib is required to invest the funds of a company in a manner that will produce good financial return; he or she is also required to take the company's long-term success into consideration by avoiding the taking of unusual risks. Ibn Qudamah (1223) stated that the Mudharib is considered to be a trustee, and if

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[254] See Siti Faridah Abdul Jabbar, "Financial crimes: Prohibition in Islam and prevention by the Shari'a Supervisory Board of Islamic financial institutions", Journal of Financial Crime, 17.3, 2010, 287.

[255] See Mervyn K. Lewis, "Accountability and Islam", Fourth International Conference on Accounting and Finance in Transition Adelaide, April 10-12, 2006.

[256] See David Milman, *National Corporate Law in A Globalized Market*, Edward Elgar, 2009, p.70.

[257] See Ali, Alkhafif, *Companies in Islamic jurisprudence*, Dar Alnahdhah Alarabiyyah, Egypt, 1978, p.62.

unusual risks are taken, he will be held personally liable and responsible towards the aggrieved parties[258].

3.1.2.2.2 Duty of care, skill and diligence

Directors have a fiduciary duty to the company before its existence in formal codified law. The **two** basic fiduciary duties of directors are the duty of loyalty, or duty of fair dealing, and the duty of care[259]. This duty is included in both the UK[260] and Saudi Law[261]. However, it is has been argued that the duty of care is not fiduciary in nature[262].

The duty to exercise reasonable care, skills and diligence was also recognised in Islamic texts. Prophet Mohammed – peace be upon him- said **"If any of you undertakes to do any work, God loves to see it, do it well and with efficiency"**[263]. Since the 7th century, Islam has emphasised the importance of behaving in good faith and with efficient care.

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[258] See Abdullah, Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p.350. As has been mentioned in s.125 in the Saudi CL 1965, s.128 of the CL 2015, that directors are required to maintain the company's capital.
[259] See Bernard Black, "The core fiduciary duties of outside directors", Asia Business Law Review, 2001, 3.
[260] S.174 in the CA 2006.
[261] Article 11 of the Saudi Corporate Governance Code 2006.
[262] See Ch 3, para 3.3.2.2.
[263] Abu Ya'ala , *Musnad Abu Ya'ala,* Dar Alma'amon, Damascus, 1984, vol 7, p.349.

Under Shari'ah law, if an unskilled employee works in employment that requires specific skills, he will held liable for damages created by his or her actions[264]. Therefore, Islamic jurists considered the Mudharib to be responsible for damages if he or she does not exercise sufficient diligence and care[265].

3.1.2.2.3 Duty to act within powers

The duty to act within powers requires directors to abide by the rules that are established either in the law or the company's constitution[266].

In Shari'ah law, Mudharib must act within certain powers[267], so Islamic jurists assume that directors (Mudharib) must act in accordance to the agreement between them and shareholders, as decided by the board of directors[268].

Acting beyond powers is prohibited, and it is considered as aggression, so if a director acts beyond powers he or she will held accountable for damages created by his or her actions [269].

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[264] See Ibn Al-Qayyim Jawziyah, *Altteb Alnabawy,* Dar Ehyaa Alkutob, Egypt, 1957, p.105.
[265] See Abdullah, Ibn Qudamah *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p.357
[266] S.171 in the UK CA 2006, and s.73 of Saudi CL 1965, s.75 of Saudi CL 2015.
[267] See Sultan Alhashimy, *provisions of the agent's actions*, Dar Albuhooth Alislamiah, Dubai, 2002, p 440-444.
[268] See Abdullah Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p350. Although contracts and agreements are preferred to be written, they were mostly dependent upon spoken words, for in depth see Abdul Qadir Odah, *Islamic Criminal Legislation*, Alkitab Alarabi, Beirut, 1981, p.56.
[269] See Abdullah Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p.350.

A number of examples were given to certain transactions which required permission by shareholders, such as, arranging loans[270]. In addition, the agent is unable to act on behalf of the seller and the buyer at the same time, as well as he is not allowed to purchase property of individuals that have connections with him or purchase his own property[271].

3.1.2.2.4 Duty not to accept profits from third parties

It is unacceptable for directors to receive any benefits not specifically allowed for or provided for in the constitution of the company[272]. The Prophet appointed a man to collect the Zakat. When he returned he said, "This (i.e. the Zakat) is for you and this has been given to me as a present." The Prophet said, **"Why hadn't he stayed in his father's or mother's house to see whether he would be given presents or not?"**[273]. This text reveals that under the principles of Shari'ah law, employees of any kind, including directors, are forbidden from accepting any benefits from others under any circumstances.

3.1.2.2.5 Duty to avoid conflicts of interest

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[270] Abdullah Ibn Qudamah, *Almugni*, Dar Hajar, Egypt, 1989, vol 7, p.147, also see Mohammed Alhattab, *Mawahib Aljalil*, Beirut, 1995, vol 7, p.455.
[271] See Sultan, Alhashimy, *provisions of the agent's actions,* Dar Albuhooth Alislamiah, Dubai, 2002, pp.226, 227.
[272] S.176 of the CA 2006.
[273] Translator: M. Muhsin Khan, *Sahih Albukhari*, Mika'il al-Almany, 2009, p.590.

Directors are forbidden from placing themselves in a position where they may receive direct or indirect benefit from any transactions made for the company, except with the permission of shareholders[274].

One of the basic legal maxims in Shari'ah law suggests that public interest is superior to private interest. Directors must therefore avoid conflict of interest. If a company employee is faced with an issue of conflict of interest between their personal interests and the interests of the employer, the interest of the company must be superior, or the employee will be in breach of duty[275].

According to Shari'ah law, if transactions could lead to a conflict of interest, these could be grounds for prohibiting them; for example, if a company had been attempting to raise capital, but the Mudharib had accepted capital from another source without the permission of the shareholders, this could cause risk to the company's investment. In addition, the Mudharib could pay insufficient attention to the needs of the investors of the company if it is spending more time in seeking new business, which takes up too much time[276].

An agent is also subject to other legal restrictions, so that unless the company representative that appoints the agent gives specific authorisation, then the agent

[274] S.175 of the CA 2006, ss.69,70 of Saudi CL 1965 and ss,71,72 of Saudi CL 2015.
[275] See Ibrahim Alshatiby, *Almowafakat*, Dar Ibn Al-Qayyim, 2003, vol 3, p88.
[276] See Abdullah, Ibn Qudamah, *Almugni*, Dar Hajar, Egypt, 1989, vol 7, p160, also see Mohammed Alhattab, *Mawahib Aljalil*, Beirut, 1995, vol 7, p457.

cannot act on behalf of the seller and the buyer, or cannot purchase property of individuals that have connections with him or purchase his own property[277]. These findings explain that if transactions involve any conflict of interest, then this should be prevented, and is clearly forbidden under Shari'ah law.

3.1.2.2.6 Duty of disclosure and transparency

The duty of disclosure and transparency is one of the fiduciary duties that allow shareholders to sue by claiming a violation of the duty of loyalty. This duty is intended to prevent any conflict of interest transactions from arising[278]. Directors must declare any personal interest in proposed transactions[279].

In Shari'ah law, the purpose of accounting information is to serve the public interest. Within an Islamic context, the wider society has a right to know about the effects of the operations of an organisation upon its well-being, as well as being advised that the activities of the company are within the requirements of Shari'ah. Relevant and truthful disclosure of information is essential in different areas of Islamic life, with responsibilities such as paying Zakat. Disclosure and

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[277] Although some scholars accept the contract in this case after being authorised, some jurists prohibit with or without mentioned permission, more in depth see Sultan Alhashimy, *provisions of the agent's actions*, Dar Albuhooth Alislamiah, Dubai, 2002, pp.226, 227.
[278] See Bernard S, Black, "The Principal Fiduciary Duties of Boards of Directors" presentation at Third Asian Roundtable on Corporate Governance Singapore, 2001, 33, 3.
[279] S.177 in the UK CA 2006.

transparency is important for predicting future obligations and assessing investment risks of companies[280].

3.1.2.2.7 Duty: Loans may not be taken from the company

Any type of cash loans cannot be provided by a company to individuals of the board of directors, or to act as guarantor for directors who take loans from third parties. Although, loans from credit companies or banks could be excluded for specific purposes, conditions or situations when dealing with the general public by individual members of the board of directors. Therefore, the provisions of this article define that cash loans to directors for all contracts would be null and void[281].

Islamic scholars perceive a fund manager or Mudharib to be only acting as an agent for a company, so they would not be able to arrange loans without the permission of the shareholders or capital. Islamic literature explains that an agent is defined to be a trustee, so that they cannot take risks. In addition, the Mudharib cannot use credit to sell or buy goods without authorisation from the trustee of the company, as this type of action involves high-level risk[282].

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280 See Mervyn K. Lewis, "Islam and accounting," Accounting Forum. Blackwell Publishers Ltd, 2001, Vol. 25. No. 2.,103.
281 S.213 of the CA 2006.
282 See Abdullah, Ibn Qudamah, *Almugni*, Dar Hajar, Egypt, 1989, vol 7, p.147, also see Mohammed Alhattab, *Mawahib Aljalil*, Beirut, 1995, vol 7, p.455.

When the directors of a company undertake an agreement whereby debt cannot be incurred by any director in carrying out the business of the company, if a director then of the company incurs debt in a manner that violates this condition, this director will be personally responsible for losses resulting from the debt. A Mudharabah or a pool of assets that is diversified within an asset management portfolio is different to the earlier issue explained, as there is a limited liability of owners of money related to the extent of investors' total capital contribution[283], except when an individual director has given personal permission to the Mudharib to incur debts[284].

3.1.2.2.8 Duty: Confidentiality should be maintained

Apart from general meetings, directors cannot divulge any information to shareholders or third parties when this knowledge is a result of their position as a company director, but if directors break their duty of confidentiality, then they will be personally accountable for compensation[285].

Throughout the history of Islamic countries, businesses and bazaars have been monitored by a Muhtasib that ensured that Shari'ah law was applied in all cases

[283] See Abdulaziz Khayat, *Companies in the Shari'ah law*, Alrrsalh Press, Beirut, 1983, p.237.
[284] See Muhammad Taqi Usmani, *An introduction to Islamic finance*, Brill, 2002, vol. 20, p 32.
[285] S.72 of the CL 1965.

of practice and quality[286], but was also responsible for monitoring the work of doctors and other professions, and to ensure that they applied confidentiality when carrying out their work. This example demonstrates the importance for employers to maintain confidential information about their business and employees[287].

According to Shari'ah law, great emphasis is placed on upholding agreed conditions, so that to serve the interests of the company, directors need to ensure confidential information about the company remains secure.

3.1.2.3 Relief from Liability

In terms of breach of trust, breach of duties, default or negligence, directors are generally considered to be liable, but directors can sometimes be found to be relieved of their liability either in part or completely due to legal regulations. In the UK, the CA 2006 neutralises a breach of directors' duties if their action is ratified by the company under section 239. Also section 1157 describes actions by directors that are fair, honest and reasonable such as would give power to courts to relieve liability from directors, when liability was caused by negligence or default. However, liability relief claimed in many courts under section 1157 is often unsympathetically dismissed[288].

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[286] More in depth about the public monitoring in Islamic history, see Mervyn K. Lewis., "Islamic corporate governance" Review of Islamic Economics 9.1,2005, 14.
[287] See Mohammed Alshihry, "Professional Responsibility in Sunnah", Dar Aluloom jornal, Egypt, 2011, 257.
[288] See Ben Pettet, *Company Law*, Pearson Education, England, 2005, p.176.

When applying Shari'ah principles, directors are required always to act in good faith and honestly[289], but if directors are found to have committed aggressive or negligent actions, then they cannot claim this as an excuse[290]. Section 1157 of the UK CA that could apply the power of the courts for forgiveness is not supported by Shari'ah law.

There are **two** main reasons why Shari'ah law does not support the provision found in s. 1157. Firstly, from the Shari'ah perspective, directors can be found to be relieved from liability to God (Allah)[291] if they acted honestly, fairly with good faith, yet cannot be relieved from liability to people. In the Islamic context, the reason behind this is that the rights of God (Allah)[292] are based upon forgiveness, pardon and leniency, while the people's rights are likely to be incontestable[293]. Therefore, in order to protect the rights of humans, a director who is held liable on the grounds of negligence cannot be relieved from liability towards the aggrieved parties.

Secondly, from the point of view of Islamic scholars, the terms of negligence and of reasonableness are seen to be contradiction, due to the fact that, if a director

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[289] It has been clarified earlier in the sub-section of "director's liability".
[290] See Wahbah Zuhayli, *Islamic Jurisprudence in its new style*, Dar Alkitab, Damascus, 1967, p.488.
[291] To be relived from liability to God means to be forgiven of a sin.
[292] The rights of God in Islamic religion is clarified in Sunnah, Prophet Mohammad - peace be upon him said, **"Allah's right on His slaves is that they should worship Him (Alone)"**, see translator M. Muhsin Khan"*Sahih Albukhari*" Mika'il al-Almany, 2009, p. 658.
[293] See Mahmoud Al-Mniawi, *Altamheed: Sharh Mukhtasar Alousool*, Alshamilah Press, Egypt, 2011, p.42.

acted reasonably, he could not be found to be negligent[294]. In *Re D'Jan of London Ltd*[295], Hoffmann LJ stated that…

"It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purposes of sec. 727[296] despite amounting to lack of reasonable care at common law"[297]

The first sentence may support the Islamic jurists' point of view. It means that, when a director has committed negligent action which involves the lack of sufficient care, and claimed that he had acted reasonably, this may seem odd. However, the s.1157 of CA 2006 may consider this action to be reasonable when the court thinks it fit.

In contrast, the Saudi CL 2015 includes s.78 that defines joint liability of directors for compensation by third parties, shareholders or companies if, as a result of their violation, abuse or misconduct of the company's constitution or company law, damage has been caused. Besides this, the Saudi law is not in favour of the power of forgiveness of the CA 2006[298].

According to Shari'ah law, there is a recognition of the principle of ratifying wrongful action, so that if shareholders or capital owners ratify the action, they

294 See Mohammed Siraj, *liability of aggression in Islamic jurisprudence compare to tort liability in Law*, Dar Alddirasat Aljame'eiah, Beirut, 1993, p251-257.
295 [1994] 1 BCLC 561.
296 Now S.1157 of CA 2006.
297 Hoffmann LJ in *Re D'Jan of London Ltd* [1994] 1 BCLC 561.
298 This will be discussed in the section of "directors' duties in Saudi law".

are not able to make a financial claim against the company's investment manager or Mudharib[299], and in these circumstances directors could be forgiven.

Excluding directors from liability through exemption clauses is rejected in Saudi and UK laws[300], and if this situation arises in disputes, then they are regarded as void clauses under Shari'ah law[301].

In addition, one may ask, would Shari'ah law permit a company to insure directors against the risk of liability? A key issue in Saudi Arabian law and one that has been laboured over by scholars of Islam for hundreds of years is the insurance contract. As regards directors, the question arises whether Shari'ah law could allow a company to insure its directors against the chance of liability. Situated in a Muslim setting, insurance contracts are considered to come in two forms, commercial and cooperative, depending on its characteristics and objectives[302]. This is a deeply divisive and complex issue and as such will only be given in summary in this section. The focus will be on commercial insurance as it is this form of insurance that is most like Directors' and Officers' Liability Insurance.

Commercial insurance's connection with a number of different elements has lead most scholars of Shari'ah law to denounce it. These elements are: the

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[299] See Abdullah Ibn Qudamah, *Alkafi*, Dar Hajar, Egypt, 1997, vol 3, p.351.
[300] S. 232 of the CA 2006, and s.76 of Saudi CL 1965, s.78 of Saudi CL 2015.
[301] See Abdullah, Ibn Qudamah, *Almugni*, Dar Hajar, Egypt, 1989, vol 5, p.110.
[302] See Abdullah Najjar, *The insurance contract in Islamic law*, Dar Al-Nahdah, Egypt, 1994, pp.93,121.

inappropriate transmission of risk to the insurer from the insured, interest (*Riba*), extreme uncertainty (*Gharar*) and gambling (*Qimar* and *Maysir*). Overall, commercial insurance has been considered to be at odds with proper and moral ways of earning money as it involves duplicitousness and enticement[303].

Yet, there are Islamic scholars who support commercial insurance claiming that the uncertainty of commercial insurance is not extreme[304]. Also, while Shari'ah law forbids usury and gambling, a legal adage (*Al dharourat Tobeh Al Mahdhorat*) exists according to which unlawful transactions can be permitted in specific situations. This adage could be used here. Additionally, Shari'ah law is founded on the public interest (*Maslaha*) [305]. Considering this, the advantages afforded to the public and society by commercial insurance, in terms of protecting individuals and organisations from liability and the potential for significant and devastating financial losses, commercial insurance may indeed be allowable in the eyes of Shari'ah law[306]. According to Shari'ah law, the need for what is held to be an unlawful arrangement must result in a different and appropriate resolution being identified. Consequently, it has been considered vital by Islamic

[303] See Mohammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons, UK, 2007, p.419.
[304] See Abdullah Najjar, *The insurance contract in Islamic law*, Dar Al-Nahdah, Egypt, 1994, pp.93,184.
[305] See Abdul Hamid Metwaly, *Sources of Constitutional Provisions of Shari'ah Law*, Egypt, 1975, p.208.
[306] See Abdullah Najjar, *The insurance contract in Islamic law*, Dar Al-Nahdah, Egypt, 1994, pp.93, 228,229.

scholars to establish a structure or arrangement that is in accordance with Shari'ah law but prevents hardship and cost[307].

Despite the fact that Shari'ah law is enshrined in the Saudi Arabian constitution, there are no shortage of organisations within the country that do, in fact, offer commercial insurance[308]. As commercial insurance contravenes Shari'ah law, these companies are engaging in an illegal and unconstitutional practice.

3.2. The Duties of Directors in Saudi Law

The duties of directors arising from the Shari'ah perspective were identified in the previous section. This section clarifies and extends the understanding of the duties of directors within Saudi Law.

Fiduciary duties are considered to be the basis of general duties in statutory law. Hence, this section aims to focus upon the fiduciary duties in Saudi Arabia, as well as to clarify the general duties of directors under CL 2015. The sub-sections will briefly identify actions that are considered to be a breach of these duties. For the purpose of this research, this chapter is limited to the duties of directors to shareholders.

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[307] See Mohammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons, UK, 2007, p.418.

[308] See the official website of Tawuniya Insurance Company at: https://www.tawuniya.com.sa/en.

A breach of these duties can lead directors to be held liable, and consequently legal ways of relieving directors from such liability are considered.

3.2.1. Fiduciary Duties

The governing statutes of most corporations provide that the business affairs of a company will be managed by or under the direction of the board of directors. The relationship between a director and the company is a fiduciary duty, which has long been recognised by the courts. Many court cases have led to the recognition of the fiduciary duties of loyalty and care.[309] Directors of a company are fiduciary agents, and their powers should be implemented as required by law, as well as for the benefit of the company.[310]

No such specific mention of the fiduciary duties of directors exists in the CL 2015 or CGC 2006 within Saudi Arabia, and fiduciary duty is not recognised by legislation[311]. Evidence suggests that concept of the fiduciary duty is underdeveloped in the Middle East[312]. It is claimed that in Saudi Arabia, a duty of care from members of the board has not been clearly defined in the CL 2015

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[309] Richard M Cieri, Patrick F. Sullivan and Heather Lennox, "The fiduciary duties of directors of financially troubled companies" Journal of Bankruptcy Law and Practice 3.4,1994, 405.

[310] David Malcolm, *Directors' Duties: The Governing Principles*, Chapter Five in Ian Ramsay, Corporate Governance and the Duties of Company Director, Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne, 1997, p.61.

[311] Majid AlSheikh, *To what extend does Saudi law on Directors' Duties mirror US/UK Models of Directors' Duties,* LLM Diss, University of Westminster, 2008, p.36. The author cite LLM as it is the only source for this aspect of this topic.

[312]Lu'ayy Al Rimawi, "Emerging Markets of the Middle East: A Critique of Selected Issues in Arab Securities Regulation", Journal of Financial Regulation and Compliance, 1999, 7 (2), 160.

or the CGC 2006. As a result, the Saudi regulator discovers that both pieces of legislation are irrelevant when determining the level of care appropriate for the board members of a corporation. It is therefore difficult to hold directors to account for dereliction of their duty of care under Saudi law, despite CL 2015 identifying two primary responsibilities for board members: civil and criminal liabilities against breaches that include cheating and management malpractice[313].

It may be assumed that, despite loyalty and care not being referred to specifically under Companies Law or the Corporate Governance Code, Saudi law recognises the concept of fiduciary duties. In Saudi Arabia, Shari'ah law is the only constitution of the state, which suggests that the major role of the Shari'ah law is to reject inconsistencies with Shari'ah principle, and to deal with specific circumstances where there is no legal precedent[314]. Although fiduciary duties fail to be mentioned clearly under Saudi Law, they have been addressed clearly under Shari'ah law, and discussed in the earlier section.

In addition, there was legal action against the chairman of Abdar company who was sued on the grounds of negligence in failing to arrange loan of 13 million $, as required, which caused a significant losses to the company. The Commercial

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[313] See Asam Al Ghamdi, *Commercial Law: Business, Dealer, Commercial Companies*, Shaqri Library, Riyadh, 2007, p.108.
[314] See Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, pp.7,8.

Court stated that the chairman was liable to the company for any damages caused by his negligence[315]. The author considers this verdict to be in accordance with Shari'ah law. Therefore, the director shall be held liable, since he is in breach of the duty of care. Furthermore, the duty of loyalty, which is at the core of fiduciary duty, is defined as the prevention of conflicts of interest and insider dealing,[316] which are both prohibited under CL 2015[317]. In fact, it is suggested that the definition and concept of fiduciary duties should be clarified and specified clearly in Saudi Companies Law, rather than being subjected to a scattered range of principles and regulations.

3.2.2. General Duties

3.2.2.1 Duty to undertake the purposes of a company

It is stated in the Saudi CL 2015 that companies will determine the purpose of their incorporation in their articles and memorandum of association, as well as their prospectuses.[318] Therefore, the first responsibility of boards of directors of companies is to ensure that the purpose, as stated in the articles and memorandum of association of a company, is upheld. Boards of directors also need to ensure

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315 The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment NO. 10421/1 in 2011.

316 See Norwood Beveridge, *The Corporate Directors' Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, DePaul Law Review, 1991, 41, p.688.

317 Ss. 69 and 70 of the Saudi CL 1965 -ss. 71,72 and 74 of the CL 2015- and Article 18-B of the CGC 2006.

318 S.55 of the CL 1965, s.65 of the CL 2015, also see Aziz Al-Okaili: *The Commercial Law*, Science and Culture Press, Jorden, 1995, p.309.

that the purposes of the company, as stated in the Memorandum of Association are realised. Boards of directors may not take on any work or business that does not meet these criteria; otherwise it is regarded as unauthorised activity beyond the competence of the company[319] and regarded as null and void. S. 99 of CL 2015 states that any decision taken by a gathering of shareholders breaches the Companies Law, articles and memorandum of association of the company or Department of General Companies, and is regarded as null and void.[320]

3.2.2.2 Duty to avoid a conflict of interest

S.71 of CL 2015 states that members of boards of directors do not gain direct or indirect personal benefits that are related to businesses or contracts used by the company without the agreement of the GM, which is reviewed on an annual basis. The interests of members of the board of directors may contradict the interests of the company with regard to some contracts. For instance, a board member making a contract with the company for his own personal interest, or a member having an interest in a project that is linked to the business of the company. Such examples would increase the probability of the member's personal interest at the expense of the interests of the company.

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[319] See Towma AlShammari, *The Board of Directors of Joint Stock Company*, Kuwait Est for Scientific Progress, Kuwait, 1985, p.107, see also: Hamad Al-Obaid, *The Board of Directors of Joint Stock Company*, Hard copy, MA Thesis, The Higher Institute of Judiciary, Riyadh, 2000, p.75. This dissertation is the only source for this aspect of the topic, and the work has not been published elsewhere.

[320] See Aziz Al-Okaili, *The Commercial Law*, Science and Culture Press, Jorden, 1995, p.257.

Companies Law attempts to ensure that members of the board of directors operate discretion in their dealings with the company in order to maintain accuracy and loyalty to the company, as well as preventing board members from using their influence and position to gain financial privileges that are illegal, and which would be at cost to both stakeholders and shareholders.[321] This rule includes any personal contract made by the member with the company, as well with any other party connected to the company. This rule is also applied to the relatives of board members. It also includes any contract or business with the company, such as the rental or sale of property, money owned by the board member, renting company property in favour of the board member, or making contracts with the company as an agent for another company.[322]

S. 69 of the CL 1965 may exempt the member if the business transaction went through a public tender process, and the member gained the best offer. In such cases there is no need for permission to be granted by a GM. A number of researchers criticise this exceptional condition on the grounds that members of the Board of Directors have ready access to privileged information, and members may use their position to their personal advantage at cost to other competitors. This may lead the company to lose future opportunities, because competitors

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[321] See Hamad, Al-Obaid, *The Board of Directors of Joint Stock Company*, Hard copy, MA Thesis, The Higher Institute of Judiciary, 2000, Riyadh, p.60. This dissertation is the only source for this aspect of the topic, and the work has not been published elsewhere.
[322] See Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p.331.

would not submit tenders for projects due to their previous negative experience with the company[323]. A member of the Board of Directors may use the information available because of his position to gain personal interest or for relatives. This is considered to be both illegal discretion and an abuse of authority. Such violations are subject to accountability[324]. Should a director use information available for public tenders, due to his position with the company, this is considered as an abuse of authority subject to liability.

In reality, offers from board members during the general bidding process are likely to be the most successful in winning, because board members are expected to be familiar with the information and affairs of the company[325]. It is therefore generally regarded that exceptional terms are unnecessary, since they damage accountability and equality, thereby permitting a monopoly by board members. Both the CGC 2006 and CL 1965 have unwittingly provided an opportunity for board members to trade in their contracts of their companies. It is therefore considered appropriate that exceptional terms be removed from the CL 1965 and CGC in order to avoid misrepresentation by top executives and board members[326].

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[323] See Mohammed Al-Moukili, *The Legal Status of Joint Stock Company's Board of Directors & its Liability*, Institute of Public Administration, Riyadh, 1984, p.30.

[324] *Ibid*, p.32, also see Mahmoud Babili, *The Commercial Companies*, Scientific institution, Syria, 1978, p.157.

[325] See Mohammad Bariri, *The Saudi Law of Commercial Transactions*, Institute of Public Administration, Riyadh, 2007, p.224.

[326] *Ibid*.

This suggestion was made prior the introduction of the new CL 2015. This exception has been repealed by s.71 of the CL 2015.

There is a well-known legal case of conflict of interest that concerned a decision made by the chairman of the board and board members of the Saudi Chemical Company. This was to allow the purchase of 15 per cent of the shares of one of the company's subsidiary groups, without informing the company's general meeting, even though the chairman had an interest in the transaction. The Saudi Chemical Company also failed to announce either on the stock exchange website or the company's website that the transaction was associated with a related group. The CMA Board consequently levied a fine of $13,333 on the chairman of the board, as well as on each board member.[327]

3.2.2.3 Duty to disclose any personal interest related to contracts and business carried out in favour of the company

S.71 of CL 2015 states the responsibility of members of the board of directors to disclose any personal interests relating to contracts and businesses carried out in favour of the company to the board of directors, and registered in the minutes of the meeting. Members are not allowed to participate in any subsequent discussion relating to a decision. It is also required that the chairman publicly announce the GM, together with all contracts and businesses carried out in the interest of the

[327] For more information, see http://www.argaam.com/article/articledetail/127502 .

company. A notification of any members of the board of directors who have a personal interest is to be included in a special report prepared by the accounts controller. However, s.71 of CL 2015 introduces a new provision that if directors failed to disclose their interest, they could be subject to a litigation by the company or stakeholders. They could be forced to cancel the contract or to compensate or indemnify the company or the stakeholders for any financial gains made by the members from these contracts.

It is clear that Saudi CL 2015 adopts the principle of transparency and disclosure in order to clarify the relationship between the company and members of the board of directors.[328] The Minister of Commerce issued a Circular in 1994, which included regulations of disclosure, as discussed below:

a. Members are required to give notice to the board of directors of any personal interest in business and contracts carried out by the company, which is to be registered in minutes of the meeting of the board of directors.
b. Members who have a personal interest in any of the company's business and contracts are not allowed to participate in decision voting.
c. The chairman of the board of directors will notify the Ordinary General Assembly when members of the board of directors have a personal interest in the company's contracts and businesses.

[328] See Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, pp.330,331.

d. A special report of these contracts and businesses is to be prepared by the accounts controller and presented to the Ordinary General Assembly of the company.
e. The Ordinary General Assembly of the company may give permission for a member to engage in such businesses, which would be renewed annually.

3.2.2.4 Duty not to engage in business that would be in competition to the company

Within the CL 2015, s.72 states that members of the board of directors cannot engage in activities, such as trading in one of its branches, or to be involved in any business that competes with the company. If this does take place, then the company could claim any profit or income from members' personal benefit to be its own revenue, as well as claiming compensation. However, if a member were to be authorised to engage in such business activities by the GM, then this activity would be considered an exception. This authorisation should comply with the Ministry of Commerce Circular issued in 1994 regarding permission regulations, as well as issues of disclosure discussed earlier.

Engaging in business that could compete with the company's interests when exceptions are made for members of the board of directors has been challenged by some researchers, as harm can be caused to stakeholders, shareholders and the company. Therefore, if a member of the board of directors is to be given permission that would raise a conflict of interest situation, then this would prohibit such competition.[329] When considering the trading and business competition concept within a branch of the company, this normally includes engaging in similar activities in a partnership company or proprietorship. In addition, irrespective of the category or type of company, this concept would include being a director or manager of a partnership company or proprietorship.[330]

This issue also includes a member involved in competition activity or similar trading activities in a branch of the company, when working explicitly or implicitly as a trader agent.[331] To clarify the issues of conflict of interest and competition, competitive activity is not interpreted within a company structure that is similar, but in activities with a similar purpose to the company.[332]

S.72 of CL 2015 has produced criticisms that its nature is too general, as all activities are deemed to form competition for the company, or even participation, which are strictly prohibited, but this includes harm if a member purchases shares in a competitor company, when members should only be restricted from involvement in managing another company[333]. However, if members of a board

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[329] See Mohammad, Bariri, *The Saudi Law of Commercial Transactions*, Institute of Public Administration, Riyadh, 2007, p.225.
[330] See Mohammed, Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p.331,332.
[331] *Ibid*.
[332] See Towma AlShammari, *The Board of Directors of Joint Stock Company,* Kuwait Est for Scientific Progress, Kuwait, 1985, p.160.
[333] See Sadiq Al-Jubran *The Joint Stock Company's Board of Directors in Saudi Law* Alhalabi for legal publications, Lebanon, 2006, p.413.

of directors engaged in business activities that would be considered competition for the company, they could be forced to compensate or indemnify the company for any financial gains made by the members from these business activities, or consider that these gains are its own revenues.[334] The penalties for these activities have been considered to be inadequate and too lenient, so that if members violate this ban on business activities that would compete with the company, they have to repay any financial gains they make from any profits, revenues or pay the company compensation due, but critics have suggested that these members should also be dismissed from the board of directors[335].

One example of a director being dismissed due to involvement in business activities that were in competition to the company was shown by Methanol Chemicals in Saudi Arabia. In this case, the member of the board of directors had been given three months to terminate his competitive business activities, but refused to comply, and so his suspension from the board was enforced. This action by the board of directors complied with ss. 68 and 81 of the CL 2015 and Article 18B of the CGC to remove the member[336]. This action demonstrated that the interests of the company had been harmed by this member of the board of

[334] See Mahmoud Babili, *The Commercial Companies*, Scientific institution, Syria,1978, p.156, also see Ibrahim Zamil and Walaa Raafat, *The Memorandum and Articles of Association of Joint Stock Company in Arab Gulf Cooperative Council Countries*, The New National Press, Khobar, 1989, p.154.
[335] See Mohammad Bariri, *The Saudi Law of Commercial Transactions,* Institute of Public Administration, Riyadh, 2007, p.225.
[336] For more information, see http://goo.gl/e4tIGv [Accessed 1 April 2014].

directors when participating in competitive activities, and showed that the penalties for members in breach of their duty were insufficiently covered by the provisions of s.72 of CL 2015. The company concluded that dismissal (expulsion) of the member was appropriate.

3.2.2.5 Duty: Confidentiality should be maintained

Other than during General Assembly Meetings, members of the board of directors cannot publically announce or disclose secret information to shareholders or other parties, and penalties for breaking company confidentiality could include the payment of indemnification and compensation subject to liability, and could be dismissed[337]. These types of secret information referred to by the CL 12015 would normally be made available to members of the board of directors due to their position within the company[338]. In addition, information made available to members of the board of directors cannot be used by them to gain benefit or interest for themselves or their relatives.[339]

The evaluation of company secrets by some researchers suggest that this would be company information that it does not wish to announce publically to shareholders or other parties, and could use penalties of compensation or

[337] S.72 of the CL 1965, s.74 of the CL 2015.
[338] See Hamad, Al-Obaid, *The Board of Directors of Joint Stock Company*, Hard copy, MA Thesis, The Higher Institute of Judiciary, Riyadh, 2000, p.70. This dissertation is the only source for this aspect of the topic, and the work has not been published elsewhere.
[339] See Mohammed Al-Moukili, *The Legal Status of Joint Stock Company's Board of Directors & its Liability*, Institute of Public Administration, Riyadh, 1984, p. 32

dismissal for members found to liable of contravening this policy.[340] This interpretation could be confusing, as members of the board of directors should not disclose or announce publically any information made available to them in their position, which could disregard whether or not the company might wish to communicate certain information to shareholders. This confusion arises because although s.74 of the CL 2015 states no information can be publically announced or disclosed to shareholders other than at General Assembly Meetings, this section does not identify whether or not the company might wish this information to be communicated. It remains unclear who has authority to dismiss a member, and even under Saudi Law, but the section has the intention of giving the board of directors full authority to claim compensation or dismiss a member, or the member in question gaining personal interest could acquire influence in deciding any legal case that occurs[341].

The issue of members of the board of directors being stopped from disclosing secret information to shareholders has been challenged by some researchers, who argue that shareholders are partners of the company and this prevention or prohibition for members should be expected. The argument is that it would be

[340] See Mahmoud Babili, *The Commercial Companies,* Scientific institution, Syria, 1978, p. 157.
[341] See Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in Saudi Law,* Alhalabi for legal publications, Lebanon, 2006, p.288.

better to assign responsibility and liability for secrets of companies that are disseminated or disclosed to other parties[342].

3.2.2.6 Duty to act within powers

The board of directors has responsibility for the administration of the company, which is defined by law as having full powers. However, the board has a scope of competence that entitles it to delegate an activity or certain actions to one or more of its members.[343] This scope of competence does not extend to the board of directors offering cash loans to individual directors, or guaranteeing a loan taken out by an individual member, and if such contracts were to be arranged, then they would have not validity.[344]

However, there is an exception in the case of banks, as Saudi Companies Law enables the board of directors within certain terms and conditions and for the purposes of the bank's business activities, to arrange loans for individual members to carry out deals and transactions, open L/Cs or guarantee a loan arranged by a member with a third party[345]. This permission under Saudi law is justified as it is not considered acceptable or reasonable to stop members of the

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[342] See Mohammad Bariri, *The Saudi Law of Commercial Transactions*, Institute of Public Administration, Riyadh, 2007, p.225.
[343] S.73 of the CL 1965, s.75 of CL 2015, and Article 11 (h) of CGC 2006.
[344] S.71 of the CL 1965, s.73 of CL 2015.
[345] *Ibid*.

board of directors in arranging transactions or ordinary deals that other clients of the bank would be likely to carry out. [346]

The board of directors cannot arrange loans that would exceed a maturity of three years, which is defined by s.73/2 of the CL 1965. Other restrictions on the board of directors identified by this section include writing off debts of debtors of the company, taking a mortgage or selling on the assets of the company unless permission is provided by terms and conditions stated in the memorandum and articles of association of the company. In such cases, the GM would need to give permission to the board of directors when such provision is not included in the memorandum and articles of association of the company, and the board would otherwise not be able to carry out any of these discretions or actions[347]. However, this provision was modified by s.75 of the new CL 2015 which states that the directors can arrange loans regardless of their length, taking a mortgage or selling on the assets of the company or any actions mentioned above, unless these actions were restricted by the company's article or GM.

3.2.3. Relief from liability

If damage has been caused to the company by directors as a result of their misconduct, abuse or violation of Companies Law or the constitution of the

[346] See Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in Saudi Law,* Alhalabi for legal publications, Lebanon, 2006, p.286.
[347] *Ibid*.

company, then s.78 of the CL 2015 states that directors have a joint liability for compensation by other companies, shareholders or third parties.

Therefore, any shareholder of a company could begin proceedings on behalf of the company against directors under Saudi law if wrongful action has caused harm to the company. However, shareholders need to notify the company of their intention of starting liability proceedings, and to have a valid right to institute this. When such action is taken by a shareholder, the level of compensation will be based on the financial damage caused to this individual. However, the Saudi legal system in the CL has no requirement for shareholders to gain permission from the courts to begin legal action against member of a board of directors, but are required to inform the company of this intention before legal proceedings begin.[348] Other countries have a different interpretation of liability, such as the UK, where directors can have their liability removed when in breach of their duties as a result of legal regulations[349], but this contrasts with Companies Law in Saudi Arabia where liability is more strictly applied.

Saudi law gives permission to the board to carry out various discretions and activities, such as gaining authorisation from the Ordinary General Assembly to engage in business that would be in competition to the company[350]. In terms of

[348] S.78 of Saudi CL 1965, s.80 of the CL 2015. The possible actions that can be taken against director will be discussed in depth under Chapter 4 and 5.
[349] Ss. 239 and 1157 of the CA 2006.
[350] Ss. 69, 73 of the CL 1965, s.71 of the CL 2015.

ratification, s.78 of the CL 2015 rejects the ratification of wrongful action under Saudi law. Originally, liability for unlawful action by directors could be ratified by a majority decision at the Ordinary General Meeting, and defined in law by s.76 of the CL1965, except for incidents of cheating or malpractice. However, in 1992, the Royal Decree no 22 amended s.76, so that ratification of unlawful action by individual directors was strictly rejected.[351]

In contrast, the UK CA 2006 (section 1157) gives courts the power to remove liability from directors if their activities were reasonable, honest and it was just and equitable to do so, but when negligence or default caused liability. This is not supported by the Saudi CL 2015, because this law considers that if directors carry out negligent or aggressive actions, this cannot be used as an excuse to remove liability from directors, as this violates elements of Shari'ah Law, and is rejected.[352] Also, under Saudi law, exemption clauses that exclude directors from liability are considered to be without validity[353]. In conclusion, under Saudi Companies Law, if a company has been harmed under any circumstances, directors cannot be relieved of their liability. This is justified as a protection for

351 S.76 of CL 1965 and its amendment by the Royal decree No. 22 in 04/02/1992.
352 The Shari'ah law perspective of the power of forgiveness is clarified in the previous section "Directors' Duties in Shari'ah law".
353 S.76 of the CL 1965, s.78 of the CL 2015.

the rights of stakeholders, investors and shareholders, and to guarantee that a company is managed well[354].

3.3. Directors' Duties in UK Law

Positive corporate behaviour has always been seen to rest on the duties of directors. In 1992, the report Financial Aspects of Corporate Governance (the Cadbury Report) provided illustrations of the chief responsibilities of directors. According to the report, directors decide on a company's strategic goals and provide the management to bring these goals about. They oversee the running of the company and ultimately must give an account of their supervision to shareholders[355].

Prior to the Companies Act 2006, the common law of negligence and equitable principles of fiduciary duties guided company directors in their responsibilities in the UK. These principles were summarised in sections 171 – 177 of the CA 2006 and are the most noteworthy aspect of the Act in that they provide a statutory foundation for director responsibilities, something that did not previously exist[356].

In the current part of this paper, the effects of the CA 2006 and common law principles on board of directors' responsibilities will be explored. The following

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[354] Mohammed, Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p.344.

[355] Adrian Cadbury, et al. *Committee on The Financial Aspects of Corporate Governance*, Gee, London, 1992.

[356] Derek French, Stephen W. Mayson, and Christopher Ryan, *Company Law*, Oxford University Press, 2015-2016, pp.476-478.

question will be answered: are these two elements enough to assure that board members will not act outside the rules in the UK or is further reform needed?

Fiduciary duties, as the foundation of the duties in the CA 2006, will be examined as will the statutory responsibilities as outlined in the CA 2006. A summary of behaviour deemed to be a violation of these responsibilities will be given. The current research will only offer an appraisal of the responsibilities of directors who protect shareholders' rights.

As a final point, the ability of the court to offer directors relief from liability will be looked at as some violations of their duties can, indeed, lead to them being held personally responsible.

3.3.1 The beneficiaries of directors' duties

The enforcement of the responsibilities of directors is closely linked to who these duties are, in fact, intended to serve. Section 170(1) of the CA 2006 clearly stipulates that companies are the intended beneficiaries of directors' duties to the exclusion of any individual or group outside the company. As a result, the responsibilities of directors can only be policed by someone who has the authority to act on the company's behalf[357].

What the CA 2006 is silent on, however, is whether individual shareholders of a company are owed fiduciary responsibilities. In the case of a business with a large

[357] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, pp.505-507.

amount of shareholders, the only circumstance in which fiduciary duties are thought to be applicable is when directors provide guidance during a bid for a takeover[358]. It has been held by Hoffmann J in *Re a Company*[359] that guidance concerning takeover bids is not required from a director. However, if such guidance is offered it has to be given with the intent of obtaining the premium price for shareholders[360].

However, it was found by Swinfen Eady J in *Percival v Wright*[361] that the directors had not violated their responsibility to not reveal discussions involving the company to shareholders of the vendor when a contract was arranged to buy shares belonging to the company. Directors do not have to act in the best interests of individual members but for the whole of a company[362].

In *Hawkes v Cuddy*[363], the Court of Appeal resolved the issue of **nominee** directors. According to this ruling, a shareholder who has nominated a director is not owed any duties from the director based on this nomination[364]. However, in

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358 *Ibid*, pp.507-509.
359 *Re a Company* [1986] BCLC 382.
360 See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.509.
361 [1902] 2 Ch 421.
362 Mohammad Rizal Salim and Teh Tai Yong, "Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors." International Journal of Law and Management 50.4, 2008, 168.
363 [2009] EWCA Civ 291.
364 For in depth review see Mathias Siems and David Cabrelli, *Comparative Company Law: A Case-based Approach*, Hart Publishing, 2013, p.65.

practice a nomination may hinder a director's responsibility to judge matters independently as a shareholder who nominates a director will want that director to think of their interests first. To deal with this, ss.173 and 175 of the CA 2006 stipulate that only when a board of directors has officially allowed it can a nominee director act in the best interests of the nominator rather than the company[365]. The commercial truths of an appointment of this kind continue to pose legal problems. There appears to be a conflict between an appointment like this and the responsibilities of directors, especially the duty to encourage the success of the company as per s.172 of the CA 2006 . The situation of nominee directors highlights the issue of just how much influence commercial practice should have on the duties of directors and the standards they need to achieve. There is currently no legislation that deals directly with nominee directors which means that CA 2006 fails to address this issue. The courts have recognised that nominee directors will deliberate on the best interests of the people who nominate them. However, it has mostly been held that this is acceptable only if the actions of directors in favour of a nominator do not have any adverse effect on the company's welfare[366].

[365] Mohammad Rizal Salim and Teh Tai Yong, "Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors." International Journal of Law and Management 50.4, 2008, 168.

[366] Deirdre Ahern "'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy" L.Q.R. 2011, 127 (Jan), 118.

Furthermore, by its reticence in this area, UK company law allows the acknowledgement of directors' duties owed to creditors, separate employees and other stakeholders[367].Yet, when a company is insolvent, s. 172 (3) of the CA 2006 states that directors must act in the best interests of creditors. This is reinforced by Street CJ in *Kinsela v Russell Kinsela Pty Ltd*[368] who affirmed that creditor interests intercede when a company is insolvent as it is now assets belonging to creditors rather than shareholders that are being administered by directors. This is the case until liquidation occurs, the company is again solvent or different management is installed[369].

A report by the Association of Chartered Certified Accountants claims that the Company Law Review did not properly deal with the issue of whose interests should be served in the running of a company[370]. This issue will not be addressed at present but will be explored during the discussion of a director's duty to encourage the success of a corporation.

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367 See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.509.

368 [1986] 4 NSWLR 722.

369 *Kinsela v Russell Kinsela Pty Ltd* [1986] 4 NSWLR 722 at 730.

370 See David Collison, Stuart Cross, John Ferguson, David Power and Lorna Stevenson "Shareholder primacy in UK corporate law: an exploration of the rationale and evidence" Council of the Association of Chartered Certified Accountants, London, 2011.

3.3.2 The fiduciary duties [371]

The fiduciary character of the association between a company and company directors poses a number of problems. The issues of who a fiduciary actually is, what a fiduciary relationship consists of, and its importance in a corporate context all need resolving[372].

The definition of a fiduciary is someone who assumes the responsibility of acting in someone else's interests in regards to a specific issue which, in turn, results in an association of close trust between the two[373]. There are two parties to a fiduciary relationship: the 'power holder' and the dependent party. The dependent party gives the power holder (and the power holder accepts) responsibility for the management of a certain element of the dependent party's existence. The dependent party now relies upon the power holder's management in this area[374].

Fiduciary principles and obligations are used in place of direct monitoring and, as a result, the expense of complicated commercial transactions is lessened. This is because these obligations do not necessitate the employment of an expensive

[371] Since there are some duties considered to be fiduciary duties but now are found in Chapter 2 of Part 10 of the statute such as, duty to act within powers, duty of care, and duty to avoid a conflict of interest (now found in s.171, 174, 175 of CA 2006 respectively), they will be discussed deeply under the sub-section (General Duties), in order to avoid the repetition.
[372] For in depth, see J. C. Shepherd, *The law of fiduciaries*, Carswell, 1981.
[373] *Bristol and West Building Society v Mothew* [1998] Ch 1, 18.
[374] See Lawrence Mitchell, "The Death of Fiduciary Duty in Close Corporations" U. Pa. L. Rev, 1990, 1675.

supervisor to oversee work. Instead deterrents are in place, much the same as a library will fine you for returning a book late rather than come knocking on your door when the book is due[375].

Fiduciary obligations strike a balance between equity and effectiveness. Power holders are stopped from taking advantage of their role and the characteristically substantial expense of direct supervision and complex bargaining is lowered which cuts down the transaction costs linked to the relationship[376].

Minority shareholders are also benefited and protected by directors' fiduciary responsibilities as directors must act in the interests of the whole of a company. Decisions made at general meetings do not have to adhere to fiduciary responsibilities so if management decisions were able to be made minority shareholders would be at a disadvantage[377].

Reliance theory provides the core structure to fiduciary duty and comes about when one party places trust or, generally, reliance in another party[378].

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375 See Frank H. Easterbrook and Daniel R. Fischel "Corporate Control Transactions" 91 Yale L. J, 1981, 700.

376 See Alison Anderson, "Conflicts of Interest: Efficiency, Fairness and Corporate Structure", 25 UCLA L. Rev, 1978, 738.

377 See Anthony O. Nwafor, "Impracticability as a ground for the court-ordered company meeting: in whose interest? A comparative perspective: Part 1" Comp. Law. 2012, 33(8), 247.

378 See J. C. Shepherd, *The law of fiduciaries*, Carswell, 1981, p.56.

A board of directors is usually entrusted with the management of the business and affairs of a company according to normal corporation statute. The courts have repeatedly acknowledged that a director of a company owes that company a fiduciary duty with innumerable court cases highlighting that loyalty and due care are particular fiduciary obligations[379].

These two duties sometimes seem to overlaps but can be distinguished in that the duty of care is founded on law of negligence principles whereas the responsibility to be loyal to a company is founded on equitable principles set down by courts of equity[380].

3.3.2.1. Duty of Loyalty

The key fiduciary principle of loyalty demands that board members avert any insider trading or conflicts of interest[381]. Additionally, if a board member provides information that will result in personal benefit this situation must be divulged[382]. Franks has explained insider trading as arising when board members employ their experience and knowledge of particular information to deal on the

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[379] Richard M Cieri, Patrick F. Sullivan and Heather Lennox, "The fiduciary duties of directors of financially troubled companies" Journal of Bankruptcy Law and Practice 3.4, 1994, 405.
[380] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.502.
[381] See Norwood Beveridge, *The Corporate Directors' Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, *DePaul Law Review*, 1991, 41, p.688.
[382] See Aaron Yoran, *Insider Trading in Israel and England*, Alpha Press, Jerusalem, 1972, pp.15, 16.

stock exchange or otherwise buy/sell their company shares and do not, in fact, receive a direct advantage from a different contractual party[383].

Scholarship in this area and relevant court cases repeatedly stress the tight association between the responsibility of loyalty and fiduciary relationships to such an extent that it has even been proposed that the two terms equate to exactly the same thing[384]. Indeed, a fiduciary relationship can be identified if a duty of loyalty is present[385].

It is important to note that a director can resign from a company even if this resignation will have negative repercussions for the company. The power to resign is not fiduciary[386].

3.3.2.2. Duty of Care

UK common law requires a duty of care, that is, that directors behave in a prudent and educated way. This duty of care demands that directors review all pertinent information that is reasonably available to them before making decisions. The

383 See John Franks, *The Company Director and the Law*, Oyez Publishing Limited, London, 1981, p.26. Also UK law has considered the insider dealing as a crime as per s.2 UK Criminal Justice Act 1993.
384 See J. C. Shepherd, *The law of fiduciaries*, Carswell, 1981, p.48
385 See Paul Finn, *Fiduciary Obligations*, University of Cambridge, 1977, p.2.
386 See Mr Livesey QC in *Hunter Kane Limited v. Watkinss* [2002] EWHC 186 (Ch).

term 'care' is defined as the care that an average, cautious person in the same position and situation would take[387].

It has been claimed that this responsibility of care is actually a management duty and not a fiduciary duty[388]. This is because it simply demands that a particular level of judgment, skill and ability be satisfied when tasks are carried out and is not essentially linked with fiduciary relationships. As a result, a duty of care can arise in tortious or contractual relationships[389].

3.3.3 The Companies Act 2006: general duties

A statutory code reaffirming and elucidating the general common law obligations of directors towards companies is provided by Part 10 of the CA 2006[390].

The law regarding the responsibilities of directors has recently undergone some serious changes in the UK. The UK has made the choice to follow Australia, New Zealand and other common law jurisdictions after traditionally looking to its own common law rules and equitable principles for guidance in regards to directors' duties. Additionally, the CA 2006, most notably in Chapter 2 Part 10, has now summarised directors' duties. The Act will now govern the conduct of directors

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387 See Richard M Cieri, Patrick F. Sullivan and Heather Lennox, "The fiduciary duties of directors of financially troubled companies." Journal of Bankruptcy Law and Practice 3.4, 1994, 405, and see *Aronson v Lewis* 473 A.2d 812, Supreme Court of Delaware, 1984.

388 See J. C. Shepherd, *The law of fiduciaries*, Carswell, 1981, pp.48,49, and John Glover, *Commercial Equity: Fiduciary Relationships*, Butterworths, 1995, p.198.

389 *Ibid*.

390 See Arad Reisberg, "Corporate Law in the UK After Recent Reforms: The Good, the Bad, and the Ugly." Current Legal Problems 63.1, 2010, 315.

and be used to identify breaches in conduct and directors can refer to it to help them in their management activities[391].

The Act is a significant change for two key reasons: firstly, more attention will be paid to how directors behave in their role when decisions go wrong as their responsibilities have been largely clarified; and, secondly, it is no longer the law courts but Parliament that determine directors' duties[392]. However, the courts retain a fair degree of power through interpretation[393].

The CA 2006 aims to solve the problem of directors' lack of awareness of their legal responsibilities by straightforwardly enumerating these legal responsibilities in a statute which is easily obtainable[394].

In a House of Lords Grand Committee, Lord Goldsmith responded to the issue of whether the CA 2006 does, in fact, deal with all areas of the responsibilities of directors. In a ministerial statement, Lord Goldsmith stated that the general duties listed in the Act were not meant to be a full list of all a director's obligations towards his/her company but simply core responsibilities that it is appropriate to put into statute. A number of other duties may still exist, including those imposed

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[391] See Andrew Keay, "The duty to promote the success of the company: Is it fit for purpose." University of Leeds School of Law, Centre for Business Law and Practice Working Paper, 2010.

[392] See Ed "Woe to the inactive director" Comp. Law. 2008, 29(6), 161.

[393] S.170(4) of CA 2006. For in depth comment see Charles Wild and Stuart Weinstein, *Smith and Keenan's Company Law*, Pearson Education, 2016, pp.184-215.

[394] See Robert Goddard, "Directors' Duties", Edinburgh L. Rev. 12, 2008, 468.

by the Insolvency Act 1986, and a director must adhere to these unlisted duties also[395].

The responsibilities of directors are listed in Chapter 2 of Part 10 of the Act but scattered throughout the Act are other references to duties. For example, the impact of one duty on another is explored in s.172 in regards to a director's obligation to further the success of a company, s. 174 in regards to the duty of care and s.179 which stipulates that different duties can simultaneously affect each other. Finally, a number of sections, such as s.39, s.40, s.43 and s.44, deal with directors taking actions that commit their companies to contractual obligations with corporations or other third parties[396].

The Act includes a nod to previous practice, stating that general responsibilities should be understood and applied in the same manner as common law rules and equitable principles demand and relevant rules and principles should be reviewed when applying the general responsibilities of the Act (s.170(4)) [397]. Sir Bernard Rix, in *Coppage v Safety Net Security Ltd*[398], stated that the statute develops and

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[395] Quoting Lord Goldsmith's statement made at the Lords Grand Committee, Companies Act 2006: Duties of company directors, Ministerial statements (by Margaret Hodge) (DTI June 2007) available online at: http://www.berr.gov.uk/files/file40139.pdf.
[396] Bryan Horrigan, "Directors' Duties and Liabilities – Where Are We Now and Where Are We Going in the UK, Broader Commonwealth, and Internationally?" International Journal of Business and Social Science, 2012, vol. 3 (2), 21.
[397] S.170 (4) of CA 2006.
[398] [2013] EWCA Civ 1176 at 28.

even replaces previous rules and principles, but it is not yet fully understood how common law rules, equitable principles and statute are supposed to work together.

3.3.3.1. Duty to act within powers

Members of boards of directors have wide-ranging powers but these are checked by substantial limitations determined either in general meetings, a company's constitution or UK law[399]. To this end, the CA 2006 states that members of a board of directors should only use powers that adhere to determinations decided upon in general meetings or the management and the constitution of their company[400]. In particular, s.171 of the CA 2006 deals with two key aspects of directors acting within their powers, firstly, that a director must act in line with their company's constitution[401] and, secondly, that directors must only use their powers for the purposes for which they were awarded them[402].

While s.172 of the Act is unequivocal in its stance that a director must encourage the success of their company, even if an action is taken that is in the best interests

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[399] Ross Grantham, 'The Content of the Director's Duty of Loyalty', Journal of Business Law, 1993, p.150.

[400] See Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company Law and Capital Markets Law*, Pearson Education Ltd, 3rd ed, 2009, p.170.

[401] The constitution of the company is the memorandum and articles of association, but under the 2006 Act now simply the "constitution". See David Chivers, "The Companies Act 2006: Directors' Duties Guidance", The Corporate Responsibility (CORE) Coalition, 2007. Moreover, S257(1) defines references to the company's constitution to include – (a) any resolution or other decision come to in accordance with the constitution, and (b) any decision by the members of the company, or a class of members, that is treated by virtue of any enactment or rule of law as equivalent to a decision by the company.

[402] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.527.

of the company, if it is outside the requirements of an company's constitution this action will still be interpreted as a breach of a director's duty[403].

Additionally, a director could be held to have acted outside their powers even if they take an action that, in their opinion, is in the company's best interests. *Eclairs Group Ltd v JKX Oil & Gas Plc*[404] concerns a board of directors who, not long before their yearly general meeting, took a majority decision to limit particular shareholders' voting rights. The power to do this came from the articles of association of their company. Mann J, although conceding that the directors had done what they thought would be beneficial for the company, held that they had overstretched their powers. This was because the power that they had used had been granted for a specific purpose which did not include limiting shareholder voting rights. Thus, the board of directors' decision was overruled. They had violated their duty to act within their powers (s.171, CA 2006) and that they had done so to fulfil their responsibility to encourage their company's success (s.172, CA 2006) did not counteract the breach[405]. Nevertheless, it was held by the Supreme Court that directors imposed restrictions with the purpose of persuading an upcoming GM. However, the power to impose restrictions had been conferred in order to redress a failure to comply with a disclosure notice under s.793 of the

[403] *Ibid*, p.532.
[404] [2015] UKSC 71.
[405] *Ibid.*

CA 2006. Therefore, the purpose of directors deemed improper and the restrictions would be revoked[406].

It can be argued that, ultimately, directors are not really affected in what they are allowed to do for their company. Nonetheless, certain actions by directors will be considered unlawful, for instance, if a director uses their powers to stop themselves from being removed[407]. If a director has the full support of the other board of director members, however, the very same use of power and results will not be considered unlawful but entirely fitting. Directors have been accused of acting as chauffeurs for their shareholders with shareholders deciding on a destination and directors getting them there regardless of whether it is a hazardous trip or a safe one. Small-sized, owner-operated companies are in no real danger here, but company's in which a single shareholder wields a great deal of power could face this issue[408].

3.3.3.2. Duty to promote success to the company

Directors need to consider the central purpose of a company before they can run one. There are a number of different perspectives on this issue. Shareholder

[406] *Ibid.*
[407] For example: in *Punt v Symons* [1903] 2 Ch. 506. Byrne J stated that issuing shares by directors to frustrate the takeover was not in the best interest of the company.
[408] See Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.

primacy theory asserts that companies exist only for the benefit of shareholders and to make a profit. Pluralists, however, see companies as social beings that have a responsibility to the community and their stakeholders (e.g. employees, suppliers, creditors)[409]. The Company Law Review Steering Group has highlighted a new concept, ESV or the enlightened shareholder value principle. This concept holds that the optimum way of ensuring general prosperity and safeguarding people's welfare is the current aim of companies that already exists in law, namely, to generate as much value or profit as possible for shareholders. ESV falls somewhere between the other two concepts, shareholder primacy and pluralism, as a kind of concession to both[410].

In *Richard Brady Franks Ltd v Price*[411] it was established that a director's first responsibility is to the company and what is in a company's best interests is typically considered to be synonymous with what is in their shareholders' best interests[412].

Since the beginning of the 1990s, optimizing shareholder value has been a contentious topic for legal researchers and scholars. A dispute has been raging

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409 See Elaine Lynch, "Section 172: A Ground Breaking Reform of Directors' Duties, or the Emperor's new Clothes? Comp. Law. 2012, 33(7), 196.
410 Ji Yap, "Considering the Enlightened Shareholder Principle" Comp. Law. 2010, 31(2), 35.
411 [1937] 58 CLR 112.
412 See Mohammad Rizal Salim and Teh Tai Yong, "Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors." International Journal of Law and Management 50.4, 2008, 168.

over what the purpose of a corporation actually is. Even as far back as 1932 the Harvard Law Review published a notorious feud between Harvard Law Professor Dodd and Professor Berle of the University of Columbia, a specialist in corporate law. They were on two opposite sides of the fence with Dodd asserting that the true purpose of a company was not wholly about shareholders but involved the acknowledgment of a responsibility owed to employers, customers and the community, and Berle who believed that any powers given to directors of a company were given solely for the purpose of obtaining optimum profits for shareholders[413]. Berle was supported in 1970 by Milton Friedman, a Nobel Prize winner who published a well-known essay in that year claiming that a company's sole true objective is to optimize profits for the benefit of the business's owners/shareholders[414].

Due to how shareholders assessed the work of companies, during the 1980s and the 1990s the strategic decision-making done in listed firms was driven by the shareholder primacy theory[415]. Eventually, the central consideration of optimizing shareholder value did progressively lose ground and the close of the

[413] See E. Merrick Dodd, "For Whom are Corporate Managers Trustees?" Harvard Law Rev, 1932, vol 45 (7), 1145, and also see Lynn A Stout, *The shareholder value myth: How putting shareholders first harms investors, corporations, and the public*, Berrett-Koehler Publishers, 2012, pp.16,17.
[414] See Milton Friedman, "The Social Responsibility of Business is to Increase Its Profits", New York Times Magazine, September 13, 1970, 32.
[415] See Jaco Lok, "Institutional logics as identity projects", Academy of Management Journal 53(6), 2010, 1305.

1990s and the early years of the 2000s saw a number of new arguments make their way into legal journals. The focus of these articles, usually penned by legal professionals, was one key idea that the Chicago School of economists had ignored or simply not considered. The real situation was that the duty to optimize the value of a company for shareholders has never been demanded by corporate law in America[416].

The optimization of shareholder value will probably remain the dominant approach to business while the Eurozone continues to face serious economic stresses. However, maintaining the status quo and not re-evaluating the importance of shareholders could lead to the failure of businesses and impropriety in business and may have a negative impact on broader stakeholders and the environment[417]. In fact, the recent financial crises of 2007-2009 have been blamed primarily on the theory of shareholder primacy and the subsequent squeeze on businesses to make short-term gains. A reduction in investment, extremely high-risk moves and over-leverage led to a temporary and damaging rise in earnings[418].

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[416] See Lynn A Stout, *The shareholder value myth: How putting shareholders first harms investors, corporations, and the public*, Berrett-Koehler Publishers, 2012, p.23.
[417] See Chizu Nakajima, "Shareholder Primacy revisited ", Comp. Law. 2012, 33(7), 193.
[418] See Jay Lorsch, Martin Lipton, Theodore Mirvis and Wachtell Lipton, "The Proposed "Shareholder Bill of Rights Act of 2009" Harvard Law School Forum on Corporate Governance & Financial Regulation (May 12, 2009), and accessible at : http://blogs.law.harvard.edu/corpgov/2009/05/12/the-proposed-%E2%80%9Cshareholder-bill-of-rights-act-of-2009%E2%80%9D/ [Accessed 7 January, 2014].

Keay, a proponent of the ESV principle, has argued that optimizing a business is not all about gaining higher profits. It includes other elements such as improving the reputation of a company, something that will positively affect a business's worth in the long run. Keay asserts that members should be advantaged by the optimization of the value of a company but only incidentally[419].

A further consideration is the range and variety of concerns and values that shareholders have. Shareholders may intend to only hold on to their stock for a little while and will care about what share prices are doing right now[420]. Others may not be able to sell their shares, for example, they may hold the market through index funds, and will be, therefore, more concerned with the longevity of their investment. They will be interested in companies in specific directories remaining strong through their adoption of good corporate practices, their adherence to legal requirements and their support of considered decisions and sensible risks[421].

Before the CA 2006, the optimization of shareholder value and the importance of generating profits for shareholders was considered to be the predominant tactic

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[419] See Andrew Keay, *The Corporate Objective*, Edward Elgar Publishing Limited, 2011, pp.273,320.

[420] Lynn A Stout, *The shareholder value myth: How putting shareholders first harms investors, corporations, and the public*, Berrett-Koehler Publishers, 2012, p.9.

[421] See Leo E Strine Jr "One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term." The Business Lawyer 66.1, Nov 2010, 1.

in the UK[422]. The Act itself aims to exemplify the ESV principle and the key objective of companies is dealt with in s.172[423]. According to this section, company directors have to behave in a manner that the director, in good faith, believes will best encourage the success of a company for all of its members. In acting, a director has to give particular consideration to: any long-term repercussions that may arise; what is best for the company's employees; the importance of supporting the company's positive relations with customers and suppliers and others; what effect may be felt by the community and environment because of the company's actions; the importance of the positive reputation of the company regarding its conduct in business; and the necessity to act equitably between company members.

The definition of success becomes important at this point. The definition offered by Lord Goldsmith posits that success is simply what members as a whole want a company to accomplish. While community-based companies and charities will seek to accomplish the goals that their company was expressly created to attain, for commercial companies, success typically equates to a long-term rise in worth[424].

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[422] Elaine Lynch, "Section 172: A Ground Breaking Reform of Directors' Duties, or the Emperor's new Clothes? Comp. Law. 2012, 33(7), 196.
[423] Ji Yap, "Considering the Enlightened Shareholder Principle" Comp. Law. 2010, 31(2), 35.
[424] Quoting Lord Goldsmith's statement made at the Lords Grand Committee, Companies Act 2006: Duties of company directors, Ministerial statements (by Margaret Hodge) (DTI June 2007) available online at: http://www.berr.gov.uk/files/file40139.pdf.

The CA 2006 has as one of its principal aims the promotion of a culture that encourages longer term investment and an increase in the participation of shareholders. The ESV principle is deeply ingrained in the statute and can be seen in the clauses that demand that directors encourage the success of a company in the interests of shareholders. To achieve this success directors have no choice but to consider both immediate and future concerns as well as broader issues, for example, environmental repercussions and the impact of the company's actions on consumers, suppliers and employees[425].

The stance taken by the UK is not approved of by the Australian Parliamentary Joint Committee on Corporations and Financial Services. The Committee argues that there is now a lot of ambiguity surrounding the legal manifestation of the responsibilities of directors. One ambiguity is the purpose of companies and the impossibility of anticipating whether a court may hold that a company's purpose goes beyond simply benefiting members and, if it does, in what way it extends beyond this. It is argued that a director may not be privy to the required basic information about their company and unaware of who they owe a duty to without a decision on the purpose of their company having been made[426].

The Australian Corporations and Markets Advisory Committee (2006) has also weighed in. The Committee highlighted the danger that any alteration to the

[425]See Company Law Reform Presented to Parliament by the Secretary of State for Trade and Industry, March 2005 (Cm 6456) available at: http://www.berr.gov.uk/files/file13958.pdf.
[426] See Parliamentary Joint Committee on Corporations and Financial Services, "Corporate Responsibility: Managing Risk and Creating Value", June 2006.

Corporations Act that explicitly necessitates or licenses directors to act in accordance with the interests of particular stakeholders or particular issues would have. Instead of elucidating the issue, the Committee argues that such an amendment would put the purpose of a company, which a director must work towards, in doubt. The rights of other parties would not be bolstered and, in fact, it would have the effect of reducing director accountability to shareholders[427].

Indeed, in the CA 2006, s.172 does not actually confer on any individual or group of shareholders the right to enforce the duty owed by a director to the company, except in the case of a shareholder derivative suit. However, this is how it has always been; as a director owes its duty to a company it is only the company that can pursue a director for any breach of these duties[428].

Any potential breach cannot be evaluated based solely on financial aspects, for example, by comparing the share price of a company before and after the disputed behaviour[429]. In a derivative suit, the court will look at whatever the claimant presents, showing that courts have the capacity to establish whether a director's actions were intended to further the interests of the company or not[430]. In *Madoff*

[427] See Corporations and Markets Advisory Committee "the social responsibility of the corporation", December 2006, pp.111, 112.
[428] See Andrew Keay. "The duty to promote the success of the company: Is it fit for purpose." University of Leeds School of Law, Centre for Business Law and Practice Working Paper (2010).
[429] Andrew Keay, *The Corporate Objective*, Edward Elgar Publishing Limited, UK, 2011, p.273.
[430] *Ibid*.

Securities International Ltd v Raven & Ors[431], it was held by Popplewell J that the fact that a director would have acted differently if left to his own devices does not consist of a breach of duty if he did what he thought, in good faith, was in the best interests of the company.

The discussion over the purpose of a company has now moved on. It is no longer a question of whether a company should harmonise shareholder, non-shareholder and community concerns but how and for what purpose this should be done[432]. In order to establish a standard that should be applied by the court when reviewing the directors' conduct to determine whether the relief can be granted or to liability can be imposed, a model of application of the business judgment rule has been introduced into statutory provisions in Australia[433]. That can be considered when the new modified law is introduced[434].

3.3.3.3. Duty to exercise independent judgment

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[431] [2013] EWHC 3147 (Ch).

[432] See Bryan Horrigan, "Directors' Duties and Liabilities – Where Are We Now and Where Are We Going in the UK, Broader Commonwealth, and Internationally?" International Journal of Business and Social Science, 2012, vol. 3 (2), 21.

[433] See Carlos Andrés Laguado Giraldo, *Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU*, Erasmus University, 2005, p.121.

[434] See Matthew Hooper, "The Business Judgment Rule: ASIC v Rich and the Reasonable–Rational Divide" Company and Securities Law Journal, 2010, 28, 423. It is suggested that the implementation of a model of BJR application is affected by three key elements: the legal doctrine, in relation to reviewing or questioning business judgements, that the courts support; the idea of the duty of care; and the extent and efficacy of derivative litigation. For in depth, see Carlos Andrés Laguado Giraldo, *Factors Governing the Application of the Business Judgment Rule: An Empirical Study of the US, UK, Australia and the EU*, Erasmus University, 2005, p.162.

A company director is under an obligation to judge situations independently. This duty is not breached if the director acts in line with any limitations on his/her discretion sanctioned by the company's constitution or through an agreement appropriately entered into with the company[435].

One example of a possible breach of the duty to exercise independent judgement is in relation to nominee directors. A nominee director comes about when a nominator (either an individual shareholder or the company) from the controlling company assigns its employees to sit on the board of a subsidiary company. In doing this, a nominee director must consider the nominator's interests and not those of the company which may occasion a breach of the independent judgement duty. This is dealt in s.173 and s.175 of the CA 2006 which allows this situation if the board of directors has sanctioned it[436].

The duty to use independent judgement implies that what a director may not always reflect the needs of members. However, s.172(2)(b) of the CA 2006 absolves directors of having to worry about the use of their own judgement so long as what they do meets with the approbation of members, a stipulations that

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[435] S. 173 of the CA 2006.
[436] See Mohammad Rizal Salim and Teh Tai Yong, "Market Freedom or Shareholders' Protection? A Comparative Analysis of the Duties of Nominee Directors." International Journal of Law and Management 50.4, 2008, 168.

appears to be a contradiction and ignores the responsibility of directors to think about employees' interests[437].

The Cadbury Report makes a number of suggestions designed to safeguard independent judgement. Every board of directors should have at least three non-executive directors (the chairman of the company may hold one of these spots) of which the majority should come from outside of the company[438].

3.3.3.4. Duty to exercise reasonable care, skills, and diligence

In UK common law, the term 'standard of care' is a subjective one. Romer J, in *Re City Equitable Fire Insurance Co Ltd*[439], held that the standard of care owed by a director was that they had to show the level of skillfulness of someone of experience and intelligence[440], a claim that has been censured as it has long been considered that directors are not subject to any minimum standard of care according to common law. The only requirement regarding care that directors must observe is simply that they have to do things to the best of their abilities[441]. The widely held explanation for common law's approach to the standard of care of directors is two-fold. The courts are believed to have been considering only

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[437] See Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.

[438] Adrian Cadbury, et al. *Committee on the Financial Aspects of Corporate Governance*, Gee, London, 1992.

[439] [1925] Ch 407 at 428-429.

[440] *Re City Equitable Fire Insurance Co* [1925] Ch 407 at 428-429.

[441] Julie Cassidy, "Directors' Duty of Care in Australia-A Reform Model." Asia Pac. L. Rev. 16, 2008, 19.

non-executive directors when discussing care and believed that non-executive directors did not hold an important position in a company of have a central part to play in the running of it[442].

The Insolvency Act 1986 (s.214(4)) went some way to making the standard of care a little more objective and was praised in *Re D'Jan* by Hoffmann LJ[443] for correctly reflecting the common law position on the duty of care owed by a director[444]. The CA 2006 similarly does not deviate from what has been established in common law in its explanation of care, given in s.174[445]. The care, skill and diligence demanded by s.174 of the CA 2006 is the same as that demanded in s.214 of the Insolvency Act 1986. The standards required all centre around what can reasonably be expected, for instance, a director has to display the level of knowledge, conscientiousness and skill that could reasonably be expected of someone who holds the position of director[446]. Although s.174 of the CA 2006 has formalised the standard of care it is still considered inadequate as it continues to be used a largely subjective yardstick. It is, therefore, subjective whether a director has actually breached their duty of care to their company[447].

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442 See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.502.
443 Hoffmann *J* in *Re D'Jan of London Ltd* [1994] 1 BCLC 561.
444 Ed "Woe to the inactive director" Comp. Law. 2008, 29(6), 161.
445 Quoting Lord Goldsmith's statement made at the Lords Grand Committee, Companies Act 2006: Duties of company directors, Ministerial statements (by Margaret Hodge) (DTI June 2007) available online at: http://www.berr.gov.uk/files/file40139.pdf .
446 See Michael Ashe, "Reasonable care, skill and diligence (case comment)" Comp. Law. 2012, 33(2), 33.
447 See Stephen Griffin, *Company Law Fundamental Principles*, England, Pearson Education Ltd, 2006, p.297.

The issue of the required level of skill was broached in *ARB International Ltd v Baillie*[448]. In this case *ARB International Ltd* sued a former employee, demanding that their previous managing director had violated a number of different directors' duties including those falling under s.174 of the CA 2006. The deputy judge found that the director did in fact have the required skill and knowledge level and did understand the company's business. This meant that he was able to act as managing director and fulfil his duties and ARB lost the trial. It certainly was not claimed that the former director had full knowledge of all aspects of the business, but he was sufficiently informed to carry out his job and had enough experience to make the necessary decisions and take the necessary actions[449].

Further progress in this area was made in *Madoff Securities Ltd v Raven & Ors*[450]. Similar to the ARB case, in this instance Madoff Securities International Ltd unsuccessfully sued their former director for breach of duty of care, skills and diligence (s.174, CA 2006). A number of comments were made by Popplewell J when he laid down his findings. The suggestion was made that a board of directors could come to an agreement by majority about the commercial benefits of any transaction. Therefore, in order to fulfill his/her duty of care, a minority director did not have to resign or decline to be involved in the practicalities of the

[448] [2013] EWHC 2060 (Comm)
[449] *ARB International Ltd. v Baillie* [2013] EWHC 2060 (Comm) at 48.
[450] [2013] EWHC 314 (Ch).

majority decision. A violation of a director's responsibilities would result if the minority director allowed themselves to be bullied by majority directors and this occasioned a complete denial of their duties. So long as there is no reason to distrust other directors, a director is completely justified in having confidence in the expertise and suggestions made by other directors[451].

3.3.3.5. Duty to avoid a conflict of interest

Circumstances in which there is even the possibility of a conflict of interest between a director and the company, whether direct or incidental and including a conflict of duties or a conflict of interest and duty, must be avoided. Section 175 of the CA 2006 makes special note of the abuse of property, opportunities and knowledge but excludes self-dealing transactions, that is, conflicts of interest where a transaction or arrangement is made with the company itself[452] which is covered by S.177 of the Act.

The most recent case with regards with the breach of this duty dealt with the situations in which a director is in breach of their duties but shareholders choose to say nothing. In such a situation, the question arises whether the silence of the shareholders should be taken to mean that the breach was conducted with their knowledge and agreement. The initial finding in *Sharma v Sharma & Ors*[453]. was

[451] *Madoff Securities International Ltd v Raven & Ors* [2013] EWHC 314 (Ch).
[452] S175 (1) (2) (3) and (7) of the CA 2006.
[453] [2013] EWCA Civ 1287.

that a director had not violated her responsibilities when she had obtained dental practices for her personal benefit and not the company's. This finding was appealed and the appeal unanimously dismissed with Lord Justice Jackson stating that as the director had obtained the dental practices with the knowledge and agreement of shareholders no breach of the duty to avoid conflicts of interest had occurred. Jackson LJ claimed that the facts of a particular case are integral in determining what a party's reticence may mean. It can be rightly concluded, he stated, that a party has given their approval to certain actions in any situation in which it would be unacceptable to stay quiet at the time and only speak up further down the line[454].

3.3.3.6. Duty no to accept profit from a third party

The CA 2006, s.176 stipulates that directors are prohibited from accepting any advantage from a third party given because s/he is a director or has done or refrained from doing something in his/her capacity as a director. The definition of 'third party' does not include an associated body corporate or individual that is acting on the company's or on an associated body corporate's behalf[455]. On the face of it, it seems that the no-conflict section in s.175 of the CA 2006 could include all of the provisions found in s.176, making s.176 redundant. However, s.176 does include a clause allowing for uninvolved directors to be sanctioned to

[454] [2013] EWCA Civ 1287at 49.
[455] S.177 (1) and (2) of the CA 2006.

accept benefits from third parties. If both ss.175 and 176 are applicable in a particular situation, then both sections should be considered[456].

A key issue concerning benefits received from third parties is whether this transaction should be considered a secret payment or a bribe and common law has established that it should be considered a bribe[457]. *Industries & General Mortgage Co v Lewis*[458] defined a transaction as being a bribe when an agent is given a benefit by a third party and that third party is aware of the position of the beneficiary as an agent and the payment/benefit is not disclosed to the principal for which the agent is acting[459]. *AG for Hong Kong v Reid*[460] clarified the variations between what can be called a secret benefit and what must be considered a bribe. Templeman LJ noted that a secret benefit can also be a bribe. It is a benefit received by a fiduciary from trust property or because of the knowledge obtained in his/her role as a fiduciary. A bribe, on the other hand, is a present taken by a fiduciary as an incentive for the fiduciary to abandon the trust owed to the principal. A fiduciary is sometimes not liable for a secret benefit except when it is, in fact, a bribe, in which case s/he is always liable.

Nonetheless, it was held by Lord Neuberger, in *Sinclair Investments (UK) Ltd v*

[456] See Paul Lyndon Davies, *Gower and Davies Principles of modern company law*, London: Sweet & Maxwell, 2012, p.611.
[457] *Ibid*.
[458] [1949] 2 All E.R. 573.
[459] *Industries & General Mortgage Co v Lewis* [1949] 2 All E.R. 573 at 575.
[460] [1994] 1 AC 324.

Versailles Trade Finance Ltd[461], that a beneficiary cannot claim a proprietary interest but only an equitable account of any assets or money obtained by a fiduciary in the case of a violation of his/her responsibilities towards the beneficiary. This only applies in the case that the assets/money has been owned beneficially by the beneficiary or that the trustee obtained the assets/money by utilising a benefit, right or prospect that was actually the beneficiary's.

In addition, it was held by Lewison LJ in *FHR European Ventures LLP v Mankarious & Ors*[462]. that Cedar was, in fact, subject to the principle and as a result held the advantage of the contract on a constructive trust for the benefit of the Investor Group. This was due to the extent of the abuse of the opportunity committed by Cedar. As such, the funds paid in pursuance of the contract that Cedar held on a constructive trust for the Investor Group were able to be traced[463]. However, this case was overturned and dismissed by the Supreme Court in July 2014[464]. It held that the notion an agent is unable to hold a bribe or commission on trust because he could not have obtained it on behalf of his principal was not consistent with previous precedent[465]. This could therefore indicate that the Supreme Court supported bribes being held on trust for the principal or beneficiary[466].

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461 [2011] EWCA Civ 347.
462 [2013] EWCA Civ 17.
463 *FHR European Ventures LLP v Mankarious & Ors* [2013] EWCA Civ 17 at 59.
464 *FHR European Ventures LLP v Cedar* [2014] UKSC 45.
465 [2014] UKSC 45 at 40.
466 [2014] UKSC 45 at 46.

Section 176 of the CA 2006 is clear in its prohibition of directors from accepting third party benefits but says nothing about whether it is appropriate for benefits to be given by directors themselves. The Bribery Act 2010, however, is clear and affects all companies, especially international corporations. The Bribery Act 2010 states that it is illegal to both accept and to give benefits or bribes[467].

3.3.3.7. Duty to declare interest in proposed transaction or arrangement

Section 175 of the CA 2006 excludes self-dealing transactions from its provisions but s.177 sets down a number of requirements. If a director is directly or indirectly interested in a suggested business arrangement or deal with the company the director must disclose the character and degree of this interest to all other directors. Additionally, this disclosure must be done prior to the company entering into the arrangement and must be done so in full and exactly[468]. Section 177 is associated with ss.175 and 176 of the CA 2006, which concern the responsibility of directors to eschew conflicts of interest and benefits from third parties.

As an example, a director would be accountable for all profits obtained if the director had used the information acquired in their role as director for their own personal benefit[469]. This situation can be avoided if a director chooses to tell the

[467] See Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.
[468] S.177 of CA 2006.
[469] See *CMS Dolphin Ltd v. Simonet* [2001] 2 BCLC 704.

members all of the details of the proposed benefit and is granted their endorsement to move forward, which can be done as a normal resolution at any general meeting[470].

3.3.4. Relief from Liability

Company law aims to establish a system that balances restrictions with the need for freedom. Any misuse of director powers must be checked but directors should not be so restricted in their activities that the effectiveness of having a powerful central core of management is compromised[471]. The post of 'director' would be an incredibly unpopular one if directors were accountable for each and every poor choice or error they make[472]. Directors should be liable for their lack of success but they must also feel safe enough to make decisions the results of which may be uncertain but could add significant worth to a company[473].

In the UK, ratification is a form of liability relief for directors. A company can ratify a variety of behaviour carried out by directors including those that equate to default, breach of trust or duty or even negligence. A company can only make the choice to ratify this behaviour from their directors by a majority vote. Neither

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[470] See Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.

[471] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.502.

[472] See William T. Allen, Jack B. Jacobs and Leo E. Strine Jr. "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law." The Business Lawyer, 2001, Vol. 56/4, 1287.

[473] See Nadelle Grossman, "Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform", Fordham J. Corp. & Fin. L. 12, 2007, 393. And also see Melvin Aron Eisenberg, "Divergence of Standards of Conduct and Standards of Review in Corporate Law", Fordham L. Rev. 62, 1993, 437.

the director nor any member associated with him/her is entitled to act as a member in a situation where this resolution is proposed as a written resolution[474].

Re City Equitable Fire Insurance Co Ltd[475] and *Re Brazilian Rubber Plantations and Estates Ltd*[476] both brought the problem of exemption from liability to the fore. In both cases an attempt had been made to protect directors from liability by including far-reaching exemption provisions in the articles of association of the companies. In 1926, the Greene Report laid out the alarming issues this situation raises[477].

According to UK law, a prudent director cannot be excused from any liability that connects him/her to negligence, breach of duty or trust or default through the use of exemption provisions. Such provisions will be rejected should the issue come to court[478]. The CA 2006 does, however, enable companies to buy insurance to cover these types of liabilities committed by their directors[479].

Furthermore, insurance can also be sought against liability brought about in association with third party claims (excluding the company or its associated companies), for example, an employee, creditor, regulatory organisation,

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474 S.239 of CA 2006.
475 *Re City Equitable Fire Insurance Co Ltd* [1925] Ch. 407.
476 *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch. 425.
477 Greene Report, Report of the Company Law Amendment Committee, London: HMSO London, 1926, Cmd 2657/1925-26, pp.19-20, paras 46-47.
478 S. 232 (1) of CA 2006.
479 S. 233 of CA 2006.

liquidator or member. This QTPIP (qualifying third party indemnity provision) is found in s.234 of the CA 2006[480].

Directors and officers insurance is also made available to companies according to the provisions in the CA 2006. This type of insurance takes the weight off directors' shoulders as they will not be obliged to personally pay for potentially long and costly litigation. Directors and officers insurance will cover situations already provided for in the CA 2006 but can actually offer more comprehensive protection than can be found in the statute. One difference is that directors and officers insurance will cover the costs of the defence of a criminal trial for directors (although not criminal penalties) until a director is convicted of an offence[481].

Section 1157 describes actions by directors that are fair, honest and reasonable would give power to courts to relieve liability from directors, when liability was caused by negligence or default. However, liability relief claimed in many courts under section 1157 is often unsympathetically dismissed[482]. Hoffmann LJ *Re D'Jan of London Ltd* stated that when a director has committed negligent action which involves the lack of sufficient care, and claimed that he had acted reasonably, this may seem odd[483].

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480 See Zoey Handforth, "Directors' indemnities under the Companies Act 2006" November 2010, Lexology and available at http://www.lexology.com/library/detail.aspx?g=9421cd83-18dc-450a-aedc-997e59ed8327 [Accessed 19 January, 2014].
481 *Ibid*.
482 See Ben Pettet, *Company Law*, Pearson Education, England, 2005, p.176.
483 Hoffmann J in *Re D'Jan of London Ltd* [1994] 1 BCLC 561.

Societal anticipation of how both executive and non-executive directors should behave has changed significantly since the publication of the Greene Report[484]. It is now necessary to look at sections of the CA 2006, such as s.1157, in terms of their context to appreciate the true objectives of the statute. For instance, the clause allowing for relief from liability for directors was enacted for the sake of non-executive directors and intended to establish a clearly defined separation between non-executive and executive directors. The special situation of non-executive directors should, therefore, be considered by courts whenever a non-executive director applies for relief[485].

3.4. The comparison

The preceding sections have highlighted the various responsibilities of directors according to UK, Saudi Arabian and Shari'ah law. While a number of similarities between the typical characteristics of directors' duties can be seen, there also exist a number of distinct variations. These differences appear in regards to a director's statutory obligations, fiduciary responsibilities, relief from liability and other areas. All of these variations must be taken into account when contrasting the obligations of directors under different jurisdictions.

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[484] Greene Report, Report of the Company Law Amendment Committee, London: HMSO London, 1926, Cmd 2657/1925-26, pp.19-20, paras 46-47.

[485] See Jean J. du Plessis and Iain Meaney, "Directors' liability for approving financial statements containing blatant incorrect items : lessons from Australia for all directors in all jurisdictions", Comp. Law. 2012, 33(9), 273.

As Saudi Arabian law is firmly based on Shari'ah law, this current section will conduct an evaluation of Shari'ah and Saudi Arabian law, taken as one, in contrast to UK law. The objective is to analyse the three legal systems in regards to directors' duties and identify what is the same and what is different between them.

3.4.1. The fiduciary duties

It has been previously discussed that the fiduciary relationship of trust is the very foundation of Shari'ah law and a concept that that the UK adopted from overseas back in the 1200s. Since then, UK common law has built upon the concept of the fiduciary relationship and has acknowledged that fiduciary responsibilities include fidelity and due attention. In contrast, Islamic scholars have given little thought to this area of law.

In Saudi Arabia, neither the CL 2015 nor the CGC 2006 refers to directors' fiduciary responsibilities. Indeed, fiduciary responsibilities are not acknowledged in legislation in Saudi Arabia. It is argued that Shari'ah law's acknowledgement of fiduciary responsibilities exerts its influence in Saudi Arabia and is applied by the courts. However, these responsibilities require explanation and codification or their integrity will be threatened by a dispersed variety of rules and principles. Saudi Arabian legislators should look to UK legislation, in particular, s.174[486] of the CA 2006 which offers an explanation of the various fiduciary responsibilities

[486] S.174 of CA 2006.

of directors, for example, the duty of care, and imposes standards that directors must meet.

3.4.2. General duties

Basic responsibilities of directors share a number of resemblances in Saudi Arabian and UK law. For example, both UK and Saudi Arabian law reflect the prohibition against conflicts of interest, the responsibility of directors to disclose any interest they may have in regards to particular deals or transactions and the responsibility of directors to act within their powers.

However, differences arise when it comes to the remedies available for a breach of duty. S.72 of the CL 2015 in Saudi Arabian law stipulates that a director is prohibited from being in any way involved with a business that is one of their company's competitors. If this situation arises, the company can claim compensation and can also demand profit or income derived for the personal advantage of the director. This remedy acts as discouragement to any director becoming involved with a competing enterprise and enhances the enforceability of this particular responsibility. The CA 2006 does not offer any such remedy for UK companies.

Directors in Saudi Arabia must encourage the prosperity of their company as per the requirement to make sure that the company's objectives are achieved[487]. If

[487] S.55 of Saudi CL 1965, s.65 of the CL 2015.

harm has been done to the company because of a director's breach of their duty or misbehaviour, s.79, 80 of the CL 2015 grant the company and the shareholders the right to bring a claim against their director/s. Yet, Saudi Arabian law is silent in regards to who exactly is owed a duty by directors and whose interests must be taken into account when a director is managing the company. This is not so in UK law. S.170 of the CA 2006, stipulates that directors owe a duty to the company and s.172 highlights the importance of the shareholder value theory, demanding that a director is duty-bound to encourage the prosperity of the company for the advantage of all members and with an eye on stakeholder interests and the enterprise's long-term prosperity.

The Saudi Arabian CGC 2006 does, in fact, acknowledge stakeholder interests as separate from shareholder interests. The CGC 2006 states that its objective is to guarantee that optimal corporate governance methods are used and adhered to in the administration of joint stock companies listed in the Exchange. The CGC 2006 goes on to state that this is done in order to safeguard the rights of both shareholders and stakeholders although it must be highlighted that the applicability of these regulations extends to listed companies only[488].

[488] Article 1-a,b of the Saudi CGC 2006.

What is contained in the CGC 2006 does indicate that the issue of whose interests need to be considered when managing an organisation has been highlighted and will be dealt with when the CL 2015 is reformed. It can be concluded that Saudi Arabian policy-makers will reflect on this issue when making decisions about revising CL 2015.

Directors in the UK are required to use independent judgement. Provided that a director's decision-making power is authorised by an arrangement agreed upon by the company in the appropriate manner or by the organisation's constitution, a director must evaluate circumstances independently[489]. However, the issue of whether a director must judge a situation independently when making a decision through the company's board is not dealt with in Saudi Arabian law.

Furthermore, in UK law, a nominee director owes their nominator no particular responsibility simply due to the fact that s/he has nominated them. This is because of the director's duty to make independent judgements[490]. Although there is no legislation that deals directly with nominee directors which means that CA 2006 fails to address this issue[491], Saudi Arabian law does not make any requirements regarding this subject. The CGC 2006 does clarify that a director is the

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489 S. 173 of CA 2006.

490 *Hawkes v Cuddy & Others* [2009] EWCA Civ 291, and also see Mathias Siems and David Cabrelli, *Comparative Company Law: A Case-based Approach*, Hart Publishing, 2013, p. 65.

491 Deirdre Ahern "'Nominee Directors' Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy'" L.Q.R. 2011, 127(Jan), 118-146

representative of all shareholders. The Code requires that a director act in the best interests not only of members who supported his being awarded the position but each and every individual he represents[492]. It again must be noted that the CGC 2006 only applies to companies listed in the Exchange and is only guidance, not law, and so may be considered to be insufficient.

3.4.3. The relief from liability

One clear similarity between Saudi Arabian and UK law is that neither allows the use of exemption clauses to safeguard discreet directors from liability[493]. Also, if a case is brought and these clauses are presented they will be rejected under both Shari'ah law[494]. Yet, a distinct difference exists in regards to ratification which is a form of liability relief allowing a company to ratify a wide range of inappropriate behaviour committed by directors that can be likened to negligence, default or breach of duty or trust. While this is disallowed in Saudi Arabian law, UK law allows it. However, it is argued that ratification will be accepted by Saudi Arabian law as prior consent given to directors is permissible and ratification is allowed in Shari'ah law.

A further relief of liability for directors in the UK is Directors' and Officers' Liability Insurance. As previously explained, directors' insurance takes considerable pressure off directors as they are not personally responsible for the

[492] Article 11-d of the Saudi CGC 2006.
[493] S. 232 of the UK CA 2006, s.76 of Saudi CL 1965 and s.78 of Saudi CL 2015.
[494] See Abdullah Ibn Qudamah, *Almugni*, Dar Hajar, Egypt, 1989, vol 5, p110.

costs of litigation, which can be both lengthy and expensive. Shari'ah law does not allow this practice and neither the CL 1965 nor the new CL 2015 makes no mention of it. There are no shortage of organisations within the country that do, in fact, offer different types of insurance contracts such as health and vehicle insurance[495]. Nevertheless, directors' liability insurance has not been recognised. In fact, insurance is vital for both individuals and business[496]. Considering this, it is necessary for Saudi Arabian legislators to identify a substitute for directors' insurance that does adhere to Shari'ah law in order to prevent potentially crippling liability.

Currently, in no circumstances does Saudi Arabian law offer directors relief of liability if a company is damaged. A director can only free themselves of liability if the board of directors authorises the director to undertaken a range of choices and actions, for example, if a director is granted a sanction to organise a loan by the Ordinary General Assembly. It is clear that UK law offers directors a far broader range of liability relief than is allowed in Saudi Arabia.

Director liability arising from default or negligence can be relieved in UK courts as per s.1157 of the CA 2006 which simply requires that directors behave in an equitable, transparent and sensible manner. However, neither Shari'ah law nor the CL 2015 makes such a provision. The reason for this stance has been

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[495] See the official website of Tawuniya Insurance Company at: https://www.tawuniya.com.sa/en. [Accessed 27 March, 2016].

[496] See Mohammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons, UK, 2007, p.418.

explained by Al-Jeber as arising from the need to ensure the proper administration of an organisation and to safeguard the rights of investors, shareholders and stakeholders[497]. Misbehaving directors have a range of liability relief at their disposal in the UK thanks to the country's relatively relaxed regulations. It is widely acknowledged that Shari'ah and Saudi Arabian law is far stricter in this matter and offers very limited liability relief for directors.

3.5 Summary

Chapter 3 has attempted to address one of the research objectives concerning directorial duties and those actions considered a breach of these duties. It has highlighted the various responsibilities of directors according to UK, Saudi Arabian, and Sharia law. While several similarities between the typical characteristics of directorial duties can be seen, there also exist a number of distinct variations. These differences appear in regards to a director's statutory obligations, fiduciary responsibilities, relief from liability for breach of duty, and other areas. The comparative exercise was done in the hope of benefiting from other countries' more advanced legal jurisdictions and avoiding any weaknesses identified in the existing Saudi law. Therefore, this chapter provided several suggestions and solutions which are intended to contribute to the enhancement of the existing Saudi law in terms of appropriate ways in which to deal with

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[497] See Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p.344.

directorial duties. This will assist the author in the critical examination of the effectiveness of the *enforcement* of directorial duties in UK legislation when compared to Saudi law. Ultimately, this stems from the fact that the evaluation of the effectiveness of the *enforcement* of directorial duties cannot be conducted without first examining the set of rules imposing directorial duties.

CHAPTER 4. Private enforcement of directors' duties

Over one hundred years ago, Roscoe Pound called for scholars to focus on law books rather than old treatises. It was Pound's belief that more attention should be paid to law in action. Law in action theory explores the role of law and its application in society, not just the law as it appears in statute[498]. Hence, if they are not efficiently enforced, the duties explored in the preceding chapter are unlikely to make any real difference to corporate management in any legal system, including that of Saudi Arabia[499]. In the case of developing nations and transition economies, the development of a successful business environment and efficient corporate management depends crucially not on regulations, laws on the books or voluntary codes, but on enforcement. This is due to the fact that the motivation of agents to conform to the rules is influenced by the manner in which the latter are applied. Thus, how efficient a regulatory system is depends simultaneously on substantive rules and approaches to implementation. Furthermore, based on whether the action is taken by a state official or a private party, enforcement is classified as either public or private[500].

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[498] See Roscoe Pound, "Law in Books and Law in Action", American Law Review 44.1, 1910, 12.
[499] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.643.
[500] John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542 .

The main difference between public and private enforcers is that, whereas the former receive payment irrespective of the results of the action[501], the latter are paid only when litigation is successful. Hence, it is reasonable to assume that cost modifications have a greater impact on private enforcement, and moreover, that private enforcement is more comprehensive compared to public enforcement when the costs are reduced[502]. Furthermore, it is easier for the public agencies to initiate enforcement due to a higher level of powers and resources which enable them to authorise any person or organisation to help them to enforce the law, such as appointing the insolvency practitioners to report whether the company directors are unfit under S.7 of the CDDA 1986. While the financial consequences are more serious in private cases, in public sanctions – when the rare penalties are imposed - errant directors often bear little relation to the profits made[503]. Moreover, public enforcement agencies are relatively centralised and subject to political control, whereas private claimants are not. By contrast, while the public actions are regularly covered, private claimants must fund litigation. Whilst this makes public enforcement easier to coordinate, detractors argue that

[501] Receiving payment through financial sanctions is not the public enforcer's main goal. Nevertheless, financial sanctions provide a self-sufficient system of securities regulation as they deliver public agencies adequate capital sources for future investigation, which, as a result, guarantees a more effective enforcement system.
[502] John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542. Also see Jonathan R. Hay and Andrei Shleifer, "Private enforcement of public laws: A theory of legal reform." American Economic Review, 1998, 398.
[503] For in depth see Andrew Keay and Michelle Welsh, "Enforcing breaches of directors' duties by a public body and antipodean experiences" Journal of Corporate Law Studies, 2015, Vol. 15, No. 2, 255.

these features also make public enforcers relatively easy to bribe[504]. Additionally, although scarce, empirical evidence indicates that the efficiency of tools of private enforcement exceeds that of public enforcement[505]. This is not to say that public enforcement is irrelevant; rather, the efficiency of private enforcement is enhanced by good public enforcement[506]. Therefore, the mechanisms of *private* enforcement are addressed in the present chapter.

However, one cannot conclude based on that common saying that a company should take legal action in each case where a director is considered to have not fulfilled his/her obligations towards the company. The key question is whether litigation would serve the interests of the company and the answer resides exclusively in the facts related to a specific case[507]. The company could suffer more serious consequences if it chooses to pursue litigation than if it chooses not to, while the personal interests of a director could also weigh substantially in the decision not to take legal action. Given these considerations, the law plays a

[504] Jonathan R. Hay and Andrei Shleifer. "Private enforcement of public laws: A theory of legal reform." American Economic Review, 1998, 398.
[505] Erik Berglöf and Stijn Claessens. "Enforcement and good corporate governance in developing countries and transition economies" The World Bank Research Observer 21.1, 2006, 123.
[506] Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.
[507] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.643.

central part in appointing a reliable individual to decide if litigation is the appropriate strategy to exercise the rights of the company[508].

Al-Abbas conducted empirical research addressing the impact of the absence of corporate governance on earnings management behaviour and questioning whether regulations should be multiplied or minimised if governance rules are to facilitate and promote Saudi commercial development. The findings of this research suggested that there is a necessity to regulate governance practices used by Saudi companies through the introduction of a monitoring programme[509].

The CL 2015 came into force on 3 May 2016. The Law represents a significant overhaul and modernisation of Saudi Company Law, aligning it closer with global trends in corporate law and governance. For example, the concept of holding companies, the possibility of setting up single-shareholder companies, provision preventing the combination of the post of chairperson with executive positions (including that of CEO) and compulsory cumulative voting have been introduced[510]. Nevertheless, as this chapter will address, the new law has made no considerable changes to minority shareholders' right to sue directors.

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[508] *Ibid*, pp.643,644.
[509] *Ibid*.
[510] A cumulative voting system permits shareholders in an election of the board of directors for more than one seat to put more than one vote towards a preferred candidate. Minority shareholders can concentrate their votes in this way, which increases their chance of obtaining representation on the board of directors.

The rules regarding the duties and obligations of directors are extensively and clearly outlined in CL 2015. However, the question is what are the measures that shareholders can take to ensure the protection of their rights if directors fail to accomplish their obligations?

A number of researchers have argued that minority shareholders have little opportunity to participate in Saudi listed companies, due to the fact that Saudi Arabia is still a developing country[511]. This argument is supported by the findings of the majority of financial, legal and political studies focusing on corporate governance systems in developing countries, which indicated that the rights of minority shareholders are largely ignored. In this context, a widespread ownership has been suggested to provide effective protection for minority shareholders[512]. Moreover, it has also been noted that minority shareholders are granted few rights by the Saudi legal system. This lack of rights arises from the definition provided by the Saudi CGC regarding minority shareholders as being those shareholders who have no control or influence over a company. Thus, according to European, American and even regional standards, the protection that corporate governance provides minority shareholders is insufficient. Being a developing corporate regulation system, Saudi CL 2015 displays significant

511 Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.230

512 Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert W. Vishny "Legal Determinants of External Finance" Journal of Finance, 1997, 52(3), 1131.

structural flaws associated mainly with the high level of concentrated ownership that it authorises in favour of the state as well as some distinguished families. As a direct consequence of these flaws, liquidity has been diminished and the stock exchange competition is almost non-existent[513].

This perspective invited intense criticism as seemingly the evidence brought forth was insufficiently conclusive to allow interpretations of the level of protection granted to minority shareholders and of the related aspects of the legal system. As proposed by La Porta and colleagues, minority shareholders are better protected by the common law system as well as by distributed ownership. However, the argument that the common law system and distributed ownership concentration are correlated is disproved by the case of Hong Kong, which has been under British colonial rule for over a century and consequently adopted the British common law system[514]. According to the findings of an empirical research, during the period 1995-2005, civil law systems gained ground on common law systems and the distinctions between them diminished. What is more, in the same period, the degree of shareholder protection offered by civil

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[513] Gonzalo Villalta Puig and Bader Al-Haddab, "The protection of minority shareholders in the gulf cooperation council", Journal of Corporate Law Studies13.1, 2013, 123. Also see Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.230.

[514] Philip Lawton and Yung Boyce, "Corporate political connection as a determinant of corporate governance in Hong Kong", Northern Ireland Legal Quarterly, 2012, 63, 449. For in depth in criticising La Porta approach see Philip Lawton "Berle and means, corporate governance and the Chinese family firm" Australian Journal of Corporate Law, 1996, 6: 348 , and Philip Lawton "Modelling the Chinese family firm and minority shareholder protection: The Hong Kong experience 1980-1995" Managerial Law, 2007, 49.5/6: 249.

law systems was greater than that provided by the common law systems not only in developed countries, but also in developing ones[515].

In the UK, a complicated network of statutory law has been created in an effort to right the balance between directors and shareholders. These laws question possible misconduct and stipulate director mechanisms and duties[516].

The UK is considered among the most advanced jurisdictions in the area of corporate law, particularly in terms of how it deals with directors' duties and their enforcement. Based on its long experience in this field, this chapter will consider a number of sources of UK law. Court cases and legislation, particularly the CA 2006, have comprehensively covered a number of actions which can be used by minority shareholders to enforce directors' duties. Even after the introduction of the new Saudi Companies Law 2015, there remain some essential points that have not yet been addressed. Hence, it will be useful to carefully consider relevant UK legislation, as it could significantly contribute to the development of the CL 2015.

The level of efficiency of existing statutory measures and practices under UK CA 2006 and SCL 2015 in safeguarding the rights of minority shareholders and their participation in private and public companies constitutes the focus of the present chapter. To this end, the measures and practices introduced under SCL 2015 compare to UK for preventing the interests of company directors from infringing

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[515] John Armour, et al. "Shareholder protection and stock market development: an empirical test of the legal origins hypothesis." Journal of Empirical Legal Studies 6.2, 2009, 343.
[516] Shuangge Wen, *Shareholder primacy and corporate governance: legal aspects, practices and future directions*, Routledge, 2013, p.74.

upon the rights of shareholders, particularly minority shareholders, are investigated in detail. The actions that minority shareholders can take to exert their rights both within and outside companies are examined as well.

Based on the analysis, it is argued that minority shareholders are insufficiently protected by the statutory measures and practices under SCL 2015 and therefore the latter should be reviewed and amended. To better achieve the outlined objectives, this chapter is separated into six sections. The first section addresses derivative claim under the UK law, which can be taken up by minority shareholders on behalf of the company, and whether this is recognised by SCL 2015. The second section concentrates on the personal suit, while the third section will explore the unfairly prejudicial conduct claim. The forth section discusses additional measures that shareholders can resort to. The fifth section presents the impediments to enforcement arising from the pervasiveness of the principle of majority rule, as well as the drawbacks of an enforcement system underpinned by shareholder action. Finally, a summary will then be provided to conclude.

4.1. Statutory derivative claim

Drawing on *Foss v Harbottle*[517], the company action is a rule which specifies that, when a company suffers damage, the company itself acts as the complainant in any litigation to rectify the damage incurred. This means that individual shareholders or a minority shareholder group are unable to initiate litigation in

[517] (1843) 2 Hare 461.

the name of the company if the latter does not give its permission first. However, several exceptions to *Foss v Harbottle* have been allowed by the courts, as the principle of majority rule could have unjust repercussions if it is unchecked. The derivative action is one such exception which permits minority shareholders to exercise the right to take legal action against directors for duty violation, right which is normally exclusive to the company. Moreover, the company receives any compensation that is awarded[518].

In the past, the UK lacked codified regulations regarding derivative claims. Nevertheless, in a few cases derivative claims were authorised, but in reality it was impossible for an individual shareholder to institute a suit on behalf of a company. This was established in *Foss v. Harbottle* in 1843 with exemptions to the rule being extremely restricted[519]. Subsequently, the CA 2006 established a codified form of the broad derivative action in ss. 260-264. The uniqueness of this wide-ranging legislative derivative action is its placement in the courts the judgment concerning whether the action is in the company's interests in order for proceedings to be instigated in any particular case. This implies that any minority shareholder interested in instituting a derivative action should obtain court's

[518] Ben Pettet, *Company Law*, Pearson Education, England, 2005, p219, 220.

[519] Mathias Siems, "Private Enforcement of Directors' Duties: Derivative Actions as a Global Phenomenon" (November 16, 2010). Final version published in: Stefan Wrbka, Steven Van Uytsel and Mathias Siems (eds.), "Collective Actions: Enhancing Access to Justice and Reconciling Multilayer Interests?" Cambridge: Cambridge University Press, 2012, 93. Available at SSRN: http://ssrn.com/abstract=1699353 or http://dx.doi.org/10.2139/ssrn.1699353

permission in order to take any extra actions in the proceedings[520]. It has been held that obtaining the permission of the court is for the benefit of the minority shareholders since they are able to get a judgment on the fundamental issue (which is, if it is for the benefit of the company for institution of a lawsuit), nonetheless, the minority shareholders' enthusiasm for derivative litigation is dependent on a judge being persuaded that a lawsuit on behalf of the company is necessary[521].

The CA requires a derivative suit as a claim emanating from an actual or proposed company director's act or omission concerning negligence, breaches of duty or trust[522]. In Part 11 of the CA 2006, a "director" includes de jure, former, de facto, as well as shadow directors[523]. Shareholders might institute a derivative action with regard to a cause of action that happened prior to them being company's members[524]. Nevertheless, an ex-member may not bring a claim even with regard to an issue that happened while he/she was a shareholder.[525]

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[520] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.652.
[521] *Ibid*, p.653.
[522] S. 260(3) of CA 2006.
[523] These directors may owe duties to the company in certain circumstances. This has been deeply analysed earlier in this thesis under Chapter 2.
[524] S. 260(5) of CA 2006.
[525] S. 260(1) of CA 2006.

The Act continues to recognise three circumstances under which leave should not be granted to institute a derivative action by a minority shareholder two of which relates to whether the existing or future breach of duty has been ratified or authorised[526]. The tests have been condemned since they are likely to leave out such actions against and with regard to common directors' negligence[527]. Even though the likelihood of approval have been constricted by s 239 of the Act that forbids self-interested members in taking part in the ratification vote, instances in which the wrong within an issue has been approved shall be encircled with contentions concerning whether the ratification is legitimate. This is because s 263 of the Act plainly insinuates that leave must not be allowed when the wrong was ratified. This implies that in several situations the efficiency of a supposed ratification shall overshadow the trial for leave, thus it is not expected to cause alteration of emphasis supportive of wide court discretion. It is a hard as well as a contentious matter that is improbable to be determined using the latest process[528]. In *Franbar Holdings v Patel*[529] the issue of ratification came about in a situation where there was an application for permission to continue with a derivative claim. In such a situation the court needs to consider whether the effect

[526] S. 263(2) (B), (C) of CA 2006. The rules of the ratification and authorisation have been discussed earlier in this thesis under Chapter 3.
[527] Arad Reisberg, "Corporate Law in the UK After Recent Reforms: The Good, the Bad, and the Ugly." Current Legal Problems 63.1, 2010, 315.
[528] Arad Reisberg, "Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?", Rationality in Company Law: Essay in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. Available at SSRN: http://ssrn.com/abstract=1092629
[529] [2009] 1 BCLC 1.

of the ratification resolution is in fact to improperly deny the claimant the opportunity to bring a claim on their company's behalf.

It is noteworthy that in Hong Kong, ratification in particular situations effectively prevents companies from bringing an action for damages against a director for losses resulting from an omission or the ratified act. However, this does not necessarily stop a statutory derivative claim or an unfair prejudice claim from being brought by dissenting minorities and does not constitute acceptable grounds for the court to refuse leave to proceed the aforesaid claims[530].

Thirdly, it is required for the judge to not permit leave to institute a derivative action where directors working in line with s 172 (which relates to the duty to promote the success of the company) would not want to carry on with the action[531]. A question arises as to whether s.172 includes non-shareholders. However, it is accepted that the statutory list presented in s.172(1) (which deals with non-shareholder constituencies) is not exhaustive. As a result, a director will be considered to be in breach of their duty if they do not consider all the issues pertaining to the decision under discussion. Yet, this is close to impossible in practice. In addition, the courts are not in a position to closely examine if a

[530] S.734 of the Hong Kong Companies Ordinance 2012.
[531] S. 263(2) (A) of CA 2006

director has considered all non-shareholder issues as this introduces the potential for the court to judge business decisions with the benefit of hindsight.[532] Company beneficiaries have previously been discussed in detail in the current thesis.[533]

Presupposing that a legal action is not within any of the circumstances above, the judge ought to grant permission but through stipulating a few aspects that must be considered when giving a decision as to whether to grant permission as recorded under S.263(3)[534]. For example, to consider if the action is contrary to the company's benefit, if the plaintiff is acting in good faith as well as whether the company has resolved not to take up the action. Of significance and as demonstrated in *Iesini v Westrip Holdings Ltd*[535], s. 263 (2) (a) is used just where courts are contented that there is no director, working in line with the duty to promote the success of the company -section 172- , is looking to proceed with the derivative action. However, when a few directors desire to proceed while others are not willing, then, section 263(3) (b) is used.

This might create an impediment to the minority shareholders at the time of instituting a lawsuit against the company directors. Keay explains that the board

[532] Shuangge Wen, *Shareholder primacy and corporate governance: legal aspects, practices and future directions*, Routledge, 2013, p.161.
[533] Chapter 3 of this thesis.
[534] S. 263(3) of CA 2006
[535] [2011] 1 B.C.L.C. 498.

of directors is a group and certainly is influenced with group features. Company board has been depicted as “elite and episodic decision-making groups”. Moreover, there appears trivial suspicion that company boards are immensely reliant on the social-psychological practices and that they may be influenced by such dynamics. So directors might decide not to trigger a claim since they may be persuaded with: the truth that the directors have turn out to be friendly to the wrongdoer; other company board members, particularly senior managers such as the CEO, are backing the wrongdoer; matters of collegiality that may imply that the directors gets it hard to examine activities of equals; leaving bare the advantage of reciprocity, that is if a director, A, has not voted for an activity hostile to a director, B, B may be desirous to return the beneficial behaviour of A in the forthcoming events or votes against or in favour of B[536]. In point of fact, even those directors categorised as independent were found to be connected to the CEO of the company. According to the Higgs Report, CEOs recruit about 50 per cent of so-called independent British directors, finding these directors through personal networks[537].

It is notable in section 261(2),(3), that during this stage, the company is not a defendant against the petition to the court to grant permission to proceed with the

[536] Andrew Keay, “The Public Enforcement of Directors' Duties” (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .
[537] Randall Morck "Behavioral finance in corporate governance: economics and ethics of the devil’s advocate" Journal of Management & Governance, 2008, 12.2: 179.

action. Therefore, it is unnecessary for the company to present any hearing or file proof. It is only after this claim has survived this assessment shall the company be asked to file proof of whether permission ought to be allowed[538].

A few people believe that the fresh legislative derivative claim is possibly extensive as well as more elastic in range compared to the common law claim because the derivative application may only be instituted in line with the CA 2006 as well as contravention of duty, violation of trust, default by directors, and notably, a simple accusation of directors' negligence, with no any accusation of absence of good faith or profit to the directors, may on the face of it be the issue of a derivative action by shareholders for the company[539]. This is an important transformation that elevates the directors' exposure to accountability for negligence[540]. In addition, the judges are not anymore limited by the principle established in *Foss* in making decisions; nonetheless, it should regard some factors that are substantial to this principle in making judgment if it is in the company's interest for a claim to be instituted[541]. Also, as this section will discuss shortly, Part 11 of the Act has no effect on the common law rules on double

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[538] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.659.
[539] Khurram Raja, "Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment" I.C.C.L.R. 2014, 25(5), 162.
[540] David Kershaw, "The Rule in Foss v Harbottle is Dead", LSE Legal Studies Working Paper No.5/2013 (January 30, 2013), SSRN, http://ssrn.com.ezproxy.lancs.ac.uk/abstract=2209061 [Accessed 17 December, 2015].
[541] Khurram Raja, "Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment" I.C.C.L.R. 2014, 25(5), 162.

derivative actions, and therefore, only the direct derivative claim may only be instituted in line with the CA 2006[542].

In spite of this, it is vague if this may actually be considered as a step forward, indeed, courts shall carry on preserving an extensive discretion on whether a derivative action can ensue. Petitioners shall as a result continue encountering the conventional doubt of the courts concerning such actions, although this moment the courts are having extremely restricted statute to 'substantiate' their positions. Further, the court ought to reject the claim (or in other words, refuse to grant the leave) on not more than four occasions as stipulated under s. 261–264[543]. It is argued that Part 11 has created a new regulatory pathway and has thus made all common law rules irrelevant. However, common law rules pertaining to multiple derivative actions are unaffected by Part 11 as it is solely concerned with direct derivative actions. Derived from the legislation only, there is an unconvincingly apparent inference substitution of the proper plaintiff rule as the substantive principle of law[544].

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542 David Kershaw, "The Rule in Foss v Harbottle is Dead", LSE Legal Studies Working Paper No.5/2013 (January 30, 2013), SSRN, http://ssrn.com.ezproxy.lancs.ac.uk/abstract=2209061 [Accessed 17 December, 2015].

543 Arad Reisberg. "Corporate Law in the UK After Recent Reforms: The Good, the Bad, and the Ugly." Current Legal Problems 63.1, 2010, 315.

544 David Kershaw, "The Rule in Foss v Harbottle is Dead", LSE Legal Studies Working Paper No.5/2013 (January 30, 2013), SSRN, http://ssrn.com.ezproxy.lancs.ac.uk/abstract=2209061 [Accessed 17 December, 2015].

In England there exist doubts on how frequent these actions shall be permitted. Furthermore, a shareholder may survive this legal threshold. Nevertheless, it is uncertain the reason she/he might desire to institute such an action. If the action was fruitless, the shareholder might shoulder the application's complete expenses, and if victorious, the applicant shall not directly gain the profits[545].

A correlated complexity is demonstrated through a Canadian occurrence, that is to say, that the derivative application shall be comprehended as the highly procedurally intricate as well as less advantageous type of application with no limits put on the extent of the unfairly prejudicial conduct action[546]. The derivative claim on occasion does not ensue that far since the permission to go on have scarcely been allowed. A pertinent dataset acquired approximately in the past 4 years by Keay demonstrates that from the time when the statutory derivative claim was introduced within the legislation that commenced being in force in 1st Oct. 2007, it is only sixteen court cases where permissions have been desired by the applicants. This figure represents a mean of only 3.2 cases per year.

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[545] Siems, Mathias M., "Private Enforcement of Directors' Duties: Derivative Actions as a Global Phenomenon" (November 16, 2010). Final version published in: Stefan Wrbka, Steven Van Uytsel and Mathias Siems (eds.), "Collective Actions: Enhancing Access to Justice and Reconciling Multilayer Interests?" Cambridge: Cambridge University Press, 2012, 93. Available at SSRN: http://ssrn.com/abstract=1699353 or http://dx.doi.org/10.2139/ssrn.1699353.

[546] Arad Reisberg, "Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?". Rationality in Company Law: Essay in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. Available at SSRN: http://ssrn.com/abstract=1092629.

In everybody's interpretation this figure represents a trivial quantity of lawsuits. During the similar time frame there have existed much more suits involving accusations of violation of director's duties in unfairly prejudicial applications within section 994, despite Lord Hoffmann's effort in *O'Neill v Phillips*[547] to trim down the prevalence of applications[548].

What cannot be clearly determined is the number of cases in which permission is granted and the case is then settled before it reaches court. It can reasonably be assumed that a considerable number of cases may be in this category, particularly given that when courts grant leave they also tend to direct the parties down that particular path[549]. Correspondingly, it is argued that courts in England should make a greater effort to manage the settlement of derivative actions. This can be achieved through the imposition of a condition whereby the court's permission is needed to settle or discontinue a case, particularly if the court has laid down an order for the company to indemnify the derivative claimant against liability for the costs resulting from a claim[550].

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[547] [1999] 1 WLR 1092.
[548] Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.
[549] David Milman, "Shareholder litigation in the UK: the implications of recent authorities and other developments" Co. L.N. 2013, 342, 1.
[550] Daniel Lightman, "Two aspects of the statutory derivative claim", L.M.C.L.Q. 2011, 1(Feb), 142.

However, a few researchers have asserted that the success of any replacement to the common law claim is most excellently decided not by the amount of suits produced within the latest procedure, but by whether the regulations regulating the conditions where such claims might be instituted are more understandable as well as available. This is in order that, in extraordinary situations, the instigation of a derivative action shall be considered as a solution worth taking up rather than excluding it in the first phase of a disagreement due to it being much harder even to think about[551].

Though, as revealed from the above, that the statutory derivative claim reform has not brought the extreme effect that some analysts had anticipated[552] (while other people were anxious about), the derivative claim reform surely symbolizes a considerable improvement in laws safeguarding shareholders. Definitely, arguments of derivative actions within the courts have grown to be more common. Regularly these arguments include deliberation on whether such assertions ought to be permitted to ensue to full court hearing. Very few cases have been recorded as continuing to full court trial[553].

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[551] Arad, Reisberg, "Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?", Rationality in Company Law: Essay in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. Available at SSRN: http://ssrn.com/abstract=1092629.

[552] As been discussed earlier, some scholars anticipated that statutory derivative action should have opened the gate for minority shareholders to sue discreet directors. They believe that for a statutory derivative claim to be successful, it has to be both understandable and accessible.

[553] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.

Judges are not ready to award permission for derivative actions to proceed to full trial to an applicant in cases where there are remedies in section 994, for example, buying the shares, in case the stock purchase order nearly always wants a majority to overthrow the minority shareholders[554]. In reality, in implementing their discretion provided for in section 263(3) (a)-(f), the judges in *Mission Capital Plc v Sinclair*[555], permission to carry on with a derivative claim under section 261 of the Act was declined in which a notional director was unlikely to append more significance to the allegation as well as the supposed damage was notional. The applicant had instituted the suit in good faith. Nonetheless, whereas a hypothetical director may carry on with the action, the director may not append more significance to the action, particularly as the injury that the company may undergo from applicant's illegal removal from office was exploratory. It was highly probable that the company would substitute applicant compared to taking steps against people liable for the injury resulting from their illegal firing. Additionally, the applicant may well regain remedies looked for through the use of an unfair prejudice petition provided in section 994 of the Act.

Moreover, in *Kiani v Cooper*[556] permission to continue a derivative claim within s.261 was granted in the case in which a director whose activities were at issue failed to give any substantive proof supporting his argument against the

[554] Ben Pettet, John Lowry and Arad Reisberg, *Pettet's Company Law: Company and Capital Markets Law*. Pearson Education Limited. 2009. p.261.
[555] [2008] EWHC 1339 (Ch).
[556] [2010] EWHC 577 (Ch).

accusations that the he had violated his fiduciary duties. Milman observed that in *Kiani v Cooper,* it was established that the derivative action was instituted in good faith in addition to being well-substantiated and that even though under section 994 a claim may well be instituted, it does not obstruct the derivative application. It was only a single aspect for the court to regard when deciding whether to grant permission to continue to trial[557].

In *Cullen Investments Ltd v Brown*[558], a derivative application was permitted to continue to trial. The application supposed that a company's director redirected a beneficial company prospect for his gain. In considering allowing the action to continue to trial, the judges assessed a few possible obstructions to the quest for a derivative action. First, the judges were of the opinion that the claimed breach of duty was not authorised. Secondly, the judges discarded the argument that no director functioning in fulfillment of his/her duty as provided in section 172 would have backed the quest of the derivative action. Even though the possible benefits of the action were unexceptional, it was not an impediment. A critical matter in this case was the taking up of all the financial dangers of the proceedings by the shareholder. Therefore, there exists no risk of the company encountering a negative expenses order. In regard to each of these issues, permission to continue to trial was awarded[559].

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[557] David Milman, "Avenues for shareholder redress in the 21st century" Co. L.N. 2011, 295, 1.
[558] [2015] EWHC 473 (Ch).
[559] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.

Many of the suits relating to the derivative actions mainly involve private companies and not public companies; this is due to the rarity of the cases relating to the latter companies. In *Bridge v Daley*[560] a petition for the permission to proceed with a derivative action was instituted by the minority shareholder of a publicly listed company. Permission to proceed was denied along with the shareholder being directed to bear the suit's expenses. The court observed an unusual characteristic of this suit as it involved a public trading company and not a private company; nevertheless shareholders must be safeguarded from a minor minority person shareholder looking to take up an action for the company in which they are shareholders at a time they do not desire the company's properties to be utilised for that cause. This is the entire aim of the derivative action process[561]. Consequently, HHJ Hodge was of the opinion that the grievances could be tested within the content of section 994 instead of drawing the company into the derivative action. Since the permission to continue to trial was denied, the litigation expenses were granted against the plaintiff. Furthermore, indemnity expenses were granted against the plaintiff with regard to expenses suffered following the time of an earlier trial, after which the plaintiff had disposed of his

[560] [2015] EWHC 2121 (Ch). This is not the first decision concerning a derivative claim and a listed public company under Part 11, see *Mission Capital Plc v Sinclair* [2008] EWHC 1339 (Ch).
[561] *Bridge v Daley* [2015] EWHC 2121 (Ch) at 80.

lawyers and became a petitioner personally. The financial dangers for shareholders in the quest of derivative claims are therefore clear[562].

People might inquire whether a member of a holding company may make an application in court for a derivative action in subsidiary's name in which such member does not hold direct shares. This circumstance is termed double (or multiple) derivative action. It arises where a plaintiff C has stocks in company A. The company A in turn holds the only stocks in company B. It is this company B that is the injured party of an illegality done by respondent D. In the event that Company B does not institute an action against D, then is it possible for plaintiff C to institute a derivative action for the company B? The response to this concern at common law seems to be affirmative[563].

In *Waddington Ltd v Chan Chun Hoo Thomas* Lord Millett describes these actions as 'multiple derivative actions'.[564] Lord Millett gave the leading judgement in the Final Appeal Court of Hong Kong's decision, allowing multiple derivate actions where an individual, specifically one who controls a parent company's subsidiary by controlling the parent company itself, defrauds a subsidiary or sub-subsidiary as this inevitably leads to the defraud of the parent company also.[565] The question is now whether Part 11 of the CA 2006 affects this

[562] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
[563] David Milman, "Shareholder litigation in the UK: the implications of recent authorities and other developments" Co. L.N. 2013, 342, 1.
[564] [2008] HKCU 1381.
[565] *Waddington Ltd v Chan Chun Hoo Thomas* [2008] HKCU 1381; [2009] 2 B.C.L.C. 82, para 74.

action by introducing a new statutory derivative action. It has been suggested by Reisberg and Prentice that Part 11 of the CA 2006, in particular s.260(20), provides that a derivative claim can only be brought in line with the statutory provisions, meaning that Part 11 supplants common law (as advised by the Law Commission).[566] Furthermore, under the statute's provisions, the right of action is vested in a company member, in that a cause of action is vested in the company itself (s.260(1)(a)), who is endeavouring to obtain relief on the company's behalf (s.260(1)(b)). From this it can be concluded that the statute does not allow for multiple derivative claims and these cannot be established at a common law level either[567].

It has been claimed by Lightman that the Act only regulates direct derivative claims as these are what the Act itself defines as constituting a derivative claim. The Act is silent on other kinds of derivative actions.[568] However, it has been determined by the Law Commission that it is for the courts to decide whether to allow multiple derivative actions and these actions should not form part of the relevant statutory law.[569] It has thus been concluded by Kershaw that the CA 2006

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[566] Law Commission report, *Shareholders Remedies*, No 246, Cm 3769, London, TSO, 1997, paras 651-655.
[567] Arad Reisberg and Dan Prentice, "Multiple derivative actions", L.Q.R. 2009, 125 (Apr), 209.
[568] Daniel Lightman, "Two aspects of the statutory derivative claim", L.M.C.L.Q. 2011, 1(Feb), 142.
[569] Law Commission report, *Shareholder Remedies*, No 246, Cm 3769, London, TSO, 1997, para 6.110.

does not exclude multiple derivative actions and the rule in *Foss v Harbottle*[570] has not, in fact, been relegated to the rubbish bin given that these actions have been recognised by common law in *Waddington Ltd v Chan Chun Hoo Thomas*.[571]

In *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [572], Briggs J was of the opinion that the common law acknowledged double derivative claims prior to the enactment of the CA 2006, further that double derivative actions had endured the Companies Act's establishment. In making judgment, Briggs J. backed the attitude assumed by Lord Millett in *Waddington Ltd v Chan Chun Hoo Thomas*[573] in the Court of Final Appeal.

Furthermore, the judge in *Bhullar v Bhullar*[574] was clear, taking notice of case laws since realisation of the statutory derivative claim that the common law persists to offer the option of double or multiple derivative actions unchanged with the launch of the legislative process in the year 2006.

Outlining all potential actions contained in any kind of legislation is a good method of determining if the derivative action has been acknowledged by the legal system in Saudi Arabia. Initiation of litigation against board members is a

[570] David Kershaw, *Company law in context: Text and materials*, Oxford University Press, 2012, p.630.
[571] [2008] HKCU 1381.
[572] [2013] EWHC 348 (Ch).
[573] [2008] HKCU 1381.
[574] [2015] EWHC 1943 (Ch).

statutory right in the Saudi legal system[575]. The legal representative of a company acts independent of the shareholders, but has the power to open litigation on the part of the shareholders in particular situations. The company action is intended to ensure that no harm comes to the rights and interests of a company, which could have an impact on its business operations. There are different ways in which a company can suffer harm, such as trust violation by its directors which leads to financial damage, breaches of duties, negligence, default or allocation of fraudulent revenue to shareholders. S.78 of the CL 2015 specifies the accountability of company directors for such damage; more to the point, the section states that directors are to be held accountable for any harm sustained by the company, its shareholders or third parties as a result of ineffective corporate management on infringement of the provisions of related laws or of the bylaws of the company. Any contravention to this stipulation is deemed to be null[576].

In the present case, the decision of shareholders made at the GM enables the company itself to initiate litigation against wrongdoing actions of the directors, the shareholders designating a plaintiff at the GM[577]; a question thus arises regarding the similarities between such an action and the derivative action existent in the UK[578]. According to some, no provisions related to this area are included in Saudi law. As previously mentioned, derivative action allows

[575] See ss. 76, 77 and 108 of CL 1965, ss.78, 79 and 110 of CL 2015.
[576] S.76 of CL 196, and now s.78 of CL 2015.
[577] S.77 of CL 1965, and now s.79 of CL 2015.
[578] Ss. 260-269 of CA 2006.

minority shareholders to commence litigation against directors who have breached their duties in the name of the company, if the company has suffered harm due to their activities and if legal action is not taken by the majority shareholders. Based on this definition, minority shareholders have no right under CL 1965 to initiate litigation against company board members in the name of the company[579]. The situation stays with no change under CL 2015.

No guidelines are provided in CL 2015 and particularly in s.79 as to the steps that should be taken if no decision is made at the GM regarding litigation against the wrongdoers, and no mention is made about whether shareholders are allowed to take derivative action on the part of the company[580]. Under no circumstances do the minority shareholders have the right to initiate litigation in the name of the company[581]. Al-Ibrahim noted that, in practice, minority shareholders cannot bring liability claims on behalf of the company[582]. Being underpinned by the principle of majority rule, the company action in *Foss v Harbottle*[583] has been

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[579] See Youseif Al-Zahrani, *Rights of Shareholders under Saudi Company Law 1965*, Hard copy, Unpublished PhD thesis in Brunel University, 2013. p.193. This thesis has led to an article by the author, see Youseif Al-Zahrani, "Examination of the Legal Ambiguities of Remedies for Shareholders under the Saudi Company Law No. 1965" Arab Law Quarterly, 29(4), 2015, 343.

[580] S.77 of CL 1965 -now found under s.79 of CL 2015- 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".

[581] Mansour Al Anazi, *Minority shareholders: improving their protection to attract foreign Investment in the Kingdom of Saudi Arabia*, LLM. 2008, p.49.

[582] Tariq AL Ibrahim, *Claims of liability in Joint stock Companies*, Dar Tariq AL Ibrahim for publication, 2010, p.22.

[583] (1843) 2 Hare 461.

incorporated in CL 2015, whereas the exception of derivative action is yet to be adopted.

A different perspective has been proposed by some researchers, who argued that there are close similarities between s.79 of SCL 2015 and the derivative action applicable in the UK arising from the fact that company members are granted in both legal systems the statutory right to initiate litigation in the name of the company[584]. In this regard, the purpose of derivative action is to prevent the majority shareholders from violating the rights of the minority shareholders on grounds of the principle of majority rule from *Foss v Harbottle*[585]. However, it is clearly specified in s.79 that the consent of the GM, where decision-making depends on a majority of more than 50%, is essential in commencing litigation against company directors[586]. However, the most crucial point in this discussion is the provision of s.80 of CL 2015.

As observed by Al-Jeber, the failure of the GM to take legal action against wrongdoing directors has prompted legal authorities in various systems to grant every shareholder the right to commence litigation in the name of the company on the condition of the validity of the right of the company to institute it and if he/she is at risk of personal harm due to the misdeeds of the directors, which is in

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584 Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.241.
585 (1843) 2 Hare 461.
586 Ss. 77, 91 of CL 1965, now ss. 79, 93 of CL 2015.

compliance with s.80 of CL 2015[587]. In addition to the previously mentioned conditions, s.80 of CL 2015 also specifies that the shareholder has an obligation to inform the company of his/her intent to initiate litigation and the compensation that the shareholder is awarded is directly proportional to the damage that he/she has suffered. To sum up the provisions of this section, a shareholder can take legal action on behalf of the company against directors if his/her personal interests have been affected and if the company's right to litigation is valid; furthermore, the shareholder has to provide notice to the company of his/her intent. However, this right to bring legal charges against directors may be misused by some shareholders, with negative implications for the public image of the company. The requirement to notify the company is intended to afford directors the opportunity to defend themselves against allegations of duty violation and as a result the shareholder may choose to drop the charges[588]. In this case, s.80 of CL 2015 states that compensation is offered to the shareholder who made the petition. An additional condition has been formulated by some researchers, in that evidence must be brought regarding the failure of the GM to initiate litigation in the name of the company[589].

[587] Mohammed Al-Jeber, *The Saudi Commercial Law*, King Fahad National Library, Riyadh, 2000, p. 342. Also, see Mohammed Al-Moukili, *The Legal Status of Joint Stock Company's Board of Directors & its Liability*, Institute of Public Administration, Riyadh, 1984, p.101.
[588] Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in* Saudi Law, Alhalabi for legal publications, Lebanon, 2006, pp.388,389.
[589] *Ibid*, p.386.

On the other hand, s.80 of CL 2015 also contains several ambiguous and uncertain points, in particular the lack of a clear distinction between personal suits filed by shareholders and derivative action, for which it has been considerably criticised[590]. Hence, the phrasing of the section has led to the conclusion that it makes reference to action in the name of the company, although implementing derivative action in the format available in other countries has never been the intention of the Saudi Legislature[591]. Moreover, the section specifies that the purpose of any legal action is to provide compensation only for the damage sustained by the shareholder. This is in contrast to derivative action where compensation is offered to the company. It must be noted that the goals and scope of the derivative suit are incompatible with the aim of litigation, as outlined in s.80 of CL 2015, as well as with damage compensation[592]. A further limitation of this section is that it could foster multiple and aggravating actions, while at the same time it is incongruous to grant every shareholder the right to initiate litigation in the name of the company without any regulations[593].

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[590] Tariq AL Ibrahim, *Claims of liability in Joint stock Companies*, Dar Tariq AL Ibrahim for publication, 2010, p.22.

[591] Mansour Al Anazi, *Minority shareholders: improving their protection to attract foreign investment in the Kingdom of Saudi Arabia*, Hard copy, LLM. 2008, p.48. The author cite LLM as it is the only source for this aspect of this topic.

[592] Youseif Al-Zahrani, *Rights of Shareholders under Saudi Company Law 1965*. Hard copy, Unpublished PhD thesis in Brunel University, 2013. p.193. This thesis has led to an article by the author, see Youseif Al-Zahrani, "Examination of the Legal Ambiguities of Remedies for Shareholders under the Saudi Company Law No. 1965" Arab Law Quarterly, 29(4), 2015, 343.

[593] *Ibid*, p.195.

Nevertheless, as asserted by some researchers, the law in Saudi Arabia allows shareholders to initiate litigation against directors alongside in the name of the company and to protect their personal interests if the directors' duty violation caused them direct damage. Furthermore, due to the fact that these two actions are not linked, the minority or individual shareholders still have the right to take personal action as a result of unfairly prejudicial conduct, even if their derivative action on the part of the company is unsuccessful[594]. Attention has also been drawn to the fact that the compensation does not classify the claim under s.80 of CL 2015 solely as unfair prejudice action. In this respect, the section specifies that the shareholder making the petition is entitled to a part of the compensation prior to its allocation to the company, as is stipulated for cases where a shareholder files a legal suit on behalf of the company[595].

The case of *Jazeera Cement* is an eloquent example; the company directors were taken to court by the minority shareholders on grounds that they reduced the company's capital without the EGM permission. This constitutes a breach of the CL 1965, s.142 (now s.144 of the CL 2015).which stipulates that the EGM has the power to decrease the capital if it is too much for the requirements of the company or if the company has sustained losses; the capital can be reduced

[594] Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in* Saudi Law, Alhalabi for legal publications, Lebanon, 2006, pp.388,389.
[595] *Ibid*, pp.390, 391.

beyond the limit sanctioned by the law only in the latter situation[596]. This can demonstrate that CL 1965 –CL 2015- acknowledges the derivative action. Ultimately, the question that has to be addressed is not the recognition by the Saudi law of the derivative action as applied in the UK under CA 2006, but rather the efficiency of the derivative action available under CA 2006 in protecting shareholder rights by ensuring that directors fulfil their duties appropriately.

Although some hold the belief that the statutory derivative claim under UK law has not had the radical effect a few analysts had anticipated, it is still seen as a considerable improvement in terms of shareholder protection[597]. Yet, in order to ensure that derivative actions in the UK are more understandable as well as accessible, some additional reforms can be suggested. As was discussed earlier, when wrongdoing has been ratified, directors cannot be held liable for their breach of duty, and the court will refuse to grant leave to bring an action. As is the case in Hong Kong,[598] it is suggested that ratification should not, in certain circumstances, prevent minority shareholders from pursuing derivative claims nor can it be grounds for the court to refuse to grant leave to proceed with such actions. The existing measures under s.263 are sufficient to prevent shareholders from implicating the company in a legal suit without acceptable reason for

[596] Alsharq Alawsat Neewspaper, 3rd February 2013, http://classic.aawsat.com/details.asp?section=6&article=715722&issueno=12486#.VFGh3_nz1qc.
[597] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
[598] S.734 of the Hong Kong Companies Ordinance 2012.

bringing a claim, or from seeking to cause damage to the company or other shareholders instead of focusing on problem resolution.

As Milman suggests, the legislative derivative claim reform surely symbolises a considerable improvement in laws safeguarding shareholders[599]. Therefore, this derivative claim must be included in Saudi's CL 2015. Nonetheless, when considering the introduction of this claim there is a need to balance the prevention of unreasonable claims by minority shareholders, which can damage the company, by imposing some limitations and filters on such actions, with the guarantee that the claim is available to minority shareholders, as it can redress the equilibrium between shareholders and directors and protect shareholders' rights.

In *Johnson v Gore Wood & Co*[600] it was decided that only a company may sue for a loss when that loss is the result of a breach of duty the company is owed. In this situation a shareholder can thus only pursue a derivative claim for company losses and may not allege they have personally suffered a loss for a personal right. This type of loss is referred to as a 'non-reflective loss' and will be examined in greater detail below.

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[599] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
[600] [2000] UKHL 65.

4.2. Personal claims

When a company director is established to be in violation of his or her duties that she or he owe to the company, then the derivative action may be utilised to implement and enforce the duties. Nevertheless, as discussed from the preceding parts of the thesis[601], the directors' duties may be owed – even though not often - to individual shareholders instead to the company. For that reason, the duties owed to shareholders personally, within the common law, must be enforceable upon making use of the derivate action by an individual shareholder (personal claims)[602]. A share within a company is an assets right furthermore, obviously some rights private to the shareholder are created due to the ownership of the shares. The major question in practice is whether or not an individual claim is obstructed by the reflective-loss rule that preclude a shareholder from regaining reimbursement for defeat that purely replicates the defeat experienced by the company[603].

The thing needed to activate the rule is the company as well as the shareholder to find an allegation in opposition to the directors coming out of similar collection of proofs, and that a fraction or the entire shareholders' injury may be viewed as imitating the damage instigated by the board of directors to the company[604]. Like

601 Under Chapter 3.
602 Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, pp.662, 663.
603 David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
604 Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, pp.662, 663.

in *Prudential Assurance v Newman Industries Ltd*[605] the company is the appropriate applicant and company's members shall be prohibited from regaining the reflective damage.

Nonetheless, this rule does not bar any shareholder from bringing an application to regain distinct damage that is a damage which is different from the damage experienced by the company. The distinguishing feature concerning the reflective and separate damages is demonstrated in *Heron International Ltd v Lord Grade*[606]. In the midst of a contested take-over bid, it was alleged that the directors of the target company (who owned a majority of voting shares) were in breach of their duties to the company and the company's shareholders. This alleged breach involved the directors accepting proposals that would lower the value of the organisation's assets. This would then lower the value of shares and would force shareholders to accept the lower of two competing offers for the company. The court decided that the loss suffered by the shareholders was separate from that suffered by the company. The shareholders could recover their losses through a personal claim as they would have been prevented from choosing the higher offer. This loss would only affect shareholders. It would not constitute a company loss which would not have more or less funds in its reserve.

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605 [1982] Ch 204.

606 [1983] B.C.L.C. 244

Nevertheless, many legal practitioners think that such difference between the reflective and separate damages is difficult to extract[607].

But in a stringent comparison to the stance at common law, the courts use section 994 of the CA 2006 in such a way lenient of a shareholder's capacity to plead for a redress symbolic of a reflective company injury. Shareholders cannot recoup personal damage that is just reflective of the injury experienced by the company. On this issue, the court construal of section 994 offered to a member's advantage is debatable[608] and shall be examined in the subsequent part.

4.3. Unfairly prejudicial claim

Under section 994 of the CA, shareholders are entitled to institute a court case if they consider the company's affairs are conducted in ways that are unfairly prejudicial to their interests. Formerly it was among the highly inactive parts of the law regulating companies, due to the stringent conditions presented under section 210 of the CA 1948. United Kingdom CA 1948 section 210 was substituted with the CA 1980 section 75 that ultimately turned out to be ss. 459 – 461 of the CA 1985. At present, it is incorporated under ss. 994 – 999 of the CA

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[607] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.665.

[608] Stephen Griffin, "Shareholder remedies and the no reflective loss principle" J.B.L. 2010, 6, 461.

2006. Based on the lawmaking history of this provision, it is apparent that it preferred the notion of “unfair prejudice” so as to liberate the judges from technical matters of legal right (and wrong) as well as to grant an extensive power to the judges to enforce matters that seemed just and equitable[609].

The unfair prejudice prohibitions are incorporated into the Act in order to safeguard the company members’ rights but also their interest. Further, it is undeniable that any wrong done against the company impacts negatively on the company members’ interests. Previous to the inclusion of the term “of its members generally” within section 459 of the Act 1985, contentions were advanced that a misconduct executed against the company that impacted on every member uniformly was beyond the scope of this provision, however, these contentions are not anymore advanced[610].

In numerous legal actions the judges have emphasized that section 994 of the Act necessitates prejudice to the minority that is unfair and not merely a prejudice per se. Besides, in exceptional suits it might be that the thing done to the claimant was unfair although it may have not resulted into prejudice of the said claimant[611]. From *McKillen v Misland (Cyprus) Investments Ltd*[612], the courts have stated that prejudice does not imply that financial damage must exist. It might be adequate

[609] *O'Neill v Phillips* [1999] 1 WLR 1092.
[610] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.734.
[611] *Ibid*, pp.732-734.
[612] [2013] EWCA Civ 781.

to demonstrate that the rights of the plaintiff have been violated not including that it resulted in a monetary injury. So as to demonstrate unfairness, a breach of a legal right granted by the company's articles or the shareholders' agreement ought to be underscored.

Since this study is more related to the claims where a director's duties might be enforceable, it is imperative to note that a breach of the duty of a director is not necessarily a reason for unfairly prejudicial conduct claims. In *Re Saul D Harrison*[613] in a wide examination of the function of the provision in section 459 of CA 1985 and presently section 994 of CA 2006, the court stated that a violation of director duties is not a threshold adequate for a claim of unfair prejudice. Additionally, in *O'Neill v Phillips*[614], Lord Hoffmann asserted that a shareholder is not usually permitted to protest of unfairness except where there is a violation of the contract terms where it was consented on the manner in which the company's affairs must be carried out.

For a shareholder to institute a court case within section 994, it must be on the foundation that she has been unfairly and prejudicially treated. In some instances, the courts have held that a breach of the duties by a company director might constitute a ground for a triumphant application within section 994. However, essentially the shareholder ought to prove that the director's conduct resulted in

613 [1995] 1 BCLC 14.
614 [1999] 1 WLR 1092.

his unfairly and prejudicial treatment. Hence, for an applicant to be successful under section 994, he has to connect the breach of duty to his unjust well as prejudice treatment[615]. In *Maidment v Attwood*[616] the unfair prejudice was made up of the violation of duties by company directors, therefore, an unfair prejudice as well as a derivative action would be incorporated within the similar application and founded on similar proof[617].

In this case *Maidment v Attwood*[618], the judges stated that the conditions established in *O'Neill v Phillips*[619], might incorporate through inference a concurrence that a person in the position of a company director shall carry out her duties under that capacity. Chief among the duties is the seven responsibilities that are presently codified within s. 171-177 of the Act. Six of these duties are fiduciary duties, i.e., duties obligatory by the law for people who use authority for others' benefit. Disobedience to these duties shall commonly denote that unfair prejudice has taken place[620].

In this regard, failure to comply with the transfer provisos within the articles of association or shareholders' contract does not constitute an act in the management

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[615] Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .
[616] [2012] EWCA Civ 998.
[617] Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .
[618] [2012] EWCA Civ 998.
[619] [1999] 1 WLR 1092.
[620] *Maidment v Attwood* [2012] EWCA Civ 998 at para [22].

of the company's affairs[621]. But in *Graham v Every*[622] it was stated that even though failure to comply with the pre-emption stipulation may not, normally, constitute an act in the management of the company's affairs behaviour (as mandatory under s.994), this lawsuit was an exemption. It was excluded from the purview of s. 994 due to a contract that the company directors ought to be remunerated via dividend payment but not via wages and in the court's opinion, such contract of remuneration as well as allotment policy was inside the company's affairs. Other justices sitting in this court, Lord Justice Vos as well as McCombe LJ, remarked on the pre-emption argument as well. As for Vos LJ weakening the shareholding of a shareholder might unfairly prejudice his/her interests. As for McCombe LJ, he asserted that not adhering to the conditions of pre-emption stipulation was a vital element of the general image of unfairly prejudicial behaviour claimed within the application and it was insincere to strike it out on the basis that, looked at in isolation, it might not be an act of the company[623].

In *Apex Global Management Ltd & Anor v FI Call Ltd & Ors*[624] the issue whether s. 994 application is suitable in every suit in which the parties' confidence and within the quasi-partnership that has collapsed was tackled. The court stated that the collapse should be as a result of a few violations of a legal right or equitable

[621] *McKillen v Misland (Cyprus) Investments Ltd* [2013] EWCA Civ 781.
[622] [2014] EWCA Civ 191.
[623] *Graham v Every* [2014] EWCA Civ 191.
[624] [2015] EWHC 3269 (Ch).

limitation influencing the carrying out of the company's affairs. The court observed that insulting behaviour is not normally adequate. However, it may be in circumstances where a quasi-partner has degraded the actions of another quasi-partner concerning the latter's management of the company affairs. This behaviour will make the degraded quasi-partner's productive continuance with the quasi-partnership impracticable[625].

Prevention from taking part in management within a close company situation is a frequent basis of complaint appearing in unfair prejudice applications. In *Re BC&G Care Homes Ltds Crowley v Bessell and Ors*[626]the keeping out from company's administration of a third of the shareholder with no realistic proposal to purchase their shares constituted unfair prejudice. The company affairs were built on a previous partnership and thus equitable limitations were involved[627].

Thomas v Dawson[628] involved an assertion for redress within the unfair prejudice remedy within a company having two shareholders, each one having a share. The company's balance sheet was insolvent. The hearing judge directed the applicant to be given an option of buying the other shareholder's stocks within the company at the value of £55,000. The applicant shareholder lodged an appeal contending that the stock was valueless and thus ought to be transmitted at the nominal worth.

625 *Apex Global Management Ltd & Anor v FI Call Ltd & Ors* [2015] EWHC 3269 (Ch) at paras [47], [48].
626 [2015] EWHC 1518 (Ch).
627 David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
628 [2015] EWCA Civ 706.

The appellate judges unanimously sustained the hearing judge's judgment establishing no procedural unfairness. It was the appellate judges' opinion that the original court's decision was in some ways extraordinary; however, the judgment was in the range of discretion bestowed by s. 996 of the Act. In this respect, the judges approved Oliver's LJ dictum in *Re Bird Precision Bellows Limited*[629] by stating that in awarding remedy for unfair prejudice, the judge was bestowed with an extensive discretion to undertake that which they regard as just as well as equitable in every circumstance of the situation, so as to appropriately remedy the unfair prejudice that the applicant has experienced from other shareholders within the company.

From the discussions in the preceding parts, it has been illustrated that there exists high number of cases that involves claims of breach of director's duties in unfair prejudice applications within section 994 of the CA contrasted with the latest statutory derivative claim, in spite of Lord Hoffmann's endeavor in *O'Neill v Phillips*[630] to trim down the occurrence of applications[631]. In *McKillen v Misland (Cyprus) Investments Ltd*[632], the court stated that suits within section 994(1) are inclined to be highly resource-exhaustive and require extensive trials.

[629] [1986] Ch 658 at 669.
[630] [1999] 1 WLR 1092.
[631] Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .
[632] [2013] EWCA Civ 781.

Consequently, it is submitted that courts need to consider whether the issues can be reduced.

Indeed, minority shareholders encountering problems in view of their status in the company are highly probable to regard unfair prejudice applications within section 994 of the Act as a road to a possible solution instead of engaging in derivative or personal actions. Having stated that, section 994 applications shall not draw an advance indemnity as to expenses, while it is hypothetically accessible for the derivative actions[633]. Nevertheless, it is imperative to note that if the unfair prejudice cases triumphs, the shareholder can apply for reimbursement of his cost, however, the company shall not receive anything. The judge may issue a directive within section 996 for a derivative application be instituted against a company's director in violation of his or her duties[634].

The right to bring an unfairly prejudicial claim is guaranteed not only by the Saudi CL 2015, but also by the Saudi CGC 2006, according to which shareholders must be granted all rights related to the share, especially the right to initiate litigation against members of the board[635]. Similarly, s.110 of CL 2015 stipulates that shareholders should be afforded every right associated with the share, in particular the right to take legal action against directors as well as to challenge

633 David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
634 Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.
635 S.3 of the CGC 2006.

the decisions made at shareholder meetings[636]. S.80 of CL 2015 grants shareholders the right to start unfairly prejudicial conduct action against the board members if they have suffered harm due to the wrongdoings of the latter. As previously highlighted, shareholders have to inform the company of their intent to take legal action and are compensated depending on the level of damage they have been caused[637].

In one case, an individual shareholder took legal action against company directors on grounds that they stopped him from taking part in the GM and requested compensation for the harm suffered. However, the accused justified their action by arguing that the shareholder failed to meet the key requirement for GM attendance, namely, to demonstrate that he was in possession of company shares. According to the ruling of the court, the shareholder would have to be compensated only if the directors breached the provisions of the CL or the bylaws of the company. The directors were not found guilty of any transgression and therefore the shareholder was not given any compensation[638]. This case substantiates the fact that a personal action is acknowledged by the Saudi legal system both in the law and in practice.

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[636] S.108 of CL 1965, now s.110 of CL 2015.
[637] S.78 of CL 1965, now s.80 of CL 2015.
[638] The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment No. 106/D/TG/7 in 2007.

In 2014, an unfair prejudice case was brought against both the Chairperson and the CEO of *Ahsa Development*, a listed company on the Saudi Stock Exchange (Tadawul), by a minority shareholder for violations of the provisions of the Companies Law and for breach of their duty as they acted in their own interests, causing the company and the company share price considerable damage. A petition was initiated to recover all losses that the company and shareholders suffered as a result of the misconduct of the CEO and Chairperson, which was estimated to exceed £25 million. The court refused the shareholder's request for compensation for the company and aggrieved shareholders as s.78 of the CL 1965[639] states that 'If a stockholder files such claim, he shall be adjudged compensation only to the extent of the prejudice caused to him/her'. Therefore, the Chairperson and CEO were ordered to pay around £5,000 to the shareholder. Also, the Chairperson and CEO were held liable for the litigation costs which exceeded £11,000.[640]

This case clearly emphasises a notion discussed earlier: that although an unfair prejudice proceeding is likely to succeed, only the petitioner can recover his or her loss, while the company itself will not receive any compensation. In this case the company's right and the petitioner's right to claim damages resulted from the same directors' wrongdoing, thus law-makers in Saudi Arabia should give the

[639] Now s.80 of CL 2015.
[640] The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment No. 132/D/TG/4 in 2014.

court power to authorise a lawsuit on the company's behalf, even without the approval of a GM. To this end, they should look to UK legislation, in particular, s.996(2)(c) of the CA 2006 which allows the court to grant permission for the petitioner or petitioners to bring an action in the name of the company and on the basis of the court's directions if the unfair prejudice claim is well-founded. If accepted by legislators, this suggested reform would not play the same role as that of the derivative action under s.260-264 of the CA 2006, due to its complexity. Having said that, given that the corresponding Saudi law has not so far allowed derivative actions on the company's behalf, it is suggested that this can be a step towards allowing the use of a full derivative claim in the country.

4.4 Additional enforcement methods available to shareholders

In order to protect their rights, selling their shares is another option that minority shareholders should have at their disposal. Since direct intervention with management is limited, the only other way in which shareholders can exact discipline is indirectly, via the markets. In this regard, the corporate control market maintains that investors can terminate their shareholding if management performance does not meet expectations. Thus, share price will decline, exposing the company to the threat of leveraged buyout which would lead to board dissolution. The directors are well-aware of these consequences, which makes them more focused on enhancing organisational performance in order to preserve share values and avoid crises[641].

The English Law Commission suggested that the ideal article ought to have a stipulation offering the minority shareholders the exit privileges to require to be produced by other company members at a fair valuation in some conditions. This stipulation should make easy the departure of a shareholder from a private company after a disagreement, with no necessity for litigation within section 459 –presently section 994-[642]. Section 996 of the CA stipulates that the court might issue order that it deems proper where an application for unfair prejudice is instituted within s. 994, to offer for the buying of the stocks of a company member by any other member or by the company.

Indeed, this mandatory acquisition seems as a remedy but not as a right for the minority shareholders and they might not demand it. However, this redress is widespread with regard to any unfair prejudice done by directors. Even though company members might negotiate for the unilateral exit entitlement to be integrated within the Articles of Association, these entitlements are scarce due to the overall right for the minority shareholders to remove their stocks at the time

[641] Ciarán O'Kelly and Sally Wheeler, "Internalities and the Foundations of Corporate Governance", Social & Legal Studies December 2012 21: 469.
[642] Law Commission report, *Shareholder Remedies*, No 246, Cm 3769, London, TSO, 1997, paras 5.1-5.32.

in which such removal appear probable of destabilising the investment purpose of the stocks[643].

However, this right is enforced by the Saudi CL 2015[644]. Despite not resulting in actual enforcement, this strategy is a cost-efficient method for shareholders to exit a company they are not satisfied with. However, shareholders in a private or non-listed public company may have to struggle with various difficulties and obstacles when deciding to withdraw. Under the Saudi CL 2015, minority shareholders in a limited liability company (LLC) must first try to sell their shares to the majority shareholders and inform them of their intention to leave the company. The minority shareholders have the right to sell their shares to third parties only if the majority shareholders do not purchase the shares within a month of the notice given[645]. However, the company does not receive compensation for directors' transgressions and the directors are not held responsible for their illegitimate actions as a result of the minority shareholders selling their shares. What is more, the withdrawal of minority shareholders could cause the share value to diminish, with negative implications for all the other shareholders[646].

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643 Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, pp.746,747.
644 S. 108 of CL 1965, now s.110 of CL 2015.
645 S. 165 of CL 1965, now s.161 of CL 2015.
646 Andrew Keay, "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN: http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.

Another enforcement action which can be instituted by minority shareholders is the company's winding up. In the UK, courts might wind up companies compulsorily through a petition instituted and founded on just as well as equitable basis[647]. Along with these orders, the judges must not award a winding up order if he or she believes that there are other options available. Nonetheless, some circumstances exist in which the only choice is the winding up of the company[648]. *Ebrahimi v Westbourne Galleries Ltd*[649] provides that a company that is essentially a partnership can be wound up when this would be the most equitable result. E and N established a company, with E and N each taking 500 shares. G, N's son, joined the company at which time E then held 400 shares, N held 400 and G held 200. N and G voted to have E removed as a director. E petitioned the court and was granted a winding up order on the grounds that the winding up of the company was a just and equitable result.

Pertaining to the judge's discretion within s. 996, it was affirmed in *Apex Global Management Ltd & Anor v FI Call Ltd & Ors*[650] , by Hildyard J that the discretion may expand to modifying the percentage of allotments on winding-up. The judge clarified that courts must not issue winding-up orders under this provision since

[647] S. 122(1)(g) of the Insolvency Act 1986.
[648] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*, London: Sweet & Maxwell, 2012, p.745.
[649] [1973] A.C. 360
[650] [2015] EWHC 3269 (Ch).

the particular stipulations for such solutions as well as the clear safeguards are germane to the use of such powers. Consequently, the winding-up of the defendant company based on fairness and equity was allowed[651].

Indeed, the likelihood of a shareholder making an application under section 122(1) (g) of the Insolvency Act 1986 for the company to be wound up based on fairness and equity is rare because the introduction of the unfair prejudice redress as well as the chances of obtaining an order for winding-up are minimal. Nevertheless, this result cannot completely be overlooked[652]. But the legislative redress of company's winding up shall result in the termination of a solvent company that will in turn lead to job losses with the majority of the minority shareholders being disadvantaged by this action[653]. Consequently, such applications hardly ever thrive due to the presence of other efficient redresses that courts are presently providing to the displeased shareholder without terminating the whole company[654].

Furthermore, ss. 148 and 180 of the Saudi CL 1965 also stipulates that minority shareholders have the right to request company liquidation by the court, but only if the company is a LLC or a joint stock company (JSC). When the LLC or JSC

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[651] *Apex Global Management Ltd & Anor v FI Call Ltd & Ors* [2015] EWHC 3269 (Ch) at 49-51 and 182.
[652] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.
[653] Jon Rush, Michael Ottley. *Business Law*. Thomson Learning Publishing. London. UK. 2006, p.266.
[654] David Milman, "Winding up, dissolution, restoration and other status re-characterisation features in UK corporate law: latest developments" Co. L.N. 2013, 333, 1.

accumulates losses amounting to three-quarters of the corporate capital, the board has to hold an extraordinary general meeting (EGM) with the purpose of discussing whether or not the company should be dissolved. Failure to do so (within a period of one month in the case of LLC) will result in anyone with an interest in the company having the right to seek to wind up the company[655].

The act of closing down a company does not hold its directors responsible for their illegitimate activities and neither does it determine the enforcement of directors' duties. The act is merely intended to liquidate the company, while the shareholders stop their involvement in the company. Therefore, for the shareholders, this procedure is the last solution. Before the introduction of CL 2015, it was suggested that the stakeholders' right to wind up the company in the circumstances stated under s.180 of CL 1965 had to be narrowed. For instance, some limitations are imposed on the process of winding up in the UK. For instance, the court may deny a dissolution request if the claimants have other options at their disposal, like a derivative action or unfair prejudice petition[656]. However, this provision has been repealed by the new Saudi CL 2015. This replacement arose because granting each shareholder the right to seek to wind up the company can put the company and its stakeholders at risk. Also, as this thesis

[655] Ss. 148, 180 of CL 1965.
[656] Brenda Hannigan, *Company Law.* Oxford University Press, 2016. p.520.

concludes, this may be an indication of Saudi legislators' desire to encourage more public enforcement actions than private ones[657].

The new ss.150 and 181 of SCL 2015 has amended s. 148 and 180 of old SCL 1965. Section 150 of the CL 2015 requires that if at any point throughout the financial year a JSC's losses reach 50% of paid capital, an extraordinary meeting of the shareholders must be called by the board within a specified time limit. At this meeting it must be decided whether the JSC's share capital should be liquidated, increased or decreased. If this meeting does not take place within an appropriate timeframe, if no decision is reached at the meeting or if it was decided that the capital would in increased but fundraising was not completed within 90 days of the issuance of this decision then the result would be the dissolution of the JSC by force of law.

Also, section 181 of the CL 2015 requires that in cases where an LLC's losses reach 50% of capital, a general meeting of the shareholders must be called by the directors. This meeting must be held within 90 days of the shareholders receiving notification of the meeting to give them time to reflect on whether the LLC should be dissolved or should continue. The dissolution of the company will occur by force of law in cases where the partners are not contacted by the directors or where the partners take no action to dissolve or continue the company.

[657] See Ch 6, paras 6.2.4., 6.2.6.

Previously, failure to do so will result in anyone with an interest in the company having the right to request the court to terminate the company. The CL 2015 has now repealed this provision.

In the 2011 case of the chairman of *Abdar Company LLC*, the court ordered the chairman to pay compensation for the damage that the company suffered as a result of his wrongdoings[658]. Three years later, the company's losses were three-quarters of the corporate capital; after a period of over a month, the shareholders made a court appeal for company dissolution. The appeal was granted and the company was liquidated. The ruling of the court was in accordance with s. 180 of the CL 1965, which specifies that every stakeholder is entitled to request company termination if no action is taken by the directors or majority stakeholders within the one-month period since the report of the company's losses[659]. The CL 2015 has now repealed this provision, and therefore, the minority shareholders are no longer able to initiate such an action.

4.5 Private enforcement challenges

4.5.1 Cost

One significant impediment for minority shareholders in taking derivative action in the name of the company is the matter of cost. Hence, providing minority

[658] The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment No. 10421/1 in 2011.
[659] The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment No. 20/D/TG3/1 in 2014.

shareholders access to sources of funding for derivative action is essential to ensure that any damage to the company is effectively dealt with[660].

The first case to acknowledge and successfully overcome the financial difficulties hindering derivative action was *Wallersteiner v Moir*[661]. In the Court of Appeal, Lord Denning MR declared that, as agents serving the interests of the company, the minority shareholders have the right to be reimbursed by the company for their expenditure during the procedures they have undertaken. However, in the event that the action is unsuccessful and considering that the action taken was justified, the minority shareholders should not be held accountable since they were serving the cause and not their personal interests, and moreover, should be compensated by the company for the costs they incurred. The court ruling in *Wallersteiner v Moir*[662] was that the individual shareholder was exercising a right obtained from the company and not a right granted to him, and therefore he deserved compensation.

By contrast, in *Smith v Croft (No.2)*[663], Walton J argued that the company should pay compensation to the minority shareholders only under the most straightforward, unquestionable circumstances. Consequently, in order to make a

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[660] Arad Reisberg, "Derivative Actions and the Funding Problem: The Way Forward". Journal of Business Law, 2006, 445. Available at SSRN: http://ssrn.com/abstract=632181.
[661] [1974] 1 WLR 991.
[662] *Ibid*.
[663] [1988] Ch. 114.

decision about whether to award an indemnity order immediately or to defer it, the court had to conduct a thorough investigation of all the data. Ultimately, in *Smith v Croft*, the court denied the indemnity order on grounds that a strong case must first be made before such an order is to be awarded.

It has been argued that, in the second case of *Smith v Croft (No.2)*[664], Knox J abided by the principle of collective decision-making and majority rule from *Foss v Harbottle*. Knox J admitted to be sceptical of the notion that the legal action initiated by a single minority shareholder to recover indemnity for the company can have a fair outcome if all the rest of the minority shareholders have grounds to believe that such action would have more negative than positive results.

The perspective of Knox J highlighted anew the crucial role played by collective decision-making in enforcing the duties of directors as well as the principle of majority rule from *Foss v Harbottle*. This perspective maintains that, even if not all shareholders participate in collective decision-making, it is better for a group, instead of individual, shareholders to make judgements regarding the appropriateness of taking legal action against directors who have breached their duties[665]. On the other hand, Pettet maintained that the use of an adaptation of the

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[664] *Ibid*.

[665] Hans C. Hirt, *The enforcement of directors' duties in Britain and Germany: a comparative study with particular reference to large companies*, Peter Lang, European Academic Publisher, 2004, pp.173,174.

principle of majority rule to decide against litigation in *Smith v Croft (No.2)*[666] was entirely unexpected and unwarranted. No clear conclusion can be drawn about the manner in which *Smith v Croft* unfolded[667].

A principle comparable to the one applied in *Smith v Croft* is also exercised by the Saudi courts in cases of indemnity and they are even tougher because they rarely award an indemnity order during an early stage or indeed rule that the shareholders should be compensated once the proceedings are finalised, regardless of whether they have been successful[668].

Nevertheless, there was a well-known case of litigation in Saudi Arabia, when the chairman of the *Abdar* Company was charged with negligence for not arranging a loan worth £8 million, as a result of which the company incurred great losses. The ruling of the Commercial Court was that the chairman was accountable for the damage resulting from his negligence and therefore had to pay compensation to the company. In addition, the Court ordered the chairman to reimburse the claimant the costs accumulated, including legal fees[669]. No specific provision is made in the CL 2015 with regard to the party responsible for paying

[666] [1988] Ch. 114.
[667] Ben Pettet, *Company Law*, Pearson Education, England, 2005, p.176.
[668] Mahmoud H. Almadani, *The reform of minority shareholder protection in Saudi Arabia and Dubai in private companies*, Hard copy, Unpublished PhD thesis University of Leeds, 2011, p.211. Further insights into this thesis can be gleaned from a perusal of Almadani's piece in "Derivative actions: does the Companies Act 2006 offer a way forward?" Comp. Law. 2009, 30(5), 131.
[669] The Board of Grievances (*Diwan Almadhalim*), the Commercial court, Judgment NO. 10421/1 in 2011.

the litigation costs in cases where the minority shareholders take legal action against directors; however, some researchers have argued that the costs should be covered by the company irrespective of the outcome of proceedings, as the action is brought not only on its behalf, but also in its interest[670]. This perspective has invited ample criticism, being considered to be damaging to the company. The business affairs of the company could be seriously affected by granting every shareholder the right to take derivative action in the name of the company without supporting the costs if the claim is unsuccessful[671]. As the UK Law Commission put it, this would mean killing the company by kindness, not to mention squandering financial resources and management time with unjustifiable lawsuits[672].

In *Cullen Investments Ltd v Brown*[673], the vital factor was that the shareholder took up all of the monetary risks of the legal action, as a result there existed no threat of the company dealing with a negative expense court directive. In view of this permission to continue with the derivative action was allowed[674].

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[670] Towma AlShammari, *The Board of Directors of Joint Stock Company*, Kuwait Est for Scientific Progress, Kuwait, 1985, p. 238.
[671] Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in* Saudi Law, Alhalabi for legal publications, Lebanon, 2006, p.390.
[672] Law Commission report, *Shareholders Remedies*, No 246, Cm 3769, London, TSO, 1997, Para 14.11.
[673] [2015] EWHC 473 (Ch).
[674] David Milman, "Shareholder law: recent developments in practice" Co. L.N. 2015, 378, 1.

Two distinct rules exist with regard to who is responsible for paying the legal fees. The American rule specifies that each party has to pay their own costs, regardless of the lawsuit result. A successful lawsuit does not exempt the shareholder from paying his/her own costs. However, it is possible to request compensation against the company. Known as “the common fund theory”, this principle signifies that part of the compensation awarded to the company for the damage suffered can be allocated to the shareholder who made the petition to cover the costs he/she incurred. An additional provision mentions that if the company stands to gain a considerable sum from a lawsuit, it will pay the costs of the shareholder. If the lawsuit is unsuccessful, the shareholder is not responsible for paying the fees of the opposing party. On the other hand, according to the English rule, the losing side is required to pay the costs of the winning side. Therefore, an unsuccessful lawsuit is particularly costly for the shareholder as he/she has to pay the lawyer fees of the opponent in addition to his/her own fees[675].

Another notable feature of the English rule is that, theoretically speaking, in legal proceedings between two parties, party A, if unsuccessful, would have to pay all

[675] Siems, Mathias M., “Private Enforcement of Directors’ Duties: Derivative Actions as a Global Phenomenon” (November 16, 2010). Final version published in: Stefan Wrbka, Steven Van Uytsel and Mathias Siems (eds.), “Collective Actions: Enhancing Access to Justice and Reconciling Multilayer Interests?” Cambridge: Cambridge University Press, 2012, 93. Available at SSRN: http://ssrn.com/abstract=1699353 or http://dx.doi.org/10.2139/ssrn.1699353.

the costs accumulated by party B in relation to the litigation. Practically, however, the court usually decides costs on a “standard” basis, in other words, the costs that the court deems to have been required by the litigation[676].

The application of conditional or contingent fee agreement in derivative actions has been extensively debated as a solution to this financial issue[677]. The conditional fee agreement specifies that, if the lawsuit is successful, the lawyer receives a significant premium regardless of the amount awarded, whereas the contingent fee agreement means that the lawyer receives a portion of the amount awarded[678].

If the courts are efficient in getting rid of suits in which the derivative actions are instituted to promote the personal interests of the individual shareholder, therefore, what encouragement shall the claimant shareholder have so as to look for the court’s leave to institute a derivative action for the company? Although companies might be instructed to compensate the claimant for the expenses of the court case, this does not generate a more constructive encouragement to institute a derivative action for the company. Further, when the plaintiff owns just a trivial

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676 Antony Morris, “Does an indemnity for costs in a commercial contract mean anything?” 22 October 2012, Lexology and accessible at http://www.lexology.com/library/detail.aspx?g=f45cb66e-4727-4c18-8fd5-cf457492feac.

677 Arad Reisberg, “Derivative Actions and the Funding Problem: The Way Forward”. Journal of Business Law, 2006, 445. Available at SSRN: http://ssrn.com/abstract=632181.

678 Winand Emons, "Conditional versus contingent fees." Oxford Economic Papers 59.1, 2007, 89.

shareholding within the company, it might not either function as a size sufficient to generate positive motivation[679].

Indeed, the reasonableness of sponsoring a shareholder's lawsuit shall stay as a main impediment to the derivative actions. The statutory derivative action procedure will not persuade a rational shareholder that he or she is at an advantage by taking the company to court (filing a derivative action) instead of trading off his or her stocks. Disappointingly, the common law stance on expenses of derivative actions remains unaffected. Litigation expenses as well as litigation charges regulations should be re-examined if a genuine transformation is to take place[680].

In *Bhullar v Bhullar*[681] permission to proceed was allowed with regard to some costs paid to a different company, however, the court settled that it was unacceptable to allow an anticipatory indemnity on the expenses out of company's properties. The *Bhullar*[682] lawsuit is a beneficial pointer of a circumstance in which it may be proper to look for an indemnity for the expenses while taking up a derivative action as well as the factors courts may possibly have

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[679] Arad Reisberg, "Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?", Rationality in Company Law: Essay in Honour of DD Prentice, J. Armour, J. Payne, eds., Hart Publishing, 2009; University College London Law Research Paper No. 09-02. Available at SSRN: http://ssrn.com/abstract=1092629.
[680] Arad Reisberg "Corporate Law in the UK After Recent Reforms: The Good, the Bad, and the Ugly." Current Legal Problems 63.1, 2010, 315.
[681] [2015] EWHC 1943 (Ch).
[682] *Ibid*.

in contemplation at the time of making judgment on the grant of such a security of costs.

4.5.2 The issue of the Saudi private enforcement regime

The main limitation of the CL 2015 is that it does not outline clearly the duties of company directors and the enforcement measures that can be taken. More specifically, as presented in earlier chapters, the CL 2015 fails to provide clarification on issues such as fiduciary duties, different directorial positions (e.g. shadow, de facto and nominee directors), as well as the parties towards which directors have obligations and whose interests have to be considered in corporate management[683]. The present part has extended a detailed discussion of whether the CL 2015 or other legislations can afford minority shareholders the right to take legal actions against wrongdoing directors in the name of the company. In particular s. 80 of the CL 2015 has been the focus of ample debate as to whether it makes provision for a derivative action for minority shareholders. The ambiguous phrasing of the section is considered to be the cause of this debate between Saudi researchers, whilst also blurring the distinction between the personal and derivative actions that shareholders can take[684].

Saudi Government has just introduced CL 2015 that came into force on 3 May 2016. Nevertheless, unfortunately, as this chapter illustrated, the new law has

[683] See Chapters 2 and 3 of this thesis.
[684] As discussed under the section of “The statutory derivative claim”.

made no changes to minority shareholders' right to sue directors. Indeed, the minority shareholders' right to wind up the company is no longer available under the new CL 2015. Before the introduction of SCL 2015, it was suggested that the stakeholders' right to wind up the company in the circumstances stated under s.180 of SCL 1965 had to be narrowed but not to be ceased. Although the winding up remedy has a severely negative impact on the company and its shareholders, employees and other stakeholders, it can be the last weapon to the minority shareholders in certain circumstances – if the court thinks fit.

Although the new CL 2015 symbolises a substantial overhaul and modernisation of Saudi Company Law, the new law is still in need to be amended. It is possible to put forth recommendations to amend the CL 2015 according to fresh developments and requirements. The main aspects that demand attention are improvement of the structure of corporate governance, better enforcement of directors' duties, and consolidation of shareholder protection based on the efficiency of enforcement actions.

4.5.3 Unawareness

Minority shareholders enjoy a range of rights under Saudi law, enabling them to interfere in organisational activities. For instance, s.90 of the CL 2015 specifies that shareholders may summon the GM if they represent a minimum of 5% of the capital. Also in the UK, this right is granted to both shareholders who represent

5% of the share capital and those who represent 5% of total voting power in cases where the company has no share capital.[685]

Moreover, shareholders accounting for a minimum of 2% of the capital may demand the MOCI to order a GM to be assembled after a period of 30 days since the date established for the meeting. Under the new CL 2015, s.90 states that shareholders who represent 2% of the capital may request that the MOCI, or the Capital Markets Authority (in the case of listed companies) call a GM, but only in certain circumstances, such as if there has been a violation of the CL 2015 or the company's articles. In this case, the MOCI or the Capital Markets Authority must call a GM within 30 days of receiving the shareholders' request.

Furthermore, as stipulated in s.96 of the CL 2015, shareholders have the right to address inquiries at the GMs to all board members and auditors. The latter have to respond to the inquiries, provided that the interests of the company are not undermined. If the answers given are unsatisfactory to the shareholders, they make take the matter up with the GM, which has to formulate a judgement.

Under the Saudi CGC 2006, companies listed on the stock market must give shareholders adequate information on the issues up for deliberation at annual

[685] S. 303(2)(a)(b) of CA 2006. The required percentage was 10% but it substituted to be 5% by The Companies (Shareholders' Rights) Regulations 2009 (S.I. 2009/1632) reg. 4(2).

general meetings. This enables shareholders to reflect on how they will vote and fully prepare for AGMs.[686] Additionally, s.110 of the CL 2015 states that the documents and records of the company must be readily available to the shareholders, to help them assess the situation of the company and make decisions accordingly[687], as well as to serve as evidence in the event that they decide to initiate litigation against directors.

One aspect that is considered to be pervasive in Saudi Arabia is that shareholders, and especially minority shareholders, are unaware of the rights that they have, or if they are aware of their rights, they do not do anything about it[688]. Moreover, since selling their shares is easy, the majority of shareholders, particularly those in large public enterprises, are negligent or ignorant of corporate matters[689]. This situation is aggravated by the mechanisms of rights enforcement which are yet to become fully developed as well as by the risks associated with involvement in legal proceedings in a system with a judicial structure that still needs to be improved and strengthened[690].

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[686] Article 5-h of the CGC 2006.
[687] Sadiq Al-Jubran, *The Joint Stock Company's Board of Directors in* Saudi Law, Alhalabi for legal publications, Lebanon, 2006, pp.252,253.
[688] Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.242.
[689] Ahmed Al-Razeen, *Corporate Governance of Joint Stock Companies*, Sabic chair for the Islamic financial studies, Saudi Arabia, 2012, p.104.
[690] Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.242.

In this respect, shareholders are advised to read all the company's books and records in order to use them as evidence when they decide to initiate litigation against directors. The Supreme Court of the New York State, New York County in January 2014 rejected a shareholder derivative court case in favour of the Travelzoo, Inc. This was due to the failure by the claimant to declare that request on the company's board of directors to bring a claim could have been unsuccessful. The judges opined that the claimant did not assert with distinctively adequate evidence to elicit a reasonable suspicion that the board of directors operated in bad faith. The judges stressed that claimants bringing such derivative actions must deal with assertions founded on absence of facts through probing the company's accounts books as well as other reports and records prior to instituting a court case. Through that, claimants shall be assisted in pleading with exactness, the particulars justifying request excusal. The judges rejected the case as well as declining the claimant's application to re-plead[691].

4.6 Summary

Chapter 4 attempted to answer the first part of the research question regarding the effectiveness of *private enforcement* actions for directorial duties provided by UK legislation, and to what extent Saudi law can benefit from them. In addition, the chapter discussed the possible actions that can be taken against directors by shareholders. For example, the author explored the derivative claims, personal

[691] *Kebis v. Azzurro Capital Inc*., No. 650253/2012 (N.Y. Sup. Ct. Jan. 21, 2014).

suits, unfairly prejudicial conduct claims, as well as other measures that shareholders can resort to. Finally, the chapter presented the difficulties and obstacles in the way of private enforcement actions, and this examination helped the author to assess the level of private enforcement with respect to directorial duties in Saudi Arabia. As revealed by the chapter, there is no effective legal course by which private actions can be initiated to punish the wrongdoers in Saudi Arabia. For instance, minority shareholders are prevented from initiating any legal action against directors on the company's behalf. This thesis has outlined several potential changes to existing Saudi law and has argued that the legal system in Saudi Arabia would benefit as a result of their implementation.

CHAPTER 5. Public enforcement of directors' duties

Chapter 4 identified the significance of directorial duty enforcement, which is a crucial component in the improvement of Saudi Arabia's corporate governance processes. Whilst the previous chapter outlined private enforcement, the current chapter evaluates *public* enforcement activities. Public enforcement relates to the state-imposed sanctions applied to directors who have acted against the best interests of the company[692]. Whether public organisations have the right to get involved in this area has long been a matter of debate. There are two key reasons for this intervention. Firstly, the law granting the company the right of limited liability was introduced by the state. This concession by the government allows companies to act as a legal person[693]. Limited liability needs to be reviewed by the state given that public policy is an issue of public interest. Secondly, safeguarding society from the damage that miscreant directors can cause comes at great cost to the national exchequer. The government pays the costs when a company fails and there is thus a public interest in attempting to ensure that companies in trouble survive[694].

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[692] The difference between public and private enforcement was clarified earlier. See Ch 4.
[693] See Michael Phillips, "Reappraising the Real Entity Theory of the Corporation" 21 Florida State University Law Review, 1994, 1064.
[694] See David Milman. *Governance of Distressed Firms*. Edward Elgar Publishing, 2013, pp.22,23.

Whereas there are some who are of the belief that it is pertinent to consider enforcement costs because it is generally the case that there are inadequate resources for public regulators to identify, probe and consequently enforce all of the infringements of the law that they become aware of[695]. Nevertheless, public enforcement possesses a securities regulation system that is self-sufficient because it is able to apply significant financial penalties[696]. Whilst empirical research remains limited in quantity, findings suggest that public enforcement methods are less effective than private enforcement methods[697]. In fact, effective public enforcement facilitates the effectiveness of private enforcement[698], which provides the rationale behind the discussion of public enforcement methods in this chapter of the thesis.

At the extreme end of public enforcement, prosecutions into any fraud and deceit can occur. In the past this was uncommon and investigations attracted limited investment. However, in UK, at the end of 2011 the creation of a specific crime agency placed more emphasis on preventing illegal activity. In contrast to this, at the other end of public enforcement, prosecutions target what is known as

[695] See Andrew Keay and Michelle Welsh, "Enforcing breaches of directors' duties by a public body and antipodean experiences." Journal of Corporate Law Studies, 2015, Vol. 15, No. 2, 255.

[696] See Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.

[697] See Erik Berglöf and Stijn Claessens. "Enforcement and good corporate governance in developing countries and transition economies" The World Bank Research Observer 21.1, 2006, 123.

[698] See Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.

technical offences. An example of this is the failure to file company accounts whereby prosecution seeks to underpin open disclosure through a public registry. This can result in companies being struck off the register, yet this often only applies to companies in debt and directors of smaller businesses[699]. Indeed, research indicates that it is extremely uncommon for directors of publicly traded companies to be excluded[700].

This chapter is primarily divided into <u>four</u> main sections in order to tackle the discussed aims. In the first part, public **enforcers** will be discussed. This part of the chapter outlines the public decision-making bodies possessing the authority to penalise directors who have violated their responsibilities in the UK and Saudi Arabia. The second part of the paper focuses on the possible **measures** that can be applied by the state officials – in the UK and Saudi Arabia- to a director who has violated civil or criminal law. These measures could be outcomes such as director disqualification, financial sanction, or even punishment under criminal law. The third section will emphasise the **obstacles** to enforcement actions. Finally, a **summary** is provided at the end.

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699 See Brenda Hannigan, "Board failures in the financial crisis: tinkering with codes and the case for wider corporate reform in the UK (Part 1)" Comp. Law. 2011, 32(12), 363.

700 See John Armour, Bernard Black, Brian Cheffins and Richard Nolan "Private enforcement of corporate law: An empirical comparison of the United Kingdom and the United States." Journal of Empirical Legal Studies 6.4, 2009, 687.

5.1. Public enforcers

5.1.1. Public enforcers in the UK

Within the United Kingdom, numerous methods of public enforcement exist. However, as already indicated, these systems are often more significant in practice when compared to formal private enforcement. Within the UK, four fundamental public enforcement agencies oversee businesses and organizations. These are the Financial Conduct Authority (FCA), the Financial Reporting Review Panel (FRRP), the Department for Business, Energy and Industrial Strategy (DBEIS) and the Bank of England. These agencies promote enforcement by adopting a combination of formal and informal actions[701].

5.1.1.1. The Financial Conduct Authority (FCA)

The FSA (Financial Services Authority) was abolished in the second part of the Financial Services Act 2012. Its role was split between two authorities, those being the PRA (Prudential Regulation Authority) and the FCA (Financial Conduct Authority). The PRA's task involves aiding the Bank of England's FPC (Financial Policy Committee) achieve its objective for financial stability. The responsibilities of the PRA include advocating the soundness and safety of firms authorised by the PRA and, in more general terms, helping the FPC through the

[701] See John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542.

minimisation of all unfavourable consequences for the financial system in the UK if any distressed firm failed[702]. The FCA operates independently, and the tactical objective is to ensure the smooth functioning of financial markets. As such, consumer protection, competition and market integrity is the responsibility of the FCA. Further, the FCA is charged with advocating effective competition that is in the consumers' interests[703]. The integrity of the market in this instance includes transparency of formation of prices in the markets, not being utilised for any purpose in connection with financial crimes and not being impacted by any behaviour that abuses the market[704]. The scope of this thesis is restricted to how director duties are enforced in solvent companies; therefore, the mechanisms and measures of the FCA are more pertinent throughout this chapter.

A large amount of powers of enforcement were inherited by the FCA from the FSA according to provisions outlined in the second part of the 2012 Financial Services Act. Such powers are permitted by FSMA 2000. More specifically, Section 6 (1-A) declares that the FSA is to be renamed to be called FCA. Further, Section 16 of this Act approves of the FCA exercising functions under FSMA 2000 Part 6. Therefore, a key role of the FCA is to write and impose Listing Rules, Disclosure and Transparency Rules and Prospectus Rules for listed

[702] S 6 (2-A,B,and C) of the Financial Services Act 2012. Also see the Bank of England and FSA, "The Bank of England, Prudential Regulation Authority: Our approach to banking supervision" 2011, p.3.
[703] S 6 (1-A) of the FSA 2012.
[704] S 6 (1-D) of the FSA 2012.

businesses[705].For listed companies, it has the ability to demand disqualification of securities. It also regulates and prohibits exploitation of the market such as insider dealing[706]. Meanwhile, the FCA is able to enforce penalties on civil and criminal actions[707]. Individuals or companies can also be targeted by the FCA and penalized via public censure[708].

5.1.1.2. The Financial Reporting Review Panel ('FRRP').

A second public enforcement agency is the Financial Reporting Review Panel which is involved in preventing managerial opportunism in listed businesses. The FRRP is supported by the Financial Reporting Council (FRC) and was developed in 1991 so as to identify material deviations from standard accounting practice by sizable businesses and to encourage organizations to correct this where able[709]. If companies fail to remedy any anomalies the FRRP is able to seek a court order to authorize correction of any data[710].

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[705] Part VI, esp. ss 72, 77, 89, 91 of the FSMA 2000.
[706] Part VIII, esp. ss 123, 129 of the FSMA 2000.
[707] Ss.401-02 of the FSMA 2000 (criminal prosecution powers, particularly in relation to insider dealing under the Criminal Justice Act 1993 Part V), 91, 123 (civil penalties for breaches of Listing Rules or market abuse), 66 (civil penalties against authorised persons).
[708] Ss.87, 89 of FSMA 2000.
[709] See John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542 .
[710] Companies Act 1989 s 12, inserting ss 245-245C into Companies Act 1985. Equivalent provisions now appear as CA 2006 ss 456-57. The FRRP was authorised to exercise these powers by the Companies (Defective Accounts) (Authorised Person) Order 1991, SI 1991/13.

Importantly, the FRC is governed by the UK's Corporate Governance Code which is underpinned by a 'comply or explain' principle. The Code requires businesses to report their compliance with the Code and to clarify any reasons for non-compliance. These reasons must include a full explanation as to why a business does not deem it suitable to comply with the provisions of the Code[711]. The position of the FRC in relation to the 'comply or explain' principle will be examined later in this section.

5.1.1.3. The Department for Business, Energy and Industrial Strategy (DBEIS).

UK companies are also governed by this Department which until 2007 was called the Department of Trade and Industry (DTI) [712]. It then enjoyed a short life as the Department of Enterprise and Regulatory Reform (BERR). Since 2009, the Department for Business, Innovation and Skills (DBIS) had also been in control of public enforcement. The department was again renamed in July 2016 in the wake of the nomination of Theresa May as Prime Minister. It became the Department of Business, Energy and Industrial Strategy. In the following

[711] See Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .

[712] John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542.

discussion, the position of the DBEIS with regards to public enforcement will be identified in relation to company instigation procedures.

Bearing in mind the important of the Department's role, the UK Government is unwilling to take initiate proceedings against directors due to its resistance to spend public finances on issues which should be the responsibility of the company members[713].

5.1.1.4. The Bank of England

In conjunction with the FCA, PRA and the Treasury, the Bank of England safeguards and promotes financial processes within the UK and helps to protect investors, public funds and stability of banking processes within the UK. In turn, public confidence in banking systems is promoted[714]. All three authorities have the legal authority to enforce these objectives. For example, the Bank of England is able to make a share transfer instrument so as to handover a failing bank to a private buyer. Meanwhile, the Treasury is entitled to take a bank into temporary public ownership via a share transfer order[715]. These methods of enforcement thus permit these authorities to alter and terminate the employment of a bank director and are able to assign new directors if deemed necessary[716].

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[713] See Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.668.
[714] S. 4 of the Banking Act 2009.
[715] S. 11,13 of the Banking Act 2009.
[716] S. 20 of the Banking Act 2009.

5.1.1.5. Companies' investigation regime

Public enforcement does not incorporate the authority to examine company affairs. An investigation into a company and its consequent report is the main method of identifying any wrong-doing by directors. Reports can result in disqualification of directors, financial restrictions, prison sentencing and the termination of a company if it is deemed to be in the public interest. All of these actions can be legally undertaken by the agent who has authorized the investigation report.

Company matters and any consequent inquiries must be reported by experienced enforcement agents to the UK Secretary of State by whom they are employed[717]. Indeed, the DBEIS has been provided with investigative powers. In *R v. Board of Trade, ex parte St Martin Preserving Co Ltd*[718], Winn J defined "the affairs of a company" to incorporate all business matters, interests and transactions together with its financial outlay, property interests, monetary gain or loss and its goodwill[719]. Sachs LJ in *Re Pergamon Press Ltd* determined that inspectors must seek to ascertain if the facts require increased action by other parties. It was held that rules of natural justice are not applicable to the questioned party and there is no compulsion for the inspector to reveal the reason behind the inquiry[720].

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[717] S.431 (1) of CA 1985.

[718] [1965] 1 QB 603.

[719] *R v. Board of Trade, ex parte St Martin Preserving Co Ltd* [1965] 1 QB 603.

[720] *Re Pergamon Press Ltd* [1971] 1 Ch 388 at 401.

As a result of *Re Pergamon Press Ltd*, it is evident that directors who are involved in wrong-doing or auditors who have behaved negligently may be fearful of providing evidence and co-operation with inspectors due to apprehension regarding potential criminal or civil litigation based upon any disclosure[721].The Court of Appeal noted in the cases of *Re Pergamon Press Ltd* and *Maxwell v Department of Trade and Industry* that a criticized party should not be able to transform the process into a full trial of each criticism levied at them. It refuted an appeal for inspectors to provide the evidence on which their criticisms were founded which incorporated paperwork and interview transcripts[722]. According to Lord Denning in the Court of Appeal, inspectors are permitted to acquire the information they require by the best possible method but must allow a party a fair prospect of disputing any criticism before they are able to judge or criticize them. Inspectors need only to outline any charges rather than disclose full details[723]. Consequently, this provision has been adopted by the DBEIS.[724]

S. 447 of CA 1985 enables the Secretary of State to request documents and material from companies. This provision for informal investigation is widely used. It has been modified under s.21 of the Companies (Audit, Investigations

[721] See Mohammed Hemraj "Audit failure due to negligent audit: lessons from DTI investigations" Comp. Law. 2003, 24(2), 45.
[722] See Derek French, Stephen Mayson, and Christopher L. Ryan, *Company Law*. Oxford University Press, 2015-2016, pp.600-605.
[723] *Re Pergamon Press Ltd* [1971] 1 Ch 388 at 399-400.
[724] See Mohammed Hemraj "Audit failure due to negligent audit: lessons from DTI investigations" Comp. Law. 2003, 24(2), 45.

and Community Enterprise) Act 2004 and was not repealed by CA 2006. The investigator is able to stipulate the inclusion of specific information within each document and requires directors to comply with these instructions. Where need be, the director is able to request evidence of the investigator's relevant power to do so[725].

Consequently, if a director provides a declaration in agreement with section 447, this can be used as evidence against them. However, during criminal proceedings where an individual is charged with an offence – (a) no evidence relating to the declaration may be presented by or on behalf of the prosecution, and (b) no question relating to it may be asked by or on behalf of the prosecution, unless evidence relating to it is presented or a question relating to it is posed in the proceedings by or on behalf of that person[726].

If an individual purposefully impedes an inspector or investigator, the individual to whom the inspector or investigator is accompanied by, as he deems suitable, is guilty of a wrong-doing and accountable to a fine on conviction on indictment; (b) on summary conviction, to a fine not exceeding the statutory maximum[727]. Additionally, the imposition of a fine can be authorized by the Secretary of State

[725] S.447 of CA 1985 which is still in force.
[726] S.447A of CA 1985 which is still in force.
[727] S.453 (A) (5) of CA 1985. The inspector is a person who is appointed by the Secretary of State to investigate the affairs of a company and to report the result of their investigations to him. See Ss. 431,432 and 442 of CA 1985 and S.1035 of CA 2006.

or an investigator if the individual fails to comply with a request stipulated by the inspector[728]. This can be endorsed in writing to the court by the Secretary of State, the inspector or the investigator. If the court deems that the individual unsuccessfully complied with the request with no reasonable reason, the court may find the individual guilty of contempt of court[729].

Research by Davies identified that the first enforcement period consisted of twelve investigations and seven prosecutions. The second period consisted of fifty-five investigations and forty-five prosecutions whilst the final period included ninety-six investigations and fourteen prosecutions. In its entirety, 163 investigations led to sixty-nine completed prosecutions. There is therefore a challenge in procuring convictions and somewhat minimal sentences apply to those convicted which do not always reflect the extent of their malpractice[730].

An inquiry into TransTec in 2000 was considered superior to the quality of any insider dealing cases undertaken by the DTI. Following the collapse of the Barings Bank in 1995, little positive input was provided to support the Bank of England, raising questions regarding the monitoring priorities of the DTI[731]. Indeed, in a 2003 study Sikka believed that the TransTec's collapse was linked

[728] S.453C (1-b) of CA 1985.
[729] S.453C (2) and (3) of CA 1985.
[730] See Jack Davies "From gentlemanly expectations to regulatory principles: a history of insider dealing in the UK (Pt.2)" Comp. Law. 2015, 36(6), 163.
[731] *Ibid.*

to the auditors' negligence. He criticised that no action had been taken against the TransTec auditors[732]. One year after of the publication of the Sikka article, the chief executive Carr and the finance director Jeffery were both charged in October 2004 after publishing dishonest financial statements and deceiving auditors. A settlement of US$18 million was reached, but this was not divulged to the TransTec board nor was it exposed as a liability in the accounts[733]. Jeffrey returned from Australia to face the proceedings and pleaded guilty to all charges in January 9th 2006[734]. Carr was acquitted on 31st March 2006[735].

When considering the costs of an investigation, S. 439 (1) of the CA 1985 stipulates who will be liable. Notably, this expense can be significant due to the high rank of the inspectors together with the prolonged nature of investigations[736]. Importantly, any expenses are initially shouldered by the Secretary of State. Subsection (2) identifies that if an officer is found guilty of an offence resulting

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[732] See Prem, Sikka, "A comment on the DTI's 'review of the regulatory regime of the accounting profession" (January 2003), http://visar.csustan.edu/aaba/DTIJan2003.pdf [Accessed August 23, 2015].

[733] See The annual report of SFO in 2006, The Official website of Serious Fraud Office (SFO) at: http://www.sfo.gov.uk/about-us/annual-reports--accounts/annual-reports/annual-report-2005-2006/proceedings-underway-.aspx [Accessed August 23, 2015].

[734] See the Official website of Serious Fraud Office (SFO) at: http://www.sfo.gov.uk/press-room/press-release-archive/press-releases-2006/transtec-plc.aspx [Accessed August 23, 2015].

[735] See the annual report of SFO in 2006, The Official website of Serious Fraud Office (SFO) at: http://www.sfo.gov.uk/about-us/annual-reports--accounts/annual-reports/annual-report-2005-2006/proceedings-underway-.aspx [Accessed August 23, 2015].

[736] See John Birds, Robert Miles, Robert Hildyard, Nigel Boardman. *Annotated companies legislation*. Oxford University Press. 2012, p. 1228. Also see Derek French, Stephen Mayson, and Christopher L. Ryan, *Company Law*. Oxford University Press, 2015-2016, pp.600-605.

from an investigative matter, then he or she may be instructed to meet the costs of the investigation. In certain situations, the corporate or applicant(s) will be responsible for the investigation expenses, as governed by subsections (4) and (5)[737]. In respect of this, it is proposed that no guidance exists for how courts should implement its discretion in terms of recovering investigation expenses[738].

MGRG manufactured MG and Rover cars, and they entered administration in 2005. The DTI appointed independent inspectors who compiled a report which was referred by the Secretary of State for Business, Innovation and Skills to the SFO on July 6th once the findings had been studied. The report was delivered by the inspectors on June 11th 2009. Following a lengthy investigation, the Office for Serious Fraud announced its intentions to not commence any criminal investigations into the selling of MGRG, once documents that had been provided by the Business, Innovation and Skills Department had been reviewed.[739]. On April 2011, the directors of MGRG (Phoenix Four) were disqualified after a lengthy and complex investigation[740]. Apparently, the Phoenix Four were held liable for recovering investigation costs. The director is required to repay any investigation costs, in accordance with Section 439 (2), once it has been found as

[737] S.439 of CA 1985.
[738] See Andrew Lidbetter, *Company Investigations and Public Law*, Hart Publishing, 1999, p.193.
[739] See the Official website of Serious Fraud Office (SFO) at: http://www.sfo.gov.uk/press-room/press-release-archive/press-releases-2009/mg-rover.aspx [Accessed August 23, 2015].
[740] See Department for Business, Innovation & Skills, "MG Rover's Phoenix Four disqualified as directors", May 9th 2011.

a result from the investigations that they are guilty of committing an offence. Therefore, the directors of MGRG did not have to pay the expenses of the investigation. Further, the MG case results potentially uphold the notion that the rates of the conviction and prosecution rates for criminal penalties are not high enough.

5.1.2. Public enforcers in Saudi Arabia

5.1.2.1. Company investigation

There are many shareholders in joint stock companies. Consequently, company issues are subject to board governance, whilst the shareholders' general assembly has little authority. Therefore, the rights of minority shareholders require greater safeguarding. In Saudi Arabia, the aim is to offer minority shareholders the ability to ask for company activities to be inspected as an extension of rights protection. Here, the judiciary court can be avoided, which offers shareholders time- and cost-saving benefits that they otherwise could not achieve[741]. Because the inspection procedure derives from the state administration body's capabilities, as per comparative law, it is an important topic to include in this paper; hence its exploration in this chapter. For instance, company inspection applications can be approved by the minister of economy under Egyptian law[742]. This is also the case in KSA, where inspection applications must be sent to the Commercial Disputes

[741] Saleh Al Balwi, *Control on Board Members in the Joint Stock Companies*, Riyadh, Law and Economy Library, 2012, p.119.
[742] S.158/2 of Egyptian Companies Law no. 159 dated 1981.

Settlement Body (CDSB). The CDSB is thought of as being associated with the minister of commerce as an administrative body[743]. In this case, the commercial court adopts the CDSB's capabilities, as explained below.

Since 1965, shareholders (of 5% ownership or more) have been granted the ability to apply to the CDSB for company inspection. In this case, shareholders must expressly articulate that the company's activities are likely being mishandled by accounts managers or board members. The CDSB then arranges for the company's managerial staff to be inspected following a meeting with the company's board members. The shareholders may be required to present a guarantee if the CDSB requests it. The CDSB has the authority to enforce preventative actions and hold a meeting to outline the required solutions if the shareholders' complaint is found to be accurate. Solutions and actions can include the dismissal of managers and directors. The CDSB can also select an interim manager whilst the investigation procedure is being conducted[744]. It should be noted that everything associated with the CDSB is overridden by Royal Decree in July 1987[745] after the Board of Grievances managed its terms of reference under the Ministers' Council resolution in June 1987[746]. After passing the new

[743] S.232 of CL 1965.
[744] S.109 of CL 1965, this section has been reformulated under s.100 of the new CL 2015, yet the provision stays almost the same.
[745] Royal Decree no. M/63 (26-11-1407 H)
[746] Ministers' Council resolution no. 241 (26-10-1407 H).

Law of Judiciary in 2007, the commercial court was formed and the Board of Grievances transferred the commercial department's terms of reference[747].

In the KSA, company inspection for shareholders with 5% capital ownership is managed by the lawmaker, who does not grant the administrative body the capability of managing company inspection. It appears that the rationale behind the restriction on the Saudi administrative body is based upon an acknowledgement of the notion of market freedom. Furthermore, unless it is unavoidable, the Saudi government does not intervene in company business.

Under Saudi legislation, there is no precise definition of wrongdoing associated with the approval of an inspection request. Instead, shareholders may ask for the company to be investigated in the event of 'suspicious' behaviour. This means that there will be some ambiguity involved in the meaning applied to this part of the legislation since 'suspicious' behaviour is a challenge to accurately define[748]. Therefore, it is suggested that shareholder investigation requests can stem from the observance of apparent misconduct of duties by a board member or by apparent abuse of the company system.

[747] S.9 of the Law of the Judiciary 2007.
[748] Saleh Al Balwi, *Control on Board Members in the Joint Stock Companies*, Riyadh, Law and Economy Library, 2012, p.125.

Whilst legislation allows for investigation-requesting shareholders to provide a guarantee to bare the expense of the investigation, the power of evaluation is judicial. The reason for this is that unless the judiciary body (i.e. commercial court) rules that a guarantee is needed, shareholders are not required to submit one. Some scholars have expressed negative reactions to the Saudi lawmakers under this point since it is believed that if their inspection request is to be considered in earnest, shareholders must submit a guarantee[749]. Other researchers perceive this approach to be a compromise between accommodation and deterrence, since the requirement for shareholders to carry the expense of the complaint or submit guarantee will cause many shareholders to avoid requesting an investigation of the company[750]. Furthermore, shareholders acting with malicious intent against the company can often be deterred through the granting of power to the judicial body to request a shareholder guarantee.

S.100 of the CL 2015 states that if the request is taken seriously, the judicial body is able to propose the required solutions through a general assembly and enforce preventative actions where required. When the complaint is time-sensitive, board members and managers may be dismissed from their posts and an interim manager may be recruited during the process. It is noted that this is not offered

[749] See Mohammed Almadhi, *CMA role in protecting the minority shareholders' right,* Law and Economy Press, Riyadh, 2012, p.194.
[750] Saleh Al Balwi, *Control on Board Members in the Joint Stock Companies*, Riyadh, Law and Economy Library, 2012, p. 126.

under Saudi law if the shareholders' complaint is invalid[751], which suggests that the ruling is down to the judgment of the legal system and the professionals within it. This highlights a level of incongruence that needs to be addressed by Saudi lawmakers[752].

In 2001, in the case of senior shareholder Allahidan, who owned 5% of Mubarrad's capital, the Saudi Board of Grievances ruled in favour of the shareholder. After eight sessions, the ruling allowed the shareholder to enlist the assistance of a chartered accountant to visit the company and investigate its accounting records. The shareholder's original claim was submitted on 9th August 2010, and took seven months to approve. The company's board of directors was given an appeal period of one month following the ruling date. This case was unique in Saudi history, and no other previous ruling had enabled a senior shareholder to review the company's accounts[753]. This case provides an encouraging basis for requests under S.109 of the Saudi CL 1965 (now s.100 of the CL 2015).

In Saudi Arabia, shareholders who hold five percent or more can apply to the court for a company inquiry whilst in the UK only the Secretary of State is permitted to do so. Allowing the court the right to authorize an investigation does

[751] *Ibid*, p.135.
[752] See Mohammed, Almadhi, *CMA role in protecting the minority shareholders' right,* Law and Economy Press, Riyadh, 2012, p.200.
[753] Middle East Newspaper:
http://archive.aawsat.com/details.asp?article=25181&issueno=8108#.VQFfafnz01I.

allow increased autonomy. However, this can be both expensive and time consuming. In some situations, it has been proposed that alongside the court power permitted within Saudi law, the legislator could provide the Ministry of Commerce the authority to commence an investigation so as to help lower the case load[754].

5.1.2.2. Capital Market Authority

Since the start of the 21st century, the Saudi Stock Market has experienced significant development. During the period 2001-2005, there was a nine-fold increase in the market value of shares, from SR. 275 billion to SR. 2438 billion[755]. However, this promising growth was cut short by the market crash in early 2006. The CMA reacted to this critical situation by publishing a detailed corporate governance regulation mandate with the purpose of informing Saudi state-owned companies about best governance practices[756].

In addition, CMA has a highly significant influence on the management of securities firms and the security issuances of public joint stock companies. The CMA also acts as a financial market mediator; possessing the authority to

[754] As this chapter will discuss, in the UK, the “undertakings” is an alternative of the disqualification order. It was formed in order to reduce the case load.

[755] See Christopher Robertson, Sulaiman Al-AlSheikh and Ali Al-Kahtani "An Analysis of Perceptions of Western Corporate Governance Principles in Saudi Arabia." International Journal of Public Administration 35.6, 2012, 402.

[756] See Mohammed, Al-Abbas “Corporate governance and earnings management: An empirical study of the Saudi market” The Journal of American Academy of Business, 2009, 15, 301.

sanction lawbreaking financial market firms[757]. Under S.5 (A) of Capital Market Law 2003, the CMA's role is to ensure the implementation of Capital Market Law rules through the provision of relevant guidelines. The CMA primarily functions as a managing force of companies' operations and actions in order to protect shareholders and the public from fraudulent, immoral or otherwise dubious practices. In order to achieve effective management of capital market companies, S.5 (c) of CML 2003 grants the CMA and its members the authority to take evidence, request the necessary documentation and call for witnesses. When reaching a judgment decision, the CMA is able to review the received documentation so as to form an opinion of the violation of the CMA's rules, senior management regulations, or the company system.

The CMA representative is granted the authority to take part in companies' general meetings for the purpose of management. The representative is not granted the authority to participate in judgements or rulings during the meetings. Under s.5 of Capital Market Law[758], the CMA's role is to organise and manage companies' operations and activities, as well as to manage the duties of the board of directors through the review of the company's financial documents. Under Section 45 of Saudi Arabia's Capital Market Law, the quarterly and annual

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[757] Saleh Al Balwi, *Control on Board Members in the Joint Stock Companies,* Riyadh, Law and Economy Library, 2012, p.126.
[758] *Ibid*, pp.140,141.

reports (cash flow, profit and loss, and balance) of security-issuing firms should be forwarded to the CMA for review. These reports should also include details of any changes that may significantly impact the firm's economic status. In order to ensure confidentiality, the firm must not share the reports with any other institution that is not duty-bound to the confidentiality of the reports prior to submitting them to the CMA. Furthermore, the CMA requires that reports should be accompanied by an account of the company's business, as well as the details of senior investors and shareholders, senior management, board members and executive officers[759].

Under Section 25 of CML2003, the Committee for the Resolution of Securities Dispute is addressed. The Committee is granted authority to manage conflicts related to this Law and its Implementing Regulations, as well as the CMA's regulations plus private and public activities under the Exchange. The Committee is comprised of securities, financial affairs and commercial experts as well as legal advisors specialising in capital market and transaction principles, and is able to conduct inspection, request relevant documentation, and issue rulings, sanctions and subpoenas[760]. Committee member positions can be renewed after a period of 36 months and are selected by the Board of Capital Market Authority. Committee members are not permitted to have a fourth-degree or closer family

[759] S.45 of CML 2003.
[760] S.25 of CML 2003.

tie with the company or complainants, nor any commercial or economic interest (whether direct or indirect) in the case. The Committee is granted a maximum of 14 days (following the filing date to the Committee) to commence judgement on the case[761]. The Committee is able to deal with appeals over Exchange or CMA rulings as well as to award compensation and order a judgment reversal or amendment in the interests of the complainant[762]. The Committee is bound to adhere to the CMA's regulations when managing lawsuits and complaints[763]. Additionally, all complaints must be registered with the CMA at least 90 days before they are registered with the Committee unless otherwise informed by the CMA[764].

In the event of an unsatisfactory ruling, it is possible to appeal to the Appeal Panel for up to 30 days following the announcement of the Committee's ruling[765]. The Appeal Panel is granted the right to reject appeals against the Committee for the Resolution of Securities Disputes (CRSD), to support the Committee's judgements, to conduct a new evaluation using the account of the Committee's hearing, and to offer any ruling that it believes to be suitable. The Appeal Panel's rulings cannot undergo further appeal[766].

761 *Ibid.*
762 *Ibid.*
763 *Ibid.*
764 *Ibid.*
765 *Ibid.*
766 *Ibid.*

In the case of the Resolution of Securities Disputes, at the IPO shares stage, against Mohammad Al Mojil Group's board of directors (November 2014), the CMA issued an Authority Council judgement to take legal proceedings before the Committee based on the misconduct of the company's accountants and senior executives, who breached Capital Market Law between 2008 and 2011. Furthermore, the CMA requested to conduct a further inspection and raised breaches of Companies Law with the Ministry of Commerce with regard to the duty of compensation towards the complainant shareholders. The CMA maintains that capital market firms' board members, accountants and senior executives must comply with the assumptions of Capital Market Law[767]. On 15th June 2016, the CRSD gave judgement in Mohammad Al Mojil Group's case and sentenced two of its executives from three to five years in prison and there were banned from being employed by listed companies between five to ten years. Of note, a director was obliged to pay approximately $427 million to Capital Market Authority for the illegal profits achieved as a result of violations of the CML 2003[768].

Studies within the legal field emphasise that the position of the CMA as a claimant for compensation on behalf of shareholders' losses was the first of its kind. It appears that this position was granted under s.59 of the CML 2003, which

[767] See the announcement by CMA in this regard on http://www.cma.org.sa/Ar/News/pages/CMA N 1560.aspx.
[768] See the announcement by CMA in this regard on http://www.cma.org.sa/en/News/Pages/CMA_N_2073.aspx.

permits the CMA to request legal action as a representative of parties injured due to market system misconduct. S.59 (A) states that the CMA is permitted to take legal action to obtain compensation or sanction for the affected party if the CMA recognises that any individual has acted, or is acting, in such a manner that represents a breach of market regulations, CMA regulations or the company system. Clause 4 of s.59 expressly states that the damage incurred due to the breach should be compensated, which grants the CMA the right to act on behalf of the affected party without the requirement of approval[769].

The CRSD acts as a third-party committee able to provide judgements under the CMA Board's executive authority. This being said, it is proposed that the CRSD is not entirely third-party in nature because its members are selected and remunerated by the CMA Board, which effectively puts members in a position similar to that of a CMA Board employee. Consequently, it is suggested that if the CRSD is to truly act in a third-party role, its members should be selected by the Council of Ministers (i.e. as is the case in the Appeal Committee for the Resolution of Securities Conflicts). Additionally, the CMA necessitates that complaints are registered for 90 days prior to a ruling unless the complainant is otherwise informed by the CMA that the complaint can be raised with the CRSD at an earlier time, under Section 25 (E) of Capital Market Law 2003. As such,

[769] See Osamah Alqahtani, "Al mojl case and the shareholders' indemnity" Alwatan Newspaper, Nov 2014, available at: http://www.alwatan.com.sa/Articles/Detail.aspx?ArticleId=23976 .

companies are restricted from submitting their defense to the CRSD until it has been registered with the CMA. Consequently, it is evident that the CMA has an impact on the procedures of Committee and, therefore, the Committee is not entirely independent[770].

Only for publicly listed companies, s.216 of the CL 2015 grants the CMA the power to impose sanctions for violations of the CL 2015 provisions. Under s.220 of the CL 2015, the CMA is in charge of ensuring that the companies' by-laws is in compliance with CL 2015 provisions. Also, it has the power for the company's investigation, inspection, requiring any documents and information when it sees fit.

5.1.2.3. The Ministry of Commerce and Industry

In the MOCI, the General Department of the Companies (GCD) is assigned a highly influential managerial function under Saudi Law, wherein the GDC monitors the operations of registered companies under Saudi CL 1965. Under s.52, it is stated that the GCD is granted permission to enforce changes to company by-laws where necessary prior to the companies' registration, so as to adhere to the assumptions of Companies Law. This section has been annulled under the new CL 2015. However, the MOCI still has the power to monitor the

[770] Faleh Al Kahtani, *Current practices of Saudi corporate governance: A case for reform,* PhD thesis, Brunel University, 2013, pp.108,109. , available at http://bura.brunel.ac.uk/bitstream/2438/7382/3/FulltextThesis.pdf [Accessed March 27, 2016]. Two articles were published as a result of this thesis, see Faleh Al Kahtani, "Current Disclosure and Transparency Practices in Saudi Corporate Governance", Arab Law Quarterly, 28(2), 2014, 176. Also see Faleh Al Kahtani, "Current Practices of Saudi Shareholders' Rights: A Case for Reform", Arab Law Quarterly, 27 (3), 2013, 231.

company's affairs for all companies, except in the case of listed companies where CMA is in charge. S.216 grants the MOCI the power to impose penalties for breaches of the CL 2015 provisions. Under s.220 of the CL 2015, the MOCI is in charge of ensuring that the companies' by-laws is in compliance with CL 2015 provisions. Also, it has the power for the company's investigation, inspection, requiring any documents and information when it sees fit. Under s.86 of the CL 2015 it is stated that the Minister of Commerce is granted permission to assign at least one company representative (excluding board members) for participation in the general assembly.

Under s.87 of the CL 1965, subsequent control entails that GM can be arranged at the request of the board. S.87 also grants GCD the ability to request a GM at the wish of shareholders with 2% or more capital, as well as at the decision of the Minister of Commerce providing a period of one month has passed from the proposed assembly date without assembly request. Under the new CL 2015, s.90 states that shareholders who represent 2% of the capital may request that the MOCI, or the Capital Markets Authority (in the case of listed companies) call a GM, but only in certain circumstances, such as if there has been a violation of the CL 2015 or the company's articles. In this case, the MOCI or the Capital Markets Authority must call a GM within 30 days of receiving the shareholders' request. In March 2015, the Ministry requested a GM for close joint stock company, Al Salheya Union, shareholders. This assembly was called in response to the failure of Al Salheya Union's board members to reply to written communication sent to them by the Ministry. This lack of action breached s.84 of the CL 1965 -s.87 of the CL 2015- (failure to call for general assembly) and s.86 of the CL 1965 -s.89 of the CL 2015- (failure to respond to the shareholders' complaints)[771].

Authority over companies' operations and activities is granted under s.99 of the CL 2015, which states that any decision made during shareholders' assemblies that breaches company by-laws or Companies Law is invalid, with the exclusion of damage to the rights of genuine independent institutions. Here, the invalidation of decisions can be requested by a company's general managers. If approved, shareholders do not achieve resolution. If a period of over one year passes following the decision announcement, there will be no hearing of any nullification claim[772].

5.1.2.4. The Saudi Arabian Monetary Agency (Central Bank)

Saudi's Central Bank, the Saudi Arabian Monetary Agency (SAMA), has a high level of influence over the creation, monitoring and maintenance of the nation's financial system and banking sector, as well as control over the actions of commercial banks and the financial market, as supported by the provisions of Saudi Law[773]. Whilst the country's domestic banking sector is considered to

[771] See the official website of the Ministry of Commerce and Industry http://mci.gov.sa/MediaCenter/News/Pages/02-03-15-02.aspx .
[772] S.97 of the CL 1965.
[773] See Waleed Al-Ajlan, *Corporate Governance in Saudi Arabia: The Roles and Responsibilities of the Board of Directors in the Banking Industry*, Hard copy, PhD thesis, University of Nottingham, 2005, p.240.

perform more competitively and efficiently than Saudi's other industries, it is argued that the SAMA is primarily responsible for its success. Consequently, it should be highlighted that it would be wise for the conduct of Saudi Arabia's commercial banks to comply with the practices adopted in more developed regions[774].

In 1966, the Saudi Banks Control System was issued, which placed restrictions on certain board activities for banks. For instance, banks were from this point onward unable to offer guarantees, credit or loans to any individual possessing more than 25% of the bank's capital[775]. This permitted the Agency to inflict sanctions on the board members of any bank that breached these or any other component of the banking system. Any board member or bank employee found to have breached these rules is subject to temporary or permanent dismissal upon the authorisation of the Minister of Finance. Furthermore, the Agency is granted the power to enforce a maximum prison sentence of 6 months and/or a maximum penalty of $26,666, on board members found guilty of wrongdoing under sections 8, 9 and 10 of the Banking Control Law 1966. Offences include offering credit, loan without guarantee, surety or guarantee, or offering to carry another type of

[774] See Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.48.
[775] S.8 of Banking Control Law 1966.

financial responsibility on behalf of an accounts manager or board member who purchases shares in any Saudi bank before obtaining the Agency's permission[776].

5.2. Public enforcement actions and mechanisms

5.2.1. Shaming or reputational sanctions[777]

Application of shaming or 'reputational' sanctions can occur in a variety of ways. One such sanction includes, for example, the publication of a public statement to the effect that a company has failed to meet a particular standard. If necessary, this publication can urge other companies not to engage in business with the company at hand. Importantly, if a company is brought into disrepute this can affect any future dealing and interaction with other business parties. Although reputational sanctions against a company can be commenced by discontented trading partners, these sanctions tend to be most effective where an impartial and qualified agency investigates company behaviour and discloses the results[778]. Additionally, in developed capital markets, the SEC in the USA together with

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[776] S.23 of Banking Control Law 1966.

[777] The following paragraphs discuss legal shaming sanctions. Besides these legal sanctions, if a company makes a critical decision that are seen to be socially unacceptable and/or contrary to the company's previously stated values, this may be damaging the company's reputation. If the reputational damage is sufficiently high, a company may go out of business as a direct consequence. For in depth see Albertha Wielsma, "Corporate Reputation and the family business" in Mattias Nordqvist, Lief Melin, Mattias Waldkirch and Gershan Kumeto (eds), *Theoretical Perspectives on Family Businesses*, Edward Elgar, 2015, 233.

[778] See John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542 .

other public authorities, strongly oversee corporate disclosure and will reprimand and penalise them for any inaccurate disclosures[779].

In this respect, the Takeover Panel can issue to directors public or private statements of censure where they are not complying with their duties that are stated in the Code of the Takeover or the rulings of the Takeover Panel[780]. Whether a director in breach may be censured publicly or privately is dependent on the parties' conduct. Where breaches are only minor, it is likely that a private reprimand will apply. However, if the matter is more significant, the director may be censured publicly via a statement[781]. On February 23rd 2015, a public censure was published by the Panel for the failure to submit an obligatory cash offer in accordance with the Takeover Code's Rule 9 and in association with breaches of Rule 2 and Rule 5. Between 2009 and 2011, Morton the Chairperson of Armour Group Plc, had committed further substantial Code breaches and was privately censured for not instantly announcing the same in accordance with Rule 2.2(b)[782]. As a result, the Panel issued the public censure statement. Such statements issued by the panel are infrequent and, as such, they are regarded as severe disciplinary

[779] See Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.
[780] S.11 (B) of the Takeover Code's Introduction.
[781] See John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542 .
[782] See The Takeover Panel, "Armour Group Plc - Criticism of Mr Bob Morton", Statement NO: 2015/3, February 2015, p.6.

sanctions[783]. While some study show that the public censure can detrimentally affect the repute of a company and can result in a consequent decline in the value of its shares[784], Unexpectedly, Armour Group Plc's share values were not affected by this sanction[785].

Importantly, reputational sanctions can reduce government expenditure when compared to other public enforcement sanctions. However, research in China indicates that even when no legal sanctions are enforced, public censure by a regulatory authority can disadvantageously affect the stock price of the company at fault[786].

In addition, it is proposed that directors can be humiliated by judges due to their reproach of their conduct even when no breach of duty is established. This is supported by Professor Edward Rock who believed that public shaming of a director can lead to dismissal, the derision of their peers and reputational damage.

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[783] See Stephen Pierce, Ben Butler and David Crone, "Takeover Panel censures Bob Morton over purchases of Armour Group shares by his sons" August 2015, Lexology and available at: http://documents.lexology.com/7049ed53-46f0-4352-a923-326ae2d243a6.pdf .

[784] Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.

[785] See London Stock Exchange, Armour Group Plc's Share Price after 23rd Feberuary 2015, available at: http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/summary/company-summary/GB0000496611GBGBXAIM.html, [Accessed August 19, 2015].

[786] Benjamin L. Liebman and Curtis J. Milhaupt "Reputational sanctions in China's securities market" Columbia Law Review, 2008, 929.

In some respects however, this could be a significant way of helping to discourage such behaviour[787].

Company directors are often encouraged to uphold their affairs conscientiously so as to avoid poor decisions and corporate failures so as to prevent any negative publicity or public shame. This is often prevalent even when a breach of conduct would not likely result in formal sanctions. However, it is notable that these social factors can diminish if enforcement procedures become relaxed or if breaches of duty face negligible punishments. Therefore, the risk of poor conduct can still exist and can indeed become more prevalent if no external accountability is present. Consequently, appropriate standards of board conduct can be replaced with inappropriate standards[788].

Saudi law has recognised the reputational sanction. However it is not applied as a main penalty but as an ancillary. For example, s.25 of the Anti-Commercial Fraud Law 2008 states that ‘A summary of the final judgment of conviction for a violation provided for in the previous sections shall be published in two daily newspapers at the convicted person's expense’. In terms of the enforcement of corporate governance, there is no such a provision that allows any public

[787] See Edward B Rock, “Saints and Sinners: How Does Delaware Corporate Law Work?” UCLA Law Review, Vol. 44, p. 1004. Available at SSRN: http://ssrn.com/abstract=10192 .
[788] See Renee M. Jones and Michelle Anne Welsh, “Toward a Public Enforcement Model for Directors' Duty of Oversight”, Vanderbilt Journal of Transnational Law, 2012, Vol. 45, No. 2, 343. Available at SSRN: http://ssrn.com/abstract=2050610 .

authority to announce its verdict against the person who is convicted for a violation of the law. Nevertheless, the CMA always publishes its decisions of fining or disqualifying directors who are in breach of the Capital Market Law 2003. Hence, it is been arguable whether this publication is considered as an illegal defamation[789]. In order to avoid the uncertainty to the law, it is suggested that the legislators should add a provision to the Capital Market Law which grant the CMA the power to publish its penalties against wrongdoers.

5.2.2. Imprisonment

The CA 2006, the Bribery Act 2010 and the Criminal Justice Act 1993 have all led to imprisonment of directors within the UK. The Fraud Act 2006 stipulates that a director will be prosecuted and punished if found guilty of involvement in fraudulent business practice. This can include imprisonment with a maximum sentence of ten years[790].

In the UK, it is acknowledged by law that directors can be subject to imprisonment if found guilty of violations or misconduct. Specifically, it is stated under Section 61 of the UK Criminal Justice Act 1993 that any person found to have committed insider trading will incur a prison sentence of up to 6 months

[789] See Mohammed Alsuhali, ‘ The people right to sue the CMA on the grounds of the defamation’, Alrriyadh Newspaper, 2010, available at: http://www.alriyadh.com/501910.
[790] S.1,12 of the Fraud Act 2006.

and/or a financial penalty up to the statutory maximum value upon summary conviction. Furthermore, Section 61 states that the director is liable to incur a financial penalty and/or prison sentence of up to 7 years upon conviction of an indictable offence.

By and large, market abuse is either sharing inside information which is known as “insider dealing” or sharing false information which is called “market manipulation”. If such activities are exploited, how confident the public are in relation to the market will likely decrease. Thus, to address this and to take control of market abuse, offenders tend to be penalised by lawmakers through the use of deferent types of sanctions, for example, financial sanctions or imprisonment[791]. In Section 118, the FSMA 2000 outlined nine types of behaviours which are by definition constitutive of market abuse. Three of these behaviours relate to insider trading while six relate to market manipulation.

The *Tribunal of Davidson and Tatham v FSA*[792] overturned the fine totalling £750,000 that was imposed on Paul Davidson, also known as “the plumber”, for reasons of market abuse. The most significant feature, it is generally believed, of Davidson’s prosecution within the United Kingdom, is that the case makes it clear

[791] See Dreek French, Stephen Mayson, and Christopher L. Ryan, *Company Law*. Oxford University Press, 2015-2016, pp.362,367.
[792] [2006] FSMT Case 031.

that market abuse is a criminal act. Although the Criminal Justice Act 1993 already looked towards insider dealing as being a criminal offence, it was not previously clarified that abuse of the market, which is an offence in accordance with the 2000 Financial Services and Markets Act, is an offence of criminal proportions also[793]. However, in the above named case, it was stated by the Tribunal that as the case was so serious, civil standards would yield similar or equal results to criminal standards[794].

George Osborne, then Chancellor of the Exchequer, made a statement in June of 2015 remarking that the public is right to question why only a small number of individuals have been punished in court when there have been a large number of scandals that have cost the country a great deal. He stated that he was in agreement with the governor: that anyone who manipulates the markets in a fraudulent manner and who commits any financial crime are criminals and must be treated as such[795]. Indeed, certain scholars make the argument that crimes committed by 'white-collar' people and organisations must face the same serious treatment any other crime or criminal would face, and therefore support individual directors' and corporations' criminal liability[796].

[793] See Julian Connerty, "Courts in Davidson Declare Market Abuse a Criminal Act [comments]" International Financial Law Review, Vol. 25 (7), 2006, 8.
[794] *Davidson and Tatham v FSA* [2006] FSMT Case 031 at 43.
[795] See News Release - Fair and Effective Markets Review Releases Final Report, June 2015, available at: http://www.bankofengland.co.uk/publications/Documents/news/2015/055.pdf .
[796] See Sally S. Simpson, 'Making Sense of White-Collar Crime: Theory and Research' 8 Ohio St. J. Crim. L., 2010, 481.

The Bribery Act 2010 specifies that a director is unable to receive a benefit from a third party if the benefit is offered on the basis of them being a director. A director is also prohibited from accepting a benefit on the basis of them doing or not doing a certain activity[797]. This indicates that anyone seeking to undertake any business activity outside of the UK would need to seek direction regarding this. Importantly, in relation to the Bribery Act 2010, directors must be aware of their duties and the potential conduct of those permitted to act on their behalf when conducting business on an international setting[798].

Through review of past precedent, it appears that no directors have been found culpable of receiving a bribe under the Bribery Act 2010. However, in the case of Smith & Ouzman Ltd, two directors were found guilty of a foreign public official's offence. They were convicted of three counts of dishonestly deciding to make payments to public officials for company contracts within Kenya and Mauritania[799].These payments amounted to £395,074 and were found to oppose the Bribery Act 2010. They were liable to a prison sentence for a maximum of twelve months[800]. However, as the payments occurred prior to enactment of the

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[797] Ss. 1,2,6,7 and 11 of the Bribery Act 2010.
[798] Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.
[799] See The Official website of Serious Fraud Office (SFO), "UK printing company and two men found guilty in corruption trial", 2014, available at: http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2014/uk-printing-company-and-two-men-found-guilty-in-corruption-trial.aspx [Accessed August 26, 2015].
[800] Ss. 6,11, and 14 Bribery Act 2010.

Bribery Act 2010[801], both directors were convicted under section 1(1) of the Prevention of Corruption Act 1906 for dishonestly agreeing to make payments.

At the start of 2015, a sales and marketing director and company chairman for a SFO were convicted by Southwark Crown Court. The former was imprisoned for three years whilst the latter received an eighteen month suspended service, 250 hours of unpaid work and a three month curfew[802]. The Director of the SFO, David Green stated that this was the first conviction by trial involving bribery of foreign officials. He reported that criminal behaviour by organisations can negatively affect the business reputation of the UK and can drive dishonest governance throughout the world[803]. Although the court has not yet passed sentencing for the SFO, the fact that jury found the organisation guilty is of note. This is because, as the offences were committed prior to the Bribery act 2010, the jury had to consider the offenders as the "directing mind and will" of the company. This doctrine of identification has faced extensive reproach as it is considered a difficult threshold to meet and it helped to underpin the development of the strict liability corporate offence under the Bribery Act 2010. However, this case does indicate that convictions of companies could be achieved prior to the

801 Louise Roberts, "UK company director jailed for bribing public officials in Africa" March 2015, Lexology and available at: http://www.lexology.com/library/detail.aspx?g=635339c1-33cc-4545-8fb4-a94a634fae01.

802 *Ibid.*

803 See the Official website of Serious Fraud Office (SFO), "UK printing company and two men found guilty in corruption trial", 2014, available at: http://www.sfo.gov.uk/press-room/latest-press-releases/press-releases-2014/uk-printing-company-and-two-men-found-guilty-in-corruption-trial.aspx.

introduction of the Bribery Act 2010[804]. The Small Business, Enterprise and Employment Act 2015 will place increased emphasis on international business conduct due to alterations in the director disqualification scheme. Disqualification will be accessible for any offences committed outside of Great Britain which would normally qualify as an indictable offence within English, Welsh and Scottish jurisdiction. This will apply to any offences linked to company promotion, formation, management and liquidation. Meanwhile, courts will also be able to evaluate the conduct of company directors relating to overseas business when reviewing applications for disqualification[805]. Disqualification orders will be discussed further in the following section.

Similarly, in Saudi Arabia, numerous provisions of Companies Law carry criminal liability as a consequence of violation. This can result in a prison sentence for directors proven to have acted in violation of the law. Under Saudi law, imprisonment represents the sole type of criminal punishment for company directors, which excludes disqualification and financial penalties (civil punishment). Nonviolent crimes committed on the basis of financial gain (i.e. fraudulent activities) carry the consequence of criminal punishment for company directors working in Saudi Arabia. These consequences apply if a director is

[804] See Amy Smart, Omar Qureshi, "Smith and Ouzman Ltd: two sentenced for foreign bribery" February 2015, Lexology and available at: http://www.lexology.com/library/detail.aspx?g=bd2ead51-847d-47c5-b289-d4f5657efe8d.
[805] *Ibid.*

found guilty of acts such as orchestrating the provision of false dividends, abuse of funds, and annual budget fraud or mishandling[806].

In the past, the Ministry of Commerce and Industry was tasked with the duty of inspecting any company director thought to be violating any rule of Section 229 of the CL 1965. The Ministry was also responsible for commencing legal proceedings if accusations made against the director were found to be true[807]. Nowadays, these duties are held by the Saudi Commission for Investigation and Prosecution, following the release of a Ministers Council decree[808]. Recently, this provision has been formulated under s.215 of the CL 2015. Nevertheless, s.220 grants the MOCI, or the Capital Markets Authority (in the case of listed companies), the power to investigate any director who is found guilty of any crime under s.213. This include, failure to publish the financial statements of the company, failure to prepare or record minutes, or any deliberate disruption to the call for, or convening of, a GM by any director.

Under Section 229 of Companies Law 1965, a prison sentence of 3-12 months and/or a financial penalty of $1,333-5,333 will be incurred by any individual found guilty of involvement in the stated crimes, excluding non-compliance to Shari'ah law. These punishments are listed with their associated violations in full

[806] S. 229 of the CL 1965. For in depth see Mohammed Al-Jeber, “Joint stock company’s directors responsibilities in Saudi legal system” Riyadh Commerce, 1992, Vol. 363, the 31st year, 100
[807] S.231 of the CL1965.
[808] Ministers Council Decree No: 34 in 2012.

under Section 229[809]; however, since the list is so exhaustive, it is not possible to outline every violation in this paper[810]. The punishments outlined in Section 229 are to be multiplied if the same crime is committed again by the offending director, as outlined in Section 231[811]. Under the new CL 2015, these sanctions have become heavier. The director can be held liable to a financial penalty up to $1,333,000 and/or prison sentence of up to 5 years[812]. Although it may initially seem that this reform can increase the deterrence for the directors who would be in breach of CL 2015 provisions, it is unclear if this may actually be considered as a step forward. To the best of the author's knowledge, since the introduction of the CL 1965, no cases has been reported in accordance to imposition of penalties for breaches of CL provisions. This is due to the fact that such insubstantial fines prove insufficient in terms of providing adequate capital sources for future investigation. If the heavy sanctions - under the CL 2015- are not enforced effectively then they will probably have no real impact on directors' behaviour.

The Ministry of Commerce and Industry reported the case of selected Mohammad Al Mojil Group's board members to The Bureau of Investigation and Public Prosecution since the Ministry had no power to enact further control over the company. The Ministry was authorised to refer the terms of reference of

[809] S. 229 of the CL 1965.
[810] For in depth, see Mansour Alhaydary, *Corporate crimes and its penalties,* MA Thesis, The Higher Institute of Judiciary, Riyadh, 2003.
[811] S. 231 of the CL 1965.
[812] Ss. 211-213 of the CL 2015.

companies and actions to the above authority based on the existence of criminal conduct[813]. The Ministry's rationale for referring the case to the above authority was based on two premises: the failure of the company's board members to respond to the Ministry's written communication; and the company's apparent breaches of the Companies Law, which caused the company's share value to drop and prevented capital market exchange[814].

Imprisonment is also supported by Saudi law, in which a number of regulations state that violating directors can incur a prison sentence. The CRSD's ruling of a multiple punishment for insider trading within the Bishah Agriculture Development Company was the most noteworthy case of its kind. The director received a 3 month prison sentence, CMA bill of $14,050, a $26,666 fine, and a 5-year ban from employment with registered companies[815]. This ruling was supported by s.57 (C) of Capital Market Law 2003, which stipulates that the Committee has the power to penalise individuals who are found guilty of creating significant harm to the stock exchange and participated in insider trading activities, as per the Authority's claim. Section 57 (C) denotes that the maximum prison sentence for these offences is 5 years[816]. It should be noted that this was the first example of the CRSD enforcing a prison sentence on a director as

[813] Ministers Council Decree No: 34 in 2012.
[814] See the official website of the Ministry of Commerce and Industry http://mci.gov.sa/MediaCenter/News/Pages/08-03-15-02.aspx .
[815] Issued Decision by the CRSD, dated 17 August 2009.
[816] S.57 (c) of Capital Market Law 2003.

punishment for breaching Capital Market Law[817]. Although it has been argued that this ruling was sufficient as a caution for others' conduct[818], it has also been contested that the CRSD should not be authorised to enact such rulings since it not strictly a third-party entity[819].

This being said, it can be a challenge to achieve a criminal penalty for the offence of insider trading. This is because the evidence required to reach an informed decision on criminal violation is often extremely detailed and complicated[820]. Furthermore, there are a variety of other prohibited actions that are associated with criminal punishments. This is especially true where conduct violates the various statutory responsibilities of the director[821]. However, it is claimed that the association between these specific actions and criminal punishment is largely theoretical and these violations have not yet ever been criminally punished[822]. Furthermore, imprisonment only affects specific people rather than entire companies. This means that imprisonment cannot be used as a supporting deterrent of fines[823].

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[817] See *Alhayat* Newspaper, 19th August 2009, issue 16938.
[818] See *Aleqt* Newspaper, 19th August 2009, Issue 5791.
[819] See *Alhayat* Newspaper, 19th August 2009, issue 16938.
[820] See H McVea, "Fashioning a System of Civil Penalties for Insider Dealing: Sections 61 and 62 of the Financial Services Act 1986", JBL, 1996, 344.
[821] See John Armour, "Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment". ECGI - Law Working Paper No. 106/2008. April 2008, available at SSRN: http://ssrn.com/abstract=1133542 or http://dx.doi.org/10.2139/ssrn.1133542 .
[822] *Ibid.*
[823] See Hazell Croall, *Understanding white collar crime*, Open University Press, Buckingham, 2001, p.137.

5.2.3. Directors Disqualification orders and undertakings

Limited liability can beneficially enhance investment, encourage managerial risk taking and can protect shareholders from company creditors. However, some disadvantages do exist. Primarily, limited liability can be subject to abuse as identified by the Cork Report in 1982[824]. This Report identified how directors can leave behind a 'trail of unpaid creditors'[825] by allowing a company to become insolvent before creating a new limited liability company and continuing business activity. Consequently, the Report recommended the stipulations provided in the CA 1985 and the Insolvency Act 1985 regarding director's disqualifications. These provisions were further solidified in the Company Disqualifications Act 1986[826].

Criminal and civil sanctions can be taken against directors for any breach of duty. For small businesses this can often cause the end of a company. Interestingly, it is questionable as to whether section 178 is appropriately titled 'Civil consequence of breach of general duties'. Indeed, this section only confirms the previous position maintained under correlating common law legislation. It is therefore possible that an opportunity exists for developing the law in this area. Irrespective of clear and recent updates to the CA 2006, old principles often need

[824] See John Lowry and Alan Dignam. *Company law.* Oxford University Press, 2014, pp.49-51.
[825] See *Report of the Review Committee on Insolvency Law and Practice* (Cork Report). 1982, Cmnd 8558, para 1813.
[826] See John Lowry and Alan Dignam. *Company law.* Oxford University Press, 2014, p.314.

to be employed where new circumstances arise. Thus, due to the complex nature of the CA 2006 together with other legislation, directors will require qualified and experience legal advice to understand the implications of this Act[827].

The concept of director duties was largely developed by the CDDA 1986 and past precedent prior to the CA 2006. Duties incorporated standards regarding the duty of care and skill[828]. *Bishopsgate Investment Management Ltd v. Maxwell (No. 2)*[829]concerned a trustee of the Maxwell group pension schemes. A fundamental issue was whether the trustee company, which was in liquidation, had breached their fiduciary duties by assenting to transfer a number of financial investments for consideration to a different company. Importantly, the trustee was the director of the recipient company which controlled Robert Maxwell's private interests. The court found that the trustee had breached their duties and on appeal of this verdict, Hoffmann L.J stated that Maxwell's failure to familiarize himself with the company's business was a breach of duty. In previous cases, the duty of a director to be actively involved in company management was not so stringent. It is evident therefore that legislation in this area is developing and changing in response to public attitudes towards corporate governance. This is demonstrated in the passing of the CDDA 1986. However, notably, the existence of a duty for

[827] Tahir Ashraf "Directors' duties with a particular focus on the Companies Act 2006" International Journal of Law and Management 54.2, 2012, 125.
[828] The standards of the duty of care and skill has been addressed earlier in this thesis under Chapter 3.
[829] [1993] B.C.C. 120.

directors to partake in company affairs will depend upon how an organization is run and the role which the director is practically able to adopt[830].

In the case discussed, the court determined the case by simply referring to the defendant's fiduciary duties. Essentially, the defendant had dispersed of the company assets without an initial enquiry and had therefore failed to uphold the interests of the company[831].If an individual is subject to a disqualification decision, they are no longer authorized to acquire or benefit from the assets of a company and are not allowed to continue within their role as director. Additionally, under Section 1 of the CDDA 1986, the individual is also unable to partake in the managerial structure of a company or any decision making[832].

The CDDA 1986 stipulates that directors may face disqualification if they are not deemed to fulfill their role as a director. Section 6 of this Act obliges the court to issue a disqualification order against an individual if (a) the director has been a director of a company which has at any time become insolvent and (b) the conduct of a director makes them unfit to be concerned in company management. This can apply to the director alone or taken in conjunction with their conduct as a director of any other company or companies. If a director is deemed unfit, Section

[830] [1993] B.C.C. 120.
[831] See Adrian Walters "Directors' Duties: the impact of the Company Directors Disqualification Act 1986" Comp. Law. 2000, 21(4), 110.
[832] S.1 of CDDA 1986.

1(1) of the CDDA provides that any disqualification should apply for a minimum of two years but no longer than fifteen years[833]. Disqualification orders can only be sought by the Secretary of State for Business, Energy and Industrial Strategy or by the official receiver if the Secretary of State directs it. The latter can occur for example in compulsory liquidation of a company across England and Wales[834]. Meanwhile, Section 8 of the CDDA permits the Secretary of State to seek a disqualification order following a specified power of investigation. If the investigation confirms that the behavior of an individual makes them unsuitable for the management of a business, a disqualification order can be applied. Unlike Section 6, Section 8 of the Act does not require company insolvency[835].

Section 6 and Section 8 of the CDDA require that the defendant is unfit to be concerned in the management of a company. When assessing this, Section 9 of this Act requires the court to pay attention to the matters stipulated in Part I of Schedule 1. Part I includes misfeasance or breach of both fiduciary and any other duties by the director of an organization. This is applicable irrespective of whether the business is solvent or not[836]. Meanwhile, Section 11 of the Act states that an offence will be committed if an individual who is subject to a bankruptcy

833 S.6 (4) of CDDA 1986.
834 S.7 (1) of CDDA 1986.
835 S.8 of CDDA 1986.
836 S.1 of Part I of Schedule 1 of CDDA 1986.

restrictions order or who is an undischarged bankrupt holds a director role within limited companies.

This indicates that foreign individuals will not be prohibited from obtaining employment as a director under English law. However, foreign directors of overseas businesses who operate in the UK may be subjected to disqualification procedures under English legislation. This poses the question as to whether foreign directors should be able to move across different states and countries in order to benefit from limited liability companies where the risk of poor conduct could arise. This has gained recognition by ss. 1181 to 1191 of CA 2006 which identifies foreign director disqualification and similar restriction orders. These orders serve to hold offending directors criminally or personably liable. Admission of any foreign restrictions is compulsory and can be made public[837].

The CDDA 1986 provides that if a director disqualification applies, the director is no longer able to maintain their job role and is not permitted to participate in company promotion, formation or management. If this rule is breached, the individual will commit both a criminal and personal liability offence. This can apply to not only the individual but also the company for any debts or liabilities endured throughout the time period in which the disqualification breach

[837] See David, Milman, *National Corporate Law in A Globalized Market*, Edward Elgar, 2009, p.118.

occurred[838]. The CDDA 1986 will apply to both natural and legal individuals[839]. However, after October 2016 when the S.87 of the Small Business, Enterprise and Employment Act 2015 comes into effect, only natural persons will be able to be employed as a company director[840]. Notably, whilst preventing a corporate body from acting as a company director can reduce the extent to which a legal director's disqualification applies, it is unable to prevent it fully. Section 156A (4) of the CA 2006 will not affect individuals who are acting as either a director or a shadow director, although the individual cannot be validly employed as a director[841].

"Disqualification undertakings" provide a different and less costly option to disqualification orders under English law. The Insolvency Act 2000 contains certain regulations which have changed the CDDA 1986. Section 6 of the Act provides that the Secretary of State is permitted to accept a disqualification undertaking by an individual which prevents the individual from being employed within a director role for a specified period of time. This is based upon Sections 7 and 8 of the CDDA 1986. Disqualification undertakings are primarily issued to

838 S.13-15 of CDDA 1986.

839 The Insolvency Service, "Company Directors Disqualification Act 1986 and failed companies", November 2014, P.5.

840 S.87 of the Small Business, Enterprise and Employment Act 2015, and the new s.156A (1) of CA 2006.

841 The new s.156A (4) of CA 2006.

reduce court time, meaning that they can be issued without the need to obtain a court order. This has helped to lower the heavy CDDA case load[842].

Year	Disqualification orders	Disqualification undertakings	Disqualification notices
2001-02	782	1281	2063
2002-03	443	1468	1911
2003-04	432	1278	1710
2004-05	375	945	1320
2005-06	267	906	1173
2006-07	246	954	1200
2007-08	248	897	1145
2009-10	255	997	1252
2010-11	287	1150	1437
2011-12	231	920	1151
2012-13	207	824	1031
2013-14	255	1018	1273

[842] See John Lowry and Alan Dignam, *Company law.* Oxford University Press, 2014, pp.325, 326.

2014-15	210	885	1095

As can be illustrated from the table[843], figures show that in 2004-2005, the number of disqualification orders reduced. Out of 1320 disqualification notices received by the Register, 945 or seventy-two percent were disqualification undertakings. Since this time period, the total number or disqualification orders and undertakings have continued to reduce. However, in 2010-2011 an increase to 1437 occurred, incorporating 1150 undertakings and 287 orders. Finally, in 2014-2015, a total of 1095 director disqualifications were obtained. Of these, there were 210 orders and 885 undertakings. It can be noted that the percentage of disqualifications that were undertakings ranges from 70% to 85%.

Importantly, Part 9 of the Small Business, Enterprise and Employment Act 2015 reinforces the rules which prevent an individual from being employed as a director where poor conduct has taken place. It also introduces new provisions for the justification for disqualification and has created an alternative way in which creditors can receive financial reimbursement for any losses experienced due to creditor transgression. Additionally, it has updated the issues courts must consider when reviewing a director disqualification[844].

[843] For in depth of Disqualifications/undertakings statistics, see Insolvency Service: annual reports and accounts, available at: https://goo.gl/q13spV . [Accessed November 19, 2015]. Also, see John Lowry and Alan Dignam, *Company law*, Oxford University Press, 2014, p.326, and, Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law*. London: Sweet & Maxwell, 2012, p.253.

[844] Ss. 104-116 of Small Business, Enterprise and Employment Act 2015.

In Saudi Arabia, the CRSD has authority to disqualify the director or directors of listed companies when they have breached the rules, regulations and laws of the CMA, under the Saudi legal system. Under Section 59 (A) of Capital Market Law 2003, it is stated that the CMA Board is permitted to commence legal proceedings through the Committee for the Resolution of Securities Disputes so as to request the relevant penalty, which is inclusive of prohibiting the individual(s) from being employed by firms that have securities on the stock exchange under the following conditions: the CMA believes the individual or company to have previous participated, currently be participating, or planning to participate in activities that represent a breach of Capital Market Law rules, CMA regulations, or stock exchange guidelines[845].

As previously stated, loyalty represents the key component of a company director's responsibilities. The issue of loyalty is comprised of the avoidance of insider trading and conduct that poses a conflict of interest[846]. The CRSD has made the decision to disqualify numerous violating directors who have acted in such a manner that violates their code of responsibility, including participation in insider trading. One such example is an instance in which the CRSD applied a

[845] S.59 (A) of Capital Market Law 2003.
[846] Norwood Beveridge, *The Corporate Directors' Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction*, DePaul Law Review, 1991, 41, p.688.

multiple penalty to a Saudi Hotels and Resorts board member, which entailed a $26,666 fine and a 3-year ban on being employed by registered companies[847]. Furthermore, a chairman of the company was found guilty of power abuse and share trading, with a penalty of a $26,666 fine and 3-year band on employment with registered companies[848]. The CRSD decision was approved by the Appeal Committee for the Resolution of Securities Conflicts has accepted the CRSD judgment[849]. A number of similar cases in Saudi Arabia have resulted in the disqualification of directors, as stated within the financial penalty, in the following subsection.

For the directors who receive the punishment of disqualification, this can be a harsh consequence. The purpose of this potential penalty is both to punish the director for his/her actions as well as ensuring that he/she cannot continue to breach the code of duty that should have been upheld as part of the role of company director[850]. It has been suggested that disqualification is one of the most effective and logical penalties that can be applied to violating directors, since this particular form of punishment manages to sidestep a number of restrictions experienced in the case of alternative penalties[851]. From this perspective,

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[847] Issued Decision, No. 289-L-D1-2008, by the CRSD, dated 8th July 2008.
[848] Issued Decision, No. 323-L-D1-2008, by the CRSD, dated 11th November 2008.
[849] Issued Decision, NO 148-L.C-2009, by the Appeal CRSD, dated 23th July 2009.
[850] David Friedrichs, *Trusted criminals: White collar crime in contemporary society*. Cengage Learning, 2009, pp.362,363.
[851] See Hazell Croall, *Understanding white collar crime*, Open University Press, Buckingham, 2001, pp.136-143.

disqualification can be equated to a hefty financial penalty in situations where the director is unable to meet the fine requirements, or where the company may take actions to protect the individual. Furthermore, this measure is the most probable to carry broad and acute preventative impacts. It is likely to be effective in deterring other directors from committing criminal acts[852].

Conversely, it could be argued that companies can appoint new directors and continue to commit offences even in the event of director disqualification[853]. Furthermore, this kind of punishment would not have prevented the director or company from engaging with legal professionals or taking other measures. This being said, the disqualification measure still manages to wield a particularly severe impact, somewhat due to the caution involved in enforcing a punishment so harsh[854].

In Saudi Arabia, only the CRSD has the authority to disqualify directors while the court in UK originally has the power to do so. Additionally, due to the fact that the disqualification order can be costly and a waste of time, the UK law has introduce the "undertakings" order which can be achieved by the Secretary of State rather than obtaining the court orders. In Saudi, the CRSD is

[852] David Friedrichs, *Trusted criminals: White collar crime in contemporary society*. Cengage Learning, 2009, p.363.
[853] *Ibid*.
[854] *Ibid*.

administratively managed by the CMA which means that any disqualification does not lie with the court. While leaving the power to the court may increase the independence to the procedure, the administrative approach serves to save money and time. Law-makers in Saudi Arabia can benefit from this dual approaches due to an increased level of autonomy and flexibility.

5.2.4. Winding up in public interest

The report compiled by the Cork Committee[855] described the overall notion behind public interest liquidation (PIL), which is that it allows winding-up to be triggered by the state when doing this is in the public's general interest. One potential trigger for this would be a firm that has prejudiced a great many consumer creditors' interests. It only applies if the creditors do not possess a significant amount of debt which would warrant costs of court proceedings[856].

Under S. 124A of the Insolvency Act 1986, the Secretary of State for Business Energy and Industrial Strategy has authorisation to petition a company's 'winding up' in the public interest. The key public interest was identified in the *Secretary of State for Business, Innovation and Skills v Top Choice Wholesale Ltd*[857]. In this case, the court held that a S.124A petition can be presented alongside a winding-up petition presented by a creditor[858]. This somewhat excessive judgement must

[855] *Report of the Review Committee on Insolvency Law and Practice* (Cork Report). 1982, Cmnd 8558,paras 1745-1751
[856] Vanessa Finch, "Public interest liquidation: PIL or placebo?" Insolv. L. 2002, 5(Aug), 157.
[857] [2012] EWHC 1262 (Ch)
[858] See David Milman, *Governance of Distressed Firms*, Edward Elgar Publishing, 2013, p.22.

however be considered in relation to information acquired through other investigations. Additionally, S.124A2 reports that if a company is already being wound up through court proceedings, a winding-up petition cannot also be used. Meanwhile, *Re Lubin, Rosen and Associates Ltd*[859] indicates that this does not apply if the action of winding-up is voluntary[860].

In *Secretary of State for Business, Innovation and Skills v PAG Management Services Ltd*[861], the Secretary of State presented a petition for the winding-up of the PAG Company which had been asked to oversee and coordinate a business rates migration scheme in 2011. The winding-up was based upon public interest grounds under section 124A of the Insolvency Act 1986. Mr. Justice Norris deemed it appropriate to wind-up the company in the public interest, not due to the integrally intolerable promotion of migration schemes but due the operating systems employed. This included for example, artificial leases with no commercial reality and the misuse of insolvency law.

In regards to the degree to which PIL may deter criminal behaviour and how much it is able to control practices of trading or maintain higher business standards, it was noted that the procedure of PIL does not have a significant public profile. As

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859 [1975] 1 WLR 122.
860 See John Birds, Robert Miles, Robert Hildyard and Nigel Boardman, *Annotated companies legislation*. Oxford University Press. 2012, pp.1220,1221.
861 [2015] EWHC 2404 (Ch).

such, there is a need to raise the directors' awareness of the reasons may wind up the company in public interest[862]. The company's winding-up in the public interest is not available under Saudi law.

5.2.5. Financial sanctions

Financial penalties can be issued by public enforcers if directors are found culpable of breaching their duties in law. For example, directors must reveal the nature and level of any direct or indirect interest in any proposed or existing business arrangements or dealings. Importantly, disclosure must be full and clear and must be made before the company enters into any business agreement. This does not incorporate financial dealings which are unlikely to lead to a conflict in interest[863]. If a director does not manage to comply with this declaration of interest they will be deemed to have committed a legal infringement. Under this section, this can result in conviction on indictment or a fine. If a summary conviction applies, a fine no greater than the statutory maximum may be issued[864].

In Saudi Arabia, under Section 229 of Companies Law 1965, a financial penalty of $1,333-5,333 will be incurred by any individual found guilty of involvement in crimes under CL 1965. Under the new CL 2015, the fine has become extremely

[862] See Andrew Keay, "Public interest petitions", Comp. Law. 1999, 20(9), 296.
[863] Ss.177 and 182 of CA 2006.
[864] S.183 of CA 2006.

heavier. The director can be held liable to incur a financial penalty up to $1,333,000[865]. It may initially seem that this reform can increase the deterrence for the directors who would be in breach of CL 2015 provisions. However, as discussed earlier, if this fine is not enforced effectively then they will probably have no real impact on directors' behaviour.

Furthermore, directors found guilty of breaching Exchange regulations, Capital Market Law implementing regulations, or the provisions of Capital Market Law are subject to the imposition of a financial penalty by the CMA Board. The CMA Board (or the Committee for the Resolution of Securities Disputes) can enforce financial penalties of between $2,666 and $26,666. Additionally, every individual breach carries an individual penalty, which means that directors can be fined multiple times[866]. One memorable example of the conflict of interest issue is the case of the Saudi Chemical Company and the actions taken by its board members and board chairman. The individuals involved in the case attempted to permit 15% of the company's shares to be bought by a subsidiary of the company. Although the board chairman possessed a conflict of interest in this decision, the company failed to report this to its general assembly. Furthermore, the company neglected to report that the decision was linked to its subsidiary. This information was not shared on the Saudi Chemical Company's website or on the stock exchange. As a result, each board member of the company was issued with a

[865] Ss. 211-213 of the CL 2015.
[866] S.59 (B) of Capital Market Law 2003.

penalty of $13,333 by the CMA Board. The board director was also issued with the same penalty by the Authority[867].

In addition to fines, individuals who have participated in the past, are currently participating, or are planning to participate in breaches of the given Law, the Authority's regulations or the Exchange's rules are liable for compensating any individual who has incurred harm as a result of the individuals' misconduct. Alternatively, the offending individual must provide a sum to the Authority as a result of committing the breaching act[868]. Furthermore, it is provided that any individual whose actions have resulted in significant harm to the stock exchange, and who has been involved in insider trading, has the option of securing resolution through the Authority rather than commencing with proceedings, under Section 64 of Capital Market Law. In this case, the individual must provide the Authority with up to three times the profit or losses gained by the individual through the breaching act(s). This agreement is made without hindering the compensation rights of those harmed due to the breach of conduct, regulation or law[869]. In one example of insider trading, a director of Saudi Telecom was proven to have abused his role of authority. The consequence of this activity, as ruled by the ACRSD, was that the director was fined $26,666, required to pay almost $2

[867] For more information, see http://www.cma.org.sa/Ar/News/Pages/CMA_N536.aspx.
[868] S.59 (4) of the CML 2003.
[869] S.64 of the CML 2003.

million to the CMA, and incurred a 3-year ban on employment with registered companies[870].

It is argued that directors will not be sufficiently deterred from malpractice if they see the financial punishment as minimal[871]. In broad terms, a dependence on financial sanctions carries various issues. For instance, in order for financial sanctions to be effective in preventing the misconduct of company directors, financial penalties would have to be set at an extremely high value. This is because directors would logically weigh up the cost of the financial penalty against the probability of being discovered and charged[872]. If the cost of financial penalty is low, this could lead directors to believe that it is worth taking the risk. This poses a potential political issue. Specifically, smaller firms may be more likely to comply through fear of paying large fines that they cannot afford, whilst large firms may still be corrupt due to being able to afford the fines[873]. Among the main proposed advantages of the move towards civil punishment was the notion that less evidence is required for civil punishment to be approved, which implies that a higher number of guilty directors could be sanctioned under civil

870 Issued Decision by the CRSD, dated 29 May 2010.
871 Imtiaz Ahmed Khan and Muhammad Abrar, "Fiduciary duties and investor protection in corporate law of Pakistan" Comp. Law. 2014, 35(5), 146.
872 Hazell Croall, *Understanding white collar crime*, Open University Press, Buckingham, 2001, p.137.
873 *Ibid*.

law than under criminal law[874]. Certain scholars claim that those very infrequent cases where criminal sanctions have been imposed, the consequences of these impositions have barely been relative to the amount of inflicted harm, or the amount of profits that were made[875].

This being said, it is contested that raising financial punishments is a logical reaction to the seemingly never-ending stream of legal and regulatory breaches and misconducts[876]. France's leading bank (BNPP) is also a leading global bank. Banks and financial institutions are disallowed from engagement in specific financial activities with specific nations, bodies and individuals under the American legal system. BNPP was found guilty of legal violations due to its involvement with Cuba, Iran and Sudan. Consequently, the bank was liable for financial punishment under American law. The punishment entailed a probation window of five years as well as extremely high fine of $8,833,600,000 USD. It could be argued that such extreme financial punishments are unfair to directors who fear court proceedings[877]. On the other hand, it is more likely that directors will commit crimes and violate rules, or at least believe that it is reasonable to do

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[874] Michael Filby, "The enforcement of insider dealing under the Financial Services and Markets Act 2000", Comp. Law. 2003, 24(11), 334.
[875] For in depth see Andrew Keay and Michelle Welsh, "Enforcing breaches of directors' duties by a public body and antipodean experiences", Journal of Corporate Law Studies, 2015, Vol. 15, No. 2, 255.
[876] See Patrick Hardouin, "The BNP Paribas "tour de fraud": extortion, war and justice" Comp. Law. 2014, 35(12), 367.
[877] *Ibid*.

so, if no sanctions exist. For this reason, it makes logical sense that since directors still commit criminal acts, fines will continue to rise until directors are deterred. Indeed, financial penalties are essential and should be appropriate to the level of misconduct or criminal activity. However, fines must be set in such a way that does not lead to devastating outcomes. In the case of BNPP and Cuba, Iran and Sudan, over $190 billion USD was secured during the decade spanning 2002 to 2012. The fine represents 4.5-5% of BNPP's total revenue, at fewer than 6 months in a decade. This reflects a significant expense for the company[878].

There is no doubt that the punishment incurred by BNPP is absolutely harsh and far from a minor loss for the company. This being said, the punishment has no detrimental impact on financial markets. Instead, the punishment helps to resolve the problem of the company's lack of adherence to the relevant laws and regulations. Consequently, it is reasonable to suggest that banks are less likely to behave hastily in terms of the violation of rules, especially the rules imposed by the United States[879]. Financial sanctions beneficially help to both deter misconduct by directors whilst providing a large resource to public authorities.

878 *Ibid*.
879 *Ibid*. With respect to US sanctions, see Stuart Weinstein and Charles Wild, *Legal Risk Management, Governance and Compliance: Interdisciplinary Case Studies from Leading Experts*, Globe Law and Business, 2016, pp.167-180.

Upon identification of any transgressions, this can lead to financial penalties making it easier for the agency to impose any actions[880].

5.3. Difficulties of Public enforcement actions

5.3.1. Company Law is Private Law

It is questionable whether a public authority should be restricted in instigating an enforcement action solely when it is in the public interest. Arguably, company law is wholly private law, yet, if this is the case, then there should be little public regulation as a result. Consequently, it could be argued that if companies are considered to be private entities, then any legal enforcement and legal solutions should also be kept private[881].

In some respects, as public representatives and the government have authority over companies' rights and operations, the public do perhaps have an interest. In other words, companies are allowed to act as a legal person due to government concession[882]. Thus, it appears that only a public authority is able to monitor and oversee the duties of directors. Additionally, in the UK, public authority intervention into private law is permissible. The UK has a capitalist society and there is an evident public interest in ensuring responsible risk taking by

[880] Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.
[881] See Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.
[882] See Michael Phillips, "Reappraising the Real Entity Theory of the Corporation" 21 Florida State University Law Review, 1994, 1064.

organizations. An example of public policy choice concerns that of limited liability which was developed in 1885 by the UK Parliament. As public policy choice arouses public interest, limited liability must consequently be reviewed by the state. Under S. 447 of the CA 1985, any violation of any financial concessions may therefore result in an informal inquiry[883].

Critique of public intervention concerns the development of regulations which stipulate what company directors are able to do and in doing so limit the ability of directors when undertaking company affairs. However, this does not mean that public intervention causes increased prohibition on directors and there is no desire to impose further duties upon them. Instead, the focus has been placed on the growing enforcement which can be directed towards directors. A study by Keay found that in the UK little public involvement occurs in company law but in Australia increased involvement does exist which has led to disapproval of public enforcement[884].

In an Australian case, *Ailakis v Olivero*[885], the Supreme Court of Appeal in Australia made several points regarding directors' duties. It considered these

[883] See David Milman. *Governance of Distressed Firms*. Edward Elgar Publishing, 2013, p.22.
[884] See Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.
[885] (No 2) [2014] WASCA 127.

duties to stem from law, equity and statute and found that statute determines the range and required standards of a director's duties. Statute can therefore be used to impose these duties yet it is notable that these duties do not always have to have a public nature. This applies for example to the duty to attend court in response to a subpoena or the duty to care for a child. Instead, the duties of a director are considered to relate to the company and can therefore be enforced by the company. In similarity, *Foss v Harbottle*[886] held that any remedy must enforce company rights not the rights of those who owe duties to the company such as the directors. Thus, the duties of a director to the company in which they are employed are not considered to be duties of a public nature[887].

Moore believes that the framework for corporate governance legislation in the United Kingdom, in spite of displaying certain noticeably contractarian characteristics, is largely regulatory by nature. Corporate law can be located within private English law but can also be located in the realm of public law. However, the analysis suggests that it is not appropriate to locate the law of corporate governance in private law but in public law. Thus, it ought to be understood to be an outcome-imposing or regulatory element of law, rather than the traditional portrayal as an outcome-facilitating or contractual element. As such, legislation for corporate governance ought to be understood as a substitute

[886] (1843) 2 Hare 461.
[887] *Ailakis v Olivero* (No 2) [2014] WASCA 127 at 103.

for democratically agreed divisions of power regarding corporate decision making in place of alternate allocations that tend to result from decentralised contractual determination[888].

5.3.2. Soft law vs hard law

Best practice in corporate governance is enforced differently around the world. Some countries rely upon regulations and legislation whilst others invoke the comply-or-explain approach. Thus, when developing legal reforms, regulators and lawmakers must identify the type of reform required. This subsection therefore focusses upon whether soft laws have any efficacy when developing improved corporate governance.

Responsive theory was developed by Ayres and Braithwaite and proposes that people, organisations and industry require responsive regulations. This is because different sectors will require different types of regulations. The foundation of responsive theory is that individual actions are encouraged by a variety of different factors. Therefore, a regulatory authority requires a wide range of potential enforcement actions so as to effectively respond to this[889]. Business individuals who are incentivised by a degree of social responsibility could be

[888] Marc T. Moore, "Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism" Oxford J Legal Studies, 2014, Vol 34(4), 693. For in depth, see Marc T Moore, *Corporate Governance in the Shadow of the State*, Hart Publishing, 2013, pp.62-98.

[889] See Ian Ayres and John Braithwaite, *Responsive regulation: Transcending the deregulation debate*. Oxford University Press, 1992, p.4.

regulated by a system based upon self-regulation. If businesses are wholly influenced by financial reasons then a system based upon penalties could be appropriate[890]. Meanwhile, driving factors will alter and differ over time[891]. Consequently, it appears impossible for a regulatory agency to recognise and react to every infringement of the law. Thus, it is critical that agencies are able to promote compliance with the law on a voluntary basis. Responsive regulation ultimately seeks to 'stimulate maximum levels of regulatory compliance'[892]. This is more likely to be obtained when agencies are able to demonstrate an 'enforcement pyramid' which details a range of different enforcement methods which increase in severity and are proportionate to the level of misdemeanour[893]. As the definition of fraud is difficult to fully clarify regulations often fail to regulate it. One example is that of fraud. Fraud is not deemed to be a criminal offence but is instead a manner in which otherwise legal activity is carried out. The most distinctive part of whether fraudulent behaviour is compliant or non-compliant with the law is whether or not the activity has been carried out dishonestly[894].

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[890] *Ibid*, p. 24,25.

[891] *Ibid.*

[892] George Gilligan, Helen Bird and Ian Ramsay, "Civil Penalties and the Enforcement of Directors' Duties", University of New South Wales Law Journal, Vol. 22, No. 2, 1999. Available at SSRN: http://ssrn.com/abstract=923002.

[893] See Ian Ayres and John Braithwaite, *Responsive regulation: Transcending the deregulation debate*, Oxford University Press, 1992, p.35.

[894] Stephen Copp and Alison Cronin, "The failure of criminal law to control the use of off balance sheet finance during the banking crisis" Comp. Law. 2015, 36(4), 99.

The "comply and explain" regulation has been identified within both the UK and the Saudi Corporate Governance Code. It is therefore challenging to evaluate whether or not this principle is working in the correct way. When companies fail to comply or have transgressed away from the code without explanation, there is often little publicity of this[895]. This correlates with the findings of a study conducted by Seidl, Sanderson and Roberts in 2009. This research examined 129 of the biggest listed companies in the UK and found that companies invariably do not fully utilise the flexibility offered by the comply-or-explain principle. It found that over fifty percent of British companies declare deviations away from the code with the most common being the requirement for autonomous non-executive directors forming the majority of the board[896].

Importantly, the large percentage of company transgressions, do not indicate the failure of the regulation. The comply-or-explain principle is designed to promote flexibility which enables companies to stray from certain code requirements if they are inappropriate for their own specific situation. Therefore, deviation does not always indicate a lack of compliance but it can show that the system is working adequately due to the element of flexibility used. A good method of

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[895] Andrew Keay, "Comply or Explain: In Need of Greater Regulatory Oversight? (September 10, 2012). Available at SSRN: http://ssrn.com/abstract=2144132 or http://dx.doi.org/10.2139/ssrn.2144132.

[896] David Seidl, Paul Sanderson and John Roberts, "Applying 'Compy-or-Explain': Compliance with Codes of Corporate Governance of the UK and Germany" Centre for Business Research, University of Cambridge, Working Paper 389, June 2009 and accessible at: http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167.6058&rep=rep1&type=pdf.

assessing if the regulatory system is functioning adequately is to evaluate both compliance statements and the nature of any explanations for any deviations. This has reflected how a substantial number of UK companies are not currently proffering complete and accurate explanations for transgressing away from the code. Interestingly, twenty-five percent of justifications provided did not include any specific reasons or provide explanations without incorporating any alternative practice[897]. The remainder were deemed to be unreasonable and illogical with one company believing that the provision does not promote best practice[898]. The authors of the study concluded that for the comply-or-explain principle to be successful it is reliant upon the company and investor acting honestly, applying the code to the best of their ability and being willing to engage into open communications regarding any deviations from the code[899].

In the "Review of the Effectiveness of the Combined Code" the FRC reported that numerous respondents, including primary investors and service providers, considered that companies' corporate governance statements offered extremely limited information. Criticism was also targeted at the detail of the explanations

897 *Ibid*.

898 David Seidl, Paul Sanderson and John Roberts, "Applying the 'comply-or-explain' principle: discursive legitimacy tactics with regard to codes of corporate governance." Journal of Management & Governance 17.3, 2013, 791.

899 David Seidl, Paul Sanderson and John Roberts, "Applying 'Comply-or-Explain': Compliance with Codes of Corporate Governance of the UK and Germany" Centre for Business Research, University of Cambridge, Working Paper 389, June 2009 and accessible at : http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.167.6058&rep=rep1&type=pdf

provided when companies failed to adhere to the Code[900]. One respondent commented that there appeared to be a substantial lack of integrity in the explanations provided and that companies adopt poor practice by communicating with shareholders before declaring a substantial infringement of the Code's principles[901]. Meanwhile, another respondent declared that explanations of deviations away from the Code have become inadequate and somewhat homogenous[902]. Thus, it is evident that a desired level of voluntary compliance is not being realised. Importantly, the FRC and other regulatory bodies are not responsible for assessing company responses to the Code. Organisations themselves evaluate if their responses are adequate. Meanwhile, the markets and shareholders must consider whether or not the response is suitable and if not, must take action to compel the companies to increase their compliance with the Code. Essentially, if compliance is truly desired then companies should seek to respond in an effective manner. Therefore, comply-or-explain seeks to embolden shareholders so that they can determine if non-adherence is acceptable based upon the situation of the company[903].

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[900] See FRC, "Review of the Effectiveness of the Combined Code : Summary of the Main Points Raised in Responses to the March 2009 Call for Evidence" July 2009, p.37 and accessible at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Summary-of-Responses-Review-of-the-effectiveness-o.pdf

[901] *Ibid*, p.38.

[902] *Ibid*, p.37.

[903] Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598.

Under the German Corporate Governance Code, Andres and Theissen explored the nature of companies which adhere to the requirements of the code. They found that managers can opt out of transparency provisions if the company structure and regulatory incentives enable them to do so. This loophole in the compulsory disclosure regulation illustrates how it can benefit small shareholders and brings into doubt the efficacy of the comply-or-explain principle[904]. However, the viewpoint of the FRC respondents show that there is a belief in a more flexible based comply-or-explain principle rather than a more regulated system[905].

The ex-Chairman of FRC, Baroness Hogg, reported that whilst reservations exist regarding the Code, it does serve to encourage company compliance even if companies are somewhat unwilling to change. The Code has helped to promote innovation such as the creation of board evaluation and due to its flexibility has helped to develop inspiring language to encourage change and diversity[906]. In May 2015, the new chairman Sir Bischoff, stated that most companies do achieve the standards required. Indeed, in 2014, ninety-four percent adhered to nearly all

[904] See Christian Andres and Erik Theissen. "Setting a fox to keep the geese, does the comply-or-explain principle work?" Journal of Corporate Finance 14.3, 2008, 289.
[905] See FRC, "Review of the Effectiveness of the Combined Code : Summary of the Main Points Raised in Responses to the March 2009 Call for Evidence" July 2009, p.3 and accessible at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Summary-of-Responses-Review-of-the-effectiveness-o.pdf.
[906] See FRC, 'Comply or Explain 20th Anniversary of the UK Corporate Governance Code, Essays" 2012, pp.4,5 and accessible at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Comply-or-Explain-20th-Anniversary-of-the-UK-Corpo.aspx.

of the UK Corporate Governance Code provisions, apart from two which have not been stipulated[907]. However, more work is required to oversee company reporting and explanations regarding non-adherence. Meanwhile, Keay suggested that it is difficult to ascertain if the comply-or-explain principle is an effective system. This is because when a company fails to adhere to the code or has transgressed away from the code, publicity is somewhat rare[908]. Further to this, Cadbury commented that corporate governance requires both statutory and self-regulation but equilibrium must be sought between the two and they must apply to specific and appropriate governance issues[909].

Recently, the UK has adopted the viewpoint that overall, corporate governance should be self-regulatory rather than overly regulated. A proposition by the European Commission Green Paper has been faced with dissent from the Department of Business, Innovation and Skills[910] which advocated that securities regulators, stock exchanges and other authorities should be given the permission

[907] See FRC ,"Speech by Sir Winfried Bischoff at Grant Thornton's Governance Dinner"2015,accessible at https://www.frc.org.uk/Our-Work/Publications/Speeches/Speech-by-Sir-Winfried-Bischoff-at-Grant-Thornton.pdf.

[908] See Andrew Keay "Comply or Explain: In Need of Greater Regulatory Oversight? (September 10, 2012). Available at SSRN: http://ssrn.com/abstract=2144132 or http://dx.doi.org/10.2139/ssrn.2144132 .

[909] See Adrian Cadbury. *Corporate governance and chairmanship: A personal view*. Oxford University Press, 2002, p.28.

[910] "UK Government Response to European Commission Green Paper : The EU Corporate Governance Framework" July 2011, at 17, and accessible at : http://www.bis.gov.uk/assets/biscore/europe/docs/u/11-1097-uk-government-response-eu-corporate-governance-framework (accessed, 12 September 2012).

to investigate comply-or-explain corporate governance statements and information. This would enable regulatory bodies to identify if these statements are accurate and to ensure that any accounts are fully detailed and comprehensive[911]. Particularly after the introduction of CL 2015, Saudi Arabian legislators seem in favour of mandatory rather than voluntary regulations. For example, ss.81 (1) and 95 of CL 2015 introduces provisions that prevent the combination of the post of chairperson with executive positions (including that of CEO) and compulsory cumulative voting. These provisions were included under Saudi CGC 2006, Articles 6-b and 12-d, which applies only to firms listed on the Saudi Arabian Stock Exchange and serves only as guidance, not law.

5.3.3. The cost

Due to the Global Financial Crisis and the negative publicity surrounding directors, it is apparent that the public could support an increase in work for public authorities within the UK despite them being overladen with work already[912]. However, unlike public enforcement, private enforcement is unable to fully provide a self-sufficient system of securities regulation. This is because the financial costs of private solutions such as insider trading prevent effective private enforcement. Within public enforcement, if a misdemeanor is recognized, it is easier for an agency to initiate enforcement due to a higher level of resources

[911] See Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .
[912] *Ibid*.

which enable regulatory investigations. This incorporates substantial financial penalties[913]. Despite this, it is evident that the UK government is not expected to expend public finances on issues which should only involve company members or creditors[914].

Arguably, if a regulator is able to redeem expenses from a director during legal proceedings, this will still affect public finances as it requires public enforcement actions[915]. This is of importance as the government currently seeks to reduce its expenditure within different sectors such as the civil service. For example, the government has recently cut its budget for the Serious Fraud Office from £52 million in 2008/9 to £31 million in 2014/15[916].

In similarity to the UK, Saudi Arabia is also due to reduce its spending on the civil service and to not increase expenditure on the public mechanisms of directors' duties. The latter is due to the fact that directors' duties should be the responsibility of company members. However, national spending and the National Budget have been reduced due to a reduction in oil prices from $110 to

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913 Howell E. Jackson and Mark J. Roe, "Public and private enforcement of securities laws: Resource-based evidence", Journal of Financial Economics, 93.2, 2009, 207.

914 Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.668.

915 Andrew Keay "The Public Enforcement of Directors' Duties" (January 16, 2013). Available at SSRN:http://ssrn.com/abstract=2201598 or http://dx.doi.org/10.2139/ssrn.2201598 .

916 *Ibid*.

$45. This fiscal deficit has been projected at SR 145 billion, equating to approximately £25 billion[917].

5.3.4. Political Pressure

The ability to successfully enforce legislation and regulations relies upon political commitment[918]. However, this can impede enforcement of directors' duties if there is an unwillingness politically to publicly penalise any misdemeanours. However, this does not apply to private enforcement actions. In other words, unlike private claimants, public enforcement agencies are somewhat centralised so therefore invite political control. Although political control can help ensure public enforcement is coordinated, there is a risk of bribery amongst public enforcer bodies[919]. Additionally, some research indicates that a company's performance can be bettered if they have a political connection, such as the adoption of formal political roles. This means that if a director is employed politically, their motivation and the repercussions of their political involvement will be analysed. Companies with political links can often benefit from biased government policies and tenders causing a subsequent increase in profits and

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917 See "Ministry's of Finance statment about the national budget for 2015"available at:https://www.mof.gov.sa/English/DownloadsCenter/Budget/Ministry's%20of%20Finance%20statment%20about%20the%20national%20budget%20for%202015.pdf [Accessed August 23, 2015].

918 See Ira M. Millstein, Shri G. N. Bajpai, Erik Berglöf and Stijn Claessens, *Corporate Governance and Enforcement" in Enforcement and Corporate Governance,* Three Views Global Corporate Governance Forum, Focus 3, 2005 at 59 and accessible at : http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGo%20v3.pdf?MOD=AJPERES (Accessed, August 23 2015).

919 Jonathan R. Hay and Andrei Shleifer. "Private enforcement of public laws: A theory of legal reform." American Economic Review, 1998, 398.

increased share prices[920]. It is only feasible to minimise sanctions against a company or its directors if the political role of the director can benefit them in other ways.

Due to the existence of close relationships between government and business, reform of enforcement in the interests of minority shareholders appears somewhat unlikely[921]. Several agencies deal with corruption in UK such as Serious Fraud Office and National Crime Agency. In August 2015, as a part of the UK Anti-Corruption Plan, the International Corruption Unit was created within the NCA. The ICU is tackling corruption, serious bribery and money laundering around the world[922]. Parlour has experience working as a UK representative on EU projects involving corruption legislation. Based upon Hong Kong as an example, he has proposed that corruption must be overcome politically and that development of an Independent Commission Against Corruption is the key to achieving success. It is questionable as to whether this would be politically approved within the UK and the EU but it appears to be a strong solution[923]. Despite this, lack of political desire to enforce the law is not always linked to corruption. Indeed, the UK

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[920] See Philip, Lawton, Yung, Boyce, 'Corporate political connection as a determinant of corporate governance in Hong Kong' Northern Ireland Legal Quarterly, 2012, 63, 449.

[921] See Ira M. Millstein, Shri G. N. Bajpai, Erik Berglöf and Stijn Claessens, *Corporate Governance and Enforcement" in Enforcement and Corporate Governance,* Three Views Global Corporate Governance Forum, Focus 3, 2005 at 59 and accessible at : http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGo%20v3.pdf?MOD=AJPERES [Accessed, August 23 2015].

[922] See the Official website of National Crime Agency (NCA), "International Corruption Unit (ICU)", 2015, available at: http://www.nationalcrimeagency.gov.uk/about-us/what-we-do/economic-crime/international-corruption-unit-icu.

[923] Richard Parlour, "Bribery and corruption - an international update" Comp. Law. 2013, 34(7), 218.

Government's unwillingness to take initiate proceedings against directors is due to its resistance to expend public finances on issues which should be the responsibility of the company members[924].

Whilst the Saudi Government has reduced expenditure on public enforcement, political pressure is prevalent. Some legislation prohibits politics from influencing company management[925] but the state has placed investment into many large companies. The Government is a significant shareholder as a result and has also adopted a managerial position with somewhat unobstructed powers. Most companies in which the Government has invested have substantial finance, are well managed and resourced and are some of the most lucrative corporates on the stock market[926]. Therefore, this indicates that despite political influence, company power is not exploited.

In 2011, the National Anti-Corruption Commission was introduced with a direct link to the King. The role of the Commission will be to oversee all government sectors together with the execution of public affairs and orders. It will also be accountable for regulating any illegal practice within administration and

[924] Paul Lyndon Davies, *Gower and Davies Principles of Modern Company Law,* London: Sweet & Maxwell, 2012, p.668.

[925] For Example: s.6 Ministers' Council Law 1994 prohibits the ministers from combining the position of company director and being minister at the same time.

[926] See Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.48.

finance[927]. The Commission is aimed at helping to improve practice within a country although its effect so far is too early to evaluate.

5.4 Summary

In contrast to Chapter 4, which outlined private enforcement, Chapter 5 evaluated *public enforcement* activities. This chapter was an attempt to answer the second half of the research question regarding the effectiveness of public enforcement actions for directorial duties provided by UK legislation, and to what extent Saudi law can benefit from a consideration of them. This chapter was divided into three main sections to address the discussed aims. Firstly, public enforcers and their functions were discussed, and this part of the chapter outlined the public decision-making bodies which possess the authority to penalise directors who have violated their responsibilities in the UK and Saudi Arabia. The second part focused on the possible measures that can be applied by the state official bodies – in the UK and Saudi Arabian contexts – to a director who has violated his/her legal duties. The final section emphasised the obstacles to public enforcement, which involved providing a detailed examination of the efficacy of directorial duties with respect to public enforcement. Ultimately, this helped the author to critically examine the current level of public enforcement of directorial duties in Saudi Arabia. In Saudi Arabia, the author found that public enforcement actions are more efficacious and efficient compared to private actions and enforcement,

[927] For more details, see the official site of the NACC, available at http://www.nazaha.gov.sa/en/About/Pages/Establishment.aspx .

and this may be an indication of Saudi legislators' desire to encourage a greater number of public enforcement actions than private ones.

CHAPTER 6. Conclusion and Recommendations

6.1. Introduction

Clearly, the duties that directors owe to their company are a key component of corporate governance. Law-makers have introduced these duties in an attempt to create a fair and balanced relationship between shareholders and directors. This balance is needed to regulate tensions between ownership and control of companies. Nonetheless, if directors' duties are not enforced effectively then they will have no real impact on corporate management. This is true regardless of the legal system that these duties are supposed to operate within.

The key objective of this thesis is to analyse and assess those measures available to shareholders that are able to protect them as regards enforcing directors' duties. It is vital to seek out an appropriate comparative legal research method as legal systems worldwide are changing rapidly. These sorts of approaches enable researchers to assess current legal concepts on a national and global basis. In recent years, the Kingdom of Saudi Arabia has taken great strides towards creating an effective legal structure for its judiciary, economy, corporations and capital market. The newly enacted Company Law 2015 substantially reformed and modernised company law in the country, bringing it closer in line with international standards and developments in corporate governance. However, as this thesis shows, the new Saudi Arabian law has not made any significant inroads in regards to enforcing the duties of directors. More specifically, the only change to have been introduced is that the new law has increased certain types of public action outcomes such as fines and imprisonment. In terms of private enforcement, minority shareholders' right to wind up the company has been annulled by the new law[928]. While the new law was expected to provide a derivate claim scheme for the jurisdiction, the law made no changes regarding this sort of claim. Therefore, minority shareholders may only rely on unfairly prejudiced conduct to sue directors. As this thesis concludes, this may be an indication of Saudi legislators' desire to encourage more public enforcement actions than private ones[929].

As a result, the new legislation requires further amendment. Fresh developments and demands can be used to create recommendations for amendments for the CL 2015. Of particular concern is the need to improve corporate governance structures and the enforcement of directors' duties as well as the need to consolidate the protection of shareholders through more efficient enforcement actions. This thesis seeks to make a contribution by examining the experience that more developed nations have had in terms of the enforcement of directors' duties.

[928] See Ch 4, para 4.4.
[929] See Ch 6, paras 6.2.4., 6.2.6.

As a developing country, the Kingdom of Saudi Arabia looks to other nations to improve its corporate governance practices. This is done in the hope of benefiting from other countries' more advanced political, financial and legal institutions and avoiding any shortcomings identified in existing legal systems. This research examines and compares the law on enforcement of directors' duties in the UK and in Saudi Arabia. This thesis will conclude by presenting a summary of the principal research findings, offering recommendations and suggestions for future studies in this area. In so doing, it is hoped that this thesis as a whole has contributed to knowledge in this area.

6.2. Summary of findings

Corporate behaviour has traditionally been seen as one of the main and central elements of efficacious corporate action and behaviour. According to the IOSC, in order to sustain the market's financial stability and future growth, a company's board of directors must display independence, integrity and accountability. Also, board members should be suitably qualified and clear about their collective remit and responsibility[930]. Indeed, many significant corporate scandals have been attributed to the misconduct of individual directors. The thinking behind the enforcement of limiting responsibilities concerning the power and position of directors managing firms presents a chance for shirking behaviour or self-dealing.

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[930] The Growth and Emerging Markets Committee of the International Organization of Securities Commissions (IOSC), *Report on Corporate Governance*, October 2016, available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD544.pdf [Accessed October 30, 2016].

As a result, a thorough and clear series of rules and regulations has been thought of as necessary in order to retain positive corporate action with regard to director behaviour[931].

The Saudi CL 2015, when trying to optimise corporate governance behaviour within the nation, published a list of directors' duties. Nevertheless, proficient corporate management also depends upon enforcement, not merely of regulations, edicts but also voluntary guidelines. This is because a director's motivation to abide by regulations is impacted by the means by which such regulations are manifested and enforced. Therefore, efficacious enforcement and comprehensive rules determine the efficiency of a system of regulation. A comparison of the law concerning the enforcement of directors' responsibilities shall be provided herein. Laws of this nature within Saudi Arabia and the UK have been critically assessed within this thesis.

The UK, as a result of its long-lived experience in this sector, is thought of as among the more advanced of all corporate law jurisdictions. Indeed, this is especially true with regard to the means by which it sorts out and the enforcement of directional duties. When endeavouring to try and assess the remit of law in Saudi Arabia, this study has assessed several UK law sources. Actions which may be utilised by minority shareholders when trying to bring about an enforcement of directors' duties are extensively covered in a number of UK cases and in

[931] See Chapters 4 and 5.

legislation, such as the CA 2006. There are some crucial elements, even following the passing of the Saudi Companies Law in 2015 that are still unaddressed. As a result, UK legislation needs to be considered in depth as it may potentially contribute to prospective CL 2015 development.

Furthermore, from the very foundation of Saudi Arabia as a nation, the Shari'ah has been the official legal code. Therefore, this thesis believes that it is significant that the analysis is expanded in order to demonstrate a viewpoint stemming from Shari'ah law concerning the issue at hand. Moreover, the duties and responsibilities of directors with regard to the principles and rights afforded by Shari'ah law are, according to Islamic academics, able to provide several suggestions. These suggestions include increased efficacy when dealing with misconduct by directors. Therefore, this assessment will not investigate Shari'ah as a legal system only for followers of Islam. Rather, it will be considered in the context of governmental actions. In other words, the review will focus on Shari'ah law as a system providing recommendations to legislators worldwide, irrespective of national religions. These recommendations may be used to improve the effectiveness of regulations, and in particular of certain aspects of commercial law[932]. Subsequently, this will alter and enforce corporate governance. Due to the fact that these issues remain unexamined, this process

[932] See Ch 3, para 3.1.

will provide new original contributions to academic understanding. Of all the findings, those listed below were ascertained by the following means.

6.2.1. Shari’ah law

This thesis has illuminated the question concerning Shari’ah, namely, whether the system of law may be imposed, with validity, upon or within modern societal systems. Many critiques of Shari’ah law stem from misunderstandings, it has been found. The concept of Shari’ah as an inflexible doctrine is founded on the incorrect conception that Shari’ah law is merely to be found in the accounts of the Qur‘an and Sunnah. Though these documents comprise Shari’ah’s main and primary sources, the legal code is not pre-made for use by humans in a passive and uncompromising manner. Rather, it should be founded on the primary sources and sacred texts, which are acknowledged as its main sources[933]. As demonstrated by this study, laws from alternative legal systems are sometimes taken and transplanted as part of Shari’ah law, assuming they do not contradict its main values. For example, in Saudi Arabia the Commercial Court Law 1931, the Commercial Register Law 1956 and the Chamber of Commerce and Industry Law 1980 have been transplanted from other legal systems such as those in France, which were not against the Shari’ah law principles[934].

[933] See Ch 3, paras 3.1.1.2.
[934] *Ibid*.

Second, this thesis has shown that the idea of a number of directors' duties have, for some time, been acknowledged by academics of Shari'ah law. Several secondary and primary sources have been scrutinised and assessed when trying to ascertain if Shari'ah has indeed incorporated certain elements within directors' duties. Furthermore, fiduciary duties have been proven as having their origins in Shari'ah law[935]. Also, it has been proven that duty to act within powers, duty not to accept profits from the third parties, duty to avoid conflicts of interest and other duties have their roots in Shari'ah law. Such an acknowledgement has shown and demonstrated by instances and provisions deliberated over by Islamic scholars, who improved them for use by contemporary companies. In one instance, which has been demonstrated above, Shari'ah law has devised processes and regulations concerning violations of due diligence. These were developed to be analogous to corporate law's duty of care standards.

This concept demonstrates a recognition in Islamic thinking of fiduciary relationships and the principles therein. Furthermore, the adoption by the UK of the idea of trust was imported from Arabic states in the thirteenth century after witnessing the operation of the Waqf institution according to Shari'ah law and its use in the Middle East[936]. Subsequently, the argument has been made that UK common law has developed the idea of a fiduciary relationship. Responsibilities

[935] See Ch 3, para 3.1.2.1.
[936] See Ch 3, para 3.1.2.1.

within this relationship include due attention and fidelity. Conversely, this aspect of law remains under-assessed in Islamic scholarship[937].

6.2.2. Directors' liability

Among the more fascinating findings are those concerned with directors' liability. With regard to the accountability of directors when contrasting UK and Saudi law, three prominent aspects are notable. First, law in Saudi Arabia is less flexible with regard to the limits placed on the abilities and freedoms of directors. Indeed, legally, under section 72 of the CL 2015, directors are not allowed to concern or involve themselves with a rival company. In the event taking place, the company is able to apply for reimbursement via income, profit or compensation from the salary of the director in question. Theoretically, this is a disincentive for any director that may be intending to concern themselves with a rival company, and reinforces the law by making repercussions more enforceable.

Also, the application of limits on the appointment of corporate directors are already applied[938]. A number of issues came to the fore several decades ago because of legal persons being appointed to joint stock company directorial boards. Consequently, a series of limits and rules were applied for such an instance, while a further instance of such an example is an aspect of Saudi CL

[937] See Ch 3, para 3.4.1.
[938] The UK Small Business, Enterprise and Employment Act 2015, s.87 prohibits a corporate body to be employed as a director, but this section is still not in force.

2015, which states that CEO and Chairperson positions may not be combined into a single role, something that remains non-bonding in UK law.

Additionally, the second aspect concerns the stance of Saudi Arabian law with regard to relief from liability. In Australia and the United States of America, the business judgement rule (BJR) is enshrined in law. The BJR sets a benchmark used by the courts when investigating the behaviour of company board members to decide whether or not they can be held liable for decisions that have damaged the company. A claimant wishing to bring a case against a director or directors and their motives must challenge the presumption of the BJR that they have made decisions in the best interests of the company. In order to rebut the BJR, the claimant is required to prove alleged fraudulent activity, conflict of interest or some other illegal action[939]. In Saudi Arabia, there is no doctrine or case law, leaving company board directors with no such avenue for protection from liability when conduct is called into question[940].

Also, in Saudi Arabia, directors do not have as many chances to avoid or relieve themselves from responsibilities and accountabilities compared to their peers in the UK. Indeed, a company in Saudi Arabia is not permitted to ratify its director's inappropriate behaviour or actions; this is not the case in UK law. Nevertheless,

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[939] See Ch 3, para 3.3.3.2.

[940] See Amgad Husein and Anas Akel, "Saudi Arabia: Officers and Directors Liability under the New Companies Law" Dentons Firm, Riyadh, available at: http://www.dentons.com/en/insights/alerts/2016/may/19/saudi-arabia-officers-and-directors-liability-under-the-new-companies-law .

ratification is permitted in Shari'ah, and some argue that Saudi law may potentially be reshaped so that ratification comes in the form of prior consent to the director, thus making it both permittable and lawful. An additional alleviation of liability is in the form of the availability of the liability insurance of directors; as expounded upon above[941], the pressure is removed from directors to some degree as they are not accountable to pay expensive litigation costs, something that can also be time-consuming. Directors' liability insurance is not dealt with in CL 2015, though it has been claimed to be crucial for legislators in Saudi Arabia to find a substitute for directors' insurance that does adhere to Shari'ah law. This is to stop the possibility of harmful liability arising.

Additionally, directorial liability was seen to increase from negligent performance or default, and this may be relieved according to UK law according to the CA 2006 section 1157. This iterates, in elementary terms, that directors merely have to act in an honest and rational way[942]. Nevertheless, there is no provision in Saudi CL 2015 providing for such a judicial pardon. Thus, there is a wider array and degree of liability in the UK when compared with and contrasted to the UK, and the reason as to why the Saudi law assumed its stand is due to the requirement to guarantee correct company administration and the protection of investor rights, as well as the rights of stakeholders and shareholders. Herein,

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[941] See Ch 3, paras 3.1.2.3., 3.3.4.

[942] Although such a judicial pardon is available in UK under CA 2006 s.1157, it is rarely used successfully. See Ch 3, para 3.3.4.

Saudi Arabian law is seen to be far less flexible, indeed it allows a relatively restricted relief concerning the liability for directors. In the case of a director breaching their obligations however, the law is unable to present or facilitate efficacious reactive actions to reprimand them. Indeed, it is not strong enough to be able to prevent shareholders from launching legal actions in order to reprimand those directors who transgressed their responsibilities.

Thirdly, a number of directors' duties have yet to be incorporated or dealt with by Saudi Arabian Law. Prior to CL 2015, a number of academics have attributed this shortcoming to the fact that we dealing with a 50-year-old law and in the UK many of the new forms of directorial liability (such as wrongful trading) have only emerged in the past 30 years. Since 1965, significant alterations to the financial, corporate and business world have been experienced[943]. However, these limitations remain, even after more recent laws have been introduced, and one instance of this is the fiduciary responsibilities which are not mentioned within the CL 2015. Some propound the argument that Shari'ah law does include and acknowledge fiduciary responsibilities is traceable in the nation and that it does have an effect on and is applied in the courts there. Explanation and codification is needed regarding these responsibilities however, or integrity may be damaged by a series of fragmented regulations and principles. UK law should be used by

[943] Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*, Hard copy, Unpublished PhD thesis in Manchester University, 2008, pp.177-180.

Saudi Arabian lawmakers when trying to improve Saudi law, especially section 174 of the CA 2006, something that delineates directors' responsibility including the duty of care while concurrently imposing directorial standards that must be adhered to by all directors.

In Saudi Arabian law, there is no mention of the person that directors owe their duties to, nor which person's concerns need to be considered when directors manage their respective companies. In UK law, however, section 170 of the CA 2006 states that companies are owed duties by directors, and that the director is bound by duty to promote the success of their company to benefit all its members, especially with regard to longevity and shareholders' interests as per s.172 of the CA 2006.

A further instance is that UK directors are able to utilise their personal scrutiny and judgement. Assuming that that the power to make decisions was approved of through a concord by the company in question and in accordance with the constitution of that company, the director of a company needs to assess the various situations on an independent basis. Nevertheless, if the director should as part of a company board also make a decision by judging situations independently remains unclear and unstipulated in Saudi law. Additionally, a nominee director within the UK legal system is not indebted to the nominator as they have been nominated by them. This is due to the fact that the director's role is to undertake independent judgements[944]. No legislation exists in the UK that concerns nominee directors. As a result of this fact, the CA 2006 does not tackle the problem, and furthermore there is no provision within the Saudi CL 2015 that necessitates independent directorial decisions.

Consequently, in Saudi law, the laws for directors' duties need to more stringent. It was recommended that shareholders be able and permitted to ratify the director through the general meetings as they see fit. In the UK, this provision is acknowledged, and similarly it is clearly permitted in Shari'ah law. Indeed, it is seen from the text stipulating the duties of directors in Saudi law that director's substantive principles are mirrored, though certain aspects are clearly ignored or neglected. What is required henceforth is for directors under Saudi law to have a broader way of covering director actions and behaviour.

6.2.3. The concept of "shadow" directors

An additional important discovery is geared toward the significance of determining the person who actually is the director of a given company. UK and Saudi law differ on this issue. In the case of the latter, the definition of the term is very significant and is based on the main issue and query as to which individual is owed the responsibility. Indeed, no law actually stipulates the precise definition of a director. One of the repercussions of the absence of such a definition is that, within Saudi law, there is no official recognition of the role of shadow director.

[944] See Ch 3, para 3.3.1.

The individual that is able to influence the board to a considerable extent is not deemed to be a director. Such individuals may be able to incur notable profits or inflict losses on the firm though nevertheless not be accountable by law. As a result of this, the identification of such an individual as part of the company is needed so their titular position can be used, as a named director, for consequential action by shareholders.

If a firm is subject to wrongdoing by a certain individual who holds no formal position on the board, theoretically speaking, this person is then able to prevent any liability on their part and thus fines, imprisonment and disqualification rulings are not applicable to them on the basis of breached duties. This due to the fact that Saudi law a formal approach in this issue and the concept of shadow directors is not recognised. Additionally, directors who have been disqualified from acting as directors are able to informally influence company's affairs[945]. Thus legal enforcement mechanisms are spurious, and the efficaciousness of disqualification penalties are doubtful.

This thesis therefore sets out a series of suggested amendments to the CL 2015. The thesis aims to ensure that all responsibilities of directors shall also be applicable to shadow directors and de facto directors too. As a result of this, such individuals will assume greater liability for misconduct or bad decisions.

[945] Since this person is not considered as a director, he/she may not be accountable for breaching directors' duties. He/she may be held accountable only on the grounds of the civil liability based on contract or tort.

Consequently, several enforcement procedures and mechanisms are attainable in the case of such a breach.

6.2.4. The private and public enforcement of directors' duties

Among the discoveries made herein one concerns the assessment of whether enforcement actions may be utilised against defaulting directors. This may be done in the case of a private party's action or the action of a state official. There are two varieties of enforcement; public enforcement and private enforcement. This thesis endeavours to assess the various Saudi private and public enforcement actions and contrast them with those of the UK.

Particularly after the Saudi CL 2015 had been introduced, among the more disappointing elements of the Saudi system is the limited range of choices for minority shareholders. While in the UK there are a number of private enforcement actions that can be taken by shareholders against that of a company director, there are very few in Saudi law. Initially, with regard to the derivative claim as covered under the UK CA 2006, it was concluded that such actions are unrecognised under Saudi law. Such an action, it is argued, is alluded to in the wording of section 80 of the CL 2015, the implantation derivative action, as it exists in other nations, is not and has not been in the past the aim of the Saudi legislators.

Once, minority shareholders held the right to seek the winding up of the company. This is no longer the case and the option is not available any more under the new

Saudi CL 2015[946]. By and large, winding up has a notable and important impact on the stakeholders of a company and the company itself. In the case of a court deciding that winding up is not appropriate due to the alternates available, a number of situations nevertheless do arise wherein it remains the sole available option. As a result of this, this thesis criticised the Saudi CL 2015 as it stopped minority shareholders from seeking this order[947].

Another possible action for minority shareholders to take against a company they are not satisfied with is the exit solution. Saudi law allows this solution even in private companies. This is an advanced US remedy[948]. However, no direct enforcement action against directors is taken and directors are not held responsible for their illegitimate actions as a result of the minority shareholders selling their shares. Though a number of shareholders are presented with the chance to escape their company, the company itself and their colleagues and other shareholders are then subject to losses and negative repercussions. Regardless, so that the destabilisation of a firm does not occur once minority shareholders have been afforded the rights to sell-off their share, a number of caveats may be enforced while ensuring this minority is still able to exercise their afforded rights.

[946] See Ch 4, para 4.4.
[947] See Ch 4, paras 4.4., 4.5.2.
[948] See s.262 of Delaware General Corporation Law, s.13,14 of the Model Business Corporation Act. For in depth comment see Raluca Papadima, Mihaela Gherghe and Radu Valeanu "Shareholder Exit Signs on American and European Highways: Under Construction." U. Pa. J. Bus. L. 18, 2016, 1059.

Minority shareholders in Saudi Arabia, can only commence unfair prejudice actions against directors in the case of private enforcement actions. Indeed, the claim of unfairly prejudicial conduct was seen as preferable to UK minority shareholders. Within this assertion, the rights of both Saudi and UK minority shareholders are similar, the UK law permits the courts the ability to judge and exercise powers under the assumption of the litigation being justified and well-grounded. The UK's section 996(2)(c) of the CA 2006 could benefit the Saudi SA 2015 as UK law permits the court to permit the petitioning body or individual to take action against directors in the name of the company based on an unfair prejudice claim as decided by the court[949].

Assuming there are a number of comparatively small levels of private enforcement in the way of directors' duties, the public enforcement of duties needs to be taken into account. This study has demonstrated that Saudi Arabia, as a developing nation is almost equivalent in the way of instructions compared to established UK institutions. This is especially true with regard to the process of disciplining and holding accountable managerial staff. Additionally, a number of enforcement mechanisms may be forced on companies by the central government. In the case of Saudi Arabia. The MOCI and the CMA are the main

[949] It is submitted that the relief under Section 996(2)(c) has, in reality, been ordered only infrequently and it is suggested that, under this provision, action such as this has never been permitted by the courts. However, as the legal environment in Saudi Arabia is very different, this does not preclude the possibility of such action being ordered. See John Lowry and Alan Dignam, *Company law*, Oxford University Press, 2014, p.211.

public agencies enforcing directors' duties under Saudi law. These institutions are responsible for dealing with and assessing directors that have transgressed and who have violated the SCL 2015. While CMA being placed in charge of directors of publically-listed companies, other companies' directors are monitored by MOCI.

Among the most disappointing of all findings seen within this thesis is that, to the understanding of the author, since the introduction of CL 1965, no single case has been recorded in accordance to imposition of penalties for breaches of CL provisions. Despite the fact that the institution is able to take action against certain actions, there have been no recorded repercussions imposed by it. Under Saudi CL 1965, the highest level of financial penalty can be seen to be equivalent to $5,333. It is believed that the MOCI will experience no benefit if it decides to take such action and initiate these proceedings against wrongdoers. This is due to the fact that such insubstantial financial penalties prove insufficient when bringing about adequate capital sources for future investigation.

Such sanctions, in accordance with the contemporary CL 2015, are far more severe. Indeed, the director may be accountable for fines of up to $1,333,000, as well as potential incarceration and a prison sentence of 5 years. It is argued that in the case of more severe financial penalties, and the successful implementation of such penalties, then MOCI will be able to initiate their penalties with greater effectiveness. Despite for the fact that it may, at the start, seem as if deterrence did increase concerning those directors breaching the provisions situated in CL 2015, it is not the case that this is certainly a positive development. Under CL 2015, heavier sections may be inadequately enforced, and, if so, they may have meagre or inadequate repercussions concerning directors' action[950].

Concerning the CMA, this thesis has shown that a number of initiatives were commended and launched by the CMA. A number of sanctions have been imposed by the CMA-managed CRSD. As a result of this, the autonomy of the CRSD remains questionable. Thus punishments like imprisonment and disqualification are imposed and are deemed as acceptable as a result. A number of commentators[951] critique the fact that the committee is not given the correct level of autonomy by which it would be able to impose the sections it makes, and this is true of the CRSD. Thus, not every imposition is necessarily to be imposed by court rulings. In the UK, courts alone have the authority to disqualify a director, though the "Undertakings order" may be brought about by the Secretary of State, and they do not require court order. Indeed, while leaving this power with the courts may increase the independence of the process, the administrative approach serves to save money and time. Saudi Arabian legal officials may learn

[950] See Ch 5, para 5.5.2.
[951] For Example see Faleh Al Kahtani, *Current practices of Saudi corporate governance: A case for reform*, PhD thesis, Brunel University, 2013, pp.108,109, available at http://bura.brunel.ac.uk/bitstream/2438/7382/3/FulltextThesis.pdf [Accessed March 27, 2016]. Two articles were published as a result of this thesis, see Faleh Al Kahtani, "Current Disclosure and Transparency Practices in Saudi Corporate Governance", Arab Law Quarterly, 28(2), 2014, 176. Also see Faleh Al Kahtani, "Current Practices of Saudi Shareholders' Rights: A Case for Reform", Arab Law Quarterly, 27 (3), 2013, 231.

from the UK and the way that it deals with higher flexibility and autonomy levels[952].

Additionally, in Saudi Arabia, the law generally permits selected public agencies to publish their rulings regarding the fining of individuals. If such publication was not supported by appropriate legal provisions, publication might be seen as illegal defamation. The CMA often publishes its decisions regarding the disqualification or fining of those directors found to have breached the 2003 Capital Market Law. Publication of this information is not facilitated or supported by any grant or ruling, and this thesis recommends that there be a provision added to the Capital Market Law that enables the CMA the means and authority to publish the penalties it has imposed on disqualified or fined individuals[953].

6.2.5. Obstacles in the way of enforcement actions

This thesis discovered that in Saudi Arabia, though the law fails to present sufficient enforcement mechanisms, a number of lesser challenges could stymie those already in place. This shortcoming may be a result of several causes.

The thesis argued that enforcement costs of such aforementioned details may present a difficulty for both the private party and the state. One of the most notable

[952] See Ch 5, para 5.2.3.
[953] See Ch 5, para 5.2.1.

differentiating factors of private law enforcement and public law enforcement is that public law enforcement assumes payment is received regardless of the action in question. In the case of private enforcement, only when litigation achieves its goal are the parties concerned paid. Private claimants need to provide the capital needed to fund the litigation. Though this results in easier coordination of public enforcement, this is because this process is able to operate a securities regulation system, one that is self-sufficient as it can be applied to notable financial penalties. As a result of this, the argument that cost modifications have greater repercussions on private investment can be maintained.

This thesis endeavours to find solutions to the minority shareholders cost issue. In the UK, the losing side needs to pay for the total capital spend on litigation for the wining party as well. Conversely, in the US, each party needs to pay for their own legal team, and this is true of all legal suits[954]. As a result, in the case of an unsuccessful legal action then the shareholders do not need to reimburse the legal costs of the party who is successful. Thus the US has a more appropriate solution to protecting the rights of minority shareholders with regard to such cases.

Additionally, minority shareholders are not aware of their rights to initiate actions against directors[955]. Indeed, under Saudi Arabian law, minority shareholders are

[954] See Ch 4, para 4.5.1.

[955] For example see Fahad M. Al-Majed, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective,* Hard copy, Unpublished PhD thesis in Manchester University, 2008, p.242.

able to influence the organisational processes, although this is uncommon. For example, they are entitled to call for a General Meeting (GM), where they may ask questions of all board members and auditors. Thus, they hold the right to gain access to information held on record by a company that they can utilise it to extrapolate evidences against directors in the case of a litigation law suit. Minority shareholders in the country are unaware of this however, according to a number of studies, and thus do not take action as a result[956].

A further obstacle that has been expounded upon herein is the means by which political agenda may present a notable challenge to directors' duties and their enforcement. As a result of the fact that, in order to efficaciously and successfully bring about litigation enforcement and impose regulations, political commitment is needed. Consequently, enforcing breaches of director's duties may be harder, assuming a political resistance to draw attention to or highlight any related transgressions. Biased governments have been known to assist companies in the past with whom they have shared some connection, and their policies generally result in higher profits and thus can increase the cost of shares. The minimisation of sanctions against a company and the directors of a company is only viable when alternative benefits can be obtained. Due to the existence of familial ties between government and companies, reform of enforcement in the interests of minority shareholders appears somewhat unlikely. Political corruption is able to

[956] See Ch 4, para 4.5.3.

stymie both private mechanisms and public mechanisms with regard to legal enforcement. As a result, corruption, it is proposed, needs to be transcended by political action. The establishment of an autonomous institution to combat corruption may attain this end. The corruption is tackled in UK by several agencies such as Serious Fraud Office and National Crime Agency. In Saudi Arabia, it was shown that the newly established National Anti-Corruption Commission is aimed at helping to improve practice within a country although its effect so far is too early to evaluate[957].

Absence of political intent to enact and enforce law is not perennially connected to corrupt practices, though it also may arise from unwillingness to allocate public funds, as previously expounded upon, concerning problems, companies and their members. As a result of this, in Saudi Arabia, as well as in the UK, governments hope to reduce their public expenditure across several sectors for a number of different reasons. This is also true for those agencies responsible for public enforcement duties and charges.

This thesis argued that GCC adoption in Saudi Arabia has made no effective contribution to the enforcement of directors' duties. Herein, the many issues and problems concerning the enforcement of director's duties with regard to the GCC, and not Companies Law, has been assessed. It must be stated that the code itself is merely a guide, and that the application of such regulations generally apply to

[957] See Ch 5, para 5.3.4.

listed companies alone. Provisions from voluntary bodies may also promote innovative practice, and one such example of this is the founding of the board of evaluation. Nevertheless, the board remains reliant on honest behaviour from directors and their use of the code to their optimal ability and capacity. Consequently, legislators in Saudi Arabia are not keen to enact such propositions via a voluntary code with regard to company directors. Indeed, a number of voluntary provisions were made mandatory via revisions made by the CL 2015. Lastly, with regard to corporate governance demands, according to Cadbury[958], both equilibrium as well as self-regulation are sought after. Nevertheless, equilibrium needs to be sought-out in a mutual endeavour before being applied to relevant and exacting governance problems.

6.2.6. Closing remarks

Lastly, the objective of this study was to look into the effectiveness of Saudi enforcement actions against directors compared to those of the UK. A critical assessment of legal sources on each nation has facilitated this process.

[958] See Adrian Cadbury. *Corporate governance and chairmanship: A personal view*. Oxford University Press, 2002, p.28.

The duties in Saudi Arabia, as can be perceived by a thorough reading of duties of directors and the provision thereof, are mirrored. However, for certain aspects and elements this is not the case.

In terms of enforcing breached duties, if a director is in breach of duty in Saudi Arabia then there is no effective legal course by which private actions can be initiated to punish the wrongdoers. For instance, minority shareholders are prevented from initiating any legal action against directors on the company's behalf. In Saudi Arabia, the author found that public enforcement actions are not only sufficient but more efficacious compared to private actions and enforcement. Indeed, they are able to protect minority shareholders, unlike the private enforcement actions, and can provide the necessary capital required by the action itself. Furthermore, as has been submitted, efficacious public enforcement assists private enforcement too.

Evidently, each enforcement system outlined here has drawbacks, as previously described. Nevertheless, it is also clear that single systems may not be sufficient on their own. As such, it is submitted that the use of appropriate multiple methods could improve corporate governance, so long as it does not unreasonably affect actions of the board[959].

A number of recommendations are presented herein in order to try and increase the scope of law. This thesis has presented a number of changes to existing Saudi

[959] Andrew Keay, *Board Accountability in Corporate Governance*, Routledge, 2015, p.241.

Law and argues that the legal system in Saudi Arabia would benefit as a result. However, it has also shown that merely transposing UK law onto Saudi Arabia cannot be seen as a change to Saudi structural accountability of directors. Indeed, lawmakers in Saudi Arabia shall not burden directors with a new list of rules. Instead, they are more likely to clarify director duties. Though this brings with it a series of notable repercussions, with regard to changing existing implications and provisions, this aim may be easily attained. The new amendments of Saudi CL 2015 are suggested by a number of enforcement actions. Regardless, this thesis thinks that in the case of UK enforcement mechanism being transposed to the Saudi legal system, they would become entrenched and mould to extant Saudi culture.

6.3. Recommendations

Recommendations are presented here in an effort to contribute to legal reform in the Kingdom of Saudi Arabia in order to improve the situation for the enforcement of directors' duties. It is recommended that Saudi Arabian political and legal actors develop a better understanding of their power in relation to enhancing existing enforcement mechanisms for the duties of directors. In particular, this research suggestions include:

1- It was submitted that the definition of 'director' is vitally important and centres on the key concern of the question of by whom the duties of directors are owed[960].

[960] See Ch 2, para 2.1.

Nevertheless, in Saudi Arabia, no piece of legislation currently provides an explicit definition of the term. As a clear definition of 'director' may prevent legal uncertainty, law-makers should amend the Saudi CL 2015. Also, the Saudi CL 2015 should specify a minimum age requirement for directors.

2- Neither 'shadow' nor 'de facto' directors are recognised in Saudi Arabian law. If Saudi Arabian law-makers were to recognise these two forms of director, this would make firms and those who act as directors more accountable for their conduct. It is thus recommended that new laws be introduced to ensure that the perpetrators of bad corporate conduct be held responsible for their actions. In addition, despite the important role played by nominee directors in representing key shareholders, groups of shareholders or, typically, a holding company, neither UK nor Saudi Arabian legislation provide legal provisions for nominee directors. It is suggested that both jurisdictions should address the issues related to nominee directors.

3- Since the fiduciary duties of directors are not well-clarified in Saudi Arabian legislation, Saudi Arabian legislators should clarify these duties under SCL 2015. In other words, Shari'ah law has recognised fiduciary duties and this acknowledgement exerts its influence in the country and is applied by the courts. Nevertheless, this recognition is gained through scattered rules and principles, which can create legal uncertainty. Given that other directors' duties are typically codified in the Companies Law 2015, it is suggested that directors' fiduciary duties should be codified too. This will offer greater clarification of Saudi Arabia's legal position in relation to fiduciary duties. In doing so they can benefit from s.174 of the UK CA 2006 which offers an explanation of the various fiduciary responsibilities of directors, for example, the duty of care, and imposes standards that directors must meet.

4- The Saudi Companies Law 2015 does not address the issue of whose interests need to be considered when running a company. However, the Saudi Corporate Governance Code 2006 does strongly indicate that the rights of both shareholders and stakeholders need to be safeguarded. However, the Code's applicability extends to listed companies only, thus, Saudi Arabian policy-makers should reflect on this issue when amending the SCL 2015.

5- In Saudi Arabia, legislation is silent on directors' liability insurance. It has been suggested that since insurance is vital for both individuals and businesses. Although the insurance companies within the country that offer different types of insurance contracts such as health and vehicle insurance, but directors' liability insurance has not been recognised[961]. Saudi Arabian legislators must identify a

[961] See Ch 3, paras 3.1.2.3., 3.3.4.

substitute for directors' insurance that adheres to Shari'ah law in order to prevent potentially crippling liability.

6- The Saudi Arabian legal position on whether to grant minority shareholders the right to initiate a derivative claim is ambiguous and uncertain. In order to remove this uncertainty, s.80 of SCL 2015 should be amended. Thus, it is suggested that derivative claims must be included in Saudi Arabia's CL 2015. Nonetheless, when considering the introduction of this claim, there is a need to balance the prevention of unreasonable claims by minority shareholders, which can damage a company, with the guarantee that the claim is available to minority shareholders. These claims are vital as they can create equilibrium between shareholders and directors and protect shareholders' rights. Unreasonable claims can be managed by imposing limitations on derivative claims.

7- In terms of unfairly prejudicial conduct claims, SCL 2015 can benefit from adoption of s.996(2)(c) of the UK CA 2006. This provision allows the court to grant permission to the petitioner(s) to bring an action in the name of the company and on the basis of the court's directions as to whether the unfair prejudice claim is well-founded.

8- Before the introduction of the Saudi CL 2015, it was suggested that the minority shareholders' right to seek to wind up the company must only apply in certain circumstances, i.e. when a winding up is the only choice. However, while this right is no longer granted to minority shareholders under the new Saudi CL 2015, it is suggested that it should be granted in certain conditions.

9- In Saudi Arabia, the Capital Market Authority often publicly publishes its decisions concerning the sanctions and penalties imposed on directors. This can offer greater transparency as shareholders and other stakeholders will be aware of any sanctions that have been imposed on directors. However, no legal provision allows the CMA to publish this information and it is arguable whether publication constitutes illegal defamation. Hence, in order to avoid legal uncertainty, it is suggested that legislators add a provision to the Capital Market Law that grants the CMA the power to publish details of the penalties levied against wrongdoers.

10- As has been previously discussed, the Saudi Arabian Committee for the Resolution of Securities Dispute has the power to impose different sanctions on discreet directors. These can include, imprisonment, fines and disqualification. Considering the administration of the CRSD is managed by the CMA, the former's independence is questionable. It is thus suggested that the CRSD should not be authorised to enact such rulings. Also, the UK courts originally had the sole power to disqualify directors, but the newly introduced 'undertakings; order can be enacted by the Secretary of State without the need for a court order. In fact, while leaving this power with the courts may increase the independence of the process, the administrative approach serves to save money and time. Law-makers in Saudi Arabia can benefit from the UK approach's higher level of autonomy and flexibility.

6.4. Contribution and suggestions for further research

As has been shown above, the accountability of directors has been thought of as a central element to efficacious corporate action and behaviour. Nevertheless, if such duties are not enforced in the correct manner then they shall have no or negligible impact on the behaviour of directors. As a result of this, this thesis intends to assess Saudi Arabian directors' duties compared to those of the UK. More exactingly, the effectiveness of the enforcement of directors' duties on their actions was assessed herein.

According to the findings of this thesis, studies under Saudi Arabian law have not considered the duties of its company directors in great detail. More significantly, the problem as to how director duties can be enforced was not assessed or invested, even before the introduction of the new CL 2015. With the commencement in May 2016 of the Companies Law, introduced in November 2015, reforms occurred to a number of kinds of enforcement mechanisms which may be enacted when directors beach their duties. Thus, the gaps that exist in extant literature can be explained by this, and the need for further research in the sector can be justified. This thesis is, according to the author's best understanding, the first study that assessed in a critical manner the enforcement of director duties in Saudi Arabia in the light of the CL 2015. Through the provision of important results and findings, this study has made a significant contribution to knowledge.

Through assessing and benefiting from the UK -and other nations'- legal, financial and political institutions, this thesis has been able to highlight the lawful limitations in Saudi Arabia regarding enforcement of directors' duties. Furthermore, the element of Islam and the Islamic viewpoint has been significant in trying to determine the opinions and perspectives of efficacious corporate action. Such contrasts try to bridge the gaps in existing literature to try and promote and argue for legal reform in Saudi Arabia. This, it is hoped, will make the current situation regarding the enforcement of director's duties in the nation more efficient and efficacious. Thus, the corporate context will be more closely scrutinized and thus safer. Additionally, the thesis endeavoured to broaden the understanding of the topic in hand and that of judges, directors, practitioners and lawyers.

Consequently, additional and prospective research concerning a number of legal topics is required. Furthermore, extant literature needs to be assessed in order to fully deal with the problem at hand. Therein, a number of important issues concerning Saudi law and the governance of corporate institutions in the nation itself demand additional and more in-depth assessment. As a result of the restrictions arising from this thesis, the author has had to restrict themselves to enforcement actions concerning directors of solvent companies. Furthermore, only the safeguarding of shareholder rights has been assessed herein. Therefore, this thesis has not concerned itself with the duties of directors regarding creditors in a situation of company solvency or insolvency in Saudi Arabia, nor contrasted them with US and UK jurisdictions. New insolvency laws are anticipated shortly in Saudi Arabia, hence the significate of this thesis.

Additionally, the aspect of this subject that demands the most research is the enforcement of directors' duties within family firms. Thus, a contrast of UK and Saudi family companies is needed in prospective research. So that the analyses can be widened, the research study should incorporate extant enforcement challenges as well as recommend a number of solutions.

Furthermore, the thesis has looked into the duties of directors as a single aspect of corporate governance. Research into the nature and the structure of corporate governance as a whole is needed. Indeed, the gap is there because there is a need for more and further studies in this area concerning Saudi legal, political and socio-economic viewpoints and corporate governance. This study shall assess such subjects in a theoretical and practical manner.

Lastly, it is essential to highlight the methodology of legal transplant as a central technique for mending the gaps identified in Saudi Arabian corporate governance regulations. Therefore, evaluation of texts on transplants is required by future examinations. The examination must assess the current methods within Saudi

Arabia for transferring corporate laws from foreign jurisdictions. This examination will try to explore the primary elements that must be highlighted during the process of transplanting recently developed regulations to ensure greater effectiveness within Saudi Arabia.

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Table of Derivations

Saudi Companies Law 2015 Table of Origins

Section	Equivalent provision in Saudi Companies Law 1965	Unchanged/ Changed
65	55	Changed
68	66	Unchanged
71	69	Unchanged
72	70	Unchanged
74	72	Unchanged
75	73	Changed
78	76	Unchanged
79	77	Unchanged
80	78	Unchanged
81	79	Changed
86	83	Unchanged
87	84	Unchanged
89	86	Unchanged
90	87	Unchanged
93	91	Unchanged
96	94	Unchanged
99	97	Unchanged
110	108	Unchanged
100	109	Unchanged
128	125	Unchanged
144	142	Unchanged
150	148	Changed
165	161	Unchanged
172	170	Unchanged
173	171	Unchanged
181	180	Changed
211-213	229,230	Changed