

## مسؤوليات مدير الشركة وأعضاء مجلس الإدارة في المملكة العربية السعودية والشريعة الإسلامية (القانون الإسلامي)

### ملخص

نظرًا لعولمة الأعمال ومفهوم الأنشطة التجارية بلا حدود، فإن هذه الظواهر الجديدة تحتاج إلى أن تكون إدارة الأعمال منفتحة وتعتمد وممارسة مهارات الإدارة مع وضع المعايير الدولية في الاعتبار، وإيلاء الاعتبار الجيد لظروف تدويل الأعمال من خلال المديرين الذين لديهم الصلاحيات المنصوص عليها في العقد والقانون. أظهرت الأزمات المالية في السنوات السابقة أهمية واجبات المديرين لإدارة شؤون الشركة بشكل صحيح؛ كانت هذه الأزمات نتيجة العديد من حالات الغش وسوء الإدارة. تم تقنين واجبات أعضاء مجلس الإدارة في عدد من الدول - كالمملكة المتحدة أو إيرادها بشكل ضمني في المملكة العربية السعودية- لتعزيز وضوح القانون وتسهيل فهم مسؤوليات المديرين تجاه الشركة والآخرين. كما يهدف إلى منع الاحتيال وسوء الإدارة الذي يؤدي إلى انهيار الشركات.

تبحث هذه المقالة في مسؤوليات مدراء الشركة في المملكة العربية السعودية والشريعة الإسلامية (القانون الإسلامي) وتحللها من أجل توضيح مدى فعالية هذه الأنظمة. يتم ذلك من خلال تقييم نقدي للتشريعات ذات الصلة والسوابق القضائية بشأن موضوع الدراسة وإظهار المشكلات العملية التي قد تنجم عن بعض التشريعات. من خلال القيام بذلك، توفر الدراسة صورة دقيقة لمسؤوليات مدراء الشركة وأعضاء مجلس الإدارة وتقدم حلولاً للمشاكل العملية للتشريع في نفس السياق.

**كلمات دلالية:** التزامات أعضاء مجلس الإدارة، قانون المملكة العربية السعودية، الشريعة الإسلامية، المسؤولية المدنية؛ المسؤولية الجنائية، الإخلال بالواجبات.



## **The liabilities of company directors in Saudi Arabian law and Islamic law**

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### **Abstract**

This article investigates and analyses the liabilities of the directors in Saudi Arabia and Islamic law in order to demonstrate the extent to which these regulation work effectively. This is by a critical evaluation of relevant legislation and case law on the subject matter of the study and demonstrating practical problems, which may result from some legislation. By doing this, the study provides an accurate picture of the directors' liabilities and provides solutions to practical problems of legislation in the same context.

**Keywords:** directors' liabilities; Saudi Arabia law; Islamic law; civil liability; Criminal liability; breach.

### **1. Introduction**

Since the beginning of the Asian financial crisis in 1997 the world has been looking seriously at corporate governance, although the first appearance of the term “corporate governance” was apparently in 1976 in Federal Register.<sup>2</sup> Among many problems that emerged during the crisis operations and transactions of employees and companies obtaining huge amounts of short-term debt at the same time as they are keen to not know the members and hide these debts through innovative accounting methods and systems, most of the loans also were made without checking profitability

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<sup>2</sup> Federal Register: 41 Fed. Reg. 52977 Dec. 3, 1976.

and returns.<sup>3</sup> The events of the so-called Enron scandal<sup>4</sup> and the ensuing string of corporate misstatements,<sup>5</sup> the latest of which was the UK economic crisis that served as a warning to many cases of fraud and mismanagement.<sup>6</sup> These have clearly demonstrated the importance of corporate governance even in countries that were considered financial markets "close to perfection". Griffin<sup>7</sup> mentions that Angel Gurri<sup>a</sup> indicated in the 2008 statement of Organization for Economic Cooperation and Development (OECD), what he considered the causes of the global financial crisis. The banks acted rationally in given their position and the opportunities in the global market when they responded to investor demand to expand mortgage lending, accordingly, the global financial system would collapse due to faltering investor confidence. The financial world is governed by assumptions concerning the necessity of capital liquidity, so the only solution that lies in the performance improvements that main market actors must make, by making informed decisions, is not only to protect themselves but also to improve how markets function. In this regard, Campbell<sup>8</sup> asserts that the main causes of the 2008 US financial crisis were a series of institutional failures in how to manage the financial services industry. This can be summed up in three reasons. First, the mortgage markets. Second, the financial services industry, since the amount of money that companies could borrow to leverage their investments increased. As a result of that, the total debt of the US financial sector increased from 22% to 117% of GDP between 1981 and 2008. The institutional reforms in banking regulation, such as adjustable-rate subprime mortgages, with no legal limit on the interest charged, created incentives for lenders

<sup>3</sup> Tejvan Pettinger, (2017) Asian Financial Crisis 1997, EconomicsHelp, 12 November 2017, available at: <https://www.economicshelp.org/blog/glossary/financial-crisis-asia-1997/> accessed on 31 July 2018.

<sup>4</sup> See Dharan, Bala G.; William R. Bufkins (July 2008). "Red Flags in Enron's Reporting of Revenues and Key Financial Measures". Social Science Research Network: 112; Healy, Paul, M., and Krishna G. Palepu. 2003. "The Fall of Enron." *Journal of Economic Perspectives*, 17 (2): 3-26. DOI: 10.1257/08953300376588840; McLean, Bethany; Peter Elkind. *Enron: The Smartest Guys in the Room*. 39-42. ISBN 1-59184-008-2.

<sup>5</sup> "Andersen guilty in Enron case". BBC News. 15 June 2002 available at: <http://news.bbc.co.uk/1/hi/business/2047122.stm> accessed on 31 July 2018.

<sup>6</sup> Arden, M. 'Regulating the Conduct of Directors' (2010) 10(1) J Corp L Stud 1, 1-2.

<sup>7</sup> Griffin, P. (2013). Gendering Global Finance: Crisis, Masculinity, and Responsibility. *Men and Masculinities*, 16(1), 9-34. 10.

<sup>8</sup> Campbell, John. (2011). Campbell, John L. 2011. "The U.S. Financial Crisis: Lessons for Theories of Institutional Complementarity." *Socio-Economic Review* 9:211-234. 217-228.

to get more credit available to borrowers, even for the borrowers with poor credit history records. Third, the absence of institutional complementarities, which institutions must compensate for each other's shortcomings rather than reinforce each other's incentives.

Following the sound principles of corporate governance leads to the creation of the necessary precautions against mismanagement, while promoting transparency in economic and the fight against fraud and corruption. The directors' responsibility is to ensure that effective corporate governance is applied in all relevant matters by establishing a compliance policy that governs the company's compliance with all applicable laws, including the establishment of effective compliance risk management policies and procedures and the obligation to prepare periodic reports regarding the compliance.<sup>9</sup>

Companies, whether they are public or private, that enjoy enduring success have core values and core purpose that remain fixed while their business strategies and practices endlessly adapt to a changing world.<sup>10</sup> Therefore, to enjoy the prosperity, and to continue the progress, the companies need proper tools for managements, with well- designed management powers, duties and responsibilities, and that requires first to have a better understanding of the concept of the corporate governance and its related practices. According to Owen<sup>11</sup> that corporate governance is the rules and systems by which the power is practiced and controlled in corporations. Corporate governance focuses on internal and external corporate structures as well, in order to monitor the actions of the management.<sup>12</sup> Companies' accountability can be established through the corporate governance mechanism, and it also regulates the distribution of the responsibilities between the different participants including:

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<sup>9</sup> See OECD. (2004). OECD Principle of Corporate Governance. OECD. The UK Corporate Governance Code 2018, the main principles of the code.

<sup>10</sup> Collins, C., & Porras, J., I. (1996). Building Your Company's Vision. Harvard Business Review. September- October 1996, 74(5), 65.

<sup>11</sup> Owen, John., The Failure of HIH Insurance, Canberra: Commonwealth of Australia, (2003), ISBN 0975067826 (volume 3).

<sup>12</sup> Sifuna, A., P. (2012). "Disclosure or Abstain": The prohibition of Insider Trading on Trial". Journal of International Banking Law and Regulation, 27 (20).



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directors, managers and shareholders claim.<sup>13</sup> The mechanisms of the corporate governance comprise: decisions and policies with the corporation and its agents, being designed for monitoring the actions.<sup>14</sup>

This article deals with the laws of Saudi Arabia in relation to the liabilities of the company director, which may be a result of a breach of duty.

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<sup>13</sup> OECD. (2004). OECD Principle of Corporate Governance. OECD.

<sup>14</sup> Tricker, A. (2009). Essentials for Board Directors: An A-Z Guide, Bloomberg Press, New York.

## 2. Directors' liability

The legislation in Saudi Arabia imposes general duties on directors, to guide them in the way that they should function to reduce the risks of their decisions, which may have unwanted consequences for the company, shareholders, stakeholders and other parties. The legislation also seeks to prevent the directors from using the position for their personal interests or for any other considerations that are not in the company's interests or are not within the purposes of the company. Accordingly, these broad powers of directors do not leave them free from liability in the event of non-compliance with the duties stipulated. This directors' liability may be civil or criminal, according to the wrongful act committed.

### 2.1 The civil liability

Civil liability, in general, is a result of a breach of the obligation required by the directors. This liability is instituted because of breaching the provisions that are stipulated in the company's articles of association, the general assembly's decisions or the Saudi Arabian Companies Law 2015 (SACL 2015). It can be also because of mismanagement of the company's affair, the abuse of the granted power or as a result of negligence in the oversight of the company's business.<sup>1</sup>

The civil liability of directors also has distinct characteristics, which is that the directors are jointly liable. Although the joint liability in commercial matters is presumed, the legislature has explicitly stipulated it for directors in order to enhance the protection of third party.<sup>2</sup> The imposition of joint liability also enhances the activation of the monitoring of the directors and members of the board of directors on the company's business affairs. If a wrongful act is proven that has arisen the civil liability and the compensation, the aggrieved (affected) party has the right to sue to any director and claim compensation from her/him or from all members of the board of directors jointly.<sup>3</sup> The damage that results from a unanimous resolution made by all directors is considered as a joint mistake, and therefore, the joint liability is against the directors regarding the compensation for the damage resulted from this unanimous

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<sup>1</sup> SACL 2015, art 78.

<sup>2</sup> SACL 2015, arts 12, 13, 78 and 165.

<sup>3</sup> Hayaa Al-Muribidh, The liability of company board members within the framework of corporate governance in Saudi Arabian law, *Dar Alfikr wAlqanun*, Mansoura, (2016), 180-181.

resolution. The principle is that the joint liability should be equal between the directors, but the court may determine the percentage of each directors' liability from the compensation according to the severity of the wrongful act s/he committed.<sup>4</sup>

A characteristic of civil liability is that it may be an individual or joint liability. The SACL 2015 states that the liability of directors and members of the board of directors may be imposed on one director, without the rest.<sup>5</sup> A wrongful act that is made by a director that caused damage to the company, shareholders or third party, which the rest of the directors are not related to this wrongful act, for example, divulging company secrets, therefore, the liability will be individual on the perpetrator of the wrongful act and not for other directors. The wrongful act may be made jointly, such as the resolution taken by the directors unanimously or by the majority. In summary, the directors are liable individually or jointly for the damage that results from mismanagement of the company's affairs. The SACL 2015 states that directors shall be jointly liable for damages to the company, the shareholders, or third parties, arising from their maladministration of the affairs of the company, or their breach of the provisions of the SACL 2015 or of the articles of association of the company. Joint liability shall be assumed by all directors if the wrongful act arises from a resolution adopted unanimously. With respect to resolutions adopted by majority vote, dissenting directors shall not be liable if they have expressly recorded their objection in the minutes of the meeting. Absence from the meeting during which such resolution is adopted shall not constitute cause for release from liability, unless it is established that the absentee was not aware of the resolution, or, on becoming aware of it, was unable to object to it.<sup>6</sup>

In Islamic law, the director is considered as an agent. Therefore, directors should be honest and trustworthy. In the event of a claim of the negligence against an agent, the burden of proof shall be on the principal. In general, Islamic law is consistent with

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<sup>4</sup> Mahmoud Mohamed Fahmy, The liability of the members of a board of directors of a company whether in their personal capacity or as representatives of others, *Majalet Misr Al-Mueasira*, (1985) 401 p.25.

<sup>5</sup> SACL 2015, arts 12, 13, 24, 31, 32, 71, 72, 73, 74, 211, 212 and 213.

<sup>6</sup> SACL 2015, art 78(1).

Saudi Arabian law, the agents may face civil liability if they neglect or violate the limits of their granted powers.<sup>7</sup>

### **2.1.1 The nature of civil liability of directors**

The purpose of civil liability is to compensate the aggrieved (affected) party for the damage that s/he sustained as a result of the directors' breach of an obligation. The basis of liability in law is making a wrongful act, and it means deviation in conduct that is a breach of legal obligation.<sup>8</sup> The nature of the civil liability of the directors differs according to the difference of those who prove this liability in facing them, and then the legal basis on which the relationship linking the directors with those who have been proven liable (affected) differs. The civil liability is either a contractual basis or tortious (default) basis. The liability with a contractual basis lies with the directors in the face of the company, because the relationship of the directors to the company is caused by the appointment contract. The liability with a contractual basis arises because of exceeding the powers granted in the appointment contract, in the law or the company's articles of association, or because of acts tainted by lack of goodwill;<sup>9</sup> or not to exercise reasonable care.

As for the liability with a tortious (default) basis, which is so-called an obligation not to hurt others, this liability arises from a wrongful act that is due to acts that involve bad faith or fraud or those acts arising from a breach of the general duties or a breach the prevision of the company's articles of association.<sup>10</sup> It may also be due to negligence or abuse of power so that the wrongful act does not reach the degree of criminal liability. The liability hold does not require that the damage be deliberate. This liability is often faced with shareholders and the third party.<sup>11</sup>

In general, civil liability arises under three conditions, and the liability is excluded by the absence of any of these conditions. These three conditions are focused on the wrongful act, the damage and the causal relationship between them. First, the

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<sup>7</sup> Kamal Ibn Al-Humam, Fateh Al-Qadeer, Dar AlKutub AlElmiah, Beirut, (2003), part 8 p 126.

<sup>8</sup> Marqis, Suleiman., Explaining the Civil Law, Second edition, Law and Economy, Cairo, 1992, Part 4, p.107.

<sup>9</sup> Tiemah Al-Shamrii, the board of directors of the joint stock company, Kuwait Foundation for the Advancement of Sciences, Kuwait, (1995), 145.

<sup>10</sup> Fahad Al-Khudair, civil liability of the members of the board of directors of the joint-stock company, First edition, Law and Economy, Riyadh, (2012), 93-94.

<sup>11</sup> Abdul-Wadud Yahya, the general theory of law, Institute of Public Administration, Riyadh, (1986), 156.



wrongful act, which is a condition for the establishment of civil liability, whether this wrongful act is due to the director's breach of her/his duties stipulated in the appointment contract, the company's articles of association or the law. Whether the wrongful act is by doing something which is considered as a breach of duties or omission doing something that must be done. Therefore, the director's concealment of the fact of the company's financial position by submitting misleading reports is considered a wrongful act because it is against the law and may be considered as criminal liability.<sup>12</sup>

In this regard, a question arises as to what kind of wrongful act arises civil liability, is it a grave wrongful act (*culpa lata*) or any wrongful act regardless of its gravity (*culpa levis*). The Saudi Arabian legislature does not specify the wrongful act whereby the civil liability of directors arises. There are those who argue that the wrongful act that gives rise to the civil liability is the grave wrongful act (*culpa lata*).<sup>13</sup> While there are those who argue that the gravity of the wrongful act has no effect on the emergence of civil liability against directors, so all wrongful acts, whether grave (*culpa lata*) or not (*culpa levis*) establish the civil liability.<sup>14</sup>

In all cases, it is considered an impediment the civil liability claim is that the absence of the existence of the wrongful act from the director. In the judgment declared by the Saudi Arabian commercial court,<sup>15</sup> a civil liability claim instituted by one of the shareholders against the company's board of directors was rejected. The shareholder claimed to abolish the resolutions of the ordinary general assembly and compensate him for the damage that he had suffered because he was not invited by the board of directors to attend the general assembly. The respondent defended that the failure to invite the shareholder is due to his lack of proof of his ownership of shares in the company at the time of the general assembly meeting, even though this condition is publicized and published. Therefore, the court held that the respondent performed his duty in accordance with the law and there is no negligence in the performance of the duty, and since the claim for compensation is required from the

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<sup>12</sup> See SACL 2015, art 211(a); Zaki Mahmoud Jamal Al-Din, Civil Liability Problems, Cairo University Press, Cairo, (1998), 527.

<sup>13</sup> Fahd Al-Habbini, the responsibility of the members of the board of directors of the joint stock company for their decisions, the National Library of Kuwait, Kuwait, (2012) 201-202.

<sup>14</sup> Al-Muribidh (n 3) 185.

<sup>15</sup> The Saudi Arabian Commercial Court, 940/TG/7 (2007).

shareholder to prove the wrongful act, which was no proof before the court, therefore, the liability claim was rejected.

The second condition is the occurrence of damage. It is not sufficient to prove the wrongful act committed by the director to establish civil liability. Rather, this wrongful act must lead to damage to the company, shareholders or the third party. The burden of proving the damage rests with the aggrieved (affected) party. The damage is of two types, material damage, which is the violation of the financial interest of the aggrieved (affected) party, and it is required that it be actual, that is, the damage is firmly certain even in the future, and that merely alleging the possibility of the damage is not sufficient for the liability to be arisen.<sup>16</sup> The second type of damage is moral harm, and it violates non-financial interests, such as the violation of reputation and dignity.<sup>17</sup>

The occurrence of damage results in the necessity of compensation from the one who caused it. The compensation for material damage is not problematic, whether for legal or Islamic law scholars.<sup>18</sup> As for the compensation for moral damage is subject to dispute among Islamic law scholars, about the possibility of the judge's discretionary power to assess the compensation for moral damage and its denial because of the difficulty or impossibility of assessing the moral damage.<sup>19</sup> As for the laws, most Arab legislatures have adopted the compensation for moral harm, although there is a dispute over the details of the kinds of moral damage that are compensated for.<sup>20</sup> For example, it is stated in *Malik v BCCI*,<sup>21</sup> about the moral damage that the House of Lords considered that it is wrong in the event of a wrongful dismissal that the award of compensation does not include compensation for the manner of the dismissal, for the injured feelings, or for the loss that the employee may suffer from the fact that the dismissal itself makes it more difficult to obtain a new job. Nor did any Lord say that it is not permissible for an employee to recover the financial loss for

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<sup>16</sup> Amr El-Feky, The Legal Encyclopedia of Civil Responsibility, *Dar Al-Kutub Al-Qanuniah*, Egypt (2002), 43-44.

<sup>17</sup> Al-Muribidh (n 3) 189.

<sup>18</sup> Hassan Akoush, Contractual and default liability in the civil law, Second Edition, *Dar Al-Fikr Al-Hadith*, Beirut, (1997), 245.

<sup>19</sup> Wahbah Al-Zuhaili, the theory of liability in Islamic jurisprudence, Second edition, Dar Al-Fikr, Jordan, (1998), 23.

<sup>20</sup> Abdul-Razzaq Al-Sanhouri, Civil Law Explanation, Second Edition, Dar Ehya Al-Turath Al-Earabi, Beirut, (1997), part 1, page 866.

<sup>21</sup> [1997] UKHL 23.

the damages caused to her/his employment prospects caused by a breach of contract. Or, in the event of breach of contract cases, compensation can never be awarded for loss of reputation. In addition, the House of Lords in *Spring v Guardian Assurance Plc*,<sup>22</sup> held that a former employee could recover damages for the financial losses incurred as a result of the negligence of the employer in preparing a reference that affected her/his reputation. Lord Steyn said that proving stigma compensation is difficult, but these difficulties do not change the legal principles that allow to claims for financial losses arising from a breach of contract for consideration.

The third condition is the causal relationship between the wrongful act and the damage. There must be a direct relationship between the wrongful act made by the director and the damage to the company, the shareholder or the third party. This is a condition for the emergence of civil liability against the directors. This relationship does not exist if the damage is due to an external cause that the director has no control over, such as force majeure or the wrongful act is from a third party provided that the director does not have a relationship with them based on the delegacy and the like.<sup>23</sup> In the judgment declared by the Saudi Arabian Commercial Court,<sup>24</sup> the court rejected the claim of civil liability and compensation, as there was no causal relationship between the acts of the directors and the damage. It has been proven that the damage claimed for compensation was due to the wrongful act of the aggrieved (affected) party and the wrongful act of the third party, and the director has no related to this wrongful act.

However, the causal relationship between the wrongful act and the damage in practice has several problems regarding the multiplicity of causes and the sequence of results. The problem is that there may be multiple causes and that the damage did not happen based on one cause, but the combination of all these causes caused the damage, and if one of these causes did not exist, the damage would have not happened. Will be the liability, in this case, be based on all causes or on some causes? This is based on two theories, which are the theory of equivalent or equal causes and

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<sup>22</sup> [1995] 2 AC 296

<sup>23</sup> Redha Wahdan, Disputes attributable to damages in the compensation claim, the Journal of Justice, v 54 (2012), 150-184, 172.

<sup>24</sup> The Saudi Arabian Commercial Court, 29/TG/1 (1991).

effective cause theory.<sup>25</sup> The theory of equivalence of causes is based on the premise that each factor is involved in causing the damage so that without each factor the damage would not have been, and that every factor would be an equal legal cause to the other causes. However, this theory has been criticized as extending the concept of causation significantly.<sup>26</sup> The second theory is the effective cause theory, and this theory differentiates between secondary and productive causes. If there are multiple causes, the productive (fundamental) cause is considered to be the cause of the damage and establishing for the liability.<sup>27</sup>

With respect to the problems of the sequence of results, it is contrary to the aforementioned theories, which are the theory of equivalent or equal causes and effective cause theory. This theory assumes that one cause had caused several damage sequentially from each other. It has been agreed that the liability of the one who made the wrongful act is limited to the direct damages resulting from the wrongful act itself, while the liability for the indirect damage to the wrongful act does not arise. This is because the sequential results are not related to the wrongful act with a sufficient causal relationship.<sup>28</sup> The determination of these direct damages or not and the possibility of avoiding sequence damages or not depends on the circumstances of the incident and the judge's discretion.

In the event that these three conditions are all met (wrongful act, damage and the causal relationship), civil liability arises against the directors.

### **2.1.2 The directors' liability in the face of the company.**

The SACL 2015 stipulates in more than one article the directors' liability to compensate the company for all damages incurred as a result of mismanagement of the company's affairs.<sup>29</sup> Although the company has the right to dismiss the director in the event of a breach of duties, the dismissal does not relieve directors of the liability in the face of the company.<sup>30</sup> The company has the right to hold directors accountable

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<sup>25</sup> Abdel-Rashid Maamoun, The causal relationship in civil liability, First Edition, *Dar Al-Nahdhat Al-Arabia*, Cairo, (1998), 10.

<sup>26</sup> Maamoun (n 25) 10.

<sup>27</sup> Anwar Sultan, Sources of Commitment, *Dar Al-Thaqafata*, Jordan, (2010), 379.

<sup>28</sup> Maamoun (n 25) 15; Marqis, Suleiman., Reasons for exemption from civil liability, *Huquq Al-Qahirah*, Cairo (1996), 240.

<sup>29</sup> See for example, SACL 2015, arts 12,13, 24,31, 32, 71, 72, 73 and 74.

<sup>30</sup> SACL 2015, arts 74 and 100(3).

against decisions and conduct that are harmful to it, such as gross negligence in management, wasting its money, or damaging its commercial reputation, and breaching the provisions of the company's articles of association or the SACL 2015 and the relevant legislation.<sup>31</sup> The principle is to institute the liability action by a decision of the general assembly and appoint a representative to pursue the case on behalf of the company. If a judgment is passed on the insolvency of the company, the institution of this action shall rest with the receiver, and upon the dissolution of the company, the liquidator shall pursue the case after obtaining the approval of the ordinary general assembly.<sup>32</sup> However, due to the possibility that the general assembly or its representatives may not play their role in instituting the liability action, the Saudi Arabian legislature has recognised the need to preserve the rights of shareholders and the third party. The SACL 2015 stipulates that a shareholder shall have the right to institute a liability claim against the directors and the board of directors on behalf of the company, except that this prosecution has conditions, which is that the shareholder had suffered personal damages and that the company's right to institute the prosecution is still valid and that s/he shall notify the company of her/his intention to do so.<sup>33</sup>

### **2.1.3 The directors' liability in the face of the shareholder.**

The wrongful act of the directors may result in damage to one or some shareholders without affecting the rest, such as if directors or the board of directors refused to hand over one of the shareholders her/his share of the profits or prevent her/him from the right to look at the necessary information, so the shareholder who was aggrieved (affected) in this case will have to claim directors or the members of the board to compensate her/him for the damage.<sup>34</sup> This prosecution in such a scenario is called the shareholder's personal claim, which aims to the reparation of the damages that shareholder incurred without the company.<sup>35</sup>

This is close to the reflective loss principle in the UK law, which is the loss of individual shareholders that are inseparable from the company's general loss. Lord

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<sup>31</sup> SACL 2015, art 74.

<sup>32</sup> SACL 2015, art 79.

<sup>33</sup> SACL 2015, art 80.

<sup>34</sup> SACL 2015, art 78.

<sup>35</sup> Dr Muhammad Hassan Al-Jabr, Saudi Commercial Law, Riyadh, (2000), ISBN 99-331-440-5, p. 342.

Bingham in *Johnson v Gore Wood & Co*,<sup>36</sup> summarised the reflective loss in three propositions:

*"(1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company... (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it...(3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other"*.

In *Sevilleja v Marex Financial Ltd*,<sup>37</sup> the court held that the reflective loss principle did not bar the appellant creditor, who was not also a shareholder, from bringing claims against the respondent owner of the companies who had acted in breach of duty by stripping the companies' assets, causing the creditor to suffer loss. Regarding the problem of possible double recovery against the defendant in respect of the loss suffered by the creditor and the loss suffered by the companies there is a mechanism available to the extent that the creditor sues the defendant and obtains a recovery from him for the judgment sum, the defendant can be subrogated to the creditor's rights against the companies or allowed a right of reimbursement in respect of them. Generally, the Supreme Court took a restrictive view of the reflective loss rule.

#### **2.1.4 The directors' liability in the face of the third party.**

Directors' wrongful acts may result in damage to a third party, such as signing forged instruments without verification of their authenticity or acting exceeding the granted power of the director or the board of directors that the stakeholder knows that

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<sup>36</sup> [2002] 2 AC 1.

<sup>37</sup> [2020] UKSC 31.

this is exceeding the director granted power; therefore, the liability claim shall be only in the face of the director.<sup>38</sup> The third party acting in good faith may institute the liability action in the face of the company itself because the company shall be bound by all the acts performed by its directors and its board of directors.<sup>39</sup> In the judgment declared by the Saudi Arabian commercial court<sup>40</sup> that it is for the plaintiff to claim on behalf of the company for compensation for the damage caused due to the wrongful act of its director, and the company has the right to institute the liability action in face of the director for the compensation due to negligence and default in his function.

In Islamic law, the third party that has dealt with the agent (director) may institute civil liability proceedings against the agent; and the agent is not entitled to exempt of the liability on the pretext that s/he is an agent of the principal (company).<sup>41</sup> The third party has the option to institute the prosecution against the agent or the principal directly if the transaction was within the powers granted to the agent. Then the relationship will be direct between the third party and the principal in order to preserve the rights of the third party; this is by making the option for the third party to raise the liability action in the face of the principal or the agent or all of them as a joint liability.<sup>42</sup> This is in the case that the third party had known about the agency contract between the agent and the principal when the transaction was done with the agent. In the event that the third party did not know about this relationship between the agent and the principal during the transaction, the third party has nothing but to raise the liability in the face of the agent.<sup>43</sup>

It should be noted that, in the context of a civil liability claim, it might be difficult to estimate some of the directors' acts and know whether they constitute mismanagement or not. Not all decisions made by directors have good consequences for the company, as it is well known that the function of the director is based on commercial risk. The Saudi Arabian courts will respect directors' exercise of

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<sup>38</sup> SACL 2015, art 77.

<sup>39</sup> Ibid.

<sup>40</sup> The Saudi Arabian Commercial Court, 11/TG/4 (1988).

<sup>41</sup> Muhammad ibn Abidin, *Radd Al-Muhtar ala Al-Durr Al-Mukhtar*, Second edition, Dar Al-Fikr, Beirut, (1992), part 1 p 224.

<sup>42</sup> Dr. Abdul-Razzaq Al-Sanhouri, *Explaining the Civil Law, Dar Al-Nahdhat Al-Arabia*, Alexandria (2004), part 1, p. 232.

<sup>43</sup> Mansour El-Bahouty, *Sharah Muntaha Al-iradaat*, First edition, Resalah Foundation, Beirut, (2001), part 2 p 308.

discretion in the management of the company, which is known as Business Judgment Rule. The directors' decision-making is part of a series of processes leading to a final decision, which is not an isolated event. The directors should carefully consider all aspects related to the final judgment, such as taking advice, due diligence and then making the decision. Accordingly, the court will take into account whether reasonable care was exercised and all aspects related to the final decision. If the decision is taken in a reasonable manner, the directors cannot be held liable for any damage as a result of this decision.<sup>44</sup>

## **2.2 Criminal liability**

The civil liability against directors may be insufficient to deter directors from some wrongful practices. The Saudi Arabian legislature has adopted criminal liability against some of the directors' acts, and it has emphasised the punishment against them, because civil penalties may not prevent the director from committing a wrongful act, and may not fit the gravity of the act. Accordingly, the Saudi legislature is seeking to protect the companies, shareholders, and the third party from wrongful conducts that may be made by directors to fulfil personal interests due to dishonesty and abuse the position, the legislature imposed criminal liability against some of the directors' acts that take place while performing their duties.<sup>45</sup> The SACL 2015 stipulates the criminalisation of many wrongful practices by directors, which would violate the integrity, trust, protecting companies, shareholders and third party, and imposing the appropriate penalties against these practices.<sup>46</sup> The directors' criminal liability derives from one of two things, either through the criminal acts that criminal law has criminalised against members of society or through the provisions on criminal liability in the SACL 2015 and relevant legislation.

It is known that the natural person is the one who commits acts that constitute an offence punishable by the laws, and is subject to criminal liability, but the criminal liability is unlike civil liability, it does not extend to other directors who did not

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<sup>44</sup> See Al-Jabr (n 35), 340.

<sup>45</sup> Ali Al-Waeli, *Governance of Saudi Joint Stock Companies and its Role in Reducing Financial Crime*, Master dissertation, (2010), Prince Nayef Arab University for Security Sciences-Department of Criminal Justice, Riyadh, 33.

<sup>46</sup> SACL 2015, arts 211, 212, 213, 214, 2015 and 216.



contribute to the commission of the criminal act.<sup>47</sup> As for the legal person is like a natural person, acquiring rights and has obligations. However, the dispute is on whether the legal person (companies) would face criminal liability or no. Some jurisdictions<sup>48</sup> have adopted the criminal liability against the legal person (companies), that equated a natural and legal person with criminal liability, but it replaced the prison sentence with a fine penalty in the event of a judgment of criminal liability against the legal person (companies). The SACL 2015 adopted the criminal liability of a legal person, since if the prosecution cannot be instituted against the offender who committed one of the violations stated in the SACL 2015; the public prosecution may institute a case against the company to adjudge the company with the fine stipulated for such violation.<sup>49</sup> While some jurisdictions do not adopt criminal liability against the legal person as is the case in the Egyptian Criminal Law, the Egyptian legislature has not adopted criminal liability against companies.<sup>50</sup> Perhaps the justification for this is that legal persons are not criminally liable for the criminal misdeeds of their representatives. The legal person also cannot commit an offence for lack of criminal will. In addition, it is inconceivable to apply the sentence of imprisonment for a legal person.<sup>51</sup>

In general, criminal liability arises under two conditions, and the liability is excluded by the absence of any of these conditions. The first condition, which is a material condition which is performing the criminal act or omission doing the obligation, and all of these are criminalized with a criminal penalty by law.<sup>52</sup> The second condition is a moral condition and it relates to the psychological and motivating aspect of the perpetrator of the offence, which is the presence of the criminal intent to commit the criminal act, for example, divulging the company secrets with the intent to obtain personal interests, or intentionally divulging the

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<sup>47</sup> Samiha Al-Qaliubi, Commercial Companies, Dar Al-Nahda Al-Arabia, Cairo, (2008), 999.

<sup>48</sup> For example SACL 2015.

<sup>49</sup> SACL 2015, art 217.

<sup>50</sup> See the Egyptian Criminal Law 1937 amended 2003, there is no provision in the Egyptian Criminal Law that establishes criminal liability for the legal person, as the legislature limits criminal liability to the natural person.

<sup>51</sup> Rana Al-Eutur, Criminal liability for the legal person, Damascus Journal of Economic and Legal Sciences, v 2, (2006), 341-424, 343.

<sup>52</sup> Abdelrahman Al-Rashoud, Criminal Liability for Distributing fictitious profits in Joint Stock Companies in Saudi Arabia, Master dissertation, (2014), Prince Nayef Arab University for Security Sciences-Department of Criminal Justice, Riyadh, 61.

company secrets with the will of the perpetrator and not through an external force such as the company emails hacked or company database hacked.<sup>53</sup>

The SACL 2015 identifies a number of acts that give rise to criminal liability and imposed criminal penalties against their perpetrators. It is possible to summarize these acts in which the director may make as a result of occupying the position.<sup>54</sup>

The offence of making false statements or omitting including some data deliberately in the company's financial statements or in the reports of the general meeting. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian Riyals<sup>55</sup> or by either of these two penalties.<sup>56</sup> Any director, official, auditor, or liquidator who knowingly includes false information in the financial statements or in the reports prepared by him for the shareholders or the general meeting; or who omits essential facts from such statements or reports with the intention of concealing the financial position of the company from the shareholders or third parties.<sup>57</sup> Whoever willfully inserts in the articles of association, bylaws, or other of the company's documents or in the incorporation license application form or in the documents attached to the incorporation application form, false information contradicting with the provisions of the SACL 2015; and whoever knowingly signs or distributes such documents.<sup>58</sup> This is also can be considered as a breach of the principle of disclosure and transparency contained in the corporate governance regulations.<sup>59</sup>

The offence of divulging company secrets should be noted. It is the duty of the director to maintain confidentiality. What is meant by this is that the company secrets that the directors have information about because of their positions only, which without their positions in the company they would not have known this information.<sup>60</sup>

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<sup>53</sup> Muhammad Swailem, Corporate Governance in Arab and Comparative regulation, *Dar Al-Nahdhat Al-Arabia*, Cairo, (2010), 406-410.

<sup>54</sup> See SACL 2015, arts 211, 212 and 213.

<sup>55</sup> 1 USD = 3.75 Saudi Riyals, Fixed exchange rate.

<sup>56</sup> SACL 2015, arts 211 and 212.

<sup>57</sup> SACL 2015, arts 211(a).

<sup>58</sup> SACL 2015, arts 212(f).

<sup>59</sup> SACGR 2019, art 89.

<sup>60</sup> SACL 2015, art 74.

Included in the scope of the commitment of the director not to divulge the secrets of the company outside the general assembly meeting. As for the information that the laws require placing at the disposal of shareholders in order to inform them of the information about the company before a period of the general assembly meeting or that information permitted by the laws to be published, it does not fall within the meaning of this duty, are not considered in the meaning of this duty.<sup>61</sup> Although the breach of the duty to maintain confidentiality arises the civil liability,<sup>62</sup> the legislature has doubled the liability for the breach of the duty to maintain confidentiality by joining criminal liability to the civil liability against every employee (including the director) who divulges to non-concerned authorities the secrets of the company that have come to her/his knowledge in the course of duties.<sup>63</sup>

The Saudi legislature also combined the civil and criminal liability in the offence of knowingly misusing the company's funds and misusing the powers granted against the company's interests. The civil and criminal liability will arise against any director, official or board member who knowingly misuses the company's funds or misuses her/his powers or votes of such power in a manner that conflicts with the company's interest for personal interests or in favour of a company or person; or benefit from a project or deal in which s/he has a direct or indirect interest.<sup>64</sup>

The offence of not calling the general assembly meeting when the losses of the company amount to half of the paid-up capital or if fails to publish such information in accordance with such losses.<sup>65</sup> In addition, the Saudi legislature considered that the director misuses the company for purposes other than that for which the company was designated, is an offence that arises the criminal liability.<sup>66</sup> It is noted that the Saudi legislature stipulates the moral condition for criminal liability, which is the existence of criminal intent, knowledge of the incident and motive for committing the criminal act with the phrases "with the intention", "knowingly misuses" and the phrase "deliberately" or mentioning the motive, whether it is personal interests, favouritism

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<sup>61</sup> Ibid.

<sup>62</sup> Ibid.

<sup>63</sup> SACL 2015, art 212(b).

<sup>64</sup> SACL 2015, art 211(b)(c).

<sup>65</sup> SACL 2015, art 211(d).

<sup>66</sup> SACL 2015, art 211(i).

or other motives.<sup>67</sup> Finally, the director may be criminally liable, according to other laws that may relate to the position of director.

### **3. The consequences of breach of the duties**

#### **3.1 Return of property and account of profits**

The company directors may be ordered to return the company property to the company in case of taking its property by breach of duties while they shall hold the property in trust for the company.<sup>68</sup> Account of profit claims is often involved in breaching some of the directors' duties, duty to avoid conflicts of interest and to declare any personal interest,<sup>69</sup> duty not to participate in any business competitive with that of the company<sup>70</sup> and duty not to accept benefits from third party.<sup>71</sup> If a company director had benefited from an unauthorised profit by breaching these duties, this profit is confiscated to the company. This is to deter the directors from exercising these wrongful acts and should be noted that profits confiscated and return of the company property are not to compensate the company for the loss, as the company compensation may be greater than the profit realised by the director.<sup>72</sup>

Consequently, the court may, at the request of the affected party (the company), rule to return the property and account of profits as a result of the directors' breach of their duties. In the judgment declared by the Commercial Court,<sup>73</sup> the respondent (a director) is obligated to return the property (building), which is the subject of the company's competition, the activity of the company is to buy or rent buildings and re-rent them as residential units. The company claimed to the director that after the expiry of the company lease contract for the building (the subject of the dispute), the director rented the building for his own account, and the rent was not renewed for the company's account. The company considered that as competing with the company's activity. Therefore, the court held that the operations done by the director were for the company account. However, logically, the directors are not liable to account for

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<sup>67</sup> SACL 2015, arts 211 and 212(c)(d)(f).

<sup>68</sup> SACL 2015, arts 24, 31, 71 and 72.

<sup>69</sup> SACL 2015, arts 31 and 71.

<sup>70</sup> SACL 2015, arts 31 and 72.

<sup>71</sup> Sharia "Islamic" jurisprudence principle "*Al'asl Bara'at Althimah*" which means each person's liability is innocent until proven otherwise; The Saudi Arabian Corporate Governance 2019, art 49.

<sup>72</sup> SACL 2015, art 218.

<sup>73</sup> The Saudi Arabian Commercial Court, 10/TG/1/7 (2013); 213/TG/2/1 (2014).

profits that are not related to the breach of the duties. The directors are liable to account for profits made by themselves or through a company and they have an interest.<sup>74</sup> In addition, the profits made jointly by other persons are not subject to confiscation unless the other person is aware of the breach of duty and may be liable.<sup>75</sup>

In Islamic law, the general rule is that every act of an agent (director) that has exceeded the granted powers or with negligence, the agent is liable for that conduct. Whether by compensation or other remedies. The compensation in Islamic law is either in-kind or monetary. In-kind compensation is the restoration of the situation as it was before the damage, if possible.<sup>76</sup>

### **3.2 Equitable compensation**

Return of property and confiscation of profits from a director who breached the prescribed duties may not be sufficient to redress the damage suffered by the company due to the director's breach of his/her fiduciary duty. Therefore, the court may award equitable compensation for any loss not compensated by the account of profit.<sup>77</sup>

The Saudi Arabian legislature does not specify a specific mechanism to compensate for the damage but rather left that to the judge's discretionary power to consider the circumstances of the case and the provisions of the Islamic law. Here a question arises as to the amount of compensation due to the affected party. In general, the amount and the type of compensation in the civil liability cases against directors according to the damage to the affected party. The general rule in assessing compensation is that if the compensation is stated by the legislature, the judges are obligated to compensation as in the manner of the legal provisions. If there is a legal provision that determines the amount of compensation for the damage, the judges are obliged by this legal provision, and they do not have discretionary authority to determine the compensation.<sup>78</sup> Since the Saudi Arabian legislature does not specify

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<sup>74</sup> SACL 2015, art 71(2).

<sup>75</sup> SACL 2015, art 74.

<sup>76</sup> El-Bahouty (n 43) part 2 p 306.

<sup>77</sup> SACL 2015, art 218.

<sup>78</sup> Redha Wahdan, The practical problems in the compensation claim before the Saudi Arabian judiciary, the Journal of Justice, v 46 (2010), 75-88, 78.

the amount of compensation for the damage caused due to the wrongful acts of the directors, the judges have discretion in assessing the appropriate compensation.

However, the judge's discretionary power to fix the compensation, as Al-Sanhouri<sup>79</sup> and Wahdan<sup>80</sup> argue, is restricted by some of the principles that have been agreed upon judicially in accordance with the provisions of Islamic law, and among these principles we should note the following. First, the compensation is to the extent of the damage, according to the opinion of those with experience in that. Second, the judge does not have to award compensation for more than what the claimant (the affected party) claim, even if the claim compensation is less than the damage that in the discretion of the judge and the experts. Third, the compensation is related to the damage itself not to the gravity of the wrongful acts. For the wrongful act that is not grave (*culpa levis*), which leads to grave damage, the compensation must be estimated on the damage, not estimated on the wrongful acts caused; and the grave wrongful act (*culpa lata*) that causes minor damage the compensation would be for the amount of damage regardless of the grave wrongful act. In addition, the financial position of the director should not be taken into account in the amount of compensation, so the compensation is not increased if the director is affluent or insured on their liability. Fourth, the affected person may not obtain more than one sum of compensation for one damage, so no matter how many perpetrators made the wrongful act, the compensation is for the damage.

The damage, whether or not it occurred, is of three types. First, the damage has already occurred. Second, the damage that its causes have occurred, but its effects have not yet occurred, and it will happen in the future certainly. Third, the potential damage, which its causes have occurred, but its effects are not certain to happen in the future.<sup>81</sup> Saudi Arabian law has adopted the same approach as Islamic law. The compensation is estimated on the damages that have already occurred or the damages that are certain to happen in the future. As for the potential damage that is not certain

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<sup>79</sup> Al-Sanhouri (n 2020), part 2, p. 971.

<sup>80</sup> Wahdan (n 78) 80-81.

<sup>81</sup> Jamal Al-Din Atwa, Contractual Liability in Islamic Jurisprudence: A Comparative Study, published doctoral thesis, Al-Azhar University, Cairo, (1979), 380.

to happen in the future, it will not be compensated because the consideration is in the occurrence of the damage, not in the expected damage.<sup>82</sup>

As already mentioned, the compensation is in the event of occurrence a wrongful act, the damage and the causal relationship between them.<sup>83</sup> The compensation for moral damage is subject to disagreement among Islamic scholars, about the possibility of the judge's discretionary power to assess compensation for moral damage, and its denial because of the difficulty or impossibility of assessing the moral damage.<sup>84</sup>

In the judgment declared by the Commercial Court,<sup>85</sup> the respondents (two directors) were liable to pay compensation to the shareholders for the damages incurred by the company due to their negligence in the company's management. Where the respondents committed financial violations such as paying incentives and bonus for the company employees including themselves despite not achieving profits in the activity of the company, but the source of these incentives and bonus was from the sale of the company's assets. It had been also proven that there were differences and inconsistencies in the company's accounts and budget and that there are deficiencies in the company's internal monitoring process. Accordingly, the court ruled the directors liable for negligence in the company's management and they are liable to pay compensation to the company. This is supported by the judgment declared by the Commercial Court,<sup>86</sup> against the defendant (the director) to compensate the plaintiffs (shareholders) for the loss resulting from negligence in the company's management. Where a large number of goods were lost in relation to the size of the company and the short period of its operation, the court held that it usually does not lose such a number (percentage) of the goods, except in the case of negligence.

In Islamic law, as previously mentioned, if civil liability is established against an agent, then the agent is obligated to pay in-kind compensation, which is to restore the situation as it was before the damage, if possible. If it is not possible, in-kind

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<sup>82</sup> Wahdan (n 78) 82.

<sup>83</sup> Jamal Al-Din (n 12) 527.

<sup>84</sup> Al-Zuhaili (n 19) 23.

<sup>85</sup> The Saudi Arabian Commercial Court, Q/3/847 (2016); 291 (2019).

<sup>86</sup> The Saudi Arabian Commercial Court, 83/2 (2014).

compensation, then monetary compensation is another remedy that is resorted to in this case.<sup>87</sup>

### **3.3 Rescission of a transaction**

The transaction of a company that has occurred due to a breach of duty to declare any personal interest, violating the grant of loans or violating the provisions of debt instruments or financing instruments is voidable in accordance with the options of the company and may be rescinded.<sup>88</sup> The rescission of a transaction involves each party returning to the other what was transferred in the transaction. Also, upon rescission of the contract of sale of property or any transactions made by a director, the director must return all the profits that they made through the transaction.<sup>89</sup> However, in some circumstances where the transaction cannot be rescission, such as the resale of the property to another party. It is also the case where the transaction was made with someone who is non-fraudster (has good faith), rescission may not be possible depending on the circumstances surrounding the transaction.<sup>90</sup>

In the judgment declared by the Saudi Arabian commercial court,<sup>91</sup> the director of the company sold part of the company's shares to herself, provided that the value of the shares be paid from future profits. It is evident that selling in this way is nothing more than being in a non-interests of the company and the shareholders, but rather is in consideration of the interests of the buyer (the director), and by claiming the shareholders to revoke this transaction (selling the shares), then the court ruled to nullify the sale, as it exceeded the granted power of the director and in breach of the duty to act in the interests of the company. Also, in the judgment declared by the Saudi Arabian commercial court,<sup>92</sup> the board of directors set aside a yearly sum to support the defaulters of the tenants, and as this violates art 30 of the SACL 2015 (Donations). This is considered by the court as exceeding the power of the board of directors and mismanagement of the company's affairs, and therefore the court annulled the support decision and obligated the board of directors to compensate for what was paid.

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<sup>87</sup> El-Bahouty (n 43) part 2 p 306-307.

<sup>88</sup> SACL 2015, arts 71, 73(1) and 124.

<sup>89</sup> SACL 2015, art 71(2).

<sup>90</sup> SACL 2015, arts 29 and 77.

<sup>91</sup> The Saudi Arabian Commercial Court, 3708/Q (2016).

<sup>92</sup> The Saudi Arabian Commercial Court, 5855/Q (2017).



In this regard, it should be noted that a personal claim could be made against third parties when the directors breached their duties. This is if the third party dishonestly assisted a director to breach their duties, the third party may be personally liable to pay compensation to the company. Or if the third party knows that such directorial acts are not within the limits of the board's competence, the third party may be liable for compensation to the company.<sup>93</sup>

In Islamic law, if the agent acts in a manner that does not benefit the principal, then this act is considered non-binding for the principal; some Islamic law scholars argue that the wrongful act is void even if it is authorised later by the principal. While some scholars believe that, the act is void unless it is authorised later by the principal.<sup>94</sup>

### **3.4 Removal of directors**

In SACL 2015, the removal of directors from their position has also ways and circumstances. This removal depends largely on the type of company and the circumstances of a director. In general partnerships, the removal of a director depends on two main things which are that the director is a shareholder in the company or not, and the appointment of the director is in the general partnerships' articles of association or in a separate service contract. If a director is a shareholder and appointed in the articles of association, s/he has immunity against the termination except by a decision issued by the competent judicial authority at the request of the majority of shareholders. The removal of a director in such manner shall entail the dissolution of the general partnership unless the general partnership's articles of association provides otherwise.<sup>95</sup> While if the director is a shareholder appointed in a separate contract, s/he may be terminated by a resolution from the shareholders.<sup>96</sup> Finally, with respect to general partnerships, if a director is not a shareholder, s/he may be terminated by a resolution from the shareholders, whether the director is appointed in the articles of association or in a separate contract.<sup>97</sup>

In a limited liability company, the shareholders have full freedom to remove a director, whether the director is appointed in the company's articles of association or

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<sup>93</sup> SACL 2015, arts 74 and 77.

<sup>94</sup> El-Bahouty (n 43) part 2 p 306.

<sup>95</sup> SACL 2015 art 33(1).

<sup>96</sup> SACL 2015 art 33(2).

<sup>97</sup> Ibid.

in a separate contract, without prejudice to their right to compensation due to removal.<sup>98</sup> Saudi Arabian Corporate Governance Regulations 2019 (SACGR 2019) stipulate that the ordinary general assembly may dismiss all or any of the board members of directors at any time. The ordinary general assembly also, upon the recommendation of the board of directors, may terminate the membership of absent members of the board of directors from attending three consecutive meetings without a legitimate excuse.<sup>99</sup>

The removal of the directors from their office at any time without a reasonable reason does not mean that the provisions of their contracts with the company, including compensation for dismissal, are not applied during the period of validity of their contracts. However, the dismissal due to the directors breaching their duties, whether, by the general assembly, the board of directors or the judicial authority exempt the company from the compensation of the dismissed director,<sup>100</sup> rather, civil or criminal liability may arise against the director because of that breach of duties.<sup>101</sup>

In the judgment declared by the Saudi Arabian commercial court,<sup>102</sup> the shareholders wanted to dismiss the director due to many violations, including not exercising reasonable care, the director's personal interests having conflicted with the interests of the company and a number of administrative violations. Whereas, the articles of association of the company stipulated that the dismissal of the director is by unanimous consent of the shareholders, which has not happened, as the director owns 1% of the company and naturally refuses to dismiss himself. Accordingly, the shareholders turned to the other option, which is to dismiss the director through the judicial authority. With the court having examined the aforementioned violations, the court ruled to dismiss the director without consideration to the rights stipulated in the appointment contract.

It should be noted that claiming the dismissal of the directors in a manner that exempts the company from applying the provisions of the directors' contracts with the company, including expulsion compensation during the period of the validity of their

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<sup>98</sup> SACL 2015 art 165(1).

<sup>99</sup> SACGR 2019 art 19(a).

<sup>100</sup> SACL 2015, arts 74, 81(4), 100 and 165(1).

<sup>101</sup> Further details in (6.1.1 the civil liability) and (6.1.2 the criminal liability).

<sup>102</sup> The Saudi Arabian Commercial Court, 6251/Q (2017).

contracts, is not an easy matter. By examining the judicial judgments that were published between<sup>103</sup> the years 2012-2016,<sup>104</sup> all judicial rulings regarding claiming to the director dismissal, in a manner that exempts the company from applying the provisions of the directors' contracts with the company, were rejected because there are not sufficient reasons that exempt the company from applying the provisions of directors' contracts with the company.

In Islamic law, a question arose as to whether the agent exceeded the powers granted or acted in a wrongful manner to the principal, so would the agency contract remain or be abolished? Islamic law scholars have two opinions. The first opinion, if the agent exceeded the powers granted or acted in a wrongful manner to the principal, then the agency contract is not invalidated, and if the agent is paid for their work, the principal is obligated to pay so. This is because the agency contract is authorising to act in accordance with the powers granted, and if the agents exceed it or act in a wrongful manner, they are liable for their acts; therefore, the wrongful act or exceeding the powers does not affect their position as agents.<sup>105</sup> The second opinion, if the agent exceeded the powers granted or acted in a wrongful manner to the principal, the agency contract is automatically abolished unless the principal authorised the agent to continue, therefore the implications for that are that the agent does not deserve the pay for subsequent work and the subsequent acts of the agent are invalid.<sup>106</sup>

### 3.5 Receivership

A receivership in Saudi Arabian law is placing the disputed money in the hands of a person appointed by agreement of all concerned parties, or failing that the judge shall make the appointment of a receiver if no agreement is reached.<sup>107</sup> The judge may order placement under receivership if the party having an interest in the movable or immovable property presents reasonable cause that imminent danger is feared if the

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<sup>103</sup> After 2017, it has not published any new judicial judgments. Perhaps the reason for this is the new organisation of commercial courts as self-standing courts since October 2017. Where the administrative and commercial courts were in the past before 2017 merged into one court. It may take some time to publish judicial judgments.

<sup>104</sup> For example, see the Saudi Arabian Commercial Court judgments, 6755/Q (2015); 788/Q (2016).

<sup>105</sup> Ali al-Mardawi, *Al-Einsaf fi Ma'rifat Al-Rajih min Al-Khilafi*, First Edition, Sunna Al-Muhammadiyah Press, Tunis, (1956), part 5 p 369.

<sup>106</sup> El-Bahouty (n 43) part 2 p 312.

<sup>107</sup> The Saudi Arabian Law of Civil Procedures 2013, art 212.

property remains in the hands of its possessor.<sup>108</sup> Receivership shall end by agreement of all the parties concerned or by a court judgment. The receiver shall then return the property under his custody to the person chosen by the concerned parties or appointed by the judge.<sup>109</sup> However, it must be established that there are no other remedies other than the receivership to remedy the damage. Because appointing a receiver for a company means destroying the company's reputation in the Saudi Arabian market and the unwillingness of traders to deal with it for fear of the company's unknown future.

### **3.6 Criminal sanctions**

The potential imposition of civil liability against directors may be insufficient to deter directors from some wrongful practices. The Saudi Arabian legislature has adopted criminal liability against some of the directors' acts; as the director may be criminally liable for acts that have been occurred during the company's operations. The criminal liability against the director can be established directly without prosecuting the company.

As it has been mentioned, SACL 2015 stipulates the criminalisation of many wrongful practices by directors, which would violate the integrity, trust, protecting companies, shareholders and the third party, and imposing the appropriate penalties for these practices.<sup>110</sup> The directors' criminal liability derives from one of two things, either through the criminal acts that criminal law has criminalised against members of society or through the provisions on criminal liability in the SACL 2015 and relevant legislation. The SACL 2015 stipulates a number of acts that give rise to criminal liability and impose criminal penalties on their perpetrators. These acts in which the director perhaps make as a result of occupying the position are.<sup>111</sup>

The offence of making false statements or omitting including some data deliberately in the company's financial statements or in the reports of the general meeting is to be noted. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding

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<sup>108</sup> The Saudi Arabian Law of Civil Procedures 2013, art 211.

<sup>109</sup> The Saudi Arabian Law of Civil Procedures 2013, art 217.

<sup>110</sup> SACL 2015, arts 211, 212, 213, 214, 2015 and 216.

<sup>111</sup> SACL 2015, arts 211, 212 and 213.

five million Saudi Arabian Riyals<sup>112</sup> or by either of these two penalties,<sup>113</sup> against any director, official, auditor, or liquidator who knowingly includes false information in the financial statements or in the reports prepared by him for the shareholders or the general meeting; or who omits essential facts from such statements or reports with the intention of concealing the financial position of the company from the shareholders or third parties.<sup>114</sup> The penalties will also be against whoever willfully inserts in the articles of association, bylaws, or other company's documents or in the incorporation license application form or in the documents attached to the incorporation application form, false information contradicting with the provisions of the SACL 2015; and whoever knowingly signs or distributes such documents.<sup>115</sup>

One of the offences is the offence of divulging company secrets. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding a year and a fine not exceeding one million Saudi Arabian riyals or by either of these two penalties.<sup>116</sup>

The SACL 2015 also stipulates the criminalisation of knowingly misusing the company's funds and misusing the powers granted against the company's interests. This act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.<sup>117</sup>

In addition, the offence of not calling the general assembly meeting when the losses of the company amount to half of the paid-up capital or if fails to publish such information in accordance with such losses, is liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.<sup>118</sup> Finally, the Saudi legislature considered that the director who misuses the company for purposes other than that for which it was

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<sup>112</sup> 1 USD = 3.75 Saudi Riyals, Fixed exchange rate.

<sup>113</sup> SACL 2015, arts 211 and 212.

<sup>114</sup> SACL 2015, arts 211(a).

<sup>115</sup> SACL 2015, arts 212(f).

<sup>116</sup> SACL 2015, art 212(b).

<sup>117</sup> SACL 2015, arts 211(b)(c).

<sup>118</sup> SACL 2015, art 211(d).

designated, is an offence that arises the criminal liability, is liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.<sup>119</sup>

In addition, the director may be criminally liable, according to other laws that may relate to the position of director, such as those offences contained in Anti-Forgery Law 2013, which stipulates that the penalty for forgery be by imprisonment for a period not exceeding ten years and a fine not exceeding one million Saudi Arabian riyals.<sup>120</sup> Also, the bribery penalty stipulated in the Saudi Arabian Anti-Bribery Law 1992 is imprisonment for a period not exceeding ten years and a fine not exceeding one million Saudi Arabian riyals or by either of these two penalties.<sup>121</sup> In addition, if the company commits fraud through its acts, the director may be criminally liable if the fraud is committed with his/her consent or connivance with another. If the fraud is committed by committing one of the offences stipulated in the Saudi Arabian Anti-Cyber Crime Law 2007, the penalty is imprisonment for a period not exceeding three years and a fine not exceeding two million Saudi Arabian riyals or by either of these two penalties.<sup>122</sup> As for if the fraud is committed by committing one of the offences stipulated in the Saudi Arabian Anti-Money Laundering Law 2012, the penalty is imprisonment for a period not exceeding fifteen years and a fine not exceeding seven million Saudi Arabian riyals or by either of these two penalties.<sup>123</sup> As for the legal person (the entity - the company), the penalty is a fine not exceeding fifty million Saudi Arabian riyals.<sup>124</sup>

Finally, the directors may be liable for a wide range of offences, including the criminal liability of directors for offences stipulated in Electronic Transactions Law 2007, Anti-Trafficking in Persons Law 2009, Environmental Law 2001, Law of Chemicals Import and Management 2006, Electronic Transactions Law 2007, Anti-Trafficking in Persons Law 2009, Environmental Law 2001, Law of Chemicals Import and Management 2006 and other relevant laws.<sup>125</sup>

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<sup>119</sup> SACL 2015, art 211(i).

<sup>120</sup> The Saudi Arabian Anti-Forgery Law 2013, arts 3, 4, 6, 8, 10, 11 and 13.

<sup>121</sup> The Saudi Arabian Anti-Bribery Law 1992, arts 1, 9, 10 and 11.

<sup>122</sup> The Saudi Arabian Anti-Cyber Crime Law 2007, art 4.

<sup>123</sup> The Saudi Arabian Anti-Money Laundering Law 2012, arts 2, 3 and 27.

<sup>124</sup> The Saudi Arabian Anti-Money Laundering Law 2012, art 31.

<sup>125</sup> See the Saudi Arabian Criminal Procedure Law 2013, art 112.

Islamic law recognises criminal punishment, establishing criminal punishment for the benefit of the community against those found to be criminally liable.<sup>126</sup> One of the criminal penalties recognised in Islamic law is imprisonment.<sup>127</sup> The punishment for imprisonment is stipulated in the Noble Qur'an,<sup>128</sup> and the Prophet Muhammad (PBUH) ordered the imprisonment of a person in some cases,<sup>129</sup> as well as the companions after him.<sup>130</sup> The Prophet Muhammad (PBUH) also ordered the punishment of a fine in some cases.<sup>131</sup>

#### **4. Elimination and limitation of liability**

##### **4.1 Relief from liability by the ratification of directors' acts**

Directors owe general duties to the company. These duties are imposed on directors to act to achieve the purposes of the company, avoid conflicts of interest and not to participate in any business competitive with that of the company and exercise the absolute good faith and fairness in the management of the company's affairs in the interests of the company.<sup>132</sup> However, this legislation also recognises that directors are subject to business judgment mistake, which allowing only the general assembly or the shareholders to relieve directors from liability arising from breach of some of the duties by ratification; without granting the court any power to relieve directors from their liability.<sup>133</sup> This is in contrast to the CA 2006 s.1157, which also grants the courts the discretion in granting relief to directors from their liability if they prove three things. They acted honestly, reasonably and having regard to all the circumstances of the case they ought fairly to be excused. Therefore, the court may relieve the director from liability in whole or in part and on conditions it deems proper.

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<sup>126</sup> Abdel-Qader Odeh, *Islamic Criminal Legislation*, 14th Edition, Al-Resalah Foundation, Beirut, (2001), Part 1, p. 609.

<sup>127</sup> Ibn Qayyim al-Jawziyya, *Al-Turuq Al-Hukmiah fi Al-Siyasah Al-Shareiah*, International Islamic Fiqh Academy, Jeddah, (2008), p 101.

<sup>128</sup> The Noble Qur'an, *Surah Al-Nisaa ayat 15*.

<sup>129</sup> Sulayman Al-Azdi, Sunan Abu Dawood, Al-Maktabah Al-Eisriah, Beirut, (2000), 3629. (Known as Sunan Abu Dawood).

<sup>130</sup> Abu Bakr bin Abi Shaybah, *The Book Classified in Hadiths and Athar*, 1st Edition, Al-Rushd Library, Riyadh, (1988), part 1, p. 132.

<sup>131</sup> Sunan Abu Dawood (n 129) 1719.

<sup>132</sup> SACL 2015, arts 29, 31, 71, 72, 74 and 75.

<sup>133</sup> SACL 2015, arts 30, 31, 71 and 72.

Under the Saudi Arabian Companies Act 2015, the company may ratify the acts of the directors by the company shareholders or the general assembly, for some of the conduct of the director, amounting to undertaking any acts beyond the scope the purposes of the company or participate in any business that conflicts with the interest of the company. This ratification makes the directors more safe from the company's actions or derivative suits. Therefore, directors do not need to certify if they act according to the powers conferred.<sup>134</sup> The Saudi Arabian Companies Act 2015, does not specify who would include in ratification, whether are the current and former directors or only the current directors. However, considering the aim of the ratification, which is making the directors more protected from the company's actions or derivative suits; it can be said that the ratification includes the former and current directors.

In order to ratify directors' conduct, there are three ways. Either by the consent of the shareholders or by the ordinary general assembly or by virtue of an express provision in the articles of association of the company.<sup>135</sup> In the case of a director who declares to the board of directors any direct or indirect interest that s/he may have in the transactions or contracts concluded for the company. Such declaration must be recorded in the minutes of the board meeting, and this director shall not participate in voting for the resolution to be adopted in this respect in the board of directors and the shareholders' meetings. The chairman of the board of directors shall inform the ordinary general assembly upon convening, of the transactions and contracts in which any director has a direct or indirect interest. Such notification shall be accompanied by a special report from the company's external auditor.<sup>136</sup>

Regarding the ratification of the directors' acts due to a breach of the provisions of the company's articles of association, or because of the director's default or negligence, or because of mismanagement of the company's affairs, the Saudi Arabian legislature prevents from certifying these acts. In the context of liability against director because of breaching the provisions of the company's articles of association or due to director's default or negligence or mismanagement of the affairs of the company; articles 78(2) and 165(3) of the SACL 2015, states that the ordinary general

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<sup>134</sup> Ibid.

<sup>135</sup> Ibid.

<sup>136</sup> SACL 2015, art 71(1).



assembly's and the shareholders' ratification and their consent a to discharge the directors from their liability shall not preclude the institution of a liability suit.

#### **4.2 Indemnification against directors' liabilities**

An indemnity clause is a contractual provision that gives benefits to the contracting parties, allowing parties to manage the risks associated with the contract. Because the indemnity enables one party to be protected against liability, by paying one party the losses incurred by the other.<sup>137</sup> Indemnity is used in a wide variety of contexts and there is no general rule as to when the indemnity will be made, depending on the circumstances of the contract.

The Saudi legislature stipulates in the SACL 2015<sup>138</sup> and the former Saudi Arabian Companies Law 1965,<sup>139</sup> that any provision, whether in the company's articles of association or in the appointment contract of the director or any subsequent agreement according to which the company provides an indemnity for the company directors against any liability incurred by them in respect of default, negligence, a breach of the provisions of the company's articles of association, or because of mismanagement of the company's affairs, or breach of trust in relation to the company shall be considered non-existent (void).

Islamic law is consistent with Saudi Arabian law to prevent the indemnity of liabilities. If the agents (directors) are provided with an indemnity against any liability incurred by themselves in respect of their wrongful acts in relation to the principal (the company) this shall be considered void.<sup>140</sup>

#### **4.3 Insurance against directors' liabilities**

Insurance may be a good way that the company directors can rely on to protect themselves from personal liability. It can also be the only means available to relieve themselves of liability when the shareholders of the company and the general assembly are unwilling to ratify the acts of the directors that breached the duties.

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<sup>137</sup> SACL 2015, arts 32, 78(1) and 165(2).

<sup>138</sup> Ibid.

<sup>139</sup> The former Saudi Arabian Companies Law 1965, arts 32, 76 and 168.

<sup>140</sup> Ibn Abidin (n 41) part 1 p 300.

Companies usually purchase insurance for the benefit of directors to attract them and retain them in their positions, because managing a daily business may be surrounded by risk. Therefore, the purpose of insurance is to indemnify for liability incurred by individuals as a result of being in the position of director.<sup>141</sup> The insurance can also cover the court, tribunal and legal fees and other costs the company or the directors personally may incur as a result of such a suit.

The SACL 2015 does not contain any provision regarding the directors' liability insurance, whether by permitting or prohibiting. Perhaps this is due to the fact that the idea of insurance on the liability of directors is considered somewhat new in the Saudi Arabian market. Directors' liability insurance is often called Directors and Officers liability insurance "D&O", which is liability insurance payable to company directors as indemnification for losses or defence costs if the insured suffers such losses as a result of legal proceedings against wrongful acts.<sup>142</sup> D&O insurance is a product subject to price fluctuations, diversity in terms and conditions, scope and size of coverage which is always there is a maximum amount of liability insurance coverage and duration of coverage. The insurance contract, therefore, relies on these terms and trade circumstances, which is negotiable. However, in general, intentional illegal, fraudulent and criminal acts and the acquisition of wrongful profits are not covered by the insurance policy. The consequences of financial problems that the insured had previously aware of before commencement coverage or breach of duty for personal benefit are often excluded from insurance coverage. Therefore, the insured must disclose material facts before contracting.<sup>143</sup>

## 5. Conclusion

The legislation imposes liabilities against the directors to reduce the unwanted consequences of their decisions for the company, shareholders, and third party, and it seeks to prevent the directors from using the position for their personal interests or for

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<sup>141</sup> Stadermann F, Banis C. (2008). From 'Severability Clause' to 'Innocent Directors Clause' in Dutch D&O Policies. British Insurance Law Association. 19-20 available at <<http://www.ph8.nl/upload/catalog/289/410245/5/From%20'Severability%20Clause'%20to%20'Innocent%20Directors%20Clause'.pdf>> [accessed 14 April 2020].

<sup>142</sup> Sprayregen JHM, Friedland JP, Ghasemi M. (2005). Directors & Officers Insurance. Thirty-first Annual Southeastern Bankruptcy Law Institute, Atlanta, Georgia. Authors are affiliated with Kirkland & Ellis LLP, 1-2 available at < <http://www.sbli-inc.org/archive/2005/documents/395189.pdf> > [accessed 17 April 2020].

<sup>143</sup> See the insurance policy of UIB-Saudi and HISCOX.

any other considerations that are not in the company's interest or are not within the purposes of the company. However, the problem is despite the fact that the legislature emphasis the liability of directors through civil and criminal liability, but that the law should be clearer regarding the duties of the directors, which is the basis of liability and not to leave it to the provisions of Islamic law, or scattered in SACL 2015 and the Corporate Governance Regulations.

Of the duties of the director stipulated in the SACL 2015 is the duty to be a liquidator upon the dissolution of the company. This duty is stated by the Saudi Arabian legislator in the SACL 2015, but the lacuna is that the Saudi Arabian legislator does not clarify the mechanisms of the directors' conduct during the period close to the preceding the company dissolution and being a liquidator, just as the legislator does not indicate a mechanism that how the liquidator will hold herself/himself accountable when s/he was a director. Because it is unreasonable to expect that a suit will be brought against themselves. Basically, the liquidator's function is to examine the directors' work before dissolution of the company, and if the liquidator was the director, then the purpose of the liquidator's function is negated. This may create a state of uncertainty, such as if the directors knew that there was no reasonable prospect that the company would avoid going into insolvent liquidation, so they are between two options, either acting in the interest of the company (shareholders) or acting in the interest of the creditors as considered they will be liquidators. Acting as a director means maintaining the company's assets; while acting as a liquidator means converting the company's assets into cash money. In the event that the directors knew that there was no reasonable prospect that the company would avoid going into dissolution or insolvent liquidation, and the price of the company's assets is high, will the director act as a liquidator and sell these assets at the best price, which will be in the interest of the shareholders and creditors after the liquidation, or the directors must wait for the company to be dissolution and be liquidated and then sell assets at the current price, which may decrease. Also, the legislator does not address the directors' interests when they act as liquidators in the event of insolvency and the impact of this on the creditors' interest when the directors themselves are shareholders or creditors.

The Saudi Arabian legislator should enact a law that is similar to the UK Company Directors Disqualification Act 1986 to protect companies and the Saudi Arabian market, provided that its provisions do not contradict the provisions of Islamic law and human rights principles. The UK Company Directors Disqualification Act 1986 can be used by Saudi Arabian legislator as legal transplantation, with some modifications needed. In the proposed Saudi Arabian law, the reason for disqualification a director should be as in the UK Act on the basis of misconduct and unfitness. Misconduct can be expanded to include a person's conviction of any criminal offence during the past 5-7 years, being insolvent or bankrupt, contravention of the provisions of the financial markets and commercial business rules, non-compliance with the provisions of the laws, regulations and continuing default and negligence and the like. As for disqualification due to unfitness, the person's conduct is unfit for the concern of the company's management or the person's physical or mental health is unfit for the company's concern or for the public interest. The directors' disqualification also in the proposed law could be effected in two ways, either by the court or through the Minister of Commerce so-called administrative equivalent, which is voluntary without the need for judicial proceedings, with some privileges given to the Minister of Commerce, such as reducing the disqualification period. It is also possible to cooperate between countries, Saudi Arabian and the UK and others in exchanging information about people disqualified from being a company director in order to protect the markets.

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