# The New Saudi Arabian Companies Law, And Its Failure to Protect Minority Shareholders in Public Joint Stock Companies

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## Abstract

Minority shareholders in public companies represent a significant component of today's corporate regulations. Numerous studies have illustrated how safeguarding them with decent protections could correspond to the development of the nation's stock exchange and attract investments. Indeed, the importance of minority shareholders guided the OECD to urge the nation's legislators to absorb these protections into their domestic laws. In addition, the Saudi government declared its long-term economic vision for the nation to be fulfilled by 2030. One important element of this vision is to polarize foreign investments. To achieve the previous intention, Saudi Arabia needs to adjust its legal infrastructure to meet its objective.

Saudi Arabia passed its newly reformed corporate law at the end of 2015. One intention of this law's passage was to attract foreign investment. However, this thesis argues that the new corporate law has failed to protect minority shareholders of publicly held joint stock companies and, hence, would fail to attract investments. This thesis sheds light on the importance of recognizing the ownership structure of the Saudi stock exchange when evaluating the protections the new law carries. This thesis argues that the substantial safeguards and protections the law provides have failed to protect minority shareholders. The significant deficiency, this thesis explains, in the Saudi companies law is its failure to provide practical private enforcement tools, which minority shareholders of public joint stock companies could deploy in the event of expropriation and abusiveness. This thesis proposes appropriate remedies that could solve the law deficiency in regards to minority shareholders.

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# Dedication

I dedicate this dissertation to those who embraced me with love, care, and prayers, in particular, to my kindest mother, Hind, and the greatest father, Ahmed. Thank you for being my role models. You are the main reasons behind my accomplishments.
I also dedicate this dissertation to my brothers and sisters:
Ziyad, Yasser, Nouf, Sarah, and Othman.

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# Chapter 1: Thesis Introduction

## 1.1: introduction

Saudi Arabia is a country that critically depends on oil production. Since the 1960s, oil income has represented more than 90% of the Saudi government's revenue. When oil prices dramatically decreased in late 2014, Saudi government grew increasingly concerned about its severe reliance on oil. Since then, the oil market has been exposed to severe fluctuations. In 2015, the Saudi government decided to confront this serious challenge and announced an urgent need to diversify the country's income. The Saudi government declared a new vision for the country's economy to be fulfilled by 2030. The main principles of this vision are to reduce the country's reliance on oil, minimize the government's role in the domestic economic cycle, and attract foreign investment to the Saudi market. Yet, to accomplish this vision, Saudi Arabia needs to adjust its legal framework to absorb the upcoming changes. Among other reforms, Saudi Arabia needs to enact regulations that attract investments. The Saudi government understands it is important to update its legal infrastructures. For instance, it passed the new Saudi Companies Law at the end of 2015, which significantly reforms the old version of the law. The Saudi commercial and industrial minister stated that one goal the law seeks to accomplish is to stimulate the Saudi economy for initiative and investment.

One important method to achieve the previous goal is to protect the weakest class of investors, the minority shareholders. The theory that protecting minority shareholders will develop the economy of a nation is supported by well-defined corporate literature. It appears that the Saudi government also believes in this theory. To clarify, the Saudi Arabian king personally participated in the Group of Twenty meeting (G20), the annual gathering of heads of state of the top 20 economies in the world. During the November 2015 G20 meeting in Turkey, the Saudi King and other leaders endorsed the Principles of Corporate Governance, which was prepared by the Organization for Economic Co-operation and Development (OECD). One standard of these principles is protecting minority shareholders, the weakest class of investors in the market. Hence, Saudi Arabia has already considered and endorsed the importance of protecting minority shareholders.

One of the most significant challenges that minority shareholders face in public companies is the problem of agency. The separation between those who manage a company (the agent) and those who own it (the principal) creates the principal-agent problem or the managerial agency cost. Three methods can assist in reducing the costs associated with this problem. The first method is the concept of a competitive market, which is considered a significant element in solving the principal-agent problem. In a product market, the value of a company is damaged when its officers expropriate company funds for their own personal interest. Thus, a competitive market would help ensure that no one person or persons would expropriate the company funds, which in turns assist in reducing agency cost. Second method is corporate governance's norms and best practices. Putting into place norms and practices that demand, for instance, an independent board of directors and an external auditor could help to solve the costs associated with the principal-agent problem. And the third and the most important method is legal intervention. In other words, legal rights that are provided to company shareholders, such as the right to file derivative suits, could work notably in reducing managerial agency cost.

This thesis argues that the new Saudi Companies Law fails to provide minority shareholders of public joint stock companies with the necessary legal rights that assist them to overcome the principal-agent problem and is therefore unsuccessful at meeting the Saudi government's intent. Indeed, the legal rights or tools that Saudi legislators provide to minority shareholders of a joint stock company to redress managerial agency problem were not sufficient. To clarify, Saudi corporate law states three substantial tools to respond to and reduce managerial agency costs: the right to file derivative suits, the right to request reduce managerial agency costs: the right to file derivative suits, the right to request judicial investigation to those who own 5% or more of joint stock company shares, and the right to have a criminal investigation and prosecution to company management that violates the Saudi corporate law criminal sanctions' provisions. This thesis thoroughly analyzes these tools and illustrates how they fail to solve the agency problem, especially in regard to minority shareholders in public joint stock companies.

This thesis demonstrates why the ownership structure in the Saudi stock exchange (*Tadawul*) is a significant factor when evaluating the effectiveness of the pervious Saudi corporate law protections from a minority shareholder's perspective. The ownership structure in the Saudi stock market and the protections provided by Saudi corporate law lead the author to argue that the law did not grant minority shareholders the right to litigate against their management on behalf of a corporation when management abuses its power. Also, this thesis argues that the Saudi public prosecutor, the entity that is responsible for investigating and prosecuting Saudi corporate law violations, such as reporting misleading information, is not an entirely independent entity. Due to the Saudi stock exchange ownership structure, this dependence will likely affect its work efficiency. Thus, minority shareholders might fail to benefit from the deterrence the Saudi public prosecutor provides when it prosecutes board members who violate the law.

To seek remedies to the Saudi Corporate Law deficiency in protecting minority shareholders of publicly held joint stock companies, this thesis looks to similar concepts in different legal systems to identify the successful tools that solve minority shareholder challenges in different nations all over the world. Zweigert and Kotz indicate that lawmakers around the globe need to rely on comparative law to enact decent regulations. Therefore, this thesis offers a comparison study for the purpose of seeking possible solutions that Saudi lawmakers should consider.

To accomplish the goal of this thesis, the dissertation is divided into eight chapters. Each chapter exemplifies a significant element in drawing the big picture of this thesis. Chapter 1 introduces this thesis and sets its boundaries. This chapter is considered an overview of the information available on this thesis. It elucidates why the Saudi government desires to protect minority shareholders. Also, the chapter explains the research questions, which this thesis seeks to answer. The chapter demonstrates the research methodology this thesis deployed to gather its information.

Chapter 2 illustrates the importance of protecting minority shareholders in the nation's laws and regulations. This chapter is basically a literature review about the justification to include shareholder protections in corporate law. It highlights why states around the globe, including Saudi Arabia, should consider granting minority shareholders in public companies with descent protections that safeguard them form expropriation by company controller. The chapter discusses the example of OECD corporate governance principles standard of 2015 as the best practice. It describes what this standard states about shareholder safeguards, particularly for minority shareholders.

Chapter 3 presents the concept of ownership structure in the equity market and its importance. The chapter explains the variety of ownership formats that exist in today's stock exchanges and the challenges each type raises. The chapter clarifies the importance of recognizing the ownership structures of a stock market when designing the later regulations. Also, the chapter investigates the extent to which OECD corporate governance principles have recognized this concept. The chapter finishes by highlighting Saudi stock exchange ownership structure. It addresses the variety of formats of ownership structure in the Saudi stock exchange. It emphasizes, though, the most prevalent legal structures that dominate company ownership in the Saudi stock exchange.

Chapter 4 highlights the Saudi Arabian legal system and features that affect Saudi company law and JSC protections. The Saudi legal system is an essential element to understand before the thesis starts explaining shareholder protections in the new Saudi corporate law. This thesis explains the current picture of the Saudi legal system with all its ambiguity and apparent confusion. Also, the chapter addresses the government branches in the Saudi Arabia legal system. These data would be essential to recognize the legal format that enacted the newly reformed Saudi corporate law and the court system that enforce it.

Chapter 5 introduces the new Saudi corporate law and provides a brief overview. It explains the type of companies the new law recognizes. It also clarifies the joint stock company. The chapter then states the most significant protections the law provides to joint stock company's shareholders. The chapter divides these protections between direct and indirect safeguards. The chapter finishes by highlighting protections that are designed for minority shareholders.

Chapter 6 evaluates the safeguards the new Saudi corporate law provides to minority shareholders to minimize agency problem. The chapter explains why the new protections the Saudi corporate law introduces for the first time likely will fail to achieve their objective. The chapter then illustrates why a Saudi derivative suit is not a potential tool for minority shareholders to use to offset agency problem. The chapter further demonstrates the deficiency of the judicial investigation tool for shareholders who possess 5% or more of the company shares. Finally, the chapter explains the failure of delegating the authority to prosecute violators of corporate criminal provisions to a Saudi public prosecutor.

Chapter 7 addresses the possible remedies that could cure deficiencies in Saudi corporate law in responding to agency problem. It starts by introducing a potential solution to the deficiencies of the derivative suit. It explains the diversity of derivative suit mechanisms that exist around the globe and evaluates these mechanisms to seek an appropriate example that suits Saudi circumstances. The chapter then addresses the probable remedy for inadequate judicial investigation tools. Finally, the chapter introduces the possible solution of delegating authorities to prosecute wrongdoers via Saudi public prosecutor.

Chapter 8 concludes the arguments of this thesis. It starts by confirming the information this thesis has previously introduced. It then states the genuine problems in the Saudi corporate world, i.e., minority shareholders of public joint stock companies do not have decent protections to shield them from majority shareholders' abuse. The chapter finishes by stating a number of recommendations that could solve deficiencies of Saudi corporate law in its treatment of minority shareholders.

## 1.2: Research Questions

The primary object of this thesis is to navigate protections for minority shareholders in publicly held joint stock companies under the new Saudi corporate law and assess whether these protections are sufficient to safeguard them. To accomplish this mission, this thesis raises a number of questions:

1. What is the importance of safeguarding minority shareholders of public corporation with statutory provisions?
2. What does the OECD corporate governance principles standard of 2015 say about shareholder protections generally and minority in particular?
3. What is the significant protections Saudi corporate law provide to shareholders of a public joint stock company? And are these safeguards adequate to protect minority shareholders?
4. What are the possible remedies that could solve Saudi corporate law deficiency toward minority shareholders?

## 1.3: Research Methodology

Critical analysis and comparative study are the primary methods this thesis relies on to illustrate its argument. This thesis addresses the literature on a variety of relevant areas, such as minority shareholders' importance, stock exchange ownership structure, and corporate law policy and regulations. This thesis critically analyzes these literatures and sheds light on the Saudi corporate law provisions that specify shareholders' protections. The purpose here is to indicate how these protections are unsuccessful in safeguarding minority shareholders of a public joint stock company. In addition, this thesis compares other states' experiences as potential remedies to cure Saudi corporate failure. The comparison is to indicate how similar concepts in other states work well to protect minority comparison is to indicate how similar concepts in other states work well to protect minority shareholders while they were unsuccessful in the Saudi corporate law model. This thesis finally evaluates these potential remedies to identify the models that could suit the Saudi legal system.

### 1.4: Research Scope and Limitations

The scope of this research is restricted to shareholder protections in the newly reformed Saudi corporate law. There are a number of laws and regulations that protect shareholders in publicly held joint stock companies other than Saudi corporate law, such as *Nidam Al-taswiya Alwaqia mn Al-iflas* (compromise to avoid bankruptcy law), Nidam *Al-mahkma Al-tejareia* (commercial law), *Nidam Soq Al-mal* (capital market law), and *Hawkmat Al-sharikat* (corporate governance regulation). However, this thesis will focus on public joint stock companies' protections accorded in the new Saudi Companies Law merely. The justification behind this concentration is the fact that there is plenty of Saudi corporate literature providing information and criticism about shareholder protections under the old Saudi corporate law and other laws and regulations. Yet, because the Saudi Companies Law is so new, there is scant literature available on the subject. Therefore, this thesis concentrates its attention to navigation and evaluation of the protections the new Saudi Corporate law provides to minority shareholders.

## Chapter 2: The Importance of Minority Shareholder Protections and the OECD Position

### 2.1: Introduction

One of the goals of this thesis is to challenge the new Saudi corporate law tools that were designed to address the principal-agent problem. However, before the thesis can evaluate these tools, it should address whether the element of minority shareholder protections is significant enough to be considered. Indeed, the concept of protecting minority shareholders has a significant place in corporate scholarly literature. This concept rises to the surface whenever the media reports on corporate scandals. For instance, the Asian financial crises in 1997 had been linked to the poor protections that minority shareholders held in public companies. Studies have illustrated how majority shareholders in the majority of companies listed in Asian stock exchanges (often family majority shareholders) expropriated minority shareholder investments to benefit themselves. Therefore, minority shareholders' rights have always been a cornerstone of corporate governance literature.

This chapter will further investigate the definition of minority shareholders and what justifies their importance. The chapter starts in Section 2 by addressing the previous inquires. The chapter then shifts to seek the best practice of corporate governance standards and whether such standards recognize and promote the protections of minority shareholders. The chapter addresses the Organization of Economic Co-operation and Development (OECD) and its corporate governance principle standard of 2015 as the chosen best corporate governance standard. The chapter seeks to discover what OECD corporate governance principles generally have to say about shareholder protections, and minority shareholders in particular.

### Section 2: Minority Shareholders' Protections Significance

A legitimate concern that often arises in the corporate governance literature is: Why is it important to protect minority shareholders? Understanding the concept of minority is it important to protect minority shareholders? Understanding the concept of minority shareholders will promote this concern. Minority shareholders own company shares but not enough to reach a threshold that will enable them to have some semblance of control in regards to company decisions. It may seem that the law has little reason to care much about these small investors. This section will try to provide justifications for the importance of protecting minority shareholders in any economy. A leading article that is often cited regarding the importance of investors' rights and minority shareholders is "Investor Protection and Corporate Governance" by La Porta et al., which has greatly contributed justifications for this importance. Three major reasons illustrate the need of protecting minority shareholders.

### 2.2.1 Stimulates growth in the economy

First, protecting minority shareholders stimulates growth in the economy. This theory that a nation's economy will grow if its regulations protect minority shareholders with solid safeguards rests on the concept that it also will result in a larger pool of investors investing in the market. The presumption is that the stock market is an efficient avenue to fund consumption and stock market growth is well in the economy's growth. A significant method to develop a stock market is by increasing the volume of capital that accesses it. The advocates of this theory indicate that strengthening minority shareholder rights makes this mission possible.

Reasonable investors will not participate in an investment opportunity unless their investments are protected. Investors, especially minority shareholders, need protection from possible expropriation by the firm's officers. A study found that in emerging markets, when the market offers weak safeguards to minority shareholders, majority shareholders are stimulated to steal minority investments. Unless there are legal safeguards protecting minority shareholders from management expropriation, cautious small investors will not invest in the market. On the other hand, if regulations protect minority shareholder investments from expropriation, ensuring that minority shareholders have the means and tools to protect themselves, then the amount of capital invested in the stock market will increase. This increase will lead to growth in the stock market, which will then spur growth in the nation's economy.

### 2.2.2 Reduce firm agency costs

Second, strong minority shareholder safeguards will shrink firm agency costs and benefit all parties. There is a conflict of interest between the firm's officers and the firm's shareholders. The conflict is that the firm's officers will seek their own personal advantage over the firm's advantage. Sometimes, their interest will not conflict; meaning the interest of both company shareholders and officers is united, and officers would seek to maximize firm interest and not their own personal interest. However, the point here is that the cost of monitoring officers' behavior is pricey and negatively affects the firm's budget. In fact, shareholders are ready to provide a generous payoff to a firm's officer when the former is assured that the latter is working genuinely in the company's best interest. Regulations that prevent officers from appropriating shareholder investments and assure minority shareholders that their investments are protected are beneficial to both management and shareholders. They also make the firm's stock more valuable because minority shareholders do not struggle to sell their shares when the potential stock buyer knows that he or she is not purchasing expropriated shares. Therefore, the assumption that firm officers are constrained from appropriating shareholder funds increases the sale of the firm's stocks and decreases agency costs.

### 2.2.3 Management efficiency

Third, minority shareholder rights most likely result in efficient management behavior. As previously mentioned, company officers may place their personal advantage behavior. As previously mentioned, company officers may place their personal advantage over the firm's advantage if there are no restrictions to restrain them. However, when minority shareholders have solid protections that enable them to deter officers who might expropriate their investments, firm officers spend their time developing the firm's value instead of expropriating it. Indeed, the better they perform in managing the firm, the higher potential for personal advantage they might receive. This personal advantage takes two forms: shareholders award them generously for their efficient management, and their labor skills are considered beneficial in the labor market. These incentives help a firm's management officers behave efficiently while leading the company.

Finally, protecting minority shareholders is important to firms that cross-list stock on foreign exchanges. Cross-listing is defined as the process of listing a company's common shares on a foreign stock exchange while also trading stock on the stock exchange of the company's nation of origin. For instance, SONY is a Japanese company. SONY shares are traded on the Japanese stock exchange and the New York Stock Exchange at the same time. By cross-listing on a different stock exchange, a company submits itself to the regulations of the foreign stock market. The foreign regulations may be stricter than the home country's regulations. One study found that a company with poor minority shareholder protections tends to cross-list its shares in a foreign stock exchange that offers strong minority shareholder rights. One reason for cross-listing is to raise foreign capital. Cross-listing shows that the market knows the importance of minority shareholder protections by taking advantage of the strong minority shareholder protections in foreign markets.

## Section 3: Organization of Economic Co-operation and Development and Minority Shareholders

The documented importance of minority shareholder protections guides the Organization of Economic Co-operation and Development (OECD) to advocate national regulations to safeguard minority shareholders alongside other protections for all market participants. The OECD is an international organization for governments of developed countries, which acts as an arena to share best market practices and policies to promote global economies and assist development on an international scale. This organization was founded in Europe around the middle of the twentieth century after World War II. Its original name was Organization for European Economic Cooperation (OEEC). The organization's mission at that time was to oversee the implementation of the Marshall Plan in European countries. After the OEEC accomplished its original mission, the organization opened its doors for nations outside of Europe to join its convention and share the advantages it gained. With the United States and Canada signing on, OEEC was renamed the Organization of Economic Co-operation and Development.

The OECD is considered a forum for governments to exchange their expertise and knowledge in confronting economic challenges in an effort to piece together the best possible solutions to common challenges. The OECD's efforts reach a variety of areas such as agriculture, health, education and corporate governance. In fact, the OECD places a lot of attention toward developing standards for corporate governance. The standards the OECD promotes include the major principles that every domestic law should support the development of "economic efficiency, sustainable growth, and financial stability". This focus began after the Asian financial crises in the late 1990s. The first OECD Principles of Corporate Governance were published in May 1999, followed by updated versions in 2004. Recently, the OECD updated the 2004 version and launched the 2015 Corporate Governance Principles. The new recommendations were presented at the G20 meeting in Turkey. Representatives from the top-20 world economies, including Saudi Arabia, endorsed the OECD's new corporate governance standards.

One problem the corporate governance standards address is the separation of function between management (agent) and ownership of a company (principal). In 1932, Berle and Means first identified the problem of separation between management and ownership. The authors pointed out that the problem with modern public corporations is that they are not managed by their true owners. Berle and Means revealed that what they that they are not managed by their true owners. Berle and Means revealed that what they call a modern "quasi-public" corporation is controlled by owners who hold very few shares of the company. The company's controllers, according to Berle and Means, make more income from serving in management positions than from the return on the shares they own. This separation between management and ownership can be a vulnerable point for company shareholders. Possible expropriation, either by management or controlling shareholders, can be expected in the absence of legal protections. This segregation dilemma is discussed at length in corporate literature. Contributing to these discussions, the OECD advocates for the protection of all major market participants, such as shareholders, creditors, and management.

### 2.3.1: Shareholder Protections Under The OECD

The OECD's corporate governance standards are divided into a number of principles, and each principle contains a number of provisions that describe it. The main principle that affects company shareholders specifies the need to treat them fairly and justly. This is a vague principle, but the OECD expounds by indicating a number of practices that shareholders of a listed company must enjoy. A listed company in this context is defined as a public firm traded on a nation's stock exchange. The practices, which OECD's corporate governance standards address, resemble the basic rights each shareholder is entitled to receive. This subsection will address these rights and deliver an explanation for each.

The first right shareholders must enjoy is protection of their stock entitlement. This means shareholders must enjoy legal recognition of ownership of their stocks and that these shares should be considered as real assets. This legal entitlement must allow shareholders to exercise full control over their shares. They can transfer ownership if they desire. Moreover, shareholders have the right to attend their company's general assembly. The board of directors should answer the shareholders' questions during this assembly. The general assembly has the ultimate power to elect the board of directors of the company, who in turn manage the company on behalf of the shareholders. The OECD insists that the compensation of the board of directors and officers must be disclosed before their election.

In addition, the OECD's principles highlight that every shareholder has the right to know a general assembly meeting's agenda in advance and to cast ballots when the general assembly vote. The process of casting ballots at the general assembly should be facilitated. The principles urge the adoption of voting methods that facilitate shareholder voting and abstain from placing obstacles in front of foreign shareholders who own cross-listed shares. For instance, a company may use technology to permit shareholders to cast ballots without forcing shareholders to attend the general assembly in person.

OECD's principles emphasize that every shareholder must have the right to receive dividends and access company data. When a company makes a profit and decides to distribute a portion of it, officers cannot decide who will receive dividends and who will not. In other words, OECD's principles insist that stockholders who belong to the same class of shares (e.g., common shareholders) must be treated fairly with no preferred treatment of some shareholders of the same class over others. For example, directors and officers cannot pay more dividends to controlling shareholders than to minority shareholders. Also, shareholders must have the right to access the company's information. Corporate directors and officers cannot prevent shareholders from accessing this information. The information that should be provided is the type of data that generally must be disclosed by the company in its financial statements or answers to shareholder questions that will not jeopardize the company's residual shareholders. Directors and officers also must declare any substantial data to their shareholders. Substantial data in this context means any information to which reasonable investors would react.

Furthermore, in regard to material decisions that affect the entire company, such as reforming the company's charter, issuance of additional shares, sale of a substantial number of shares or sale of the corporation, The OECD's standards assert that shareholders must be informed of these material decisions in a timely manner and be allowed to vote on these decisions. Directors and officers cannot act on these types of significant corporate decisions without the approval of the company's shareholders. This is considered an important protection to safeguard the company's shareholders.

One important principle the OECD adopted is the duty of loyalty. The duty of loyalty is deeply rooted in Anglo-Saxon legal literature. The duty of loyalty asserts that when making any decision as corporate fiduciaries, the directors and officers must act without personal economic conflicts. The transaction should be identified and managed in a manner that protects the interests of the company and its shareholders. The direct and implied interests of the directors should be treated similarly.

Another important principle emphasizes the importance of organizing the procedure for acquisitions and mergers in a way that is clear to shareholders. To illustrate, when any significant change occurs in a corporation, such as a merger or acquisition, the principles demand that every shareholder should be made aware of his or her rights ahead of the occurrence, and the transaction should take place with full transparency. In the event of an unwanted takeover, the board of directors and officers may employ anti-takeover defensive tactics. The principles insist that these defensive tactics not be at the expense of minority shareholders. For example, the board of directors and officers are not allowed to employ this defensive tool with the intent to avoid their corporate responsibilities, particularly their fiduciary duty. The principles of the OECD assert that directors and officers must maintain their responsibilities toward shareholders throughout any event during the company's life.

All of the practices and rights previously mentioned are the basic rights of each shareholder in every listed company under the OECD's corporate governance principles. These rights fall under the principle requiring the just and fair treatment of all corporate shareholders. This principle is purposely vague. Any practice that helps to achieve fair and just treatment of shareholders is strongly welcomed and should be adopted even if not specifically mentioned in the OECD's corporate governance publication.

### 2.3.2: Minority Shareholder Protections in the OECD

All the rights discussed in the previous section are considered as being the rights of all shareholders, including minority shareholders. However, there are specific shareholder rights that are significant to minority shareholders in particular. Statistically, the word "minority" is mentioned 13 times in the OECD's 2015 Principles of Corporate Governance. These rights circle around the concept of safeguarding minority shareholders from the abuse of the majority shareholders.

According to OECD standards, minority shareholders should have the right to add topics to the meeting agenda. The agenda of the general assembly is determined by the board of directors. Often, a single shareholder cannot add a new topic to the agenda without the approval of the board of directors. However, OECD principles seek to allow minority shareholders who own a reasonable threshold of shares, such as two percent or five percent, to propose a topic for discussion at the general assembly meeting, without the approval of the board. There is no threshold of ownership set by OECD standards. For instance, a listed company has shares that are owned substantially by A, B, and C shareholders. Each one of them owns 28% of the company. Thus, A, B, and C own 84% of the company. The rest of the shares are owned by many minority shareholders. The company set the threshold for proposing a topic for the agenda at 15 to 20%. In this example, none of the minority shareholders have the right to propose topics for the agenda. However, according to the OECD, the threshold to propose topics to the agenda of the general assembly must consider minority shareholder ownership and give them a chance.

The OECD's principles assert the need to provide minority shareholders with powerful tools to offset management recklessness. For instance, in the event that management breaches its fiduciary duty and leads to a company's losses, minority shareholders should have the right to redress this loss with effective tools. The principles mention the derivative action as one of the devices minorities can employ to challenge company management when the company has incurred losses. In other words, the principles seek to remove any obstacles in front of minority shareholders that may stand in the way of their rights to litigate against the company's management in court. Any obstacle that prevents shareholders from litigating the management's bad judgment should be banned. However, the principles also highlight the need to establish a standard that prevents excessive litigation. While this protection safeguards all company shareholders, the OECD has specifically included it in minority shareholders' protections.

One main objective of the OECD's principles is to promote the protection of minority shareholders from majority abuse. The principles give a number of examples. One example addresses granting minority shareholders a preemptive right. If minority shareholder owns five percent of company shares and the company decides to issue additional stock, the additional stock could result in the minority shareholder ownership falling below 5%. A preemptive right would help prevent the additional stocks from diluting the minority shareholder's ownership.

Another tool the OECD proposes is adopting a supermajority voting standard for some company decisions. A company's ordinarily general assembly makes decisions based on a simple majority vote. That is, 50% of the vote, plus one. However, the OECD proposes to raise this standard to a supermajority when the decisions are significant for the company. Furthermore, the OECD's principles suggest cumulative voting when the company holds a general assembly meeting to vote for its board of directors. Another tool that corporate law could embrace to fight majority abusiveness is appraisal rights. To illustrate, if a company decides to delist its stock from the stock market, minority shareholders end up in a significant disadvantage. The is due to fact that there would be no market to sell their shares, and their company management would not be obligated to follow the regulations of the stock exchange. Appraisal rights guarantee protection of minority shareholders by assuring them that the majority may have to offer them an option to purchase their shares. The value of minority shares should be determined by an independent entity.

### 2.4: Conclusion

In conclusion, the corporate governance literature illustrates the importance of protecting minority shareholders. Indeed, assuring minority shareholders of safeguards has been introduced as a method to develop national economies. The OECD's corporate governance principles pay significant attention to the protection of minority shareholders. The OECD's principles advocate the acknowledgment of shareholders' rights to bring suit against their company's management for bad decisions and to prevent majority shareholders from abusing the minority. The next chapter will move on to describe the importance of recognizing the ownership structure on protecting minority shareholders in publicly held companies.

## Chapter 3: The Importance of Ownership Structure for Minority Shareholders

### 3.1: Introduction:

The ownership structure of public corporations has been extensively considered in both economic and legal literature. The understanding that the ownership structure is important began in the early twentieth century. Berle and Means, in their book *Modern Corporation and Private Property*, understood that the problem of companies traded in the 1930s stood in the shape of their ownership structure. According to Berle and Means, the main ownership structure was dispersed ownership. In dispersed ownership, shareholders own very few shares of the company. In the absence of controlling shareholders, officers must make most decisions. This issue raised the problem of agency. To clarify, the challenge, which the Berle and Means company model brings, is the separation between management (agent) and ownership (principle). This separation permits the companies' management to take advantage over a company's dispersed owners. The concept of restricting the company's management from abusing the company's owners emerged in corporate literature, especially after the Great Depression in the United States. The idea here is that Berle and Means guided the literature into deeply researching the importance of recognizing the ownership structure of companies when drafting laws with respect to corporate governance.

This chapter will examine the type of corporate ownership that exists in today's stock markets and highlight the corporate governance challenges each type brings. There are two types of ownership structure that dominate today's stock markets: dispersed ownership and concentrated ownership. Dispersed ownership is identical to what Berle and Means discovered, and concentrated ownership stands for the shareholders who own a big chunk of company shares that enable them to influence company decisions. The chapter will speak in Section 2 about the dispersed ownership structure and the legal issue this model brings. Section 3 will address the concentrated ownership structure and highlight the challenges shareholders confront in this model. The chapter, in Section 4, will indicate the importance of recognizing the ownership structure in corporate governance. Section 5 seeks to determine whether OECD corporate governance principles have recognized the importance of recognizing the ownership structure. Finally, section 6 will explore the ownership structure of the Saudi stock exchange, as they would be critical in evaluating the protections Saudi corporate law provides to shareholders generally and minority in particular.

## Section 2: Dispersed Ownership Structure

As previously mentioned, dispersed ownership is the model Berle and Means highlighted in their 1932 book. This means that the modern firm's ownership is dispersed among multiple small owners. Berle and Means discovered that modern corporations tend to not have a single shareholder who owns the majority of the corporation shares that entitle him or her to run the company. This discovery was counter to the earlier business experience when families and farmers were themselves the owners and the managers of their ventures. Berle and Means found, in contrast, that the trend of modern corporations was the fact that their shares were divided among multiple small owners. Because the owners were small investors who did not hold adequate shares to manage the company, this fact, according to Berle and Means, resulted in the separation between controlling the firms and owning them. In other words, the agency problem between the agent (managers) and principal (dispersed shareholder) was the challenge of modern companies.

The owners of modern companies were forced to let others run their enterprises. These owners are either working in other industries, did not have the knowledge to run the company, or were simply passive investors who did not have the interest to run venture in which they hold shares. And because the dispersed shareholders hold a small number of shares, they did not have the incentive to monitor the company management. Additionally, Berle and Means illustrated that, even if these small shareholders decided to monitor their management, the law did not provide them any tool to do so. The point here is that these small shareholders were retail investors who sought to have return on their investments. This fact resulted in management expropriating the company funds for their own personal advantage. The management, in the absence of shareholders' protections, might lead a company in a method that jeopardized returns to the company and its shareholders.

Dispersed ownership leads to a conflict of interest between management and shareholders. As previously mentioned, dispersed shareholders have little incentive to monitor their company management. This monitoring vacuum works well for company management because the personal revenues they receive are higher than the proportionate firm revenues. That is, management salaries and bonuses are much higher than returns to shareholders the company would distribute in the form of dividends. This is the conflict of interest between the dispersed shareholders and the company management. Berle and Means suggest solving this issue by increasing the legal safeguards for shareholders and increasing their control over the company management. These solutions would deter company management from any action that might jeopardize the shareholders. One way to resolve this conflict of interest is obligating corporations to have a board of directors that oversees company management. Another way is stock options for management, which might align the interests of the managers with shareholder interests.

La Porta and others found that countries with strong shareholder protections, such as common law countries, tend to have a dispersed ownership structures. The United States (U.S.) and the United Kingdom (U.K.) are famous examples of jurisdictions that utilize dispersed ownership structures in their stock exchanges. It is worth mentioning that, while this ownership structure was dominant in the stock exchange in the U.S. during the 1930s, this structure began to shift to a concentrated ownership structure. The next section describes this ownership structure and its features.

## Section 3: Concentrated Ownership Structure

The second ownership structure that exists in today's corporations is concentrated ownership. Concentrated ownership means that firm ownership is concentrated in a single or multiple parties that own 20% or more of the company's voting shares. LaPorta surveyed the top-20 leading economies around the globe. It was concluded that 20% ownership of the company voting shares was sufficient to entitle a holder to control the company and become controlling shareholders. Voting shares are shares that entitle holders to a number of rights, including voting on important decisions in the company's general assembly. La Porta insisted that, when evaluating whether a firm has a concentrated ownership, the voting power and not the cash flow rights should be considered. Cash flow rights mean the actual ownership the shareholders own in the listed firm. Voting power determines who controls the company, especially when the company has different classes of shares. Some of these classes of shares do not have voting powers, such as preferred shares. Here is a simple example of the concentrated ownership structure. A owns 20% of the company's common shares. This entitles him to a 20% voting power in company decisions. B owns 70% of the company's preferred shares. B has no voting rights. Thus, A is considered an owner of concentrated shares, even though the cash flow rights A possesses are less than the cash flow rights B possesses.

There is another form of concentrated ownership with a pyramid structure. In this format, the majority shareholder creates a group of companies that have a parent company and subsidiaries. This majority shareholder would hold substantial controlling shares in the parent company of the group, which, in turn, establishes a subsidiary. This subsidiary establishes another subsidiary, and the process moves on. The majority shareholder has substantial ownership in the parent company, and minor ownership in the subsidiaries in different layers. This majority shareholder would have a lot of control over all the subsidiaries, regardless of the actual cash flow right in the different layers of companies. This is a complicated structure, so here is an example to simplify. A owns 40% of B company. B company owns 40% of C company. C company owns 60% of D company. In this example, A the ultimate owner, or the majority shareholder owns very small cash flow rights in D company. However, A has a significant control rights over D company because of the substantial ownership shares A owns in the parent company B. This pyramid ownership structure is very common in East Asia and provides an alternative shape of concentrated ownership.

One advantage of the concentrated ownership model is heightened scrutiny of company management. Indeed, unlike the dispersed shareholders model, where the shareholders own a small amount of shares that fail to incentivize them to monitor their company, concentrated shareholders have high incentive to monitor closely, if not being the management themselves. This is justified due to the highly concentrated ownership these shareholders possess. Therefore, the legal issues, which dispersed shareholders mainly complain about, are that management in a dispersed shareholders company is interested in empire building, which incentivizes them personally instead of working for the interest of the company and its shareholders; this complaint often does not exist when a company has a concentrated shareholder or shareholders.

a concentrated shareholder or shareholders.

Management expropriation is common in a dispersed shareholder ownership. It is uncommon in a concentrated ownership. However, concentrated ownership has a whole different set of challenges. Shareholders, particularly minority shareholders, in a firm with concentrated ownership could be victims of expropriation, not from management interest, but from majority shareholders' interest. The literature pertaining to this model stresses the importance of organizing the relationship among majority shareholders and minority shareholders, in contrast with the model Berle and Means discussed. Studies have illustrated that majority shareholders would expropriate minority shareholder funds if there were no regulations to restrain them. There is clearly a need to protect minority shareholders.

### 3.3.1 Concentrated Ownership Formats

The literature in regards to concentrated ownership in public corporations divide them, in regard to the owners' identity, into three main types of categories: states, families, or institutions. This section will briefly highlight each.

**State concentrated ownership**

State-concentrated ownership means that the company's majority shareholder, or the shareholder who holds a huge block of the company shares, is the state or the government. There are number of reasons on why governments would be interested in investing in the market and own concentrated ownership shares. Some instances to justify state ownership could be to start the development of a particular sector, assist the domestic economic cycle, or for social welfare reason such as, enhancing employment and reducing unemployment rate. However, the point in this section is not to survey all government justification to hold concentrated shares, but instead to break this concept down and understand its format by highlighting briefly its history.

A famous example of state-concentrated ownership is a state-owned enterprise (SOE). The latter is defined as a firm that is established by the government to practice commercial activity. The government ownership in the enterprise could be entire ownership or partial ownership. The government might be interested, after it establishes the SOE, to privatize the entity entirely or to sell some of its shares. To illustrate, the government might be interested in transferring some or all of the shares of the SOE from being owned by the state to be owneship by the private sector, a transformation that is called privatization. It could accomplish this by many methods. One well-known method is to conduct an initial public offering. However, while the state might be interested in privatizing some shares of the SOE, it could be interested, too, to maintain its control over the entity. There are many control mechanisms the government can implement to make this mission possible. Some of these methods are to use the pyramid control structure, dual stock structure, or golden shares. These mechanisms might be effective in granting the government the power to control the firm, regardless of whether the government sells a major block of their shares.

The modern history of state-concentrated ownership has been recognized even since the 1930s. In fact, it was prevalent and famous during the mid- and late twentieth century among developed countries. However, the push for privatization had limited developed nations' intervention in the market and resulted in limited state ownership in developed economies, especially in the U.S. and the U.K. Yet, even when privatization limited the growth of state intervention in the market of states, state ownership in the stock exchanges around the globe remains present and strong. For instance, the governments of nations such as U.K. and Russia, all of which are considered developed nations, continue to hold concentrated shares in companies listed on their equity exchanges. It is worth noting that some economic crises and recessions sometimes drove some developed nations to intervene heavily in the market again and to buyout some major corporations, while these nations are well known to be highly adverse to intervening in the market. This was the case with the U.S. and U.K. in 2008 when both governments purchased contrlling shares of major companies such as banks and auto industries. While this could be a simple overview about the history of state-concentrated ownership in developed nations, the case is different in developing countries. State-concentrated ownership was and remains a significant component in developing nations' economies.

### Family concentrated ownership

While states possess a large percentage of concentrated shares, families, too, are equally well known for holding concentrated shares in public companies around certain part of the globe, such as continental of Europe and South Korea. Family-concentrated ownership means that a family is the entity that holds big blocks of the company shares, which entitle them to control the company. This model is common in both developing and developed countries. While the literature in family-concentrated ownership concentrates mainly on studying either the importance of the family-concentrated ownership to the market, or the firm performance when firms have a family-concentered ownership structure, this section will focus on merely introducing family-concentrated ownership theory and provide some of current paradigms.

Family ownership in most firms would take one of two forms. The first form starts with the family establishing the business. The family, then, must decide to make some of the firm's shares available to the public. They can achieve this by simply conducting an initial public offering (public IPO). In this example, the family would sell some of the firm's shares directly to the public on the stock exchange. Often, the family would maintain sufficient shares to make them eligible to control the business. The second form of family ownership is different. Instead of establishing the business from the ground up, the family can simply acquire an existing public firm. The family can purchase a firm's concentrated shares either directly from the stock exchange or from the owners. The point here is that family-concentrated shares could be acquired through a variety of methods.

As noted, family-concentrated ownership exists in developed and developing nations. Continental Europe, South Korea, and Japan provide well-known examples in the corporate literature of nations that have a high level of family-concentrated ownership in their stock exchanges. Indeed, South Korea, family firms, or *Chaebol* represent a significant component of the South Korean economy and the stock market in particular. Further, Japan has a similar concept to the South Korean *Chaebol*, firms called *Keiretsu*. The latter also own a substantial block of the Japanese stock exchange. To summarize, family-concentrated shares remain significant in today's economies.

### Institutional concentrated ownership

The final significant holder of concentrated shares in today's stock exchange is the institutional investor. Institutional investors are another major holder of concentrated shares in the stock exchange. In this context, institutional investors are entities that pool a large amount of capital for the purpose of investing in the stock exchange. Some examples of this model are mutual funds, pensions, insurance companies, and hedge funds. Institutional investors are dominant in today's stock exchanges. The American capital market consists mostly of concentrated ownership with institutional investors owning a majority of shares. Thus, institutional investors have a significant impact in today's economy. This chapter now shifts its attention to the importance of recognizing the ownership structure in a nation's corporate governance.

## Section 4: Ownership Structure and Corporate Governance

Understanding ownership structure is important for those who discuss the governance of corporations. Ownership structure informs which protections lawmakers must provide to shareholders. Otherwise, these protections will fail to deliver. Corporate governance must align the interest of all market participants and not favor one over the other. The law must balance the rights of majority and minority shareholders to assure the latter that the former won't expropriate their investments. As previously discussed, dispersed ownership is the problem of agency. The challenge to this model is the conflict between the principal (dispersed shareholders) and the agents (company managers). Without deterrence, managers would likely expropriate the dispersed shareholders' investments for their own personal interest. In dispersed ownership, corporate governance attempts to align the interest between agent and principal, thus discouraging management expropriation.

Concentrated ownership tends to raise other problems. The challenge here is the conflict of interest between majority shareholders (concentrated ownership) and minority shareholders. However, shareholders in a concentrated ownership are not worried about investments being expropriated by management. Management is closely monitored in a concentrated ownership structure. However, the concern is majority shareholder oppression. Thus, the corporate governance challenge is to protect minority shareholders and prevent their oppression by the majority.

The nature of stock ownership must be considered when designing effective corporate governance. For instance, as previously mentioned, cumulative voting is a protection the OECD advocates in its corporate governance standards. This protection works well a in dispersed ownerships example. To clarify, if company shares are divided among many small owners, voting power also is divided among these many small owners. These owners can decide amongst themselves who runs the company. In contrast, cumulative voting would be extremely ineffective in corporations with a concentrated ownership structure. Here is an example: A owns 70% of a public company. Minority shareholders were successful in appointing one out of the seven board members, with the use of a cumulative voting policy. A, the majority shareholder, appointed the remaining six board members. Thus, even though the minority shareholders utilized a cumulative voting policy, it did not benefit them. A still ultimately decides the company business. Therefore, ownership structure is an important component to consider when deciding corporate governance policies and protections.

## Section 5: OECD Corporate Governance Principles and Ownership Structure

The major question in this section is: Has the newest publication of OECD corporate governance principle in 2015 illustrated recognition of the importance of ownership structure of companies with shares listed on the stock exchange when a nation designs or reforms its corporate law? The answer is yes. Yet, the OECD recognition is more inferred than stated clearly by the standard. To illustrate, there is no principle in the OECD corporate governance standards that states, for instance, that every corporate law of a nation must recognize its ownership structure. However, what does exist in the OECD principles is the number of articles that protect dispersed shareholders and others protecting minority shareholders. It can be inferred here that the OECD principles, while not clearly noted, do indeed state the importance of recognizing the ownership structure of corporations, at least impliedly. This section will provide some examples to confirm this finding.

Statistically speaking, as the world of numbers works better for clarification than mere rhetoric, the words "minority shareholders" are mentioned 10 times in the OECD corporate governance principles. The word "dispersed," in the context that it identifies the dispersed shareholder, as Berle and Means depicted in their famous book, has been mentioned once. The word "concentrate" is used twice, and the words "controlling shareholders" are stated 15 times, both of which refer to majority shareholders in concentrated ownership structure corporations. These numbers, no doubt, indicate an implied importance of ownership structure in OECD corporate governance principle.

Furthermore, in our statistical findings, the first principle of OECD corporate governance standard states, "Ensuring the basis for an effective corporate governance frameworks." This vague principle has been defined in numerous provisions that attempt to clarify it. However, these explanatory provisions could be simplified to mean that the OECD principle urges those who articulate their own corporate governance to create an environment and enforcement mechanisms that make corporate law effective. In achieving this mission, the law must assert a high level of transparency and create consistency between the agencies whose responsibilities are to implement the law. The principle declares that lawmakers must consider if the law will be effective when drafting it. One of the provisions that explain this principle asserts that the law should be "flexible" and considers precisely "company's ownership and control structure." This assertion from the principle confirms the importance of ownership structure when drafting or reforming a corporate law.

Another example of the OECD standards that confirms the importance of ownership structure can be understood within the context of the standard language. For instance, the principle highlights the importance of raising the credibility of the stock market by protecting shareholder investment. The principle asserts that shareholder investment must be protected from management, board of directors, or controlling shareholder oppression and misconduct. The language in the previous example was designed to fit ownership structure, dispersed, and concentrated. To clarify, the language mentioned "management" in reference to shareholders' challenge in dispersed ownership structure and "controlling shareholders" in reference to shareholders' challenge in concentrated ownership structures.

Moreover, the principles assert the need for transparency, especially when the company ownership structure indicates the existence of parties that practice high control, which does not reflect their genuine ownership in the company shares. To clarify, we have addressed the example of a pyramid-ownership structure earlier and highlighted that, in this structure, the owner would enjoy greater control than would be proportionate with the percentage of ownership he or she really holds of the company's capital. The pyramid structure allows its ultimate owner (majority shareholder) to practice this high degree of control. The principles seek, in the event a company ownership structure including shareholder that have a pyramid structure, to divulge this data to the investors. This transparency would assist shareholders to evaluate their decision to whether they should invest or abstain. The argument here is that the OECD principle provides another example of the importance of recognizing the ownership structure in a company's corporate governance. To summarize, the OECD corporate governance standard provides multiple instances that illustrate with no doubt the high level of importance of recognizing the ownership structure in a nation's corporate law.

## Section 6: Ownership Structure in Saudi Equity Market

After understanding the importance of ownership structure and its reliance to effective corporate governance, attention should be focused at the ownership structure of the firms listed on the Saudi stock market. The importance of firm ownership structures in today's market has been addressed above. The Saudi stock market is not unique when compared with other civil law countries or even developing states' markets, which signals the fact that the majority of firms in the Saudi stock exchange are formed using a concentrated ownership model. However, unlike the Chinese model, where the government is the major owner of shares listed on the nation's stock market, or the Japanese and South Korean models, where families are the major owners of companies' shares traded on the nations' stock exchanges, the Saudi stock exchange is a hybrid between the two models. To clarify, firms listed on the Saudi market have ownership structures characterized as being concentrated owned either by the state or by families. While the majority of firms have a concentrated share model, a number of firms do indeed have a dispersed shareholders model. This section will highlight each of the previous types.

### 3.6.1: State Concentrated Ownership

The government of Saudi Arabia invests heavily in the Saudi stock exchange. Indeed, out of the entire Saudi stock market, the government, either through direct partial ownership or state-owned enterprises, owns more than 36% of its value. This percentage could be higher because stock market regulations require only those who own 5% or more of a company's shares to disclose their identity. To clarify, if the government owns 4.99% or less of any company listed in the Saudi stock exchange, it can decline to declare its of less of any company listed in the Saudi stock exchange, it can decline to declare its ownership. Thus, the government's ownership percentage of the stock market could definitely be larger.

To illustrate this argument, the Saudi government owns a significant portion of the value in the stock exchange through two methods. One method is through partial governmental agency ownership. For instance, the Saudi Wealth Fund, General Organization for Social Insurance, and Public Pension Agency are the biggest investors in the Saudi stock exchange and are considered public agencies fully controlled by the Saudi government. The second method of government ownership in the market is in the form of state-owned enterprises where the government owns 70% or more of the company shares. For example, Sabic is a leading company on the Saudi stock exchange, and the Saudi government owns 70% of the company's shares. Also, electricity is a prominent utility substantially owned by the government. The argument is that, with this significant ownership in the stock exchange, the government is capable of influencing the appointment of a majority of the board of directors in many companies. These board members can be considered the highest staff members of the government's bureaucracy.

### 3.6.2: Family Concentrated Ownership

Saudi families have concentrated ownerships in many firms listed on the Saudi stock exchange. The Saudi royal family owns substantial amounts of concentrated shares, as do other Saudi families. For instance, Prince Alwaleed Bin Talal Bin Abdul-Aziz Alsaud is a 95% owner of Kingdom Holding Company. The remaining 5% of Kingdom Holding Company's shares are traded on the Saudi stock exchange. In addition, the Al-Othman family owns around 58% of Takween Advanced Industries. Examples of Saudi family concentrated ownership in the Saudi stock exchange are numerous. However, the point here is not to survey them all but to merely show that Saudi families own substantial concentrated shares in the Saudi stock exchange.

### 3.6.3: Dispersed Ownership

As mentioned earlier, the absolute majority of the companies listed on the Saudi stock exchange is owned in the form of concentrated ownership structure. The only companies that can be found that have the shape of dispersed ownership structure on the Saudi exchange are *Dar Alarkan*, *Chemical*, and *Febco*. *Dar Alarkan* used to be controlled by *Alshlash* family. However, apparently as of February 27, 2017, the company's financial documents have asserted that the *Alshlash* family had sold its concentrated ownership, and no single shareholders own 5% or more of the company shares. *Febco* and *Chemical* also have no concentrated shareholders as of February 27, 2017. We should highlight, again, that Saudi stock market regulations request only those who own 5% or more of company shares to declare their identity. Therefore, there is a possibility that some or all of these companies have a hidden majority of shareholders, such as family members, which divide their shares' threshold among them and does not exceed the 5% limit.

In addition, there are numerous companies whose biggest shareholder is one entity that owns 10% or less of the companies' shares. This entity could be a single individual or a company. For instance, *Nama Chemicals* financial statements as of February 27, 2017, have asserted that its one major shareholder is a family company, which owns 7.4% of the company shares. The point of this section is to assert that there are only a few instances of companies that have the shape of a dispersed ownership structure. Yet, the majority of the companies that are the most effective in the Saudi economy are held in the shape of concentrated ownership structure. For instance, *Forbes* magazine published the top 100 companies traded on Arab stock exchanges in 2016, including the Saudi stock exchange. Saudi companies have dominated this list. The financial documents of the top 20 Saudi corporations indicate that these companies all have the form of concentrated shareholders, and the state or families own the majority of them. To summarize, this section illustrates the variety of ownership structures that exist in the Saudi stock markets. Concentrated shareholders own the majority of company's shares in the latter exchange. The Saudi shareholders own the majority of a company's shares in the latter exchange. The Saudi government and Saudi families hold the majority of these concentrated shares.

### 3.7: Conclusion

In conclusion, this chapter has addressed the concept of ownership structure in public companies. There are two types of ownership structures that are well known in the stock exchanges: dispersed ownership and concentrated ownership. Recognizing the differences between the models and the challenges each model derives is essential in protecting a national market. Indeed, the chapter has illustrated why acknowledging the ownership structures of the listed companies of a nation is important when drafting or reforming the corporate law of a nation. The chapter addresses the OECD corporate governance principles' position on ownership structure and illustrates how the OECD standards have recognized the importance of ownership structure in the text of and the context of the principles. The chapter finishes by highlighting the variety of ownership structures that exist in the Saudi stock exchange. It asserts that the majority of companies traded in the Saudi equity market has a concentrated structure and are owned by either the Saudi government or Saudi families. The next chapter will investigate the legal system of Saudi Arabia. The later is considered an essential element to genuinely evaluate Saudi corporate law and its shareholder protections, especially those dedicated to minority shareholders.

## Chapter 4: Saudi Arabian Legal System and Its Ownership Structure

### 4.1: Introduction

The importance of minority shareholder protections and the urgent need to observe them in the corporate law is clear by now. Also, the ownership structure of firms listed in Saudi stock exchange has been illustrated. That is, Saudi government and Saudi families owns the majority of concentrated shares listed in the Saudi equity market (*Tadawul*). What is left is to examine the Saudi Companies Law and the protections the law assures its shareholders. Yet before describing and examining these protections, it is important to address a significant detrimental component that is essential when evaluating Saudi corporate protections. This component is the legal system, which the Saudi corporate law existed in. La Porta and others found that legal systems matter in regard to shareholder protections. The authors found that nations that are considered civil law legal systems tend to offer weak shareholder protections to public corporations. On the other hand, the authors found that states that implement a common law legal system offer strong shareholder protections.

The first observation of the Saudi legal system is the complexity and contradiction the system indicates. Saudi Arabia is a religious state, and Islam as a religion reflects a significant component in the nation's legal system. Saudi Arabia also based the majority of laws on the civil law legal system, particularly Egypt's, which was heavily influenced by French colonies in the region and the French legal system. This issue creates a duality in the Saudi legal system. This chapter will draw out this ambiguity and provide an accurate picture of the Saudi legal system. To accomplish this mission, this chapter will briefly explain, in Section 2, how Islam took such a significant place in the kingdom and define the concept of Islamic law. The chapter in Section 3 addresses the kingdom's legal system and its constitution. Finally section 4 highlights Saudi government structure and how these structures are highly important to recognize in order to evaluate the newly reformed Saudi corporate law and its minority shareholders protections.

## Section 2: Saudi Arabia as a Religious State

### 4.2.1: Islam and the Arabian Peninsula

The story behind the kingdom declaring that Islam is the religion of a nation begins in the early ages. To illustrate, Islamic law (Sharia law) is considered to be Saudi public policy and the main source of regulations when adjudicating people's conflicts. The history of this story goes back to 607 AD when Islam was revealed to the prophet Mohammad, which Muslims believe to be God's (Allah's) messenger. The revelation to the prophet Mohammed happened in the Arabian Peninsula, on a mountain near Mecca, located in the western region of Saudi Arabia. Arabs, the inhabitants of the Arabian Peninsula, were Bedouins and nomadic. The harsh environment and weather forced inhabitants into this style of life. Two famous cities occupy the Arabian Peninsula: Mecca and Medina. The former is the place where the prophet was born; the latter is the place where the prophet migrated to and resided for the rest of his life. In fact, Medina was the center and first capital of Islamic civilization, which spread around the globe.

The life of Arabian inhabitants was based on collaboration among tribes. The tribe would be constituted of families and relatives who shared the same blood. Each tribe would appoint a head of the family who would be considered their chief *Sheik*. The major association between the tribe members is the fact that all of them share the same blood. Because there was no political system that governed inhabitants of the Peninsula, except north of the region, which was governed by the Romans, Arabian tribes functioned as a substitute for political power; thus, each tribe governed its own members. Individuals sought tribes to provide them with protection. Tribes often collaborated with each other to defend themselves from any possible attacks from other tribes or foreign enemies.

In addition, after the revelation of Islam and the prophet's migration to Medina, a new phase in history had been created for the people of the Arabian Peninsula. The prophet started implementing Islamic law. The significant movement the prophet sought was uniting society not under the tribe's umbrella, the tradition that was prevalent in the Arabian Peninsula for hundreds of years earlier, but under a single faith. That is, Muslim society should be united because of its people's faith in God and his prophet's message. This movement became the seed that implanted the first political authority that bound the people of the Arabian Peninsula because of religion and not because of the tribe and blood association. The Prophet Mohammed was the political and religious leader of the first Islamic nation in history. After the prophet's death, Muslims elected their caliphate, and the Islamic empire grew to reach Africa, central Asia, and south Europe. The ruler of Islamic empires alternated among many families, such as *Umayyed*, *Abbasi*, and *Ottoman*. All of them stated that they implemented Islamic law as their source of authority.

In the beginning of the twentieth century, a new movement started in the Arabian Peninsula. The Ottoman Empire was ruling the eastern and western coats of the peninsula. More importantly, Mecca and Medina, the two cities that contain two holy destinations, which Muslims seek to visit, were under Ottoman rule. The Ottoman Empire sided with the Germans and entered World War I; and after its loss in the war, the Ottoman Empire territories in Middle East were colonized by France and Great Britain, two nations that defeated the Germans. French and British colonies were based in Egypt, Syria, Palestine, and northwest Africa. The western region of the Arabian Peninsula was left without colonization, particularly Mecca and Medina. During that time, King Abdulaziz bin Saud, the founder of the kingdom of Saudi Arabia, captured the city Ymamah (known today as Riyadh, the capital of Saudi Arabia) and started the movement to unify the majority of lands of the Arabian Peninsula under his rule. His rule was based purely on religious authority and implementing Islamic law. King Abdulaziz established a monocratic system that still governs Saudi Arabia today. This brief overview captures the Arabian Peninsula's history and how this land since 607 AD has been ruled in accordance with Islamic law. In other words, all different families and empires that governed this part of the world relied on the Islamic religious authority to support their rule. The remaining question after this brief overview is to explore the concept of Islamic law.

### 4.2.2: What is Islamic law?

Islamic law or Sharia law can be briefly defined to be the law that is extracted from the two holy sources in Islam. The first source is *Quran*, which Muslims believe to be the genuine words of God (Allah) that Gabriel revealed to prophet Mohammed. The second source of Islamic law is *Sunnah*, the prophet Mohammed's speech, tradition, and approval. *Sunnah* had been gathered and transecribed by the prophet's companions after his death and then had been collected and called *Hadith*. It differs from *Quran* in that the *Quran* is the actual record of God's (Allah's) words, and the *Hadith* is a collection of the prophet's companion's record of them seeing or hearing the prophet's speech, tradition, or approval. Therefore, *Sunnah* scriptures are not considered to be the genuine words of the prophet, unlike the holy *Quran*, which reflects the actual and unedited words of God (Allah). These two, *Quran* and *Sunnah*, are considered the two highest and primary sources in Islamic law. This law, Muslims believe, is capable of governing people's lives from the beginning until the end.

Muslim scholars developed methods to interpret Islamic law judgments on legal issues that have not been mentioned in the two sacred sources. To clarify, the concept here is that primary Islamic law scriptures are definite, while incidences are indefinite. When Muslim scholars confront a legal problem that has no answer in either the *Quran* or *Sunnah*, these scholars would rely on Islamic law's secondary sources to reach an answer. The first secondary sources is *Ijma*, which means "the consensus of opinion of Muslim jurists in particular legal conflicts, in a particular era, after the death of the prophet." *Ijma* must be reached with accordance to the context of two holy sources of Islamic law and in light of their principles.

*Aljtihad* is another secondary Islamic law source that can be utilized. *AIjtihad* means interpretation. Muslim scholars employ this source to interpret the guidance in the *Quran* and *Sunnah*, which would guide them to legal judgments when confronted with a legal challenge. One significant tool that assists in utilizing *Alijtihad* is *Qiyas*, which means analogy. To clarify, it means to find the purpose and the reason behind the sacred text and then apply it to the new case due to similarity of the purpose. For instance, the *Quran* prohibits Muslims from drinking wine. The reason behind this ban is the intoxication of wine. Drinking wine affects the brain. Thus, even though other intoxicating substances, such as marijuana and drugs, have not been mentioned in Islam's primary texts, Muslim scholars ban them for the same reasons.

In addition, *Alijtihad* can utilize other tools such as "discretion (*Alisthsan*), legal presumption (*Alistishab*), social custom (*urf*), and public interest and welfare (*Almasalih Almursalah*)." All of these tools can help Muslim jurists to find an answer for the legal question at issue based on the interpretation of Islamic law sources. We should mention that some effort has been made to codify Islamic law in a method similar to Western regulations. The Ottomans became the first Islamic nation that codified Islamic law principles in a regulation similar to civil law. It is well-known by the name *Majlat Alahkam Alsharia*. Saudi Arabia, however, decided to abstain from codifying Islamic law. The next section will address the legal system of Saudi Arabia and its constitution.

## Section 3: The Legal System of Saudi Arabia and Its Constitution

We have addressed how the Islamic religious authority has reflected a significant component in unifying the people of the Arabian Peninsula for the past 1400 years. The latest movement that started with King Abdulaziz, the founder of Saudi Arabia, relied on combining its political power with Islamic authority, which involved the commitment to implement Islamic law. Moreover, the literature in Islamic law was rich and covered many aspects of people's life. This was the case because Muslim jurists were given more space to practice *Aljtihad* ("the exercise of critical thinking and independent judgment"). Yet, the door of *Alitihad* was closed in front of Muslim jurists for numerous political reasons. This action restricted the development of Islamic law literature and resulted in a significant gap between the development of Islamic law and other legal systems such as civil and common law legal systems.

King Abdulaziz acknowledged to the reality of Islamic law gap and started to resolve the issue. He knew when he unified the country that he must develop the nation, especially economically, and make it similar to neighboring countries, such as Egypt, whose legal system was developed after being colonized by the French. Egypt, for instance, transplanted many regulations from the French legal system, the nation that was considered the godfather of the civil law legal system. Therefore, King Abdulaziz started the movement to transplant many Egyptians regulations, which were heavily influenced by the French. The kingdom was clear that it would exclude any provision in any civil law regulation that violated Islamic law principles. The successor kings of Saudi Arabia follow the same steps as the founder. These actions made the legal system of Saudi Arabia a unique mixture. Thus, Saudi Arabia's legal system is a hybrid legal system as a result of the combination of an Islamic religious and western civil law legal system.

The hybrid legal system between Islamic law and civil law did not come without a price. Scholars assert that this reality of a duality in the Saudi legal system has created contradictions and confusion. To clarify, as Saudi Arabia has developed and grown, the government was forced to adopt some controversial laws that include provisions which clearly contradict Islamic law principles. For instance, banking regulations in Saudi Arabia recognize conventional modern banks and their practices. This means that bank customers in Saudi Arabia can have access to a conventional loan privilege that carries with it interest, which the customer must pay. Islamic law, expressly, prohibits loan interest (which is considered to be *usury*). Were a customer sued to sue his bank in a general court that implements Islamic law, the court would rule that the customer should not pay the loan interest because it violates Islamic law's clear provisions. This judgment would destroy the conventional banking industry in Saudi Arabia and would jeopardize the national economy. How, then, can Saudi government confront this serious obstacle?

The government created a stratagem to overcome this challenge: special tribunals or committees under the executive branch. In other words, these tribunals are not under the judiciary that implements Islamic law. The mission of these tribunals is to litigate precisely the conflicts that arise because of the controversial matters related to these departures from Islamic law. For instance, the special tribunal for conflicts of banking law provisions would have the sole jurisdiction to litigate these types of cases. The judges of this tribunal are enjoined to implement the particular controversial banking law and place it in context. On the other hand, the general court that implements Islamic law would decline to litigate this case because it has no jurisdiction over it. While this strategy has been successful in overcoming this challenge, it does not change the reality of the confusion and ambiguity of the Saudi Arabian legal structure. Numerous scholars have urged the reform of this duality in the Saudi legal system and have illustrated its negative impacts on the market. However, the scope of this thesis is to not challenge this system but merely to deliver a brief overview of this dual legal structure. The next section highlights whether the Saudi Arabian legal system contains a constitution.

### 4.3.1: Does the Kingdom of Saudi Arabia Have a Constitution?

To answer this question clearly, the definition of "constitution" has to be established. In other words, what do we really mean by the word "constitution"? Modern literature on constitutionalism defines the word constitution to be the body of law that describes the state format, its structure, and the procedure by which the government "operates". This body of law also includes primary rights for each of the state's citizens. This law should be the highest legal enactment in the state legal structure hierarchy. Finally, the threshold and trigger to modify and change this law must be higher than other for ordinary laws of the state. These could be the major characteristics that define the concept of constitution. Going back to our question, has the word "constitution" existed in the Saudi legal discourse?

Answering this inquiry requires knowing whether the term "constitution" (its Arabic translation is *dostor*) was known in Saudi Arabia's region. In other words, had some states in the Middle East recognized the word *dostor* (constitution) with its modern concept from the early on? Starting with Egypt, the country which has had the most significant influence on the Saudi legal system, Egypt has acknowledged the concept of a constitution since 1923 when the country of Egypt was a monarchy system. Kuwait, which shares a border with Saudi Arabia, recognized the concept of a constitution and enacted its *dostor* in 1962. Syria, the Arabian country located to the north of Saudi Arabia, passed its constitution in 1964. The United Arab Emirates, a significant state in the Arabian states' map, which shares an eastern border with Saudi Arabia, enacted its constitution in 1971. The point should be clear by now. The concept of *dostor* (constitution) was widespread and well known among Saudi Arabia's neighbors during the twentieth century. However, the Saudi legal system has no body of law that is named *dostor* (constitution).

It is worth noting that the word *dostor* (constitution) is mentioned once in Article 1 of the Basic Law of Governance in Saudi Arabia. The article states: "The kingdom of Saudi Arabia is a sovereign Arab Islamic state. Its religion is Islam, and its constitution is the Holy *Qur'an* and the prophet's (peace be upon him) *Sunnah* (traditions). Its language is the Arabic language, and its capital city is Riyadh." While obviously the word *dostor* (constitution) has been mentioned in the Saudi Basic Law of Governance, it does not indicate the same meaning that has been addressed in modern constitutional literature. In other words, there are no descriptions of the state structure or the government process that can be found in both Holy *Quran* and prophet *Sunnah*. Thus, the word *dostor* (constitution) has been used in Saudi legal discourse yet in a different context.

The fact that there is no body of law in the Saudi legal system that is named *dostor* (constitution) should not prevent the search for an alternative body of law that delivers the same purpose the constitution does. Indeed, the characteristics of the constitution that, for instance, describe the state structure, the government process, and the citizen's significant rights can be found in a number of Saudi laws. These laws are Basic Law of Governance, Council of Ministers law, Consultative Council law, Regional law, and Allegiance Council law. The aggregate of these laws would deliver the same result as a constitution, regardless of whether the Saudi lawmaker calls them "constitution" or not. The first four laws were enacted in 1993. The Allegiance Council law, on the other hand, was passed in 2007. The purpose of these laws is to define the process of the Saudi government, the way it functions, and the people's primary rights. The laws also deliver the shape of the legal system in Saudi Arabia and clearly state the nation's Islamic identity. This section will not go through the details of all of these laws and will merely deliver a brief overview about the basic law of governance.

The basic law of governance (BLG) does indeed include similar characteristics of the conventional constitution. This law is composed of nine chapters and 82 articles. The major feature of this law is asserting that the regime of the Saudi Arabia is a monarchy. The law defines the structure of governance in the nation and divides the state authority among three branches: executive, legislative (regulatory), and judicial. Citizens' rights are mentioned clearly in this BLG. For instance, human rights, the right for health care, and the right to education are granted in this law for the people of Saudi Arabia. Also, BLS states in Article 8 that the governance in the kingdom is based on applying justice, equality, and consultations from the prospective of Islamic law.

In addition, the significant statement of BLG declares the Islamic identity of Saudi Arabia. For example, the law states that one of the Saudi government's missions is to protect Islamic law. BLG also organizes the Islamic religious authority by creating a number of formal institutions; their missions are to research and declare Islamic law positions when they have been questioned. The BLG named *Hayat Kibar Alolama* (Council of Senior Scholars) to be a significant institution in this matter. To clarify, if the king is questions, for instance, whether selling or trading debt is permissible under Islamic law principles, then the king would send this concern to *Hayat Kibar Alulama* (Council of Senior Scholars) to clarify Islamic law positions about trading debt. This institution will issue a statement (*Fatwa*) whether they find this concern permissible in Islamic law or that it violates it. This could be a brief highlight of the constitution concept, in general, and the it violates it. This could be a brief highlight of the constitution concept, in general, and the BLG in Saudi Arabia legal model. The next section presents an overview of Saudi state authorities.

## Section 4: Saudi State Authorities and Government Branches

As noted, the BLG recognized three government branches to have the authority in governing Saudi Arabia. However, the concept of three governments branches came from Western political literature. In other words, the majority of Western-developed nations state authority is based on the separation of powers. This separation resulted in creating three authorities. These are the executive branch, made up of the state president or prime minister; the legislative branch, made up of the congress or parliament; and the judicial branch, made up of the supreme or constitutional courts. The purpose of these authorities is to maintain the concept of check and balance. Saudi Arabia, on the other hand, has a unique state of authority, which is different than the Western concept. The practicality of the Saudi model indicates that the actual Saudi authorities can be divided among the king, the executive branch, the legislative branch, and the judicial branch. Some of these authorities do indeed interact with each other and, thus, trigger the concept of separation of the powers in the kingdom. This section addresses an overview about every authority.

### 4.4.1: The King

The power of the king of Saudi Arabia is believed to be derived from the history of the Islamic state since the early ages. As previously mentioned, scholars in the Islamic state literature indicate that the Islamic state leader or the head of an Islamic state has both political and religious authority. This concept of leadership would recognize the Saudi Arabian king to have absolute authority over the all the Saudi state branches: the executive, the legislative, and the judicial. In fact, the heritage of rulers who governed the Arabian Peninsula and other parts of Islamic nations claims that these rulers had the absolute authority to run their states. Therefore, the Saudi king, having this absolute power, is not considered precedent and is merely considered a practice that was well known during many ages in Islamic state history. However, scholars asserted that there is limitation to this absolute power, to which the king is entitled. The limitation of a king's powers occurs when the latter violates an undisputable Islamic law principle. The history of this limitation started on early stages in Islam. Prophet Mohammed had number of speeches that indicated this limitation. In addition, the Council of Ministries' law in Saudi Arabia states that the king is the head minister of the Council of Ministries. Hence, the Saudi king is considered both the king and the prime minister of Saudi Arabia. The next section addresses the Council of Minister's mission.

### 4.4.2: Executive Branch

The executive branch in Saudi Arabia is divided among numerous executive bodies, besides the Saudi king, as mentioned above. These bodies are Council of Ministers, local governments and ministry subsidiaries, in addition to other public, independent and quasi-independent agencies. The most significant body of these entities is the Council of Ministers. The law which organizes this council states that this council has the authority to monitor the implementations of the laws and regulations. Also, the council has the right to create the nation policies. Examples of these policies are the foreign, internal, and economical policies. The ministers are appointed by the unilateral will of the Saudi king will. The law grants the Council of Ministers, besides its executive mission, a legislative assignment covered in the next section. This offers a brief overview about the executive branch in the Saudi model.

### 4.4.3: Regulative (Legislative) Branch

The distinctive feature of Saudi legal discourse is the reluctance to name the legislative branch with its name: legislative. The legal discourse in Saudi Arabia tends to name this branch with the name "regulatory" instead of legislative. The reason behind this move is the belief that the legislator, under Islamic law principles, is Allah (God), and the Islamic state leader's mission is to enforce these principles, in addition to creating any "regulations" that would assist to clarify Islamic law or fill the gaps that Islamic law has not covered. Therefore, lawmakers in Saudi Arabia can issue regulations to fulfill an area that Islamic law has not covered, for instance, the Saudi stock market law, or to clarify an area Islamic law has not explained sufficiently well. In addition, the regulatory authority in the Saudi model is divided among three entitles: the king, *Majls Alshwra* (the consultative council), and the Council of Ministers. The law that is enacted by the regulatory authority in Saudi Arabia has three forms: royal order, royal decree (law), or secondary legislation (regulation).

**Royal Order**

The royal order is the unilateral formal written order from the Saudi king to an institute that amends or repeals a law. The presumption of the Royal order is this law has not been reviewed by either *Majlis Alshwra* (the consultative council), or the Council of Ministers, and the order merely reflects the king's discretion about the order matter. As previously mentioned, the Saudi king has the absolute authority over all Saudi authorities and particularly the executive. When the king issues a royal order, he issues it from the position of monarch, and not the position as the Council of Minister's chief. The law issued by this order is considered highest law in the Saudi legislative hierarchy.

**Royal Decree**

The royal decree is also a formal written reflection of the king's consent but, unlike a Royal Order, is about an issue that has been previewed by the two councils: ministers and *Majls Alshwra* (the consultative council). Unlike the royal order, this decree is presumed to be considered by both councils first. If these councils approve the decree draft, which could be issuing, appealing, or amending a law, this draft would go to the king. The latter either approves it and issues a royal decree about it or declines to pass it. This decree would be considered the second-highest legislative authority after the royal order. It is similar to the act in the U.S. legal discourse. The newly reformed Saudi corporate law, which this thesis concentrates its attention at, was enacted by the Royal Decree tool. This means that this Companies law had been reviewed by two councils before its had been enacted.

**Secondary Legislation (Regulation)**

The lesser legislative power is given to the executive branch, particularly the Council of Ministers. Each ministry or agency can issue a regulation that clarifies a royal decree law and assists its implementation when Saudi regulators delegate clarification mission to this ministry or agency. This regulation does not create a law and merely clarifies an existed law. The regulation does not need the king's consent and can be simply issued by the ministry. The process of issuing a regulation is more flexible than royal orders and decrees. A regulation is considered the lowest legal instrument in Saudi's legal hierarchy. This regulation is similar to primary regulation issued by a U.S. agency.

### 4.4.4: Judicial Branch

The judicial branch has occupied a significant place in the Saudi legal system. The importance of this branch has led Saudi lawmakers to assert twice, and in two different bodies of laws, the independence of the judiciary in Saudi Arabia. To illustrate, BLG (Saudi constitution virtually) states in Article 46: "The judiciary shall be an independent authority. There shall be no power over judges in their judicial function other than the power of the Islamic *Shariah*" Article 1 of Saudi Law of the Judiciary states: "Judges are power of the Islamic *Shariah*. Article 1 of Saudi Law of the Judiciary states: "Judges are independent and, in the administration of justice, they shall be subject to no authority other than the provisions of *Sharia* and laws in force. No one may interfere with the judiciary." Therefore, the importance of the judiciary and the sensitive job they conduct required Saudi lawmakers to assure the independence of this governmental branch in the highest legal texts. Also, one important element of Saudi judiciary is the courts' services are provided to the public without fees. This means litigants can rely on the courts to solve their complaints with paying court costs.

Moreover, the judicial branch in the Saudi legal system underwent massive reform in 2007 when Saudi lawmakers reformed the old version of the law that had been enacted in 1975. This move was believed to modernize the judiciary and make it compatible to meet the upcoming challenges. In addition, the complexity of the Saudi legal system does not end in the executive and legislative branches but has reached to shield the judiciary as well. This complexity is reflected by the fact that there are three types of institutions that adjudicate legal conflicts in Saudi Arabia. Two of these institutions are under the judicial branch umbrella and one type is under the executive branch. To clarify, courts under the judicial branch are the General Judiciary (*Almhakm Alsharia*), and Board of Grievance (the administrative courts). On the other hand, courts under the executive branch are known as *lijan Shibh Qdaiyah* (Quasi-Judicial Committees).

### General Judiciary (*Almhakm Alsharia*)

The general judiciary has the jurisdiction to litigate cases that do not include the state. In other words, these courts litigate conflicts that arise from private citizens' complaints. This judiciary has the absolute jurisdiction to litigate all types of cases, unless the laws mentioned otherwise. The general judiciary implements provisions of Islamic law principles, and the regulations that come under its jurisdiction, such as civil law procedures. Its hierarchy is divided among three levels of courts: the Supreme Court, which is the highest in the hierarchy ladder; courts of appeals, which is the middle court; the first level courts, which litigant initially file claims. The first level of courts, on the other hand, is composed of five courts: general courts, which mainly have jurisdiction over civil cases and all other cases that do not fit under other court types; penal courts, which litigate criminal cases; family courts litigate family law cases, such as marriage and divorce conflicts; commercial courts litigate all cases that include businessmen or the commercial industries, such as corporate law cases; labor courts litigate the cases that include employee and employer conflicts. In addition, the law of the judiciary states that judges in the general judiciary are organized by an internal judicial body called the Supreme Judicial Council. This council has all authority over judges, such as promotion, transfer, discipline, and termination in accordance to legal procedures. The concept behind this council is to provide the judiciary with the necessary tools to have full independence.

### Board of Grievance (the Administrative Courts)

The Saudi legal system delegates the right to sue the state or any of its affiliates to special body of the judiciary called the Board of Grievance (referring to administrative courts). For example, if a public employee is unlawfully discharged from his position, he could sue the public employer in these administrative courts, and not labor courts, as noted in the previous section. The reason to direct this type of suit to these administrative courts is the fact that the latter has the absolute jurisdiction to litigate conflicts in which the state is a party. This concept of creating a judicial body that adjudicates state-related litigations came from the French judicial structure. Indeed, French court structure distinguishes between courts that litigate civil and criminal cases, and courts that litigate state-related matters. We previously mentioned how the French legal system has indirectly influenced the Saudi legal structure. The structure of these administrative courts in Saudi Arabia is similar to that of the general judiciary. To illustrate, the administrative courts are composed from three layers: the supreme court, the courts of appeals, and the first level administrative courts.

**Quasi-Judicial Committees (*lijan Shibh Qdaiyah*)**

In previous sections, we mentioned how Saudi Arabia felt it necessary to transplant controversial regulations that were considered necessary to develop the nation. These regulations brought provisions that contradict Islamic law principles and would not be enforced in the general judiciary, which implements Islamic law. In light of this obstacle, the concept behind creating committees to work as tribunals was introduced. These tribunals are under the umbrella of the executive branch. These executive committees were granted judicial authority to litigate cases that should have been litigated initially in the general judiciary, except the law stated the latter courts have no jurisdiction to hear them.

The government discovered that these quasi-judicial committees do their work efficiently and have specialized in their work. This belief has helped to increase the number of these committees. Dr. Alkoli surveyed a number of these committees and found their actual number is 104. For instance, the Committee for Resolution of Securities Dispute (CRSD) is the entity that litigates cases related to the Saudi stock exchange. When companies violate the Saudi Capital Market Law, violations can be pursued in the CRSD and not the commercial courts. Article 20 of the Capital Market Law states that only CRSD has the jurisdiction to litigate these matters. In this example, the entity that often deals with violations of this law is the Capital Market Authority. CRSD is structured to be under this Capital Market Authority, and it's the entity that employs CRSD judges. This issue creates an obvious conflict of interest.

Numerous Saudi scholars have criticized these quasi-judicial committees and urged that they be included under the judicial umbrella. Their claims are based on number of legitimate reasons, such as the serious conflict of interest and the lack of independence. Also, the experience of these judicial committees indicates that they do not appreciate rights of the accused in the same manner as the general judiciary and administrative courts do. For instance, some of these committees do not have a second level of litigation, such as appellate committees, which make their judgments final, and this without doubts triggers concern about the concept of justice.

To summarize this section, numerous Saudi scholars have pointed out the major deficiencies these committees have. The obvious concerns implicate the lack of genuine independence and the failure to respect all suspects' rights. This thesis aligns with these arguments. However, the point of this section is to deliver a brief overview about the state authorities without digging deeper into on the obvious ambiguity and contradiction the authorities have fallen into. The concept here is that Saudi corporate law was enacted by the Royal decree order and Saudi commercial court is the entity that has the jurisdiction to litigate the law violations. The next section shift gears in order to navigate the second important element before this thesis starts addressing shareholder protections in Saudi company law, that is, the ownership structure in Saudi stock exchange.

## 4.5: Conclusion

The chapter attempts to demonstrate a genuine depiction of the Saudi legal system. This legal system typically creates confusion and ambiguity. Sometimes the legal system contradicts its fundamental principles. However, the point of this chapter is to deliver a brief overview of the general picture of the Saudi legal system without challenging it. The chapter further pointed out that Saudi corporate law was enacted by the Royal decree order and Saudi commercial court is the entity that has the jurisdiction to litigate the law violations. The chapter also explains the historical roots of Saudi Arabian reliance on Islamic law as its main law and its public policy. The chapter illustrates the government's branches, and how there is no genuine separation among these branches in the kingdom. Finally, The chapter further pointed out that Saudi corporate law was enacted by the Royal decree order and Saudi commercial court is the entity that has the jurisdiction to litigate the law violations. This chapter is essential to introduce the next chapter, which highlights the Saudi Companies Law and the legal protections the law provides to shareholders in public corporations.

# Chapter 5: Saudi Companies Law and its Shareholder Protections

## 5.1: Introduction

The Saudi Companies Law has recently been reformed. The reformation was in response to financial challenges in regards to oil and the government's desire to diversify the nation's economy. Indeed, the Saudi minister asserts that the object of the recently passed Companies Law is to stimulate the Saudi economy for initiative and investment. In other words, to improve and enhance Saudi's private sector and help it to contribute more to the Saudi economic cycle instead of the current Saudi model where the government is the biggest player in the economy. In addition, corporate law is considered one of the main factors of any nation's legal structure. It is generally considered a fundamental component of commercial regulation in any country. It is the law that defines the legal tools entrepreneurs can use to legally practice their business and assure their protections.

Corporate law serves many purposes. It regulates interactions and resolve conflicts between shareholders, between shareholders and company managers, and between outsiders and the company. Corporate law also shapes the features and characteristics of each company and lays out the requirement to make the corporation legal. By meeting these conditions and obligations, investors receive the full advantage of incorporating their firms.

The objective of corporate law is not merely to help expand the wealth of the shareholders. While the previous statement might be accurate when specifying the duty the corporate directors and officers owe their company, the goal of corporate law itself is broader and more socially aware. It is believed that corporate law's objective is "to serve the interests of society as a whole. More particularly, the appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm's activities, including the firm's shareholders, employees, suppliers, and customers as well as third parties such as local communities and beneficiaries of the natural environment." This chapter will deliver a brief overview of the history of Saudi corporate law and describe the business vehicles the law recognizes. The scope of this chapter will then be narrowed to investigate shareholders' protections in a joint stock company because it is the type of vehicle focused on by the OECD's corporate governance principles. This chapter will wrap up by highlighting minority shareholders in a joint stock company.

minority shareholders in a joint stock company.

## Section 2: Saudi Companies Law Overview

### 5.2.1: Overview

The history of Saudi corporate law goes back to the middle of the twentieth century. The first corporate statute was enacted in 1965 through a royal decree by King Faisal bin Abdulaziz. The first Saudi corporate statute was heavily influenced by the French legal system, a residual effect of previous French domination in the Middle East. The Saudi monarch later enacted a handful of reforms and modifications to the first corporate regulations. However, on November 3, 2015, Saudi lawmakers passed a new Companies Law that contains major changes to the previous corporate law. Despite these significant revisions, however, a number of the original articles were retained, although in a different order.

### 5.2.2: Corporations Types

Saudi corporate law organizes the process to incorporate a company. Investors have five types of corporations they may choose for their firms: general partnership, limited partnership, joint venture, limited liability company, and joint stock company. Of all these types of firms, a limited liability company and joint stock company are the only two that feature limited liability. In other words, all or some of the shareholders in a general partnership, limited partnership, and joint venture are vulnerable to personal claims for the company's financial obligations if the company defaults on its debt. Brief definitions of each of these company types will be addressed.

**General Partnership**

A general partnership, or *Sharkit Tadamon*, is a company that can be established between two or more individuals and registered in the Saudi commercial register. All of the shareholders of a general partnership will be held personally or jointly liable for the entire debt of the company. This company has a legal identity that differentiates it from its shareholders. However, its partners have no limited liability.

**Limited Partnership**

A limited partnership, or *Sharitkat Altawsya Albaseta*, is a company that can be composed of two or more partners and recorded in the commercial register. This type of company has the privilege of being a person for legal purposes, yet it has no limited liability at least for one of its shareholders. This company can be composed of one shareholder who is a general partner and one or more limited partners. The general partner will manage the company and be personally responsible for the entire debt of the enterprise. The limited partners, on the other hand, will not be part of the management and will be accountable only for the amount of shares they invested in the business.

**Joint Venture**

A joint venture, or *Sharkit Al-mahasa*, is a silent company that can be founded by two or more shareholders. The meaning of a silent company is that the law does not require the shareholders in this enterprise to publish or register the company in the commercial register. Further, unlike the other types of corporations, this type of company will not have the privilege of the juristic person. The creditors of this type of company have the right to hold the shareholders jointly or personally liable for the company's entire debts.

**Limited Liability Company**

**Limited Liability Company**

A limited liability company (LLC), or *Sharkit That Al-msolya Almahdoda*, is a corporation that can be composed of one person or more but may not exceed a total of 50 members. From its name, the shareholders of this type of firm would be fully protected from personal liability and would only be liable for the amount of capital they invested initially in the enterprise. There is no minimum capital requirement to establish an LLC in Saudi Arabia. The law mentions, however, that the LLC's capital must be sufficient to achieve its goals. The law is clear in prohibiting this type of firm from practicing any business related to banking, lending, insuring, or investing for others. The prohibition exists to prevent the owners of an LLC from making an initial public offering to gain or increase its capital. If the investors desire to offer their LLC shares for public trading, they have to change their company from an LLC to a joint stock company, which would then entitle them to make the initial public offering.

**Joint Stock Company**

The final vehicle the Saudi Companies Law awards its investors, and the most important type of firm in the eyes of the OECD's corporate governance principles, is a joint stock company (JSC), or *Sharhat Al-mosahma*. It is a company that can be composed of one natural person or more. Nevertheless, the law requires that if just one natural person establishes a JSC, the JSC's name must indicate that it is owned by one shareholder. The major feature of this company type is the concept of limited liability. The shareholders of this type of company will not be financially accountable for more than the shares they invested in this enterprise. However, this general concept of limited liability has some exceptions regarding the management and the board of directors. The holdings of a JSC are divided into multiple kinds of shares or stocks, and these shares or stocks can be tradable. The law asserts that this type of firm is required to have a minimum capital of 500,000 Saudi Riyal (around $133,000 U.S.). In fact, the law indicates that the company's capital must be sufficient to accomplish the corporation's goals.

There are two types of JSCs: public (listed in the stock exchange) and closed (unlisted in the stock exchange). Even though the similarities between the public and closed JSCs are many, there are some distinguishable differences. The most significant difference is that the public JSC is listed in the stock market and is required to follow Saudi stock market authority regulations, while the private JSC is not listed in the stock market and is required to follow only commercial and investment ministry regulations. The next section will navigate the protections the law awards shareholders of a JSC.

## Section 3: JSC Shareholder Protections in Saudi Corporate Law

Saudi corporate law protects JSC's major parties, such as shareholders, directors, and creditors, with a decent number of articles that assure their protections. Indeed, out of 227 total articles in Saudi corporate law, 99 articles are devoted to merely clarify JSC protections. In other words, more than one-third of Saudi corporate law has been dedicated to JSCs and their safeguards. Shareholders are awarded a large chunk of articles that illustrates their legal positions and protections. Before addressing these protections, we must initially reassure a legal issue in the Saudi legal environment. That is, there are a number of laws and regulations that protect a public JSC's shareholders other than Saudi corporate laws, such as *Nidam Al-taswiya Alwaqia mn Al-iflas* (compromise to avoid bankruptcy law), Nidam *Al-mahkma Al-tejareia* (commercial law), *Nidam Soq Al-mal* (capital market law), and *Hawkmat Al-sharikat* (corporate governance regulation).

However, we will focus on JSC protections awarded in the new Saudi Companies Law. There is plenty of Saudi corporate literature providing information and criticism about shareholder protections under the old Saudi corporate law and other laws and regulations. However, because the Saudi Companies Law is so new, there is little literature on the subject. This section will address protections mentioned in any Saudi laws or regulations that the OECD corporate governance principles highlight as important.

Saudi corporate law divides these shareholder protections into two types: explicit and implied. Explicit protections grant the beneficiaries direct rights. For instance, shareholders who possess 5% of the company's shares have the right to request a court investigation. The qualifying shareholders must demonstrate grounds for suspicion that the directors or officers are damaging the company. Implied protections, on the other hand, are the type of protections that relies on indirect methods to safeguard shareholders, such as intimidating violators with severe sanctions or demanding JSC to establish internal independent bodies to monitor wrongdoing. For instance, Saudi Companies Law provides severe sanctions to company management, which reports misleading information in JSC financial statements. The penalty for the previous action could reach up to five years in prison, 5 million in Saudi Riyal fines, or both, as it dependent to the court discretion. The penalties work as a deterrent for directors and officers and establish a powerful prevention against wrongdoing. This section will start by addressing the direct protections for shareholders and follow with the implied protections.

### 5.3.1: Shareholder Direct Protections

The basic and direct protection for a JSC's shareholders in the Saudi Companies Law is their right to have full legal recognition to their stocks. This legal recognition entitles shareholders to have absolute control over their stocks and the ability to transfer or sell their stocks whenever they wish. The shareholders have the right to receive dividends. When the company decides to distribute some of its profits in the form of dividends or additional stocks, the shareholders have the right to get their fair share of dividends or stocks. Also, the law guarantees shareholder protections when the company dissolves. A JSC's shareholders are assured of their right to receive whatever is left of the company's assets when the company dissolves. The distribution is on a pro rata basis.

Additionally, the shareholders' investments are protected when the company fails to incorporate in accordance with the law. The law asserts a shareholder's right to be fully refunded the amount they invested in the JSC in the event the JSC's founders did not follow the legal procedures of incorporation as articulated by the law. The law explains the legal process to incorporate a JSC. The JSC's founders must follow these procedures, such as filing a claim in the commercial and investment ministry and registering the JSC in the commercial register. Should the founders fail to follow the legal procedures to incorporate a JSC, the JSC won't be recognized, and the founders are personally liable to compensate the JSC's shareholders for the full amount of their investments.

Moreover, the law assures a JSC's shareholders of their rights to attend and vote in the JSC's general assembly. Every JSC must have an ordinary general assembly held at least once annually. The meeting must take place during the six months subsequent to end of the annual fiscal year of the company. The board of directors is the entity responsible for calling the meeting. The law, however, permits those who own 5% or more of the company's shares the right to request the board of directors to call the meeting. The law insists that, upon this request, the board of directors must call for a general assembly meeting.

The general assembly has the final authority to run the enterprise. Some major assignments of this assembly are to elect and discharge those who manage the company, amend the company's bylaws, and appoint an audit committee. The law demands that electing the board of directors must be conducted through the cumulative voting process. This process offers better chances for minority shareholders to have a voice in electing the board of directors. Managing a JSC is executed through the elected board of directors. The law requires that the company's bylaws state the number of directors on its board, which must be no less than three individuals and not more than 13. In addition, the general assembly has the right to discharge any board member without violating these fired directors of their right to be compensated if the discharge is for no legitimate reason. Furthermore, the company's bylaws cannot be amended without the general assembly's approval. The general assembly has the supreme authority to modify the company's bylaws. The board of directors can merely make recommendations for amendments. In addition, the general assembly appoints the audit committee members. The audit committee is responsible for reviewing the company's actions and its financial documents and may request clarification from the board of directors or management. This committee also has the right to request the board of directors to call for a general assembly in the event the committee notices any violations.

Furthermore, the law is flexible and has permitted the use of new technology that allows shareholders to attend and vote during the general assembly session without being physically present at the meeting. While this could be considered a practical right to shareholders, the decision to facilitate general assembly attendance rests in the hands of the company and its bylaws. Furthermore, a JSC may call for an extraordinary general assembly to modify the company's charter. The law, however, asserts that a JSC is prohibited from modifying the company's charter by a method that jeopardizes its shareholders. For instance, an extraordinary general assembly cannot decide to prevent shareholders from accessing company data or monitoring board members' actions or deny the resolutions of the ordinary general assembly. Also, the law is clear that, if the result of the company's charter modification during the extraordinary general assembly raises the company's financial obligations, then this decision must receive a consensus approval from all shareholders, not merely a simple majority.

Shareholders of a JSC have the right to access the company's data and question the board of directors. The law obligates a JSC's board of directors to prepare and publish the company's financial statements every fiscal year. The board of directors must publish these in a daily newspaper or provide the shareholders personally with a copy of the statements if the company did not publish them in the newspaper. The shareholders have the right to question the board of directors about any concern in the financial statements or any other issues not related to the statements.

In addition, the law assures that members of JSC's board of director are personally and jointly liable to compensate the company and its shareholders when their actions damage the company. The legal tool to hold them personally responsible has been identified by the law as a "liability action," which is similar to a derivative suit in the common law legal system. In the Saudi corporate law context, a liability action is a legal claim available to shareholders that can be raised against directors if their actions result in damaging the company. This suit will be filed on behalf of the corporation, not just those who raise it. Hence, the award will benefit all shareholders of the corporation in the event of a favorable ruling by a judge, just like the derivative suit. This type of suit can only be brought with the general assembly's approval. The mechanism to initiate this suit begins with adding the topic of the liability action to the general assembly meeting agenda. The shareholders then vote on this item, and if the shareholders approve of suing the directors, the general assembly appoints the person who will file the case and follow up in its process.

Article 80 of the Saudi Companies Law entitles one or more shareholders to raise a liability action and claim a personal award for damages, only when the directors' action damages the shareholder personally, rather than all of the company's shareholders. This suit can be interrupted as personal suit. An example of grounds for a personal suit is when the company distributes dividends to the shareholders but excludes one of them. The one shareholder who does not properly receive dividends then has the right to sue the company personally. The next section will speak comprehensively about both liability action and personal action in Saudi corporate law.

Another safeguard is offered to shareholders who own 5% or more of the company's equity. The law asserts that those who own 5% or more have the right to request a judicial intervention to investigate the actions of the board of directors or the auditors if their actions are suspicious. An example of this remedy is as follows: If a shareholder who owns at least 5% of the company's stock believes that the board's actions are suspicious or that the board may be falsifying financial documents, this shareholder can ask the judiciary to intervene and investigate the issue. The cost of the investigation will be upon this shareholder until his or her claim is proven genuine. When the court verifies that the claim is accurate, the court then will issue any necessary restraining orders, including and not limited to suspending the board or appointing a new manager temporarily until the general assembly may appoint a new one.

The new Companies Law also calls for capping the compensation of JSC's directors

The new Companies Law also calls for capping the compensation of JSC's directors and forbids them from disclosing the corporation's secret information. The law sets a ceiling for the compensation the board members may receive. The compensation must not exceed 500,000 Saudi Riyal annually for each member (around $133,000 U.S.). This provision is designed to deter any attempt by the board to take advantage of its position. Also, board members are not allowed to divulge the corporation's secrets to anyone except the general assembly. They cannot disclose any sensitive information they have access to in order to gain any personal advantage for themselves or their relatives. Failing to honor this requirement exposes board members to being discharged and sued for compensation.

Duty of loyalty is clearly emphasized in Saudi corporate law. The statute asserts that any board member with personal interest in any transaction the company makes must disclose this interest to the board and decline from voting on the matter. The law expects that any such personal interest will be covered whether it is explicit or implicit. If the board member fails to disclose his or her interest to the board then he or she will be accountable to the company for any profit he or she makes out of the transaction. Also, the company can ask the judiciary to invalidate the transaction. Furthermore, no board member may own a personal business that is similar to the company's business. If a board member violates this prohibition, the company has the right to file a suit seeking compensation for damages that result from improper competition. However, the law exempts those board members who obtain a license from the general assembly to continue practicing a personal business similar to the JSC's business, which must be renewed annually.

The shareholders are also protected from any damage that results from the audit committee's actions. A JSC's general assembly votes during its ordinary meeting to elect the company's audit committee. This committee has access to the company's financial statements. This committee's main responsibility is to deliver to the general assembly a report that indicates any violations by management. Also, the committee must verify that the company's financial statements are accurate. In the event the audit committee fails to comply with these duties, the committee members will be held personally liable if their actions result in damage to the company or the shareholders.

To sum up, shareholders in a JSC are provided with significant rights that assure them of their protections. In the event a direct violation occurs to a JSC's shareholders, the law grants these shareholders a right for compensation. An obvious observation is that the Saudi corporate law provides the JSC general assembly with a number of rights that make assembly members eligible to run the company, side by side with the company's board of directors. This approach is considered different, for instance, to that of the majority of U.S. corporations. To clarify, Saudi corporate law, as was mentioned earlier, provides the JSC general assembly with significant rights, such as electing an audit committee and filling derivative suits. This stands in contrast to U.S. corporate law approaches. For example, shareholders' powers in the majority of U.S. corporations is limited to replacing a company's board of directors, or deciding on material business decisions, such as merger transactions. Other than that, the board of directors has the absolute authority to run the firms, without the intervention from the company general assembly. The upcoming subsection will shift the attention to demonstrate the implied safeguards the Saudi Companies Law grants a JSC's shareholders.

**5.3.2: Implied Shareholder Protections**

Shareholders of a JSC also enjoy a number of implied protections. While, noticeably, the purpose of these implied safeguards is to protect a JSC's shareholders, they utilize different methods. To clarify, the law follows two different approaches to protect JSC's shareholders. The first approach obligates the JSC to create independent bodies. These independent bodies have the responsibility to inform the company's management and the general assembly regarding any violations of the company's charter or bylaws. In other words, every JSC must have internal police that monitors the company and validates its actions. The second approach uses deterrence in criminal and financial sanctions for violations by company officers, directors, and JSC related parties.

### Independent JSC bodies

The first method of implied safeguard a JSC's shareholders has is obligating a JSC to have both an audit committee and an external auditor. The audit committee was introduced for the first time in the newly reformed Companies Law; the 1965 Saudi Companies Law had not recognized this. In addition, the ordinary general assembly appoints the audit committee members. The audit committee, as we note, is responsible for reviewing corporate actions and the company's financial documents and may request clarification from the board of directors or management. This committee also has the right to request the board of directors to call for a general assembly in the event the committee notes any violations. This committee must be composed of a minimum of three and up to five members, who must be non-executive members. To clarify, these committee members could be members of the board of directors but must be independents. In other words, if a director is occupying an executive position in the company besides his or her position in the board, then this director is not eligible to be a member of the audit committee. This requirement to have non-executive members fill the audit committee is apparently designed to assure the shareholders that the committee can act as an independent watchdog of the company and its financial documents.

The external auditor is also required to be another independent entity that oversees the company's financial documents while existing outside the company. The law asserts that every JSC must employ one or more external auditors. This external auditor must be independent and must have not worked in the company or even with one of the company's directors or management members. The external auditor must be completely independent from any interest that could tie him or her to the company or its management. The auditors cannot work for the JSC for more than five continuous years. The auditor has the privilege of accessing all the company's financial data and can make further inquiries of the management if the auditor sees fit. Also, the auditor ensures that the JSC's financial documents are accurate and complete. Should the management decline to assist the auditor's work, the auditor must document the incident in a report and deliver it to the board of directors. If the board then fails to take action, the auditor must ask the board of directors to call for a general assembly, which then has the authority to settle the issue.

To summarize, requiring JSCs to have an audit committee and an auditor, both of which must be independent, indicates that Saudi legislators consider the financial documents of JSCs to be an important tool for the stock market generally and company shareholders particularly. These two entities, an audit committee and an auditor, would work as internal monitors to assure the company shareholders of their company and its financial documents.

### Criminal and financial sanctions

The second implied protection for JSC shareholders is legal sanctions. These deter the company's managers, board of directors, and related JSC parties, such as auditors. Chapter 11 of the Saudi Companies Law lists the type of actions and the appropriate sanctions. These actions and their sanctions are varied and diverse; however, this subsection stresses the sanctions that contain criminal charges, as these are considered highly effective deterrents. Financial sanctions are also effective, but the financial sanctions easily can be shifted from the wrongdoer to the company. Thus, the company would be the one who pays these penalties instead of, for instance, directors or managers who committed the violations. This subsection will concentrate on the sanctions that carry imprisonment. These sanctions are a significant deterrent that reassures JSC shareholders that directors and managers are not expropriating their investment. Saudi corporate law contains two articles that list prison time as a punishment for violators. The Saudi Arabian Bureau of Investigation and Public Prosecution prosecutes cases that might include imprisonment sentences. The prosecution has the right to initiate a case on its own when it determines a violation has occurred or be instructed to prosecute the case based to suggestion of Capital Market Authority. In addition, if any individual repeats one of these crimes, the penalty is doubled.

**Article 211**

This article is considered as the most significant and severe article, which includes the highest imprisonment and fine limits, compared with other penalties the law carries. The law composes this article in five provisions. The law states that any one of those, who have been mentioned in this article, and who violate any provisions of it, could be punished by serving up to 5 years in person and a fine that does not exceed 5 million SR (around $1.3 million U.S.). The judge, who litigates this case, would have a full discretion to apply both of these penalties or one of them. For instance, the judge could decide to punish the wrongdoer with imprisonment only and vice versa.

The first provision in article 211 highlights the concept of reporting misleading information. The law states:

> "Every manager, officer, director, auditor or liquidator, who registers deliberately false or misleading information in the company's financial statements (or the reports he or she made for the partners or the general assembly contains false or misleading data); or fails to insert material facts in such statements or reports aiming at hiding the company's financial position from the partners or others."

Obviously, the legislators consider an accurate financial statement to be of critical importance to the shareholders. The purpose of this article is to deter those who control the financial statements from reporting misleading information or hiding material data that might, when known by shareholders, cause them to respond. This provision sends a clear message to those who run the company and who works for them. This message is controlling the company does not mean you tolerate with reporting correct and martial information in the company financial documents. Those who have been mentioned in this provision are obligated to report correct and accurate data in the company statements to avoid the probability of serving person time.

The second provision fights company fund expropriation for the personal interest of those who runs the company. Provision B of article 211 states:

> "Every manager, officer, or director who exploits the company's funds, knowing that such exploitation will prejudice the company, and aims to achieve personal interest, or giving benefit to a company or person, or getting benefit from a project or transactions in which he has a direct or indirect interest."

The provision uses the word "exploit" instead of the word "expropriate," as the former does indeed cover more actions than the later. The idea here is that the law will not allow either managers, officers, or directors to jeopardize company shareholders by exploiting or expropriating company funds for their personal advantage. The law is clear that the personal advantage of expropriation is not necessarily to be of direct interest, as implied personal advantage is considered as if it is direct. This provision, no doubt, is considered a significant safeguard for company shareholders who, especially minorities, are highly concerned with being expropriated when they invest in any company. Knowing that those who are found guilty of expropriating company funds would confront the reality of imprisonment typically assures them that those who run the company would be deterred from expropriating.

The third provision is designed to criminalize those who use their power in the company to benefit themselves and jeopardize the company and its shareholders. The difference between this provision and the previous one is that this provision speaks about those who use their "power" to jeopardize the company, not using the company "fund" as provision B insists. The law says:

> "Every manager, officer, or director who uses his powers or votes in a manner prejudicing the company's interest and achieving personal interest, or giving benefit to a company

> or person, or getting benefit from a project or transactions in which he has a direct or indirect interest."

The law again wants to assert shareholders that it would not tolerate those who consume their power in the company in a method that jeopardizes them and benefits the controllers.

The fourth provision, Article 211, highlights the importance of reporting company losses to the company general assembly in an urgent timing. Provision D declares:

> "Every manager, officer, director or auditor who fails to call for the general assembly meeting of the company (or fails to take the necessary action) while he or she is aware of the company losses has reached the limits articles no. 150 and 181 of the law states, or fails to publish the incident as set forth in the provisions of article 181 of the law."

The law states in Article 181 that, when JSC loses 50% or more of its capital, JSC must call the general assembly for an extraordinary meeting. To clarify, the law asserts that any JSC administrator or auditor who observes JSC 50% loss must notify the chairman of JSC board of directors immediately. The board, then, must call for the extraordinary general assembly to meet. During the meeting, the shareholders must decide whether to increase JSC registered capital, decrease JSC registered capital, or to dissolute the JSC before the time its charter indicates. The purpose of this provision obviously is to force the company representative to inform the JSC shareholders of the company losses before the company reaches the limit of absolute bankruptcy. This provision would give the shareholders the option to prevent company bankruptcy by, for instance, changing JSC company management who led JSC to this level.

Finial provision in Article 211 criminalizes the company liquidator who uses company assets, funds, and rights to jeopardize the company and its shareholders. The law states:

> Every liquidator, assigned to liquidate the company, who uses the company's funds, assets or rights held with third parties in a manner prejudicing the company's interest or intentionally causing damage to the partners or creditors, whether for achieving personal interest; or giving benefit to a company or person; or getting benefit from a project or transactions in which he has a direct or indirect interest, or giving priority for a creditor as to the collection of his dues without reasonable cause.

Again, the law desires to comfort the shareholders in the event the court-assigned liquidator runs the company until the latter finishes the process of company dissolution. Has this liquidator taken advantage of his or her position to benefit him or herself at the expanse of the company and its shareholders, then the law would penalize this liquidator with serious sanctions, which is another comfort message the law sends to JSC shareholders.

As we mentioned earlier, the punishment for the aforementioned wrongdoers is a fine and imprisonment, imprisonment only, or a fine only. The statute grants the court full discretion as to which penalties to impose in any case the court may encounter. Nevertheless, the law states that any prison sentence must not exceed five years and the fine must not surpass five million Saudi Riyal (around $1,333,333 U.S.). The next subsection addresses the penalties for Article 212 in Saudi corporate law.

**Article 212**

Saudi corporate law sets its offenses in a hierarchal manner. Serious offenses carry more severe penalties than less serious offenses. Article 212 addresses the offenses that are considered less serious than the offenses in Article 211. Article 212 also has been divided into multiple provisions. Each provision describes the type of action the law penalizes. The sanctions of all these provisions are the same: imprisonment of up to one year, fines up to 1 million SR (around $333,000 U.S.), or both of these penalties at the court's discretion. Two of the nine provisions in Article 212 are the most significant for shareholders, as these two are considered the most significant sanctions that trigger shareholders interest.

The first provision penalizes the company auditor, who confronts a violation during his or her work and declines to report it to the company representative who is responsible for managing this sort of violation. The law asserts that the auditor must report the violation, especially when this violation is considered a criminal one. As we have mentioned, Saudi corporate law requests that every JSC has an auditor that must be independent, in an effort to raise the level of credibility to later works. In addition to this request, the law would penalize this auditor seriously if his or her work has not implemented in accordance with the law. This provision obviously is designed to deter company auditors and force them to immediately reports any violations to avoid prosecution.

The second significant provision in Article 212 is considered vague and might include numerous actions in its context. This provision sanctions those who use the company for the purpose that was not licensed to do so. Meaning, when the company license indicates that it is a company that is permitted, for example, to practice transportation in Saudi Arabia, managers cannot decide all of sudden to use the company funds and assets to do agricultural business. The law here sends a message to company managers and directors that they must obligate themselves to practice the business the company has licensed to do and not other practices unrelated to pure company business. This provision is intended to comfort shareholders in that the company controller would concentrate his or her attention and work in achieving the objective the company seeks in its license and charter.

To summarize, shareholder protections are a significant component of Saudi corporate law. These protections have multiple forms. They could be in the shape of direct protections, such as requesting judicial investigations to those who own 5% of the company shares, or they could have the form of implied protections, such as the promise of criminal sanctions to those who violates the law. The next section concretes its attention to explore the significant protections that trigger minority shareholders in particular.

## Section 4: Minority Shareholders in Saudi Companies Law

As previously mentioned, shareholder protections serve both majority and minority shareholders. In other words, the safeguards that Saudi corporate law bestows to a JSC's shareholders are also granted to all of the JSC's stockholders regardless of the number of shares they possess. However, while some protections make no significant difference to minority shareholders, other protections certainly do. For instance, having the rights to attend and vote in the company's general assembly will not change the fact that majority shareholders will overwhelmingly decide the result of the meeting in the company that has the shape of concentrated ownership structure. Therefore, this section will navigate the protections that are highly significant to minority shareholders in the newly reformed Saudi Companies Law.

The first protection, which is introduced for the first time by the new Saudi Companies Law, affects the voting method for electing a JSC's board members. The law asserts that, to elect a JSC's board members, shareholders must use a cumulative voting method. Cumulative voting in this context means each share represents one vote, and, when shareholders are voting to elect the board members, they can either divide their shares to multiple board seating positions or concentrate their votes to one seat position. This voting system offers an optimal possibility for minority shareholders to have representation on the board. While the old Saudi Companies Law stated that a JSC's company charter determines the method of voting for the board of directors, the new law is clear that every JSC must use cumulative voting when electing its board of directors. It is worth mentioning that the OECD's corporate principles advocate for this voting method and state its effectiveness at enhancing minority shareholder rights.

Another protection highly important to minority shareholders is their right to sue their management personally for the personal damage the management did to them. This right, for instance, will assure minority shareholders that they are paid dividends when the company decides to distribute some of its profit to the owners of common shares. Should the management decide to distribute dividends to the owners of all common shares except minority shareholders, the latter can deploy this protection and sue management personally for the damages they incur. In other words, for any damage that affects minority shareholders personally, and not the entire corporation, this protection assures minority shareholders of their right to bring management to court without any procedural obstacles.

The law also tries to comfort minority shareholders and assure them that the board of directors won't be able to expropriate the company's investments. The method the law implements to achieve this goal is through capping the board members' compensation. The law is clear that a member of the board of directors is not allowed to receive compensation that exceeds 500,000 Saudi Riyal (around $133,000 U.S.). The law further asserts that the board of directors must disclose everything they receive from the company, including their salaries, in the general assembly's ordinary meeting. This level of transparency and the fact that the law limits the amount of financial benefit board members may receive from the company are considered implied means to shelter minority shareholders.

### 5.5: Conclusion

These safeguards could be considered the major protections Saudi corporate law effectively awards minority shareholders. While this thesis previously mentions significant tools to protect shareholders, such as the rights to raise a derivative suit, to request judicial investigation, and the promises of severe criminal and financial penalties to wrongdoers, this thesis argues that these protections do not deliver genuine and effective protections to minority shareholders. Hence, this section does not include them in the minority shareholder protections. The upcoming chapter will address comprehensively why the previous tools cannot be considered minority shareholder protections and illustrate how the new Saudi company law fails to protect minority shareholders.

## Chapter 6: Evaluating Minority Shareholder Protections of a JSC and Illustrating Their Failures

### 6.1: Introduction

Minority shareholder protections have been demonstrated to be significant to the economic development of any nation. These protections raise the level of credibility of any market and comfort investors with the knowledge that their investments are shielded from any sort of expropriation or abusiveness. The OECD advocates for protection of minority shareholders and encourages every nation to include articles in their corporate statutes that assure minority shareholders with basic protections. These protections primarily must circle around the concept of protecting minority stockholders from the majority's potential abusiveness. A quick overview of the Saudi Companies Law and the protections the law confirms suggest, at first glance, that lawmakers have succeeded in stating strong legal textual protections to a JSC's shareholders, including minority shareholders. For instance, knowing that Saudi corporate law guarantees a JSC's shareholders the right to bring either a derivative suit (Saudi Companies Law names it liability action) or a personal suit if management recklessly damages the company or them personally is considered a significant step toward strengthening minority shareholder protections and reducing agency problem.

This chapter, however, would not be satisfied with the mere solid textual safeguards the law provides but must also evaluate these protections to see whether these safeguards accomplish the legislators' goals. A stated objective the Saudi government seeks is to incentivize Saudi economic development and make investing more appealing to investors. One method of reaching the previous goal is through protecting the weakest class of investors in any economy, the minority shareholders. This chapter argues that the newly reformed Saudi Companies Law fails to protect minority shareholders and is, therefore, unsuccessful in providing legal rights that protect minority shareholders from agency problem. While the text of the law indicates solid protection for minority shareholders, this chapter argues that their mechanisms and enforcements render them fruitless. This chapter starts by answering the question of why a derivative suit is not an efficient or applicable tool for minority shareholders under Saudi corporate law. The section next will address why the concept of third-party intervention, particularly of the judiciary, does not make a significant difference to minority shareholders' safety. Finally, the chapter claims that delegating the right to prosecute the wrongdoers to the Saudi public prosecution unilaterally eventually fails to achieve its objective of deterring the wrongdoer. Hence, this chapter claims that, even though the newly reformed Saudi Companies Law articulates solid texts that seem to protect minority shareholders, their applications fail to deliver.

## Section 2: Why a Derivative Suit Fails to Achieve its Goals

### 6.2.1: Derivative Action Overview

Before explaining why a shareholder's derivative suit is unsuccessful at protecting minority shareholders in Saudi corporate law, we must initially deliver an overview of the concept of a derivative action. A shareholders' derivative action, which originated in the Anglo-Saxon legal system, is commonly known as a lawsuit raised by one or more shareholder on behalf of the company because of damages that were most likely the result of actions by the directors, officers, or an outsider. This suit challenges damaging actions for the purpose of seeking judicial reparation. Judges in common law countries, particularly England, originated this concept. The documented history of derivative actions indicates that they date back to the sixteenth century. Derivative actions were recognized by an English court considering a group action where a number of plaintiffs brought suit on behalf of themselves and other interested people, similar to a class action. Judges in the Chancery Court in England requested the "necessity rule" to litigate any case. The previous rule can be simply defined by stating that every interested party must be part of the legal suit before the court litigates it; otherwise, the defendant would demur and request the court to dismiss the case. The Chancery Court, however, developed an exemption to this rule, which is that a group's case will be admitted if there is solidarity of interests between the parties.

There is one English precedent, however, that strongly influences the corporate law literature and, more particularly, the arena of derivative suits. This precedent is *Foss v. Harbottle*. This litigation started when shareholders in Victoria Park Company sued its managers alleging that management harmed the company and its shareholders. Yet, the defendants argued that the company was the entity responsible for raising the suit, not shareholders. The court responded by asserting that, if a corporation is exposed to damages, only corporations could sue to recover those damages. In other words, majority or minority shareholders cannot sue the corporation's representatives on behalf of themselves for damages to the company. Thus, the decision to file a lawsuit against the company's representatives, according to *Foss*, rests in the hands of the company's general assembly. The principle the court adopts here is observable. The court considered the corporation as a fictional person with a legal personality that must be differentiated from its shareholders. However, the court stated exceptions to this concept. That is, when a company's general assembly fails to respond to shareholder demands, or when a corporate management commits fraud or misleading actions, a shareholder has the right to sue on the company's behalf. The court in England awarded shareholders the right to file a derivative suit if they could demonstrate one of the exceptions above.

The history of derivative suits in England indicates that it was paused up until 2006. The justification for this pause was an English legislative intervention that resulted in

The justification for this pause was an English legislative intervention that resulted in passing the Companies Act in 1948. This statute enhanced restrictions on shareholders to raise derivative suits against either the company's board of directors or corporate officers. This action was shifted, though, when the English legislators passed the 2006 Companies Act, which acknowledges shareholders' right to raise derivative suits without preventable restrictions.

Furthermore, the history of derivative suits in England can be clearly distinguished from the United States' experience. Even though United States courts adopted the "necessity rule" from English courts, which means that all interested parties must be part of the litigation before the court considers it, cases in the United States are unique and distinguishable. United States' courts are more flexible in accepting litigation of derivative suits and do not restrict derivative actions on precise exceptions as do English courts. This notion does not mean that the history of derivative suits in the United States does not carry any limitations at all. In fact, U.S. courts initially started by requesting any shareholder who intended to raise a derivative suit to demand a managerial intervention that sought to correct the corporate damage. Should the management fail to fulfill the shareholder's call, the shareholder has the right to file a derivative suit. However, the point here to illustrate is that the U.S. experience with derivative suits was more flexible when compared with the English experience. To conclude this brief overview about derivative actions history, courts in common law countries such as England and the United States invented and refined this lawsuit. The movement to protect shareholders through derivative actions has reached other nations. In fact, the OECD's principles highlight the importance of granting the shareholders the means to litigate the company's directors and officers when they abuse their powers. In light of this overview, we will evaluate Saudi derivative actions and illustrate why they fail to protect minority shareholders.

### 6.2.2: Saudi Derivative Action Failure

As we mentioned in the previous section, Saudi legislators awarded the shareholders of a JSC the right to raise a derivate suit, yet they have named it "liability action or suit" *Dawa Almswlia* instead of derivative action. The first issue that needs to be illustrated is that the concept of derivative actions in the Anglo-Saxon system is different than how it is understood by Saudi legislators. In fact, what is clear is that the context of Saudi corporate law indicates that Saudi legislators understand the concept of derivative actions in a narrower perspective. A derivative suit in the Saudi Companies Law is considered a lawsuit that merely challenges the board of directors of a JSC when they act recklessly and damage a corporation. In other words, Saudi legislators did not grant shareholders the right to sue outsiders who damage the company with their actions while a company's management resists taking action. The law context is clear here on limiting the lawsuit to the board of directors when their actions damage a company. Therefore, shareholders in a JSC are not able to litigate against outsiders on behalf of the company such as in the derivative suit model in England and United States. For instance, Delaware courts granted the shareholder in *Dodge v. Woolsey* the right to sue the state on behalf of the company because of a law the legislators passed that obligated their company to pay income taxes. While the management in *Dodge v. Woolsey* refused to challenge the state law, shareholders did so with the derivative action tool. In this example, an obvious recognition to bring a derivative action against an outsider is inherent in the derivative actions literature. However, Saudi legislators have declined to recognize it. The derivative action concept, though, in the Saudi instance has covered damages that are the result of directors' recklessness.

Yet, Saudi legislators not recognizing that a derivative action could go beyond directors to reach out to third parties is not the real concern. In fact, it is rare in the U.S. corporate literature to find cases that challenge outsiders who damage a company. The real concern is concentrated in the derivative suit mechanism where the Saudi Companies Law obligates a JSC's shareholder who intends to file a derivative action to ask for permission from the company's general assembly. To illustrate, Article 79 of the Saudi Companies Law explains the process shareholders must follow to gain the privilege of raising a derivative suit on behalf of the company against its board of directors. In this process, shareholders of any JSC must ask to include in the ordinary general assembly agenda a derivative suit topic. This topic is basically asking to get the assembly's approval to raise a derivative suit against one or all of the company's directors or officers. Should the general assembly approve this call with a simple majority vote, the general assembly appoints a lawyer to follow up with the suit. However, should the general assembly deny the call for a derivative action, then the company would be denied from raising the suit. In other words, the board of directors or officers would receive immunity from litigation. Thus, the main point of a derivative action in Saudi corporate law is restricted by the acceptance of the general assembly.

To understand why this is considered a significant deficiency, especially for the minority shareholders, we must understand the concept behind who elects the board of directors and company officers. In the normal course of business, members in the board of directors are elected directly from the company's shareholders during the general assembly. The shareholder who owns the majority of shares gets the advantage of electing the majority of the board of directors' seats. This is the case when the company has the shape of concentrated ownership structure. Of course, the voting policy shapes the board of directors. For example, a cumulative voting policy brings a better chance for minority shareholders to elect a representative member to a board. However, the argument here is that, eventually, the majority shareholders in a concentrated ownership structure, which is identical to the Saudi ownership model, gain the advantage to appoint their preferred board members who lead the company, and this action with no doubt is their simple right. The significant obstacle that confronts minority shareholders in Saudi corporate law is that if they want to challenge their board members' decisions, they must seek permission from the general assembly of a company controlled by majority shareholders when the latter are the folks who appoint the board members in the first place. Sometimes, the majority shareholders are themselves members of the board of directors. By applying simple common sense, the majority shareholders would not allow the small minority shareholders to sue either themselves as board of directors' members or others they've elected to the board. The Saudi Companies Law's demand for approval by the general assembly to raise a derivative suit impedes the minority shareholders' ability to sue and makes their chances of proceeding very small, if not entirely impossible. While this mechanism of bringing a derivative suit could work in companies, in which their ownership structures are dispersed, similar to Berle and Means model, it would fail miserably in a concentered ownership structure similar to majority of Saudi companies listed in the stock exchange. It is worth mentioning that Al-Ibrahim claims that no minority shareholders in the Saudi stock exchange could ever raise a derivative action in the name of the company.

Other nations that have gone through the same deficiency have confronted it with some innovative solutions. Italy and Spain do not require permission by a general assembly and merely demand that the minority shareholders have 2% or 5% of the company's shares to be able to raise suit. In fact, in the previous instance, the minority shareholders can cumulate their shares to reach the threshold the law requires. In extreme contrast, derivative suits in American law can be brought by a single shareholder with no restrictions.

### 6.2.3: Why Article 80 of Saudi Company Law Cannot Be Considered as a Tool Similar to Derivative Action?

The purpose of derivative action, as mentioned earlier, is to redress the damage that injured the company and not shareholder personally. Article 80 of Saudi Companies Law states: "Every stockholder shall have the right to file a liability claim against the members of the board of directors on behalf of the company if the wrongful act committed by them is of a nature to cause him personal prejudice. However, the stockholder may file such claim only if the company's right to file such claim is still valid and after notifying the company of his intention to do so. If stockholder files such claim, he shall be adjudged compensation only to the extent of the prejudice caused to him." The obvious confusion this article raises is the fact that it named this suit as "liability claim or action" *Dawa Almsolia*, which is identical to the name Article 79 uses to describe a derivative suit and its mechanism. Article 80 sets the conditions to be eligible to file this suit. It states, first, a shareholder must suffer from personal damage. Second, a shareholder cannot file this suit unless the company has the right to file such claim. Third, a shareholder must notify the company about his or her intention to raise this claim. Finally, the sought remedy should be personal and not seek compensation for the entire company damage. The question now would be: Can a shareholder of a public company, who suffers from a reckless director's decision that resulted in damaging the company stocks value, raise this liability claim or action and seek personal compensation instead of derivative action?

Before we answer the question, we should mention that this article had been mentioned identically in the old version of the Saudi Companies Law. Indeed, Saudi corporate law of 1965 contained an identical article in a different order in the statute. Many Saudi scholars stress the level of confusion created by this article. Al-Zahrani asserted that this article creates confusion between personal action and derivative action. Al-Zahrani even argues that this article could lead to "vexatious litigations," where a number of shareholders would raise this suit seeking personal compensations, and the biggest sufferer would be the company and the entire economy. Al-Zahrani concluded his argument by stating that Saudi lawmakers should clarify this suit and remove its ambiguity.

We agree with Al-Zahrani's analysis and even clarified this matter. We argue that the reason behind this confusion is the fact that the law treats both JSC companies, publicly held and closely held, with the same articles. Public JSC is a completely different corporation than closely held JSC. The public JSC shareholders have immediate access to the stock market where they can sell their shares in a matter of moments, while close held JSC shareholders have no market or accessible channels to sell their shares. Also, public JSC tends to have hundreds if not thousands of shareholders, unlike close JSC, which tends to be small and may have a handful of shareholders.

In regards to the previous discussion, we should analyze Article 80. This thesis argues that the law has designed this suit to redress the damage that confronts both the company and the shareholders in closely held JSC. In other words, the nature of this damage is based on the fact that it affects a company and its minority shareholders at the same time. We know that a derivative suit addresses damage a company may incur, while a direct suit addressed damage that shareholders individually experience. Therefore, we believe that Article 80 of Saudi corporate law creates a tool that is designed to reimburse damage that has a mixed nature of derivative and direct suits. This type of suit could work only to treat shareholders of closely held JSC and would fail miserably to address damage of publicly held JSC.

The notion that a minority shareholder could sue the private company board of directors directly, even though the company is the entity that incurred the damages not just the minority shareholder, is not a new concept. Indeed, the Supreme Court of New Hampshire had recognized that minority shareholders in a private company could directly litigate company management, even though the damage was experienced by the company and not just by minority shareholders. The facts in *Durham v. Durham* stated that the New Hampshire company is a closely held corporation, which had the entitlement of a camp and was its daily operator. This company had four shareholders. Durham, the plaintiff, owned 40% of the company shares, and the defendants, the remaining three shareholders, owned the residual 60% shares, with 20% for each. The defendants were the directors and executives of the camp and had excluded plaintiffs from any position. The defendants had used the camp's propriety to benefit themselves, such as living on the camp propriety without paying for the renting expenses. The plaintiffs sued the defendants directly alleging that the company incurred losses that were reflected by the defendants' actions. The defendants claimed that the plaintiff had no right to file a direct suit because the company incurred injuries, and the plaintiff should follow the procedures to file a derivative suit. Therefore, the defendants urged the court to dismiss the case.

The trial court agreed with the defendants' arguments and dismissed the plaintiff claim. However, the court of appeals declined with the trail court's conclusion and stated that plaintiff could file a direct suit, even though the company incurred damages. The court explained that a derivative suit is required to "(1) prevent multiple lawsuits; (2) protect explained that a derivative suit is required to "(1) prevent multiple lawsuits; (2) protect corporate creditors; (3) protect the interests of all shareholders, rather than just the shareholder bringing the claim; and (4) protect the shareholder bringing the suit through an increase in the value of her shares." However, in the plaintiff facts, and when a closely held corporation suffered injuries, minority shareholders could raise a direct suit, even though the shareholder did not incur the loses individually.

Going back to the Saudi example of Article 80, this thesis argues that this suit is designed to treat damages that are suffered by the closely held JSC, which has few numbers of shareholders. We agree with the importance of this article to unlisted JSC; however, we conform that this article's limits were never meant to include public JSC. This thesis agrees with the presented argument and by Al-Zahrani's discussion. This thesis also agrees with the call for clarifying this article to remove any possible ambiguity.

To summarize this section, minority shareholders under the Saudi Companies Law are restricted in raising derivative actions against the company's board of directors or officers because of conditions demanded by the law. Requesting the approval of the company's general assembly, which is prejudiced toward the majority shareholders, kills the minority shareholders' opportunity to challenge board members' decisions. The next section will highlight why judiciary intervention cannot be considered a strong defense to protect minority shareholders.

## Section 3: The Judicial Investigation Tool's Failure to Protect Minority Shareholders

Saudi corporate law awards minority shareholders who own 5% of the corporation's shares the right to ask the judiciary to investigate their company. The law restricts this investigation tool to a specific shares' threshold. That is, this investigation tool is available to shareholders who possess at least 5% of the company's shares. These 5% shareholders have the right to call for an investigation. In addition, the law asserts that the shareholders' appeal must contain indications that the actions of the board of directors or the external auditor are reasonable to doubt. The 5% shareholders' owner could be a singular owner or plural. In other words, the law accepts that multiple shareholders in a JSC may aggregate their shares to reach the threshold. While this tool should be considered a major and significant means of protection that minority shareholders enjoy, we argue that the mechanisms to employ them make them ineffective and even unpractical.

However, before illustrating why the judiciary investigation tool fails to genuinely protect minority shareholders, it is essential to include some background information. The judicial investigational right of minority shareholders is not new to Saudi corporate law. In fact, the old version of the Saudi Companies Law, which dates back to 1965, contained an identical provision. In other words, it is not a new tool that was recently introduced with the newly reformed Saudi Companies Law. It is believed that the Italian, Dutch, and English company laws recognized this condition first. Indeed, Article 2409 of the Italian corporate law assures that those who possess 10% of a company's shares have the right to raise a claim in the judiciary by stating their belief that there are "grounded suspicions" concerning the managers' actions. The only difference between the Italian corporate law and Saudi corporate law in this particular matter is the threshold. Saudi lawmakers are satisfied with a mere 5% of shares, while Italian regulators believed that 10% of shares is necessary.

Going back to this tool in the Saudi corporate law context, the urgent question is why this powerful minority shareholders' tool is unsuccessful at sheltering minority shareholders. The quick answer is because the method the law uses to implement the protection did not recognize the concentrated ownership structure of Saudi companies. Article 100 in the Saudi Companies Law defines the process to use this tool. It states that, when 5% possessor shareholders have solid indications to suspect board members' actions, they can complain to the commercial court and request the court to investigate the company. The article asserts that the court can set up a personal hearing of both the company's board of directors and its audit committee. The court has the right to initiate a company investigation at the expense of those who demand the investigation. Should the company investigation at the expense of those who demand the investigation. Should the court confirm the complaint, the law allows the court to issue necessary protective orders, which may include isolating the board members. The court, then, must call the company's general assembly to meet and make arrangements. The law asserts that the general assembly has the ultimate power to make any arrangements after the court's discovery.

When the law requires the general assembly to make the ultimate arrangements and permits the court to issue protective orders that end up requiring validation from the general assembly, the law fails to genuinely protect minority shareholders or deter wrongdoers. The genuine concern is that, when the court confirms an actual violation by the board of directors, the court should respond to this violation by permanent sanctions, not protective orders that are pending for the general assembly to eventually make the final call, especially when the ownership structure of the company is concentrated. The general assembly is prejudiced toward the board of directors. Indeed, the majority of shareholders are the ones who appoint board members in the first place. To summarize this argument, the law fails to protect minority shareholders because the final say in a court investigation rests in the hands of the general assembly, an entity that is biased and controlled by majority shareholders. While the law allows the court to issue protective procedures, the orders can remain pending at the general assembly's will. When the court actually confronts a genuine violation by the company's board of directors, and the law mission is restricted to protective orders, then the law has logically retracted the court claws. These laws would have effectively sanctioned and deterred any wrongdoers or potential violators had they been correctly articulated. The next section will clarify why delegating the right to prosecute wrongdoers via Saudi public prosecution also fails to protect minority shareholders.

## Section 4: Saudi Public Prosecution's Failure to Enforce the Law's Serious Sanctions

The Saudi Companies Law carries a large number of offenses with sanctions that range from imprisonment to fines or both. These offenses are diverse in nature and cover many aspects that are well considered by all interested parties, including shareholders. For instance, reporting misleading information in a JSC's financial statements might subject the company's board of directors to sanctions that include up to five years in prison. The same penalty applies to managers and directors who misuse their authority and expropriate company funds. These are two out of many offenses tied to criminal charges, the Saudi Companies Law assures the market. These sanctions do indeed deliver the Saudi legislators' goals. That is, they deter potential wrongdoers and assure interested parties in the market, such as shareholders and creditors, that company representatives will lead with the highest integrity and morals without misleading them. In fact, the simple possibility that board members could confront criminal charges and be prosecuted can be sufficient to deter them. Moreover, the harsh sanctions the law embodies are believed to significantly benefit all interested parties in the Saudi market, especially minority shareholders. In fact, the severe penalties assure minority shareholders that company managers and directors are watched by an entity that is responsible to prosecute those who violate company law. However, this chapter argues that the entity, precisely the Saudi public prosecution that is responsible to enforce these severe penalties, is not genuinely an independent entity and might fail to enforce the law. Hence, this would weaken minority shareholder positions, as some companies' managers and directors would not be deterred from the serious sanctions in accordance with the law.

To understand the significance of this failure, we need to recall some information already addressed. That is, the entity that is responsible for prosecuting those who violate the Saudi Companies Law, as previously mentioned, is stated in Article 215 of the Saudi Companies Law. The law asserts that the Bureau of Investigation and Public Prosecution (hereinafter referred to as "Saudi public prosecution") is the entity that is responsible for prosecuting those who violate the law's codes that their sanctions could include imprisonment. Investigating deeply into this entity reveals that it is part of the executive branch and, due to Saudi stock exchange ownership structure where government own branch and, due to Saudi stock exchange ownership structure where government own substantial blacks of corporations' shares, it would likely fail to deliver its mission independently. This section initially demonstrates why public prosecution is not an independent entity. Then, it illustrates why the independence feature significantly affects minority shareholders in the Saudi stock exchange.

The law that organizes the Saudi public prosecution is the law of Bureau of Investigation and Public Prosecution *Ndam Hiyat Altahqeq wl Idiea Al-am*. Article 1 of this law asserts that this entity is an organization linked to the Saudi interior minister, and its financial budget is under the interior ministry budget. This article is sufficient to demonstrate that the Saudi public prosecution is an entity that is deeply rooted in the interior ministry. However, there are some arguments that assert the independence of this entity, regardless of Article 1, which they interpret as an article designed strictly for organizing purposes. Their assertion is based on Article 5 of the same law. Article 5 clearly states that members and employees of the public prosecution are fully independent, and no one should interfere with their work. The same article insists that only Sharia law and legislative laws control the work of Saudi public prosecution members. Thus, a number of scholars consider the Saudi public prosecution an independent entity. This section disagrees with this conclusion and asserts that the context of Saudi public prosecution law awards the Saudi interior minister a number of capacities and powers that genuinely affect the independence of this entity. This thesis will show how a number of law codes exhibit why the role of Saudi interior minister in the law affects the independence of the Saudi public prosecution.

The first issue that affects the independence of the Saudi public prosecution circles around the managing committee, which the law requires to be established inside the Saudi prosecution organization. Article 4 of Saudi public prosecution law states that the mission of this committee is to review the indictment the entity is contemplating and study the issues related to the investigation and prosecution. The law clearly states that committee members are appointed by the interior minister based on the suggestions of the chief of Saudi public prosecution, who is elected by the king himself based on suggestions from the interior minister. Thus, to be selected in the highest position of Saudi public prosecution, a candidate needs the interior minister's approval. Indeed, the context of Article 4 asserts that this committee cannot make any study that is related to investigation and prosecution unless they receive a command from the interior minister himself. For example, if the public prosecution desires to study some innovative method of technology that is related to a criminal investigation, the law indicates that the organization needs the interior minister's approval.

Second, the employment of Saudi public prosecution members cannot be terminated unless by royal decree by the Saudi king. The royal decree, the law asserts, must be based on a decision from the managing committee and a call from the interior minister. Furthermore, the interior minister has the sole authority to raise a disciplinary suit against any member of the Saudi public prosecution entity. Article 17 of the law asserts that this suit might be based on suggestions from the chief of the Saudi public prosecution. Finally, Article 27 of the law is clear when it describes that the interior minister is the one who oversees the public prosecution entity. The argument is obvious by now. The context of the previous indications should make the picture clear. That is, the role of the Saudi interior minister in the entity of the Saudi public prosecution is not entirely for the purpose of organizing the entity and does indeed interfere subjectively in the entity's work. Therefore, this thesis argues that Saudi public prosecution is not an independent entity. The law of Saudi public prosecution illustrates that it is prejudice to the interior ministry particularly and the executive branch generally.

It should be mentioned that the Saudi Arabian Shura Counsel, a body in the Saudi legislative branch, has understood Saudi public prosecution dependency to the interior ministry. The council had studied this dependency, and some of its members had proposed to keep the issue as it is. Thus, maintaining the public prosecution alliance to Saudi interior ministry and awarding it its independency. Other members have proposed to extract this alliance and make the public prosecution an independent entity. However, the Saudi public prosecution law, and up until now, has not been reformed. Thus, the argument of the dependency of the public prosecution stands.

The question now shifts to whether the independence of the Saudi public prosecution should be considered highly by minority shareholders. The answer is linked to what we have addressed already in the Saudi stock exchange ownership structure. The Saudi government owns concentrated shares on number of significant companies. This concentrated ownership provides Saudi governments with the power to influence the companies' board of directors. In fact, the government itself is the one who appoints the majority of the board of directors in a number of listed companies that are traded in the Saudi stock exchange. These board's members can be considered the highest staff members of the government's bureaucracy. This section argues that Saudi public prosecution, as the watchdog of the market, would be under obvious conflict of interest when the violations came from companies in which the Saudi government owns concentrated shares. This conflict of interest might affect minority shareholders because the public prosecutors might decline to press charges toward the directors whom the government has appointed in the first place. Thus, the minority shareholders could lose the deterrence element the public prosecution has when it prosecutes wrongdoers.

To clarify, this section claims that the Saudi public prosecution fails to deliver its genuine job of monitoring and prosecuting violations of the Saudi Companies Law, especially when the Saudi government appoints the board members who commit the violations. This failure is attributed to recognizable conflicts of interest. That is, the Saudi public prosecution is an entity that we have illustrated has an alliance with the Saudi interior minister and is a significant part of the Saudi government. Therefore, this entity cannot independently prosecute a company's board members when the Saudi government has appointed the members and they are considered similar to high-ranking public employees. This independence failure in the Saudi public prosecution deeply affects minority shareholders in the stock exchange. Indeed, minority shareholders lose the advantages the law grants, exemplified by deterring any potential wrongdoers, because the latter know that those who appoint them are not likely to prosecute them. To wrap up this section, evaluating the major protections granted to a JSC's shareholders illustrates their significant failure to shelter minority shareholders.

### 6.5: Conclusion

The chapter argues that, while the new Companies Law did not recognize the Saudi stock exchange ownership structure, the law has failed to protect minority shareholders. Even though the law introduces for the first time new tools, which are considered protections for minority shareholders, the context of the law significantly fails to protect minority shareholders. The reason behind this failure, in addition to failing to recognize the concentrated ownership Saudi stock exchange has, is attributed to two major deficiencies: that the law restricts minority shareholders from suing the company's management on behalf of the company in times of serious disagreement, and that the entity responsible for overseeing the market and prosecuting wrongdoers is not genuinely independent and its judgment is prejudiced. Next chapter would investigate possible remedies to Saudi corporate law deficiency to safeguard minority shareholders.

## Chapter 7: Possible Remedies to Saudi Corporate Law Deficiency

### 7.1: Introduction

This thesis by now has evaluated the protections the new Saudi Companies Law provides to minority shareholders. This thesis illustrates that the law fails to provide minority shareholders private enforcement tools to redress management wrongdoing and reduce agency problem. Also, the Saudi public prosecutor, the institution that is responsible reduce agency problem. Also, the Saudi public prosecutor, the institution that is responsible to cooperate in monitoring the stock exchange and prosecute the violators, would be under serious conflict of interest with many companies that are state-owned enterprises, or with partial Saudi government ownership in their common shares. The justification for this conflict of interest, as noted, is the lack of independence in this entity. The purpose of this chapter is to seek solutions that could assist Saudi lawmakers in overcoming these challenges.

To seek remedies to minority shareholder challenges, this chapter would compare similar concepts in different legal systems. The reason behind this comparison is to identify the successful tools that solve minority shareholder challenges in different nations around the globe. As we mentioned earlier, Zweigert and Kotz indicated, "legislators all over the world have found that on many matters good laws cannot be produced without the assistance of comparative law." Therefore, this chapter offers a comparative study for the purpose of seeking possible solutions that Saudi lawmakers should consider. This chapter is divided into three sections. In Section 2, this thesis seeks a possible remedy for the infective Saudi derivative action. This section compares a derivative suit mechanism between civil law states and common law states and identifies which model works better. Section 3 searches for a possible solution for the judicial investigative tool for those who own 5% of company common shares. The section addresses the Dutch experience in this area and compares it with the variables that make the latter a successful tool, in contrast with the Saudi model. Section 4 responds to the Saudi public prosecutor's failure and the Egyptian prosecution model, combined with the French criminal investigation, to solve the Saudi deficiency.

## Section 2: Derivative Suit Solution

As previously mentioned, this thesis illustrates the problem of a derivative suit, in Saudi corporate law, is the mechanism the law provides. Article 79 of Saudi Companies Law specifies that those who desire to challenge their board of director's decisions, which resulted in damaging the company, for instance, must receive an approval from the company general assembly. In other words, the topic to sue the company directors must be included in the ordinary general assembly's agenda and must receive simple majority votes. This thesis also identifies how unlikely it is that the majority shareholders would authorize this lawsuit to proceed because of the serious conflict of interest. Al-Ibrahim asserted that, up to 2008, no minority shareholders to bring such a suit; after that date, no reliable data is available. Due to the ownership structure of the Saudi stock exchange, minority shareholders would likely find it impossible to bring this suit because the majority of companies have a concentered ownership structure, with one shareholders owning a majority and thus likely to be able to dictate the result of a general assembly decision.

Some arguments could be that minority shareholders could rely on other Saudi laws or regulations to challenge their board of directors' decisions. For instance, Saudi Corporate Governance Regulation states in Article 5/7 that every shareholder has the right to sue his or her board of directors in accordance to the conditions and limitations of Saudi corporate law and the company charter. Could this article make a difference? While the obvious regulation text illustrates that shareholders must follow the conditions which companies law states, this article would not make a difference. Indeed, courts interpretations to this article assert this understanding. To illustrate, an earlier section in this thesis described the Saudi Committee for the Resolution of Securities Disputes (CRSD). The CRSD is a tribunal that is responsible to litigate all cases that are related to Saudi Capital Market Law or its affiliates regulations, such as Saudi Corporate Governance Regulation. Through its numerous judgments, the CRSD has concluded that, when shareholders are challenging their board of directors' decisions, they must rely on Saudi corporate law provisions. Therefore, CRSD has no jurisdiction to litigate these cases, and shareholders must raise this case in the commercial courts, which has the absolute jurisdiction. This confirms that the only applicable law that shareholders can rely on to challenge their board of directors or management decisions is the Saudi Companies Law.

To propose a possible solution for this dilemma, the section will initially reveal how

To propose a possible solution for this dilemma, the section will initially reveal how other states articulated their derivative suit mechanism. The section will then criticize some of these experiences and illustrate their deficiency. The section would sit the principle that should be met to have an effective derivative suit mechanism.

### 7.2.1: Derivative Suit Mechanism

While a derivative suit or action was initially a common law initiative, it has spread across the globe. States that are considered from the civil law legal family have absorbed in their corporate law a derivative action concept. This indicates the importance of this tool in the eyes of the legislators. The derivative suit mechanism can be distinguished from one nation to the other. The mechanism of a derivative suit is designed by the legislators to align two interest: allowing minority shareholder to challenge their management in the event if misconduct or expropriation, and filtering frivolous lawsuits from genuine and material lawsuits. Indeed, frivolous lawsuits or “strike suits” created the problem of “litigation expenses” which would be harmful to the company interest, its management, and workers. Obviously, legislators want to prevent frivolous lawsuits because of the severe consequences these lawsuits carry. At the same time, legislators want to facilitate genuine lawsuits, which may remedy legitimate concerns of possible wrongdoing. The distinction between nations’ corporate laws in regard to derivative suit mechanism are the facts that every nation designs their mechanisms in the method they see as appropriate. However, we could divide these mechanisms into two categories. The first category is dedicated to civil law states’ derivative suit mechanisms; the second category is dedicated to common law states’ derivative suits mechanisms.

**Civil Law Mechanisms**

The majority of civil law countries tend to impose some limitations to file a derivative suit. The obvious theme in the majority of civil law countries, which adopted derivative suits in their corporate statutes, is the demand of the minimum ownership requirement.. These limitations and the concept behind requesting a minimum ownership to be eligible to file a derivative suit have a purpose. The reason is to filter out frivolous claims from genuine claims. The former should be barred and the latter should proceed. This minimum shareholding requirement basically means that shareholders must hold a specific ownership threshold, the law states, to be eligible to file a derivative suit. They could satisfy this ownership threshold requirement either personally or jointly. For instance, Italian corporate law asserts that minority shareholders could bring a derivative suit when they hold individually or jointly 2.5% of the company shares. Spanish corporate law requires 5% of the company equity. Further, Belgian law obligates those who want to file a derivative suit to hold 1% of the company shares or possess shares valued at least 1,250,000 Euro. China also has adopted the concept of a derivative suit in 2005 and requested shareholders who intend to file a derivative suit to own 1% of the company shares.

Germany, on the other hand, demands two conditions to file a derivative suit: a minimal ownership requirement and passing a judicial screening. To illustrate, to bring a derivative suit in Germany, shareholders must hold 1% of company shares or shares valued at 100,000 Euro. The German model, further, designed a judicial entity to review the derivative filing and validate that shareholders have requested their company management to file a derivative suit. Also, shareholders in the German model must demonstrate that management committed “dishonesty or serious violations of the law or the corporate charter,” and the judiciary will review the shareholders’ claim before permitting the case to proceed.

French and Swiss corporate law models, in regard to a derivative suit, depart from the prevailing trend in civil law countries. These states have not requested the shareholders to hold specific amounts of shares to be eligible to file a derivative suit. Both models have allowed a single shareholder to raise this suit. The section now shifts to navigate derivative suit mechanisms in common law states.

**Common Law Mechanisms**

This section highlights the derivative suit models in the two most important common law states: U.S. and U.K. First, the U.S. current experience with derivative suits is free from the limited ownership requirement. Unlike the previous civil law states' experience with derivative suits, most states in the U.S. allow a single shareholder to raise this case since the mid-20th century. However, the U.S. derivative suit tends to request a shareholder, who intends to challenge a management decision, to initially make a demand to the company board. The nature of this demand is requesting the company to sue the managers or directors for their misconduct. We mentioned earlier how the common law school of thought has considered the corporation as a legal person which has a separate legal personality. According the "plaintiff proper rule", only a corporation can sue those who damage it. However, derivative suit is the exemption of this rule and it allows a single shareholder to fill a derivative action on behalf of the company. Therefore, the desired shareholder who wants to be exempt from the "plaintiff proper rule" has to demand the corporation representative to react in this context. Yet, U.S. courts sometimes exempt shareholders from this demand when the latter demonstrate the "futility" of this request. In other words, if the demand would be pointless, such as when the plaintiff's claim is to sue all members of the board of directors, then the board would be in severe conflict of interest, and the plaintiff could be exempted from satisfying this demand. This could be the only limitation the U.S. courts demands to file a derivative suit.

After a U.S. court accepts that derivative suit to be initiated, the claim would go back to the company. The company then must establish an independent committee to review this demand and assess whether or not it is for the best interest of the company. The members of this committee must be genuinely independent and relieved from any conflict of interest. The committee must study this derivative suit and make its judgment based on the best interest of the company. This committee's judgment, then, would go back to the court. The court will then evaluate this committee's assessment and make sure the committee members are independent and that they acted in "good faith." If the court finds that the company committee is genuinely independent and has acted in "good faith," the court would dismiss the case. On the other hand, had the court concluded that the company committee, for instance, is not independent, the individual shareholder would control the litigation (not the board of directors) and the suit could advance.

While the majority of modern derivative actions in U.S. corporate statutes merely request the demand requirement, the historical development of this practice illustrates that a number of states' legislators requested some limitation similar to the civil law minimum ownership requirement to be eligible to fill derivative actions. The historical story behind U.S. states' legislators demanding those who desired to fill derivative suits to have minimum ownership requirement started when U.S. courts confronted the challenge of "strike suits". Plaintiffs were filling derivative actions for the purpose of seeking to settle cases, not to award the company with the damage latter encountered. The outcomes of these "strike suits" were harmful to corporations, their management, and their workers. During the 1940s, a number of state legislators decided to respond to this challenge. For instance, New York Security for Expenses Act demanded those who owned less than 5% of company shares, or those whose company shares were valued at less than 50,000$, to provide security for the expenses that the derivative case may encounter, such as attorney fees. The point here is that the development of derivative action in U.S. corporate literature went through stages, until it reaches the limit that merely request the demand requirement.

The U.K. experience is quite different than the U.S. derivative suit mechanism, even though both experiences, currently, abandon the concept of minimum ownership requirement. In other words, the U.K. model of a derivative suit accepts that a single shareholder has the right to file a derivative suit on behalf of the company. Yet, the U.K. Companies' Act demands the shareholder obtain approval from the U.K. court. The court must grant this suit its approval to allow the derivative suit to continue. The standard the court would consider when it adjudicates this derivative suit's claim is whether or not this claim is for the best interest of the company. Apparently, the law grants the U.K. courts great discretion when the latter adjudicate the derivative litigation claim. In contrast to the U.S. experience, which removes the court from the derivative litigation and sends the litigation back to the company to decide independently upon it. This is a brief overview about how common law states designed their derivative suit mechanism. The next section will evaluate these mechanisms.

### 7.2.3: Which Derivative Suit Model Works Well?

The obvious differences between a derivative suit in the civil law model and common law model is the requirement of the minimum ownership. The majority of civil law states tend to mandate shareholders possess sufficient shares that make them eligible to file a derivative suit. These shares' percentage ranges from 1%, 2.5%, up to 5%. The common law model rejects this demand and allows a single shareholder to proceed with a derivative suit, regardless of the amount of shares this shareholder holds. The global statistics indicate that a derivative suit has worked well in the common law model and has failed in the civil law model. Kristoffel Grechenig, and Michael Sekyra, in their article "No Derivative Shareholder Suits in Europe: A Model of Percentage Limits and Collusion," attempts to explain why the civil law model of requesting a specific share requirement has failed to produce derivative suits.

Grechenig and Sekyra's main argument is that the company shareholders who do not hold a sufficient share percentage that makes them eligible to file a derivative suit would decline from monitoring the company management. Managers, on the other hand, would take advantage of this lack of monitoring to expropriate the company and its assets. Managers, also, would make sure to "bribe" block shareholders who possess adequate shares that make them qualified to bring a derivative suit in the form of settlements. An argument could be made that these settlements, which are equivalent to bribes, could deter the managers from misappropriating the company. Grechenig and Sekyra responded to this argument and illustrated that these settlements would not deter company managers nor halt the later expropriation. The authors' study indicates that demanding a threshold to file a derivative suit would "increase the problem of bribery and misappropriation."

Grechenig and Sekyra relied on an empirical study that illustrates no derivative suit had been filed in the states that demand an ownership percentage threshold. This, with no doubt, is considered a significant failure in a derivative suit mechanism. Hence, the authors conclude their argument by urging the removal of derivative suit minimum of shareholder limitations to solve the mechanism's deficiency. However, it should be mentioned that Grechenig and Sekyra could not find justifications for the absence of a derivative suit in the French and Swiss models, which both do not request a minimum shareholder ownership requirement and allow a single shareholder to bring a derivative suit, similar to the common law model. They urge further research, in this area, to be conducted in order to understand why both the French and Swiss derivative model has failed to produce a successful derivative suit such as the common law model.

Martin Gelter decided to follow up in Grechenig and Sekyra efforts. Apparently, he sought to know why both the French and Swiss derivative suit model was not successful while both systems carry no limitations similar to the majority of civil law states. Gelter wrote in his article: "Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?" which contains empirical data of the actual derivative suits that have been filed in the majority of states in the continental Europe. The results were not surprisingly different than what Grechenig and Sekyra found. Only a handful of derivative suits have been filed in the majority of nations in continental Europe since the end of the twentieth century. Therefore, Gelter's finding confirms the previous assumption of derivative suits' deficiency in civil law states. The only difference Gelter found in his article is that failure of a derivative suit model in civil law states is not due to the limitations of ownership threshold only. He indicates that there are other variables that essentially contribute in the success or failure of derivative suits.

Gelter relied on the "*Anna Karenina* principle" to distinguish why derivative suits have failed in civil law nations. Russian author Leo Tolstoy in his famous novel *Anna*

*Karenina* originated this principle. In the opening of the novel, Tolstoy states that "All happy families resemble one another; each unhappy family is unhappy in its own way." This quote explains the core of "*Anna Karenina* principle." In other words, it means happy families share the same criteria; an unhappy family lacks one or all of the previous criteria. Gelter relied on this principle to identify four characteristics that each successful derivative suit has in common. The absence of one these characteristics would presume the derivative suit is unsuccessful.

The fundamental characteristics of a successful derivative suit, as Gelter found, are defined briefly as follows. First, the demand to file a derivative suit the shareholders must be permissive not include ownership percentage requirement. In other words, requesting shareholders to have 1% or 5% of company shares to file a derivative suit must be abolished and substitute it with a requirement "friendly" to shareholders such as court screening. Second, the cost and risk distribution of a derivative suit should not deter minority shareholders. This characteristic triggers the concept of court fees and the recognition of "contingency fees," which would be the real generator of derivative suits. The previous characteristic seeks to reconsider these elements when crafting a derivative suit and assuring it does not deter minority holders. Third, shareholders should have full access to the company data that assists them in deciding whether to file a derivative suit or not. Fourth, the scope of a derivative suit should not be limited to suits against company directors or officers but should be expanded to include controlling shareholders. These conditions and characteristics must be found in any successful derivative suit model. The absence of one or a number of these characteristics would explain the ineffectiveness of the derivative suit. To summarize this section, the common law model of a derivative suit was successful because the later absorbs these characteristics in their derivative suit model.

### 7.2.5: Reform of a Derivative Suit in Saudi Corporate law

Gelter's conclusion is that a derivative suit must be combined with fundamental variables to be an effective tool. This conclusion has drawn the roadmap for civil law states that seek to implement a successful derivative suit model similar to common law models. The conclusion asserts that it not sufficient to merely abolish the minimum ownership requirement to make a derivative suit successful, as has been addressed. Applying this conclusion to the Saudi model would create some obstacles. To clarify, there are numerous challenges that confront a derivative suit model from the Saudi prospective. The first challenge is the absence of class actions in the Saudi legal discourse. A derivative suit is considered being a type of class action, yet the revenue that generates from this suit is returned to the company not the shareholders who raised the suit. This class action absence creates a vacuum that triggers the effectiveness of derivative suit, such as contingency fees. The latter are considered significant incentives to bring this action. To clarify, small shareholders would not have an incentive to bring a derivative suit and be burdened with lawyer fees. Contingency fees relieve the shareholders from lawyer fees and, indeed, incentivize the law firms to proceed with the suit, as the law firm would be the biggest winner of suit result. Therefore, the lack of class actions in the Saudi legal system is considered a significant challenge.

The second challenge is the complimentary judicial service to the Saudi public. As mentioned earlier, one significant element that distinguishes Saudi Arabia judiciary is the free court system. This means that Saudi Arabia provides judicial service that is free from any fees or costs. Any citizen or resident who is suing any entity is relieved from paying any court fees. While this could be considered a positive element for shareholders, it raises the risk of frivolous suits and, therefore, is considered a challenge that needs to be contained. These could be the major challenges that confront a derivative suit in the Saudi example.

The initial contribution of this thesis to solve the derivative suit gap in Saudi experience is by flagging the problems that trigger the success of a derivative suit. This thesis opens the dialogue for navigating the appropriate methods to overcome a Saudi derivative suit deficiency in light of the previous discussion. In this regard, this thesis proposes that Saudi Arabia needs to adjust some fundamentals in its legal system to overcome this challenge. This means that a clear recognition to class actions, similar to class actions in the common law model, need to be approved and adopted. Second, this thesis claims the urgency to change current Saudi derivative suit mechanisms, which now demands the approval of the company's general assembly. This thesis argues the need for permitting a single shareholder to raise the derivative suit. For filtering a frivolous suit from genuine suits, this thesis argues for implementing judicial screening that allows the courts to decide whether the lawsuit is fruitless and stands on solid ground similar to the U.K. model. Also, this thesis argues to introduce court fees that are designed especially for litigation that seeks derivative claims. When deciding the amount of these court fees, lawmakers must consider minority shareholders and make sure these fees would not deter them. Judicial screening combined with the court fees, this thesis argues, could work well to filter genuine suits. This could be a solid starting point to protect minority shareholders in Saudi corporate law.

## Section 3: Saudi Judicial Investigation Solution

As previously mentioned, Saudi corporate law provides JSC shareholders who hold 5% or more of the company shares the right to request a judicial investigation. The law asserts that the shareholders' request must contain indications that the actions of the board of directors or the external auditor are open to reasonable doubt. This thesis, earlier, illustrates the major deficiency of this protection in that the law grants the court the right to correct the problem temporarily by issuing protective orders and leave the permanent decision to the company general assembly. This means that any decision the court makes in this context, according to the provision that are clear in the text, can be changed by the company's general assembly's will. The law provides the general assembly with the final say on this matter. And, because the majority of corporations in the Saudi stock exchange have concentrated shares, the general assembly would be biased to the majority shareholders interest. Therefore, conditioning this powerful protection to approval of the general assembly makes this tool fruitless in a Saudi public company context.

### 7.3.1: Dutch Experience with Judicial Investigation

To correct this significant tool, we need to mention the experience of The Netherlands. The Dutch state protects company shareholders with the "right to inquiry." This right basically provides the company shareholders who possess either 10% of the company shares or shares' value that equal 225,000 Euros, individually or jointly, the right to request a judicial investigation. The plaintiff must first make a request to the "Chambers of Business Affairs" (a court division) to initiate an investigation. The plaintiff's request must include justification for the reason he or she seeks the court to investigate, such as mismanaging the company. The court then decides whether the plaintiff's request has grounds to be genuine. If the answer is yes, the court will appoint an investigator. The later would investigate the company and report to the court the investigation's result. The court then studies this result and decides whether the result's finding confirms the plaintiff's claim and call into question the company management, for instance. It should be mentioned that the company pays for investigator costs.

When the investigation results demonstrate a lack of mismanagement by the company, the court dismisses the plaintiff's request. However, when the results do indeed indicate the mismanagement of the company, the court has a variety of options to react upon. The court's options include, for instance, "the dismissal of board members, the rescission of board or shareholder resolutions, the appointment of temporary board members, and even the dissolution of the company." These serious court options can definitely deter company management and guarantee company shareholders, particularly minority shareholders, that the court would intervene upon their request when the management fails in running the company. The law grants this significant right to inquiry not merely to company shareholders. The law also permits the Dutch "advocate general" (attorney general) the right to file this request for “public policy” justifications, and the “labor union” can also initiate this request.

The importance of this significant right justifies the absence of a derivative suit in the Dutch corporate law. The only corporate law in continental Europe that does not include provisions that declare shareholders’ rights to raise derivative suit is found in the Netherlands. The reason for a derivative suit’s absence in the Dutch legal system is the existence of “right to inquiry.” It seems that this right substitutes the need to adopt derivative suit, as both tools deter and redress corporate management’s wrongdoing. The available empirical data of this right indicates that it has been deployed 23 times since 2002 and 2008. Minority shareholders employed this right 19 times out of the 23. These numbers no doubt illustrate how the “right to inquiry” was successful in treating minority shareholder when a company abuses its rights. The next subsection will highlight how the Dutch experience with the “right to inquiry” could solve the deficiency of Saudi judicial investigation.

### 7.3.2: Possible Solution for Saudi Juridical Investigation Tools

Obviously, the Saudi corporate law right for shareholders who possess 5% of the company shares to request a judicial investigation on the grounds of suspicious activities of company management is a similar concept to the Dutch “right of inquiry.” In protecting companies’ shareholders, this thesis argues that the Dutch “right of inquiry” has succeeded, while Saudi judicial investigation has failed. Three understandable justifications explain the success of the Dutch right, in contrast with the similar Saudi right. First, the Dutch right awarded the court that litigates the case, when the investigator report confirms the management’s violation, with decent and permanent sanctions that are not suspended to the approval of general assembly. For instance, the right to inquiry in The Netherlands could guide the court to dissolve a company. The latter ruling is considered as the harshest sanction a corporation could confront. The point here is that the Dutch law entitles the court to issue either protective orders (temporary orders) or permanent orders that are perpetual.

The second justification that elucidates the success of the Dutch right of inquiry is delegating the investigation process to a third party. In other words, the court would not be the entity that conducts the investigation by itself. This is considered a logical step by the Dutch lawmakers. Courts generally are not responsible for gathering evidence. The court’s mission is hearing the two litigants’ arguments and weighing one argument over the other. In addition, professional investigators who have years of expertise in this profession would tend to do a better job in investigating the company details and secrets than the court, which has no great expertise in this area. Finally, the third justification is the process to activate the Dutch right of inquiry is clear, obvious, and shareholder-friendly. The law designed the process, which the shareholders must follow to get advantage of this protection, step by step, with no ambiguity or confusion. The clear and straightforward process would facilitate the litigation and save courts and litigants precious time. The Dutch law also is considered shareholder-friendly when it states that the company would pay for the investigator fees if the court is convinced by the petitioner claim. This relieves the shareholders from paying the initial expenses, which could burden them. These could be the major justifications that explain why the Dutch right of inquiry is successful in contrast with the Saudi judicial investigation, which has been unsuccessful.

The above discussion should clarify that Saudi lawmakers need to reform judicial investigation protections in light of the Dutch right of inquiry success. This means that Saudi corporate law needs to adjust its language, in regard to the judicial investigation right, and ensure that the courts would have the authority to make final decisions that are not contingent upon the approval of the company general assembly, when the former finds serious violations from the management and majority shareholders. The authority to have a final decision should be beside the courts’ current authority to make a temporary decision, as the latter could be efficient enough to solve a number of issues that are not considered serious.

Moreover, Saudi Companies Law has not been mentioned, when designing the judicial investigation article and delegating the investigation process to an investigator. The article gives the impression that the Saudi commercial court would be the entity that conducts the investigation. This thesis considers this as a sort of procedural deficiency, even though, subjectively, the Saudi court would most likely hire an auditor to conduct the investigation. This thesis analysis is biased toward outsider investors who evaluate the new Saudi corporate law and the protections the law provides to JSC shareholders. The law should be clear and meticulous when drafting the rights that affect shareholders and especially the minority shareholders, as the Dutch law does.

Also, Al-Zahrani criticized the Saudi judicial investigation right when the law requested from the petitioner to pay for the investigation costs, which are considered as limitation against unserious petitioner. This thesis agrees with Al-Zahrani's criticism and even argues that the Dutch model with the right of inquiry process would work perfectly to create a balance in the Saudi example. To clarify, when Saudi commercial courts are convinced with the petitioner argument to investigate a company, on the ground of genuine allegations, the courts should obligate the company to initially pay the investigator fees. The court might demand petitioner shareholders to pay the investigator expenses only when the latter reports illustrate that management did not commit any violation toward the company or its shareholders. Finally, the process of the judicial investigation right should be identified clearly and straightforwardly, similar to the Dutch model. Al-Zahrani argues that Saudi corporate law did not explain the process shareholders must conduct to deploy this protection. This thesis agrees with this argument and highlights the importance of clearly identifying the procedures to deploy this protection in order to maintain an effective protection. This could be the major argument to solve the deficiency of Saudi judicial investigation rights. The next section seeks a solution to the Saudi public prosecutor deficiency.

## Section 4: Saudi Public Prosecution Solution

Saudi corporate law carries significant sanctions for those who violate the law and mismanage their companies. This thesis addresses the majority of these violations; their sanctions include the possibility of imprisonment, fines, or a combination of the two as the courts decide. This thesis argues that the law has failed to protect minority shareholders when the former delegates the right to prosecute the wrongdoing to the Saudi public prosecutor. The latter entity is not entirely independent from the Saudi executive branch. Therefore, a Saudi public prosecutor's dependence on the executive branch could affect minority shareholders in companies, for which the Saudi government owns substantial shares and influences the directors' decisions. In other words, the Saudi public prosecutor would be under a severe conflict of interest when violations occur from directors in companies, which considered state-owned enterprises. This conflict might discourage the public prosecutor from prosecuting wrongdoers. Thus, this conflict of interest might jeopardize minatory shareholders, as the latter would lose a powerful tool of deterrence when the law articulates these sanctions to penalize the wrongdoers.

The essential justification of these severe sanctions the Saudi corporate law promises is to deter wrongdoers, which is similar to the concept of the derivative suit as the latter does deter and redress the wrongdoing. Therefore, officers and directors of companies that are state-owned enterprises would likely not be deterred because the public prosecutor would not prosecute them due to the conflict of interest. The question now is: how could Saudi legal system solve this deficiency? This section cites two examples that could solve the challenge of conflict of interest and the practicality of deploying these harsh penalties. To clarify, the section would address the model of the Egyptian public prosecutor to solve Saudi public prosecutor's conflict of interest. Second, the section would address the French model of criminal prosecution and how this model works well for minority shareholders.

### 7.4.1: The Egyptian Model of Public Prosecutor

**7.4.1: The Egyptian Model of Public Prosecutor**

The Egyptian Constitution of 2014 states in Article 189 that the entity of public prosecution is considered an entity under the judicial branch. The latter branch is considered to be an independent branch that has full autonomy to function without other branches' intervention, which could compromise its independence. In other words, the Egyptian public prosecution is a fully independent entity. Attorney's general who work in the office of public prosecution have the same the immunity that judges have. The Egyptian Supreme Judicial Council elects the chief of the public prosecution office. This chief must be a judge from the judicial branch. The position of the chief of public prosecution is not indefinite, but is limited to one term only (the term is four years) or until the latter reaches the retirement age, whatever comes first. The chief prosecutor could only hold this position once in his lifetime. These could be the major features that signal that the Egyptian public prosecution is an independent entity.

Obviously, the model of an Egyptian prosecutor could be the solution for the Saudi public prosecution deficiency. To clarify, this thesis earlier illustrates how the law of a Saudi public prosecutor provides the Interior Minister with numerous responsibilities that could compromise the public prosecutor's independence. The reality of the Saudi stock market indicates that the Saudi government is investing heavily in it. In fact, some companies' ownership reveals that the Saudi government owns 70% of their shares. Awarding the Saudi public prosecutor with genuine and full independence, similar to the Egyptian model, could be the solution to the conflict of interest challenge that confronts the public prosecutor when directors in a state-owned enterprise face a violation. Prosecutors, after receiving full independence, won't be intimidated when the latter prosecute state-owned enterprise directors, which are considered metaphorically to be top government officials. Hence, this move would enhance the credibility of the stock exchange. Indeed, this enhancement would be highly beneficial to minority shareholders, who hold shares in state-owned enterprises.

**7.4.2: French Criminal Investigation**

There is another method that could increase the efficiency of the deterrence in the serious sanctions the Saudi corporate law provides and protect minority shareholders at the same time. This method allows minority shareholders to "piggyback" on the public prosecutor's litigation. To clarify, the concept here is to authorize the public prosecutor to seek both criminal and civil actions, when the public prosecutor finds adequate evidence that criminalizes company managers or board of directors. Thus, instead of seeking criminal charges only, the prosecutor would seek the civil compensation company shareholders should embrace. The French model of criminal investigation is the originator of this concept. Minority shareholders in the French legal system are permitted to "piggyback" on the magistrate's criminal actions against the company board of directors. Minority shareholders need to raise a criminal complaint to join the magistrate litigation.

The French commercial code states that shareholders are permitted to file a criminal complaint against a company's board of directors. This complaint must reveal how the board of directors acted, with bad faith, against the company interest, either to gain direct or indirect benefits for themselves. The French magistrate would review this complaint to see whether the shareholder's claim is backed with convincing evidence. The French magistrate would proceed with the complaint only when the shareholder's claim is considered plausible. The magistrate would then seek to implement criminal and civil actions. The civil actions, though, would be considered as a derivative suit where the company receives a reward of positive civil judgment. This system of permitting minority shareholders to "piggyback" on criminal prosecution has worked well for minority shareholders. The empirical data indicates that members of boards of directors in French companies have been convicted with this tool around 480 times from 2000 to 2006. These numbers with no doubt indicate how powerful this tool is to protect minority shareholders.

Piggybacking a criminal investigation could be a practical method that protects minority shareholders in Saudi public corporations. The current procedures in Saudi corporate law authorize the Saudi public prosecutor to prosecute violators of Articles 210 and 211. The public prosecutor will seek to penalize wrongdoers either with imprisonment or fines. The fines' income would proceed to the state treasury. When the prosecutor convicts the wrongdoers, the shareholders, then, can initiate a civil action to seek compensation. The main point here is that a Saudi public prosecutor would seek a criminal sanction only. Shareholders cannot bring a complaint to initiate a public prosecutor investigation. The latter would investigate a company either unilaterally (moving for the public interest) or with the instruction of Saudi Capital Market Authority (CMA). Therefore, the French model of criminal investigation could suit the Saudi model and raise the level of the protection for minority shareholders.

### 7.5: Conclusion

To summarize this chapter, this thesis has investigated the possible solutions that could fill the gaps the newly reformed Saudi corporate law missed. The chapter started with the Saudi derivative suit mechanism problem. The chapter illustrated how the common law model of a derivative suit was successful in shaping a mechanism that protected minority shareholders, while civil law legal states' derivative suit models have failed. Second, the chapter investigated the possible treatment of Saudi judicial investigation tools to shareholders who hold 5% or more of JSC shares. The experience of Dutch "right of inquiry" has been addressed as a possible and effective remedy for the Saudi judicial investigation gap. Finally, the chapter highlights the problem with Saudi public prosecutor's conflict of interest with violators who work in state-owned enterprises. The examples of the Egyptian public prosecutor, combined with the French criminal investigation, could be a possible solution for this deficiency.

## Chapter 8: Conclusion and Recommendations

The picture should be clear by now. Saudi Arabia is country that is aiming to achieve change in its economic dynamic, yet its company law, a fundamental component of the nation legal infrastructure, has failed to contribute in this change. In other words, the newly reformed Saudi corporate law has failed to provide minority shareholders with decent protections that deter management or majority shareholders' abusiveness. This thesis earlier asserts the importance of providing minority shareholders in a public company with strong protections. In fact, safeguarding minority shareholders would grow the economy, reduce agency cost, and lead to efficient management behavior. This thesis investigated the OECD corporate governance principles standard as an icon of the best practice corporate governance model. The investigation results were not surprising: the standard asserts the need to protect minority shareholders and safeguard them, particularity from management and majority shareholder abusiveness. This thesis clarifies the importance of recognizing the ownership structure of firms in any stock exchange and the different formats of ownership structures that exist around the globe, specifically dispersed and concentrated ownership structures. The former raises the challenge between management and dispersed shareholders, while the latter raises the challenge between majority shareholders and minority shareholders. Each ownership format requires a different type of tools, which are designed to protect non-controlling shareholders. Hence, it is necessary to acknowledge the ownership structure of the stock market to create decent corporate governance that protects minority shareholders.

The challenge of establishing protections that genuinely safeguard minority shareholders is not an easy task. As mentioned above, there must be recognition of the environment in which minority shareholders exist. In other words, the corporate governance must acknowledge the ownership structure of the equity market when it articulates minority protections. This thesis has comprehensively highlighted this argument and illustrated that lawmakers must consider the ownership structure of the nation's stock exchange if they seek to implement effective corporate governance. Also, this thesis illustrates the ownership structure of the Saudi stock exchange and how the vast majority of corporations listed in the equity market have concentrated ownership. The owners of these concentered shares tend to be either the Saudi government or families.

After demonstrating minority shareholder importance and the need to recognize the ownership structure, this thesis shifted its attention to introducing the Saudi legal system as an essential variable to evaluate minority shareholder protections in the new Saudi corporate law. The Saudi legal system and state authority were highlighted. This thesis asserted the current picture of complexity and ambiguity, which the Saudi legal system presents. This thesis agrees with the calls that urge the removal of this ambiguity and to reform of the system.

This thesis, then, introduces the new Saudi corporate law and the type of firms the law recognizes. This thesis describes the JSC and the most significant shareholder protections the law provides to its owners, especially to minority stockholders. The corporate law divides these safeguards between direct and indirect protections. The purposes of these protections are to redress and deter wrongdoing. Moreover, this thesis highlights that Saudi lawmakers have introduced new tools that are believed to safeguard JSC shareholders and solve agency problem, which had not been recognized in the old version of the law. For instance, the law obligates to using a cumulative voting method when electing a JSC board of directors. A cumulative voting method could provide minority shareholders a probable chance to appoint directors to the company board.

The primary contribution of this thesis is to evaluate these protections the law provides to overcome agency problem from a minority shareholder's prospective. For instance, when evaluating a cumulative voting right, this thesis illustrates that this right could be considered a significant protection in an environment other than the Saudi stock exchange. In other words, the Saudi equity market is heavily dominated by concentrated ownership corporations. Cumulative voting would fail to deliver a genuine safeguard to minority shareholders due to the way the ownership of the stock market is structured. On the other hand, cumulative voting could powerfully contribute to safeguards in a dispersed ownership market structure where dispersed shareholders ally when managing the company.

This thesis extends its evaluation to cover other tools, such as derivative suits, judicial investigations, and criminal prosecution of the wrongdoer. This thesis explains why all of these tools could not be considered genuine protections. From a minority shareholder's prospective, the deficiency in Saudi corporate law rests upon two claims. First, the law has not provided a practical tool to redress the management or board of directors' wrongful acts, such as recklessness that resulted in company damage. This thesis illustrates that Saudi derivative suits and judicial investigation tools for those who own 5% company equity are not practical tools for minority shareholders. Second, the law delegates the rights to prosecute the wrongdoers who committed criminal sanctions to the Saudi public prosecutor. The latter is not an entirely independent entity from the Saudi executive branch, and this dependence would create a significant conflict of interest, especially when the violation occurs from a company that is a state-owned enterprise. Therefore, minority shareholders would lose the powerful deterrence tool the law embodied when it provides these serious criminal sanctions.

It is worth mentioning that the current protections Saudi corporate law provides could mathematically work in an environment different than the current Saudi equity market. This means if a corporation's ownership in the Saudi equity exchange has the shape of a dispersed structure, as Berle and Means depicted, these protections could possibly work. For example, the current Saudi derivative suit mechanism that demands the approval of a general assembly to file a derivative suit could work well if the ownership of the corporation's structure is composed of dispersed shareholders. However, this thesis illustrates that the ownership structure of the majority of companies in the Saudi stock exchange has the shape of a concentrated structure, and this character of ownership triggers the efficiency of the protections the Saudi corporate law provides.

This thesis has sought to identify potential remedies for Saudi corporate law failure to protect minority shareholders. In this context, this thesis compared derivative suit mechanisms in civil law legal families with derivative suit mechanisms in common law families and evaluates which model works well. It concludes that the common law model of the derivative suit tends to work better to redress management wrongdoing, while civil law derivative suits have been less successful reaching the same result. Also, this thesis investigated how the Dutch concept of "right to inquiry," a similar concept to the Saudi judicial investigation tool, has protected minority shareholders in The Netherlands. This thesis has extracted the elements that contributed to the success of the Dutch judicial investigation experience.

A Saudi public prosecutor's conflict of interest with violators who possess high positions, such as officers and board directors, in companies that are state-owned enterprises is the final obstacle this thesis seeks a solution for. This thesis explains the lack of independence for a Saudi public prosecutor. This thesis further illustrates how the public prosecutor's dependence on the Saudi executive branch could be at the expense of minority shareholders. To solve this challenge, this thesis has introduced the Egyptian experience of a public prosecutor as a potential remedy to solve the Saudi public prosecutor conflict of interest. Also, this thesis explores the French concept of criminal investigation and how minority shareholders could piggyback upon a criminal action to seek civil compensation. These similar concepts, which other states have developed, could open the dialogue to seek the appropriate remedies that protect minority shareholders and suit the Saudi legal system at the same time. The next section will offer recommendations of this thesis.

## 8.1: Recommendations

The appropriate corporate governance is one that balances the rights between majority and minority shareholders without overweighting the rights of one party over the other. While this thesis has clearly indicated its opposition to allowing majority shareholders to manage the company with no level of accountability toward minority shareholders, this thesis also disagrees with the concept of providing minority shareholders with rights that could halt the business activities of the firm and freeze its life. Therefore, the argument this thesis advocates for is to establish a balanced line that awards majority shareholders the right to manage a company with some level of accountability toward minority shareholders. This argument is driven by the understanding of OECD corporate governance principles.

This section would try to draw a road map for Saudi legislators that could assist them in solving corporate law deficiency regarding minority shareholders of JSC. The theory of this road map is responding to factors that have not been recognized by Saudi lawmakers and resulted in producing laws ineffective for minority shareholders' protection. These factors are, first, the majority of companies in the Saudi stock exchange have the shape of a concentrated ownership structure. The trend toward concentrated ownership structures has affected many equity markets around the globe, including in the U.S. Thus structures has affected many equity markets around the globe, including in the U.S. Thus, this ownership structure, as previously addressed, raises the challenge of majority shareholders versus minority shareholders and not management versus dispersed shareholders. Second, one of the biggest investors in the Saudi stock exchange is the Saudi government. To clarify, the majority of the top 20 public corporations in the Saudi stock exchange, according to *Forbes* magazine, are either state-owned or have partial state ownership. Hence, the entity that enforces the law and prosecutes wrongdoers must not have a conflict of interest.

**8.1.1: Public and Private JSC Shareholder Tools Recommendation**

Saudi corporate law should differentiate between derivative and direct suits that are designed to redress wrongs to shareholders in public and private JSC. As previously mentioned, Article 80 of Saudi corporate law created ambiguity for Saudi scholars who sought to interpret it. The confusion allows JSC shareholders to bring personal suits, even though the company is the entity that incurred damages due to their personal status. This thesis highlights that Article 80 is designed to treat the company damages only when the company has a shape of a closely held JSC. Shareholders of private JSC could fill personal suits against their board of directors, even when these shareholders have not individually incurred damage, but the company is the entity that suffered the damage. This article cannot expand to cover publicly held corporations because it would create "vexatious litigations," as Mr. Alzahrani asserted. Therefore, this thesis' first recommendation is differentiating the derivative and direct suits between public and private companies.

**8.1.3: Derivative Suit Recommendations**

The second recommendation is creating a derivative suit mechanism for publicly held JSCs. OECD corporate governance standards advocate lawmakers adopting a derivative suit that is practical for shareholders. Therefore, this thesis recommends adopting the U.K. model of a derivative suit. This model permits a single shareholder to file a derivative suit and demands judicial screening to allow the shareholder's claim to proceed. This thesis previously mentioned the challenges that confront transplanting this model to the Saudi legal system. To overcome these challenges, this thesis recommends demanding court fees, particularly for those intending to file a derivative suit. Also, this thesis recommends adopting the concept of class action, as the implementation of this concept would guarantee the success of a derivative suit mechanism, as this thesis clarifies earlier. The class action would correspondingly solve the problem of a direct suit, where big numbers of shareholders suffer the same damage. For instance, when all preferred shareholders of a public JSC suffer from board of directors' damaging decision toward them as a class of shareholders, a small number of preferred shareholders could file a class action in the form of a direct suit, instead of the current model where the law requires every single shareholder to personally raise the direct suit. This class action would create a powerful private enforcement instrument that deters company management from any action that could jeopardize any specific class of JSC shareholders.

This thesis recommends Saudi lawmakers take into consideration the essential characteristics of a successful derivative suit when drafting this article. This suit must have no limitation of ownership such as a 1% or 5% ownership requirement for those eligible to file the suit. Also, court fees should consider minority shareholders' financial abilities, and fee amounts should not restrict minority shareholders from bringing a suit. The level of transparency should increase; finally, this suit must not be restricted to challenge the board of directors only. The extent of this suit should include company officers and majority shareholders. Absorbing these characteristics in the potential Saudi derivative suit model would create a high possibility of its success to treat failure to enforce minority shareholders' rights.

**8.1.4: Judicial Investigation Tool Recommendation**

To solve the Saudi right of judicial investigation for those who own 5% of JSC shares and suspect that their company board of directors' actions could damage them, this thesis recommends adopting the Dutch concept of "right to inquiry." The previous concept is similar to the Saudi judicial investigation right. This Dutch model is highly successful in protecting minority shareholders of public companies. The success of this tool justifies the absence of derivative suits in Dutch corporate regulations. This thesis recommends Saudi lawmakers design a judicial investigation right similar to the Dutch right to inquiry. This means the Saudi court should not be satisfied with issuing temporarily decisions, as the current law states. The court that investigates a JSC should be permitted to make final judgments and not just temporarily ones. This thesis recommends that, when the court finds an obvious mistake from the board of directors, for instance, the court should have the right to make a final decision. The law should provide a high level of discretion to cure the damage found, without restricting the court to rely on issuing temporarily decisions that could be overturned by a company's general assembly decision.

Also, this thesis recommends that Saudi lawmakers draft a clear provision that specifies the way shareholders can employ this right. The procedures of this right should be clear and practical. This means the law should mention that, when the court is convinced of the plaintiff's claim, the court would hire an investigator to conduct the investigation. The company should pay for the cost of the investigator, unless the result of the investigation shows a lack of mismanagement; then the plaintiff must pay for the cost. Mr. Alzahrani found that the only time shareholders employed this right in the previous law was in 2002. He found that the court took close to nine months to decide whether or not to investigate the company. Mr. Alzahrani urged solving this long time period, which could strip the practicality of this right. This thesis agrees with the previous argument and highlights the importance in creating a functional right that protects minority shareholders and deters the wrongdoer.

### 8.1.5: Saudi Public Prosecution and Criminal Sanctions' Recommendations

To solve the conflict of interest when a Saudi public prosecutor confronts a corporate criminal violation, which happened in a company that is a state-owned enterprise, this thesis recommends adopting the Egyptian public prosecutor model. This model creates genuine independence, as this thesis earlier illustrated. It also would consider the office of public prosecution as an entity that fits under the judicial umbrella. Therefore, the prosecutors should receive all the privileges the judges receive and, most importantly, have the autonomy to manage themselves without intervention from the executive branch. This recommendation would relieve a Saudi public prosecutor from any possible pressure that could affect their job. It also would raise the level of protection of minority shareholders, as the latter guaranteed that the public prosecutor has no conflict of interest with any companies in the Saudi equity market. It also would raise the level of deterrence toward officers and directors of companies in which the Saudi government owns significant shares, as they would know that they could be prosecuted when they expropriate their companies.

In addition, this thesis recommends the French criminal investigation model where minority shareholders could piggyback on criminal action. This means allowing minority shareholders to raise a claim that demands public prosecutor intervention because of possible violations of Saudi corporate law criminal sanctions that occurred from acts of officers or directors. If the prosecutor is convinced of the shareholders' claim, the former would initiate an investigation. If the investigation result confirms the shareholders' claim, the public prosecutor would seek two actions at the same time, criminal and civil. In other words, minority shareholders would piggyback on the public prosecutor's litigation. This thesis recommends treating the award of damages in this action as a derivative suit award, where all the civil proceeds go to the company, which is identical to the French model. This thesis argues that the French investigation model could increase minority shareholder protections.

## 8.2: Suggestions for Further Research

The scope of this thesis has been limited to describing and evaluating minority shareholder protections in the new Saudi corporate law. This thesis illustrates the failure of Saudi Companies Law to provide genuine protections that could safeguard minority shareholders from management or majority abuses in a public JSC. Therefore, this failure could damage the Saudi government's intent of attracting investment in the Saudi market generally and Saudi stock market in particular. This thesis suggests additional research on numerous areas that could affect the government's intent of attracting investment. These suggested researches are

1. Could the ambiguity and the confusion in the Saudi legal and political system be an obstacle against attracting investment in the Saudi market? And how to correct these failings in the political and legal system in Saudi Arabia while maintaining its heritage of Islamic law reliance?
2. How the duality of legal system in the Saudi Arabia affects investors in the market? And how to solve this problem?
3. Class actions have never been recognized in Saudi legal discourse; what are the pros and cons, from a Saudi perspective, for adopting this action?
4. Are the protections the new Saudi corporate law provides to closely held JSCs sufficient?
5. Is the level of transparency which Saudi laws and regulations request public JSCs to implement adequate to assist minority shareholders to decide whether to sue management or not?

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