

# Corporate Governance

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There have been various developments recently in Saudi Arabia towards increasing the effectiveness of the Corporate Governance framework. The Saudi Capital Market Authority ("CMA") announced the amendment of Article 9 of the Corporate Governance Regulations (CGR)<sup>1</sup> to regulate the remunerations and compensations paid to the members of the Boards of Directors of companies listed on the Saudi Stock Exchange "Tadawul". The insertion of the definition of the expression "Remunerations and Compensations", is a step by the CMA to strengthen the principles of corporate governance applied to joint stock companies. The amended Clause (e) of Article 9 stipulates that the report of the Board of Directors which is appended to the annual financial statements of the company shall include: "Details of compensation and remuneration paid to each of the following:

1. The Chairman and members of the Board of Directors.
2. The top five executives who received the highest compensation and remuneration from the company; the CEO and the CFO shall be included if they were not among the top five.

For the purposes of this paragraph, "remunerations and compensations" shall mean salaries, allowances, profits and any of the same; annual and periodical performance-related bonuses; short or long-term incentive schemes; and any other rights in rem"<sup>2</sup>.

For the purpose of the above, the Board of Directors is also required to establish a committee to be named "Nomination and Remuneration Committee". Based on CMA resolution No. (1-10-2010) dated 30/03/1431H. (corresponding to 16/03/2010G.), the provisions of Article 15 of the CGR in connection with the appointment of the Nomination and Remuneration Committee, its duties and responsibilities shall be mandatory on all listed companies effective from 01/01/2010G.

Further, in order to foster transparency in the Saudi Capital Market and to develop standards of Corporate Governance, the CMA, by its decision No. (1-20-2008) dated 14/5/1429H. (corresponding to 19/5/2008G.), endorsed an amendment to Clause (a) of Article 18 of the CGR to read "A Board member shall not, without prior authorization from the General Assembly, which must be renewed each year, have any interest (whether directly or indirectly) in the company's business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company's account. Such notification shall be entered in the minutes of the meeting. A Board member who is an interested party shall not be entitled to vote on the resolution to be adopted in this regard neither in the General Assembly nor in the Board of Directors. The Chairman of the Board of Directors shall notify the General Assembly, when convened, of the activities and contracts in respect of which a Board member may have a personal interest and shall attach to such notification a special report prepared by the company's auditor".

These steps would help protect the rights, investments and savings of the company, the investors and the shareholders. However, this is only a small step and there is need for completely overhauling the system to develop the corporate sector, in particular, and to ensure effective Corporate Governance in KSA.

Saudi Arabia is a religious country governed by Islamic Law (Shariah). Under Shariah law, a government may issue regulations provided that these do not conflict with established principles of the Shariah. Therefore, all legislation is intended to supplement Shariah law and must adhere to its principles.

The Islamic guiding principles of accountability, trust, fairness and transparency serve as strong motivations for the company directors in Saudi Arabia to ensure that they protect the interest of their shareholders and fulfil their duties and obligations within best of their abilities. On the other hand, there is need to implement these Islamic principles in terms of laws and regulations to ensure compliance. Since these principles are based on Islam and Shariah, they would gain widespread acceptance and compliance.

There is no published single comprehensive code of Corporate Governance in Saudi Arabia, although there is a code issued by the CMA which the companies are advised to follow. Nevertheless, the enforcement of this code is yet lacking in terms of putting strict compliance requirements<sup>3</sup>.

- The Companies Law, and its subsequent amendments, covers the rules for the formation and operation of business entities in Saudi Arabia. The Saudi Companies Law lays down the basic duties and responsibilities of the Directors individually and their collective duties as Board of Directors.
- Corporate Governance Regulations: these relate to the management of joint stock companies listed on the Saudi Stock Exchange "Tadawul" to ensure their compliance with best governance practices that ensure the protection of shareholder rights.
- Capital Market Law: provides general rules covering a variety of areas, including but not limited to, establishment of the CMA and the Saudi Stock Exchange, issuance and trading of securities, manipulation and insider trading, sanctions and penalties for violations of this law and its implementing regulations.

### **Directors Duties in the Kingdom**

Board of Directors is a key element of the governance mechanism of any company. The directors are regarded as persons with the information, the will and the power to act, within a corporation to protect shareholders and stakeholders alike. Therefore, their role is very important and crucial in the development of an effective corporate governance framework in any jurisdiction.

In addition to any obligations arising out of Shariah principles, the Directors' general duties and liabilities include the following:

**a. Duty to avoid Conflict of Interests<sup>4</sup>:** A director may not have an interest whether directly or indirectly, in any transactions or contracts made for the account of the company, except with an authorisation from the General Assembly, to be renewed annually.

b. A director owes the duty of disclosure of personal interest to the board in any transaction made for the account of the company and such interested Director shall refrain from voting on the resolution to be adopted in this respect.

c. The Chairman of the Board of Directors is required to communicate to the General Assembly when it convenes the transaction and contracts in which any director has a personal interest. Such communication shall be accompanied by a special report from the company's auditor.

**d. Duty not to participate in Competing Business<sup>5</sup>:** A director may not, without authorisation from the General Assembly meeting, participate in any business competing with that of the company, or engage in any of the commercial activities carried on by the company, otherwise the company has the right either to claim damages from him or to consider the operations he has conducted for his own account as having been conducted for the account of the company.

**e. Duty not to take loan<sup>6</sup>:** A corporation may not grant any cash loan whatsoever to any of its directors, nor may it guarantee any loan contracted by a Director with a third party. Banks and other credit companies shall be excepted from this provision, for these may, within the limits of their objects and under

the same terms and conditions as they apply to their transactions with the public, grant loans to or open credits for their Directors or guarantee loans contracted by them with third parties. Any contract concluded in violation of this rule is considered null and void.

**f. Duty to keep Confidentiality:** A director owes the duty of confidentiality and must not disclose any information to the shareholders outside a general meeting as may have come to his knowledge by reason of his position as a director <sup>7</sup>.

**g. Duty to adhere to core Ethical Values <sup>8</sup>:** A director must carry out his duties in a responsible manner, in good faith and with due diligence and he represents all shareholders and not just a group of shareholders.

**h. Duty to be accountable <sup>9</sup>:** Directors are jointly responsible for damages to the company or its shareholders or third parties, arising from their misadministration of the company's affairs or their violation of the provisions of the Companies Law or of the company's memorandum of association or by-laws. Joint liability arises in case of a wrongful act arising from a resolution adopted by a unanimous vote, but where resolution is adopted by a majority vote and dissenting directors objection is expressly recorded in the minutes, a dissenting director is not liable. Absence from the meeting at which such resolution is adopted shall not constitute cause for relief from liability, unless it is established that the absentee was not aware of the resolution, or, on becoming aware of it, was unable to object to it. The company may institute an action in liability against its directors for wrongful act: that cause prejudice to the body of stockholders. The resolution to institute this action shall be made by the Ordinary General Assembly meeting, which shall appoint a person (or persons) to pursue the case on behalf of the company. If the company is adjudged bankrupt, the institution of this action shall rest with the receiver, and upon the dissolution of the company, the liquidator shall institute and pursue the case after obtaining the approval of the regular General Assembly meeting <sup>10</sup>.

Except in cases of fraud and forgery, the right of instituting the action in liability vested in the company shall be extinguished by the Ordinary General Assembly meeting exonerating the Board of Directors from responsibility for its administration. In all cases, such action shall be barred after the lapse of one year from the date of such exoneration <sup>11</sup>.

**i. Duty to Act within Powers <sup>12</sup>:** Under the law the Board of Directors enjoy full powers in the administration of the company. It is entitled within the scope of its competence, to delegate one or more of its members or others to perform an act or certain acts. Nevertheless, the Board of Directors may not contract loans for terms exceeding three years, or sell or mortgage the real property or the place of business of the company, or release the debtors of the company from their liabilities, unless it is authorized to do so by the company's articles of association and by-laws. If the company's by-laws and articles of association do not contain any provisions to this respect, the Board may perform the above acts only with an authorization from the General Assembly meeting, unless such act fall by virtue of their nature within the scope of the company's objects.

**j. Duty to submit annual report <sup>13</sup>:** The Directors have the duty to submit report to the Ordinary General Assembly meeting. It must include a comprehensive statement of all the amounts received by directors during the financial year in the way of emoluments, share in the profits, attendance fees, expenses, and other benefits, as well as of all the amounts received by the directors in their capacity as officers or executives of the company, or in consideration of technical, administrative, or advisory services.

**k. Accountability towards Shareholders:** Under the law every stockholder shall have the right to institute the action in liability against 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 institute such action only if the company's right to institute it is still valid and after notifying the company of his intention to do so. If a stockholder institutes such action, he shall be adjudged (compensation) only to the extent of the prejudice caused to him <sup>14</sup>.

Penalties for breach of directors duties or abuse of position are severe and include:

- 1.** liability to company, to its shareholders and to third parties; and
- 2.** imprisonment for a maximum of five (5) year; and
- 3.** a fine of between Saudi Riyals ten thousand and one hundred thousand (SAR 10,000 and SAR 100,000).

<sup>1</sup> Issued by the Board of Capital Market Authority pursuant to Resolution No. (1/212/2006) dated 21/10/1427H. (corresponding to 12/11/2006G.) based on the Capital Market Law issued by Royal Decree No M/30 dated 2/06/1424H. (corresponding to 31/07/2003G. )

<sup>2</sup> As amended by CMA Resolution No.(1-1-2009) dated 8/1/1430H (corresponding to 5/1/2009 G.)

<sup>3</sup> In its annual report dated 2008, the CMA stated that it will create an independent department to monitor compliance of listed companies with the corporate governance regulations. According to the CMA annual report of 2009, 6 companies failed to comply in 2009 with disclosure in their board of directors' reports for the preceding year, in accordance with the requirements of the "Corporate Governance Regulations", as compared with 11 companies in 2008.

<sup>4</sup> Article 69 of the Companies Law and Article 18 of CGR.

<sup>5</sup> Article 70 of the Companies Law and Article 18 of CGR.

<sup>6</sup> Article 71 of the Companies and Article 18 of CGR

<sup>7</sup> Article 72 of the Companies Law and

<sup>8</sup> Article 11 of CGR

<sup>9</sup> Article 76 of the Companies Law

<sup>10</sup> Article 77 of the Companies Law

<sup>11</sup> Ibid

<sup>12</sup> Article 73 of the Companies Law and Article 11 (h) of CGR.

<sup>13</sup> Article 9 of CGR

<sup>14</sup> Article 78 of the Companies Law