Takeovers of Publicly Traded Companies in KSA: A Critique of Regulations and Minority Shareholders Protection Rules in the Takeover Context

Khalid Sami Alsadhan

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Newcastle Law School

Newcastle University

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Abstract

Takeovers are relatively new strategies and are still developing in the Kingdom of Saudi Arabia (KSA), which explains the lack of sufficient studies in this area. This work will attempt to explore the KSA system of takeover from a legal perspective. It is expected that this research will contribute to the body of knowledge in the sphere of takeovers and minority shareholders' protection in takeovers in KSA and will serve as a major reference point in this area of concern. This thesis will provide a general critique of the takeover system of listed companies in the KSA. It will begin by providing an understanding of the KSA's corporate governance system and ownership structure. It will then provide an insight into the KSA's takeover system and the stock market. The thesis will examine the role of authorities that are concerned with takeovers, such as the Capital Market Authority (CMA) and the General Authority for Competition (GAC). The research will question the efficiency of the current KSA regulations in protecting minority shareholders' and directors' duties in takeovers. The thesis argues that the existing laws in KSA are not effective in protecting minority shareholders in takeovers, while considering influential factors in the KSA environment, such as the concentrated ownership structure. The research also argues that the regulations governing directors' roles and duties in takeovers and the litigation actions to hold them accountable are unclear and vague and require reform. The UK takeover system will be used as a benchmark for this thesis in recommending reforms to address these issues and at the same time to fit into the KSA's legal environment. The primary objective of this research is to suggest reforms to the KSA takeover system of publicly traded companies to improve certain areas that the researcher found to have issues, especially minority shareholders' protection and directors' roles and duties. From the researcher's point of view, the suggested reform would contribute to the promotion of a sound takeover system and, more generally, to the development of the corporate governance system and commercial environment in the KSA.

Acknowledgment

It has been a challenging task to accomplish the project due to many difficult circumstances. I would like to express my sincere gratitude to my supervisor, Professor Bryan Clark, who supported me in overcoming all difficulties during my Ph.D journey. His academic support and exceptional mentorship have been fundamental to this research. I am also grateful to my second supervisor, Dr. Sarah Morley, for her guidance and her valuable and constructive comments on this thesis. I would also like to thank my parents and my wife, Abeer. This work would not have been completed without their help and support.

Contents

Abbreviations

ACRSC	Appeal Committee for the Resolution of Securities Conflicts
AGM	Annual General Meeting
CG	Corporate Governance
CMA	Capital Market Authority
CML	Capital Market Law
CRSD	Committee for the Resolution of Securities Disputes
EGM	Extraordinary General Meeting
GAC	General Authority for Competition
GCC	Gulf Cooperation Council
IPO	Initial Public Offering
KSA	Kingdom of Saudi Arabia
M&A	Mergers and Acquisitions
MOC	Ministry of Commerce
OECD	Organisation for Economic Co-operation and Development
QFI	Qualified Foreign Investor
SAMA	Saudi Central Bank (previously known as the Saudi Arabian Monetary Authority)
SAR	Saudi Riyals
UK	United Kingdom
US	United States of America
WTO	World Trade Organization

Chapter 1. Introduction and Overview

1.1 Introduction

1.1.1 Background

The KSA's stock market is the largest in the Middle East and the 9th largest stock market among the 67 members of the World Federation of Exchanges.[1] The KSA has been undergoing major reforms in the past two decades to create an attractive market for both KSA and foreign companies and investors. The introduction of the Capital Market Authority (CMA) to the stock market in 2003 has encouraged public participation in stock trading and improved legal and institutional frameworks for the corporate governance of publicly held companies.[2] Furthermore, the introduction of the Merger and Acquisition Regulations in 2007 was an important reform of the KSA Stock Exchange to govern takeovers of publicly listed companies.[3] Most recently, in 2016,[4] the 2030 Saudi vision was announced, having two major objectives: becoming an international powerhouse for investment and establishing a distinct placement of the KSA as a worldwide hub with links to the Asian, European and African continents.[5]

Despite these reforms, takeovers are a relatively recent phenomenon in the KSA in comparison with the UK and the US, where takeovers have been increasingly common since the 1960s.[6] Indeed, takeovers are considered a relatively new method to have been adopted

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[1] Saudi Exchange website: <https://www.saudiexchange.sa/wps/portal/tadawul/about?locale=en>

[2] Fahad Almajid, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective' (PhD thesis, Faculty of Humanities, University of Manchester 2012) 15 <https://books.google.com.sa/books?hl=en&lr=&id=YZbx0clpceAC&oi=fnd&pg=PA1&dq=Almajid,+Fahad.+%E2%80%9CA+Conceptual+Framework+for+Reforming+the+Corporate+Governance+of+Saudi+Publicly+Held+Companies:+a+Comparative+and+Analytical+Study+from+a+Legal+Perspective,%E2%80%9D+Ph.D.+Thesis,+School+of+Law,+University+of+Manchester,+2011.&ots=P9ABArt62j&sig=aL9Q0geL_nZBriye5tCCtbcNHRc&redir_esc=y#v=onepage&q&f=false > accessed 20 October 2022

[3] Other examples of these reforms include: the introduction of the competition law and market conduct regulations in 2004, joining the World Trade Organization in 2005, replacing the 1965 company law with a modernised one in 2015, continual updates to the market regulations by the CMA such as corporate governance regulations and the adoption of international financial reporting standards (IFRS) for listed companies in 2017.

[4] Vision 2030 website: < https://vision2030.gov.sa/en>

[5] ibid

[6] John Armour and David A Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? - The Peculiar Divergence of U.S. and U.K. Takeover Regulation' 1727, 1753 <https://scholarship.law.upenn.edu/faculty_scholarship://scholarship.law.upenn.edu/faculty_scholarship/687> accessed 2 September 2021; Peer C Fiss, 'Institutions and Corporate Governance' [2007] SSRN 1, 24 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003303>.

by companies in the Middle East, including KSA, compared to other countries such as the UK and the US for example.[7] Even with the increasing practice of takeovers in recent years in the KSA, the practice is still in its infancy. There is still a wide gap between the KSA's takeover system and commonly accepted global standards, and this is attributable to a number of factors, mainly a lack of experience with this relatively new concept and a relatively less developed legal system in general.

Indeed, there are many aspects of the current takeover regulations in the KSA that still need further reform. For example, the 50% threshold for the mandatory bid rule[8] is considered one of the highest thresholds in comparison with other jurisdictions.[9] This can minimise the efficiency of the rule which is considered a protective tool for minority shareholders. Another example is the sell-out rule,[10] which allows minority shareholders to force the acquirer to buy their shares once a certain threshold is reached, but which is not adopted in the takeover system in the KSA. Thus, the efficiency of the corporate and takeover system in protecting minority shareholders needs to be examined to ensure the system's efficiency. Furthermore, regulations governing directors' roles, duties, and accountability in takeovers require analysis to evaluate their efficiency considering the important role that directors play in takeovers. Moreover, the role of governing authorities such as the CMA and the Competition Authority requires assessment considering the integral role they play as facilitators of takeovers.

This thesis will analyse these issues and provide recommendations for reform after paving the way by providing a clear understanding of several factors that need to be considered in any potential programme of reform. These factors include the corporate governance system and the share ownership structure in the KSA. The concentrated ownership structure is one of the features of the KSA's market that is most distinguishable from the systems in the UK and US. The government and family-owned firms dominate the

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[7] Joseph W Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 Stan J Int'l L 307 <https://heinonline.org/HOL/Page?handle=hein.journals/stanit41&div=12&start_page=307&collection=journals&set_as_cursor=0&men_tab=srchresults> accessed 15 July 2018

[8] This rule can be interpreted in a broad sense to mean that once a person or company acquires a certain percentage of a company's shares, that party must be prepared to buy the rest of the shares by making a general offer to all of the remaining shareholders at a price that is considered to be fair. The mandatory bid rule is discussed in detail in chapter 6.

[9] See the OECD Corporate Governance Factbook 2021 26–27, available at: <https://www.oecd.org/corporate/Corporate-Governance-Factbook-Chapter-3.pdf>

[10] The sell-out rule is discussed in detail in chapter 6.

market in KSA and are considered a controlling shareholder in many companies.[11] In addition to the 'agency problem'[12] that occurs between shareholders and managers as a result of the separation of ownership and control,[13] this dynamic of concentrated ownership raise further agency problems between controlling shareholders and minority shareholders. These important considerations will be taken into account when analysing the takeover system in the KSA and the kind of reforms that might be introduced. Although this thesis will focus on the minority shareholders' protection in takeovers, it will also suggest reforms to develop regulation of takeovers more generally by maintaining a balance between shareholders' rights protection and the economic needs of companies, considering that takeovers are viewed as common tools used by companies to grow and expand.[14] The focus on minority shareholders' protection is due to the importance of this protection, as it can ensure that companies are run more effectively considering that shareholders can monitor the management, which can prevent companies collapse and benefit the economy.[15] While minority protection is essential in increasing investors' security and confidence in the market, the right regulatory balance still needs to be struck in order to not inhibit market freedom.[16]

1.1.2 Research Purpose and Contribution

The main objective of this work is to propose reforms to the KSA takeover system for publicly traded companies in order to address problems found by the researcher, particularly minority shareholder protection and directors' roles and duties. From the researcher's

[11] The government holds 78.46% of the KSA's stock market. See: Quarterly Statistical Bulletin for the second quarter of 2022 on the CMA website: <https://cma.org.sa/en/MediaCenter/PR/Pages/Bulletin_for_Q2-_2022_en.aspx>. See also the ownership information of the listed companies, available on the Saudi Exchange website: https://www.saudiexchange.sa/wps/portal/saudiexchange

[12] Agency theory refers to a situation where the directors control the company as a result of a diffused ownership and shareholders' passivity, and those directors may not always act in the best interest of shareholders, especially in a conflict of interest situation. See for example: Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26, 301, 304 <https://www.jstor.org/stable/725104?seq=1#page_scan_tab_contents> accessed 20 February 2022

[13] See for example: A Berle and G Means, *The Modern Corporation and Private Property* (Macmillan 1932)

[14] Companies that choose to grow typically attempt to gain a new market share, reach a new customer base, and generate economic profits, whereas companies that choose not to grow are under the threat of failure due to customer and market share losses. Thus, many companies grow through takeovers. See Rima Tamosiuniene and Egle Duksaite, 'The Importance of Mergers and Acquisitions in Today's Economy' (2009) 11 <http://tksi.org/JOURNAL-KSI/PAPER-PDF-2009/2009-4-03.pdf> accessed 5 December 2022.

[15] Jonathan Mukwiri and Mathias Siems, 'The Financial Crisis: A Reason to Improve Shareholder Protection in the EU?' (2014) 41 Journal of Law and Society 51, 51 <https://www.jstor.org/stable/43862373> accessed 7 March 2023.

[16] Filippo Belloc, 'Law, Finance and Innovation: The Dark Side of Shareholder Protection' (2013) 37 Cambridge Journal of Economics 1 <http://ssrn.com/abstract=1452743> accessed 7 March 2023.

perspective, the proposed reforms would help advance a sound takeover system and, more broadly, the development of the KSA's corporate governance system and commercial environment. In terms of the originality of this work, there is very limited literature on this subject in the region as a whole, and the KSA in particular. The KSA's takeover system currently suffers from unclarity and uncertainty. This is a result of unclear and incomprehensive legislation and the courts' hitherto inactive role in development of law in this area, especially in relation to certain important matters such as minority shareholders' protection, directors' roles and duties, and litigation options in the takeover context.

One of the key contributions this thesis makes is to provide recommendations for reforming the takeover system in the KSA, which it is hoped will assist the KSA's legislature in future reforms. This contribution is in line with the recently announced KSA Vision 2030 which aims to attract more local and foreign investment, develop a vibrant stock market, and enhance the business environment. Therefore, this thesis aims to present recommendations that would contribute to the promotion of a sound takeover system by designing a law that provides strong protection to minority shareholders, clear roles and duties for directors, and a clear and efficient accountability and litigation system in the takeover context.

The thesis will also contribute to the body of knowledge in the area of takeovers more generally, especially in respect of areas concerning minority shareholders' protection and directors' duties in the KSA, and will serve as a reference point in this field.

1.1.3 Scope of the Thesis

This thesis addresses takeover regulations of publicly listed companies in the KSA. The term 'takeover' in this thesis refers to acquisition or merger involving trading transactions on the shares of a publicly traded company in order to acquire corporate control. Thus, the scope of the thesis will be limited to joint stock companies, as the only form of company permitted to be listed in the KSA's stock market. The thesis will hence not cover other forms of companies or closely held joint stock companies. There are three main reasons for excluding non-listed companies from the scope of this thesis. Firstly, the CMA regulations require listed companies to disclose a significant amount of information about the company, enabling the availability of a great deal of critical information relevant to the thesis topic, such as ownership structures. This is in contrast to non-listed companies, where there is a lack of disclosure requirements in KSA which makes finding essential information very difficult.

Secondly, the M&A Regulations, the Corporate Governance Regulations, and other CMA regulations only apply to listed companies, causing non-listed companies to be mainly governed by the Companies Law 2015 alone, which suffers from many issues and loopholes concerning takeovers and related topics such as protecting minority shareholders and directors' duties. Thus, it is very difficult to assess the takeover system of non-listed companies in the absence of takeover statutes and regulations. Thirdly, with the emergence of corporate scandals and financial crises that not only negatively impact the vast majority of investors, employees, and creditors, but also the economy as a whole, the topic of corporate governance for listed corporations receives considerably more attention in most countries.[17]

Although Sharia is the fundamental source of law in the KSA, this thesis will not focus on Sharia. Section 2.4 in this chapter will provide an overview of Sharia, however, and its underpinning principles, and will illustrate the primacy of state laws as the primary source of law for listed companies. Instead, the thesis will focus on statutes and regulations related to corporate law and takeovers, such as the Companies Law 2015 and the M&A Regulations. This is because the corporate legal frameworks of most countries in the region, including the KSA, are influenced by French civil law,[18] while the Anglo-American common law concepts are more prominent in the capital market regulations.[19] Indeed, the World Bank assessments of several countries in the region did not illustrate a direct influence of Sharia on the development of the corporate governance systems.[20] Moreover, the KSA takeover system is highly influenced by the UK's takeover system. In addition, disputes arising from issues related to takeovers of listed companies will be addressed by a specialist judicial committee[21] which is governed by the CMA's regulations, where the influence of Sharia is minimal.

The thesis will not cover all details related to the takeover system in the KSA. Instead, it will focus on selected issues that pose particular problems in the KSA's takeover system and require reform.

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[17] Carol Graham, Robert E. Litan, and Sandip Sukhtankar, 'Cooking the Books: The Costs to the Economy' (Brookings Policy Brief Series, Brookings Institution, August 2002) < https://www.brookings.edu/research/cooking-the- books-the-cost-to-the-economy/ > accessed 12 October 2022

[18] See for example: The World Bank (2001a). Corporate governance country assessment: Arab Republic of Egypt. Report on the Observance of Standards and Codes (ROSC). Egypt: The World Bank p1. <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/110881468233681903/egypt-report-on-the-observance-of-standards-and-codes-rosc-corporate-governance-country-assessment>

[19] ibid

[20] The World Bank (2009b). Corporate Governance Country Assessment: Kingdom of Saudi Arabia. Saudi Arabia: Report on the Observance of Standards and Codes (ROSC) Corporate Governance <https://openknowledge.worldbank.org/handle/10986/28086>

[21] The General Secretariat of Committees for Resolution of Securities Disputes

1.1.4 Research Questions

It is common for a country to transplant some laws of another jurisdiction when developing its own legal system. Nevertheless, the adoption of foreign laws is subject to local economic, political, and cultural considerations. Therefore, the main research question of this thesis is how to improve the KSA's current takeover legal system through addressing its issues and recommending reforms by transplanting certain foreign regulations, mainly from the UK, that fit the KSA's market environment. In addition to this general question, the research will focus on two sub-questions:

- How effective are the current applied regulations of the KSA in protecting minority shareholders' rights during takeovers?
- How clear and effective are the regulations governing directors' roles, fiduciary duties, and accountability in takeovers in the KSA?

1.1.5 Methodology

This study will adopt a combination of methods to achieve its purpose. Primarily, the thesis will use a doctrinal method and contain an analysis of the existing legislations, regulations, and statutes related to takeovers in the KSA. However, it is necessary to use a descriptive method in some parts of the thesis to identify characteristics and features of the KSA stock market, corporate governance, and ownership structure, to be able to assess and analyse the takeover regulations in an accurate context.

The thesis will partially use a comparative method in some parts by using the UK and other jurisdictions' relevant regulations to extract important lessons and advantages that can be implemented in the KSA to improve the takeover legal system. According to studies, comparative assessment is a significant tool for the advancement and development of law reforms in any country.[22] However, the proposed methodological approach holds that a foreign regulation can be implemented in the KSA only if it can be modified to fit the

[22] Perti Mantysaari, *Comparative corporate governance: Shareholder as a rule-maker* (Springer 2005) 10; J Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) Oxford Journal of Legal Studies 9, 102; H. Xanthaki, 'Legal transplants in legislation: Defusing the Trap' (2008) International and Comparative Law Quarterly 659, 660; K. Zweigert and H. Kotz, *An Introduction to Comparative Law* (Oxford University Press 1998) 34

country's specific market structure and legal environment.[23] In using this comparative method, the study will rely mainly on the UK as a benchmark and yardstick for assessing the takeover system in the KSA and recommending reforms where applicable. The reason for choosing the UK is based on its deep-rooted and developed legal system, and its recognition as one of the world's top jurisdictions for providing strong protection to minority shareholders.[24] Indeed, the UK is viewed as the world leader in corporate governance reforms.[25] Besides this, the KSA's company law, corporate governance, and takeover system are highly influenced by the UK. Thus, instead of attempting to discuss the limitations of the UK's takeover system, the objective is to benefit from its advanced legal system in order to address the deficiencies of the KSA's takeover system.

The following primary resources in the KSA will be examined: capital market regulations, company law, takeover rules, corporate governance regulations, and administrative and judicial authorities. The UK's counterpart primary resources will also be examined on relevant topics related to the thesis. In addition, so as not to limit the emphasis to primary resources, the present research will look into secondary resources such as books, journal articles, working papers, and reports available through the Newcastle University library, both physically and electronically, such as HeinOnline, Lexis, and Westlaw International.

1.1.6 Research Structure

The thesis is divided into eight chapters. The first chapter presents an overall introduction to this thesis. It contains an illustration of the purpose and contribution of the thesis, its scope, thesis questions, methodology, structure, and an overview of the KSA's background and its political, judicial, and legal system.

Chapter 2 will focus on the concepts of corporate governance and ownership structure as a starting point from which to analyse the KSA's takeover system. The chapter will define these concepts and illustrate their importance in the takeover context analysis. It will also

[23] See for example: Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, 'Economic Development, Legality, and the Transplant Effect' (2003) 47 European Economic Review 165 < https://ideas.repec.org/a/eee/eecrev/v47y2003i1p165-195.html> accessed 12 October 2022

[24] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) LII The Journal of Finance 52, 769 <https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.1997.tb04820.x>. accessed 12 October 2022

[25] Jill Solomon, *Corporate Governance and Accountability* (4th edn, Wiley 2013) 47

provide an overview of the US and UK corporate governance systems and ownership structures as predominant global corporate governance models before analysing the KSA's corporate governance system and ownership structure.

The third and fourth chapters will lay the foundation for the chapters that follow by providing a comprehensive insight into the KSA's stock market and takeover system. The purpose of the third chapter is to provide an understanding of the KSA's stock market as the platform where takeovers take place. The fourth chapter then addresses the KSA's takeover regulatory system and provides definitions of the types of takeover transactions that can take place in accordance with the laws and regulations. The purpose of the fourth chapter is to provide an understanding of the takeover regulatory framework in the KSA, thus paving the way for later chapters where a more critical and analytical approach to the takeover system in the KSA will be applied.

The fifth chapter will provide an overview of the Competition Law and the General Authority for Competition (GAC). It will illustrate and examine their importance and role in the takeover context. The chapter will present an illustration of how takeover transactions in the KSA overlap with the Competition Law and the GAC jurisdiction by analysing the merger control system embodied in the Competition Law. The chapter will analyse the economic concentration concept in KSA and identify takeover transactions that fall under this concept, requiring GAC pre-approval for the transactions. Chapter 5 will analyse the dominant position concept in the takeover context and will argue that abuse of dominant position is neither defined nor clearly explained in the KSA's legislation. The chapter will recommend reforms aimed at defining this concept by looking for a definition in another more developed system which can provide a better understanding of the concept. Chapter 5 will also analyse the role of the semi-judicial committee (Committee for the Resolution of Violations of the Competition Law), which is authorised to adjudicate disputes related to the Competition Law. recommendations for future reforms of the Competition Law in areas related to takeovers will also be presented in this chapter.

Chapter 6 will illustrate the importance of protecting minority shareholders in takeovers, considering their vulnerable position in change of control transactions and the high possibility of conflict of interest in these situations. The chapter will focus on protective rules in takeovers in the KSA that require reform to enhance the protection of minority shareholders in the country. The ownership structure in the KSA and the principle of

separation of ownership and control will be considered important factors to analyse in the context of minority shareholders' protection rules. Recommendations to reform important tools that provide protection to minority shareholders in takeovers, such as the mandatory bid rule and the sell-out rule, will be provided in this chapter. Additionally, it will attempt to balance shareholders' protection with market needs for flexible regulations to promote the economy; in this area chapter 6 will provide recommendations to adopt the squeeze-out rule.

The seventh chapter will provide an overview of the board of directors and its structure and the role of independent and non-executive directors. It will also provide a critique and analysis of the directors' duties, accountability, and litigation options in the takeover context of the KSA. The chapter will examine the legal framework governing directors' duties and their role in takeovers and will argue that this legal framework lacks clarity and comprehensiveness in the KSA. Chapter 7 will address board neutrality and the non-frustration rule in takeovers. It will analyse the two main different approaches adopted in the US and the UK in this regard and the rationale for this divergence, to pave the way for examining the rule and its efficiency in the KSA. The chapter will also address the litigation options in the KSA that suffer vagueness and ambiguity which undermine the protection of minority shareholders. Recommendations for reform will be provided to address the issues discussed in the chapter. Chapter 8 will draw together the arguments presented in the previous chapters and present the conclusion of the thesis.

1.2 An Overview of the KSA and its Political, Legal, and Judicial System

This section aims to provide the reader with an overview of the country upon which this thesis is based. A brief history of the KSA and its political, legal, and judicial system will be provided in this section to provide context for the ensuing discussion.

1.2.1 Brief History

The Arabian Peninsula (Current KSA and other countries) is known as the birthplace of Islam. At the beginning of the seventh century, the prophet Muhammad brought the people of the Arabian peninsula under one religious and political system that adhered to Islamic principles.[26] It has been nearly three centuries since the establishment of the first Saudi

[26] James E Lindsay, *Daily Life in the Medieval Islamic World* (Hackett Publishing Company 2008) 32.

state.[27] In the year 1744, the meeting of Muhammad bin Saud and Muhammad bin Abdul Wahab resulted in a collaborative effort to establish a state, which subsequently ushered in a new epoch for the Arabian Peninsula.[28]

By the 19th century, the first Saudi state had spread its influence across most of the Arabian Peninsula.[29] However, in 1818, the first Saudi state was brought to an end after the Saudi-Ottoman war.[30] Soon after the collapse of the first Saudi state, the second Saudi state was established in 1818, lasting until its collapse in 1891. In 1902, a direct descendent of the establisher of the first Saudi state,[31] Abd al-Aziz ibn Saud, began the journey to establish the third Saudi state, finally succeeding on September 23, 1932, when the current Kingdom of Saudi Arabia was officially united and established. Despite periods of nominal or intermittent Ottoman administration over sections of the present-day state from the 16th century onwards, the KSA was never colonised; it was and has always been ruled by its people.[32] There were Ottoman representatives in Mecca, Medina, and a few other cities, but the Ottoman Empire's jurisdiction over domestic affairs was limited, leaving local rulers in charge.[33]

1.2.2 Location and Influence

The KSA's central location in the Middle East provides it with a strategic edge in the region's political and economic affairs. Kuwait, Qatar, Bahrain, and the United Arab Emirates are to the east, and Jordan and Iraq are to the north. In the west is the Red Sea, which Egypt, Sudan, Eritrea, and Ethiopia all share. Yemen and Oman border the KSA to the south. The KSA additionally shares the Arabian Gulf with Iran. The KSA is a vital religious centre because it is home to the two most important sites in Islam, Mecca and Medina. Furthermore, the KSA is considered one of the pivotal countries in the Middle East and the international community

[27] The first Saudi state was established in 1727.
[28] Wahbi Hariri-Rifai and Mokhless Hariri-Rifai, *The Heritage of the Kingdom of Saudi Arabia* (GDG Publication 1990) 26
[29] See: A Chronology of the House of Saud, available at <http://www.pbs.org/wgbh/pages/frontline/shows/saud/cron/> accessed 20 October 2022
[30] James Wynbrandt, *A Brief History of Saudi Arabia* (Checkmark Books 2004) 143.
[31] Muhammad ibn Saud (1710-1765)
[32] See for example: Wynbrandt (n 30). The leaders of the Ottoman empire were not Arabs, but rather members of Turkish tribes.
[33] ibid

in view of its political and economic weight.[34] Due to its oil production, the KSA is firmly linked to the global financial markets.

1.2.3 Political and Legislative Systems

The KSA is an absolute monarchy.[35] According to article 44 of the constitution, the Authorities of the KSA consist of the Executive, Legislative (Regulatory), and Judicial branches. The article also stipulates that 'These authorities shall cooperate in the discharge of their functions in accordance with this Law and other laws. The King shall be their final authority'.[36] The Council of Ministers serves as both an executive and legislative body.[37] The King is the Prime Minister of the Council of Ministers.[38] The Council of Ministers is the sole executive body; however, legislative functions are shared with the Al Shura Council.

Referred to in English as the Consultative Assembly of the KSA, the Shura Council (*Majlis Al Shura*) reviews proposed legislation and provides advice and suggestions on it before forwarding it to the Ministers Council.[39] In most instances, the Ministers Council enacts laws once the Shura Council has reviewed them. According to article 17 of the Shura Council Law:

> The Shura Council's resolutions shall be brought before the King who shall decide the resolutions to be referred to the Council of Ministers. If the views of both the Council of Ministers and the Shura Council coincide, the resolutions shall come into effect following the King's approval. If the views of the two Councils are at variance, the matter shall be referred back to the Shura Council to express its views on such variance and shall then bring it before the King to take appropriate action.[40]

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[34] Abdullah Hazaa Othman, Oleg Evgenievich Grishin and M. Yoserizal Saragih, 'Transformation of the Political System of Saudi Arabia: Regional Dimension' (2020) 7 Konfrontasi: Jurnal Kultural, Ekonomi dan Perubahan Sosial 237, 237 <https://www.researchgate.net/publication/346803527_Transformation_of_the_Political_System_of_Saudi_Arabia_Regional_Dimension>. accessed 25 October 2022.
[35] Basic Law of Governance (constitution) Article 5(a)
[36] Basic Law of Governance (constitution) Article 44
[37] The Council of Ministers Law Articles 1 9and 24
[38] The Council of Ministers Law Article 1
[39] The Shura Council Law Articles 15–18
[40] The Shura Council Law Article 17

1.2.4 Legal and Judicial Systems

The purpose of this subsection is to briefly provide the reader with a general understanding of the KSA's legal and judicial systems. Further detail on different aspects of the legal and judicial systems that are related to takeovers will be provided in different chapters of this thesis.

The KSA has a *Sharia*-based law. The primary source of *Sharia* law is the *Qur'an* – the sacred text revered by Muslims. The *Qur'an* is the basis for any legal rulings in Islam. The secondary source of *Sharia* comes from the sayings or practices of the Prophet Muhammad (*Sunnah*). The interpretation of these sources is not left to the courts. There are four main schools of thought that interpret the *Qur'an* and the *Sunnah*, on which judges rely.[41] The KSA generally adopts the Hanbali school of thought. Thus, as Vogel concluded, 'in the absence of a rule of judicial precedent (stare decisis), Islamic law is still best described as a jurists' law, not a judges' law'.[42] Indeed, the principle of judicial precedent is not adopted in the KSA, unlike in the UK for example.

Under *Sharia* law, the default rule is that unless specifically prohibited by the *Qur'an* or *Sunnah,* all transactions and actions are permissible.[43] While there are purely religious rules and moral principles in the *Qur'an,*[44] a number of its verses are concerned with what can be described as legal material. This involves injunctions and principles concerning family and inheritance, crimes and punishments, contracts, and business. Regarding commercial transactions, the *Qur'an* contains a variety of general guiding principles. For instance, Muslims are obligated to fulfill their contractual obligations[45] and adhere to the principles of trustworthiness, honesty, and justice in all aspects of their lives,[46] including commercial transactions.[47] However, It is noteworthy that Sharia law typically offers overarching foundational principles in the realm of corporate and commercial affairs, while refraining from prescribing specific regulations for the implementation of these principles in particular

[41] The main schools are: the *Shaf'i*, the *Hanbali*, the *Hanafi*, and the *Malki.*
[42] Frank E Vogel, *Islamic Law and the Legal System of Saudí: Studies of Saudi Arabia.* (Brill 2000) 24.
[43] Ibn Taymiyyah. Majmu' AlFatawa (21, 535). (Arabic)
[44] For example, treating one's parents with kindness; see Qur'an 17:23
[45] See Qur'an 5:1
[46] See Qur'an 83:1–3; Qur'an 55:9; Qur'an 4:58
[47] Lilian Miles and Simon Goulding, 'Corporate Governance in Western (Anglo-American) and Islamic Communities:
Prospects for Convergence?' (2010) Journal of Business Law 126, 132–133
<https://www.researchgate.net/publication/236880978_Lilian_Miles_and_Simon_Goulding_2010_Corporate_Governance_in_Western_Anglo_American_and_Islamic_Communities_Prospects_for_Convergence_Journal_of_Business_Law_2_126_-_149> accessed 8 December 2022

contexts. This approach enables legal scholars to construct a comprehensive legal framework that can be effectively applied to specific situations. The company law of the KSA serves as the primary legal source that regulates the operations of publicly traded corporations. The aforementioned encompasses the diverse array of relationships present within the corporation, including the relationship between shareholders and directors.

To further clarify the role of judges in the KSA, it is important to differentiate between two main bodies of law in the country, the *Sharia* law which is discussed above, and the state law. State laws are the regulations and statutes enacted by the government and its agencies to regulate modern matters such as company law and the M&A Regulations, which mostly are of foreign origin. Courts have limited power to interpret codified rules as they generally tend to merely enforce them. Thus, the absence of the judicial precedence doctrine in the KSA and the limited role of courts in the development of law are relevant to several areas of this thesis where there are gaps in the legislation in the takeover context that cannot be filled by courts. Therefore, the transplantation of foreign regulations, such as those of the UK, to fill these gaps can be an effective tool.

The KSA judicial system has three main branches: the general courts (ordinary courts), the Board of Grievances (administrative courts), and the semi-judicial courts. The general courts have jurisdiction over civil, commercial, and criminal disputes.[48] The Board of Grievances has jurisdiction over administrative disputes.[49] The semi-judicial courts, usually referred to as 'committees', are 'administrative committees with judicial authority'.[50] There are over 100 committees distributed between many government agencies.[51] Each of these committees resolves disputes within a specialised subject area. In terms of independence, these committees are independent of the agencies that supervise the same specialised field and they report only to the King.[52] Most of these committees are provided with a single level of appeal, after which their rulings become final.[53]

One of these semi-judicial committees in the KSA is the Committee for the Resolution of Securities Disputes (CRSD), which has jurisdiction over disputes that fall within the CMA

[48] See the Implementation Mechanism of the Judiciary Law and The Board of Grievances Law 2007, available in Arabic at <https://www.moj.gov.sa/Documents/Regulations/pdf/03.pdf>
[49] Ibid
[50] Frank E Vogel, *Saudi Business Law in Practice: Laws and Regulations as Applied in the Courts and Judicial Committees of Saudi Arabia* (Hart Publishing 2019) 46
[51] ibid
[52] ibid 47
[53] ibid

and the Capital Market Law (CML) and its Implementing Regulations jurisdiction.[54] Disputes arising from takeovers in the listed companies fall under the CRSD jurisdiction. The CRSD will be discussed in further detail in chapter 4 of this thesis.

To summarise, the purpose of section two of this chapter is to provide an overview of the country upon which this thesis is based. A brief overview of the history of the KSA and its political, legal, and judicial systems was presented to provide context for the ensuing analysis in the following chapters.

[54]Article 30 of the Capital Market Law

Chapter 2. Corporate Governance and Ownership Structure

2.1 Introduction, definition, and Importance

2.1.1 Introduction

The past two decades have seen rapid development of corporate governance systems worldwide as countries' policy-makers realised the importance of corporate governance in protecting shareholders rights, improving companies' performances and promoting economies. In particular, the fall of major companies such as Enron and Lehman Brothers, and the 2008 financial crisis were a wake-up call for many countries to reform their corporate governance systems.[1] Inefficient corporate governance systems can lead to financial problems for companies and negatively affect their performance, which may cause investors to lose their trust in the market.[2]

This chapter is mainly concerned with corporate governance systems and ownership structures as a starting point from which to analyse the KSA takeover system. This chapter will provide definitions of corporate governance, explain the importance of corporate governance and ownership structure, and show how these two concepts are fundamental for analysing takeovers. This chapter will also present an illustration of the predominant global corporate governance models, and a brief descriptive analysis of the UK and US corporate governance systems and ownership structures. This analysis is undertaken to provide insights into ways that KSA corporate governance and ownership structure might be reformed, but this thesis does not intend to present a comparative analysis of different systems. The chapter will discuss fundamental corporate governance theories that are essential for analysing the KSA corporate governance and takeover systems.

2.1.2 Definition

There is no consensus amongst scholars on the definition of corporate governance as, inter alia, the term could be interpreted differently depending on the point of view of various

[1] Jill Solomon, *Corporate Governance and Accountability* (4th edn, Wiley 2013). 4
[2] Christine Mallin, *Corporate Governance* (4th edn, Oxford University Press 2007) 1

disciplines. Moreover, the country where corporate governance is considered may significantly influence how the term is defined.[3] In the UK context, a general definition was presented by the Cadbury Committee's Report in which corporate governance was defined as 'the system by which companies are directed and controlled'.[4] At the international level, the Organization for Economic Cooperation and Development (hereinafter OECD) adopted the Cadbury report definition of corporate governance and added:

> Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.[5]

However, another broader definition can be considered more accurate, as a sound corporate governance system should consist of

> those formal and informal institutions, laws, values, and rules that generate the menu of legal and organizational forms available in a country and which in turn determine the distribution of power; how ownership is assigned, managerial decisions are made and monitored, information is audited and released, and profits and benefits allocated and distributed.[6]

This broad definition will be adopted in this thesis for various reasons. Firstly, it combines key elements of both the Cadbury and the OECD definitions of corporate governance. Secondly, and more importantly, this broad definition illustrates the fundamental aspects of corporate governance that are very much related to the objectives of this thesis. This definition of corporate governance includes important elements like the structure of ownership, the separation of ownership and control, and agency costs for monitoring the controllers, whether these controllers are directors or major shareholders. More importantly, these concepts will be essential as tools for analysing the KSA takeover system.

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[3] Solomon (n 1) 5
[4] Adrian Cadbury (1992) Report of Committee on the Financial Aspects of Corporate Governance
[5] The Organization for Economic Cooperation and Development (OECD). Available at www.oecd.org
[6] Peter Cornelius and Bruce Kogut, *Corporate Governance and Capital and Flows in a Global Economy* (Oxford University Press 2003) 2–3; Fahad Almajid, 'A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective' (2008) <https://books.google.co.uk/books/about/A_Conceptual_Framework_for_Reforming_the.html?id=YZbx0clpceAC&redir_esc=y>.

2.1.3 Importance of Corporate Governance and Ownership Structure

Corporate governance has been extensively examined by scholars from different disciplines in numerous countries in the past three decades. Major financial crises have been linked to corporate governance failures such as low level of transparency, and poor supervision of directors by shareholders.[7] Major financial events since the late 1990s, including the Asian financial crises, the fall of Enron in 2001 and Lehman Brothers in 2008, as well as the global financial crisis in the same year, have placed corporate governance mechanisms and principles under scrutiny. The lesson to be learned is that inefficient corporate governance systems lead to an unattractive investment environment and can cause more devastating results such as an economic crisis.[8]

Indeed, the weak corporate governance system of a country can affect its ability to attract foreign investors.[9] This is attributed to the fact that investor protection is a fundamental principle of any sound corporate governance system. La Porta and his colleagues confirm that 'Corporate governance is, to a large extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders'.[10] Minority shareholders, specifically, and creditors, are more dependent on the law to protect their rights, as in many countries they are in a vulnerable position where controlling shareholders and directors can take advantage of their weak position.[11] Hence, many developing countries, such as the KSA, strive to improve their corporate governance system to provide more protection for minority shareholders and all other stakeholders as they realise the importance of a strong corporate governance system in attracting investors to their financial markets.[12]

Not only emerging markets that are concerned about their corporate governance systems; advanced markets, such as those of the UK and the US, are frequently reforming

[7] Brenda Hannigan, *Company Law* (3rd edn, Oxford University Press 2012) 128
[8] Oskar Kowalewski, 'Corporate Governance and Corporate Performance: Financial Crisis (2008)' (2016) 39 Management Research Review 1494, 1495 <www.emeraldinsight.com/2040-8269.htm> accessed 8 March 2023; Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) LII The Journal of Finance 52, 769 <https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.1997.tb04820.x>. accessed 12 October 2019.
[9] Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of Financial Economics 3 <https://scholar.harvard.edu/files/shleifer/files/ip_corpgov.pdf> accessed 11 November 2018.
[10] ibid
[11] ibid
[12] ibid

their corporate governance systems.[13] In fact, to illustrate the practical importance of corporate governance, there is a great deal of debate among scholars, lawyers, and market professionals from various developed countries on the efficiency of the existing corporate governance systems.[14]

On a national level, corporate governance has highly practical importance as it shapes the market and the economy of a country. Indeed, a country's corporate system can be seen as an 'institutional matrix that provides both the roles to the players and the goals to be pursued by the corporation'.[15] Hence, many activities and transactions on the market of a country, specifically takeovers, cannot be properly analysed without a full understanding of that country's corporate governance system and its key features such as ownership structure.

The structure of corporate ownership is a fundamental aspect of corporate governance. In fact, ownership structure, inter alia, is a determining factor that shapes a country's corporate governance system.[16] Corporate ownership structure has been the centre of concern among many scholars. Berle and Means discussed and analysed the ownership structure in the US market, and noticed the beginning of the diffused ownership[17] that is present in US corporations.[18] They also raised the issue of the separation of ownership and control as an important outcome of the diffused ownership US market.[19] The divergence of interests between the owners and the directors was one of the results of the separation of ownership and control; it has been examined by many scholars and referred to as the 'agency problem', which will be discussed later on this thesis.

Ownership structure varies from one country to another. For listed companies, corporate ownership in the UK and the US is considerably diffused whereas it is concentrated

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[13] Thomas Clarke, *International Corporate Governance, a Comparative Approach* (2nd edn, Routledge 2017) 27

[14] ibid; Abdul Ghafoor Awan and others, 'PROBLEMS OF CORPORATE GOVERNANCE IN USA' (2014) 2 European Journal of Business and Innovation Research 55 <www.eajournals.org> accessed 9 March 2023; Sridhar Arcot, Valentina Bruno and Antoine Faure-Grimaud, 'Corporate Governance in the UK: Is the Comply or Explain Approach Working?' (2010) 30 International Review of Law and Economics 193 <https://www.sciencedirect.com/science/article/pii/S0144818810000050> accessed 9 March 2023.

[15] Peer C Fiss, 'Institutions and Corporate Governance' [2007] SSRN 1, 24 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1003303> .; Douglas C North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press 1990)

[16] Solomon (n 1) 5

[17] Diffused ownership means that most of the company's shares are owned by many small shareholders.

[18] Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (1932) <https://ia801603.us.archive.org/5/items/in.ernet.dli.2015.216028/2015.216028.The-Modern.pdf>.

[19] ibid

in most other countries around the world.[20] A market ownership structure can be classified as concentrated when most of its listed companies have one or few investors (individuals or institutions) that hold substantial shares, such as 10 percent or more.[21]

In the takeover context, corporate governance and ownership structure are of the essence. Corporate governance is, inter alia, concerned with the exercise of power within companies.[22] The ownership structure of these companies affects how this power is exercised.[23] Thus, a country's corporate governance and ownership structure shape its takeover activities. Takeovers are widely viewed as an external corporate governance mechanism to address governance issues.[24] In the US, according to Shleifer and Vishny, takeovers play a vital role as a control instrument to prevent managers from exploiting shareholders.[25] This thesis will attempt to illustrate the importance of takeovers as an external corporate governance mechanism in later chapters.

Takeover activities in KSA, as a market concentrated country, are different from the takeover transactions in a diffused market such as the UK's. In a market where ownership is concentrated, controlling shareholders play the crucial role in takeovers.[26] However, takeovers, especially hostile takeovers,[27] are less common in countries where the corporate ownership is concentrated compared to more diffuse ownership regimes.[28] As a result of

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[20] Julian Franks, Colin Mayer and Stefano Rossi, 'Ownership: Evolution and Regulation' (2009) 22 Review of Financial Studies 4009 <https://academic.oup.com/rfs/article-abstract/22/10/4009/1588851?redirectedFrom=PDF>.

[21] Shleifer and Vishny (n 8) 753–754

[22] Gustavo Visentini, 'Compatibility and Competition Between European and American Corporate Governances: Which Model of Capitalism? Recommended Citation', vol 23 (1998) <http://brooklynworks.brooklaw.edu/bjilhttp://brooklynworks.brooklaw.edu/bjil/vol23/iss3/3> accessed 7 April 2019.

[23] Shleifer and Vishny (n 8) 739.

[24] ibid; Christiana Dharmastuti and Sugeng Wahyudi, The Effectivity of Internal and External Corporate Governance Mechanisms Towards Corporate Performance (2013) 4 Research Journal of Finance and Accounting 132 <https://www.iiste.org/Journals/index.php/RJFA/article/view/4986> accessed 9 March 2023; Charlie Weir, David Laing and Phillip J McKnight, 'Internal and External Governance Mechanisms: Their Impact on the Performance of Large UK Public Companies.' (2003) 29 Journal of Business Finance & Accounting 576 <https://rgu-repository.worktribe.com/output/247757/internal-and-external-governance-mechanisms-their-impact-on-the-performance-of-large-uk-public-companies> accessed 9 March 2023

[25] ibid

[26] Andrei Shleifer and Robert W Vishny, 'Large Shareholders and Corporate Control', vol 94 (1986) 463 <https://www.jstor.org/stable/pdf/1833044.pdf?refreqid=excelsior%3Ac7798f78b17f77357c9a13aaaf6c0a6f> accessed 1 April 2019.

[27] A hostile takeover is an offer for shareholders which is not welcomed by the management. See: Simon DeakinSIMON DEAKIN and GILES SLINGER, 'Hostile Takeovers, Corporate Law, and the Theory of the Firm' (1997) 24 JOURNAL OF LAW AND SOCIETY <https://onlinelibrary.wiley.com/doi/pdf/10.1111/1467-6478.00040> accessed 17 April 2019.

[28] Solomon (n 1) 196; John C Coffee Jr., 'The Rise of Dispersed Ownership: The Role of Law in the Separation of Ownership and Control' (2001) 111 Yale Law Journal

these differences, this thesis will assess the efficiency of takeovers as a fundamental corporate governance instrument.

The differences in the ownership structures of different jurisdictions have been discussed and debated widely and theories have been presented to explain the reasons for this divergence in corporate structure. In this sense, there are three predominant theories presented. The first theory, presented by La Porta and his colleagues, explains that corporate concentration is a reaction to poor shareholders' protection.[29] They argued that, in less developed jurisdictions where laws and courts are not sophisticated enough to properly protect investors, corporate ownership concentration can be an effective method to reduce agency costs and prevent managers from exploiting their rights.[30]

In the second theory, Mark Roe argued that the diffused ownership structure in the US can be attributed to political factors.[31] He argues that the US government restricted the power of large financial institutions by federal and state regulations as a response to populist pressure.[32] Last but not least, Coffee linked the ownership structure in the common-law countries to the early separation of the private sector, as this separation gave the opportunity for self-regulation in the market.[33] Coffee stated that the state intervention in continental Europe left little room for self-regulation, and this state centralisation and intervention, according to Coffee, is a 'principal variable accounting for the earlier development of dispersed ownership in the United States and the United Kingdom than in Continental Europe'.[34]

Although these theories and studies provided an in-depth analysis of ownership structures, it can be argued that the theories were designed to analyse developed markets, and that therefore, they do not fully apply to emerging markets such as the KSA's. Moreover,

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<http://digitalcommons.law.yale.edu/ylj/vol111/iss1/1> accessed 24 March 2019. See subsection 2.2.1 for further detail on hostile takeovers in concentrated ownership markets.

[29] Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 The Journal of Finance 1131, 1132 <http://doi.wiley.com/10.1111/j.1540-6261.1997.tb02727.x>; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance' (1998) 106 Journal of Political Economy 1113 <https://www.jstor.org/stable/pdf/10.1086/250042.pdf?refreqid=search%3A58c63b3232920f41584301915a36acdf> accessed 1 April 2019

[30] La Porta, Lopez-de-Silanes and Shleifer (n 29); Shleifer and Vishny (n 8) 1116

[31] Mark J Roe, *Strong Managers Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1994) 21 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2310710> accessed 5 April 2019

[32] Mark J Roe, 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 Stanford Law Review 539 <https://about.jstor.org/terms> accessed 10 April 2019

[33] Coffee Jr (n 28) 9

[34] ibid

these theories do not explain the reasons for the ownership structure in a country with a completely different culture and legal system from those of the UK, US, and continental Europe. For example, KSA's political system is categorised as an absolute monarchy and the government is highly involved in the market as a regulator and investor. All these elements are fundamental factors that need to be considered when examining the ownership structure in the KSA economy. Nevertheless, these theories, among others, will be partially used to analyse the KSA market later in this thesis.

As a conclusion of the above illustration, corporate governance and ownership structure are fundamental elements to consider in order to properly analyse the KSA's takeover system. Therefore, this chapter will examine the predominant corporate governance global systems and theories. It will also analyse corporate ownership structure theories and their applicability to the KSA market.

2.2 Corporate Governance Global Systems and Theories

2.2.1 Corporate Governance Models

Each country has developed its corporate governance system in response to its unique cultural, political, legal, economic, and historical impacts.[35] Moreover, ownership structure has a substantial influence on a country's corporate governance system.[36] Hence, corporate governance models vary from one country to another. Understanding the differences between corporate governance models and the drivers and rationales for these differences will be essential in providing an effective analysis of the KSA's corporate governance and takeover systems. Therefore, this chapter will not analyse the different corporate governance systems for the sake of comparison or to determine the most effective one. Instead, this chapter will critically describe the predominant corporate governance models for the sake of illustration and as a starting point for analysing the KSA's corporate governance system.

Corporate governance systems have been divided and categorised by many scholars to provide a better understanding of different global corporate governance systems.[37] Although it should be noted that this classification can be considered loose as each country has

[35] Fiss (n 15) 26
[36] Solomon (n 1).116–117
[37] Fiss (n 15) 5

different and unique factors that shaped its system. Thus, it is not always easy to fit a country's corporate governance into a certain category. Nevertheless, there are two predominantly categorised corporate governance models that are widely recognised by many scholars.

The first model is the 'outsider model'. In this model, most listed companies are controlled by their managers and owned by outside shareholders.[38] The ownership structure in this model is mostly a diffused one.[39] Therefore, agency[40] issues are high in this model as a result of the separation of ownership and control.[41] Additionally, takeovers are more common in this model and can serve as a management disciplinary tool.[42] The US and the UK fit neatly in this model, also referred to as the 'Anglo-American' corporate governance model.[43] It has been argued widely that Anglo-American countries provide stronger protection for investors.[44] The belief that the Anglo-American model is a stronger model for investors' protection has been attributed to a debatable variety of factors that will be discussed later in this chapter. This model, when categorised by the structure of the financial system, can be described as a 'market-oriented' model where most firms raise capital from public investors who directly bear the risk of their financing.[45]

The second model is referred to as the 'insider model'. In this model, most listed companies are owned and controlled by small groups of major shareholders.[46] In some countries, such as Germany, most of these major shareholders are lending banks.[47] In most other countries in this model, companies are usually owned and controlled by founding families or the government.[48] One of the main features of this model is ownership concentration, as a high percentage of shares are held by a small range of controlling shareholders.[49] As a result of this ownership concentration, agency problems are arguably less common between shareholders and management.[50] However, other types of agency

[38] Solomon (n 1) 195
[39] Clarke (n 13) 50
[40] Discussed later in the Theories section.
[41] Coffee Jr (n 28) 6
[42] Clarke (n 13) 63
[43] ibid
[44] Shleifer and Vishny (n 8) 737; La Porta and others, 'Investor Protection and Corporate Governance' (n 9)
[45] Visentini (n 22) 836
[46] Solomon (n 1) 194–195
[47] Julian Franks and Colin Mayer, 'Ownership and Control of German Corporations' (2001) 14 The Review of Financial Studies 943 <https://www.jstor.org/stable/2696732> accessed 20 March 2019
[48] Shleifer and Vishny (n 8) 770
[49] Clarke (n 13) 63
[50] Solomon (n 1) 195

problems are very common in this model.[51] Such problems include those arising between the controlling shareholders and minority shareholders.[52] Indeed, more generally, a feature of this model is the poor protection of minority shareholders.[53] In addition, hostile takeovers, as a powerful mechanism to limit agency costs in listed firms,[54] are rare in this model.[55] This is because hostile takeovers are more likely to occur in countries where investor protection is strong, corporate governance quality is better, and agency problems are less severe.[56] Indeed, if market-wide agency problems are less probable, dispersed ownership is more common.[57] This assumption is in line with the finding in the law and finance literature[58] that shareholder protection and ownership concentration are inversely related.[59]

Nonetheless, it should be noted that there are other corporate governance models that have unique features and cannot be fully categorised under these two general models: for example, the Japanese model and the German model which can be described as a 'bank-oriented' model in which companies rely heavily on banks to raise capital.[60]

2.2.2 Corporate Governance Theories

Many theories have been presented to explain and analyse certain aspects of corporate governance.[61] However, this chapter will not address all these theories. Instead, the scope of this section will be limited to theories that are related to the main scope of this thesis. These theories are fundamental as tools to understand and analyse the KSA corporate governance and takeover systems and corporate ownership structure.

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[51] This point will be discussed in further detail on several occasions in this chapter.
[52] Shleifer and Vishny (n 8) 774
[53] ibid; La Porta, Lopez-de-Silanes and Shleifer (n 29) 1132
[54] Roe (n 32) 558
[55] Solomon (n 1) 196
[56] Gary Gorton and Matthias Kahl, 'Blockholder Scarcity, Takeovers, and Ownership Structures' (2008) 43 Source: The Journal of Financial and Quantitative Analysis 937, 942 <https://www.jstor.org/stable/27647380?saml_data=eyJzYW1sVG9rZW4iOiIwZWYwMjQ3Ni1mODE0LTRjZmItODYwMC0xNDMxMTIwYWZmYTEiLCJpbnN0aXR1dGlvbklkcyI6WyIxNWE0NDMwMC1hZDMxLTQ4M2YtOTQ2YS03OTU4NzQ4MmFjM2EiXX0> accessed 12 March 2023.
[57] ibid
[58] Rafael La Porta and others (29)
[59] Gary Gorton and Matthias Kahl (n56)
[60] Visentini (n 22)
[61] Such as transaction cost theory, stakeholder theory, and institutional theory.

2.2.2.1 Agency Theory

As a result of the separation of ownership and control of large companies in the US in the early 1930s, the role of the shareholders as the controllers of their own companies has declined.[62] According to Berle and Means, managers became the ultimate controllers of large companies as a consequence of the shareholders' passivity.[63] Managers may not always act in the best interest of shareholders, especially in a conflict-of-interest situation, such as takeovers, in which managers may pursue their own interest rather than that of the shareholders of the company.[64] Thus, shareholders play a fundamental monitoring role to minimise conflict-of-interest situations and to prevent directors from exploiting their rights.

This monitoring role by shareholders arises from what can be termed an agency relationship.[65] This agency relationship is defined by Jensen and Meckling as 'a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent'.[66] In this relationship, if both parties (the shareholders and managers) have a divergence of interest, managers could pursue their interest at the expense of the shareholders.[67] Thus, shareholders need to adopt and apply monitoring strategies to minimise and limit this divergence of interest.[68] These strategies are referred to as agency costs. Indeed, agency costs include 'the costs of structuring, monitoring, and bonding a set of contracts among agents with conflicting interests'.[69]

2.2.2.2 Path Dependency Theory

Another theory fundamental to this thesis is the 'path dependency' theory. This theory attempts to explain corporate ownership structure and corporate governance in different

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[62] Berle and Means (n 18) 1-4
[63] ibid
[64] Michael C Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) 76 American Economic Review 323 <https://www.jstor.org/stable/1818789?seq=1#page_scan_tab_contents>; Brenda Hannigan, *Company Law* (3rd edn, Oxford University Press 2012) 680
[65] Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26, 301 <https://www.jstor.org/stable/725104?seq=1#page_scan_tab_contents>.
[66] Michael C Jensen and William H Meckling, *Theory of the Firm Managerial Behavior, Agency Costs and Ownership Structure* (Q North-Holland Publishing Company 1976) vol 3 <https://ac.els-cdn.com/0304405X7690026X/1-s2.0-0304405X7690026X-main.pdf?_tid=52c36b79-97bc-43d0-86b3-c02fd40021b6&acdnat=1553118698_5173272fee9530746e7145c8a5025a9d> accessed 20 March 2019
[67] ibid
[68] ibid
[69] Fama and Jensen (n 65) 304

markets. In this sense, Bebchuk and Roe explain the importance of this theory in analysing corporate governance systems by stating that 'Path dependence is an important force – one that students of comparative corporate governance need to recognize – in shaping corporate governance and ownership around the world'.[70]

According to this theory, companies and ownership structure develop and are shaped by influential pre-existing starting points.[71] These starting points could be initial ownership structures in the economy that impact subsequent corporate structure choices.[72] As another form of path dependency, a country's national culture is very influential in shaping its ownership structure and its corporate governance system.[73]

To explain how initial ownership structures are formulated, and then became starting points, Bebchuk in his 'rent-protection' theory claimed that dispersed ownership structures accrue when the private profits of control are high.[74] According to the rent-protection theory, large private benefits of control will encourage investors to hold a substantial amount of shares to ensure their control, and therefore, ownership will be concentrated.[75] And, as long as these benefits of control exist, controlling shareholders will be reluctant to lose this control, and thus, ownership concentration will continue to exist.[76]

2.3 UK and US Corporate Governance Systems and Ownership Structures

2.3.1 UK Corporate Governance and Ownership Structure

In order to properly evaluate the KSA corporate governance framework and ownership structure as a first step in analysing its takeover system, this thesis will use those of the UK as a benchmark model. This thesis will also identify the factors and policy-changing drivers that shaped the UK's corporate governance system over the years, as it is crucial to understand the rules and regulations that shaped the framework of this system. Indeed, as discussed in the

[70] Lucian Arye Bebchuk and Mark J Roe, 'A Theory of Path Dependence in Corporate Ownership' (1999) vol 2, 170 <https://www.jstor.org/stable/pdf/1229459.pdf?ab_segments=0%2Fdefault-2%2Fcontrol&refreqid=search%3A8f6b0a5d94a367490816f7d3db943f30> accessed 5 April 2019
[71] Coffee Jr. (n 28) 3-4; Bebchuk and Roe (n 70). 169
[72] Bebchuk and Roe (n 70) 169
[73] Amir N Licht, 'The Mother of All Path Dependencies' (2001) 26 Delaware Journal of Corporate Law 147 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=266910&download=yes>.
[74] Lucian Arye Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' (1999) 1 <http://www.nber.org/papers/w7203> accessed 21 March 2019
[75] ibid
[76] ibid

previous section about the path dependency theory to explain how corporate governance systems are shaped, each country has its own unique corporate governance system.[77] As Cheffins stated, '… corporate governance arrangements in any one country are, to a significant extent, a product of the local economic and social environment'.[78]

The history of the UK corporate governance reforms and its evolving judiciary and legal systems over the years made it an excellent choice as a benchmark. The Cadbury report and the UK corporate governance code (formerly known as the Combined Code), provided a foundation for good corporate governance around the world.[79] Indeed, according to Cheffins, 'The work which has been done in the United Kingdom has spurred reviews of corporate governance in markets around the world and has provided a yardstick against which investment frameworks in other countries are measured'.[80]

The UK corporate governance framework has been widely recognised as highly developed. Many scholars view the UK as the world leader in corporate governance reforms.[81] The UK corporate governance reforms, such as the Cadbury Report, have not only made a significant contribution to the UK's corporate governance framework, but have also played a key role at the international level.[82] These reforms have built a corporate governance foundation generally accepted worldwide and considered a benchmark for sound corporate governance.[83] Indeed, the UK's corporate governance framework is considered more efficient and highly developed than those of other European countries and across the globe.[84]

As noted above, the UK corporate governance system fits within the 'outside' model where most listed companies are owned by outside shareholders and controlled by managers.[85] The creation of wealth and increasing shareholders' value has traditionally been

[77] Solomon (n 1) 194
[78] Brian R Cheffins, 'Current Trends in Corporate Governance: Going From London To Milan Via Toronto' (2000) 2 Duke Journal of Comparative & International Law 17, 11 <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1225&context=djcil> accessed 15 September 2019
[79] Solomon (n 1) 48; The UK Corporate Governance Code July 2018. Available at <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf>
[80] Cheffins (n 78) 6; Jean-Nicholas Caprasse and Shervin Setareh, 'Dèminor Corporate Governance Survey', 9 Eur Bus L Rev 126 (1998); 'Higher Corporate Governance Standards Can Increase Returns, Study Claims', 11 Int'l Sec Reg Rep, Feb. 12
[81] Solomon (n 1) 47
[82] Cheffins (n 78) 6
[83] Solomon (n 1) 47
[84] Cheffins (n 78) 6
[85] Solomon (n 1) 195

the norm in UK listed firms and it is their primary objective.[86] Historically, the UK market and corporate governance system have been influenced by individualism and are less characterised by government interference.[87] Moreover, the UK corporate governance system is considered one of the most efficient systems in protecting shareholders.[88]

The UK corporate ownership is broadly dispersed among diversified shareholders.[89] However, the UK's corporate governance is highly influenced by institutional investors.[90] Indeed, institutional investors play a fundamental role in the UK's corporate governance, as most of the listed companies in the UK are owned by institutional investors.[91] Indeed, more than 70% of stocks in listed UK corporations are held by UK institutions.[92] Therefore, it would be reasonable to say that institutions are a dominant class as shareholders in UK listed companies.

Over the past three decades, the UK went through significant corporate governance reforms. These reforms were mostly recommendations and codes of best practice carried out by a series of committees as a response to corporate scandals and collapses such as the cases of the Maxwell, Bank of Credit and Commerce International (BCCI), and Coloroll corporations.[93] Reforms also took place to tackle corporate governance issues and thus

[86] William Lazonick and Mary O Sullivan, 'Maximizing Shareholder Value: A New Ideology for Corporate Governance' (2000) 29 Economy and Society 13, 14 <https://www.researchgate.net/publication/304686914_Maximizing_Shareholder_Value_A_New_Ideology_for_Corporate_Governance>. accessed 12 March 2023; Andrew Gamble and Gavin Kelly, 'Shareholder Value and the Stakeholder Debate in the UK' (2001) 9 Corporate Governance 110, 110 <https://onlinelibrary.wiley.com/doi/pdf/10.1111/1467-8683.00235> accessed 15 April 2019.

[87] Coffee Jr (n 28) 58, 65

[88] Shleifer and Vishny (n 8) 769; La Porta and others,(n 9)

[89] Shleifer and Vishny (n 8) 754

[90] An institutional investor is a legal entity that gathers the capital of numerous investors (who may be private investors or other legal entities such as sovereign wealth funds) in order to invest in a variety of financial instruments to make a profit. See: Serdar Çelik and Mats Isaksson, 'Institutional Investors and Ownership Engagement' (2014) 2013 OECD Journal: Financial Market Trends 95–96 <http://dx.doi.org/10.1787/888932315602.> accessed 16 December 2022.

[91] Hampel Report (1998) The Final Report, The Committee on Corporate Governance and Gee Professional Publishing, London. <https://www.icaew.com/technical/corporate-governance/codes-and-reports/hampel-report> accessed 1 November 2019

[92] The Office for National Statistics: <https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2020.> Last visited 13 March 2023.

[93] James Tutu, 'Corporate Governance Reforms Post 2008 Global Financial Crisis'' (2016) 85 <http://epubs.surrey.ac.uk/846463/1/Updated SG typos corrections %281%29 latest %28Repaired%29 %28Repaired%29.pdf> accessed January 18, 2020; Austin Mitchell and Prem Sikka, 'Taming the Corporations', Association for Accountancy & Business Affairs, Essex, UK, 2005, p. 7; <https://www.theguardian.com/business/2012/may/17/bcci-scandal-long-legal-wranglings> accessed January 18, 2020

prevent future collapses and market abuses. Executive remuneration and transparency requirements are examples of these reforms.[94]

The first significant corporate governance reform took place in 1991 when the Cadbury committee was reformed. This committee was initially formed by the Council of the Stock Exchange and the Accountancy Profession and chaired by Sir Adrian Cadbury.[95] This reform was a response to 'continuing concern about standards of financial reporting and accountability'[96] and concerns about the effectiveness of corporates' internal control..[97]

The report released by this committee (hereinafter Cadbury report) substantially shaped the UK's corporate governance system and had a great influence on other corporate governance systems worldwide.[98] The Cadbury report also had an influence on the OECD as many of its principles have been inspired by the Cadbury report.[99] The Cadbury report provided a set of principles of sound corporate governance (the Code of Best Practice). Moreover, the report also introduced the 'comply or explain' principle.[100] This principle means that companies should adopt and apply the recommendations provided in the Cadbury report; alternatively, companies who do not comply should explain to the London Stock Exchange (LSE) their reason for non-compliance with code.[101] The 'comply or explain' approach is a distinguishable feature of the UK's corporate governance system. This type of approach is referred to as 'soft law', which essentially means 'rules of conduct which, in principle, have no legally binding force but which nevertheless may have practical effects'.[102]

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[94] Such as the Greenbury Committee, which reviewed recommendations on executives' remuneration and transparency and released a recommendation report. More details available on: Financial Reporting Council website < https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code>

[95] Solomon (n 1) 52

[96] Financial reporting council website <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code>

[97]Cheffins (n 78) 19

[98] Andrew Keay, 'Assessing Accountability of Boards under the UK Corporate Governance Code' (2015) Journal of Business Law 551

[99] For example, the OECD adopted the Cadbury report definition of corporate governance; The Organization for Economic Cooperation and Development (OECD). Available at www.oecd.org.; Tutu (n 93) 214.

[100] Adrian Cadbury, 'Report of the Committee on the Financial Aspects of Corporate Governance' (1992) vol 1 <https://www.frc.org.uk/getattachment/9c19ea6f-bcc7-434c-b481-f2e29c1c271a/The-Financial-Aspects-of-Corporate-Governance-(the-Cadbury-Code).pdf> accessed 7 November 2019

[101] ibid

[102] Paul Sanderson and others, 'Flexible or Not? The Comply-or-Explain Principle in UK and German Corporate Governance' [2010] Centre for Business Research, University of Cambridge, Working paper No. 407 1, 1 <www.cbr.cam.ac.uk> accessed 13 November 2019; Francis Snyder, 'Soft Law and Institutional Practice in the European Community' (Law Working Paper 93/5). Florence: European University Institute.

Although the Cadbury Code did not have statutory force, the comply or explain principle added force to the Code when the LSE amended the Listing Rules so as to require listed companies to either comply with the Code or provide reasons for non-compliance.[103] The purpose of this principle is to provide flexibility to companies for non-compliance to the code when the directors believe it is necessary to practise it.[104] This principle also strengthens transparency and provides investors with vital information regarding the application of the Code. Indeed, according to the Cadbury report, 'This requirement will enable shareholders to know where the companies in which they have invested stand in relation to the Code'.[105]

The second significant reform was led by the Greenbury committee in 1995. This committee was created as a response to concerns over directors' remuneration.[106] The level of concern of public companies' shareholders increased in the 1990s after several cases where directors received excessive remuneration.[107] The recommendations of this committee[108] did not aim to reduce executives' salaries. Instead, it provided recommendations to strike a balance between directors' salaries and their performance.[109]

The third important corporate governance reform was the Hampel report in 1998. This committee was reformed to mainly 'review the extent to which the objectives of the Cadbury and Greenbury Reports were being achieved'.[110] The Hampel committee also released recommendations that led to the creation of the Combined Code in the same year.[111]

This code combined the issues and recommendations from the previous committees and has been revised and redrafted ever since. The Combined Code is currently applicable to all UK listed companies as a code for best corporate governance practice.[112] It is worth mentioning that there are several committees and revisions of the Combined Code that were conducted over the past two decades.[113] This occurred most recently with the 2018 revision of the Code.

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[103] Cheffins (n 78) 26
[104] Cadbury (n 100)
[105] ibid
[106] Solomon (n 1) 52
[107] Financial reporting council website <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code>
[108] Annette Risberg, *Mergers and Acquisitions: A Critical Reader* (2013).
[109] Solomon (n 1) 53
[110] Financial reporting council website <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code/history-of-the-uk-corporate-governance-code>
[111] Solomon (n 1) 53
[112] ibid
[113] For example, the Turnbull, Higgs, and Smith reports.

It can be concluded from this review of the UK corporate governance system that diffuse ownership structure is the norm in the UK public companies. Institutional investors, such as hedge funds, form the majority of shareholders in the UK. Another distinguishable feature of the UK corporate governance system is the soft law approach represented by the 'comply or explain principle'. It is worth noting that the purpose of this descriptive analysis is not to fully examine the UK corporate governance system, but rather to illustrate certain elements that need to be pointed out before analysing the KSA corporate governance system, and before analysing the takeover systems of both the UK and KSA.

2.3.2 US Corporate Governance and Ownership Structure

The US is one of the most developed and prosperous economies worldwide. Extensive studies by scholars with financial, legal, economic, and political background have examined US corporate governance. As early as the 1930s, Berle and Means addressed the issue of the passivity of shareholders as a result of the separation of ownership and control in large corporations in the US.[114] More recently, the fall of Enron and the US banking crisis in the 2008 global financial collapse drew more attention to the US corporate governance system as well as to most other countries' corporate governance systems around the globe.[115]

US corporate governance is similar to a certain extent to that of the UK. Both are Anglo-American systems and fall into the 'outsider' and market-based model.[116] The US legal system is principally classified as a common law system.[117] The US market ownership structure has another similarity to the UK as most of its listed companies are owned by dispersed shareholders.[118] This structure is arguably a result of the limitation imposed by the US government on financial institutions.[119] These limitations are a result of the philosophy that large institutions must be controlled, as the US public has mistrusted large institutions.[120]

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[114] Berle and Means (n 18)
[115] Solomon (n 1) 252
[116] Solomon (n 1) 195
[117] Mark J Roe, 'The Inevitable Instability of American Corporate Governance' (2005) 1 Corporate Governance Law Review <https://heinonline.org/HOL/Page?handle=hein.journals/crpgvrn1&id=11&div=8&collection=journals> accessed 15 April 2019
[118] ibid
[119] Roe (n 32) 577
[120] Roe(n 31) 14

According to Roe, the US government restricted institutional ownership and discouraged large investors by enacting laws to prevent ownership concentration.[121]

Thus, financial institutions' influence on US corporate governance is significantly different from that in the UK.[122] Therefore, the policy-making process in the US is more in the hands of government bodies rather than of financial and investment groups.[123] Nevertheless, listed companies and other financial groups have had indirect influence on US corporate governance reforms by responding to corporate governance issues before the policymakers enact a regulation as a response to these issues.[124] For example, when in the 1970s the New York Stock Exchange required all listed companies to have an audit committee consisting of independent directors, the vast majority of US-listed companies had already established the required committees as a sound corporate governance mechanism before the rule was enacted.[125]

Moreover, the US is distinguished by its dual source of law. The first is federal law enacted by the US congress,[126] and the second is state law enacted by individual state policy-makers.[127] Given that each US state has its own corporate regulations, it is assumed that state company law is the cornerstone of the US corporate governance system.[128]

However, the federal government participated in the formation of the US corporate governance system significantly by adopting measures and statutes as a response to the passivity of the states' role, and in many cases, as a reaction to major financial crises.[129] Although this participation failed to achieve harmonisation of states' corporate laws similar to the role of the European Union, as Cheffins stated,[130] the federal government gradually contributed to US corporate governance by enacting statutes and forming financial commissions. This governmental interference shifted the power of shaping US corporate governance from states to the federal government.

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[121] ibid
[122] Roe (n 32) 557
[123] Roe, (n 31) 45
[124] Brian R Cheffins, 'The History of Modern U.S. Corporate Governance - Introduction' 29/2012 24 <http://ssrn.com/abstract=2192151Electroniccopyavailableat:http://ssrn.com/abstract=2192151> accessed 18 January 2020
[125] Cheffins (n 78) 24
[126] Roberta Romano, *The Genius of American Corporate Law* (1993) 4-12 ; Roe (n 120) 13
[127] Roe (n 117) 13; Romano (n 124).
[128] Cheffins (n 124) 25
[129] ibid 26
[130] ibid

In the early 1930s, after the great depression, and as a response to the US market crash in 1929, the US Congress enacted the Securities Act and the Securities Exchange Act, and established the Securities Exchange Commission (SEC).[131] These significant legislations aimed to restore public confidence in the stock market and struck a balance between the roles of state law and federal law in shaping the US corporate governance system. The main role of the SEC is to 'protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation'.[132] Many reforms were made to the legislative scheme in the following years that gave the SEC the power to regulate the internal affairs of public companies.[133]

The second major federal reform in US corporate governance was the Sarbanes-Oxley Act (SOX) in 2002 as a response to accounting and financial misconducts that led to a collapse of significant US companies such as Enron and WorldCom.[134] This Act placed new requirements on listed companies and their managers with the aim of restoring public confidence in the stock market after the major corporate scandals of the late 1990s and early 2000s.[135] SOX particularly was enacted to 'enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud'.[136]

Most recently, after the 2008 financial crisis, the federal government realised the necessity of intervention to restore public confidence in the US economy and provide more protection to investors in the US stock market.[137] In 2010, the Dodd-Frank Wall Street and Consumer Protection Act was enacted for this purpose. This Act aimed to reform the US regulatory system in many areas such as 'consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency'.[138]

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[131] Available on the US Securities and Exchange Commission website https://www.sec.gov/Article/whatwedo.html
[132] Available on the US Securities and Exchange Commission website https://www.sec.gov/Article/whatwedo.html
[133] Cheffins (n 124) 26
[134] Tutu (n 93) 180; The US Securities and Exchange Commission website https://www.sec.gov/Article/whatwedo.html
[135] Cheffins (n 124) 26
[136] Available on the US Securities and Exchange Commission website https://www.sec.gov/Article/whatwedo.html
[137] Cheffins (n 124) 27
[138] The U.S. Securities and Exchange Commission website https://www.sec.gov/Article/whatwedo.html. See also Jason Mance Gordon, 'Corporate Governance and the Dodd Frank Act', in The Business Professor, updated January 13, 2015, last accessed January 18, 2020: <https://thebusinessprofessor.com/knowledge-base/corporate-governance-and-the-dodd-frank-act/>

It is noteworthy to mention here that Delaware courts' judgments and laws played a substantial role in the development of the US corporate law and corporate governance system.[139] This is attributed to the fact that more than half of publicly traded corporations in the US are incorporated under Delaware corporate law[140], and since the courts in Delaware decide a large amount of important corporate law cases and that other states' courts frequently apply Delaware case law.[141]

In conclusion, there are some general similarities between the US and UK corporate governance systems such as the diffused ownership structure. However, the factors contributing to this dispersed structure vary from the one in the UK. The US has its unique legal structure due to its duality of the sources of regulations, which highly affects the corporate governance system and its reforms. The majority of the corporate governance reforms in the US are in the hand of governmental bodies, unlike in the UK where many reforms were driven by non-governmental organisations such as investment groups. Thus, many corporate governance policy changes in the US were led by the federal government, and were mostly crisis-driven reforms.

2.4 Corporate Governance and Ownership Structure in the KSA

2.4.1 Corporate Governance Translation Issues

Corporate governance in KSA is considered to be in its infancy as the KSA economy is still a developing one. The term 'corporate governance', therefore, is relatively new in KSA, especially among non-specialists.[142] The vagueness of the term or use of the wrong definition could hinder the development of corporate governance in KSA. As mentioned earlier, there is no consensus among scholars on the definition of corporate governance and the situation for Arab scholars is even more challenging when it comes to translating such definitions into Arabic.

[139] Brian R Cheffins, 'Delaware and the Transformation of Corporate Governance' (2014) 1 Delaware Journal of Corporate Law 0, 93–94 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2531640> accessed 19 March 2023.
[140] See the State of Delaware official website. http://www.corp.delaware.gov/aboutagency.shtml
[141] Cheffins (n 139) 93. The role of Delaware law and Delaware court rulings on corporate governance on topics related to takeovers, such as directors' duties, are discussed in further detail in chapter 7.
[142] Almajid (n 6) 27

The challenge facing scholars was to find an expression in the Arab language that was linguistically and culturally equivalent to the English term.[143] The term *'hawkamat alsharekat*' has been established in the Arab world despite some criticism from scholars.[144] Al Alshehri argued that the literal application of the term '*hawkamat alsharekat'* will apply to companies only and will not be applicable to non-profit organisations or the public sector.[145] This term seems to neglect the cultural and practical aspects of corporate governance and to mainly reflect the literal translation of corporate governance from English. Translators should cover the practical aspects of corporate governance by finding another term that fits culturally and linguistically in the Arab region rather than merely mirroring the literal translation. One of Alshehri's interviewees in his study suggested the term '*aledarah alrashedah'*, which means in English 'rational management' and argued that this term would be a suitable equivalent to 'corporate governance' in the Arab world.[146] However, adopting this term would narrow its scope to the management only and would not apply to the wide scope of corporate governance.

Since the term *'hawkamat alsharekat'* has been established and used in KSA for more than two decades, changing it now may cause more uncertainty and likely return the concept of corporate governance to its infancy, with the new term being unfamiliar to most people. This thesis recommends that the best approach for clarifying and efficiently establishing the concept of corporate governance is to explain this concept and illustrate the aims and consequences of sound corporate governance. This can be done by teaching corporate governance principles in law schools in KSA and organising workshops and conferences for professionals and investors about corporate governance.

2.4.2 Corporate Governance System and Ownership Structure Analysis

The KSA corporate governance system can be categorised as an insider-dominated model. In this model, publicly listed companies of a country are owned and controlled by a few major shareholders.[147] In the KSA case, most companies are owned and controlled by rich families and the government, which means that the shares ownership structure in KSA is a

[143] ibid
[144] Ahmad Abdulkareem Mohammad Al-harkan, 'An Investigation into the Emerging Corporate Governance Framework in Saudi Arabia' (2005); Amer Alshehri, 'An Investigation into the Evolution of CG and Accountability in SA' (2012); Almajid (n 6)
[145] Alshehri (n 144) 339
[146] ibid
[147] Solomon (n 1) 241

concentrated one. For example,the government alone holds approximately 78.46% of the KSA's stock market value.[148]

The features of the KSA market and its corporate governance system are similar to markets that fall within the control-based model. The main features of this model are concentrated ownership structures, inefficient disclosure regulations, and inactive takeover markets.[149] However, it can be argued that the KSA market is a hybrid system of both market-based and control-based models. Despite the influence of the government on KSA market activities, Almajid concluded that KSA policymakers consider the market as a disciplining method and have adopted corporate governance principles that usually prevail in market-based systems such as the UK's.[150] According to Almajed, the KSA economy is 'free from economic and political constraints which have prevailed in other regional and non-regional economies as is the case in the transitional or emerging economies in Central Europe and China'.[151] However, this view can be challenged.[152] Although the author of this thesis partially agrees that political influence by the government on the KSA's market might be less than in other jurisdictions such as China, these political constraints are more common in the KSA than in developed jurisdictions such as the UK. Examples of these political constraints and influence are illustrated on several occasions in this thesis.[153]

The pros and cons of the concentrated ownership structure have been discussed by several scholars.[154] Before assessing these advantages and disadvantages, it is important to state that it will not be accurate to assume that the positives of this structure will be always beneficial for all markets, as each country has its own culture, laws, and political influence, and what functions well for one country may not necessarily be as functional for another.

It has been argued that controlling shareholders might use their rights to achieve private profits by exploiting the rights of other shareholders, especially minority

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[148] See: Quarterly Statistical Bulletin for the second quarter of 2022 on the CMA website: <https://cma.org.sa/en/MediaCenter/PR/Pages/Bulletin_for_Q2-_2022_en.aspx>. See also the ownership information of the listed companies, available on the Saudi Exchange website: https://www.saudiexchange.sa/wps/portal/saudiexchange

[149] Xiaofan Wang, 'Takeover Law in the UK, US and China. A Comparative Analysis and Recommendations for Chinese Takeover Law Reform' (2013) 143

[150] Almajid (n 6) 262,266

[151] ibid

[152] See for example: Frank E Vogel, *Islamic Law and the Legal System of Saudí: Studies of Saudi Arabia* (Brill 2000) 29.

[153] For example, the CMA's non-independence from the government might expose it to possible political influence. This is discussed in detail in chapter 6.

[154] Shleifer and Vishny (n 26); Shleifer and Vishny (n 8)

shareholders.[155] Moreover, it is argued that family and government ownership in KSA might have a negative influence on the reforms of corporate governance.[156] According to Alshehri, 'Many Saudi companies are family businesses. Even after launching these companies on the stock market, the founders and major shareholders still own the majority of shares, which means they control the decision-making within the company. This makes the development of corporate governance difficult to perform'.[157] This can be explained by Bebchuk's 'rent-protection' theory,[158] as he concluded that when the benefits of control are high, concentrated ownership will prevail.[159] And as long as these benefits of control exist, controlling shareholders will be reluctant to lose this control.[160] Therefore, controlling shareholders are likely to resist any corporate governance reforms that weaken their power of control.

On the other hand, ownership concentration may improve companies' performance by reducing monitoring costs.[161] From an agency theory perspective, managers act as agents of shareholders, which can lead to issues arising from conflict-of-interest situations.[162] Thus, in the case of ownership concentration, the controlling shareholders are placed to monitor the management, and in many cases in KSA, members of the controlling family are usually in the top management of their companies. This assumption is supported by leading KSA studies which examined KSA corporate governance extensively. According to the Almajed study, better corporate governance practices exist in companies in which wealthy families and government invest.[163] Almajed concluded in his study that 'although concentrated ownership could sometimes have negative effects on minority shareholders, in the Saudi context, the case was reversed'.[164] Another study by Soliman, which examined the performance of 64 publicly listed companies in KSA over the period 2006–2008, concluded that ownership concentration has positive effects on companies' performance, and stated that the more the

[155] Rami Zeituna and Gary Gang Tian, 'Capital Structure and Corporate Performance: Evidence from Jordan' (2007) 1 Australasian Accounting Business and Finance Journal <http://ro.uow.edu.au/aabfjhttp://ro.uow.edu.au/aabfj/vol1/iss4/3> accessed 28 January 2019
[156] Solomon (n 1) 242
[157] Alshehri (n 144) 337
[158] Discussed in subsection 2.2.2.2 (Path dependency theory)
[159] Bebchuk (n 74) 37
[160] ibid
[161] Shleifer and Vishny (n 8) 739
[162] Jensen (n 64) 1
[163] Almajid (n 6) 384
[164] ibid

ownership is concentrated in a company, the more the performance of that company improves.[165]

These findings support the claim that the KSA ownership concentration structure should not be seen as a problem in itself. Instead, the particular problems of this structure in the KSA context, such as minority shareholders' vulnerability, should be addressed. As explained earlier in this chapter, in the KSA, agency problems between shareholders and management are reduced due to the benefits of shareholding concentration. However, in the KSA context, another kind of agency problem exists, this time between controlling shareholders and minority shareholders. This problem can arguably be avoided by many approaches such as improving the efficiency of independent non-executive directors and enhancing regulations to provide more protection for minority shareholder's rights. According to Shleifer and Vishny, an ideal system would be the one where the structure of ownership is concentrated, and minority shareholders and other stakeholders' rights are protected by an efficient legal system.[166]

Despite the potential advantages of a concentrated-ownership structure, Shleifer and Vishny argued that companies with high state-ownership will have controlling power vested in bureaucrats who may pursue their own political goals instead of achieving the social purpose of these companies.[167] In Shleifer and Vishny's words concerning state-owned firms:

> While in theory these firms are controlled by the public, the de facto control rights belong to the bureaucrats. These bureaucrats can be thought of as having extremely concentrated control rights, but no significant cash flow rights because the cash flow ownership of state firms is effectively dispersed amongst the taxpayers of the country. Moreover, the bureaucrats typically have goals that are very different from social welfare, and are dictated by their political interests.[168]

This argument, however, was based on a different governing regime from the one in KSA which is an absolute monarchy and where income tax on citizens is not applicable.

There is a lack of studies in KSA and the Middle East regarding the relationship between concentrated ownership and companies' performances. This thesis, in later chapters,

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[165] Mohammed Soliman, 'Ownership Concentration and Firm Financial Performance - Evidence from Saudi Arabia' [2013] SSRN 1 <http://ssrn.com/abstract=2257832>. accessed 10 April 2019
[166] ibid
[167] ibid
[168] ibid

will attempt to find the influence of concentrated ownership structure in KSA on takeovers and its effects on stakeholders. It will also analyse many of the takeover regulations that have been implemented in KSA, adopted from a dispersed-ownership structure market such as that of the UK.

The importance of protecting minority shareholders is vital to economies, as sound minority shareholders protection 'promotes an attractive environment for minority ownership and so it fosters investor trust as well as opening up access to international capital markets'.[169] As the policymakers in the KSA have realised the importance of this aspect, major reforms have been implemented to improve the market and minority shareholders' protection. Indeed, the World Bank recently ranked KSA as 3rd in protecting minority investors, moving from 63 in only a few years.[170] Although these developments have improved the KSA's market, the efficiency of current regulations, especially the M&A Regulations, on protecting minority shareholders' rights are still considered inadequate.[171] KSA takeover regulations require more reforms, as minority shareholders are deprived of some rights such as the right to a sell-out.[172]

2.5 Chapter Conclusion

As policy-makers in most countries, including the KSA, strive to reform their corporate governance system to improve their economy, this chapter has attempted to provide a clear understanding of the KSA corporate governance system and its ownership structure by analysing its main features.

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[169] Gonzalo Villalta Puig and Bader Al-Haddab, 'The Protection of Minority Shareholders in the Gulf Cooperation Council' (2013) 13 Journal of Corporate Law Studies 123 <https://www.tandfonline.com/doi/abs/10.5235/14735970.13.1.123>.

[170] Available at the World Bank website: And the World Bank website: https://archive.doingbusiness.org/en/data/exploreeconomies/saudi-arabia#DB_pi However, this ranking by the World Bank may not reflect the practical reality of a complex matter such as the protection of minority shareholders. This ranking could be a result of superficial reforms without significant practical effects on the minority shareholders' protection. The role of international organisations in evaluating KSA minority protection reforms is discussed in detail in Chapter 6 (6.3.1)

[171] Meshal Faraj, *Toward New Corporate Governance Standards in the Kingdom of Saudi Arabia: Lessons from Delaware* (SabicChair 2016) 92 <https://books.google.com.sa/books?hl=en&lr=&id=sMWRCwAAQBAJ&oi=fnd&pg=PA5&dq=M.+Faraj,+Toward+new+corporate+governance+standards+in+the+Kingdom+of+Saudi+Arabia:+lessons+from+Delaware+(Sabic+Chair+2016)+92.&ots=uj35C8ZOYB&sig=P-_vUp88hVprMp0WjtfiMsm93OM&redir_esc=y#v=onepage&q&f=false> accessed 11 June 2017

[172] The right of sell-out enables the remaining shareholder(s) to require the offeror to buy his/her shares from him/her at a fair price.

This chapter has provided definitions of corporate governance, explained the importance of corporate governance and ownership structure, and shown how these two concepts are fundamental for analysing takeovers. This chapter illustrated the predominant global corporate governance models, providing a brief comparative analysis of the UK and US corporate governance systems and ownership structures in order to illustrate the analysis of the KSA corporate governance and ownership structure. This chapter also discussed fundamental corporate governance theories that are essential for analysing the KSA's corporate governance and takeover systems.

Moreover, this chapter addressed the problem of mistranslating corporate governance from English to Arabic. To tackle this issue, this chapter provided the recommendation that the concept of corporate governance should be explained properly by experts, by teaching corporate governance principles in law schools in KSA and organising workshops and conferences for professionals and investors about corporate governance, and what 'good' corporate governance is from the KSA perspective. Additionally, this chapter provided an argument regarding the concentrated ownership structure, as it can be a strong and beneficial feature of the KSA market if reforms are provided to protect minority shareholders' rights.

Chapter 3. Overview of the KSA's Stock Market

3.1 Introduction

This chapter will lay the foundation for the chapters that follow by providing a comprehensive insight into the KSA's stock market. The purpose of the third chapter is to provide an understanding of this stock market as the platform where takeovers take place. The chapter provides an analysis of the KSA stock market's chronological development, including the major 2006 stock market crash. It will also analyse the recent and gradual foreign participation in the KSA's stock market. The chapter will briefly overview the country's parallel market (Nomu), which is an alternative equity platform with more flexible listing rules.[1] As stated at the beginning of the thesis, listed companies in the main market are the scope of the thesis.

The role of the stock market has increased across the world, for example by increasing investments and savings[2] while reducing the cost of capital and offering investors alternative sources of intermediation.[3] Many countries realise the importance of capital markets and the role they play in economic growth. Capital markets' improvements have also been of increasing concern to international organisations such as the World Bank and the World Trade Organisation.[4]

Indeed, more recently, the G20 Finance Ministers and Central Bank Governors meeting in February 2020 has shown the international interest in capital markets and

[1] Nomu is 'A parallel equity market with lighter listing requirements that serves as an alternative platform for companies to go public, and the investment in this market is restricted to Qualified Investors.' Tadawul website: <https://www.tadawul.com.sa/wps/portal/tadawul/knowledge-center/about/parallel-market>

[2] Muhammad Wasif Zafar and others, 'The Role of Stock Market and Banking Sector Development, and Renewable Energy Consumption in Carbon Emissions: Insights from G-7 and N-11 Countries' (2019) 62 Resources Policy 427. <https://www.sciencedirect.com/science/article/abs/pii/S0301420719302764> accessed 3 May 2020

[3] David Hillier and Tiago Loncan, 'Stock Market Integration, Cost of Equity Capital, and Corporate Investment: Evidence from Brazil' (2019) 25 European Financial Management 1, 3. <https://onlinelibrary.wiley.com/doi/abs/10.1111/eufm.12147> accessed 5 May 2020

[4] See World Trade Organisation website: <https://www.wto.org/english/thewto_e/whatis_e/what_we_do_e.htm>; World Bank website: <https://www.worldbank.org/en/topic/financialsector/brief/capital-markets> and <https://www.worldbank.org/en/news/speech/2020/02/23/domestic-capital-markets-debt-transparency-and-sustainability>; G20 website: <https://g20.org/en/g20/Pages/documents.aspx>

emphasised their importance to economic growth and financial stability, as they have concluded that 'Accelerating efforts to develop domestic capital markets is essential to support growth and enhance financial resilience and inclusion'.[5]

Stock markets, as a major financial instrument for capital flow, can play a key role in providing finance for government and companies. If efficiently regulated, resilient capital markets can play a pivotal role in the provision of socio-economic sectors such as infrastructure and small and medium-sized enterprises.[6] Indeed, well-functioning markets can be a source of long-term funding as they provide liquidity and stability during ordinary times and a safeguard during crises.[7]

Taking into consideration the economic importance of the KSA in the regional and global context,[8] the KSA government realised the significant role that stock markets can play and launched many significant reforms to develop its stock market. However, despite these reforms, KSA's stock market is still considered an emerging market, given that its legal framework and institutional infrastructure are still evolving.[9]

[5] G20 website: <https://g20.org/en/g20/Documents/Communiqué%20Final%2022-23%20February%202020.pdf>

[6] Asli Demirguc-Kunt and Ross Levine, 'Stock Markets, Corporate Finance, and Economic Growth: An Overview' (1996) 10, 223, 229 <http://documents.worldbank.org/curated/en/395201468150596848/pdf/771210JRN0WBER0Box0377291B00PUBLIC0.pdf> accessed 2 March 2020; World Bank web

[7] Anshula Kant, 'Domestic Capital Markets & Debt Transparency and Sustainability' (Managing Director and World Bank Group Chief Financial Officer Remarks delivered at the G20 Finance Ministers and Central Bank Governors Meeting Riyadh, Saudi Arabia, 2020) <https://www.worldbank.org/en/news/speech/2020/02/23/domestic-capital-markets-debt-transparency-and-sustainability> accessed 2 March 2020

[8] KSA is the world's second oil producer:<https://www.worldometers.info/oil/oil-production-by-country/>; <https://www.reuters.com/article/us-global-oil-opec-iran-idUSKBN21Q0EI>.
Moreover, KSA is the second-largest OPEC member country and the only Arab country in the G20: The Organization of the Petroleum Exporting Countries (OPEC) <https://www.opec.org/opec_web/en/about_us/169.htm>; <https://g20.org/en/about/Pages/whatis.aspx>.
Additionally, KSA contains the world's two most holy places in Islam. For more see: <https://oxfordbusinessgroup.com/overview/unique-circumstances-despite-challenges-these-two-holy-cities-are-poised-growth.> For further detail, see section 2 of the first chapter 'An overview of the KSA and its political, legal, and judicial system'.

[9] Mohammed Sulaiman Aleid, 'A Critical Analysis of Investor Protection under Saudi Stock Market Regulations' (PhD, University of Essex 2017) 18 <http://repository.essex.ac.uk/22110/1/phd thesis.pdf> accessed 29 October 2020

3.2 Features of the KSA's Stock Markets

The stock market in KSA is referred to as Tadawul. It is the largest stock market in the Middle East countries, and it operates as the country's main market.[10] The main market was the solely authorised stock exchange in KSA until recently when the parallel market was established. The stocks offered in Tadawul include mutual funds, exchange-traded funds, Islamic bonds referred to as Sukuk, equities, right entitlements, negotiated deals, and derivatives.[11]

In 2017, the parallel market Nomu was established as the first parallel market in the country.[12] Nomu has features that are less restrictive to listing, which have increased the number of companies that qualify for listing in the KSA. The parallel market is restricted to qualified investors with a minimum market capitalisation of SAR10m (KSA currency is the Saudi Riyal, abbreviated SAR) equivalent to $2.7million, and at least 20% of an issuer's shares should be offered publicly.[13]

The KSA Stock Market Index (TASI) is a primary stock market index in KSA. The TASI index works by tracking the performance of all companies listed on Tadawul joint stock. However, there are other indexes such as a parallel market capped index referred to as NomuC,[14] which helps the investors to make comparisons and understand trends in the stock market value and prices.

The KSA's market ownership structure is viewed as concentrated, in that government bodies and wealthy families dominate the market (as discussed in more detail in chapter 2). The stock market is owned mainly by citizens from the Gulf Corporation Council (GCC)

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[10] Oxford Business Group, 'New Legislation in Saudi Arabia to Attract Foreign Investment' (Oxford Business Group, 2020a) <https://oxfordbusinessgroup.com/overview/regulatory-updates-new-legislation-geared-towards-attracting-foreign-investment-and-enhancing-job> accessed 27 Jul 2020

[11] Tadawul, Capital Market Overview' <https://www.tadawul.com.sa/wps/portal/tadawul/knowledge-center/about/Capital-Market-Overview?locale=en> accessed 29 Jul 2020

[12] Oxford Business Group, 'New Legislation in Saudi Arabia to Attract Foreign Investment' (2020a) <https://oxfordbusinessgroup.com/overview/regulatory-updates-new-legislation-geared-towards-attracting-foreign-investment-and-enhancing-job> accessed 27 Jul 2020

GCC is a political and economic alliance of six Arab countries of the Arabian Gulf. The counties are Saudi Arabia, Bahrain, Kuwait, Oman, Qatar, and the United Arab Emirates. See GCC website: <https://www.gcc-sg.org/en-us/AboutGCC/Pages/Primarylaw.aspx>.

[13] Oxford Business Group, 'New Legislation in Saudi Arabia to Attract Foreign Investment' (2020a) <https://oxfordbusinessgroup.com/overview/regulatory-updates-new-legislation-geared-towards-attracting-foreign-investment-and-enhancing-job> accessed 27 Jul 2020

[14] Tadawul, 'Saudi Stock Exchange (Tadawul): Index Rules and Methodology: Tadawul Indices' (Tadawul, 2016) <https://www.tadawul.com.sa/wps/wcm/connect/e8ebe4c5-b7e9-47fb-83d7-05d682a1dbb1/Index+Rules+and+Methodology+-+EN.PDF?MOD=AJPERES&CVID=> accessed 8 August 2020

countries, followed by residents of the KSA, and least by foreign investors. The value of shares owned by GCC citizens as of July 2020 was SAR 38.93 trillion, while the value of shares owned by KSA residents is SAR 8.23 trillion.[15] However, the Capital Market Authority (CMA) has eased the rules on shareholder ownership,[16] which has consequently increased foreign investments.

3.3 Analysis of the KSA Stock Market Chronological Developments

This section will provide a chronological overview of the development of the KSA market and provide an analysis of the policy-drivers of the market reforms.

The first attempt to supervise and regulate the business market and trade can be traced back to the early days of KSA[17] when the Commercial Court Law (subsequently changed to Commercial Law) was enacted in 1931.[18] The origins of the stock market date back to 1932, when the Arab Automobile was founded as the first joint-stock corporation.[19] From the 1930s until the early 1980s, the KSA capital market was unofficial and unorganised.[20] The market however, emerged more substantively in the late 1970s and early 1980s with the nationalisation of numerous foreign firms such as banks.[21]

In this unorganised market, between the 1930s and late 1970s, as a result of the insufficiency and incapability of the Commercial Court Law, some investors as individuals had to adopt rules and regulations from different, more developed, jurisdictions at that time such as the Egyptian commercial law.[22] This approach has caused confusion and instability in

[15] Riyadh Mubasher, 'Foreign Ownership on Tadawul hits SAR 177bn in Week' (Mubasher, 2020) <https://english.mubasher.info/news/3670378/Foreign-ownership-on-Tadawul-hits-SAR-177bn-in-week/> accessed 27 Jul 2020

[16] Rules of foreign investment are discussed in further detail in section 3.5.

[17] The KSA's name was Kingdom of Hejaz and Najd before King Abdulaziz united all regions under the name of Kingdom of Saudi Arabia in 1932.

[18] Bureau of Experts at the Council of Ministers website: <https://laws.boe.gov.sa/BoeLaws/Laws/LawDetails/c58ba10c-4e89-4c06-98d7-a9a700f1c706/1>

[19] Kingdom of Saudi Arabia Capital Market Authority, 'Investing in the Stock Market' (CMA, 2020) <https://cma.org.sa/en/Awareness/Publications/booklets/Booklet_2.pdf> accessed 30 Jul 2020

[20] CMA website: <https://cma.org.sa/AboutCMA/Pages/AboutCMA.aspx>

[21] Batool Asiri and Hamad Alzeera, 'Is the Saudi Stock Market Efficient? A Case of Weak-Form Efficiency' (2013) 4 Research Journal of Finance and Accounting 6, 36. <https://www.iiste.org/Journals/index.php/RJFA/article/view/5647> accessed 5 August 2020

[22] Abdullah M Alshowish , 'An Evaluation of the Current Rules and Regulatory Environment Framework of Corporate Governance in Saudi Arabia: A Critical Study in Order to Promote an Attractive Business Environment' (2016) 241 <https://eprints.lancs.ac.uk/id/eprint/82805/>.

the KSA business sector and the government found itself unable to regulate and control the market properly.[23]

As part of the government effort to improve the commerce and industrial sectors, and the government's realisation of the need for a more developed regulatory framework, the year 1954 witnessed the establishment of the Ministry of Commerce[24] (hereinafter 'MOC'), whose main role was to develop and regulate the commercial sector. Moreover, the 1965 Company Law was enacted as the country's first law dedicated to governing companies. Before this law, companies were governed by the Commercial Court Law, which contained a limited number of provisions related to companies.[25]

This absence of regulation and existence of the informal market can be attributed to the absence of the private sector, and to the assumption that government and family-owned entities were not at that time in desperate need of a capital market as an alternative source of funding.[26] Indeed, for government organisations, finance was not a problem, as oil surpluses were a sufficient source of money.[27] On the other hand, family-owned entities counted on internal revenues to finance their businesses.[28] Moreover, the ability and willingness of banks to lend encouraged both government and family-owned entities to rely on this type of financing source.[29]

Nevertheless, as a result of the oil price shocks in the 1970s and early 1980s, the KSA government grasped the importance of diversifying its oil-dependent economy.[30] The rapid increase in the number of KSA joint-stock companies made the situation more difficult for the government to cope with such economic growth.[31] Accordingly, the government initiated

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[23] ibid 240

[24] The name was changed to The Ministry of Commerce and Industry in 2003. In 2016, the Ministry of Commerce and Industry was amended to the Ministry of Commerce and Investment. Then in 2020, the ministry was renamed Ministry of Commerce.

[25] General Sharia laws also applied to companies and all other commercial activities.

[26] Aljazira Capital, 'The Financing Role of the Saudi Capital Market Promising Prospects' (2010) 1 <https://www.aljaziracapital.com.sa/report_file/ess/ECO-4.pdf> accessed 2 March 2020

[27] ibid 1

[28] ibid

[29] ibid

[30] ibid

The government depended greatly on specialised credit institutions, such as the Saudi Industrial Development Bank, to finance industrial developments rather than developing a strong stock market that could be an alternative source of financing. For more details see: Aljazira Capital, 'The Financing Role of the Saudi Capital Market Promising Prospects' (2010) 1 <https://www.aljaziracapital.com.sa/report_file/ess/ECO-4.pdf>

[31] Bader Abdulaziz Alkhaldi, 'The Saudi Capital Market: The Crash of 2006 and Lessons To Be Learned' (2015) 8 International Journal of Business, Economics and Law 135, 135 <https://www.researchgate.net/publication/302543636_THE_SAUDI_CAPITAL_MARKET_THE_CRASH_OF_2006_AND_LESSONS_TO_BE_LEARNED> accessed 27 February 2020; Josh Lerner, A Leamon and

privatisation plans for the KSA entities to enable the undeveloped private sector to flourish and to develop an industrial base.[32]

In the 1970s, there was rapid growth and increased interest in the power and cement[33] industries over the capital market[34] which accounted for most of the KSA's 14 large public corporations.[35] The following decades were associated with a new phase in capital market expansion in KSA, which encouraged many foreign financial institutions and banks to enter the KSA's joint-stock ventures. By the 1980s, the system was increasingly becoming inadequate for the corporate sector, especially due to the increased demand from the rapidly expanding national oil wealth.[36]

To that end, in 1984, the government took a significant step towards developing its economy by formalising the unofficial stock market. A committee composed of members from the Ministry of Commerce and the KSA Central Bank[37] (hereinafter 'SAMA') was formed to regulate and develop the stock market.[38] Both MOC and SAMA were assigned to supervise and regulate the stock exchange, and later on in that year, the Saudi Share Registration Company was founded by commercial banks with significant support and supervision from SAMA.[39] The main role of this company was to provide registration services for all joint-stock companies.[40]

In 1990, as part of its important supervisory role in the market, SAMA launched the Electronic Securities Information System as a step towards using technology to develop the

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Steve Dew, 'The CMA and the Saudi Stock Market Crash of 2006' (2017) 1 <https://cma.org.sa/en/Market/Documents/CMA_Crash2006_en.pdf> accessed 1 March 2020

[32] Alkhaldi (n 31) 140; Aljazira Capital (n 26) 4

[33] The cement sector is one of the KSA's most important industrial sectors. KSA is the biggest producer of cement in the GCC. See: <http://www.jadwa.com/en/search/index?q=cement&x=0&y=0>

[34] Oxford Business Group, 'New rules make it easier for foreign investors to access Saudi Arabia's stock exchange' (2016) <https://oxfordbusinessgroup.com/overview/fair-share-new-rules-are-making-it-easier-foreign-investors-access-saudi-stock-exchange> accessed 30 July 2020

[35] ibid

[36] Batool Asiri and Hamad Alzeera, 'Is the Saudi Stock Market Efficient? A Case of Weak-form Efficiency' (2013) 4 Research Journal of Finance and Accounting 6, 36 <https://www.iiste.org/Journals/index.php/RJFA/article/view/5647> accessed 5 August 2020

[37] The name was the Saudi Arabian Monetary Authority, changed to the Saudi Central Bank in 2020.

[38] Amer Alshehri, 'An Investigation into the Evolution of CG and Accountability in SA' (2012) 89; CMA website: <https://cma.org.sa/en/Pages/default.aspx>

[39] Kingdom of Saudi Arabia Capital Market Authority: 'Investing in the Stock Market' (Booklet) <https://cma.org.sa/en/Awareness/Publications/booklets/Booklet_2.pdf> accessed 6 March 2020; J Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 Stanford Journal of International Law 307, 313

[40] Kingdom of Saudi Arabia Capital Market Authority: 'Investing in the Stock Market' (Booklet) <https://cma.org.sa/en/Awareness/Publications/booklets/Booklet_2.pdf> accessed 6 March 2020

market.[41] This system provided member banks with market prices and information more efficiently.[42] It was a 'widely distributed computer network trading system linking the banks of KSA via the existing telecommunications infrastructure of the country."[43]

However, despite these developments, the absence of a single and formal trading platform resulted in the unattractiveness of this market as it was considered an underdeveloped broker-operated system. This system consisted of two entities, the Saudi Share Registration Company and the Electronic Securities Information System, and was owned by several local banks who operated as brokers. [44]

The growing need for an efficient and more formal stock market as a source of finance led to an important moment in KSA market history when Tadawul was launched in 2001. Even though Tadawul was an entity created from the consolidation of the above-mentioned entities, it moved the stock market from a dispersed-broker trading system to a more formal structured and centralised system that provided greater transparency and efficiency to the trading activities in the market.[45]

This step increased the attractiveness of the stock market as a source of funds. Domestic banks historically have been the main source of money in KSA for most corporations. However, since the launch of Tadawul in 2001, the stock market increasingly became a desired alternative mode of financing for companies.[46] Indeed, initial public offerings (IPOs) became a popular and favourable tool for raising capital among both government- and family-owned companies. This is because IPOs can offer better and easier terms, considering that many companies may not benefit from the leverage of easy bank financing due to their relatively smaller size and higher risk profiles.[47]

The Saudi Telecommunications Company IPO in 2002 was a significant event in the KSA market, which encouraged the KSA population to invest in the stock market and introduced to KSA citizens an appealing alternative instrument for investment.[48] Nearly half

[41] 'Kingdom of Saudi Arabia Capital Market Authority: 'Investing in the Stock Market' (Booklet) (n 40)
[42] Joseph Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 Stanford Journal of International Law 307, 314.
[43] ibid 312.
[44] Banks as brokers were matching orders through the electronic system (ESIS). See J Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 Stanford Journal of International Law 307
[45] Beach (n 42) 314
[46] Aljazira Capital (n 26) 1
[47] ibid
[48] Lerner, Leamon and Dew (n 31) 2

of the KSA population participated in the Yansab, the Saudi Arabian petrochemical company, IPO in 2005.[49] More recently, the government received around $119 billion bids for the world's biggest IPO at that time, for the oil giant company Aramco in late 2019.[50]

However, this rapid growth, and the inadequacy of the market's legal framework, raised questions about the efficiency of the market and the ability of the government agencies (SAMA and MOC) to cope with this growth. Some significant events and factors occurred at the same time in that particular era – from 2001 to 2003 – that made a market reform more urgent.

Firstly, the formation of Tadawul as a formal stock exchange platform in 2001 led to the increase of investors participating in the market and encouraged companies to launch IPOs as an instrument to raise capital. The major Saudi Telecommunications Company IPO in late 2002, mentioned above, is an example of the increasing popularity of IPOs for both companies and KSA citizens. This growth in IPOs increased the complexity of the market and made it more difficult to control by two different governmental agencies.[51]

Tadawul was controlled by SAMA and MOC and both were empowered with legislative, executive, and judicial authorities by royal decrees to run the stock market and regulate listed companies. The MOC's main role is to improve and supervise the commerce sector in the broad scene. Its responsibilities have expanded since the 1980s to govern and regulate the stock market. The MOC was responsible for supervising IPOs and governing companies' internal structures.[52] On the other hand, SAMA's primary role is to run and supervise the banking sector. However, SAMA had to expand its jurisdiction as it was designated to run day-to-day market tasks such as the selling and buying of stocks. This expanded role of SAMA created difficulties in monitoring individual investors.[53] SAMA did not have full formal authority to monitor all the market activities of those investors, as it was mainly concerned with the part of the market where banks are involved. Consequently, the role of SAMA as the market's daily monitor was questioned with regard to its competence as

[49] ibid
[50] Bloomberg <https://www.bloomberg.com/news/articles/2019-12-05/saudi-aramco-raises-25-6-billion-in-world-s-biggest-ipo>; Argaam website: <https://www.argaam.com/ar/article/articledetail/id/1334594>
[51] Fahad Almajid, *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: A Comparative and Analytical Study from a Legal Perspective* (2008) 274 <https://books.google.co.uk/books/about/A_Conceptual_Framework_for_Reforming_the.html?id=YZbx0clpceAC&redir_esc=y>.
[52] ibid 275
[53] ibid 277

a market regulator.[54] This dual regulatory structure, the assignment of two agencies already burdened with many responsibilities to govern the market, and the absence of a well-defined jurisdiction for both agencies, made it more difficult to manage the market's growth. Consequently, growing fears concerning market performance and its regulatory structure emphasised the importance of urgent market reform.

Secondly, as a result of the 9/11 events in 2001 in the US, many KSA investors, both governmental entities and wealthy families, repatriated their capital from western countries on account of concerns of the instability and safety of these markets.[55] Consequently, most of this large amount of returned investment went into the stock exchange, since there was no profitable investment alternative back then.[56]

Indeed, this event increased the liquidity of the KSA stock market, as a large amount of capital was simultaneously flowing into the domestic market.[57] Furthermore, the sharp rise in oil prices in 2000 and the succeeding five years increased government revenues which fostered government spending on infrastructure projects.[58] Therefore, more participation of the private sector in these projects led to greater stock market liquidity.

Thirdly, corporate scandals of major companies such as Enron and WorldCom in 2001 and 2002 triggered global concerns among investors over the integrity and safety of stock markets. Several countries, including KSA, realised the necessity of markets' legal reforms to avoid corporate financial scandals and to restore public trust in the stock market.[59]

Given the complications outlined above, inter alia, the government took a significant and historical step to launch a long-awaited reform of the stock market. In 2003, the Capital Market Authority (hereinafter CMA) was formed under the Capital Market Law (hereinafter CML) pursuant to a Royal Decree.[60] The CMA functions as a governmental organisation with an independent legal personality and direct supervision by the Prime Minister; it has financial

[54] ibid
[55] Alkhaldi (n 31) 136
[56] ibid
[57] Lerner, Leamon and Dew (n 31) 2
[58] ibid
[59] Almajid (n 51) 276
[60] Royal Decree No. (M/30) dated 2/6/1424H. CMA website: <https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>

and managerial autonomy.[61] The CMA was established as the sole entity assigned with one main objective: to regulate and supervise the stock market.

Articles 5 and 6 of the CML provided the CMA with legislative and executive authorities and powers to issue and impose rules and regulations to improve the market, protect investors, and ensure fairness and transparency in the market.[62] Thus, on becoming the sole market regulator, the majority of the MOC and SAMA powers, and responsibility for governing the market, were taken over by the CMA.

This major reform by the government eliminated the issues arising from the dual regulatory structure of the market. SAMA retained its original authority to supervise banks, while the MOC's role in the stock market has been limited to one main task: licensing the incorporation of publicly held companies.[63]

Having become the stock market's main regulator, the CMA carried out several measures to achieve its mission.[64] Examples of these measures include:

- Promoting investment in financial securities and increase the number of listed companies.
- Developing and elevating the Capital Market, attracting funds for investment, diversifying financial instruments and providing adequate liquidity.
- Development of an ideal, efficient and fair capital market that ensures effective and regular disclosure of material information and enforces the rules and regulations for protection of the market and maintaining its stability.
- Maintaining the stability of the financial system through establishing and enforcement of sophisticated rules and regulations that cope with the most advanced international standards and practices applied, in terms of transparency, licensing, supervision and regulation.[65]

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[61] 'Kingdom of Saudi Arabia Capital Market Authority, 'Investing in the Stock Market' (Booklet) (n 40); CMA website: <https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>

[62] CMA website: <https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>
Between 2004 and 2006, the CMA issued nine Implementing Regulations. CMA Annual report 2007, 24. Available at: <https://cma.org.sa/en/Market/Reports/Documents/cma_2007_report.pdf> accessed 11/3/2020

[63] Article 60 of the Companies Law.

[64] The CMA mission was 'development of the Capital Market, protection of investors against the market risks and exerts all efforts to strengthen fairness, transparency and disclosure'. CMA Annual Report 2007, 13. Available at: <https://cma.org.sa/en/Market/Reports/Documents/cma_2007_report.pdf> accessed 11/3/2020

[65] 'CMA Annual Report 2007' (2007) 13
<https://cma.org.sa/en/Market/Reports/Documents/cma_2007_report.pdf> accessed 11 March 2020

Indeed, the establishment of the CMA as an autonomous and sole regulator of the market, with no other duties to distract it from its main mission, regained investors' confidence in the market and significantly improved and shaped the regulatory frameworks of the KSA stock market.[66] Consequently, the number of market activities significantly increased, including surges in IPOs.[67]

Since then, the government has carried out several reforms to improve the stock market and ensure its efficiency. KSA's government took several steps to meet the World Trade Organisation (WTO) requirements for membership until it finally succeeded in joining in 2005.[68] Joining the WTO was a great step for KSA towards liberating the market and paving the way for future reforms that increased its openness to the world, especially in the investment sectors. The mere process of obtaining WTO membership accelerated reforms to improve the economy in general and to make the KSA more attractive for investment.[69] For example, the WTO required that the KSA launch further reforms in the following areas:

- allowing majority foreign ownership of investment projects
- treating foreign and local investors equally
- opening up service sectors such as banking, legal, insurance and capital markets to greater foreign participation.[70]

3.4 The 2006 Market Crash Overview

3.4.1 Introduction and Causes of the Market Crash

In 2006, the KSA stock market witnessed its first major crash as a formal market.[71] KSA suffered from this historical collapse on almost all levels. The sudden great loss in such a

[66] Aljazira Capital (n 26) 1
[67] Lerner, Leamon and Dew (n 31) 2; Aljazira Capital (n 26) 1.
[68] World Trade Organisation website: <https://www.wto.org/english/thewto_e/countries_e/saudi_arabia_e.htm>
[69] Mohamed A Ramady and Mourad Mansour, 'The Impact of Saudi Arabia's WTO Accession on Selected Economic Sectors and Domestic Economic Reforms' (2006) 2 World Review of Entrepreneurship, Management and Sustainable Development 189, 191 <https://www.researchgate.net/publication/5173465_The_impact_of_Saudi_Arabia's_WTO_accession_on_selected_economic_sectors_and_domestic_economic_reforms>.
[70] ibid 192
[71] As explained earlier in section 3.3, the market was informal until the mid-1980s.

short period had its influence on individuals, companies, investment funds, and the country's economy. The Tadawul All Share Index (TASI) reached its highest level at 20634 in early 2006.[72] At the end of the same year, TASI dropped to 7859, losing 12775 points in just 10 months, while the KSA market lost around SAR 2 trillion.[73]

This catastrophic collapse was a result of several issues that had been building up over the past few years before the crash. The liquidity of the market increased rapidly between 2001 and 2005. As mentioned in the previous section, the reasons for this rapid increase of liquidity were the increasing number of IPOs in the market after the formation of Tadawul, and the large amount of capital that had been directed to the KSA stock market after it was repatriated from western markets after the events of 9/11. Moreover, oil prices were increasing in the few years before the crash;[74] hence, petrochemical listed companies were performing well with an increase of paid dividends to investors, which boosted public confidence in the market and encouraged more people to invest.[75]

Public participation in the market was one of the factors in the crash for two reasons. Firstly, Saudis' participation in the market was sudden and significant in a relatively short time. This participation led to a substantial and rapid growth of the market and created an inflated bubble that the market and the supervisory agencies could not handle.[76]

The launch of online trading and growing use of the internet encouraged many individuals to invest in the stock market.[77] At that time, Saudis did not have many options for investment. Starting a new business was not easy, was an undesirable investment option for many Saudis due to bureaucratic complications and high costs, and was viewed as a time-consuming investment.[78] According to the World Bank, KSA was described as one of the most difficult countries in which to start up a new business in the year before the crash.[79]

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[72] See Tadawul: <http://www.tadawul.com.sa>.
[73] ibid Tadawul
[74] The Organization of the Petroleum Exporting Countries (OPEC) website: <https://www.opec.org/opec_web/en/data_graphs/690.htm>
[75] Lerner, Leamon and Dew (n 31) 3
[76] Alkhaldi (n 31) 135
[77] Lerner, Leamon and Dew (n 31) 3
[78] ibid
[79] World Bank, 'Ease of Doing Business: 2006' (Washington DC, 2006), <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB06-FullReport.pdf>. KSA was ranked 38th of 155 countries in the ease of doing business report in 2005. In 2020, the report showed that KSA still had obstacles that made doing business relatively difficult, as it was ranked 62 of 190 countries. <https://www.doingbusiness.org/en/rankings>

As a consequence of this dramatic and sustained increase in the number of Saudi people in the market, retail individual investors represented more than 95% of the market's daily trade volume in a market where only a few institutional investors existed.[80]

Secondly, most of the individual participants in the market were unprofessional, unsophisticated, and inexperienced investors. Many of these people sold their cars and liquidated their most valuable assets or borrowed money from relatives or banks to invest in the market.[81] Indeed, the number of personal bank loans reportedly increased substantially between 2002 and 2005.[82] The investment decision process for many Saudi people at that time exacerbated the situation. Making stock-investment decisions based on public announcements, rumours, and advice from friends and family was the norm.[83] Indeed, jumping into the market based on rumours and inexpert advice instead of making these decisions based on rational factors such as the company's performance, or considering other related factors, worsened the problem.[84]

A group of academics described the individual investors' behaviour in KSA as herding. According to the study, herding in stock markets is 'the behavior of the investors to follow the investment decisions of others rather than their own beliefs and information'.[85] They concluded that 'Saudi investors are found to herd each other in their investment decisions irrespective of market conditions as reflected in the level of the market return, return volatility and trading volume'.[86]

Nevertheless, these inexperienced investors were victims rather than the main cause of the catastrophic market collapse. The stock market was very tempting for many people in the absence of other fruitful investments. Moreover, the media worsened the situation and negatively influenced inexperienced investors instead of raising awareness to promote proper

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[80] M Arifur Rahman, Shah Saeed Hassan Chowdhury and M Shibley Sadique, 'Herding Where Retail Investors Dominate Trading: The Case of Saudi Arabia' (2015) 57 Quarterly Review of Economics and Finance 46, 58 <https://reader.elsevier.com/reader/sd/pii/S1062976915000034?token=DB524B259ECBB4640205765264576C15CC97778BEB718305A2E6ADB3D86B4A2602361B63730CD1059F4AC1995613E5F6> accessed 11 June 2020. According to some observers, during the few years before the market collapse, more than 50% of Saudi adults invested in the market. See: Tim Niblock and Monica Malik, *The Political Economy of Saudi Arabia* (Routledge 2007) 218.

[81] Lerner, Leamon and Dew (n 31) 3

[82] ibid

[83] Abdulrahman A Al-Twaijry (2007) 'Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis', 34 J. Human Sciences 1, 8 <https://www.slideshare.net/Zorro29/saudi-stock-market-historical-view-and-crisis-effect>

[84] Alkhaldi (n 31) 136; Al-Twaijry (n 86) 28

[85] Chowdhury, Rahman and Shibley Sadique (n 83) 46

[86] ibid 58

stock investment. As Al-Twaijry concluded, 'Media played negative role since there was no real warning about the possible collapse and writers about stock market were not specialist and indirectly encouraged people to continue speculating in the stock market even though the share prices were unreasonably high'.[87] Therefore, there were two major causes of the collapse: the weak and inexperienced governmental agencies who governed the rapidly inflated market, and the very wealthy elites who took full advantage of this governmental weakness and the inexperienced investors.

The economic elite exploited the vulnerable, inexperienced Saudi investors in the absence of efficient market supervision. Members of very wealthy Saudi families contributed to the market bubble before the crash when they sold and bought stocks among themselves to create artificially high stock prices based on trading volume.[88] Just before the crash, most of these elites suddenly sold their shares at the inflated high prices.[89] Insider information, improper annual reports, inefficient accounting and auditing, and lack of proper disclosure and transparency existed in the KSA stock market before the crash and provided the perfect environment for corruption.[90]

All the above-mentioned flaws in the market's regulatory framework were the responsibility of the government agencies, as the market regulators who failed to protect and raise the awareness of the investors.

The accounting and auditing standards were criticised and were considered among the main factors in the market crash.[91] The CMA as the market regulator failed to oversee these vital professions and raise their efficiency to an adequate level. Consequently, some companies illegally covered their operating losses by using their reserves.[92] Some of the highest stocks in terms of price in the market belonged to the worst-performing companies.[93]

Furthermore, the absence of high standards for disclosure and transparency, and poor supervision of the CMA, allowed for annual reports violations and scandals that contributed to market collapse.[94] These abusive practices in the market occurred due to the CMA's lack

[87] Al-Twaijry (n 86) 28
[88] Faleh Salem Al-Kahtani, 'Current Practices of Saudi Corporate Governance: A Case for Reform' (Thesis, Brunel 2013) 137 <https://bura.brunel.ac.uk/bitstream/2438/7382/3/FulltextThesis.pdf>; Alkhaldi (n 32) 2.
[89] Al-Kahtani (n 91) 137.
[90] ibid 114
[91] ibid
[92] ibid 137
[93] ibid 23
[94] ibid 169

of proper oversight and deterrent penalties. It has been argued that this lenience of the CMA towards these illegal acts was due to the CMA's fear of 'possible negative consequences from any tough action that might be taken against manipulators in the market'.[95] This claim is reasonable to a certain extent, in view of the fact that most companies in the stock market are owned and controlled by rich families and government, and the likely possibility of their influence on the CMA back then.

Nonetheless, it is fair to say that the CMA was an inexperienced newly formed agency facing a rapidly growing market. Regardless of the reason, the CMA is still partially responsible for the market collapse due to its lack of proper leadership and its leniency and hesitation in dealing with violators, which encouraged more persistence in the illegal acts.

3.4.2 Aftermath of the Crash and the Government Response

The consequences of this unprecedented collapse were devastating, with middle class and working families being the most affected. Many people reportedly lost their entire life savings and their jobs. In some cases, investors were imprisoned for failure to pay off their debts.[96] Many bankrupted retail investors suffered physically and mentally due to stress, and in some cases lost their lives.[97]

The crash also created uncertainty and instability in the market and the economy. Economic growth and new investment slowed down and were postponed for several months. For example, many unlisted companies who had intended to go public were forced to delay this step after the uncertainty caused by the crash.[98]

As a response to the unprecedented market collapse, the government through its different agencies launched reforms to restore confidence, stability, competitiveness, and liquidity in the market, and to avoid similar collapses. For instance, the government permitted

[95] Alkhaldi (n 31) 137
[96] ibid
[97] Lerner, Leamon and Dew (n 31) 7
[98] ibid 8

foreigners living in KSA as well as Gulf Cooperation Council (GCC)[99] citizens to invest directly in the stock market for the first time to increase the liquidity of the market.[100]

The CMA, as the market regulator, implemented significant reforms after the crash**.** In late 2006, the CMA launched the first official Corporate Governance Code (CG Code) in the country to improve the market and to ensure fairness and transparency.[101] Most of the KSA's CG Code principles were inspired by the UK corporate governance code and the OECD principles for corporate governance.[102] This adoption of rules and principles from more developed jurisdictions and organisations supports the assumption that entry to the WTO, inter alia, encouraged the convergence with global legal standards.[103]

In 2007, the Council of Ministers approved the formation of Tadawul as a joint-stock company.[104] This step was in accordance with article 20 of the reformed Capital Market Law (CML) which stated that 'A market shall be established in the Kingdom for the trading in Securities which shall be known as the "Saudi Stock Exchange", and will have the legal status of a joint-stock company in accordance with the provisions of this Law. This Exchange shall be the sole entity authorized to carry out trading in Securities in the Kingdom'.[105]

The main objectives of this step according to article 20 C of the CML are:

1. Ensuring fair, efficient and transparent listing requirements, trading rules and technical mechanisms and information for Securities listed on the Exchange;

2. Providing sound and rapid settlement and clearance rules and procedures through its Securities Depositary Center;

3. Establishing and enforcing professional standards for brokers and their agents:

[99] The Gulf Cooperation Council (GCC) is a union consisting of all Arab states of the Arabian Gulf except Iraq, namely: Saudi Arabia, Bahrain, Kuwait, Oman, Qatar, and the United Arab Emirates. <https://www.gcc-sg.org/en-us/Pages/default.aspx>

[100] More details about foreign investors' participation in the market in section 3.5.

[101] CMA website: <https://cma.org.sa/en/RulesRegulations/Regulations/Documents/CGRegulations_en.pdf>

[102] Hussam Al Ahmary, 'Does Saudi Corporate Governance Attain International Standards Using the UK Best Practice as an Exemplar' (2018) 189 <http://openaccess.city.ac.uk/id/eprint/23224/http://openaccess.city.ac.uk/> accessed 12 March 2020; Faleh Salem Al-Kahtani, 'Current Practices of Saudi Corporate Governance: A Case for Reform' (2013) 86 <https://bura.brunel.ac.uk/bitstream/2438/7382/3/FulltextThesis.pdf>

[103] Alshehri (n 38) 74

[104] Tadawul website: <https://www.tadawul.com.sa/wps/portal/tadawul/about/company?locale=en>

[105] Capital Market Law. Available at CMA website: <https://cma.org.sa/en/Pages/default.aspx>.
The CML was issued on 31/7/2003 and has been reformed frequently by the CMA. These reforms are published on the CMA website.

4. Ensuring the financial strength and soundness of brokers through the periodic review of their compliance with capital adequacy requirements, and setting such arrangements to protect the funds and Securities in the custody of brokerage Companies.[106]

This strategic reform improved the infrastructure of Tadawul to a certain extent, with the aim of being in line with international standards and increasing its efficiency. This is a consequence of making it a joint-stock company where more legal requirements apply to ensure transparency and a more sophisticated board of directors structure, governed by strict rules that apply to joint-stock companies to ensure independence and efficiency such as the requirement for independent non-executive directors.[107]

At the individual level, investors became more careful when investing in the market after the crash and the CMA continually launched investment-awareness reports and booklets on their website and other media platforms.[108] However, despite the CMA's reforms, the CMA response to the crash has been questioned. Some of the causation issues of the crash were not addressed until recently, and some other issues still exist.[109]

For example, low levels of accounting and disclosure standards and non-compliance of many companies with these standards were major factors in the crash.[110] However, the

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[106] Article 20(C) of the Capital Market Law

[107] The role played by non-executive directors increases the efficiency of the company as they provide objective criticism of the board. See: Barry Curnow and Jonathan Reuvid, *International Guide to Management Consultancy: Evolution Practice and Structure* (Kogan Page Publishers 2005) 138
Tadawul has been frequently reformed, and its main published objectives are to:
'Enhance existing assets classes while developing derivatives and commodities markets in line with investor needs, become a partner to KSA's privatization and debt listing and encourage Saudi and GCC private companies to list, diversify investor base by attracting international and institutional investors, establish a CCP and enhance post-trade products & services, develop a comprehensive suite of information & analytics services, build and operate a regional exchange platform across the value chain, build an agile, digitized and business oriented org, and collaborating with local, regional and international stakeholders to implement the strategy.' Available on Tadawul website:
<https://www.tadawul.com.sa/wps/portal/tadawul/about/company/strategy/!ut/p/z1/pZDJCsIwFEW_xQ-Q3AxN4zLWakpLY9EOZiNZSUGriPj9ShfujAXf7sE5b7jEkY64wT_7k3_018Gf3_3ByWOkJZhRsHaZRagEF5LlOYWNSTsCpSkSA8VyFa8otEy3MpWcAoK4KT5jiaILgWKTlTF0pU2zbvYclv_nT92PL6Xx23cjEkpgBEIvBoHPhMCRO38nt0td1x36bK5nL4FCDX0!/dz/d5/L0lHSkovd0RNQUZrQUVnQSEhLzROVkUvZW4!/>
accessed 09/03/2020

[108] 'CMA continues to work in line with its strategy to support and promote investor awareness programs which was first launched in 2006. As part of its awareness efforts, CMA launched a website specifically for investor awareness.' CMA website: <https://cma.org.sa/en/Pages/default.aspx>

[109] See for example: Alshowish (n22). Although some issues were addressed by the reforms, these issues are still, to some extent, present. For example. weak minority shareholders' protection, unclear directors' duties, insider information, and a lack of proper disclosure and transparency. Most of these issues are discussed in depth in this thesis.

[110] Al-Kahtani (n 91) 114

proper reforms with which to address these issues were not introduced until more than six years after the market collapse. In this sense, the CMA adopted the International Financial Reporting Standards in 2012 as a significant and long-awaited step to improve the accounting and disclosure standards in the market. The International Financial Reporting Standards are a set of rules 'to develop standards that bring transparency, accountability and efficiency to financial markets around the world'.[111] The CMA obliged all publicly-traded companies to comply with these standards by 2017.[112] More recently, to increase the level of disclosure and transparency, the CMA announced that all listed companies are obliged to publish any of their notifications and announcements in both Arabic and English languages, starting from 2021.[113]

It is noteworthy to mention that there are some other flaws that the CMA has still not properly addressed. Elite investors can still manipulate prices by buying a large amount of stocks in the market, inflating prices and then selling.[114] This unsolved structural problem could be a consequence of the ownership structure in the KSA market. Also, starting and running a business in KSA is still difficult despite the slight improvement in the ranking in this regard by the World Bank.[115] Additionally, the amount of fines for non-compliance with the accounting and disclosure requirements has been criticised and their deterrent effect is questioned.[116]

3.4.3 Conclusion

The sudden increase in market liquidity between the years 2002 and 2006, and the formation of Tadawul as the market main regulator, changed the features of the KSA stock market. Although liquidity can be a positive thing for any market in general, if the liquidity of the market increases too fast under the supervision of a newly formed and inexperienced agency, major flaws and instability can be expected in the market. This was the case in KSA in 2006 when the country witnessed its first, and – so far – only major stock market collapse.

Public participation in the market was sudden and in great numbers. Most of these retail individual investors were inexperienced middle-class people. They based most of their

[111] The International Financial Reporting Standards Foundation website: <https://www.ifrs.org/about-us/>
[112] CMA website: <https://www.cma.org.sa/en/market/news/pages/cma_n_2107.aspx>
[113] CMA website: <https://cma.org.sa/en/Market/News/pages/CMA_N_2811.aspx>
[114] Lerner, Leamon and Dew (n 31) 8. The high mandatory bid threshold (50%) in KSA may contribute to this problem. The mandatory bid rule is discussed in detail in chapter 6.
[115] KSA is ranked 38 out of 190 countries. <https://archive.doingbusiness.org/en/rankings>
[116] Lerner, Leamon and Dew (n 31) 8

investment decisions on rumours and friends and family advice in a behaviour described as 'herding' where they followed others instead of making their own informed investment decisions. This large unsophisticated participation created an inflated bubble and a perfect environment for corruption, especially when the protector of the market was a new, inexperienced agency facing a rapidly expanding market that outpaced its ability.

The market collapse was a result of many causes mentioned earlier; however, the CMA is more accountable for the crash than any other factor considering its position as the market's sole regulator. Accounting and disclosure violations were alarming before the crash but the CMA was hesitant to enforce deterrent penalties and failed to adopt compulsory international accounting and disclosure principles to cope with the market expansion.

The inefficiency of the CMA that contributed to the market crash in 2006 should be a lesson for the future to avoid similar consequences when instituting any future market reforms. For example, the takeover is considered a new investment activity in KSA and the agencies governing the process of takeovers are either new or inexperienced with regard to takeovers. There should hence be strict regulations to protect investors and all stakeholders from abusive acts due to the inefficiency and inexperience of these agencies, or due to any possible leniency with violators at stakeholders' expense.

3.5 Foreign Participation in the KSA's Stock Market

The financial regulators have taken additional measures to counter the impacts of the 2006 crash, including allowing international investors to access the KSA's stock market.[117] The opportunity to gain portfolio benefits from international diversification motivated KSA to involve foreign investors in the stock market.[118]

This foreign participation in the KSA stock market is relatively recent. Trading in Tadawul was hitherto exclusive to Saudis and expatriates residing in KSA. The opening of Tadawul to foreign investors has been performed gradually in a multistep process. In 2007, the CMA allowed nationals of GCC countries to participate in Tadawul; however, it still

[117] Abeer F Almutiri, 'Capital Market Liberalisation: Effect of Foreign Investors on Saudi Stock Market Performance' (2020) 10 Journal of Mathematical Finance 2, 267–286, 269 <https://www.scirp.org/pdf/jmf_2020051515282706.pdf> accessed 5 August 2020

[118] Sabilil Hakimi Amizuar, Anny Ratnawati and Trias Andati, 'The Integration of International Capital Market from Indonesian Investors' Perspective: Do Integration Still Give Diversification Benefit' (2017) 9 International Journal of Economics and Finance 9, 157–165, 159 <https://www.researchgate.net/publication/319266108_The_Integration_of_International_Capital_Market_from_Indonesian_Investors%27_Perspective_Do_Integration_Still_Give_Diversification_Benefit> accessed 2 August 2020

maintained strict rules that minimised investor involvement.[119] Before 2008, no foreign investors could participate in KSA's stock market. However, with globalisation and an increased need to enhance growth in the stock market, KSA implemented policies that promote market liberalisation.

In 2008, the CMA issued a circular permitting foreign institutions and individuals to participate in the stock market.[120] However, this resolution has rigorous restrictions and did not allow direct investment for foreigners. The only permitted way for foreigners to invest in Tadawul was by entering into Swap Agreements with local Authorised Persons.[121] Consequently, the legal ownership of the shares would be retained by the Authorised Persons while the economic benefits of the listed shares would be transferred to the foreign investor.[122] In other words, the foreign investors will be deprived of voting and attending general meetings in the company that they have indirectly invested in, and will only be able to gain revenues or losses.

3.5.1 Qualified Foreign Investors and Strategic Foreign Investors

A historic development that moved the KSA market from a closed to a relatively liberal and open market was the opening of the KSA Stock Exchange (Tadawul) to international investors for the first time in 2015. However, this significant development has been limited to a certain group of foreign investors, termed by CMA as qualified foreign investors (QFI).[123]

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[119] Saqib Sharif, 'How Foreign Investors Influence Stock Markets? The Saudi Arabian Experience' (2019) 11 Middle East Development Journal 1, 1–19, 3. Available at <https://www.tandfonline.com/doi/full/10.1080/17938120.2019.1583511?scroll=top&needAccess=true&instName=Newcastle+University> accessed 15 August 2020

[120] Resolution # 2-28-2008 dated 17/8/1429H corresponding to 18/8/2008G. Available at the CMA website: <https://www.cma.org.sa/en/market/news/pages/cma_n434.aspx>. The latest amendment for this circular was published on the CMA web in 2018: <https://cma.org.sa/RulesRegulations/circulars/Documents/circular21.pdf>

[121] ibid. Authorised person according to the CMA 'Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority' is: 'a person who is authorised to carry on securities business by the Authority'. CMA, 'Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority' (2019) 12 <www.cma.org.sa> accessed 1 April 2020. The CMA provided several requirements and conditions of being an authorised person; for example Article 6(H) of the Authorised Persons Regulations: 'An applicant must have its management and head office in the Kingdom'.

[122] Resolution # 2-28-2008 dated 17/8/1429H corresponding to 18/8/2008G. Available at the CMA website: <https://www.cma.org.sa/en/market/news/pages/cma_n434.aspx>. The latest amendment for this circular was published on the CMA website in 2018: <https://cma.org.sa/RulesRegulations/circulars/Documents/circular21.pdf>

[123] The CMA approved nine highly recognised brands in 2015 such as BlackRock Advisors UK, Ashmore Equities Investment Management US, HSBC Bank, Silchester International Investors, Ashmore Investment Management, Ashmore Equities Investment Management US, Citigroup Global Markets, La França Asset Management, and Unlu Menkul Degerler.

The main policy drivers behind the permission for QFI to enter the KSA market are not to attract capital or liquidity, according to the CMA. The main reason for allowing QFI to invest in the KSA market is to achieve the following objectives:

- Promote CMA's efforts to increase institutional investment in the Saudi Capital Market which would contribute to market stability and reduce high volatility in prices through attracting the expertise of specialized foreign investors, with long-term investment goals in the local market.
- Transfer the knowledge and expertise to the local investors and financial institutions and to raise the level of professionalism of the market participants by attracting highly professional experts.
- Enhance the market efficiency and motivate the listed companies and the specialized investment companies to raise their performance by improving the level of transparency, financial information disclosure and governance practices.
- Strengthen the Saudi Capital market's position to become a leading market. In addition to increase the opportunities of raising its rating to be classified as an emerging market under the global indices, led by the Morgan Stanley Capital International (MSCI) index which many markets seek to be part of.
- Raise the level of research, studies and evaluation done on the market in general and on listed companies in particular which would provide more accurate information and more fair assessments.[124]

It can be concluded that the policy drivers behind opening the market for QFI are to gain economic and social advantages. Increasing and diversifying investors and luring more sophisticated investors from developed countries boost the market depth and increase its efficiency.[125]

The QFI model governed by CMA provides foreign investors with full legal ownership of listed shares and all rights associated with being a shareholder, but with many imposed restrictions as well. No more than 49 percent of an issuer may be owned in

[124] Available at CMA website <https://cma.org.sa/en/Market/QFI/Pages/default.aspx> accessed 2 August 2018.
[125] Saqib Sharif, 'How foreign investors influence stock markets? The Saudi Arabian experience' (2019) 11 Middle East Development Journal 1, 1–19. Available at <https://www.tandfonline.com/doi/full/10.1080/17938120.2019.1583511?scroll=top&needAccess=true&instName=Newcastle+University> accessed 15 August 2020

aggregate by foreign investors, except for foreign strategic investors.[126] Each QFI qualifying to trade in the KSA stock market should have at least $5 billion assets under management and can only hold 5% of the shares by listed companies.

KSA gained noticeable benefits after easing foreign access to its market. This step helped to accomplish several targets set by the CMA, such as increasing institutional investment efficiency and increasing the profile of the market and its international classification.[127] Evidence of these achieved benefits can be seen in the recognition by notable international institutions and indexes. For example, KSA joined FTSE Emerging Markets Index in 2017.[128] Moreover, Morgan Stanley Capital International (MSCI) listed the KSA's market in its Emerging Markets category in 2019[129], which expanded the KSA investor base.[130]

These benefits led the CMA to ease access and registration requirements for foreign investors further. The recent amendments include the proviso that firms should be subject to oversight by a regulatory body and established in a location that adheres to regulatory and supervisory criteria that are in line with, or deemed satisfactory by, the CMA and have a minimum of SAR 1,875,000,000 or its equivalent.[131] Also, the ownership bar restriction was raised to 10% of the shares of any issuer whose shares are listed. According to article 12, 'each QFI, may not own 10% or more of the shares of any issuer whose shares are listed'.[132] Based on this rule, foreign investors would always be considered a minority in their companies.

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[126] Tadawul: <https://www.tadawul.com.sa/wps/portal/tadawul/market-participants/investors/qfi/!ut/p/z1/pZBBCsIwFETP4gEk0yRN2mVQTKPVWmpizUaykoJWEfH8aneCVsXZfXgP_gzxpCa-DddmFy7NsQ37-73xYhsrAZolKLSoxigrN03lUjMUnKw7gNJREqUcOXIZQQkNU845wywm_idfm4WEKlXmJm7FkND_fPDvfLyJwmffd0jfAs_Ai4q9wKNDB_Q8WYUzOR2stTUaM1SDG3KAknU!/dz/d5/L0lHSkovd0RNQUZrQUVnQSEhLzROVkUvZW4!/>

[127] Abeer Faleh H Almutiri, 'Capital Market Liberalization: Effect of Foreign Investors on Saudi Stock Market Performance' (2020) 10 Journal of Mathematical Finance 267, 268 <https://doi.org/10.4236/jmf.2020.102017> accessed 7 November 2020

[128] Tadawul website: <https://www.tadawul.com.sa/wps/portal/tadawul/market-participants/investors/qfi/!ut/p/z1/pZBBCsIwFETP4gEk0yRN2mVQTKPVWmpizUaykoJWEfH8aneCVsXZfXgP_gzxpCa-DddmFy7NsQ37-73xYhsrAZolKLSoxigrN03lUjMUnKw7gNJREqUcOXIZQQkNU845wywm_idfm4WEKlXmJm7FkND_fPDvfLyJwmffd0jfAs_Ai4q9wKNDB_Q8WYUzOR2stTUaM1SDG3KAknU!/dz/d5/L0lHSkovd0RNQUZrQUVnQSEhLzROVkUvZW4!/>

[129] ibid

[130] Almutiri (n 130) 268

[131] Rules for Qualified Foreign Financial Institutions Investment in Listed Securities (2019) Article 6

[132] Rules for Qualified Foreign Financial Institutions Investment in Listed Securities (2019) article 12

The policy behind this rule, as mentioned earlier, is not to fully open the market for any foreign investor but rather to achieve specific goals. The limitations on foreign investment in the KSA stock exchange will theoretically achieve the five goals set by the CMA.

In 2019, the CMA issued an implemented regulation for the foreign strategic investor (FSI). The QFI regulations do not apply to FSI regulations as stated in the Instructions for the Foreign Strategic Investors Ownership in Listed Companies. According to the regulation, the definition of a foreign strategic investor is 'a foreign legal entity that aims to own a Strategic Shareholding in listed companies'.[133]

This recent step by the CMA was to encourage more foreign investment in KSA. If a foreign investor meets the requirements to be an FSI, the investor can own more than 49% of a listed company's shares. For FSI to earn strategic shareholdings that are intended to positively contribute to the operational and financial performance of a listed company, then it has to be licensed under country regulations acceptable by the CMA, must have a client account with an authorised person as well as an account with a security depository centre, and must meet all the regulations provided by the CMA.[134] The entities have to meet industry-specific regulations in order to gain approval to enter into strategic investments in a listed company.

3.5.2 Foreign Investment in the KSA's Market Regulatory Framework

Foreign participation in the market is governed by several laws and supervised by different governmental agencies and ministries. In addition to laws and regulations that apply to all market participants, some other laws and regulations only apply to foreign participation in the market.

Foreign Investment Law regulates any foreign investment in KSA. The law defines the foreign investor as: 'A natural person who is not of Saudi nationality or a corporate

[133] Instructions for the Foreign Strategic Investors Ownership in Listed Companies part 2. Available on the CMA website: <https://cma.org.sa/en/RulesRegulations/Regulations/Documents/Instructions-FSI-Ownership-Listed-Companies-en.pdf>

[134] CMA, 'Instructions for the Foreign Strategic Investors Ownership in Listed Companies' (2019) <https://cma.org.sa/en/RulesRegulations/Regulations/Documents/Instructions-FSI-Ownership-Listed-Companies-en.pdf#search=foreign%20strategic%20investor>

person whose partners are not all Saudi'.[135] The Ministry of Investment[136] oversees the application of this law and is responsible for amending it when necessary. The main role of the Ministry of Investment is to achieve economic growth in the KSA by fostering investment opportunities and provision of services, and creating a business environment.[137] The ministry's approval is required through submission of a request before making any foreign investment in KSA. According to article 2, 'Without prejudice to the provisions of the laws and agreements, the authority shall issue a license for foreign capital investment in any investment activity in the Kingdom, whether permanent or temporary'.[138]

The other agency that governs foreign investment is the CMA, which has issued many implemented regulations: most notably, the QFI Regulations and the Instructions for the Foreign Strategic Investors Ownership in Listed Companies.[139] Article 3 of the QFI regulations issued by the CMA in Listed Securities gives the CMA the right to exempt QFIs partially or completely from the QFI regulations.[140] Article 3 states that 'The Authority may waive a provision of these Rules in whole or in part as it applies to an applicant, a QFI or any of their clients[,] or an authorized person[,] either on an application from any of the aforementioned persons or on the Authority's own initiative'.

Statutes and regulations are designed to be general and apply to everyone, and if there is a possibility of exemptions, there should be an indication of the grounds on which these exemptions can be applied. However, based on the wording of article 3, the CMA can exempt investors randomly rather than on the basis of legal grounds. The article also does not provide bases for such exemption, a lack of objectivity that can lead to inequality among investors and uncertainty. The CMA can exempt investors on its own initiative, which also can lead to inequality and vagueness among foreign investors due to the absence of rules that explain when an exemption is possible, which areas or issues can justify an exemption, and the procedure for acquiring an exemption.[141]

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[135] Foreign Investment Law Article 1(e); Article 1(g) defines foreign capital as follows: 'For purposes of this Law, foreign capital shall mean, for example, but not limited to, the following assets and rights so long as they are owned by a foreign investor: (1) Cash, securities and negotiable instruments'.
[136] Known as the General Investment Authority before it was changed to a ministry in 2020.
[137] Ministry of Investment website: <https://www.misa.gov.sa/en/about/>
[138] Article 2 of the Foreign Investment Law
[139] CMA website: <https://cma.org.sa/en/Pages/default.aspx>
[140] Rules for Qualified Foreign Financial Institutions Investment in Listed Securities (2019) Article 3
[141] Mulhim Almulhim, 'A Critique of Saudi M&A Laws' (SJD Dissertations 2016) 2 <http://elibrary.law.psu.edu/sjd/2/?utm_source=elibrary.law.psu.edu%2Fsjd%2F2&utm_medium=PDF&utm_campaign=PDFCoverPages> accessed 13 June 2017

Thus, because of the need for legal regimes to provide certainty for commercial entities and equality and fairness among investors, this article should provide details about the grounds of the exemption and clearly state the when, who, and how of gaining the exemption.

3.5.3 Conclusion

Involving foreign investors in the stock market is associated with significant benefits, such as increasing liquidity and stock trading. The stock market liberalisation through an increase in foreign investments has led to a significant positive growth rate and broader impacts on economic welfare. In the past, KSA did not have adequate regulations to support foreign investment in the stock market. However, the KSA stock market has evolved and produced favourable regulations that favour investors both within and outside the GCC.

The CMA adopted the principle of gradually opening the market to foreign investors. First, the KSA launched the CMA, which constantly improved regulations and foreign participation in the market. The CMA launched the swap agreements in 2008; however, due to their limitations, they launched the QFI in 2015 and allowed ownership of equities among foreign investors. The easing of foreign investor regulations contributed to the recognition of global institutions and indexes of the KSA market such as FTSE and MSCI which will further expand the market investors base.

However, in order to achieve fairness, certainty, and equality, this section has provided a recommendation for the QFI regulations, suggesting that the grounds for exemption from the QFI regulations by the CMA should be provided in detail, rather than the CMA being granted unrestricted authority to randomly waive and exempt any foreign investor from the QFI rules.

3.6 Chapter Conclusion

This chapter has provided an analysis of the KSA's stock market. The chapter has laid the foundation for the following chapters in order to make it easier for the reader. In the process, the chapter provided an analysis of the KSA stock market chronological developments, including the major 2006 stock market crash. It also provided an analysis of the recent and

gradual foreign participation in the KSA's stock market. The purpose of this descriptive analysis is to provide a comprehensive insight into the KSA's stock market as the place where takeovers occur, considering that the scope of this thesis is focused solely on takeovers of listed companies in this market. The clarification presented in this chapter is essential before providing an overview of the takeover legal system and the various types of takeover transactions that can occur in this market in the following chapter.

Chapter 4. Overview of the KSA's Takeover System

4.1 Introduction

This chapter provides an overview of the KSA's takeover regulatory system and identifies the types of takeover transactions that can take place in accordance with KSA's laws and regulations. The purpose of this chapter is to provide a summary and basic understanding of the takeover regulatory framework in KSA to pave the way for later chapters where a more critical and analytical approach to the above topics will be applied. The chapter will also provide an analysis of these transactions in relation to their definitions and meanings, as the author found issues in the definitions that can cause uncertainty and unclarity in the legislations. The chapter also presents an overview of the agencies, laws, and judicial authorities governing takeovers.

As explained at the beginning of this thesis, the term 'takeover' will be used here to mean any merger or acquisition involving trading activities on the shares of a listed company to acquire corporate control. Thus, mergers and acquisitions that do not involve a listed company are outside the scope of this thesis and will not be discussed in detail.[1]

Merger and acquisition could be interpreted differently depending on the point of view of various disciplines. More importantly, each country may regulate these activities differently; therefore, the definition of these terms will differ based on how they are regulated. Regulators in KSA have not given a specific and accurate definition of M&A, nor a clear distinction between the types of each of these terms. In the absence of clear definitions in the Company Law and the M&A Regulations as the main regulatory sources, the CMA should have provided clear and accurate definitions and an extensive illustration of the different types of M&A.

Despite the importance of acquisitions, especially in a rapidly growing emerging market like that of the KSA, the Company Law enacted in 2015 did not mention or regulate this already-existing type of transaction.[2] Instead, the Ministry of Commerce, the legislative

[1] Scope, limitation, and reason for excluding non-listed companies are discussed in chapter 1.
[2] Acquisition is not mentioned in the Company Law; only mergers were regulated under the section 'Companies transformation and merger' in Articles 190–193 of the Company Law.

body that enacted the Company Law, has left acquisitions to be regulated by the CMA, who included acquisitions in their regulations.[3] The absence of clear definitions and differentiation between different types of these relatively new activities in KSA can cause misuse and misunderstanding of these terms among investors, company directors, scholars, and media.[4] This unclarity can have a negative influence on the financial-legal system in KSA.

Nevertheless, although some definitions lack clarity, the author found some definitions and types of mergers and acquisitions in KSA in different laws and regulations that have addressed these activities.[5] The author has also provided clearer definitions and suggested names for some types of transactions that could more accurately reflect the meaning and scope of the articles addressing that transaction.[6] There are several types of takeover transactions regulated in KSA. Company Law regulates mergers activities, which applies to all types of companies. For listed companies, the Merger and Acquisition Regulations presented by the CMA apply, in addition to the rules in the Company Law. The following sections will address the issues and differences in the definitions and the consequences of these issues.

4.2 Takeover Transactions in KSA

This section will discuss the types and definitions of takeover transactions in KSA in accordance with the takeover laws and regulations. The section will analyse these permitted types of takeovers in the KSA and will illustrate the issues related to the definitions and names of these transactions and the impact of these issues. The section will also recommend reforms to address these problems.

[3] Mainly in the Merger and Acquisition Regulation in 2007, last amended 2018.
[4] For example, an article about a new imminent merger in Al-Jazirah, a well-known newspaper in KSA, used the term 'acquisition' in the title and the term 'merger' in the article to describe the same possible deal. See *Al-Jazirah* 1 (8 October 2020) 1171518 Arabic version, available at: <https://www.al-jazirah.com/2020/20201018/ar5.htm>
[5] Definitions and types discussed in the next section.
[6] See for example Acquisition by compulsory share exchange which is discussed in section 4.2.1.2.

4.2.1 Issues Related to the Definitions and Names of Takeovers and the Impact of these Issues

4.2.1.1 Acquisition

As mentioned earlier, the Company Law did not regulate or mention acquisition. The CMA defined this term in its regulations. The definition of acquisition, according to the CMA in the English version of its regulation, is as follows: 'Takeover: the acquisition of control of a company listed on the Exchange'.[7] However, the definition is different in the Arabic version, where the term is defined as 'Acquisition: A deal that involves buying and selling shares of a company whose shares are listed in the market by tendering an offer or by a private sale and purchase deal'.[8]

These definitions provided by the CMA raise several important issues. Firstly, there are the clear differences between the Arabic and English versions. This inaccuracy in translation and differences between language versions of the same regulation give a worrying indication of the reliability of the CMA's English regulations. Thus, these regulations might be questioned as to whether they reflect the original Arabic ones properly. This issue can be an obstacle to the country's efforts to liberalise the market and attract foreign investment, because foreign investors and companies may hesitate to join the market if its regulations are not clear and not reliable.

Moreover, the English version used the term 'Takeover' and defined it as an acquisition. In the Arabic language, takeover and acquisition are referred to by the same word "إستحواذ". The CMA should have used one of these terms in all its regulations; otherwise, it should have differentiated between them. Nevertheless, it can be concluded from the laws and regulations in KSA that there are no differences between the two terms, but that they mean the same thing.

Secondly, although the English version mentioned the most important element of acquisition, which is acquiring corporate control, the Arabic version neglected this main element in its definition. The definition in the English version was brief and did not mention

[7] Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 2004 updated 2019, English version. CMA website.
[8] Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 2004 updated 2019, Arabic version. CMA website.

how this acquisition can accrue. The Arabic definition affirmed that acquisition is a deal that involves buying and selling shares by a private sale and purchase deal.

This element of the definition is not accurate as private deals do not necessarily result in the acquisition of a company. The definition of a private deal/transaction according to the CMA is a 'transaction involving the purchase and/or sale of shares carrying Voting Rights in any company listed on the Exchange, negotiated between the Offeror and selling shareholder(s) of the Offeree Company without making an Offer or involving the other shareholders or directors of the Offeree Company'.[9]

Thirdly, the CMA definitions of both M&A have not mentioned the most distinguishable legal element that differentiates between a merger and an acquisition. This identifiable element is the existence of the legal personality of the entity after the transaction. However, it can be concluded from the laws and regulations in KSA that the legal personality of a company remains after an acquisition despite the acquirer's control, whereas in the case of a merger, the legal personality of the merged company will cease to exist.[10]

Before attempting to suggest a definition for acquisition that reflects the regulations in KSA, the meaning of control in the takeover context must be illustrated to provide an accurate definition. The concept of control is defined by the CMA in several regulations.[11] In the takeover context, it is defined as 'the ability to influence the actions or decisions of another person through, whether directly or indirectly, alone or with a relative or affiliate (a) holding 30% or more of the voting rights in a company, or (b) having the right to appoint 30% or more of the members of the governing body; "controller" shall be construed accordingly'.[12]

The CMA has not explicitly spelled out in clear and objective words when a transaction is considered an acquisition. The CMA defines acquisition as: 'the acquisition of control of a company listed on the Exchange'.[13] Thus, to clearly and objectively define and understand acquisition, the meaning of control in this context is essential. As illustrated

[9] Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 2004 updated 2019, English version. CMA website.
[10] Khalid Alruwais, 'The Process and Legal Consequences of Merger Between the Companies under Saudi Laws' (2017) V29 Journal of King Saud University 2, 198
[11] The concept of control is discussed in depth in chapter 6.
[12] Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 2004 updated 2019, English version. CMA website.
[1313] Glossary of Defined Terms Used in the Regulations and Rules of the Capital Market Authority, 2004 updated 2019, English version. CMA website.

above, control is defined by the CMA as holding 30% or more of the voting rights in a company.[14] The author recommends that the CMA enhance its M&A Regulation by clearly stating the activities that are considered acquisitions. This can be done by objectively mentioning the exact threshold that causes a purchase to be considered an acquisition. Clarity and objectivity of the regulations are highly important to avoid confusion among market participants. The concept of acquisition can be defined with greater precision to reflect the scope of the KSA regulations. An acquisition can be defined as a deal that involves buying 30% or more of the shares of a listed company to acquire corporate control by holding 30% or more of the voting rights in a company.[15]

It can be concluded from the above definition, along with the legislation governing acquisitions in KSA, that this transaction is between the offeror and the shareholders of the offeree company who accepted the deal. In other words, unlike other takeover transactions, such as the acquisition by compulsory share exchange transaction[16], where the approval of the deal by 75% votes in the EGM makes it valid and compulsory to all shareholders, shareholders in an acquisition deal cannot be forced by law to sell if they do not accept the offer. Hence, companies may not find this transaction suitable if they want to secure 100% ownership of another company, especially in the absence of the squeeze-out right[17] in KSA legislations. Additionally, the free-rider problem is highly expected in this transaction in the absence of legal means to compulsorily buy the minority shares whose owners refused to sell.[18]

Although the CMA has recently provided the acquisition by compulsory share exchange transaction as an alternative transaction to secure 100% of the offeree shares (discussed below), the CMA should follow other developed jurisdictions and provide the squeeze-out right in acquisition transactions once a certain threshold is reached to avoid free-

[14] ibid

[15] The remainder of the acquired company's legal personality should also be mentioned in the definition or in other articles to distinguish between M & A in the KSA regulations.

[16] This transaction is similar to the scheme of arrangement in the UK. Discussed in further detail in the following subsection.

[17] In other jurisdictions, once a threshold is reached, an offeror can require all the remaining shareholders to sell their shares at a fair price. See for example: The European Union Directive on Takeover Bids: Directive 2004/25/EC Article 15. More discussion of the squeeze-out right in chapter 6.

[18] The free-rider problem occurs when minority shareholders refuse to sell their shares and benefit from the rise of the post-takeover share value with no contribution made for this increase in value. See Jonathan Mukwiri, 'Takeovers and Incidental Protection of Minority Shareholders' (2013) 10 European Company and Financial Law Review 432, 14 <http://ssrn.com/abstract=2398543>. More discussion of the free-rider problem in chapter 6.

rider problems. The squeeze-out right and its importance for adoption in KSA will be discussed extensively in chapter 6.

4.2.1.2 Acquisition by Compulsory Share Exchange

This transaction was newly introduced and regulated by the CMA for the first time in the amended M&A Regulations in 2018. This new type of acquisition is regulated in only one brief article (article 26). The term 'Acquisition by compulsory share exchange' is not explicitly spelled out in any of the CMA regulations. However, in the absence of extensive information and details about this new form of acquisition by the CMA, this suggested name could more accurately reflect the meaning and scope of the new article.

The new article described this type as 'Securities Exchange Offer for all the shares of the Offeree Company'.[19] The articles defined it as 'An Offeror (who is a joint-stock company) may provide, after obtaining the Authority's prior approval, the Offeree Company with a Securities Exchange with the Offeror in consideration of all the shares in the Offeree Company'.[20] The acquisition by compulsory share exchange is valid only if it is approved by a special resolution (75%) in the extraordinary general meeting (EGM) in the offeree company.[21]

It is worth mentioning that this new form of acquisition applies to listed companies only. A possible policy driver for this new type can be to encourage acquisitions among listed companies in KSA. [22]

This new transaction provides companies with more options to acquire control other than acquisition by purchasing shares through an offer to the shareholders of the offeree company. The difference between a merger and this transaction is that the target company will not dissolve as in the case of a merger; instead, it will remain as a separate legal person after the transaction.

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[19] Article 26 of the M&A Regulations

[20] Article 26(A) of the M&A Regulations

[21] Article 26(C) of the M&A Regulations: 'With no prejudice to the Companies Law, to the decision to complete the acquisition offer by offering an exchange of securities for all the shares of the offeree Company, shall not be deemed valid unless it is issued by the votes of 75% of the shares represented in Extraordinary General Assembly.'

[22] Mulhim Almulhim, 'The new Merger and Acquisition Regulations', *Al Eqtisadiah* (14 December 2017) <https://www.aleqt.com/2017/12/14/article_1298466.html> accessed 16/8/2020

Acquisition by compulsory share exchange is also different from an acquisition by an offer to the offeree company's shareholders in several aspects. Firstly, acquisition by compulsory share exchange is a deal with the offeree company, not a direct offer to buy the shares from the shareholders as in the acquisition transaction.

Secondly, this transaction is valid once approved by a special resolution (75%) in the EGM. Accordingly, the remaining 25% minority who might oppose the transaction will be forced to accept the deal. By contrast, in an acquisition, only shareholders who accepted the offer will sell their shares, and shareholders who refused the deal cannot be forced to accept it.

Thirdly, acquisition by compulsory share exchange gives offeror companies 100% ownership of the offeree shares; whereas in an acquisition, the offeror company will only receive shares from shareholders who agreed to sell their shares and accept the offer.

This new type presented by the CMA is, to a certain extent, similar to other types of transactions available in other jurisdictions. It is similar to the Scheme of Arrangement in the UK[23] despite several differences in the regulatory framework between the two similar transactions in the UK and KSA.

Therefore, given the well-established nature of the UK's scheme of arrangement, a brief overview of it will be provided to draw recommendations to improve the new and underdeveloped transaction in KSA. Additionally, KSA's M&A regulations are heavily influenced by the UK takeover code; thus, looking at the UK's scheme of arrangement for regulatory recommendations in this context can be useful.

A) UK's Scheme of Arrangement

There are several types of schemes of arrangements in the UK that can be used for different purposes other than just acquiring control.[24] For example, it can be used as a restructuring tool to alter a company's share capital, such as cancellation of different classes of shares, and it can also be used as a tool for restructuring companies' debt.[25] The purpose of the scheme of arrangement when first introduced in the UK was only to restructure debt as an agreement

[23] Mulhim Almulhim, 'The new Merger and Acquisition Regulations', *Al Eqtisadiah* (14 December 2017) <https://www.aleqt.com/2017/12/14/article_1298466.html> accessed 16/8/2020
[24] David Kershaw, *Principles of Takeover Regulation* (1st edn, Oxford University Press 2016) 45
[25] ibid 45

between companies and their creditors.[26] Nevertheless, in 1900, the scheme of arrangement became a tool for performing a takeover of a company, as an alternative to a takeover offers.[27]

However, for the purpose of this thesis, and considering that acquisition by compulsory share exchange in KSA is permitted as an alternative takeover tool, this section will only discuss the scheme of arrangement in the UK when used as a tool to acquire corporate control. Thus, other different types of the scheme of arrangements in the UK will not be reviewed.

A unique feature of the scheme of arrangement that differentiates it from a takeover offer is court interference. Even after the required approval of 75% of shareholders to accept the deal, court approval is further required.[28] The court has two main roles in this context. The first is to ensure that the required approvals were secured and that each class of shareholders is fairly represented.[29]

This role of the court is important in the context of protecting shareholders, as it aims to ensure that the class meeting is properly constituted. Hence, in cases where shareholders object to the scheme on the ground that their class meeting was improperly constituted, the court will not sanction the scheme.[30] As additional protection for minority shareholders, the court will ensure that

> the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent.[31]

The second is to apply an objective test to ensure that the deal is performed for the members' interest.[32] Legislation did not provide guidelines or criteria for the court to exercise this discretion; therefore, the court will sanction the scheme if it is convinced that the deal is fair

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[26] Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press 2012) 82 <https://www-cambridge-org.libproxy.ncl.ac.uk/core/books/schemes-of-arrangement/B5BE58C38862092C14CF6CD0FA113C77> accessed 10 February 2020
[27] ibid
[28] Section 899 of the Companies Act 2006; Kershaw (n 24) 56
[29] Part 26 of the Companies Act 2006; Kershaw (n 24) 55
[30] See for example: *Re British Aviation Insurance Co Ltd* [2006] 1 BCLC 665; Brenda Hannigan, Company Law (3rd edn, Oxford University Press 2012) 716.
[31] *Buckley on the Companies Act* (13th edn 1957) 407. This principle was approved by Plowman J in *Re National Bank Ltd* [1966] 1A 11 ER 1006 at 1012; Hannigan (n 29) 720.
[32] *Re British Aviation Insurance Co Ltd* [2006] 1 BCLC 665; Payne (n 25) 82

and reasonable.[33] The court will ensure that the terms of the scheme are fair 'such that an intelligent and honest man, a shareholder of the class concerned and acting in respect of his interest, might reasonably approve'.[34]

B) Conclusion and Recommendations

Acquisition by compulsory share exchange in KSA can only be used as an alternative to an acquisition offer and not as a restructuring debt tool as is possible in the UK's scheme of arrangement. This can be concluded from article 26 of the M&A Regulations which required the offeror to be a joint-stock company only. The new article provides an option that is better than an acquisition if a company wants to obtain 100% of the shares. This transaction can be performed once approved by 75% of the shareholders, which could be negative for minority shareholders in the absence of additional protection for this unique transaction, such as the approval of the court in the UK. Other jurisdictions who have adopted the scheme of arrangement from the UK have added articles to protect minority shareholders when the scheme is used as an alternative mechanism to acquisition. For example, according to the New Zealand Companies Act, the court will ensure that shareholders of the company would not be adversely affected by the scheme of arrangement used as an alternative to a takeover to avoid the rules in the Takeovers Code.[35]

Therefore, the author recommends a reform to the newly introduced article in KSA to provide more protection for minority shareholders. This can be done by requiring the approval of courts or specialist legal committees for the transaction where the fairness and reasonability of the transaction are validated, to ensure that the minority shareholders' rights are protected. Another alternative for protecting minority shareholders when the court sanction is not required by law is to raise the transaction approval threshold. This can be done by requiring the approval of at least 90% of the shareholders to accept the deal. This threshold is the trigger to the squeeze-out right in takeover transactions in other jurisdictions.[36] Raising the approval threshold is highly recommended, especially in the absence of a sell-out right in KSA whereby minority shareholders can force the acquirer to

[33] Per Lindley LJ in *Re Alabama, New Orleans, Texas and Pacific Junction Ry. Co*. [1891] 1 Ch. 213; per Richards J in *Re Telewest Communications plc (No 2); Re Telewest Finance (Jersey) Ltd (No2)* [2005] 1 BCLC 772; *Man group Plc v Mann Strategic Holdings* [2012] EWHC 4089; Kershaw (n 24) 56

[34] *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 215, 239, 247; *Re AngloContinental Supply Co Ltd* [1922] 2 Ch 723, 736

[35] Payne (n 26) 139; s. 236(A)(2)(b) New Zealand Companies Act 1993

[36] See for example, The European Union Directive on Takeover Bids: Directive 2004/25/EC Article 15.

buy their shares as an equal right to the squeeze-out right given to the acquiring party. Providing more protection to minority shareholders in the newly introduced transaction (acquisition by compulsory share exchange) by using the 90% threshold is more sensible as it is a change-of-control transaction similar to an acquisition bid that leads to 100% control either by the approval of all shareholders or, more likely, by acquiring 90% of the company's shares, then using the squeeze-out right to secure full control.

Furthermore, the author recommends changing the term of the transaction from 'Securities Exchange Offer for all the shares of the Offeree Company' to 'Acquisition by compulsory share exchange' to reflect the accurate meaning and scope of the newly introduced transaction.

4.2.1.3 Mergers

Unlike acquisitions, mergers are regulated by the Company Law in four articles (190–193). The Company Law defined mergers as follows: 'Merger shall be made by combining one or more companies with another existing company or by combining two or more companies to establish a new company'.[37] The termination of the legal personality of the target company (the merged company) is the legal result of a merger that distinguishes it from an acquisition. This distinguishable consequence is mentioned several times in the M&A Regulations. According to article 49, upon successful completion of the merger transaction, 'the Merged Company will cease to exist and its shares will be delisted from the Exchange…'.[38]

The types of mergers are explained more clearly in the M&A Regulations.

1- Merger by way of absorption:

A) Merged company absorbed by another listed company.

B) Merged listed company absorbed by a non-listed company.

2- Merger by way of forming a new legal entity: in this type two companies, one of which must be listed, merge to form a new legal entity. This type of merger is outside the scope of the thesis due to the absence of the element of acquiring corporate control by one company over the other.

[37] Company Law 2015 Article 191(1)
[38] M&A Regulations Article 49(a)(1)(b)

4.3 Takeover Governing Authorities and Laws

This section will provide a basic understanding of the governmental agencies, laws, and judicial authorities that are relevant to takeovers in KSA.

4.3.1 Governing Authorities and Laws

Takeover laws are scattered in different laws and regulations issued by different governmental authorities and ministries. Also, the approval of different agencies is required before completing a takeover transaction. Some of these laws and authorities, and others, will be discussed in other relevant chapters in more depth.

The main supervisory authority of takeover transactions is the CMA. The CMA's fundamental role is to 'regulate and develop the capital market and promote appropriate standards and techniques for all sections and entities involved in Securities Trade Operations'.[39] According to article 219 of the Company Law,

> Without prejudice to the provisions of the Law, and to the powers of the Saudi Arabian Monetary Agency as stipulated in relevant laws, …, CMA shall be the Competent Authority to oversee and monitor the joint-stock companies listed in the Saudi capital market, and issue rules regulating their work, including regulation of mergers if a party thereto is a company listed in the Saudi capital market.'[40]

Indeed, the CMA supervises and ensures the proper application of its regulations in all takeover transactions that include at least one listed company.[41]

In terms of regulations, the CMA issues, and frequently amends, several regulations that are related to takeovers, most importantly, the M&A Regulations which is considered the country's takeover code. The CMA also issued other regulations relevant to takeovers such as the Capital Market Law (CML), the Market Conduct Regulations, and Corporate Governance Regulations.

[39] CMA website: <https://cma.org.sa/en/AboutCMA/Pages/AboutCMA.aspx>
[40] Article 219 of the Companies Law 2015
[41] M&A Regulations Article 2

The other agency that regulates takeovers is the Ministry of Commerce (MOC). The ministry regulates and supervises both listed and non-listed companies. It also issued the Company Law which includes articles related to takeovers that apply to all types of companies in KSA. The MOC has the strategic role of developing the country's commercial and investment sectors.[42] In the takeover context, the MOC supervises takeover transactions between unlisted companies only.

Another important agency in the takeover context is the (GAC).[43] The GAC is an independent authority with responsibility for ensuring the enforcement of Competition Law and implementing its regulations. The authority's main role is to 'protect and encourage fair competition and combat monopolistic practices that affect lawful competition'.[44]

In the takeover context, GAC approval for takeover transactions is necessary in situations where economic concentration exists.[45] According to the Implementing Regulations of the Competition Law, economic concentration is defined as

> any act resulting in full or partial transfer of ownership rights or usufruct of an entity's properties, rights, stocks, shares or obligations to another entity that puts an entity or a group of entities in a position of domination of an entity or a group of entities, by way of merger, takeover, acquisition, or combining two or more managements into one joint management or any other means which leads to having a market share of 40% of the total sales of a commodity in the market.[46]

In other words, for any takeover transaction that results in the control of 40% of the share of the total supply of a commodity within the market, the GAC's approval must be secured. The

[42] One of the main roles of the MOC is 'To enhance the potentials of both commerce and investment sectors and protect the beneficiaries' interests, by developing and implementing effective and efficient policies and mechanisms, which will contribute to achieving sustainable economic development'. <https://mci.gov.sa/en/about/mcvision/pages/default.aspx>

[43] Due to its importance in the takeover context, the GAC's role and the Competition Law will be discussed in more depth in the next chapter.

[44] General Authority for Competition website <https://gac.gov.sa/AboutUs_en.aspx?id=10>

[45] One of the main duties of the GAC is to 'Approve cases of merger, acquisition, or combining of two managements or more into one joint management resulting in a dominant position in the market'. General Authority for Competition website <https://gac.gov.sa/AboutUs_en.aspx?id=10>

[46] The Implementing Regulations of the Competition Law Article 2

GAC has the right to issue approvals, conditional approvals, and refusals for the takeover requests that fall under its scope.[47]

Another agency that might be involved in a takeover transaction, depending on the transaction parties, is the Ministry of Investment.[48] If at least one of the companies involved in a takeover transaction is a foreign company, the Ministry of Investment's approval is required and its regulations will apply in accordance with the Foreign Investment Law.[49]

Lastly, the KSA Central Bank (SAMA) and its laws will apply to certain takeover transactions. SAMA was established in 1952 as KSA's central bank.[50] Its main roles are to protect and strengthen the Saudi currency and to supervise and regulate the banking sector.[51] In the takeover context, SAMA has other functions that involve it in takeover transactions. For instance, SAMA performs the following duties:

- Regulating and supervising financial sectors.
- Supervising commercial banks and exchange dealers.
- Supervising cooperative insurance companies and the self-employment professions relating to the insurance activity.
- Supervising finance companies.
- Supervising credit information companies.[52]

Accordingly, for any takeover transaction where at least one of the transaction parties is one or more of the above companies, SAMA approval is required, and its regulations will apply.

However, there are other industry-specific regulations and other relevant agencies' approvals required for specific takeover transactions in different sectors. It is also worth mentioning that other takeover-relevant rules exist in a non-compulsory form: most relevantly, the Unified rules for acquisitions in the financial markets of the Cooperation

[47] Competition Law Article 10: 'The Board shall issue a resolution concerning the economic concentration notices in one of the following forms: 1. Approval. 2. Conditional approval. 3. Refusal. The resolution of conditional approval or of refusal must be reasoned.'
[48] Previously known as The Saudi Arabian General Investment Authority. Established in 2000.
[49] Foreign Investment Law Article 1
[50] SAMA website: <http://www.sama.gov.sa/en-us/about/pages/samahistory.aspx>
[51] ibid
[52] ibid

Council for the Arab States of the Gulf. These rules are for guidance only; they are not yet compulsory.[53]

4.3.2 Judicial Authorities

Generally, commercial disputes fall under the Commercial Court's authority. M&A disputes are thus heard in the Commercial Court. Nevertheless, disputes arising from matters related to the M&A Regulations fall under the CMA committees' jurisdiction.

A) The Committee for the Resolution of Securities Disputes (CRSD)

The committee was established in 2004 in accordance with the Capital Market Law.[54] It is one of the country's semi courts[55] that play a crucial role in the business sector in KSA. The role of the committee is to address any disputes related to CMA's law or any of its implemented regulations. According to the Capital Market Law:

> The Authority shall establish a committee known as the 'Committee for the Resolution of Securities Disputes' [CRSD], which shall have jurisdiction over the disputes falling under the provisions of this Law, its Implementing Regulations, and the regulations, rules and instructions issued by the Authority and the Exchange, with respect to the public and private actions. The Committee shall have all necessary powers to investigate and settle complaints and suits, including the power to issue subpoenas, issue decisions, impose sanctions and order the production of evidence and documents.[56]

Therefore, any disputes related to takeovers, or violations of the M&A Regulations[57] will fall under the committee's jurisdiction.

B) The Appeal Committee for the Resolution of Securities Conflicts (ACRSC)

This committee was established to provide an opportunity to file an appeal from a CRSD decision. According to the Capital Market Law:

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[53] Council of Ministers of Saudi Arabia order (427) 19 July 2016
[54] Capital Market Law Article 25(a)
[55] Semi courts in KSA are discussed in chapter one.
[56] Capital Market Law Article 25(a)
[57] As explained earlier, M&A Regulations are among the CMA's implemented regulations.

f. The Committee's decision may be appealed before the Appeal Panel within thirty days from their [sic] notification date.

g. An Appeal Panel is to be formed by a Council of Ministers' decision, and it shall have three members representing the Ministry of Finance, the Ministry of Commerce and Industry, and the Bureau of Experts at the Council of Ministers. The members of the Appeal Panel shall be appointed for a three-year term renewable. The Appeal Panel shall have the discretion to refuse to review the decisions of the Committee for the Resolution of Securities Disputes, to affirm such decisions, [or] to undertake a [de novo] review of the complaint or suit based on the record developed at the hearing before the Committee[,] and to issue such decision as it deems appropriate in relation to the complaint or the suit. The decisions of the Appeal Panel shall be final.[58]

4.4 Chapter Conclusion

To sum up, this chapter has provided an overview of the takeover regulatory framework. The types and definitions of takeover transactions in KSA are illustrated. The chapter also discussed the importance of clear definitions that distinguish between types of takeover transactions in order to understand the scope of regulations and to avoid confusion among market participants in takeovers. Recommendations were provided to enhance takeover laws and regulations in terms of clarity of definitions and accuracy of translations of the original Arabic regulations into English. Also, the concept of control was concluded from the regulations to provide a better understanding of this concept in the takeover context.

The M&A Regulations were criticised with regard to the newly introduced Acquisition by compulsory share exchange. This new form of acquisition is regulated by only one brief article while it should have been explained extensively by the CMA. Moreover, an overview of the UK's scheme of arrangement was presented due to its similarity to the acquisition by compulsory share exchange in KSA, in order to provide reform recommendations. The section provided a recommendation to require court interference and approval in the new transaction to ensure protection for minority shareholders where their rights might be compromised due to the nature and structure of the transaction. The chapter also provided an alternative reform to the newly introduced transaction to increase minority

[58] Capital Market Law Articles 25(f) and (g)

shareholders' protection by raising the shareholders' approval requirement to 90% instead of 75% to approve the deal.

The chapter presented an overview of the agencies, laws, and judicial authorities governing takeovers. The purpose of this chapter is to provide an understanding of the takeover regulatory framework in the KSA to pave the way for the following chapters, where a more critical and analytical approach to the takeover system in the KSA will be applied. The chapter discussed briefly the importance of the General Authority for Competition and the Competition Law in the takeover context, which will be discussed extensively in the next chapter.

Chapter 5. The KSA Competition Law in the Takeover Context

5.1 Introduction

5.1.1 Introduction to the Chapter

KSA recently enacted a new competition law that came into force in 2019. KSA has worked towards increasing the ease of doing business in the country by implementing various reforms, such as enacting regulations to protect minority investors and reducing barriers for foreign investors, as discussed in the previous chapter. Competition law reforms are among the KSA's steps to ensure market integrity while encouraging fair competition in the business environment, and they can have a positive impact on the country's ease of doing business. Additionally, Competition Law plays an integral role in takeover transactions in KSA.

This chapter will provide an overview of the Competition Law and the General Authority for Competition (GAC). It will illustrate and examine their importance and role in the takeover context. Furthermore, the chapter will present an illustration of how takeover transactions in the KSA overlap with the Competition Law and the GAC jurisdiction, by analysing the merger control system embodied in the Competition Law. The chapter will analyse the economic concentration concept in KSA and identify takeover transactions that fall under this concept, requiring GAC pre-approval for the transactions. It will also analyse the dominant position concept in the takeover context and will argue that abuse of dominant position is neither defined nor clearly explained in the KSA's legislation, and will recommend reforms aimed at defining this concept by looking for a definition in another more developed system which can provide a better understanding of the concept. Also, this chapter will analyse the role of the semi-judicial committee (Committee for the Resolution of Violations of the Competition Law), which is authorised to adjudicate disputes related to the Competition Law. This chapter will provide recommendations for future reforms of the Competition Law in areas related to takeovers.

5.1.2 Competition Background

Minimal regulation is often attractive for investors because market forces are left to influence business decisions in a free market economy. Competition in the market environment is thus driven by economic power and innovative business strategies that can enable firms to meet the needs and expectations of consumers while attaining their profit goals.[1]

However, regulations are sometimes enacted to prohibit firms from abusing their dominant positions in the market because business enterprises are ultimately driven by profit objectives, meaning that they will always seek to use their resources and capabilities to advance their interests even if these interests are advanced at the expense of smaller business entities. The law of competition is designed to regulate competition in the business environment and ensure that larger corporations do not abuse their vantage positions by using them to drive smaller enterprises out of the market.[2]

The law seeks to prevent anti-competitive conduct by business enterprises and maintain the integrity of a free market. Competition law enables regulatory authorities to ensure that a company does not become too big in the market, to the extent that it establishes a monopoly. Undue concentration of companies can distort competition in the market and limit the ability of smaller enterprises to thrive in a free market. The aim of competition law is to promote healthy competition among companies. 'When firms compete with each other, consumers get the best possible prices, quantity, and quality of goods and services.'[3] The competition law encourages competition among companies to ensure that they meet the needs and preferences of the customers and that the large firms do not abuse or engage in anti-competitive agreements that would limit the operations of the small businesses.

The enforcement of competition law protects consumers by the detection and sanctioning of anti-competitive activities such as cartels, abuse of dominant market positions,

[1] Anu Bradford, Adam S Chilton, Christopher Megaw and Nathaniel Sokol, 'Competition Law Gone Global: Introducing the Comparative Competition Law and Enforcement Datasets (2019) 16 Journal of Empirical Legal Studies 2, 414 <https://onlinelibrary.wiley.com/doi/epdf/10.1111/jels.12215?saml_referrer> accessed 10 November 2020

[2] Daniel Zimmer and Edward Elgar, *The Goals of Competition Law ASCOLA COMPETITION LAW The Fifth ASCOLA Workshop on Comparative Competition Law* (2012) 155 <http://www.justice.gov/atr/public/> accessed 31 December 2020

[3] Consumer.ftc.gov, 'How Competition Works' (Consumer.ftc.gov) <https://www.consumer.ftc.gov/sites/default/files/games/off-site/youarehere/pages/pdf/FTC-Competition_How-Comp-Works.pdf> accessed 10 March 2021 para 1

and uncontrolled takeover transactions.[4] Also, as every business should enjoy free and fair competition, competition law enhances innovation and creativity among companies as the law prohibits market domination by some of the companies in an industry. This is because a monopoly can be achieved if a firm produces products and controls the market: that is, if it is the only company producing the specific product which it sells to the consumers. It means that it has the ability to dominate the market by controlling the price and other factors.[5] Competition laws ensure that power is distributed among companies or entrepreneurs, and prevent companies from abusing their dominant market position.

5.1.3 Competition in the Takeover Context

The importance of competition law in the takeover context is continuously increasing on the global level.[6] The regulation of takeover bids by competition laws is integral as it prevents any potential mergers or instances of acquisition that would contribute to market dominance by a firm that adversely impacts fair competition.[7] In this sense, some of the reasons that explain merger initiatives by firms may include the desire to exclude rivalry within the market and enhancement of their market power, which enables such a corporate entity to control production and the pricing of products or services within a market territory.

The interventionist role of competition authorities in takeover transactions in different jurisdictions across the globe is increasing.[8] This interventionist role takes place where pre-notification and approvals by competition authorities are required before the takeover transactions can occur. The purpose of this merger control conducted by competition authorities is to enable them to determine beforehand whether the transaction may lead to unfair or anti-competitive conduct in the market that negatively affects competition.[9] In

[4] United Nations Conference on Trade and Development, 'The Benefit of Competition Policy for Consumers' (Unctad.org, 2014) <https://unctad.org/system/files/official-document/ciclpd27_en.pdf> accessed 10 March 2021, 3

[5] Cooperation A. P. E, Guide to the investment regimes of the APEC member economies (2003) APEC Secretariat 257

[6] Paolo Palmigiano, 'Merger Control: Why Is Competition Law Relevant to M&A?' (2013) International Financial Law Review para 4 < https://www.iflr.com/article/b1lt377lq1d2gq/merger-control-why-is-competition-law-relevant-to-ma>

[7] William S Comanor and Akira Goto, *Competition Policy in the Global Economy: Modalities for Co-operation* (Routledge 2005) 373. See also The Federal Trade Competition's website, available at <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/single-firm-conduct/monopolization- defined>

[8] Palmigiano (n 6) para 4

[9] Dennis W Carlton and Jeffrey M Perloff, *Modern Industrial Organization* (4th edn, Pearson) 642;

situations where a competition authority finds that a takeover transaction will lead to anti-competitive results, the authority can impose restrictions or conditions on the transaction parties to eliminate the anti-competitive effects, or ban the transaction completely.[10]

Indeed, the jurisdictional power of many competition authorities around the world is not only limited to domestic transactions, but also extends to cross-border takeover transactions, even entirely foreign ones.[11] The power to approve or decline a takeover transaction between foreign companies by a competition authority in a certain jurisdiction usually occurs when the transaction has anti-competitive effect within that jurisdiction.[12] Thus, it is vital for companies intending to implement a takeover transaction to carefully evaluate the transaction to determine whether certain competition authorities' approvals and pre-notifications are required to avoid financial and reputational consequences.[13]

In this regard, takeover parties may encounter unnecessary costs when required to obtain approvals from multi-jurisdictional competition authorities in the absence of a converged system of international competition law.[14] Thus, reducing the number of different competition authorities evaluating a proposed transaction to a stage where fewer notifications are required can be an effective way to lower the costs for the takeover parties.[15] However, there has been some success and notable failure in international attempts to promote procedural convergence in order to reduce the unnecessary costs of multi-jurisdictional competition review.[16]

The above illustration shows the importance of competition law in the takeover context and how it is a significant aspect that should be considered in many takeover transactions.

Addison-Wesley, 2005; Paolo Palmigiano, 'Merger control: Why is competition law relevant to M&A?' (2013) International Financial Law Review < https://www.iflr.com/article/b1lt377lq1d2gq/merger-control-why-is-competition-law-relevant-to-ma>

[10] Palmigiano (n 6) para 8

[11] ibid paras 7 & 10

[12] See OECD: COMPETITION LAW AND FOREIGN-GOVERNMENT CONTROLLED INVESTORS. 2009 <https://www.oecd.org/daf/inv/investment-policy/41976200.pdf> accessed 20 Dec 2020.

[13] For example, the European Commission fined Electrabel €20 million in 2008 for acquiring control of another company without the European Commission's approval. See: Case No COMP/M.4994 -ELECTRABEL /COMPAGNIE NATIONALE DU RHONE in EUR-Lex at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32008M4994>. And, Lexology website: <https://www.lexology.com/library/detail.aspx?g=e80ee133-ee5f-4fc0-bf33-a5be392c1072>

[14] Jonathan Galloway, 'Convergence in international merger control' (2009) 5(2) Competition Law Review 179, 181 < http://new.clasf.org/CompLRev/Issues/Vol5Iss2Art2Galloway.pdf> accessed 3 April 2023.

[15] ibid 183

[16] ibid 191

5.2 Overview of the KSA Competition Law and the GAC

This section aims to provide a background to the competition law in KSA and the governing competition authority to facilitate understanding of the main competition system characteristics in KSA.

5.2.1 Enactment of the KSA Competition Law

The concept of a separate competition law is relatively new in KSA. Hitherto, the principles of competition law were scattered throughout different other laws and regulations. In 2004, the Competition Law was enacted by Royal Decree No. M/25, Dated 4/5/1425H, to create, along with its Implementing Regulations, the country's first competition regime and a formal competition legal framework.[17]

5.2.2 The New Competition Law

In 2019, the law was amended to ensure that the country not only attracts investors but protects businesses in the market environment. The new Competition Law was enacted through Royal Decree titled M/75 dated 29/6/1440H corresponding to the 6th of March 2019 and came into force on 23rd September 2019. The new law aims to prevent anti-competitive practices in the business environment and ensure that market integrity is maintained.

The new KSA Competition Law is part of the ambitious Vision 2030 that aims to ensure sustainable growth of the country's economy, an indication that it was formulated with the objective of improving the ease of doing business in the country.[18] Indeed, article 2 of the Competition Law states that the law seeks to safeguard and encourage fair competition in the business environment. The law further aims to deal with and prevent practices that are monopolistic and that impact consumer interest or lawful competition in the marketplace. Overall, the law aims to improve the market environment and economic development.

[17] The Law became effective in January 2005. See: Grahame Nelson, 'Saudi Arabia: The Competition Law Regime' (Al Tamimi & Co) <https://www.tamimi.com/law-update-articles/saudi-arabia-the-competition-law-regime/> accessed 20 November 2020
The KSA Competition Law was amended twice; in 2013 by Royal Decree No. M/25, Dated 11/4/1435H, and in 2019.

[18] The Saudi Vision 2030 can be found at <https://vision2030.gov.sa/en>

Moreover, considering that KSA unveiled its Vision 2030, which aims to diversify the country's economy and reduce its dependence on oil, the Competition Law may also have been enacted with the objective of attracting foreign investors into the country. The danger of enacting a competition law that is designed to attract investors is that the law can be counter-productive to small local businesses that do not have the type of money or resources that major foreign corporations have. For example, considering that large multinational companies often have lower marginal costs, they may draw demand away from domestic companies, causing domestic businesses to reduce their production.[19]

An example of the foreign investment influence in KSA was seen when the giant US e-commerce platform Amazon took over Souq,[20] a regional e-commerce platform in the Middle East.[21] Allowing Amazon to enter the regional markets led to the dominance of Amazon and other giant multinational companies, as they have more resources and more expertise than local businesses in the same sector. The retail e-commerce sector in KSA is now dominated mostly by foreign companies.[22]

Although, in theory, foreign investment can enhance competition in the local market by transferring technology to that market, pressuring local companies to improve and renovate their products, reduce their prices, and increase their efficacy,[23] some negative influence of this foreign participation can occur in practice. Several studies have suggested that different factors that vary from one country to another, such as the level of financial market development, should be considered when deciding whether foreign investment in a specific country has positive outcomes.[24] For example, Blomström et al. found that developing countries with lower incomes do not enjoy significant growth benefits from foreign direct investment, while developing countries with higher incomes gain more benefits.[25] It can be concluded from this study that a certain level of development threshold is

[19] Dierk Herzer, 'How Does Foreign Direct Investment Really Affect Developing Countries' Growth?' (2010) 2 <http://www.iai.wiwi.uni-goettingen.de> accessed 14 February 2021
[20] Souq.com was ranked number 1 as the most popular e-commerce platform in the Middle East in 2016. See Argaam website (Arabic version), available at: <https://www.argaam.com/ar/article/articledetail/id/445727>
[21] Amazon acquired Souq in 2017 and Souq was rebranded as Amazon in 2019. CNBC website: <https://www.cnbc.com/2019/04/30/amazon-rebrands-souq-launches-new-middle-east-marketplace.html>
[22] See Argaam website (Arabic version), available at: <https://www.argaam.com/ar/article/articledetail/id/445727>
[23] Oman Charles, 'Policy Competition for Foreign Direct Investment: A Study of Competition among Governments to Attract FDI' [2000] Development Centre Studies, OECD, Paris, France 18 <https://www.oecd.org/mena/competitiveness/35275189.pdf> accessed 14 February 2021
[24] Herzer (n 19) 3
[25] Magnus Blomström, Robert E Lipsey and Mario Zejan, 'What Explains Developing Country Growth?' (1992) vol 4132, 22 <http://www.nber.org/papers/w4132> accessed 14 February 2021

essential in order to absorb new technology from foreign companies' investments.[26] Alfaro et al. used data for several developing and developed countries and concluded that foreign direct investment can contribute to economic growth.[27] However, they stated that for these positive effects to be achieved, a certain degree of development of the local financial markets is essential; thus, taking advantage of the foreign investment might be difficult for underdeveloped financial markets.[28] In another study, Herzer found that foreign direct investment's effect on developing countries' economic growth is negative in general.[29] The study concluded that less intervention by the government and freedom from business regulation are important factors for increasing the benefits of foreign direct investment. Nevertheless, several other factors can have a significant influence on the growth effects of foreign investment, such as level of per capita income, freedom from corruption, and business freedom.[30]

It can be concluded that attracting foreign investment should not be the main goal of the competition law and other legislation reforms; instead, these reforms should regulate the foreign investment in a manner that benefits the local market and increases its growth without having a negative influence on competition.

The KSA's new Competition Law followed universal principles of competition law, specifically that of preventing firms from using their dominant positions in the market to drive out competitors through unreasonably lower prices of goods and services.

The implication of this provision in article 6 of the Competition Law demonstrates that even if large corporations invest in the country, they cannot sell their products and services at extensively lower prices such that small businesses are unable to compete against them. Dominant positions cannot, therefore, be used to intentionally cause losses to other business entities. The KSA Competition Law seeks to ensure that these positions are not abused.

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[26] Herzer (n 19) 3
[27] Laura Alfaro and others, 'FDI and Economic Growth: The Role of Local Financial Markets' (2004) 64 Journal of International Economics 89, 91 <https://reader.elsevier.com/reader/sd/pii/S0022199603000813?token=58013BDD1AC862AC8972D5BC20EA639E489001EC527B69BDFB17C6128F6E41167A2E8AE8F431C602D4594BE09B5A9E92> accessed 10 February 2021
[28] Ibid Alfaro
[29] Herzer (n 19) 27
[30] ibid

On the other hand, the law states that state-owned companies and public establishments are exempt from the provisions of the law if 'such establishments or companies are solely authorized by the Government to provide goods or services in a particular field'.[31] The implication of this provision is that the successful implementation of the competition law and the realisation of its objectives will also depend on political factors such as transparency in governance and general goodwill of the government.

As an absolute monarchy, the ability of KSA's competition law to improve the market environment will also depend on the desire of the government to see its successful implementation. The use of state-owned companies to drive out competition in the market can be counterproductive to the main objectives of the law. Political goodwill will thus play an integral role in ensuring the efficacy of the competition law. The new Competition Law did not provide any grounds for the exemption from the law of public establishments and state-owned companies,[32] which may lead some of these establishments to abuse the market as they hold a dominant position that is out of reach of the Competition Law.

Prior to the enactment of the country's first competition law in 2004, some of the state-owned companies abused their dominant position and had an absolute monopoly in their sectors. For example, the telecommunication sector was dominated by the Saudi Telecom Company[33] as the sole provider in KSA, until the Saudi Arabian Communications Commission allowed other companies to participate in the sector pursuant to the Competition Law regulations in 2004.[34] The dominant position of the Saudi Telecom Company prior to 2004 was negative for consumers, as many complained about the inefficiency, high prices, and unfair practices of the company in the absence of alternative providers.[35]

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[31] Article 3(2) of the Competition Law

[32] ibid

[33] The Saudi Telecom Company was a public company owned by the government until 2003 when the company was partially privatised; currently the government owns 70% of the company. See Tadawul website: <https://www.tadawul.com.sa/wps/portal/tadawul/market-participants/issuers/issuers-directory/company-details/!ut/p/z1/pZHBToNAEIafpQeOssNCC_WGUAGhJFhpcS9mUaQkwBLYSurTd0EvjRU1zm0z3zeZ_QcRlCBS07cip7xgNS3F-5EsnkI3sFwwsO-sHlQwF_baug89DABoNwIYW4ay1CCAQFcE4IAXrTUVIhWRP_mOF-pgRqa7vd0K1MD_80H7nQ_flAk_-XeI5CVLP6Lac95cSyABpy-0P5SS0J9Z1dD6uDlWKROQDgoMqFmnqpEj0mavWZu18qEVzcHvxgF938s5Y3mZyWKA3FHporVnHUfJF1j8ipwvDi62xeIr37etOYab-Scwdbhz4MJlJoEh-hGYyHZDW9RUcRwn70G2M_jSK7wrczY7AQJN3Dw!/dz/d5/L0lHSkovd0RNQU5rQUVnQSEhLzROVkUvZW4!/>

[34] Ibrahim M Alotaibi, 'The Role of Competition Law in the Telecommunications Sector in Saudi Arabia' (2019) 4 <https://bura.brunel.ac.uk/bitstream/2438/18916/1/FulltextThesis.pdf> accessed 30 December 2020

[35] ibid 73

Monopoly by state-owned companies in certain sectors can have a negative impact, unless the government enhances the welfare of the whole society and illustrates how the monopoly in this sector can have greater advantages to the public and the country than allowing other private competitors in the sector. However, giving all state-owned entities' unlimited exemption from the Competition Law may lead to anti-competitive practices.[36]

Thus, the author recommends that the Competition Law should clearly set out the sectors that need to be dominated by state-owned companies and to provide objective criteria for the exception of these companies from the provisions of the Law.

5.2.3 Establishment of the General Authority for Competition (GAC)

The GAC was established when the Competition Law was enacted in 2004 and given the power by the law.[37] It was referred to as the 'Competition Protection Council'[38] and fell under the oversight of the Ministry of Commerce.

In 2017, the Council of Competition became an independent authority and its name was changed to the General Authority of Competition. The new authority is under the supervision of the King – in his capacity as the Prime Minister – who appoints the chairman of the GAC's board of directors by a Royal Order.[39] This step expands the GAC's jurisdiction and power to protect the market from anti-competitive practices as the entitled agency to enforce and supervise the enforcement of the Competition Law and its Implementing Regulations.[40]

The practical role of the GAC to protect the market from monopolistic practices includes the following:

- Approve draft general plans and policies as well as laws of competition and submitting the same according to the related legal procedures, and pursue their implementation upon approval.
- Determine GAC goals and policies to achieve its purposes, and approve relevant programs and supervise their implementation.

[36] ibid
[37] The 2004 Competition Law Article 8. Replaced with the amended 2019 Competition Law
[38] The name was changed to The Council of Competition in 2013.
[39] Saudi Press Agency: <https://www.spa.gov.sa/1895555#>
[40] The General Authority of Competition website: <https://gac.gov.sa/AboutUs_en.aspx>

- Monitor the market to ensure the application of the rules of fair competition.
- Approve cases of merger, acquisition, or combining of two managements or more into one joint management resulting in a dominant position in the market.
- Approve taking action of inquiry and collection of evidence as well as ordering investigation and prosecution to reveal any practices violating the rules of competition, whether such action is taken pursuant to a complaint, or at the initiative of GAC.
- Approve the initiation of criminal action against violators of the provisions of the Law.
- Decide on economic concentration applications that are submitted to GAC.
- Disseminate the culture of competition, raise the awareness of society of the rights guaranteed under the Competition Law, and create an online interactive channel via the Internet between GAC and the community.
- Designate the employees who are assigned the capacity of recording violations of the provisions of the Competition Law.
- Form the Committee for Review and Adjudication of Competition Law Violations.
- Determine the activities exempted from the application of the provisions of the Competition Law.
- Issue the Implementing Regulations of the Competition Law and approve the administrative and financial regulations applicable to GAC.
- Approve the draft annual budget of GAC and forward the same to the competent agency.
- Approve the annual report, balance sheet, and auditor's report of GAC, in preparation for submitting the same to the competent agencies.
- Enhance cooperation and coordination with the authorities concerned with competition within the Kingdom and in other countries so as to achieve GAC goals.[41]

[41] ibid

5.2.4 Anti-competitive Practices and Dominant Position

5.2.4.1. Restrictive Practices

Article 5 of the Competition Law is a cornerstone article of the Law as it specifically identifies several prohibited practices that violate competition in the market. As stated in Article 5:

> Practices including agreements or contracts between entities, whether written or oral, explicit or implicit, are prohibited if the purpose or effect thereof prejudice competition, particularly the following:
>
> 1. Determining or proposing prices of goods, service fees, and terms of sale or purchase, etc.
> 2. Determining the sizes, weights, or quantities of goods produced or the performance of services.
> 3. Limiting the free flow of goods and services to or from the markets in whole or in part by unlawful concealment or storage or refusal to deal therein.
> 4. Any conduct that excludes or obstructs the entry of an entity into the market.
> 5. Denying a particular entity or entities access to goods and services available in the market in whole or in part.
> 6. Dividing markets for the sale or purchase of goods and services, or designating them according to any standard, particularly the following standards: a. Geographical areas. b. Distribution centers. c. Customer type. d. Seasons and time periods.
> 7. Freezing or limiting the manufacturing, development, distribution, marketing, and all other investment activities.
> 8. Colluding or coordinating in bids or offers in government tenders, auctions, etc., in a manner that interferes with competition.[42]

Nevertheless, these practices serve as examples of common prohibited practices. Thus, based on the wording of the article, any other practices, contracts, or agreements between entities are prohibited if they violate or can cause anti-competitive effects.[43]

[42] Article 5 of the Competition Law 2019
[43] ibid

The regulations provided guiding standards for the GAC when determining whether or not a practice is anti-competitive. Thus, the GAC can apply one or more of the following assessment criteria:

1. percentage and market shares of vendors and purchases affected by the practice;
2. the time period during which the practice occurred;
3. price or volume deviation in the commodity in comparison to the expected levels in the absence of such practice;
4. the impact on the prices, quantities, outputs, quality, diversity, or innovation of commodities compared to the expected levels in the absence of the practice;
5. impact on consumer interests;
6. impact on freedom of import and export;
7. the extent to which the practice is consistent with the normal competitive behavior of firms in normal conditions of competition.[44]

This clause increases the objectivity and clarity of the legislation as it relatively restricts the GAC's discretion when making a decision on a possible anti-competitive practice, by providing clear criteria that shall be considered when evaluating the practice.

5.2.4.2 Exemptions

The Competition Law[45] empowered the GAC with the authority to approve any exemption requests by entities from articles (5), (6), and (7) of the Competition Law where prohibited anti-competitive practices are explicitly stated in articles 6 and 7, and the duty to pre-notify the GAC of any transactions that amount to economic concentration in article 7.[46] However, the Law did not give the GAC unlimited discretion to waive application of the articles. Instead, article 8 of the Competition Law restricted the GAC authority to exempt with two conditions.

The first condition is to ensure that the practice or transaction would 'lead to improved market performance, or improve the performance of entities in terms of the quality of the product or technological development or creative efficiency or both. The benefit of

[44] Article 11 of the 2019 Competition Implementing Regulations
[45] Article 8 of the Competition Law 2019
[46] Articles 6 and 7 regulate transactions and practices by entities with dominant position and entities seeking to participate in economic concentration transactions.

such exemption to the consumer should outweigh the effects of restricting the freedom of competition'.[47] The second condition imposed by the article is that a technical committee be formed by the GAC board of directors to evaluate the exemption request; and that the committee recommends the exemption.

To provide a recommendation on the request, the committee may: '1. conduct studies, collect information and data necessary for reviewing the exemption request, and interview parties and firms that may be affected by the exemption or those with potential interest therein, enable them to express their views, and review the documents submitted thereby; and 2. announce the request for exemption and its basic information for public consultation, which shall be received in writing within a specified period.'[48] Additionally, the Implementing Regulations allow any other governmental body to express its opinion on the exemption request.[49] This step provided by the new competition legislation increases the transparency of the GAC's role and encourages the participation of the public in the decision-making process.

Unlike some other laws and regulations in KSA,[50] these conditions imposed by the Competition Law increase the clarity of the Law and eliminate vagueness, as they explicitly state the grounds of the exemption and the articles that can be exempted from. The article also boosts fairness among entities, as the exemption will be granted based on a recommendation by a committee of experts, rather than exemption requests being approved solely at the unlimited discretion of the GAC with no clear conditions or grounds for exemptions.

In terms of the exemption decision duration, the Competition Law and Implementing Regulations did not specify the timeline for the GAC to review and make a decision on exemption requests. Instead, the assessment period will be decided by the GAC on a case-by-case basis.[51]

[47] Article 8 of the Competition Law 2019
[48] Article 29 of the Competition Implementing Regulations
[49] ibid
[50] For example, Article 6 of the M&A Regulations empowered the CMA with unlimited authority to exempt from all or some of the Regulations with no conditions or restrictions by the law. Discussed in chapter 4.
[51] Article 28 of the Competition Implementing Regulations

5.2.4.3 Dominant Position

Dominance means a scenario in which a corporate entity or several entities possess the capability to largely influence or control a significant market percentage within the commercial sector where the entity conducts its operations. Unlike the relatively restricted definition or interpretation of dominance under the repealed KSA Competition Law of 2004, the provision of the 2019 Law offers a wider understanding of dominance in the KSA jurisdiction.

A) Definition of Dominant Position:

Article 1 of the Competition Law defines a dominant position as follows: 'A situation in which an entity – or a group of entities – controls a certain percentage of the market where it operates or has influence, or both'. The article also granted the GAC the authority to determine, through the Implementing Regulations, the percentage that amounts to control and dominant position.[52]

B) How Dominant Position is Achieved:

The bases for dominant position assessment by the GAC are stipulated in article 10 of the Implementing Regulations. Dominance in the relevant sector is attained by meeting one or both of the following criteria. First, the determination of dominance is based on the evaluation of the market share which is conducted in the market where the corporate entity conducts its activities. Specifically, market share for dominance is capped at 40% of the relevant sector, whether this share is reached by a single entity or a group of entities that 'acts with a common will in committing the violation or causing the effect'.[53]

The second criterion in determining whether an entity is dominant is premised on the influence of the firm, whether it is the ability of a single entity or a group of entities that acts with a common will within the relevant market, such as the inherent ability of the entity to control pricing.[54] This article grants the GAC with wider discretion to categorise an entity or group of entities as being in a dominant position once the GAC detects a possible violation of the Competition Law due to the position of these entities. If the GAC chooses to adopt this

[52] Article 1 of the Competition Law: 'The Regulations shall determine such percentage in accordance with criteria approved by the Board'.
[53] Article 10(1) of the Implementing Regulations
[54] Article 10(2) of the Implementing Regulations

criterion to determine the dominant position, it should consider several guiding factors in its assessment. These factors include:

a. market share of a firm – or group of firms – and the market shares of competitors;
b. the actual or potential competition;
c. the growth in the supply and demand for the commodity;
d. the obstacles that limit or prevent competitors from entry, continuity, or expansion in the market;
e. the bargaining power of the client, including its purchasing power;
f. the accessibility of production inputs;
g. the financial and non-financial resources of the firm and its competitors;
h. economies of size and capacity available to the firm; and/or
i. Level of product differentiation.[55]

The recent reform of the Competition Law did not set a timeline to establish dominant positions, whereas the preceding Law stated that 12 months should be met to establish dominance.

C) Is holding a Dominant Position Always Prohibited by the Law?

Holding a dominant position is not prohibited by the Competition Law. The GAC will intervene and prohibit the dominance in instances where the dominant position is abused or leads to anti-competitive practices.

Article 9 states that that abuse of dominant position is prohibited.[56] The article also provides two examples of instances where dominance is deemed anti-competitive once they have occurred. The first instance is for the dominant entity to require an entity to refrain from dealing with another firm.[57] The second instance is when the dominant entity makes 'the sale of the commodity, or dealing therein, conditional upon assuming an obligation or accepting a commodity, which by nature or according to commercial use is not related to the commodity subject of the contract or the original deal'.[58] However, the concept and definition of the

[55] ibid
[56] Article 9(1) of the Implementing Regulations: 'No firm - or group of firms - with a dominant position in a relevant market may abuse such dominance, whether the purpose thereof prejudices competition or leads to actual or potential restriction thereof and whether such purpose is explicit or implicit.' In addition to this article, Article 11 will apply as it provided general guiding standards for the GAC when determining whether or not a practice is anti-competitive. Further discussion is provided in section 5.2.4.
[57] Article 9(2)(A) of the Implementing Regulations
[58] Article 9(2)(B) of the Implementing Regulations

abuse of dominant position is not stipulated in the Competition Law. The following subsection will discuss this concept.

D) The Concept of Abuse of Dominant Position:

The GAC is responsible for determining dominance and to prevent the market from anti-competitive practices arising from the abuse of a dominant position. However, neither the Competition Law nor its Implementing Regulations provided a clear definition of the abuse of dominant position.

Thus, looking for a definition of this concept in another more developed system can provide a better understanding of the concept. It can be referred to the definition in *Hoffman-La Roche v Commission*[59] due to the influence of the EU law on the creation of the KSA's Competition regime.[60] In this case, the concept of abuse of dominant position was defined as:

> An objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transaction of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition.[61]

5.2.5 Committee for the Resolution of Violations of the Law

In accordance with article 18 of the Competition Law, the GAC through its Chairman shall create a judicial committee consisting of five members for a renewable period of three years by a resolution of the GAC board. At least three of the members should be legal specialists. The role of the committee is to adjudicate violations of the Competition Law and its Implementing Regulations[62] and to impose penalties on violators.[63]

[59] Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461
[60] Alotaibi (n 27) 154
[61] Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461 para 91
[62] Except for violations committed by officials of the GAC, such as the breach of the conflict of interest rule.
[63] The committee's role, its creation process, and how it operates are stated in Article 18 of the Competition Law and Chapter 10 Articles 69 to 87 of the Implementing Regulations.

5.2.5.1 Proceedings and Decision of the Committee

The committee hearings are public.[64] However, the law granted the committee the discretion to determine whether or not the hearing should be held privately if it deems fit.[65] The author recommends that the grounds and criteria for holding a private hearing should be stated by the law to ensure transparency of the decision process to the public, and to ensure equality, as the committee will follow a unified approach for holding private hearings if clear grounds are provided by the law.

The proceedings and pleading before the committee shall be in writing.[66] The committee, however, can allow verbal arguments and statements.[67] According to article 80, all means of proof can be presented before the committee as evidence, such as e-mails, telephone recordings, and computer data.[68] The committee is empowered by the article with the authority to access confidential information and documents for adjudicating the case before it.[69]

Moreover, witnesses can be summoned by the committee when it sees fit.[70] The committee, whether on its own initiative or based on one of the case parties' requests, can also request that governmental agencies and other entities provide information and documents required to examine and give a ruling on the case.[71] The committee may also request experts and specialists' assistance while reviewing the case to adjudicate it.[72]

The committee's rulings and resolutions shall be by a majority[73] and the ruling should be reasoned[74/*75] However, there are a few translation issues in this regard. The majority

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[64] Article 76 of the Implementing Regulations
[65] ibid
[66] Article 77 of the Implementing Regulations
[67] ibid
[68] Article 80 of the Implementing Regulations
[69] ibid
[70] Article 81(1) of the Implementing Regulations
[71] ibid
[72] Article 81(2) of the Implementing Regulations
[73] Simple majority (three out of the five members)
[74] Reasoned decisions are considered a fundamental principle of a judicial ruling. A reasoned decision ensures to the case-parties and the public that the judgement is reached after due consideration of all relevant evidence, arguments, and materials. See: Anju P. Singh, 'Reasoned Decision: The Necessity and Importance to Achieve Transparent and Accountable Society' (2015) 3 Journal of National Law University Delhi 1, 163–181. <https://journals.sagepub.com/doi/abs/10.1177/2277401720150110?journalCode=jlub#:~:text=Reasoned%20decision%20is%20one%20of%20the%20facets%20of%20natural%20justice.&text=A%20statement%20of%20reasons%20in,reasons%20promotes%20good%20decision%20making.> accessed 10 January 2021. And: V S Chauhan 'Reasoned Decision: A Principle of Natural Justice' (1995) 37 Journal of the Indian Law Institute 1, 92–104. <www.jstor.org/stable/43951591>. accessed 10 Jan. 2021
[75] Article 18 of the Competition Law (Arabic version)

ruling condition is stated in the Arabic version of article 82 of the Implementing Regulations but not mentioned in its English version counterpart.[76] The reasoned decision requirement is stated only in the Arabic version.[77] This improper translation of the Law and its Implementing Regulations might lead to misinterpretation of the legislation by non-Arabic speakers.

The author recommends establishing a governmental ad hoc committee, consisting of legal experts and professional translators, with the purpose of reviewing and examining the translations of legislations enacted by all governmental entities to ensure the accuracy of the translated versions of the legislations by these entities. Ensuring well-translated legislations is integral in this unprecedented era where the country has made major reforms to attract foreign investors.

The decision of the committee is final unless parties appeal within thirty days from the date of notification of the Committee's decision, or from the date specified for delivering the decision to the parties.[78] However, unlike some other governmental agencies,[79] the law does not empower the GAC with an appeal committee. Thus, an appeal to the committee's decision can be filed before the competent court.[80] Giving the appeal option to a competent court can help prevent biased appeal decisions in cases where the appeal was before another GAC committee whose members were also appointed by the GAC.[81] This step can ensure the impartiality of the GAC decision process.

The Competition Law and its Implementing Regulations did not clarify whether the competent court decision is final or can be appealed. For example, if the committee's decision was appealed before the commercial court as a First Instance Court,[82] the law did not state whether the commercial court decision can be appealed before the Appellate Court.[83]

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[76] Although Article 18 of the Competition Law stated the majority requirement for making the decision in both versions.
[77] Article 18 of the Competition Law (Arabic version)
[78] Article 18(3) of the Competition Law, and Article 84 of the Implementing Regulations.
[79] For example, the CMA has two judicial committees, one of them being the Appeal Committee for the Resolution of Securities Conflicts. The committee is formed by a Council of Ministers' decision, and has three members representing different governmental agencies. Thus, once the appeal committee has made a ruling, it is final and cannot be appealed to another committee or court. This is discussed further in chapter 4.
[80] Article 18(3) of the Competition Law, and Article 84 of the Implementing Regulations.
[81] Unlike for example, the CMA appeal committee where its members appointed by the Council of Ministers. Discussed further in chapter 4.
[82] The KSA courts system is organised hierarchically as follows: The Supreme Court, Appellate courts, Courts of First Instance. Discussed in more detail in chapter 1.
[83] However, the Commercial Courts Law indicates that, generally, all decisions of the First Instance Court can be appealed to the Appellate Court. According to the Law: 'Where no special text is provided for, all judgments

Article 87 of the Competition Implementing Regulations states that 'As for cases not provided for in the Law or the Regulations or in the rules and instructions issued by the Board, the Committee shall apply the Law of Civil Procedures and its Implementing Regulations.'[84] Thus, it can be concluded from the Civil Procedures Law that the First Instance Court decisions can be appealed before the Appellate Court.[85] Moreover, according to the GAC committee's decision against BeIN Sports, the decision went through three stages, the GAC committee, the Administrative Court in its First Instance stage, then the Appellate stage.[86] Therefore, decisions of the competent court can also be appealed despite the absence of explicit articles in the competition legislations.

5.2.5.2 Rules of Leniency and Settlement

The new Competition Law introduced a novel principle to the KSA competition system through the new 'Rules of Leniency and Settlement' where violators of the law can apply to the GAC for leniency or settlement[87] instead of going through criminal proceedings before the GAC judicial committee.[88]

According to article 23 of the Competition Law, the GAC board of directors 'may decide not to refer to the Committee the entity in violation of the provisions of this Law, if such entity proactively provides evidence to reveal its partners in that violation. The Board may also accept a settlement with the violating entity. The Regulations shall specify the

and decisions issued by the court of first instance circuits are subject to appeal, with the exception of minor cases that do not exceed fifty thousand riyals, as determined by the Council.' Law of Commercial Courts 2020 Article 78.

[84] Article 87 of the Implementing Regulations

[85] Article 176 of the Law of Civil Procedures

[86] The GAC imposed penalties on BeIN Sports on 13/7/2020. The GAC concluded that 'BeIN Sports abused its dominant position through several monopolistic practices with respect to potential subscribers to an BeIN's exclusive sports broadcast bundle of the 2016 UEFA European Championship matches'. Details of the ruling can be found on the GAC website: <https://gac.gov.sa/PageNews_en.aspx?id=2383>

[87] Article 1 of the Implementing Regulations provided definitions of leniency and settlement. According to the Article, leniency is defined as 'An application whereby – If accepted by the Board – criminal proceedings shall not be initiated before the Committee, in a specified case, against the violating firm in the event that the firm hand over evidence that reveals, or could reveal, its partners in committing the violation, as prescribed by the Regulations and approved by the Board.' And settlement is defined as 'An application whereby – if accepted by the Board – criminal proceedings shall not be initiated before the Committee, in a specified case, against the violating firm in return for an amount to be paid by such firm, along with implementing any required measures, conditions, or pledges or paying any compensations to affected persons, as prescribed by the Regulations and approved by the Board.' The key differences are the amount that must be paid in a settlement agreement by the violator to the GAC, and the requirement for the violator to reveal its partners in the violation to the GAC to apply for the leniency request.

[88] The Committee for Adjudication of Competition Law Violations

necessary controls and requirements therefor, and the mechanisms for compensating aggrieved persons.'

It can be concluded from the Competition Law and its implementing Regulations[89] that certain conditions must be met to accept a request for leniency or settlement. Leniency requests can be accepted only by one applicant who first took the initiative to apply for leniency.[90] The applying entity for a leniency request is only eligible where it proactively 'provides evidence revealing – or is able to reveal – its partners in the violations of the provisions of the Law'.[91] For both leniency and settlement, requests cannot be accepted after the GAC has transferred the case to the committee for the resolution of violations of the Law to initiate criminal proceedings.[92] Moreover, any entity applying for leniency or settlement should cooperate with the GAC during the examination of the request and should rectify its situation by removing its violation of the law.[93]

Fulfilling these conditions means that the request can be reviewed by the GAC. However, it does not necessarily mean approval of the request. The GAC still has full discretion to approve the request or refuse it and transfer the case to its committee for the resolution of violations of the Law.

According to article 58, the GAC should notify the applying entity for leniency or settlement of the GAC decision on the request, or to inform it that the application is still under consideration, within a period not exceeding 120 days from the date of submitting the application.[94] This article can cause ambiguity, as giving the GAC unlimited authority to reply with 'application is still under consideration' can eliminate the purpose of this article, which is to provide applicants with a certain period of time when they can receive a decision on their requests. Considering that the GAC might face obstacles in certain cases that can hinder the decision process, the author recommends that the wording of this article be improved, and the vagueness removed by stating general and objective criteria that explain when the GAC can extend the period of reviewing the case.

[89] Rules of leniency and settlement are stated in Article 23 of the Competition Law and Articles 54–66 of the Implementing Regulations.
[90] Article 54(1) of the Implementing Regulations
[91] ibid
[92] Article 55 of the Implementing Regulations
[93] Article 60 of the Implementing Regulations
[94] Article 57 of the Implementing Regulations

To help in assessing leniency and settlement requests, article 56 of the Implementing Regulations provides the GAC with the authority to establish one or more, standing or ad hoc, advisory committees to examine these requests. These committees are not authorised to make a decision on the requests; rather, the role of the committees is solely to provide reasoned recommendations to the GAC board of directors who make the decisions on the requests.[95]

Article 61 of the Implementing Regulations provided guidance to the GAC on how to assess leniency and settlement requests. The GAC can consider extenuating circumstances when reviewing the application to make the decision. The article also provides examples of the extenuating circumstances that can be taken into consideration by the GAC. As stated in the article,

> The Board, for the purpose of accepting the request for leniency or settlement, and the Committee, when imposing penalties, may take into account extenuating circumstances of the case, including the firm's taking of preventive measures and procedures necessary to comply with the Law and the Regulations and raising the awareness of its staff. The firm may submit proof of its exercise of due diligence before the violation occurred.[96]

This article can minimise the number of entities violating the law, as it provides an opportunity to rectify their unlawful situation with lessened penalties. The article reveals a potential purpose of the newly introduced principle of Leniency and Settlement requests by offering a rectification opportunity to some entities who may violate the Competition Law unintentionally. For example, many companies may be confused about whether they should pre-notify the GAC before certain transactions such as takeovers.[97] Thus, this article can give companies who commit unintentional violations an opportunity for rectification, especially if the company succeeded in proving that it has taken preventive measures and procedures necessary to comply with the law.

[95] According to Article 56 of the Implementing Regulations, 'The Board may establish one or more standing or ad hoc committees to review the requests for leniency or settlement and the compensation of aggrieved persons. Such committee may hold discussions with the firms and request necessary reports and data. It may, upon examining the request for leniency, assess the evidence – and similar material – and its viability to uncover the violation. It shall submit its reasoned recommendations to the Board.'

[96] Article 61 of the Implementing Regulations

[97] Competition Law Workshop (Concept, Objectives, Prohibitions), 20 December 2020, attended by the author.

Once leniency or settlement requests have been approved by the GAC, two main consequences will follow. Firstly, any evidence revealing violations of the law proactively submitted by the applicant entity will be legally effective only against other violating entities associated with the applicant. This evidence will not be legally effective against the applicant who submitted it, whether or not the leniency request has been approved.[98] The purpose of this article is to encourage violators to rectify their position as they will be aware that they will be legally protected from any evidence they submit to the GAC. However, it should be noted at this point that this article will only apply if the evidence was provided by the applicant proactively and before referring the case to the GAC committee for adjudication of Competition Law violation.[99]

The second outcome of the approval of the requests by the GAC is that the case will not be transferred to the committee for criminal proceedings, although the GAC can still take measures against the approved entities in accordance with the Competition Law and its Implementing Regulations.[100] Examples of these measures are found in article 62, as the article stated that the entity benefitting from the settlement should pay an amount determined by the GAC board of directors.[101] The GAC can also require the entity, even after approval of the leniency or settlement, to compensate aggrieved parties who were damaged from the violation of the applicant entity.[102]

5.2.5.3 Rules for Compensating Aggrieved Parties

The purpose of these rules is to protect and compensate third parties who were damaged by the entity who violated the Competition Law in circumstances in which after, or during the reviewing process, the GAC has approved the entity's leniency or settlement request.[103]

According to article 64, compensation shall:

> apply only to complainants who file a specific complaint against a firm with which the Board accepts settlement. This shall include all persons who file a complaint relating to the case under review against the firm prior to the issuance of a decision

[98] Article 58 of the Implementing Regulations: 'GAC may use the evidence proactively submitted by a firm revealing their partners in the violation and consider such evidence as legally effective against firms – except the applicant firm, whether or not the Board accepts the leniency request.'
[99] Article 55 of the Implementing Regulations. Discussed in section 5.2.5.2.
[100] Article 62(1) of the Implementing Regulations
[101] Article 62(2) of the Implementing Regulations
[102] ibid
[103] ibid

accepting settlement therewith. GAC may request the aggrieved parties to provide proof of their harm to estimate the compensations within a period to be determined on a case-by-case basis, provided such period shall not in any way be less than 30 days.[104]

The GAC can withdraw the settlement decision if the entity did not provide evidence of its commitment to indemnify the aggrieved parties required by the settlement decision.[105] In addition to the GAC's role in protecting damaged parties and requiring the violating entities to compensate them, the law also granted aggrieved parties another opportunity to receive compensation by filing suits to courts. According to article 65, 'leniency or settlement with a violating firm shall not prejudice the right of third parties to claim damages from such firm, and the competent court shall decide thereon. The court may seek GAC's opinion in assessing the effects of the practice'.[106]

5.2.6 Conclusion

This section has provided an overview of the KSA competition system as well as a brief analysis of the Competition Law and the GAC's role as the supervisory authority for reforming and enforcing the Law. Various concepts and definitions of terms under the Competition Law have been illustrated in the section. This includes prohibited and anti-competitive practices, dominant position, and the judicial role of the Committee for the Resolution of Violations of the Law. These concepts and definitions were illustrated to provide an understanding of the main competition system principles and features before reviewing the takeover transactions in the competition context in KSA in the next section.

5.3 Competition Law in the Takeover Context

5.3.1 Introduction

This section will discuss the KSA's merger control system. First, the section will illustrate the scope of the Competition Law generally, and then specify its scope in the takeover context. The section will also analyse the 'economic concentration' concept in KSA and identify

[104] Article 64 of the Implementing Regulations
[105] Article 63 of the Implementing Regulations
[106] Article 65 of the Implementing Regulations

takeover transactions that fall under this concept and require GAC pre-approval. Finally, the section will discuss the process of the economic concentration requests and how they are examined and evaluated by the GAC before making decisions on these requests.

5.3.2 Scope and Jurisdiction of Competition Law

The Competition Law and its Implementing Regulations have a broad scope as they apply to all entities and individuals engaged in economic activities in KSA. The wording in the legislation stressed that the legal form of the entity, its nationality, and its ownership are irrelevant as it will fall under the authority of the Competition Law once the entity has engaged in any economic activity, including electronic platforms and applications, whether or not they are licensed to practise its activity.[107]

The recent reform of the Competition Law granted the GAC further power over other governmental agencies to apply the Competition Law and its Implementing Regulations to entities operating in a sector that is regulated by other governmental agencies, such as the information technology and pharmaceutical sectors.[108]

As stated in article 5(2) of the Implementing Regulations, 'Any conflict or overlap of jurisdiction with other governmental bodies arising from the implementation of the provisions of the Law shall not prejudice existing or future provisions of other laws. In such cases, GAC shall have the primary jurisdiction. This new clause empowers the GAC with jurisdiction in situations where conflict of competence occurs with other governmental agencies. In the takeover context, this clause is integral as it grants the GAC the primary jurisdiction in cases of conflict of jurisdiction with the CMA when examining a takeover transaction.

The scope of the legislation is extended to practices occurring outside the KSA, provided that the practice has an impact on competition in the country.[109] The Competition Law granted the GAC the discretion to make an assessment of whether the practice has an existent or potential impact on competition in KSA. Once the GAC has determined that there is an impact of that practice occurring in another jurisdiction on competition domestically, the

[107] Article 3 of the 2019 Competition Implementing Regulations
[108] Article 5 of the 2019 Competition Implementing Regulations; Baker McKenzie, 'Saudi Arabia Reforms its Competition Law – What is New?' <https://www.bakermckenzie.com/en/insight/publications/2019/11/saudi-arabia-reforms-competition-law>
[109] Article 3(2) of the 2019 Competition Implementing Regulations

GAC may take necessary procedures to prevent or mitigate the impact of the practice, including requesting those foreign competent authorities, especially competition authorities, to adopt the same procedures to prevent or mitigate the impact of the adverse practice.[110]

5.3.3 The Scope of the Competition Law in the Takeover Context

As illustrated in the Introduction to this chapter, competition laws have always been relevant to takeover transactions. The KSA takeover system is not an exception. Article 5 of the M&A Regulations stated that compliance with Competition Law and its Implementing Regulations is required for publicly-held corporations[111] once a takeover offer or transaction falls under the scope of the Competition Law. The notification and approval of these transactions by the GAC is required by the article.[112] The article also required the takeover offering company to state in its announcement whether the approval of foreign authorities, such as foreign competition authorities, is required.[113]

As a new concept presented in the 2019 Competition Law, the scope of the Competition Law, and the requirement to receive GAC approval, can apply to takeover transactions even if they occur in another jurisdiction, provided that the transaction 'have an adverse effect on fair competition within the Kingdom, in accordance with the provisions of the Law'.[114] This power given by the new law grants the GAC more authority to protect the market from anti-competitive practices. This approach is the norm among other competition authorities worldwide.[115]

The scope of the Competition Law, and the jurisdiction of the GAC, is extended to all forms of corporate restructuring activities, once the activity is determined as an economic concentration,[116] including mergers, acquisitions, strategic alliances, and joint ventures. The GAC took a valuable step when amending the previous law, as the new Competition Law explicitly identified acquisitions as transactions that fall under the scope of the Law, whereas

[110] ibid
[111] The M&A Regulations are exclusively applicable to companies that are publicly listed. Nevertheless, the applicability of the Competition Law and its Implementing Regulations extends to all takeover transactions falling within its scope of application.
[112] Article 5 of the M&A Regulations
[113] ibid
[114] Article 3(b) of the Competition Law
[115] Palmigiano (n 6) para 4
[116] Defined in the next paragraph.

in the previous law the word 'acquisition' was not stated, which caused confusion and ambiguity as to whether the law applied to mergers only or to acquisitions as well.[117]

Thus, all takeover transactions that lead to economic concentration will fall under the scope of the Competition Law and require the pre-approval of the GAC. Economic concentration is defined by the Implementing Regulations as:

> Any action that results in a total or partial transfer of ownership of assets, rights, equity, stocks, shares, or liabilities of a firm to another by way of merger, acquisition, takeover, or the joining of two or more managements in a joint management, or any other form that leads to the control of a firm(s) including influencing its decision, the organization of its administrative structure, or its voting system.[118]

More in-depth discussion of economic concentration, triggering amount, and standards to determine the economic concentration is provided in the next subsections.

5.3.4 Economic Concentration

High economic concentration simply implies that large parts of economic assets within a given economy are controlled by a small group of business entities.[119] The effects of high levels of aggregate concentrations in an economy are a major concern of several jurisdictions across the globe.[120]

Large conglomerates can have a significant effect on welfare and competition. On the one hand, such conglomerates can improve competitive pressures to enhance the effectiveness of service delivery and consumer satisfaction.[121] In other words, there are instances in which economic concentration benefits consumers. For example, in industries with low or moderate initial concentration that are more exposed to international trade and face more import competition, an increase in concentration can increase aggregate welfare.[122] KSA

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[117] Mulhim Hamad Almulhim, 'A Critique of Saudi M & A Laws' (2016) 134 <https://elibrary.law.psu.edu/sjd/2/>. The definition section in Article 1 of the 2019 Competition Implementing Regulations stated the word 'acquisition' in the definition of economic concentration.
[118] Article 1 of the 2019 Competition Implementing Regulations
[119] OECD website: <https://www.oecd.org/daf/competition/market-concentration.htm>
[120] Michal S Gal and Thomas K. Cheng, 'Aggregate Concentration: A Study of Competition Law Solutions' (2016) 4 Journal of Antitrust Enforcement 2, 283 <https://academic.oup.com/antitrust/article/4/2/282/2196294> accessed 15 Dec 2020
[121] ibid
[122] Rigoberto A Lopez, Elena Lopez and Carmen Lirón-España, 'Who Benefits from Industrial Concentration? Evidence from U.S. Manufacturing' (2014) 14 Journal of Industry, Competition and Trade 303, 303

Competition Law places a lot of emphasis on the wellbeing of consumers and thus there is a possibility that economic concentration can be authorised when such concentration benefits consumers. Large conglomerates strengthen competition pressures and improve consumer satisfaction because, through their varied experiences and extensive resources, they can easily and readily enter markets compared to other smaller firms.[123]

On the other hand, economic concentration by large conglomerates can lead to adverse effects on competition in the market. Oligopolistic coordination resulting from economic concentration can have a bad effect on the market environment by limiting competition, causing the exploitation of customers, damaging productivity, and expanding inequality.[124] Economic concentration can also hinder the entry of new competitors into the market, a factor that can hinder innovation and cause poor utilisation of resources.[125]

The fact that the KSA's new Competition Law specifically identifies economic concentration as an issue that needs regulating shows that the GAC is aware of the negative effects of this phenomenon. KSA cannot achieve its Vision 2030 if it does not support the entry of new firms into the market, as such entry is important in creating a modern economy driven by innovation. The new Competition Law thus aims to regulate how large conglomerates operate in the market environment by ensuring that their desire for economic concentration does not run counter to the country's move towards a modern economy that is sustainable.

5.3.4.1 The KSA's Competition Law Definition of Economic Concentration

The KSA Competition Law and its Implementing Regulations define and address issues relating to economic concentration in several articles.[126] Economic concentration is defined as

> Any action that results in a total or partial transfer of ownership of assets, rights, equity, stocks, shares, or liabilities of a firm to another by way of merger, acquisition,

<https://www.researchgate.net/publication/257580269_Who_Benefits_from_Industrial_Concentration_Evidence_from_US_Manufacturing>. accessed 20 March 2023

[123] Mor Bakhoum, 'Abuse without Dominance in Competition Law: Abuse of Economic Dependence and its Interface with Abuse of Dominance' in *Abusive Practices in Competition Law* (Edward Elgar Publishing 2018) 19

[124] OECD website: <https://www.oecd.org/daf/competition/market-concentration.htm>

[125] ibid

[126] Articles 7-11 of the Competition Law. And articles 12-25 of the Implementing Regulations.

takeover, or the joining of two or more managements in a joint management, or any other form that leads to the control of a firm(s) including influencing its decision, the organization of its administrative structure, or its voting system.[127]

According to this definition, any takeover transaction will be considered an economic concentration transaction from the GAC and Competition Law point of view. However, economic concentration is not necessarily considered an anti-competitive practice nor is it prohibited by law. The Competition Law identifies certain situations and sets a specific threshold at which GAC approval is required for economic concentration parties prior to the completion of a transaction. The following subsections will discuss the pre-takeover notification for the GAC and the threshold set by the law.

5.3.4.2 Pre-takeover Notification

Merger control regulations and competition authorities around the globe tend to set thresholds to control takeovers and prevent concentrating transactions that might reinforce a firm's market power; once these thresholds have been reached, the takeover parties must notify and receive pre-approval for the transaction by the relevant authority which examines the transaction to ensure that the transaction does not have anti-competitive influence on the market.[128] The KSA regulations prescribe pre-takeover notification and approval by the GAC which should occur by written notice within sixty days preceding the completion of the takeover operation.[129]

[127] Article 1 of the Implementing Regulations. The same article also provided definitions of economic concentration parties, the term being defined as 'Firms engaged – or seeking to engage –- in an economic concentration transaction, whether or not they have applied for approval to complete the economic concentration'. And it defined parties related to an economic concentration as: 'Parties affected by economic concentration, including competitors, customers, suppliers, distributors, and stakeholders'.

[128] Practical Law's website, Thompson Reuters, list of merger control threshold around the world. Available at <https://content.next.westlaw.com/2-557-0145?__lrTS=20210103163607387&transitionType=Default&contextData=(sc.Default)&firstPage=true>

[129] Article 7 of the Competition Law: 'Entities seeking to participate in an economic concentration transaction must inform GAC at least ninety (90) days before completion if the total annual sales value of the entities seeking to participate in the economic concentration exceeds the amount determined by the Regulations.'

5.3.4.3 The Triggering Threshold

The latest reform of the Competition Law in 2019 presented a new principle in determining the triggering threshold for concentrations that require GAC pre-notification. The new reform incorporates a turnover-based threshold in line with international standards.[130] Under the new Law, any organisation planning to engage in an economic concentration must notify the GAC prior to completing the transaction if the cumulative annual amount of revenue of the participating entities exceeds one hundred million Saudi Riyals (SAR 100,000,000) during the previous fiscal year.[131] The new Competition Law and its Implementing Regulations did not indicate whether the threshold is domestic or worldwide. Thus, in the absence of such an indication, the threshold should be interpreted as a total global turnover amount.

Accordingly, any takeover transactions, whether these transactions take place in the KSA or abroad,[132] are subject to GAC approval once the threshold amount is triggered. There are two possible exceptions stated in the Law from the requirement to report an economic concentration. The first one, for wholly-owned state entities, required that 'it is solely authorised by the Government to provide a commodity in a particular field. Such exception shall be effective only by a royal order or decree, a Council of Ministers' resolution, or a high order exclusively authorizing such establishment or company thereto'.[133]

The second exemption from reporting an economic concentration request is when entities apply for an exemption to the GAC in accordance with article 8 of the Competition Law. By virtue of this article the GAC may exempt these entities from reporting an economic concentration if the GAC decides that the exemption will lead to improved market performance and will not cause adverse results to the competition.[134]

Prior to the new Competition Law reform, its predecessor did not set a turnover-based threshold. Instead, the Law required entities planning to perform a takeover transaction to

[130] Practical Law's website, Thompson Reuters, list of merger control threshold around the world. Available at <https://content.next.westlaw.com/2-557-0145?__lrTS=20210103163607387&transitionType=Default&contextData=(sc.Default)&firstPage=true)>
[131] Article 12(1) of the Implementing Regulations
[132] Provided that the transaction is determined to have in impact on competition in KSA by the GAC. Discussed in section 5.3.2.
[133] Articles 4(1) and (2) of the Implementing Regulations. The exemption of state-owned companies from the Competition Law is discussed in more detail in section 5.2.2.
[134] The exemption requests are discussed earlier in more depth in section 5.2.4.2.

notify the GAC if the transaction would lead to a dominant position.[135] In other words, dominance was the determining factor for whether a takeover transaction required GAC pre-notification for the transaction. Adopting the turnover-based threshold in the new Law provides more clarity to companies and market participants because using dominance as the sole determining factor for the pre-notification may cause difficulties for the takeover parties in terms of identifying whether the outcomes of their transaction will amount to the 40% dominance threshold in the relevant market. Moreover, adopting the turnover-based threshold in line with international standards can improve the Competition Law and encourage foreign companies to participate in the KSA market.[136]

To sum up, the new Competition Law adopts a turnover-based threshold as a sole triggering event that requires the GAC approval prior to takeover transactions where the total annual sales value of the takeover participating parties exceeds SAR 100,000,000.

5.3.4.4 Unreported Economic Concentration Transactions

The GAC has the authority to supervise takeover transactions, and any transaction that the GAC classifies as concentrations, even if these were not reported by the takeover parties. The GAC can prevent unreported takeover transactions, and compel the companies who completed the transactions to restore their previous status and terminate the takeover transaction. As stated in **a**rticle 17:

> Without prejudice to the Law, the failure of the parties to an economic concentration to duly report such concentration shall not preclude the right of GAC to initiate an examination and evaluation of the economic concentration, whether prior to or following completion thereof. If the firms have completed the economic concentration after reporting it but before the issuance of a decision thereon or the lapse of the statutory period for review, the Board may require said firms to restore their previous status and terminate the economic concentration within a specified period. Firms shall

[135] However, even though dominance is no longer a definite and automatic trigger for economic concentration, the GAC may consider dominance as a factor when undertaking assessments of economic concentration transactions. See Article 22 of the Implementing Regulations.

[136] See, for example, the EU threshold for merger control, Practical Law's website, Thompson Reuters, available at <https://uk.practicallaw.thomsonreuters.com/6-578-2386?__lrTS=20200315045336968&transitionType=Default&contextData=(sc.Default)&firstPage=true>; and Practical Law's website, Thompson Reuters, list of merger control threshold around the world. Available at <https://content.next.westlaw.com/2-557-0145?__lrTS=20210103163607387&transitionType=Default&contextData=(sc.Default)&firstPage=true>

comply therewith and incur the damages arising from the completion of the economic concentration in this case.[137]

5.3.5 Process of the Economic Concentration Request

5.3.5.1 Documents to be Submitted

Companies that intend to participate in a takeover transaction that meets the concentration threshold must submit certain documents to the GAC as a first step towards obtaining approval for the transaction. The duty of submitting these documents lies on the economic concentration parties. Article 1 defines economic concentration parties as 'Firms engaged – or seeking to engage – in an economic concentration transaction, whether or not they have applied for approval to complete the economic concentration'.[138]

Article 19 illustrates the required documents for the request, and the condition that must be met for the request to be deemed complete and legally effective. According to the Article, the following information must be provided in the request to describe:

a. the basic information on the economic concentration transaction and parties thereto;
b. relevant sectors and markets;
c. potential impact of the economic concentration transaction on competition in general;
d. key clientele; and e. key competitors.[139]

Additionally, concentration parties should provide the GAC with any other documents or information that the GAC requires to examine the economic concentration request.[140]

The regulations also state that conditions must be met to consider the request legally valid and completed. These conditions are as follows:

1- The reporting shall be made at least ninety (90) days prior to completion of the economic concentration, which starts from the date GAC notifies the applicant that the reporting is complete, upon satisfying the conditions and providing the

[137] Article 17 of the Implementing Regulations
[138] Article 1 of the Implementing Regulations
[139] Article 14(4) of the Implementing Regulations
[140] Article 14(5) of the Implementing Regulations

information and documents required, without prejudice to its right to request information and documents necessary for the review of the economic concentration.

2- Filling in and attaching the relevant forms, including a full explanation of all the required documents and a statement of the accuracy of the data and attachments.

3- Payment of the prescribed fees for examining the economic concentration, in accordance with the procedure determined by GAC.[141]

5.3.5.2 Procedures for Inquiry, Gathering of Evidence, and Investigation

The new Competition Law grants the GAC broad power to supervise and investigate takeover transactions and other economic concentration transactions. Whether or not takeover parties have submitted a pre-notification request, the GAC may now request records, documents, and data, as well as the opportunity to inquire about and visit the premises of parties or entities that may be affected by the proposed transactions, such as suppliers and competitors.[142]

The new Law provides officials of the GAC with broad powers to enter premises during business hours, inspect books and records, and make copies. These officials also have the authority of judicial investigators and will be able to help competition cases in any way they see fit, including using e-mails and telephone recordings.[143] The GAC's officials also have the right to investigate and question current or former owners of the entities, directors, and employees[144] when performing their duties and may seek the assistance of competent authorities, including security authorities.[145]

5.3.5.3 Public Opinion

According to article 21, the GAC may seek public opinion on the concentrations. As stated in the article,

> GAC may ask the public to express opinion on an economic concentration transaction by publishing basic information thereof in any appropriate media. GAC shall

[141] Article 14(1,2, and 3) of the Implementing Regulations
[142] Article 20 of the Implementing Regulations
[143] Article 38(4) of the Implementing Regulations
[144] Article 38(2) of the Implementing Regulations
[145] Article 37(4) of the Implementing Regulations

> determine at the time of publication the period for reception of such views on a case-by-case basis, and it may adopt and rely on whatever opinion it deems appropriate upon examination of the economic concentration.[146]

However, this is a discretionary option as the article does not make this step compulsory for the GAC. Neither the Law nor the Regulations provide conditions or guidance on whether or not an economic concentration request should be published to seek public opinion.

5.3.5.4 Evaluation and Decision

A) Assessment of Economic Concentration Transactions:

When evaluating takeover and other economic concentration transactions, the GAC aims to ensure that fair competition is achieved in the KSA's markets. The law provides several factors for the GAC to consider when assessing a concentration request to ensure that the proposed transaction does not have a negative influence on competition in the relevant market. These factors are as follows:

1. Structures of relevant markets and the level of actual or potential competition between firms inside the Kingdom or abroad, in cases where it has an impact on local markets.

2. Financial positions of the parties to an economic concentration.

3. Commodity alternatives that are available to consumers, vendors, and clients and how accessible such alternatives are.

4. Level of product differentiation.

5. Consumer interests and welfare.

6. Potential impact of the economic concentration on prices, quality, diversification, innovation, or development in a relevant market.

[146] Article 21 of the Implementing Regulations

7. Actual or potential harm or benefits to competition from the economic concentration transaction.

8. Supply and demand growth and trends in the relevant market and commodities.

9. Barriers to entry or exit of new firms into a relevant market, their continuation therein, or expansion, including regulatory barriers.

10. The extent to which an economic concentration may create or strengthen a significant market power or a dominant position of a firm – or group of firms – in any relevant market.

11. The level and historical trends of anti-competitive practices in a relevant market, either for the parties to an economic concentration or the firms influential in such market.

12. Views of the public, economic concentration-related parties, and sector regulators.[147]

B) Issuing the Decision:

Once the GAC notifies the parties of the concentration of receiving a completed request of the concentration, the GAC should issue its decision within a period not exceeding 90 days from the notification date.[148] The GAC decision could take one of the following forms: approval of the request, conditional approval, or rejection of the request.[149] However, the decision of conditional approval and rejection must be reasoned by the GAC.[150]

C) Notification of the Decision

According to article 24, 'GAC shall notify the applicant of the decision issued with regard to the economic concentration prior to the expiry of the 90 days prescribed for examining the economic concentration in accordance with the provisions of the Law and the Regulations. GAC may announce it to the public.'[151]

[147] Article 22 of the Implementing Regulations
[148] Article 23(1) of the Implementing Regulations
[149] ibid
[150] ibid
[151] Article 24 of the Implementing Regulations

The author believes that this article could be amended to increase transparency in the market, as the article confers upon the GAC unrestricted authority to disseminate and declare its determination to the public. The article may provide conditions and factors that, having once occurred, the GAC may not make the decision public. For example, if publishing the decision is likely to negatively influence the relevant market or competition, the GAC may not publish its decision.

5.4 Chapter Conclusion

In conclusion, this chapter has provided a background for the KSA competition system and the role of GAC as the supervisory competition authority. The chapter discussed and illustrated how takeover transactions in KSA overlap with the Competition Law and the GAC's jurisdiction by analysing the merger control system embodied in the Competition Law. The analysis mainly focused on defining the concept of economic concentration as the cornerstone of merger control and identifying the threshold set by the law that triggers the concentration situation. The chapter argued that abuse of dominant position is neither defined nor clearly explained in the KSA's legislation, and recommended reforms aimed at defining this important concept by looking for a definition in another more developed system that can provide a better understanding of the concept. Moreover, the GAC pre-notification requirement for takeover transactions and the process and assessment of the request have been discussed in the chapter. This chapter analysed the role of the semi-judicial committee (Committee for the Resolution of Violations of the Competition Law), which is authorised to adjudicate disputes related to the Competition Law.

The chapter suggested recommendations for future reforms of the Competition Law in areas related to takeovers, considering that reforming competition regulations is essential for takeover reforms. The purpose of this chapter is to provide an understanding of the integral role of competition law in the takeover context. An example of this importance was illustrated by Article 5(2) of the Competition Implementing Regulations, which grants the GAC the primary jurisdiction in cases of conflict of jurisdiction with the CMA when examining a takeover transaction. Thus, the examination of the competition law in this chapter serves as an essential step before addressing other takeover regulatory issues such as minority shareholders' protection and directors' duties in takeovers in the following chapters.

Chapter 6. Minority Shareholders' Protection in Takeovers

6.1 Introduction

This chapter will provide an overview of the importance of protecting minority shareholders in takeovers, considering their vulnerable position in change-of-control transactions and the high possibility of conflict of interest in these situations. The chapter will focus on protective rules in takeovers in KSA that require reforms to enhance the protection of minority shareholders in the country. The ownership structure in KSA and the principle of the separation of ownership and control will be considered as important factors against which to analyse the minority shareholders' protection rules. Moreover, the level of protection of minority shareholders in KSA will be assessed along with recommendations to reform important tools that provide protection to minority shareholders in takeovers, such as the mandatory bid rule and the sell-out rule.

The chapter will attempt at some points to balance the shareholders' protection with market needs for flexible regulations to promote the economy, by recommending adoption of the squeeze-out rule.

6.2 Shareholders' Protection

6.2.1 Importance of Minority Shareholders' Protection

Trade barriers appear to be disappearing as a result of globalisation effects. Investors can now effortlessly transfer funds from one country to another in order to acquire shares in a variety of companies. Thus, in order to attract both foreign and local investors, it is increasingly necessary for countries to consider adopting sophisticated rules and reforming their legal systems. Indeed, considering that minority shareholders' protection is an essential element of sound corporate governance,[1] effective regulations that provide protection to minority shareholders assist young firms to attract investors, to raise capital and promote economic development.[2]

[1] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) LII The Journal of Finance 52 773 <https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.1997.tb04820.x> accessed 1 April 2022

[2] ibid 772

In the takeover context, effective minority protection is even more necessary. In general, there is a formal separation of ownership and control in most listed companies.[3] This separation can increase agency costs and enable directors who control companies to exploit minority shareholders' rights by rejecting beneficial bids in the absence of strong legal protection, or profit from these bids in a way that is harmful to the shareholders.[4] Exploitation in takeovers can also be effected by a controlling shareholder, especially in concentrated ownership companies, in the absence of legal tools that protect minority shareholders in this vulnerable position.[5]

6.2.2 The Principle of Equal Treatment

The principle of equal treatment among shareholders lies at the heart of shareholders' protection laws. One of the primary goals of the M&A regulations is to ensure that all shareholders are treated fairly and equally and are not denied the opportunity to decide on the merits of a takeover bid. Ensuring equitable treatment of shareholders is a primary principle that underpins the framework of the M&A regulations in KSA and is covered by the General Provisions in article 3. As stated in the article: 'In the case of an Offer, all shareholders of the same class of an Offeree Company must be treated equally by an Offeror'.[6]

Under the M&A Regulations, the principle of equal treatment for all shareholders comes in several forms. The regulations stress the significance of the information equality that must be delivered to all shareholders. Directors of the offeree company and the offeror must give sufficient information to the shareholders to allow them to reach a properly informed decision.[7] All shareholders should have equal and sufficient time to consider the offer, and no relevant information should be withheld from shareholders.[8] The Regulations also prohibit directors of the offeree company and the offeror from providing information to some shareholders which is not readily made available to all shareholders.[9]

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[3] Separation of ownership and control is discussed in section 6.2.3.
[4] Shleifer and Vishny (n 1) 756
[5] Rafael La La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Corporate Ownership around the World' (1999) 54 The Journal of Finance 473 <https://www.jstor.org/stable/pdf/2697717.pdf?refreqid=search%3Aef384b9fe3451d793d33f1062df7b6fe> accessed 1 April 2019
[6] Article 3(c) of the M&A Regulations 2018
[7] Article 3(h) of the M&A Regulations 2018
[8] ibid
[9] Article 3(e) of the M&A Regulations 2018. Exceptions to this prohibition are specified in the article: 'This principle does not apply to the following:1) the furnishing of information in confidence by the Offeree Company

Furthermore, to achieve equality among shareholders, there are several obligations on the offeror to ensure that equivalent offer value is extended to all shareholders of the same class. These obligations aim to prevent value bias and discrimination between shareholders who received payments from the offeror who is accumulating large securities before launching a formal bid, and the other shareholders.

According to the M&A Regulations, if an offeror has purchased shares in the target company within a three month period before the start of the offeror's announcement to launch a bid, the offer to the shareholders of the same class shall not be of less value than the value paid prior to the announcement of the bidder's intention to make the offer.[10] If the offeror secures any shares in the offeree company after the announcement of the bid intention and until the end of the offer period, the bid price shall not be of less favourable value than the highest premium paid to the shares purchased during that period.[11] Another form of equality in the price paid to target shareholders is illustrated in the mandatory bid rule which is discussed in detail in this chapter.

6.2.3 The Principle of Separation of Ownership and Control

In widely held companies, unlike most other forms of business entities, ownership of the company is formally separated from its control. This means that the shareholders as 'owners'[12] of the company have no power to control the company's day-to-day affairs or its long-term strategies. Instead, directors who were elected by the shareholders 'control' the company and manage its operations on behalf of the shareholders. The separation of ownership and control in public companies is a principle that has been well established and widely discussed in corporate law.[13]

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to a bona fide potential Offeror or vice versa in the context of an Offer; or 2) the furnishing of information in confidence by the selling shareholder and/or Offeree Company to an Offeror in the context of a Private Transaction.'

[10] Article 20(a) of the M&A Regulations 2018

[11] Article 20(b) of the M&A Regulations 2018

[12] The term 'owners' is used here for illustration. Shareholders do not own the company; instead, they own shares that give them rights such as votes. See: Chassagnon Virgile and Hollandts Xavier, "Who Are the Owners of the Firm: Shareholders, Employees or No One?" (2014) 10 Journal of Institutional Economics 47< https://www.cambridge.org/core/journals/journal-of-institutional-economics/article/abs/who-are-the-owners-of-the-firm-shareholders-employees-or-no-one/587374B0969C7F1A3566F70D97732399> accessed 20 March 2023

[13] See for example: Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (1932); Eugene F Fama and Michael C Jensen, 'Separation of Ownership and Control' (1983) 26, 301, 304 <https://www.jstor.org/stable/725104?seq=1#page_scan_tab_contents> accessed 20 February 2022.

In the US, at the beginning of the last century and in the following decades, significant technological advancements, particularly the development of modern mass-production techniques, provided significant advantages to companies large enough to accomplish economies of scale, resulting in the formation of massive industrial companies.[14] These companies needed vast sums of money, far beyond the financial ability of most individuals or families.[15] These giant corporations were funded by pooling a large number of small investments, which was done by selling shares to a large number of investors, each of which owned a small portion of the company's shares.[16] Therefore, separating ownership and control has been considered a necessary precondition of companies' success.[17]

Although on the one hand, this separation of ownership and control may enhance the productivity and performance of companies, as it will arguably be managed by expert managers for the benefit of the company as a whole, this separation, on the other hand, can create a major dilemma, which is the agency problem that has been extensively discussed among scholars.[18]

The agency relationship refers to a situation where the directors control the company as a result of a diffused ownership and shareholders' passivity, and those directors may not always act in the best interest of shareholders, especially in a conflict-of-interest situation.[19] Thus, the principal (shareholders) needs to monitor the agent (directors) to ensure that the latest actions and decisions are for the benefit of the shareholders and the company as a whole.[20] This monitoring role is referred to as agency costs.[21]

It is noteworthy that most studies of the agency problem were based on diffused ownership structure markets, such as those of the UK and US, and in developed countries. Therefore, when looking at the separation of ownership and control from the agency theory

[14] Stephan M. Bainbridge, *Mergers and Acquisitions* (3rd edn, Foundation Press 2012) 12
[15] ibid
[16] ibid
[17] ibid
[18] See for example: Michael C Jensen and William H Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, vol 3 (Q North-Holland Publishing Company 1976) <https://ac.els-cdn.com/0304405X7690026X/1-s2.0-0304405X7690026X-main.pdf?_tid=52c36b79-97bc-43d0-86b3-c02fd40021b6&acdnat=1553118698_5173272fee9530746e7145c8a5025a9d> accessed 20 March 2019; Eugene Fama, 'Agency Problems and the Theory of the Firm', in *The Economic Nature of the Firm: A Reader* (3rd edn, vol 88 (1980) <https://about.jstor.org/terms> accessed 20 March 2019; Mark J Roe, *Strong Managers Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1994) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2310710>.
[19] Fama and Jensen (n 13) 304
[20] ibid
[21] Agency theory is discussed in further detail in chapter 2 (Corporate governance and ownership structure).

perspective, it is essential to consider two important elements. The first aspect of the market under study that needs to be considered is its ownership structure, as the agency parties can vary depending on the ownership structure, as will be illustrated in this section. The second factor is the level of development of the legal system where the market operates, considering that weak or less developed legal systems can fail to provide legal solutions to the agency problem.

Indeed, the influence of ownership structure on the level of separation of ownership and control was recognised by the famously influential study by Berle and Means, which has been widely associated with the issue of separation of ownership and control.[22] According to the study, public companies were divided into three categories based on the ownership structure that determines the level of the separation of ownership and control.

The first category is majority control. In this type of company, a dominant shareholder, or a group of shareholders acting in concert,[23] own more than 50% of the company's voting shares. Majority controlled companies have a partial separation of ownership and control; and minority shareholders participate in the ownership of the company, but not in its control.

The second category is the minority-controlled companies where a dominant shareholder, or a group of shareholders acting in concert, owns less than 50% of the company's voting shares, but is able to exercise de facto control over the company. Their ability to attract sufficient proxies from dispersed shareholders, in addition to their significant minority interest, allows them to control a majority of the votes on special and ordinary resolutions. In this category, separation of ownership and control is also partial, and minority shareholders do not participate in the company's control, but only have a share in its ownership.

Management control is the third category identified by Berle and Means. In this category, the ownership in these companies is widely diffused so that no one shareholder, or group of shareholders acting in concert, holds even a minority stake large enough to influence the decisions of the board or achieve control by using the voting power of the shares. Management-controlled companies represent a complete separation of ownership and control.

[22] Berle and Means (n 13) 70-90
[23] Acting in concert is defined and discussed in section 6.4.5.

Indeed, considering that market features can vary widely between different countries, ownership structure can influence the level of separation of ownership and control in each market. In countries where ownership structure is mostly diffused, the third category (managerial control) is the most common, examples being the markets in the UK and US. In these types of markets, where there is a complete separation of ownership and control, agency problems mostly occur between managers who control the company, and its shareholders.

In KSA, although all the categories identified by Berle and Means can be found in the listed companies, the second category (minority-controlled) is the most common in the KSA market.[24] This means that a single minority shareholder, or group of shareholders acting in concert, who owns less than 50% of the company's shares, is able to exercise de facto control over the company; and separation of ownership and control is partial. Therefore, minority shareholders share in the ownership of the company but not its control. Consequently, the concept of the agency problem can shift because of this ownership structure. The agency problem can occur between the controller of the company, the minority stakeholder (not the directors in this case), and the remaining block of shareholders who each own a minority stake. This illustrates the importance of regulations that protect minority shareholders, not only from directors, but also from the de facto controller of the company, namely the blockholder.[25]

6.2.4 Principle of Shareholder Decision-making

As a result of the separation of ownership and control in listed companies as illustrated in the previous subsection, a question can arise about who makes the decisions of the company. In principle, the decision-making is in the hands of the owners of the company, i.e., the shareholders. The role of the directors as agents of the shareholders is to perform and execute the instructions of the shareholders. However, in listed companies, the company is a legal entity separate from its shareholders. In this case, directors are agents of the company and owe their duties to the company as a whole, and primarily act for the interest of the company and not necessarily of the shareholders.[26] In most listed companies, the size of the firm is

[24] More detail on the KSA listed companies' ownership structure provided in sections 6.3 and 6.4.4.2.
[25] See for example: La Porta, Lopez-De-Silanes and Shleifer (n 5) 511. According to La Porta et al., 'These controlling shareholders are ideally placed to monitor the management, and in fact the top management is usually part of the controlling family, but at the same time they have the power to expropriate the minority shareholders as well as the interest in so doing.'
[26] Directors' duties are discussed in detail in the next chapter.

huge in terms of the number of investors, amount of capital, number of employees, and number of daily tasks and decisions. Thus, conferring the decision-making power on a board of directors and managers, who are elected by the shareholders, can prevent the chaos that would result from shareholder participation in day-to-day decision-making, and can increase the efficiency of making decisions.[27]

Nevertheless, company laws and regulations generally give the shareholders the power to participate in the decision-making process by exercising their voting rights in general meetings. Moreover, laws confer the power of decision-making on the shareholders regarding significant corporate decisions. For example, in the case of a takeover bid, many jurisdictions, such as the KSA and the UK, confer the power to decide on the merits of the bid on the shareholders, and prohibit the board of directors from rejecting the bid without the approval of the shareholders in the general meeting.[28] The role of the directors, in this case, is to provide shareholders with advice and information to enable them to make properly informed decisions.[29]

In practice, in diffused ownership markets, such as those of the UK and US, where big companies have no blockholder(s), a complete separation of ownership and control would probably lead to the passivity of the investors, passing control and most decision-making to directors.[30] Consequently, senior 'managers dominate their boards by using their de facto power to select and compensate directors and by exploiting personal ties with them'.[31] This is referred to in the literature as the managerialism problem, leading in turn to the agency problem where the interest of owners and managers may, and often do, diverge.[32]

To tackle the managerialism and agency problems, several corporate solutions are presented in several corporate governance systems. For example, several laws require the presence of independent non-executive directors in response to the potential divergence of shareholders' and managers' interests, considering that the role of the non-executives is to

[27] Bainbridge (n 12) 12
[28] Article 3(j) of the M&A Regulations 2018, and Rule 21 of the UK Takeover Code
[29] The role of directors in takeover bids is discussed in chapter 7.
[30] Mark J Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (1995) 4
[31] Barry Baysinger and Robert E Hoskisson, 'The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy' 15 The Academy of Management Review (1990) 72, 72 <https://www.researchgate.net/publication/230996310_The_Composition_of_Boards_of_Directors_and_Strategic_Control_Effects_on_Corporate_Strategy> accessed 25 March 2022
[32] Jensen and Meckling (n 18) 308

provide objective criticism to the board.[33] Moreover, some laws attempt to align the interest of shareholders with management by imposing tax requirements that encourage directors to own a larger percentage of the company's shares.[34]

Several legal and judicial remedies can also provide minority shareholders with protection from managers' exploitation. For example, in a case of a takeover bid where the interest of shareholders and management can potentially diverge, many jurisdictions adopt the approach applied by the UK Takeover Code, which provides protection to shareholders by granting them the authority to decide on takeover bids.[35] This is achieved by imposing restrictions on the management against refusing the bid or adopting bid-frustrating strategies.[36] Moreover, many jurisdictions provide judicial options to protect shareholders, such as the unfairly prejudicial remedy and the derivative claim that will be discussed in chapter 7.

6.2.5 Control and Decision-making in KSA

In listed companies in KSA, there is a formal separation of ownership and control. In theory, qualified elected directors run their companies and have the decision-making authority in most matters, except decisions that require shareholders' approval in general meetings. Laws and regulations in KSA provide protection to shareholders from managers' exploitation. For example, directors' fiduciary duties are stated in law and all listed companies are obliged to have non-executive directors.[37] Furthermore, judicial remedies are provided in KSA that can tackle the matters that can arise from the separation of ownership and control, such as the unfairly prejudicial remedy and the derivative claim, which is discussed in detail in chapter 7.

However, in practice, as illustrated earlier in this section, most listed companies in KSA fall into the second category identified by Berle and Means, the 'minority controlled' companies.[38] In these companies, separation of ownership and control is partial, as a

[33] See for example Article 16 of the Corporate Governance Regulations 2021; Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee Publishing 1992) 22; Barry Curnow and Jonathan Reuvid, *International Guide to Management Consultancy: Evolution Practice and Structure* (Kogan Page Publishers 2005), 138. The role of independent non-executive directors is discussed in the next chapter.
[34] Bainbridge (n 14) 13
[35] The UK Takeover Code also provides the mandatory bid rule as a tool to protect minority shareholders. See Rule 9 of the Takeover Code. The mandatory bid rule is discussed in section 6.4.
[36] See for example Rule 21 of the Takeover Code. Shareholders' right to decide on the merits of the bid and the prohibition of bid-frustrating strategies by directors are discussed in chapter 7.
[37] See for example articles 16 and 29 of the Corporate Governance Regulations 2021. Directors' duties are discussed in chapter 7.
[38] Berle and Means (n 20) 67.

dominant minority shareholder who owns less than 50% of the company's shares can exercise de facto control over the company.[39] As Bainbridge concluded:

> … we can speak of a 'control block,' i.e., shares held by one or more shareholders whose stock ownership gives them effective control. Firms having such a shareholder exhibit a partial separation of ownership and control. The dominant shareholder controls the firm, despite owning less than 50% of the outstanding voting shares, leaving the minority shareholders without significant control power.[40]

Indeed, in most KSA listed companies, controlling families have members on the board or ensure that a 'friendly board' is in place.[41] This means that most boards of directors represent a de facto controller such as families and the government through its investment agencies.[42]

To sum up, decision-making and control depend mostly on the ownership structure of the company. As illustrated above, in practice, most listed companies in KSA have a partial separation of ownership and control and have a blockholder who is able to exercise de facto control despite owning less than 50% of the companies' shares. For this reason, when reviewing shareholders' protection in takeovers, it is essential to recognise this ownership structure, as the threat of exploiting minority shareholders' rights is less likely to come from directors,[43] as happens in diffused markets, the UK for instance. Instead, the threat of exploitation is more likely to come from the controlling shareholder, such as wealthy families and government agencies. Thus, the focus of this chapter will be on legal tools that need reforms to provide protection to minority shareholders from the controlling shareholder, such as the mandatory bid rule and the sell-out rule. Reforming minority shareholders' protection regulations in takeovers is important to achieve the objectives of the regulations, which seek to create an attractive and fair market.

[39] De facto control in KSA listed companies is discussed further in section 6.2.5.
[40] Stephan M. Bainbridge, *Corporate Law* (3rd edn, Foundation Press 2015) 79
[41] Jenifer Piesse, Roger Strange and Fahad Toonsi, 'Is There a Distinctive MENA Model of Corporate Governance?' (2012) 16, 645, 663 <https://libkey.io/choose-library/10.1007/s10997-011-9182-5> accessed 23 February 2022
[42] ibid 667
[43] Except in so far as they are nominees for de facto controllers. The role of directors is discussed in detail in the next chapter (chapter 7).

6.3 Protection of Minority Shareholders in KSA

The main reason that investors finance companies is that they receive control rights and increase their wealth in exchange. Voting is the most essential right possessed by investors, especially on crucial company matters such as takeovers. The role of law is to ensure that minority shareholders' rights attached to their shares are protected from those who control the company, i.e., directors or shareholders having de facto control, and to ensure that the controller must share a proportional benefit with the minority.

Legal systems in different countries vary in the structure and level of minority shareholders' protection. Laws are not written from scratch; instead, most laws are transplanted from a few main legal families.[44] Generally, commercial laws come from two different systems: common law and civil law. The KSA is among the nations that follow civil law, which originated from France. Furthermore, ownership structure plays an integral role in shaping the corporate governance system and can have an enormous effect on the level of minority shareholders' protection.[45] According to La Porta, Lopez-de-Silanes et al., common law jurisdictions offer stronger protection to minority shareholders; on the other hand, civil law counterparts offer less protection to small investors.[46] They also concluded that poor minority shareholders' protection is associated with concentrated ownership.[47]

The KSA has carried out major reforms in the past two decades to improve its stock market.[48] These reforms improved many aspects of the market including the protection of minority shareholders. However, despite these reforms, there are many concerns about their practical effects on protection of minority shareholders. According to an empirical study by Piesse et al., considering that the KSA has a concentrated ownership structured market, many publicly held companies have a controlling family who achieves this indirect control by electing family members or acquaintances to hold positions on the board of directors.[49] Piesse et al. also found that many non-executive directors in listed companies are friends of the

[44] Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance' (1998) 106 Journal of Political Economy 1113, 1115 <https://www.jstor.org/stable/pdf/10.1086/250042.pdf?refreqid=search%3A58c63b3232920f41584301915a36acdf> accessed 1 April 2019

[45] The ownership structure is discussed in the corporate governance context in chapter 2, and this chapter in the takeover and control context in sections 6.4.4.2.

[46] La Porta, Lopez-de-Silanes and Shleifer (n 44) 1116

[47] ibid 1145

[48] Reforms of the KSA market are discussed in further detail in chapter 3.

[49] Piesse, Strange and Toonsi (n 41) 663

controlling family.[50] Indeed, Aleshaikh concluded that several listed companies controlled by families or wealthy individuals have disproportionate board representation.[51]

Moreover, the government, through its different investment agencies, is a key player in the stock market as a dominant shareholder in several companies in almost all sectors.[52] This highly concentrated ownership of the government can have a negative influence in the absence of strong regulations to protect minority shareholders and of an independent authority that governs the market. Indeed, companies with highly concentrated government ownership may be pressured to appoint politically connected directors; and these companies may pursue political and social objectives instead of maximising shareholders' value.[53] Furthermore, the CMA as a market supervisory and regulatory agency is not independent of the government, which could increase the possibility of political interference. According to Al Ahmary, compliance with company law, transparency, disclosure, and other corporate governance practices tend to be poor due to the incompetence of the CMA as a result of its managerial control by the government.[54] Al Ahmary adds that politicians who interfere may lack the knowledge required to run a complex financial market, which can weaken the CMA's ability to implement and enforce regulations that protect minority shareholders.[55]

6.3.1 The role of International Organisations in Evaluating KSA Minority Protection Reforms

With the lack of extensive and independent research in KSA around the practical issues of minority shareholders' protection,[56] it might be difficult to determine the practical influence of these legal reforms on minority shareholders' protection.

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[50] ibid
[51] Abdullatif Mohammed Aleshaikh, 'Towards Legal Reform of Saudi Law of Directors' Duties and of Enforcement by Derivative Action' (2018) 57 <https://theses.gla.ac.uk/30630/> accessed 20 March 2022
[52] The government owns 78.46% of the stock market's value. See 'The Values and Percentages of Ownership in the Stock Market: Quarterly Statistical Bulletin for Q2 2022 CMA', the CMA website <https://cma.org.sa/en/MediaCenter/PR/Pages/Bulletin_for_Q2-_2022_en.aspx> accessed 10 December 2022
[53] Anne O Krueger, 'Government Failures in Development' (1990) 4 Journal of Economic Perspectives 9, 20 <https://www.aeaweb.org/articles?id=10.1257/jep.4.3.9> accessed 12 April 2022
[54] Hussam Al Ahmary, 'Does Saudi Corporate Governance Attain International Standards Using the UK Best Practice as an Exemplar' (2018) 67 <http://openaccess.city.ac.uk/id/eprint/23224/http://openaccess.city.ac.uk/> accessed 12 March 2020
[55] ibid
[56] There are many reports and studies published by the CMA and other agencies, but they may lack independence and neutrality as these reports are published by the same agency under evaluation.

Thus, 'professional and independent' international organisations, such as the World Bank and the OECD,[57] can be considered a reliable source for measuring the impact of these reforms and the level of the minority shareholders' protection. Such international organisations mainly rely on quantitative indicators to measure different concepts in different jurisdictions, such as investors protection, corruption, and the rule of law.[58] Reports and evaluations by these organisations can have a significant impact on jurisdictions and can help improve private sector development as well as helping governments to design and implement regulatory and economic reforms.[59] For example, the Ease of Doing Business index by the World Bank has influenced the laws and regulations related to corporate matters in many countries.[60] Some countries may rely on these international reports and indexes to reflect the effectiveness of their recent reforms and can use these indexes to raise their economic attractiveness and attract foreign investment.[61]

The KSA's recent regulatory market reforms have been recognised by several international bodies. The KSA was ranked 63 in the Protecting Minority Investors index by the World Bank in 2017 and jumped to the third rank in the index in the 2020 report,[62] ahead of many developed legal systems.[63] However, this highly ranked position of KSA in protecting minority shareholders could be a result of superficial reforms without significant practical effects on the minority shareholders' protection. The accuracy of organisations' indicators to reflect and evaluate complex concepts and social phenomena has been criticised by several scholars, as outlined below.

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[57] Organisation for Economic Co-operation and Development.

[58] Galit A Sarfaty, 'Regulating Through Numbers: A Case Study of Corporate Sustainability Reporting' (2013) 53 SSRN Electronic Journal 575, 575 <https://deliverypdf.ssrn.com/delivery.php?ID=509005100118097001028115104005092101062011084076070069105104081101120097072089000104001126060041109056096072067107015086089010029022075093060097014004013069085088052035024091086097087066000024111005101070028002> accessed 13 February 2022

[59] See for example the World Bank website: <https://www.worldbank.org/en/programs/business-enabling-environment>

[60] Lin Lin and Michael Ewing-Chow, 'The Doing Business Indicators in Investor Protection: The Case of Singapore' [2016] SSRN Electronic Journal 46 <http://ssrn.com/abstract=2762088> accessed 13 February 2022

[61] For further detail, see for example: Bénédicte Fauvarque-Cosson and Anne Julie Kerhuel, 'Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law' 811 <https://scholarship.law.georgetown.edu/facpub/372> accessed 15 February 2022; Lin and Ewing-Chow (n 60) at 52.

[62] See the CMA website: https://cma.org.sa/MediaCenter/PR/Pages/Protect-minority-investors.aspx; And the World Bank website: https://archive.doingbusiness.org/en/data/exploreeconomies/saudi-arabia#DB_pi

[63] Reaching this high rank in the index by such a prominent indicator has been widely published in the CMA website and its other platforms and in several major newspapers to illustrate the success of the recent market reforms.

Despite the notion that independent organisational indicators and reports can represent neutrality and scientific truth, they can promote a 'box ticking' approach and superficial compliance.[64] The box-ticking can be defined as a 'rigid, mechanical practice involving the use of needlessly detailed "standardized checklists" and pursued without regard to weighing costs against benefits'.[65] Concerns were also raised regarding the methodologies employed by organisations to produce indicators, as they may be limited or concentrated on gathering precise data but not necessarily relevant data.[66] The Doing Business index by the World Bank, where minority shareholders' protection is evaluated, has attracted various criticisms.[67] One particular study argued that the concept of minority shareholders protection is fundamentally too context-specific to be assessed using merely quantitative methodologies.[68] Another study criticised the Doing Business index for concentrating on the breadth of coverage at the expense of depth.[69] The data are gathered from specialists who may not have direct experience with the market environment they are assessing, and hence such evaluations may not indicate the true concerns of local shareholders.[70] In 2021, the World Bank issued a statement to declare that it would discontinue its yearly Doing Business report and pause the next report due to 'data irregularities' in the 2018 and 2020[71] Doing Business reports.[72]

To sum up, prominent organisations' indexes and reports can play an integral role in helping policymakers to implement reforms and evaluate the status of their market and regulations. However, these reports and indexes may not reflect the practical reality in certain complex matters such as the protection of minority shareholders.

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[64] Sarfaty (n 58) 606.
[65] Michael Power, 'Organized Uncertainty: Designing a World of Risk Management' (2007) 153
[66] Sarfaty (n 58) 606.; Bénédicte Fauvarque-Cosson and Anne Julie Kerhuel, 'Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law' 811 <https://scholarship.law.georgetown.edu/facpub/372> accessed 15 February 2022
[67] See for example: Kevin E Davis, Benedict Kingsbury and Sally Engle Merry, 'Indicators as a Technology of Global Governance' (2012) 46 Law and Society Review 71 <https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1540-5893.2012.00473.x> accessed 16 February 2022
[68] Lin and Ewing-Chow (n 60) 46
[69] Kevin E Davis and Michael B Kruse, 'Taking the Measure of Law: The Case of the Doing Business Project' (2007) 32 Law & Social Inquiry 1095, 1103
[70] Lin and Ewing-Chow (n 60) 51
[71] It is noteworthy that the KSA was ranked third for minority investors protection in 2020 and ranked 10 on the 2018 report.
[72] See the World Bank website: <https://www.worldbank.org/en/news/statement/2021/09/16/world-bank-group-to-discontinue-doing-business-report>. According to the statement: 'After data irregularities on Doing Business 2018 and 2020 were reported internally in June 2020, World Bank management paused the next Doing Business report and initiated a series of reviews and audits of the report and its methodology. In addition, because the internal reports raised ethical matters, including the conduct of former Board officials as well as current and/or former Bank staff, management reported the allegations to the Bank's appropriate internal accountability mechanisms.'

Legal scholars have criticised the World Bank's Doing Business index, and the World Bank has recently reviewed the report for data irregularities and audited its methodology, so the index's high ranking of KSA in protecting minority shareholders and its ranking as the third country may not be entirely accurate, and the box-ticking approach may have been adopted to achieve this ranking.

The protection of minority shareholders should not be examined solely by scope-limited indicators and viewed separately from the legal system of a country. In other words, the level of development of the legal and political system, the level of the judicial system, and the level of corruption are all major factors that will influence the level of minority shareholders' protection. Consequently, it may not be logical for a less developed country with a relatively new and less developed legal and judicial system to be ranked in investors' protection ahead of many countries with more efficient and developed deep-rooted legal, political, and judicial systems.

Thus, governments and market authorities should use these indexes and reports for self-evaluation and to detect issues that require genuine reforms instead of adopting a box-ticking approach to merely achieve superficial compliance with global standards and reach highly ranked positions.

6.3.2 Possibility of Imposing Fiduciary Duties on Controlling Shareholders

From a legal perspective, it is well-established that a shareholder acting as a shareholder is allowed to use their voting rights regardless of the interest of other shareholders as long as the board of directors acts independently.[73] On the other hand, considering that directors 'control' and run their companies, laws impose fiduciary duties on them to protect the companies and their shareholders from any exploitation by the directors.[74] However, in markets where ownership is concentrated, such as the KSA, and there are blockholders who have the ability to exercise de facto control over their companies, and the board may not act independently of the controlling shareholder, the question to be asked is: is it possible to impose fiduciary duties on controlling shareholders considering that the agency problem exists between controlling and minority shareholders?

[73] Bainbridge, (n 14) 118
[74] Directors' duties are discussed in the next chapter (chapter 7).

The KSA and the UK do not adopt such an approach and do not impose fiduciary duties on controlling shareholders in their company laws. Instead, considering that it is well-settled that the controlling shareholders should not use takeovers as a tool to damage the interest of the company and abuse the lawful rights of minority shareholders, many jurisdictions adopt other legal tools to protect minority shareholders from the controlling shareholder in takeover scenarios, such as the mandatory bid rule and the sell-out rule, which will be discussed in detail in this chapter.

However, in a market where ownership is concentrated and dominant shareholders can have de facto control over their companies, and in scenarios where conflict of interest is likely, such as takeovers, the mandatory bid rule may not always protect minority shareholders from being abused by the controller.[75] Thus, given the existence of dominant shareholders in the market, general company law is not fully adequate to supervise the behaviour of the dominant controlling shareholders.[76]

Indeed, these tools, despite their effectiveness, may not always apply to all cases in which the dominant shareholder abuses minority shareholders. Therefore, adopting a general and flexible principle that can be applied to any case in which the controller abuses the minority shareholders will ensure protection for them and increase the attractiveness and fairness of the market. This principle is imposing fiduciary duties on controlling shareholders. Although such a principle may not be necessary for a market where ownership is diffused such as that of the UK, it seems to be essential for ensuring the protection of minority shareholders in KSA where the ownership is concentrated.

In several US states, case law has established that controlling shareholders may owe fiduciary duties to the firm and other shareholders in the sale of control.[77] This approach is justified by the fact that laws impose a fiduciary duty upon anyone who has the ability to control another person's property.[78] Indeed, controlling shareholders can have the ability

[75] Guanghua Yu, 'The Problem with the Transplantation of Western Law' (2004) Comparative Corporate Governance in China 10 <http://ssrn.com/abstract=1535683> accessed 20 April 2022
[76] Reinier Kraakman and others, *The Anatomy of Corporate Law* (2017) 228
[77] See for example: *Southern Pac. Co. v Bogert* (1919) 250 US 483, 487–88 ('The majority [shareholder] has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors'); Bainbridge (n 14) 118
[78] Zipora Cohen, 'Fiduciary Duties of Controlling Shareholders: A Comparative View' (1991) 12 University of Pennsylvania Journal of International Law 379, 380 <https://scholarship.law.upenn.edu/jil/vol12/iss3/2> accessed 24 April 2022

to control other shareholders' property; they may act in a way that influences the company's property and exert influence on the rights of minority shareholders.[79]

To hold a controlling shareholder liable for breaching their fiduciary duties, courts inquire as to whether this shareholder controlled the company[80] and whether the directors lacked independence.[81] Courts also require a demonstration that the controlling shareholder acted in a way that was unfairly prejudicial to the non-controlling shareholders.[82]

Indeed, in takeover transactions where conflict of interest is common and when the company has a dominant shareholder, imposing fiduciary duties on controlling shareholders can provide significant protection to the vulnerable minority shareholders. In the US case of *Brown v. Halbert,*[83] a dominant shareholder persuades and supports a prospective buyer in purchasing first his shares (at a premium for control) and then the minority's shares, at a lesser cost, without informing the other shareholders. The court held the defendant liable for breaching his fiduciary duty to the minority shareholders. The logic underlying this judgement established that these fiduciary duties would be activated if the controlling shareholder contemplated a premium sale with the potential to harm the minority.

The adoption of a fiduciary relationship between controlling and minority shareholders in the KSA's corporate law can improve the protection of minority shareholders in takeover situations, especially given the absence of case law as a legal source in KSA, the fact that the ownership structure in many listed companies is concentrated and the presence of controlling shareholders is not uncommon, and the level of minority shareholders' legal protection is not adequate. An example of adopting the US approach in this regard can be found in Israel. Although the UK company law highly influences Israeli company law,[84] as in the KSA, the Israeli policymakers veered towards the US approach and implemented the imposition of fiduciary duty on controlling shareholders to minority shareholders in their company law.[85]

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[79] ibid
[80] See *Kahn v Lynch Communication Systems* (1994) 638 A.2d 1110; *Emerald Partners v Berlin* (1999) 726bA.2d 1212, 1221 n.8 (Del).
[81] See cf. *Summa Corp. v Trans World Airlines, Inc.* (1988) 540 A.2d 403 (Del).
[82] See *Donahue v Rodd Electrotype Co of New England* (1975) 367 Mass 578, 328 NE 2d 505; *Sinclair Oil Corp. v Levien* (1971) 280 A.2d 717 (Del. SC); *Citron v Fairchild Camera & Instrument Corp* (1989) 569 A 2d 53 (Del); *Gabelli & Co. v Liggett Group Inc.* (1982) 444 A.2d 261 (Del Ch), affd, 479 A.2d 276 (Del. SC 1984).
[83] *Brown v Halbert* (1969) 271 Cal. App. 2d 252, 76 Cal. Rptr. 781 (Ct App)
[84] Cohen (n 78) 379
[85] Article 193 of the Israeli Companies Law 1999

One of the suggestions for the practical application of this concept in the KSA is that corporate legislation should include articles that allow minority shareholders to request the approval of the takeover transaction by the semi-judicial committee in the CMA, the CRSD,[86] in cases where the minority believed that their interests are exploited by a controlling majority. Also, the articles should illustrate how the CRSD should evaluate the legitimacy of the transaction by examining the following: whether there are controlling shareholders who used their influence in this transaction and impacted the rights of minority shareholders; and whether directors lacked independence.

6.3.3 Conclusion

In conclusion, despite the fact that minority shareholders' protection in KSA has witnessed several reforms in the past two decades, there are still many concerns about the protection of minorities in listed companies and the enforcement of the laws that protect them. The topic requires further independent research to determine the level of protection and detect the causes of the problems and the factors that lead to poor minority protection, and provide recommendations for future reforms. The role of independent international organisations in addressing the above matters seems to be less than it is expected to be.

It can be concluded that the level of minority shareholders' protection in publicly held companies in KSA has not reached the same level of protection as that in developed countries such as the UK. Many factors may have influenced the efficiency of the minority shareholders' laws and regulations. As discussed in this thesis, one of the main factors is the ownership structure and the concentration of ownership in the hands of elite families and the government. Moreover, the CMA's non-independence from the government may expose it to possible political influence. There may be several other factors that could influence and participate in shaping the concept of protecting minority shareholders in KSA that require further research, such as the influence of the political and judicial systems and social and cultural matters. One of the solutions to enhance the protection of minority shareholders in the KSA, and to address the negatives of having concentrated ownership in the market, is to implement regulations that impose fiduciary duties on controlling shareholders in takeover

[86] The Committee for the Resolution of Securities Disputes

transactions and to provide clear criteria for examination of this fiduciary relationship by the relevant court.

Adhering to the scope of this thesis, there are several laws and regulations that require further reforms, taking into consideration the ownership structure, to enhance the protection of minority shareholders in listed companies – especially in takeovers where there is a change of control, conflicts of interest are more common, and minorities are in a more vulnerable position to be exploited by directors, or most likely in KSA by the shareholder who has de facto control. The following section will address the mandatory bid rule as a device to protect minority shareholders in takeovers.

6.4 The Mandatory Bid Rule

6.4.1 Introduction

The mandatory bid rule was first introduced in the KSA takeover system in 2007. The rule is a fundamental principle adopted by many jurisdictions to protect minority shareholders in takeovers or after a change in control.

A broad meaning of this rule is that once a person or company acquires a certain percentage[87] of a company's shares, this party must be prepared to buy the rest of the shares by a general offer to all the remaining shareholders at a fair price[88] to provide an opportunity to the remaining shareholders to exit the company after the change of control occurred as a result of this acquisition. It is noteworthy that there are two fundamentally different regulatory approaches that will apply to such a change of control in different jurisdictions. The first approach, which can be referred to as the 'market rule', will treat the transaction in the same way as any other sale of private property. In this case, the selling shareholder will maintain all the profits paid by the purchaser. This deregulatory approach is adopted in the US. The second approach, which can be referred to as the 'sharing rule', will apply the mandatory bid rule to impose sharing requirements obliging the parties to include other

[87] The triggering threshold varies among different jurisdictions; it generally varies between 15-50% of the company's voting shares.
[88] Several jurisdictions generally define fair price in this context as a price not less than the highest price paid by the acquirer for shares during the takeover offer period and within 12 months before its commencement. More details on the fair price principle in section 6.4.6.

shareholders in the bargain. This approach is adopted in the UK and KSA, and in many other jurisdictions around the world.

This section will examine the efficiency of the rule and its suitability for KSA. Therefore, the section will look at the origin of the rule and the rationale behind it. To analyse the mandatory bid rule in KSA, this section will first refer to mandatory bid regulations in the UK as a benchmark, for two reasons. Firstly, the KSA's takeover system is highly influenced by the UK Takeover Code. Secondly, the mandatory bid rule had its origins in the UK before spreading to different jurisdictions around the world.[89]

The section will also examine the concept of control and the threshold set by the CMA that triggers the mandatory bid rule and whether this threshold fits the unique features of the KSA market and provides enough protection to minority shareholders. The concept of acting in concert and its meaning in the mandatory bid context will also be discussed. Recommendations for reforms will be presented in this section. These reforms include the recommendation to lower the mandatory bid threshold from 50% to 30% to enhance minority shareholders' protection in KSA, which has a concentrated ownership market and developing legal system. Recommendations will also be presented regarding the CMA's unlimited discretion to adjust the mandatory bid price and exempt it from the rule.

6.4.2 The Mandatory Bid Rule in the UK: Overview and Policy Drivers

The purpose of this subsection is to provide an overview of the origins of the rule and the policy drivers behind it before reviewing the rule in the KSA. As mentioned earlier in the introduction of this section, the mandatory bid rule was first established in the UK before spreading to many other jurisdictions.

The rule was not adopted when the UK's City Code[90] was first introduced in 1968. Due to the influential effect that a change of control can have on a company, the original City Code did, however, partially address the transfer of control by providing an obligation to make a similar offer to the other shareholders once effective control of a company is obtained

[89] Edmund-Philipp Schuster, 'The Mandatory Bid Rule: Efficient, After All?' (2013) 76 The Modern Law Review 529, 529 <https://www.jstor.org/stable/41857485> accessed 12 July 2021
[90] The City Code on Takeovers and Mergers. See the Takeover Panel website, available at: <https://www.thetakeoverpanel.org.uk/the-code/download-code>

by purchasing shares from major shareholders or directors in their capacity as shareholders.[91] The responsibility lay upon the selling major shareholder or director, who should not sell the controlling shares unless an offer was made to the remaining shareholders. There was no objective percentage by which to determine effective control when the Code was introduced; hence, effective control was decided by the Panel on a case-to-case basis.[92] However, in 1972 control was determined by the Panel as purchases giving the buyer more than 30% of the company's shares.[93]

The Panel presumed, in 1968 when the Code was first introduced,[94] that acquiring control of a company by purchasing shares in the open market was unfeasible with the exception of doing so over a very long period of time.[95] For this reason, the obligation to make a bid for the remaining shareholders when selling controlling shares was limited to major shareholders and directors of the company and not for control obtained by open market purchases. However, after certain events, the Panel established that acquiring such control in the open market was possible.

The mandatory bid rule was first implemented in the City Code in 1972 following David Rowland's case.[96] In 1971, Rowland, who was a shareholder of Venesta International, started to purchase large amounts of the company's shares in the market. As a result of this heavy purchase, he secured a dominant position in the corporation without resorting to a takeover bid. This strategy is referred to as 'creeping control', where the acquirer gradually purchases shares of a company in the open market to obtain a controlling interest and avoid the obligation to pay a premium price in a formal takeover offer. The Takeover Panel[97] was concerned after Rowland's approach that, under the current regulations, an open market

[91] Andrew Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 Cambridge Law Journal 422, 11–12 <https://www.jstor.org/stable/pdf/4500912.pdf?refreqid=excelsior%3Afd4dcf73ae83d659ffe8451cfe7c47bb&ab_segments=&origin=> accessed 20 January 2022

[92] Rolf Skog, 'Does Sweden Need a Mandatory Bid Rule? A Critical Analysis' [1995] The European Money and Finance Forum, Vienna 1, para 2 <https://www.econstor.eu/bitstream/10419/163434/1/suerf-study-02.pdf> accessed 23 June 2021

[93] Rule 34, 1972 edition of the Takeover Code; see The Takeover Panel, Panel Statement on the Report of A Panel Working Party on Takeover Rules an practices (1989/10), 3 P4. Available at: <https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1989-10.pdf> accessed 25 January 2022

[94] See the Takeover Panel website: <https://www.thetakeoverpanel.org.uk/the-code/download-code>; Johnston (n 91).

[95] David Kershaw, *Principles of Takeover Regulation* (1st edn, Oxford University Press 2016) 236

[96] See Takeover Panel, 'Announcement by the City Working Party' (1972/2), available at <https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1972-02.pdf> accessed 20 August 2021.

[97] The Panel on Takeovers and Mergers. The Panel is an independent body that issues and administers the City Code. See the Takeover Panel website, available at: <https://www.thetakeoverpanel.org.uk/>

purchase can deny minority shareholders the chance to sell their shares on favourable terms similar to the ones the purchaser had offered.[98]

Consequently, the Panel implemented a new rule in 1972: the mandatory bid rule, which obliged any individual or entity who acquired 40% or more of a company's shares to make a takeover bid to the remaining shareholders.[99] However, despite setting 40% as a threshold for mandatory bid for purchases in the market, in terms of selling controlling shares by major shareholders or directors, effective control is still defined by the Panel as holding 30% or more of a company's shares. The two different criteria by which to trigger the mandatory bid, effective control and the 40% threshold, caused uncertainty among market participants and created problems in their application.[100]

For that reason, both criteria were merged into a single rule in 1974. Accordingly, anyone purchasing shares that represent at least 30% of the voting rights of a company, whether the purchase was made in the open market or in the form of a private deal from a major shareholder, will be subject to the mandatory bid rule and the acquirer will be obliged to offer to buy the remaining shares. The rule is still in place today. Underpinning this change in the mandatory bid threshold from 40% to 30% is the notion that acquiring de facto control over a company can be achieved, in most cases, with fewer shares than a simple majority.[101] In other words, effective control can be obtained by holding 30% or more of a company's voting shares.[102] This may be especially the case in the UK where most shareholder resolutions are approved with a simple majority. For example, the removal and appointment of directors are passed with an ordinary resolution of the votes counted.[103]

Currently, Rule 9 of the Code sets two mandatory bid thresholds. The first triggering threshold is reached when a person, or persons acting in concert with it,[104] acquires 30% or more of the voting shares of a company. The second triggering threshold is reached when a

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[98] 'New Problem for the Panel', *The Times* (London, 18 Dec. 1971) 19; John Armour and David A Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? - The Peculiar Divergence of U.S. and U.K. Takeover Regulation' 1727 1764 <https://scholarship.law.upenn.edu/faculty_scholarship://scholarship.law.upenn.edu/faculty_scholarship/687> accessed 2 September 2021

[99] See Takeover Panel, 'Announcement by the City Working Party' (1972/2) available at <https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1972-02.pdf> accessed 20 August 2021.

[100] Skog (n 92) para 2

[101] ibid

[102] A Guide to Takeovers in the UK 2008 p 41, Clifford Chance, available at: <https://www.cliffordchance.com/content/dam/cliffordchance/PDF/takeover_guide.pdf> accessed 1 September 2021

[103] Section 282, UK Companies Act 2006

[104] The concept of 'acting in concert' is defined later in this chapter in section 6.4.5

person, or persons acting in concert with it, who already holds between 30 and 50 percent of the voting shares in a company acquires any additional shares.

The policy driver for the latter threshold is the prevention of creeping control, in which a person gradually obtains more voting shares to increase his control over a company whilst avoiding paying a premium price in the formal takeover offer. However, the rule was flexible prior to 1998 as the Code permitted an annual purchase of up to 1% for shareholders with 30% to 50% shareholding without their having to submit a formal offer to the remaining shareholders in accordance with the mandatory bid rule.[105] Although this flexibility may have struck a balance between minority shareholders protection and the need for regulatory flexibility, the Panel reasoned that its decision to remove the 1% annual allowed purchase as follows: 'the Panel has decided that the interests of shareholders generally would be best served by removing the 1% purchasing freedom allowed under Rule 9'.[106] The Panel has not provided a further explanation on how this change in the rule would serve the best interest of the shareholders.

In conclusion, as the mandatory bid rule was first introduced in the UK in the early 1970s and the core of the rule remains unchanged until today, several scholars concluded that the efficiency of the rule as a protective tool for minority shareholders may not be what it is expected to be, especially in more developed jurisdictions such as the UK, which has a sophisticated legal system that already provides strong minority shareholders protection.[107]

The justification for this approach is that the rule is unlikely to provide actual protection to minority shareholders, rather than offering the possibility of discouraging a productive share acquisition of companies and adding unnecessary rigour to the regulations. Moreover, in the UK, many legal reforms that provided more protection to minority shareholders took place after the rule was implemented.[108] Thus, several recommendations

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[105] Takeover Panel, 'Rule Changes' (1998/10) <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/12/1998-10.pdf> accessed 10 September 2021

[106] ibid

[107] See for example: Jesper Lau Hansen, 'The Mandatory Bid Rule: Unnecessary, Unjustifiable and Inefficient' [2018] SSRN Electronic Journal 2018 <https://deliverypdf.ssrn.com/delivery.php?ID=530112070066074002094015066096070022009056033020093009075021083091005077125007125023004010006016122030040068026103005121122108056014025055017120083065071028073119001017015016100066006016087121089013089116109107> accessed 27 January 2022; Alexander Dyck and Luigi Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 The Journal of Finance 537, 540 <https://onlinelibrary.wiley.com/doi/full/10.1111/j.1540-6261.2004.00642.x> accessed 8 August 2021; Skog (n 90) para 2. More discussion about the efficiency of the rule can be found in the 'Rationale and objectives of the mandatory bid rule' in section 6.4.3

[108] For example, the corporate governance codes developed rapidly during the 1990s, such as the Cadbury Report in 1992.

have been presented to reassess the mandatory bid rule in the UK. For example, the rule triggering threshold can be changed from 30% to 50% to strike a balance between investors' protection and regulation flexibility.[109]

6.4.3 Rationale and Objectives of the Mandatory Bid Rule, and is it Necessary in KSA?

6.4.3.1 Rationale and Objectives of the Mandatory Bid Rule

The rationale behind the mandatory bid rule is justified by two main principles. The first principle is the protection of minority shareholders once a change of control occurs in their company. In this context, the mandatory bid rule works as a device to protect minority shareholders from potential upcoming exploitation by the new acquirer of the controlling position.[110] The mandatory bid rule precludes the purchase of only a portion of the company's shares from giving the buyer control over all of the company's assets.[111] Using the de facto control over the company, such as the voting power in the general meetings and influence over the board of directors, the acquirer could exploit his position at the expense of the minority shareholders.[112] Thus, the rule serves as an option for the minority shareholders to leave the company before that possible exploitation takes place.

> The UK Takeover Panel adopts this philosophy as it has concluded:
>
> The company now has a new controller where before it was controlled by another person or was not controlled at all and shareholders should be given an opportunity to dispose of their shares as, for a variety of reasons, they may not wish to remain interested in the company under a new controller.[113]

The second principle justifying the mandatory bid rule is the equal treatment of all shareholders. Accordingly, in a change of control transaction, the concept of equal treatment for shareholders necessitates that all shareholders be able to acquire the value per share given

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[109] Kershaw (n 95) 258
[110] Paul L Davies, 'The Notion of Equality in European Take-Over Regulation' [2002] SSRN Electronic Journal 1, 11 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=305979#:~:text=It identifies three situations within,of control of a company.> accessed 20 January 2022
[111] ibid
[112] Schuster (n 89) 533
[113] Takeover Panel, 'Miscellaneous Code Amendments: Revision Proposals Relating to Various Rules of the Takeover Code (PCP 2009/2)', Consultation Paper Issued by the Code Committee of the Panel, <https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP200902.pdf>, accessed 14 July 2021, para 2.4

to that control.[114] Indeed, the UK Takeover Panel observed: 'the new controller is likely to have paid a premium price to the shareholders from whom he has acquired shares and a general offer at the highest price paid by the new controller is required so that all shareholders have the opportunity to share the premium'.[115]

However, despite these justifications for the rule, there is no consensus among scholars on the efficiency of the rule as a minority shareholders' protection tool, nor is there consensus on the threshold that triggers the rule in different jurisdictions. Moreover, the rule has not been adopted in several countries.[116]

The justification of the mandatory bid rule, which assumes that the new controller might exploit the company at the minority shareholders' expense, is based on the concept of private benefit of control. Private benefit of control is often described in theoretical literature as 'the "psychic" value some shareholders attribute simply to being in control'.[117] In other words, the private benefit of control refers to the financial gain derived from controlling shareholders exercising an influence on a company at the expense of minority shareholders.[118]

However, this justification that the rule works as a tool to protect minority shareholders from new controller exploitation has been criticised as it is based merely on possible not actual abuse of power.[119] This criticism of the justification of the mandatory bid rule is supported by an empirical study by Dyck and Zingales, who provided a multi-jurisdiction financial evaluation to measure the private benefit of control in different jurisdictions. The study found very limited scope for exploiting minority shareholders by the

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[114] Skog (n 92) para 2

[115] Takeover Panel, 'Miscellaneous Code Amendments: Revision Proposals Relating to Various Rules of the Takeover Code (PCP 2009/2), Consultation Paper Issued by the Code Committee of the Panel, <https://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP200902.pdf>, accessed 14 July 2021, para 2.4

[116] For example, the USA did not adopt the mandatory bid rule.

[117] Dyck and Zingales (n 107) 59

[118] See Michael J Barclay and Clifford G Holderness, 'Private Benefits from Control of Public Corporations' (1989) 25 Journal of Financial Economics 371 <https://reader.elsevier.com/reader/sd/pii/0304405X89900883?token=02E0F6810DD0F7832E42B9F07691EAC3E3F1D35EA9C694B5A792A26BF81807F6F6163988329E2A47E086E97FDBA2C0F1&originRegion=eu-west-1&originCreation=20210816153905> accessed 8 August 2021; Dyck and Zingales (n 107).

[119] Jesper Lau Hansen, 'The Mandatory Bid Rule: Unnecessary, Unjustifiable and Inefficient' [2018] SSRN Electronic Journal 2018, 13 <https://deliverypdf.ssrn.com/delivery.php?ID=530112070066074002094015066096070022009056033020093009075021083091005077125007125023004010006016122030040068026103005121122108056014025055017120083065071028073119001017015016100066006016087121089013089116109107> accessed 27 January 2022.

controller in some jurisdictions such as the UK.[120] Nevertheless, the study revealed an important result. According to it, the possibility of private benefit of control is likely in less developed countries with high concentrated ownership structures.[121]

Thus, the mandatory bid rule cannot always be effective as a minority shareholders protection tool in any jurisdiction; instead, several factors need to be considered to determine the efficiency of the rule, such as the level of legal development that a jurisdiction has, and the ownership structure of its market.

The second argument against the mandatory bid rule is that shareholders who are unhappy with the change of control can sell their shares on the market; thus, the mandatory bid rule is not necessary.[122] However, it can be noted that. if many shareholders sought to do so, this could cause the shares' market price to fall.[123] Moreover, in the absence of the mandatory bid rule, shareholders may feel compelled to accept the market price, as any other offer may be lower or not presented at all.[124]

The third argument in opposition to the mandatory bid rule is compatible with the US approach towards takeovers. This school of thought suggests that the mandatory bid rule is ineffective as some productive transfers of control may be prevented by the rule, which would consequently deter better new controllers who could run a company's assets more efficiently and increase the company's value.[125]

The objection to this argument is that the new controller ('looter') may obtain substantial private benefits of control of the corporation.[126] In this scenario, minority shareholders' main protection will depend on the presumed bona fide new controller. However, in jurisdictions with developed legal systems that provide strong protection to minority shareholders, it is unlikely that the new controller will be able to exploit his position

[120] Dyck and Zingales (n 107).
[121] ibid 573.
[122] Skog (n 92) 6.3
[123] ibid
[124] Davies (n 110) 9
[125] See Lucian Arye Bebchuk, 'Efficient and Inefficient Sales of Corporate Control' (1994) 109 The Quarterly Journal of Economics 957 <https://www.jstor.org/stable/pdf/2118353.pdf?refreqid=excelsior%3A2fe80a7f9f8e4ba3bece6a7cb44ae32a> accessed 10 August 2021
[126] Georgios Psaroudakis, 'The Mandatory Bid and Company Law in Europe' (2010) 7 European Company and Financial Law Review 552 <https://www.degruyter.com/document/doi/10.1515/ecfr.2010.550/html> accessed 25 January 2022

in the absence of the mandatory bid rule because minority shareholders already enjoy strong regulations protecting their vulnerable position.[127]

6.4.3.2 Conclusion, and is the Mandatory Bid Rule Necessary in KSA?

The debatable nature of the rule reveals that the mandatory bid rule is not fit for all. The effectiveness of the rule to strike a balance between shareholders' protection and the need for regulatory flexibility in order to avoid preventing valuable purchases of controlling shares and deter prosperous takeovers depends on different subjects. There are a variety of factors that need to be considered to determine whether the rule is suitable for a certain jurisdiction.

The main fundamental factors to consider in assessing the effectiveness and need for the rule are the level of development and sophistication of the legal system in general that a jurisdiction has, and the level of development of its takeover system, especially in terms of minority shareholders protection rules. Moreover, the importance of the ownership-structure factor in the mandatory bid context lies in the integral role that it plays in determining the need for the mandatory bid rule as a device to protect minority shareholders. This is because concentrated ownership markets such as that of the KSA, which has a less developed jurisdiction, tend to present a higher possibility of extracting private benefits of control at the expense of the minority shareholders.[128] Even if all these factors are considered, the nature and conditions of each company in the same jurisdiction may differ widely. For this reason,

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[127] Kershaw (n 95) 253. The unfairly prejudicial remedy and the derivative claim will be discussed later in other sections as litigation options for minority shareholders. There are many protection tools for minority shareholders in listed companies other than litigation remedies. The UK has a developed takeover system that provides strong protection for minority shareholders, especially when compared to less developed systems such as that of the KSA. To name a few of these protection tools, the mandatory bid is triggered automatically in the UK, unlike in the KSA where the rule only applies after the approval of the CMA who has unlimited discretion to exempt from the rule. Moreover, the sell-out right also provides protection to minority shareholders; this tool is adopted in the UK and not applied in the KSA. These tools are discussed in further detail in this chapter. Moreover, there are several factors that can have an indirect influence on minority shareholders' protection in listed companies. The UK has a developed corporate governance system, developed takeover system, efficient transparency regulations, sophisticated and experienced supervisory authorities, and a deep-rooted and developed legal system in general. All the above factors create an investment environment that provides more protection to minority shareholders, especially when compared to countries that have less developed legal systems and less experienced supervisory authorities, such as the KSA.

[128] See Dyck and Zingales (n 107) 537; Rafael La La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer (n 5) 471; Michael J Barclay and Clifford G Holderness, 'Private Benefits from Control of Public Corporations' (1989) 25 Journal of Financial Economics 371 <https://reader.elsevier.com/reader/sd/pii/0304405X89900883?token=02E0F6810DD0F7832E42B9F07691EAC3E3F1D35EA9C694B5A792A26BF81807F6F6163988329E2A47E086E97FDBA2C0F1&originRegion=eu-west-1&originCreation=20210816153905>; Andrei Shleifer and Robert W Vishny, 'Large Shareholders and Corporate Control' (1986) 94 Journal of Political Economy 461 <https://about.jstor.org/terms> accessed 23 February 2022

market authorities in many jurisdictions have the power to exempt from the mandatory bid in certain circumstances.[129]

Therefore, in developed jurisdictions such as the UK and US where strong minority shareholders protection rules are implemented, and where ownership structure is diffused, the mandatory bid rule may not be necessary as it may hinder a rewarding transaction that benefits the company as a whole. For example, the UK as one of the most legally developed countries that provide strong protection to minority shareholders, the mandatory bid rule is unlikely to be necessary and it may be removed, or the triggering threshold might be increased from 30% to a higher percentage: 50% for instance.[130] Indeed, the analysis that opposed the mandatory bid rule was mostly based on diffused markets or in developed countries where the legal system is developed and minority shareholders already have regulations that provide strong protection.[131]

In contrast, in less developed legal systems where minority shareholders protection is relatively weak,[132] and the ownership structure of the market is concentrated, the mandatory bid rule can be necessary, to serve as an effective tool to protect minority shareholders who are vulnerable in the less developed markets.

Thus, the author believes that the mandatory bid rule is suitable for the KSA, and the triggering threshold should be lowered from 50% to 30%[133] for several reasons. Firstly, the KSA legal system is less developed in general, and specifically regarding the protection of minority shareholders. Secondly, the ownership structure in KSA is concentrated, as most of the major shareholders are the government through its different agencies as well as elite wealthy families.[134]

Therefore, the rule in this developing market where concentration is high is necessary to provide protection to minority shareholders to give them an opportunity to exit the

[129] Exemption from the rule is discussed later in this chapter.
[130] Kershaw (n 95) 258
[131] See for example: Hansen (n 107); Psaroudakis (n 126); Mike Burkart and Fausto Panunzi, 'Mandatory Bids, Squeeze-out, Sell-out and the Dynamics of the Tender Offer Process' [2003] European corporate governance institute
<https://deliverypdf.ssrn.com/delivery.php?ID=078097097001123069090005004093124098058008055027062063031027084066115073063062103043098100004027108022072100095010034010002086104091007083091099025116001099070082077066068076087004091123001111101067027078079122> accessed 22 November 2021.
[132] See section 6.3 (Protection of minority shareholders in KSA)
[133] Mandatory bid threshold in KSA is discussed in more detail in section 6.4.4.3
[134] More detail of the de facto control in KSA is provided in the following subsections.

company once a change in control has occurred where they believe the new 'controller' is going to exploit his position at the expense of the company and the minority shareholders. The rule also provides minority shareholders with the opportunity to sell their shares at a fair value, which means selling the shares at the highest-paid price by the new controller in the past 12 months.[135]

The mandatory bid rule as a protection tool for minority shareholders is a necessity in KSA where public opinion and media pressure on companies' management is less effective as in other more developed countries where broader freedom of speech is possible. According to an empirical study by Dyck and Zingales, they concluded that: 'public opinion pressure helps to curb private benefits of control'.[136]

The following sections will discuss the concept of control and the mandatory bid threshold in KSA in further detail.

6.4.4 The Mandatory Bid Rule in KSA

6.4.4.1 Introduction

The mandatory bid rule was first introduced in KSA in 2007 when the country's first M&A Regulations were implemented. Underpinning this adoption of the rule is the concept of equal treatment to all shareholders in the case of a takeover and change of control. The concept of equal treatment of all shareholders of the same class is illustrated in the general provisions article of the M&A Regulations, which states the following: 'In the case of an Offer, all shareholders of the same class of an Offeree Company must be treated equally by an Offeror.'[137] As stated earlier in this thesis, the KSA takeover system is influenced by the UK takeover system, the City Code, and as a result of this influence, many regulatory concepts have been adopted from the UK such as the mandatory bid rule which is one of the distinguishable features of the UK's City Code.

The concept of equal treatment in takeovers, and the mandatory bid rule based on it, are initially triggered in the case of change of control which a takeover represents. Nevertheless, in KSA, change in control occurs without triggering the rule, since control is

[135] M&A Regulations Article 23(C)
[136] Dyck and Zingales (n 107) 590
[137] M&A Regulations Article 3(C)

defined as holding 30% or more of the voting shares,[138] whereas the rule is triggered by a threshold of 50% in KSA. Moreover, the mandatory bid rule is not necessarily triggered by the law after reaching this threshold, as in the UK. Instead, the CMA has the discretion to apply the mandatory bid rule on a case-by-case basis. This discretionary power should not be granted to the CMA. These issues will be discussed further in this section.

The mandatory bid is regulated in article 23 of the M&A Regulations as follows:

> The Mandatory Offer a) Where a person (or persons Acting in Concert with it) increase an aggregate interest in shares through a restricted purchase of shares or restricted Offer for shares so that such person's ownership (individually or collectively with persons Acting in Concert with it) becomes 50% or more of a given class of shares listed on the Exchange carrying voting rights, the Board shall have the right to exercise its discretionary power in accordance with Article 54 of the Capital Market Law to order such person (and any person or persons Acting in Concert with it) to offer to purchase the shares of the same class it does not own of the Offeree Company on the terms set out in this Article and in accordance with the other relevant provisions of these Regulations. When an obligation to make a general Offer is incurred under this Article, it is not necessary for the Offer to extend to treasury shares in the Offeree Company.

The article states that this rule will apply for a 'restricted purchase of shares or restricted Offer'. The definition of these terms is provided in article 52 of the CMA Law. The CMA definition of these terms is:

> For the purpose of application of the provisions of this Law, these two terms mean the following:
>
> a) A restricted purchase of shares is the purchase of voting shares listed on the Exchange when as a consequence of such purchase ten percent (10%) or more of such class of the relevant company shares is owned by, or under control of, the purchaser or those acting in concert with the purchaser.
>
> b) A restricted offer for shares is making a public announcement by which the announcer offers to purchase voting shares of a particular class of shares listed on the

[138] The Glossary of Defined Terms Used in The Regulations and Rules of the Capital Market Authority, amended 2021. Control is discussed in further detail in section 6.4.4.2

> Exchange if the amount of shares sought to be acquired by the offering party would increase its ownership or the ownership of those acting in concert with the offering party, or the shares under their control, to ten percent (10%) or more of the shares of the relevant company.[139]

The purpose of the 10% threshold that represents the restricted purchase and restricted offer is to promote transparency once a change of ownership occurs or in situations where a potential offer will lead to that percentage.[140] The restricted offer and purchase regulations grant the CMA with wide authority to impose any requirements, such as requirements for disclosure and manners of such disclosures, that it sees fit to ensure the protection of investors and the safety of the market.[141] This 10% threshold does not contradict the mandatory bid threshold (50%). Restricted purchases or offers do not necessarily mean they will lead to the mandatory bid being triggered. On the other hand, all mandatory bid requirements will necessarily mean that the person who reached the mandatory bid threshold had already reached the restricted purchase and restricted offer threshold (10%).

6.4.4.2 The Concept of Control in the Takeover Context, and is the Mandatory Bid Triggered Once Control is Achieved?

The Concept of Control

Understanding the meaning of control over a company and the objective criteria with which to determine control is important in the mandatory bid context. As discussed in detail in the rationale of the mandatory bid section, one of the main policy drivers behind the rule was to allow other shareholders to leave the company once a change of control occurred, and (or) receive an equal price paid to secure the controlling stake. Thus, the concept of control is a key factor in establishing the mandatory bid triggering threshold. However, the triggering threshold of the rule is not always aligned with the control percentage determined by authorities in different jurisdictions. Other factors can influence the mandatory bid rule threshold, such as the level of legal development of a jurisdiction and the protection it provides for minority shareholders, and the nature of the capital market and ownership

[139] Capital Market Law Article 52
[140] Capital Market Law Article 53(c)
[141] Capital Market Law Article 53(e)

structure of each jurisdiction. Furthermore, some jurisdictions, such as the US, do not adopt the mandatory bid rule even if control is achieved.

The CMA provided several definitions of control. A broad definition of control is illustrated in the Capital Market Law as follows: 'The direct or indirect ability or power to exercise effective influence over the actions and decisions of another person'.[142] Other CMA regulations provided a more detailed definition of control. These regulations defined control as 'The ability to influence actions or decisions of another person directly, indirectly, individually or collectively with a relative or an affiliate through: (A) owning %30 or more of the voting rights in a company, (B) having the right to appoint %30 or more of the administrative team members'.[143] The regulations also provided a specific definition of control in the takeover context. According to the regulation,

> Control: means in the Merger and Acquisition Regulations: the ability to influence the actions or decisions of another person, directly or indirectly (excluding indirect ownership through a swap agreement or through an investment fund, where the owner of its units does not have any right in its investment decisions), alone or in combination with a person or persons acting with him in concert, by owning (directly or indirectly) %30 or more of the voting rights in a company, and the term 'controlling' is interpreted accordingly.[144]

It is worth noting that this definition is only mentioned in the Arabic version of the Regulations. This raises concerns about the translations and accuracy of the regulations in KSA when translated to English, as the author has noted on several occasions in this thesis.

It can be concluded from the above articles from different regulations of the CMA that control can be determined once an effective influence over the actions and decisions of another person is achieved, and an objective measurement to determine this influence is owning 30% or more of the voting shares.

In addition to the CMA's definition of control, it is important to explore several ownership thresholds that impact shareholders' rights, in order to provide an insight into different levels of control exercised by the shareholder. Firstly, the ownership of 2% of the

[142] Capital Market Law Definitions section Article 1
[143] The Glossary of Defined Terms Used in The Regulations and Rules of The Capital Market Authority, amended 2021, and the Corporate Governance Regulations, definitions section, Article 1. Amended 2021
[144] The Glossary of Defined Terms Used in The Regulations and Rules of The Capital Market Authority, amended 2021. Arabic version.

shares allows shareholders to request an annual general meeting (AGM) from the competent authorities under any of the situations specified in the corporate statute.[145] The second threshold is the ownership of 5% or more; this gives the power to call an AGM[146] and enables the relevant shareholders to request that any questionable conduct committed by board members or the auditor be investigated by the competent judicial authority.[147]

The next threshold occurs with ownership of more than 25%; this ownership provides the shareholder(s) with blocking minority[148] and veto power which may be used over significant company resolutions that need a supermajority to be approved. For example, shareholder(s) of such a stake can veto, in extraordinary general meetings (EGM), resolutions related to takeovers, increase or decrease of capital and the termination of the company.[149] A shareholding of more than 33% confers additional control to the relevant shareholders: they are entitled to a further veto power at the EGM,[150] allowing them to, for example, refuse to amend the company's articles of association,[151] issue preference shares, and issue debt instruments.[152]

The next threshold is the ownership of 50% or more of the shares, which represents a simple majority. Ownership of such shareholdings enables the shareholders to determine all the outcomes of the AGM resolutions.[153] For example, they are able to appoint and remove directors,[154] authorise directors' undertakings relating to conflicts of interest.[155] The last notable threshold that confers wide controlling powers is the ownership of 75% or more. This allows the shareholder to determine most of the company's resolutions in both the AGM and

[145] Article 90(3) of the Companies Law 2015. 'A number of shareholders representing at least 2% of the capital may submit a request to the Competent Authority to call for an ordinary general assembly meeting if any of the cases provided for in paragraph 2 of this Article exist.'
[146] Article 90(1) of the Companies Law 2015
[147] Article 100(1) of the Companies Law 2015
[148] A blocking minority is found when a shareholder or minority shareholders block a meeting resolution by their vote. See Julian Franks and Colin Mayer, 'Ownership and Control of German Corporations' (2001) 14 The Review of Financial Studies 943 <https://www.jstor.org/stable/2696732> accessed 20 March 2019.
[149] Article 94(4) of the Companies Law 2015 specified a few subjects that need a special resolution approved by a majority of 75% votes in the EGM. According to the article: 'Resolutions of an extraordinary general assembly meeting shall be passed by a two-third majority vote of shares represented therein. Resolutions pertaining to an increase or decrease of capital, extension of the term of the company, dissolution of the company prior to the expiry of the term set forth in its articles of association, or merger with another company, shall be valid if adopted by a three-quarter majority vote of shares represented at the meeting.'
[150] According to Article 94(4) of the Companies Law 2015, most resolutions of the EGM require the approval of a two-thirds majority.
[151] Article 88(1) of the Companies Law 2015
[152] Articles 114 and 122(2) of the Companies Law 2015
[153] Article 93(3) of the Companies Law 2015
[154] Article 68(3) of the Companies Law 2015
[155] Articles 71 and 72 of the Companies Law 2015

EGM, including critical resolutions such as approving takeovers and amending the company's articles of association.[156]

After reviewing these key thresholds that determine the level of control exercised by blockholders, it is essential to answer a twofold question to understand the level of control exercised in KSA: are blocking minorities (25% ownership and above) common in KSA listed companies? And do those blockholders enjoy de facto control over their companies?

As discussed in more detail in chapter 2,[157] ownership is concentrated rather than diffused in KSA's market. Table 1 below provides details of the ownership of the two main governmental investment agencies in the KSA main stock market (Tadawul), the Public Investment Fund (PIF), and the General Organisation for Social Insurance (GOSI). The table shows the ownership equal to or higher than all the thresholds mentioned above.[158]

Blockholder's ownership size (Control threshold)	**Distribution of the governmental agency's ownership in the sample companies**	
	Number	Percentage
5 ≤ B	39	18.93%
25 ≤ B	12	5.83%
33 ≤ B	10	4.85%
50 ≤ B	4	1.94%
66 ≤ B	3	1.46%
75 ≤ B	1	0.49%

Table 6.1: Distribution of the governmental agency's ownership according to the important control thresholds in the KSA stock market in October 2021.
Source: The author of this thesis conducted this survey of 206 listed companies in the KSA Stock Market (Tadawul) based upon official data published on the Tadawul website (October 2021).

[156] Article 94(4) of the Companies Law 2015
[157] The chapter discussed corporate governance and ownership structure.
[158] 5%, 25%, 33%, 50% 66%, and 75%

Based on the above survey of all listed companies in the KSA Stock Market (Tadawul), around 32% of the listed companies have a single blockholder owning at least 30% of the shares of the company.[159] This means that approximately one-third of the companies in Tadawul have a single blockholder who can exert de facto control over the company.[160] In markets where ownership is mostly concentrated, blockholders could be able to disproportionately affect board nomination beyond their ownership rights. This can happen more often in family-controlled companies, such as in KSA where board members are either part of the controlling family or friends of the family including non-executive directors.[161] Indeed, according to La Porta et al., 'These controlling shareholders are ideally placed to monitor the management, and in fact the top management is usually part of the controlling family, but at the same time they have the power to expropriate the minority shareholders as well as the interest in so doing'.[162] Moreover, a blockholder in concentrated markets tends to have the ability to affect several important corporate decisions.[163]

This conclusion is based on the CMA's definition of control illustrated earlier (control is holding at least 30%). Also, the ownership of 30% or more of a company's voting shares confers on the owner several veto powers regarding critical corporate resolutions, such as blocking (EGM) decisions related to takeovers or the company's capital increase or

[159] The survey considered the main two governmental investment agencies as one group (The Public Investment Fund (PIF), and the General Organisation for Social Insurance (GOSI)). However, the survey considered each individual or entity separately without counting the ownership of shares by individuals within the same family as a single group. Details of listed companies' ownership available on the Tadawul website: https://www.saudiexchange.sa/wps/portal/tadawul/markets/reports-%26-publications/market-reports?locale=ar

[160] De facto control by a minority blockholder usually occurs in markets where the ownership structure is concentrated. This can override the apathy of shareholders and eliminate the agency issues between managers and shareholders that are usually found in markets where the ownership is diffused. However, especially in less developed jurisdictions, when ownership is concentrated the agency problems will not be between managers and shareholders; instead, agency problems will be between minority shareholders and the controlling blockholder(s) who may extract private benefits at the expense of the minority. See for example: Rafael La La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer (n 5) 511; Michael J Barclay and Clifford G Holderness, 'Private Benefits from Control of Public Corporations' (1989) 25 Journal of Financial Economics 371, 372 <https://reader.elsevier.com/reader/sd/pii/0304405X89900883?token=02E0F6810DD0F7832E42B9F07691EAC3E3F1D35EA9C694B5A792A26BF81807F6F6163988329E2A47E086E97FDBA2C0F1&originRegion=eu-west-1&originCreation=20210816153905 accessed 10 February 2022; Andrei Shleifer and Robert W Vishny 'Large Shareholders and Corporate Control' (1986), vol 94 <https://www.jstor.org/stable/pdf/1833044.pdf?refreqid=excelsior%3Ac7798f78b17f77357c9a13aaaf6c0a6f> accessed 1 April 2019. More detail about ownership structures in chapter 2.

[161] Jenifer Piesse and others, 'Is There a Distinctive MENA Model of Corporate Governance?' (2012) 16, 645, 663 <https://libkey.io/choose-library/10.1007/s10997-011-9182-5> accessed 23 February 2022

[162] La Porta, Lopez-De-Silanes and Shleifer (n 5) 511.

[163] Michael J Barclay and Clifford G Holderness, 'Private Benefits from Control of Public Corporations' (1989) 25 Journal of Financial Economics 371, 349 <https://reader.elsevier.com/reader/sd/pii/0304405X89900883?token=02E0F6810DD0F7832E42B9F07691EAC3E3F1D35EA9C694B5A792A26BF81807F6F6163988329E2A47E086E97FDBA2C0F1&originRegion=eu-west-1&originCreation=20210816153905>.accessed 10 February 2022

reduction. Moreover, from a legal theoretical perspective, even though the ownership of 30% does not give the owner a direct power to impact all resolutions in the general meeting or appoint board members, in reality, the owner of such a percentage can exercise de facto control over the company without the need to own the majority of the company's shares. This can occur in the KSA market, considering that the majority of those blockholders who own 30% or more of their companies are governmental agencies and wealthy family members who would likely be able to select directors in a way that is disproportionate to their shareholding rights.[164]

In the light of the ownership control levels and the extent of influence exercised by blockholders in KSA outlined above, the following subsection will examine the mandatory bid in KSA and its efficacy in protecting minority shareholders, and whether the triggering threshold of the rule is proportional to the levels of control exercised in KSA.

6.4.4.3 Mandatory Bid Threshold in KSA

The mandatory bid is not triggered when control (30% or more) is secured; instead, the CMA established a 50% threshold for the mandatory bid to be triggered. According to article 54 of the Capital Market Law:

> If any person increases its ownership of shares in a given company through a restricted purchase of shares or restricted offer[165] for shares so that such person or those with whom such person is acting in concert become the owner of (50%) fifty percent or more of a given class of voting shares listed on the Exchange, the Board shall have the right, within sixty (60) days, if it believes it would achieve the safety of the market and the protection of shareholders, to order such person to offer to purchase the shares of the same class it does not own on such terms and conditions as the Board shall determine. In no case will the prospective purchaser be compelled to offer to purchase the remaining shares at a price exceeding the highest price he paid to

[164] Abdullatif Mohammed Aleshaikh, 'Towards Legal Reform of Saudi Law of Directors' Duties and of Enforcement by Derivative Action' (2018) 56 <https://theses.gla.ac.uk/30630/>. Also, see J Piesse, R Strange and F Toonsi (n 41) 645; Mohammed Alghamdi 'Family Business Corporate Performance and Capital Structure: Evidence from Saudi Arabia' 2016 < https://hydra.hull.ac.uk/assets/hull:13601a/content>

[165] Restricted purchase and restricted offer are defined earlier in section 6.4.1

purchase any of the shares of that company during the (12) months preceding the date of the Board order.[166]

It can be concluded from the CMA laws and regulations that the mandatory bid threshold is not aligned with the concept of control defined by the CAM. Accordingly, a change of control of a company will not give other shareholders the opportunity to leave the company with the same price offered to secure control, provided that the new controller does not secure or reach the mandatory bid threshold which is 50% or more of the voting shares.

This threshold by the CMA is considered one of the highest thresholds among different jurisdictions.[167] Other jurisdictions that adopted a 50% or higher threshold, such as Indonesia and Estonia, imposed additional triggers for the rule if the new controller is capable of appointing the majority of the company's board directors, which is often achievable with a percentage lower than 50%.[168] This additional trigger of the mandatory bid rule can provide additional protection to minority shareholders, especially in countries that have a less developed legal system and high mandatory bid threshold such as the KSA. The CMA has not adopted such additional triggers; hence, minority shareholders will only be protected by the mandatory bid rule once the threshold of 50% is reached, and once the CMA, using its discretionary power,[169] orders the new controller to extend the offer to the other shareholders.

[166] Capital Market Law Article 54. Moreover, the Merger and Acquisition Regulations addressed the mandatory bid in Article 23. According to the article: 'a) The mandatory Offer: Where a person (or persons Acting in Concert with it) increase an aggregate interest in shares through a restricted purchase of shares or restricted Offer for shares so that such person's ownership (individually or collectively with persons Acting in Concert with it) becomes 50% or more of a given class of shares listed on the Exchange carrying voting rights, the Board shall have the right to exercise its discretionary power in accordance with Article 54 of the Capital Market Law to order such person (and any person or persons Acting in Concert with it) to Offer to purchase the shares of the same class it does not own of the Offeree Company on the terms set out in this Article and in accordance with the other relevant provisions of these Regulations. When an obligation to make a general Offer is incurred under this Article, it is not necessary for the Offer to extend to treasury shares in the Offeree Company.'

[167] The majority of jurisdictions adopting the mandatory bid rule set the threshold between 30 and 33%. Although thresholds can vary enormously among different jurisdictions, the threshold can be as low as 1% and up to 90% in few jurisdictions. For more, see the OECD Corporate Governance Factbook 2021, 26–27, available at: https://www.oecd.org/corporate/Corporate-Governance-Factbook-Chapter-3.pdf

[168] OECD, *OECD Corporate Governance Factbook 2021* 26 <https://www.oecd.org/corporate/Corporate-Governance-Factbook-Chapter-3.pdf> accessed 18 October 2021

[169] As the mandatory bid in KSA is not necessarily triggered after reaching the threshold, as in some other jurisdictions such as the UK, the CMA has an unlimited discretionary power to determine whether triggering the rule is necessary for 'the safety of the market and the protection of shareholders'. This discretionary power of the CMA in this context will be discussed in further detail in section 6.4.7

6.4.4.4 Reforming the Mandatory Bid Rule Threshold in KSA

Interestingly, although KSA appears to have incorporated the mandatory bid rule from the UK, in addition to the fact that its takeover regulations are influenced by those of the UK, the CMA has not adopted the 30% triggering threshold applied in the UK, despite the fact that the jurisdiction of the rule's origin lowered the threshold from 40% to 30% in the 1970s to, inter alia, align the rule threshold with the percentage that reflects effective control of a company.[170] This high threshold adopted by the CMA can be justified at the establishment and beginning of the formal stock market, as the CMA was keen at that time to encourage investment in it.[171] The ownership structure was largely concentrated before the market was opened to foreign investors and qualified foreign investment funds. However, at the present time, with the rapid development of the market, the expansion and diversification of investors and change of ownership structure, and the opening of investment to foreigners, it has become urgent to change this threshold to cope with these changes,[172] especially in the absence of strong protection regulations for minority shareholders like the ones implemented in a more developed jurisdiction such as the UK.

The author recommends lowering the mandatory bid threshold to 30% instead of 50%. There are several reasons for such a recommendation. The KSA general legal system is a developing one, and specifically in the aspects of protection of minority shareholders.[173] Moreover, the ownership structure in KSA is concentrated, as most of the major shareholders represent the government through its different agencies and elite wealthy families, which reinforces the need for a more efficient mandatory bid rule to protect minority shareholders. As illustrated earlier in the subsection 'The concept of control', about 32% of the listed companies in KSA have a single blockholder owning at least 30%, which confers several veto powers on the owner of such percentage; and most of those blockholders are

[170] See Rule 9 of the Takeover Code. Available at: https://www.thetakeoverpanel.org.uk/wp-content/uploads/2021/08/567845_005_The-Take-Over_Bookmarked_02.08.21.pdf?v=28Jun2021. The mandatory bid in the UK is discussed in section 6.4.2

[171] Yaser Alsuraihy, 'The Compulsory Acquisition Offer for Listed Companies A Comparative Analytical Study' (2017) 64 Journal of Legal and Economic Research, the Faculty of Law - Mansoura University 382 <http://search.mandumah.com/Record/918995> accessed 28 January 2022

[172] ibid 383

[173] An effective mandatory bid rule is integral in developing jurisdictions with concentrated ownership more than in developed systems; see Dyck and Zingales (n 107) 537, 540. More details are presented in the Rationale of the mandatory bid rule subsection (6.4.3)

governmental agencies or wealthy family members who can exercise de facto control over their companies.[174]

Additionally, aligning the triggering threshold of the mandatory bid rule with the definition of control stated by the CMA regulations,[175] and aligning this threshold with the de facto control percentage exercised in KSA as presented above, will increase the efficacy of the rule, and provide additional protection to minority shareholders.

Moreover, in 2015, the GCC countries approved general non-compulsory guideline rules to regulate takeovers in the GCC states.[176] According to article 22 of the GCC Rules, the acquisition of 30% or more of a company's shares will trigger the mandatory bid and the acquirer will have to extend the offer to the remaining shareholders.[177] The adoption of this threshold by the GCC members indicates that the 30% threshold for the mandatory bid is more sensible in the GCC countries which have similar market systems in terms of ownership structures and levels of legal development and minority shareholders protection.

In conclusion, triggering the mandatory bid in KSA when an individual or an entity reaches the ownership of 30% can enhance the efficacy of the rule as a tool adopted for the purpose of protecting minority shareholders when a change of control occurs in their companies. If the CMA were to adopt this suggested threshold, it is recommended that it avoid the rule applied in the UK which obligates any person who already owns 30% of the shares but less than 50% to make a mandatory offer once he has acquired any additional shares.[178] Instead, the CMA can allow the purchase of additional shares for people who already own 30% up to 49.9%; and once they reach 50% or above, the mandatory bid rule should be triggered. The reason for this recommendation is that, even though powers vary between the ownership of 30% and 49%, this variation between these percentages has limited

[174] This argument is presented with more details in section 6.4.4.2
[175] The CMA defined control as holding 30% or more of the voting shares.
[176] The GCC council decided to adopt the rules in an advisory capacity pending completion of the preparation of a system of unified rules and principles for the integration of financial markets in the GCC countries, and to ensure their compatibility and compatibility with each other. It is noteworthy that there is no direct impact of the GCC takeover regulations on takeovers in KSA, considering that the GCC takeover regulations are merely guidelines and non-compulsory regulations. The GCC regulations would probably have no direct impact on takeovers in KSA until the completion of the unified rules and regulations for GCC financial markets, for which a time has not yet been set. See Unified Rules for Acquisition in Financial Markets in The Cooperation Council for the Arab States of the Gulf (GCC) (guidelines) 2016 Arabic version available at: https://www.gcc-sg.org/ar-sa/CognitiveSources/DigitalLibrary/Pages/Details.aspx?itemid=732
[177] Article 22 of the Unified Rules for Acquisition in Financial Markets in The Cooperation Council for the Arab States of the Gulf (GCC) (guidelines) 2016 Arabic version available at: <https://www.gcc-sg.org/ar-sa/CognitiveSources/DigitalLibrary/Pages/Details.aspx?itemid=732> accessed 20 October 2021
[178] The Takeover Code 2021 Rule 9.1(b)

effect on the minority shareholders. For example, the shareholder of 30-49% is still from a legal perspective unable to directly remove or appoint members of the board, as the law requires the approval of a simple majority in the general meeting. However, if a person or entity who already owns between 30-50% reaches 50% or more, their controlling powers in the company will be substantially changed. A sudden change to the threshold of the mandatory bid in an already concentrated market can cause instability and uncertainty in the market. Indeed, avoiding triggering the mandatory bid rule for any additional purchases between 30 and 49% can strike a balance between minority shareholders' protection and the need for regulatory flexibility.

Alternatively, if the CMA did not adopt the 30% triggering threshold for the mandatory bid rule and maintained the 50% threshold, an additional trigger should be adopted to protect minority shareholders: for example, by imposing a trigger of the rule when a shareholder together with people acting in concert with him[179] have the ability to appoint the majority of the board members, even if this shareholder owns less than 50%, which is the current trigger of the rule in KSA.[180] This additional trigger can provide substantial protection to minority shareholders, especially in KSA where governmental agencies and several members of the same family can have de facto control over the appointment of the board members beyond their de jure one.

6.4.5 The Concept of Acting in Concert in the Takeover Context

A person, or group of people, who would like to secure a controlling stake of a company may use some techniques to avoid regulatory requirements such as the mandatory bid rule. They may do so to extract private benefits of control by collectively coordinating and acting together to secure a controlling position at the expense of other shareholders. Thus, regulators in many jurisdictions deployed the concept of 'acting in concert'.

The purpose of this concept is to protect other shareholders and ensure that any group of people who are working together or associated with each other to secure a controlling position will be covered by the takeover regulations. This means that, even though each

[179] The concept of 'acting in concert' is defined in the next subsection.
[180] Similar approaches were adopted in several countries that have a high triggering threshold, such as Argentina and Estonia. See OECD Corporate Governance Factbook 2021 26 <https://www.oecd.org/corporate/Corporate-Governance-Factbook-Chapter-3.pdf> accessed 18 October 2021.

member of the party deemed to be acting in concert does not own shares amounting to the threshold of the mandatory bid, the aggregate of the share of those members who acted in concert for the purpose of acquiring control of a company will be considered and the group will be seen as a single person who is required to make the mandatory bid. The CMA defines the concept of acting in concert as follows:

> Acting in Concert means, at the sole discretion of the Authority, actively co-operating, pursuant to an agreement (whether binding or non-binding) or an understanding (whether formal or informal) between persons, to be controllers (whether directly or indirectly, excluding indirect ownership of shares through swap agreements or through an investment fund whose unit owner have no discretion in its investment decisions) of a company, through the acquisition by any of them (through direct or indirect ownership) of voting shares in that company. Moreover, 'concert parties' shall be construed accordingly.
>
> Without prejudice to the general application of this definition, the following persons shall be presumed to be acting in concert with other persons of the same class unless the contrary is established, including but not be limited to:
>
> 1) Members of the same group;
>
> 2) a person's relatives;
>
> 3) Person(s) who provided financial assistance to the offeror or offeree or members of the group with such person (other than a bank in the ordinary course of business) in order to purchase shares that carry voting rights or convertible debt instruments.[181]

The CMA has not stated which member of the group is responsible for launching the mandatory bid. The CAM can adopt the approach adopted in the UK to determine the member who is required to make the mandatory offer. According to the Takeover Code, the member that will be responsible on behalf of the group to make the mandatory bid will be either the person who purchased the shares that crossed the threshold or the person who is deemed by the Panel to be the principal member.[182]

[181] The Glossary of Defined Terms Used in The Regulations and Rules of The Capital Market Authority, amended 2021.
[182] Note on Rule 9.2, the Takeover Code

6.4.6 Pricing the Mandatory Bid

The essence of the mandatory bid rule relies on the concept of equal treatment between all shareholders of the same class in the case of a change in control.[183] Thus, determining the price that needs to be paid to the other shareholders is important to achieve equal treatment once a mandatory bid is triggered. The M&A Regulations adopted the UK's approach[184] to determining the minimum price that should be paid to the remaining shareholders.[185] Accordingly, article 28(a) states that:

> In the event where shares of any class in the Offeree Company are purchased in exchange for cash by an Offeror (or any persons acting in concert) during the Offer period or in the 12 months prior to it, in which case the Offer for that class shall be in cash or accompanied by a cash alternative at not less than the highest price paid by the Offeror (or any persons acting in concert) for shares of that class during the Offer period or in the 12 months prior to it.[186]

The mandatory bid rule's robustness is undermined by any deviation from the minimum pricing rule, because the mandatory bid rule is based on the sharing of the benefits from the transfer of control.[187] A low offer price means that shareholders are not strongly responsive to takeover offers. This facilitates changes of control under conditions that are favourable to the acquirer (low takeover costs) and detrimental to the interests of the minority shareholders.[188]

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[183] Merger and Acquisition Regulations 2007 amended 2018, Article 3(C): 'In the case of an Offer, all shareholders of the same class of an Offeree Company must be treated equally by an Offeror.'

[184] The UK Takeover Code Rule 9.5. The minimum price must be 'not less than the highest price paid by the [acquirer] or any person acting in concert with it for any interest in shares of that class during the 12 months prior to the announcement of that offer'.

[185] Some jurisdictions have adopted a different approach by relying on market price to determine the minimum price of the mandatory offer, such as Japan and Korea, where the acquirer determines the price of a mandatory offer. See Umakanth Varottil and Wai Yee Wan, 'The Divergent Designs of Mandatory Takeovers in Asia' [2021] SSRN Electronic Journal <https://law.nus.edu.sg/wp-content/uploads/2021/06/011_2021_Umakanth.pdf> accessed 19 October 2021.

[186] In the case of a non-cash offer if the acquiror is a company, Article 28(c) of the M&A Regulations states that: 'If the Offeror is a company, it may make an Offer that includes in whole or in part non-cash consideration (including issuing share by Offeror to the shareholders of the Offeree Company) as per the following conditions:
a. All shareholders of the same class of the Offeree Company are treated equally by the Offeror; and
b. Where the Offeree Company's shareholders are offered shares in the Offeror or other non-cash consideration, the Offeror must provide a valuation report of the non-cash consideration prepared by the Offeror's Independent Financial Advisor and which shall be required to be published in accordance with paragraph (f) of Article 38 of these Regulations.'

[187] Umakanth Varottil and Wai Yee Wan, 'The Divergent Designs of Mandatory Takeovers in Asia' [2021] SSRN Electronic Journal 25 <https://law.nus.edu.sg/wp-content/uploads/2021/06/011_2021_Umakanth.pdf> accessed 19 October 2021

[188] ibid.

The CMA's adoption of the highest price rule can enhance fairness in the market and provide protection to minority shareholders, as they will be assured of receiving a fair price in the case of a mandatory offer. However, article 28 of the M&A Regulations granted the CMA unlimited discretion to adjust the price if requested by the offeror.[189] This authority to adjust the price in mandatory bids is not uncommon in other jurisdictions. But some developed jurisdictions attempted to limit the discretional authority by providing factors that need to be considered to gain exemption from the highest price rule or to adjust the price. The UK Takeover Code, for example, provided several circumstances to be considered by the Panel to adjust the highest price rule.[190] For instance, the panel may consider adjusting the price in cases where such an adjusted price offer is necessary to rescue a company experiencing a serious financial crisis.[191]

The author believes that limiting the CMA's discretion in this regard is important, especially in the KSA where the government through its different investment agencies has an influence on many publicly traded companies. Because based on the above exception rule, any governmental investment agency can request the CMA (another agency controlled by the government) to be exempted from the highest price and may pay an unfair price to minority shareholders, and the CMA has an unlimited authority to approve such request with no obligations to justify and publish its decision. Thus, the rule should provide factors and grounds for such exemption or adjustment of the highest price rule to improve fairness in the market and clarity of the CMA's powers, and to ensure that minority shareholders' interests are protected. Moreover, as applied in the UK,[192] the M&A Regulations should oblige the CMA to publish its decision for exceptions from the rule to increase transparency in the market.

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[189] M&A Regulations 2018 Article 28(b) Exemption from highest price: 'If the Offeror considers that the highest price (for the purpose of paragraph (a) of this Article) should not apply in a particular case, the Offeror should approach the Authority, which has discretion to agree on an adjusted price.'

[190] The Takeover Code 2021 Notes on Rule 9.5(3) Adjustment of highest price: 'Circumstances which the Panel might take into account when considering an adjustment of the highest price include: (a) the size and timing of the relevant acquisitions; (b) the attitude of the board of the offeree company; (c) whether interests in shares had been acquired at high prices from directors or other persons closely connected with the offeror or the offeree company; (d) the number of shares in which interests have been acquired in the preceding 12 months; (e) if an offer is required in order to enable a company in serious financial difficulty to be rescued; (f) if an offer is required in the circumstances set out in Note 12 on Rule 9.1; and (g) if an offer is required in the circumstances set out in Rule 37.1. The price payable in the circumstances set out above will be the price that is fair and reasonable taking into account all the factors that are relevant to the circumstances. In any case where the highest price is adjusted under Rule 9.5(c), the Panel will publish its decision.'

[191] The Takeover Code 2021 Notes on Rule 9.5(3)

[192] The Takeover Code 2021 Notes on Rule 9.5(3)

6.4.7 Exemption: Is the Mandatory Bid Automatically Triggered After Reaching the 50% Threshold?

Unlike in several developed jurisdictions such as the UK,[193] the mandatory bid is not necessarily triggered even if the threshold set by the regulations is reached. As stated in article 23(a) of the M&A Regulations, the CMA has the right to obligate the acquirer to make a mandatory offer to the remaining shareholders. Thus, the mandatory offer can only be triggered by the CMA when it uses its unlimited discretionary power.

The purpose of the mandatory rule is to create a policy that if an individual or entity acquires a specific ownership percentage of a company, the mandatory bid will be triggered and the bid will be presented to the remaining shareholders. Therefore, giving the CMA such unlimited power over whether to apply the mandatory bid may not provide the equality and stability in the market that the mandatory bid rule is intended to attain. Thus, the author suggests that the mandatory bid should be automatically triggered once the threshold set by the regulations is reached; and the CMA should have the discretion to exempt parties from the rule upon their request in certain circumstances set by the law.

6.4.8 The Takeover of the Saudi Research and Media Group (SRMG)

The SRMG is a KSA listed company on the KSA Stock Exchange with a capital of SAR 800 million (USD 213 million).[194] The company operates through a number of its subsidiaries in KSA and abroad and its main activities are in the fields of media, advertising and publishing, licensed projects, and public relations.[195]

In 2015, SRMG announced that changes in the ownership of its shares occurred following private transactions.[196] SRMG stated that SNB Capital's Fund (4) acquired 25.3% of SRMG's shares, and SNB Capital's Fund (13) acquired 29.9% of SRMG's shares, which in total resulted in the ownership of 55.21% of SRMG by SNB Capital.[197] It is noteworthy

[193] Rule 9 of the Takeover Code states that the mandatory bid is triggered once the threshold of 30% is reached, although the panel has the authority to grant exemption from the rule.
[194] The Saudi Research and Media Group's file on the KSA Stock Exchange website, available at <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 5 February 2022)
[195] ibid
[196] See Maaal International Media Company website. Available at: <https://maaal.com/archives/201511/86361/>
[197] ibid.

that SNB Capital is a subsidiary of the Saudi National Bank (SNB).[198] SNB is a listed company on the KSA Stock Exchange, and its sole major shareholder is the government through the Public Investment Fund, as it holds 37.23% of SNB.[199]

On the same day as SRMG's announcement, the Kingdom Holding Company, a listed company with a capital of SAR 37 billion (USD 138 billion),[200] announced the sale of 29.9% of its shares in SRMG in a private deal.[201] It should be noted that the sole major shareholder of the Kingdom Holding Company is Prince Al Waleed bin Talal Al Saud, as he holds 95% of the company's shares.[202] As of February 15, 2022, SNB Capital's Fund 4 and Fund 13 collectively held 59.8% of SRMG shares (29.9% each).[203]

Despite the fact that SNB passed the mandatory bid threshold (50%),[204] the CMA has not required SNB to present a mandatory offer to the remaining shareholders who wish to sell their shares at the same price as the private deal. According to the M&A Regulations, the CMA has unlimited power to decide whether to enforce the mandatory bid obligation.[205] Moreover, the CMA is not obliged by law to provide any statements or explanations if it has not enforced the mandatory bid rule. A case such as this one illustrates the importance of triggering the mandatory bid rule automatically once the threshold is reached, and limiting the very wide discretionary power granted to the CMA by stating in the M&A Regulations the grounds for exemption from the mandatory bid rule.

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[198] The name of the company was the National Commercial Bank (NCB) before it was changed in 2021. See SNB file on the KSA Stock Exchange website, available at <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 5 February 2022).
[199] SNB overview page on the KSA Stock Exchange website, available at: <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 17 February 2022)
[200] The Kingdom Holding Company page on the KSA Stock Exchange website, available at: <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 17 February 2022)
[201] Other parties also sold substantial shares in private transactions, such as Prince Faisal Al Saud, a representative of the company's founder heirs. See Maaal International Media Company website. Available at: <https://maaal.com/archives/201511/86361/>; and <https://www.marefa.org/%D8%A7%D9%84%D9%85%D8%AC%D9%85%D9%88%D8%B9%D8%A9_%D8%A7%D9%84%D8%B3%D8%B9%D9%88%D8%AF%D9%8A%D8%A9_%D9%84%D9%84%D8%A3%D8%A8%D8%AD%D8%A7%D8%AB_%D9%88%D8%A7%D9%84%D8%AA%D8%B3%D9%88%D9%8A%D9%82>.
[202] The Kingdom Holding Company page on the KSA Stock Exchange website, available at: <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 17 February 2022)
[203] The Saudi Research and Media Group's file on the KSA Stock Exchange website, available at <https://www.saudiexchange.sa/wps/portal/tadawul/home?locale=en> (last visited 5 February 2022)
[204] Article 23 of the M&A Regulations
[205] ibid

6.4.9 Conclusion

In conclusion, this section has provided an overview of the mandatory bid rule and the rationale behind it as an important tool adopted by many jurisdictions to provide protection to minority shareholders once a change of control in a company takes place as a result of a takeover. The section looked at the rule regulations in the UK as the origin of the rule to provide recommendations to reform the rule regulations in KSA. Moreover, the section provided an analysis of the concept of control in the KSA market as a determining justification for the rule, and concluded that the triggering threshold of the rule should be lowered to 30% instead of 50%, considering several factors such as the level of legal development and the ownership structure in KSA. Recommendations were presented to reform the CMA's unlimited discretionary power regarding the adjustment of the mandatory bid price and the exemption from the rule, to ensure equality and fairness in the market.

6.5 Partial Offers

6.5.1 Introduction

There are several options for companies and individuals to increase their stakes in listed companies via takeover bids. They can launch a general takeover bid to all shareholders to acquire all or some of the company's shares. However, as illustrated in the previous section, once a threshold is reached, a mandatory bid will be triggered to extend the offer to the remaining shareholders. Another option is permitted for acquirers to launch a partial offer to all the company's shareholders, and in certain circumstances, such acquirers can escape the mandatory bid rule through partial offers. A partial offer is described as an offer to all shareholders to buy an equal percentage of each shareholder's holdings for less than the entire shares of the target company.[206]

Partial offers can provide the benefit of avoiding the need to make a mandatory offer. They can perform an economic function by offering potential acquirers flexibility in takeover transactions and can enable acquirers to secure corporate control with reduced costs when compared to general offers or mandatory bids.[207]

[206] Stephen Kenyon-Slade, *Mergers and Takeovers in the US and UK* (Oxford University Press 2004) 623
[207] Davies (n 110) 14; Hui Huang, 'The New Takeover Regulation in China: Evolution an Enhancement' (2008) 42 International Lawyer 153, 170 <https://www.jstor.org/stable/23824441> accessed 9 November 2021

6.5.2 Partial Offers in KSA

The CMA permitted partial offers and mainly regulated such offers in article 25 of the M&A Regulations. The CMA defines a partial offer as: 'an offer (except for offers made by the same offeree company) subject to the Merger & Acquisition Regulations, made to all holders of the shares carrying voting rights in the offeree company to purchase a certain percentage of shares in the offeree company'.[208]

According to the M&A Regulations, a partial offer can be made to the target company once a prior CMA approval is obtained.[209] Therefore, the rule grants the CMA the discretion to allow such offers through a case-by-case approach. The regulations concluded that mandatory offer rules will apply to partial offers.[210] However, the CMA has an unlimited discretionary power to allow partial offers without triggering the mandatory bid rule even if the threshold of 50% is reached. The CMA's unlimited power to exempt from the mandatory bid rule was illustrated in the previous section.[211] Accordingly, partial offers can be for the purchase of any percentage less than 100% of the companies' shares, and only the CMA has the power to approve such offers regardless of the purchase percentage of the offer, even if it reaches the mandatory bid threshold.[212] Thus, both mandatory offers and partial offers are at the unlimited discretion of the CMA to allow or exempt from them; and shareholders will have no powers to influence these decisions according to the regulations. Indeed, this wide discretionary power accorded to the CMA indirectly made the mandatory bids and partial offers regulations merely guidelines rather than clear policies that provide fairness and equality or increase transparency in the market.

[208] Glossary of Defined Terms Used in The Regulations and Rules of the Capital Market Authority (2021)
[209] M&A Regulations 2018 Article 25(a)
[210] M&A Regulations 2018 Article 25(d)
[211] M&A Regulations 2018 Article 23(a)
[212] Although the regulations set a threshold of 30% of the partial offers, once it is planned to reach this threshold, the offer should 'not be conditional unless the Offeror obtains the approvals relating to the shares which, together with the shares acquired or agreed to be acquired by the Offeror before or during the offer, result in the offeror obtaining 30% or more of the voting rights (in the absence of any other regulatory approvals necessary to implement the offer)'. See M&A Regulations 2018 Article 25(b).

6.5.3 Recommendations

Although the CMA's discretionary power is important as the regulator and supervisor of the market, the author recommends limiting this power in situations where minority shareholders are in vulnerable positions. In the partial offer context, if the offer will lead to the acquisition of a controlling position for the offeror, which is 30% or more of the company's shares, shareholders should have the right to approve such offers in addition to the CMA's prior approval. This can be achieved by adopting the UK's Takeover Code principles in this regard. Accordingly, such partial offers should be approved by shareholders owning more than 50% of the voting shares in the target firm (who are independent of the offeror and persons acting in concert with it), whether or not those shareholders plan to accept the offer.[213]

6.6 Squeeze-out and Sell-out Rules

6.6.1 Introduction

After a successful takeover bid, the acquirer may not end up holding 100% of the company's shares. In these scenarios, several jurisdictions incorporated squeeze-out and sell-out rules in their takeover systems to address issues that can arise as a result of takeovers that confer on the acquirer a substantial extent of but not full ownership of the company. These rules provide an opportunity to the remaining minority shareholders to leave the company after the takeover and provide acquirers with the means to secure 100% ownership of the company's shares. The rules can also have an indirect pre-bid influence on the takeover system. For example, the sell-out rule can eliminate the pressure on the shareholders to accept a takeover bid, as they will know that they have another opportunity to leave the company at a fair price if the bid is successful. The squeeze-out rule, on the other hand, can encourage potential acquirers to offer takeover bids, as the rule will provide an opportunity to acquire the shares of the minority shareholders who refused to sell after the successful takeover once a certain

[213] See Rule 36.5 of the Takeover Code 2021: 'Any offer which could result in the offeror and persons acting in concert with it being interested in shares carrying 30% or more of the voting rights of a company must be conditional, not only on the specified number of acceptances being received, but also on approval of the offer, normally signified by means of a separate box on the form of acceptance, being given in respect of over 50% of the voting rights held by shareholders who are independent of the offeror and persons acting in concert with it. This requirement may on occasion be waived if over 50% of the voting rights of the offeree company are held by one shareholder.'

ownership threshold is reached by the acquirer. The KSA takeover system does not include or permit squeeze-out and sell-out rules in its laws and regulations.

This section will overview these rules and their impact on minority shareholders and takeover activities in general. The section will argue that it is integral to incorporate squeeze-out and sell-out rules in the KSA takeover system as tools to protect minority shareholders, and also to provide economic benefits, considering that takeovers can have beneficial economic influence and can be an instrument for better corporate governance,[214] by encouraging potential acquirers who might hesitate to offer a bid in the absence of the squeeze-out rule. Moreover, the free-rider problem, which can occur after a successful takeover of a company that confers ownership of less than 100% of the company's shares, will be discussed and the squeeze-out right will be presented as an instrument with which to tackle the free-rider issue.

6.6.2 The Squeeze-out Rule

The squeeze-out rule is a right that enables an offeror to force minority shareholders to sell their shares following a bid offered to all the shareholders of the offeree company for all their shares at a fair price.[215] The fair price is generally established based on the same form and amount as the consideration offered in the takeover bid.[216] This rule may only apply once an acquirer reaches a certain ownership percentage of the offeree company; this percentage varies in different jurisdictions. The EU Directive on Takeover bids[217] and the UK Companies Act[218] both set the threshold for triggering the squeeze-out rule when the acquirer holds shares representing 90%[219] or more of the company's voting shares.

[214] Michael C Jensen, 'The Takeover Controversy: Analysis and Evidence' (1986) 4 Midland Corporate Finance Journal 7–8 <https://www.hbs.edu/faculty/Pages/item.aspx?num=8998> accessed 10 November 2021
[215] Christophe Clerc, Diego Demarigny, FabriceValiante and Mirzha de Manuel Aramendía, 'A Legal and Economic Assessment of European Takeover Regulation' [2012] Marccus Partners and Centre for European Policy Studies 88
<https://www.researchgate.net/publication/256041254_A_Legal_and_Economic_Assessment_of_European_Takeover_Regulation>
[216] ibid 90
[217] DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on takeover bids, Article 15.
[218] UK Companies Act 2006, s. 979
[219] However, the EU Directive allows member states to adjust the squeeze-out threshold to between 90% up to 95%: Article 15(2)(b) of the EU Directive on takeover bids.

6.6.2.1 The Rationale Behind the Squeeze-out Rule

The purpose and rationale for the squeeze-out rule are that the rule works as a bid-enhancement mechanism which is proposed to facilitate and ease takeover activities, considering that takeovers can be an important strategy for companies to expand their businesses.[220] Indeed, the squeeze-out rule can increase takeover transactions as it enables the acquirer to force minority shareholders to leave the company in order to avoid higher costs and risks associated with those shareholders.[221] Considering that some shareholders may refuse to sell their shares during the takeover bid as they anticipate an increase of the value of the shares after the successful takeover, this creates the 'free rider' problem.[222] The free-rider problem is generally defined in the literature as the situation that arises when 'one firm (or individual) benefits from the actions and efforts of another without paying or sharing the costs'.[223] The squeeze-out rule can be an effective solution to the free-rider problem.[224]

However, there are concerns regarding the violation of property rights created by forced squeeze-out. According to Mukwiri: 'The acceptance of the squeeze-out right in company law is in effect a promotion of capitalism at the cost of protection of minority shareholders where such minority does not wish to give up his shareholding.'[225]

Although minority shareholders will be offered a fair price in the squeeze-out scenarios, the measurement of fairness is whether the price paid to the minority shareholder in exchange is an economically appropriate offer price, not whether it is fair to remove a minority shareholder's property rights and investing liberty.[226] From this point of view, fairness is associated with economics, and law in the takeover context can be seen as an economical device used to facilitate commercial transactions.[227]

Nevertheless, the Winter Report considered the property right issue related to the squeeze-out rule and concluded that:

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[220] Clerc, Demarigny, FabriceValiante and Aramendía (n 215) 88
[221] ibid
[222] Jonathan Mukwiri, 'Implementing the Takeover Directive in the UK' (2008) 100 <https://lra.le.ac.uk/bitstream/2381/3993/1/2008MukwiriJPhD.pdf> accessed 27 December 2018
[223] See the OECD website: <https://stats.oecd.org/glossary/detail.asp?ID=3222>.
[224] G K Yarrow, 'Shareholder Protection, Compulsory Acquisition and the Efficiency of the Takeover |Process' (1985) 34 The Journal of Industrial Economics 3, 4 <https://www.jstor.org/stable/2098478> accessed 1 December 2021
[225] Mukwiri (n 222) 104
[226] ibid 103.
[227] ibid

> There is indeed a general and public interest in having companies efficiently managed on the one hand, and securities markets sufficiently liquid on the other hand. So long as the squeeze-out right applies only when the minority is fairly small and appropriate compensation is offered, the use of squeeze-out to address these public interests is proportionate.[228]

Indeed, takeovers can play an integral role in improving financial markets by replacing incompetent management, as the cost of controlling these under-performing companies is low when compared to the benefits that the new controller will gain after appointing more efficient management.[229] The performance of management can be improved in markets where takeover transactions are common, considering that the threat of a takeover will pressure management to efficiently run the company to avoid removal by a potential new acquirer of the company.[230] Furthermore, companies need the flexibility of regulations and the availability of financing mechanisms, such as takeovers, to achieve their goals.[231]

Thus, the absence of the squeeze-out rule, as an efficient tool to overcome the free-rider problem,[232] can minimise the benefits that takeovers provide as the cost of takeovers will likely rise in the absence of the rule.[233] Moreover, some potential takeovers can be frustrated by small minority shareholders who refuse to tender their shares in the hope of extracting a better price than the other shareholders or from a lack of interest in the matter.[234] To overcome the concerns about property rights and minority shareholders that the rule may represent, it is essential to strike a balance between public good and economic incentives, and the protection of minority shareholders.[235] This balance is usually achieved when the legal and takeover systems of a jurisdiction already provide strong protection to minority

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[228] A report by Jaap Winter, that is: European Commission, 'Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe' (Brussels, 4 November 2002) 60–61.
[229] Yarrow (n 224) 3
[230] ibid
[231] Christoph van der Elst and Lientje van den Steen, 'Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-out and Sell-out Rights' (2009) 6 European Company and Financial Law Review 35 <https://www.degruyter.com/document/doi/10.1515/ECFR.2009.391/html> accessed 3 March 2022
[232] Sanford J Grossman and Oliver D Hart, 'Takeover Bids, The Free-Rider Problem, and the Theory of the Corporation' (1980) 11 The Bell Journal of Economics 42, 43 <https://about.jstor.org/terms> accessed 4 November 2018
[233] Yarrow (n 224) 15; Burkart and Panunzi (n 131)
[234] Yarrow (n 224) 11
[235] Christoph Van der Elst and Lientje SF Van den Steen, 'Opportunities in the M&A Aftermarket: Squeezing Out and Selling Out' [2006] SSRN Electronic Journal 14 <https://deliverypdf.ssrn.com/delivery.php?ID=055111099081017084108112124119031087063040063045057050005106067121025114122099122031031061097043039126023028071103120069119116013058073027124120088080067066026018049019103094098096069011114031089014025118077030> accessed 7 March 2022

shareholders.[236] This will, on the one hand, ensure that the process of the takeover did not involve exploitation of the minority shareholders and that when the small minorities are being squeezed out, they receive an appropriate and fair compensation, while, on the other hand, maintaining the public good in having corporations properly managed and increasing the liquidity of the market.[237]

Therefore, the rule can be a necessary tool to be adopted by regulators to reduce the cost of takeovers, which may be less appealing without a squeeze-out right due to the costs and risks associated with the existence of minority shareholders after the takeover, to facilitate a productive change of control that improves management and the company performance and may provide a positive impact on the development of a takeover market.[238] The squeeze-out rule has long existed under the UK company law and several takeover laws in different jurisdictions. The following subsection will provide an overview of the rule under the UK's Company Law.

6.6.2.2 The Squeeze-out Rule in the UK

The historical position of the UK common law was that when a company offered for or bought another company's shares, the acquiring company did not have the right to force any shareholders to sell their shares against their will.[239] However, this position changed nearly a century ago after the enactment of the Companies Act 1928.[240] Over time, the squeeze-out, as well as the sell-out right, became fully entrenched in UK company law. Now, the squeeze-out rule is regulated in the Companies Act 2006.[241]

The UK adopted the 90% threshold as a trigger to the squeeze-out rule. Thus, an acquirer who secures 90% or more of a company's shares as a result of a takeover can compel the remaining minority shareholders to sell their shares to him. This threshold coincides with

[236] Yarrow (n 224) 3,15; Van der Elst and Van den Steen (n 235) 14
[237] Van der Elst and Van den Steen (n 235) 14
[238] Marc Goergen, Marina Martynova and Luc Renneboog, 'Corporate Governance Convergence: Evidence from Takeover Regulation Reforms in Europe' (2005) 21 Oxford Review of Economic Policy 243, 247, 252 <https://www.jstor.org/stable/23606982> accessed 5 March 2022
[239] See *Re Castner-Kellner Alkali Co Ltd* [1930] 2 Ch 349; and *Re Hoare & Co Ltd* [1933] All ER Rep 105; Jonathan Mukwiri, 'Takeovers and Incidental Protection of Minority Shareholders' (2013) 10 European Company and Financial Law Review 432, 14 <http://ssrn.com/abstract=2398543> accessed 2 December 2021
[240] Section 50 of the Companies Act 1928; the section provided a right to force the remaining minority shareholders to tender their shares after a successful takeover, which is an equivalent right to the squeeze-out rule; Mukwiri (n 220) 14.
[241] Chapter 3, Sections 979–982 of the Companies Act 2006

the EU Directive on Takeover Bids'[242] threshold for the squeeze-out rule. It is worth noting that many jurisdictions adopt the squeeze-out rule. Even prior to the EU directive on takeover bids, many European countries adopted the rule in their takeover systems.[243]

6.6.2.3 The Squeeze-out Rule in KSA

The squeeze-out rule has not been adopted in the KSA Companies Law 2015 or the CMA's M&A Regulations. Although the rule can be an important tool to facilitate takeover transactions and has been adopted in many developed jurisdictions, such as the UK, which the KSA takeover regulations are mostly influenced by, the squeeze-out right does not exist in the KSA takeover system. The rationale behind the absence of the rule in KSA is not clear, and it cannot be attributed to concern over violations of property rights.[244] This is because the principle of forcing minority shareholders to accept decisions related to their companies is already established in KSA Companies Law in many forms. For example, a target company can merge with another company if 75% approved the transaction in the extraordinary general meeting (EGM) despite the opposition of the minority shareholders.[245]

Moreover, the principle of forcing minority shareholders to sell their shares against their will was established in the M&A Regulations in 2018 when the Acquisition by compulsory share exchange article was introduced.[246] According to the article, an offeror may provide, after obtaining the CMA's prior approval, the offeree company with a securities exchange with the offeror in consideration of all the shares in the offeree company.[247] The acquisition by compulsory share exchange is valid only if it is approved by a special resolution (75%) in the EGM in the offeree company.[248]

Therefore, the absence of the squeeze-out rule in the KSA takeover system cannot be attributed to concern over the violation of minority shareholders' property rights because concepts similar to the squeeze-out rule are already adopted in the Company Law and M&A Regulations.

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[242] DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on takeover bids, Article 15
[243] Clerc, Demarigny, FabriceValiante and Aramendía (n 215) 88
[244] For more detail about the squeeze-out rule and the balance between economic incentives and protection of property rights, see 'The rationale behind the squeeze-out rule' in section 6.6.2.1
[245] Article 94(4) of the 2015 Companies Law
[246] Acquisition by compulsory share exchange is discussed in more detail in chapter 3.
[247] Article 26(A)of the M & A Regulations 2018
[248] Article 26(C) of the M & A Regulations 2018

6.6.2.4 Recommendation to Adopt the squeeze-out Rule in KSA

The KSA stock market and takeover system may be considered relatively new and still developing, especially when compared to developed and deep-rooted jurisdictions such as the UK. However, the KSA market developed rapidly over the past twenty years and many major reforms were implemented which made the KSA the largest stock market in the Middle East[249] and the 9th biggest stock market among the 67 members of the World Federation of Exchanges.[250]

Thus, more developed and sophisticated regulations are required to cope with this rapidly developing and large market. Consideration should be paid to the fact that the squeeze-out rule has been implemented in many developed jurisdictions, and to the integral role that the squeeze-out right can play in overriding the free-rider problem. Furthermore, the rule can also be an effective tool to facilitate and encourage takeovers, as bidders can ensure complete ownership of the company, considering that takeovers can be an important device for the market for corporate control as an external corporate governance mechanism and a disciplining tool for under-performing companies.[251]

The author recommends the implementation of the squeeze-out rule in the KSA takeover system. The CMA can adopt a 'soft' approach to adopting the rule by applying it only when this is permitted by the article of association of the target company. This approach has been adopted by the United Arab Emirates when the country recently implemented the squeeze-out rule for the first time in 2017.[252] The concept of allowing the compulsory acquisition of the shares of minority shareholders where only this is permitted by the articles of association of

[249]See Business Insider website. Available at: <https://www.businessinsider.com/saudi-arabia-just-opened-the-middle-easts-biggest-stock-market-to-global-investors-for-the-first-time-in-history-2015-6>

[250] See Saudi Exchange website: <https://www.saudiexchange.sa/wps/portal/tadawul/about?locale=en> accessed 10 December 2021.

[251] Maria E Maher and Thomas Andersson, 'Corporate Governance: Effects on Firm Performance and Economic Growth' [1999] Organisation for Economic Co-operation and Development 37 <https://www.oecd.org/sti/ind/2090569.pdf> accessed 27 December 2021

[252] The threshold set by the Emirates Securities and Commodities Authority to allow the acquirer to apply for the squeeze-out right is reached when he secures more than 90% of the company's shares. According to the article: 'The Acquirer, which acquired (90% + 1 Security) and above, may submit an application to the Authority for approval to submit a mandatory Offer to enforce the minority Securities' holders to sell/swap all the Securities held by them in favor of the Acquirer where this is permitted by the Articles of Association of the acquired Target Company, within 60 days from the date of final settlement of the primary Offer'. Article 11 (2) Resolution No (18/RM) of 2017, regarding the Rules of Acquisition and Merger of Public Shareholding Companies. The Emirates Securities and Commodities Authority: <https://www.sca.gov.ae/en/regulations/regulations-listing.aspx#page=1>

the acquired company has long existed in the UK common law prior to the regulation of squeeze-out in the takeover regime.[253] This approach was established at common law and considered valid and enforceable when a compulsory acquisition clause was adopted in the article of association.[254] This approach allows shareholders to willingly accept the possibility of a squeeze-out in the future prior to entering the company.[255]

The author recommends the adoption of the squeeze-out rule in the KSA takeover system and sets two conditions for its application. Firstly, the acquirer should have secured 90% or more of the company's shares as a threshold to allow him to submit a request to the CMA to permit the squeeze-out. Secondly, the target company must have incorporated a squeeze-out clause in its articles of association.[256]

6.6.3 The Sell-out Rule

The notion of the sell-out rule is to enable the remaining shareholder(s) to force the acquirer, who has control through holding a majority of shares, to buy their shares at a fair price.[257] The fair price is generally established based on the same form and amount as the consideration offered in the takeover bid.[258] The sell-out rule is triggered once the acquirer reaches a certain ownership threshold determined by law. This threshold is often determined when the acquirer owns a significant percentage of the company's shares, which gives him almost absolute power over the company. The EU Directive on Takeover Bids[259] and the UK Companies Act[260] both set the threshold for triggering the sell-out rule at the point when the acquirer holds shares representing 90%[261] or more of the company's voting shares.

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[253] Mukwiri (n 239) 18

[254] *Phillips v Manufacturers' Securities Ltd* (1917) 86 LJ Ch 305, 116 LT 290.

[255] In terms of altering the article of association to include a clause that permits squeeze-out, the UK courts allowed such modifications only if this step was bona fide for the benefit of the company as a whole. In *Dafen Tinplate Co Ltd v Llanelly Steel Co Ltd* [1920] 2 Ch 124, the court refused to alter the article of association to include the squeeze-out clause because it found that it would benefit the majority rather than the company as a whole. In *Sidebottom v Kershaw Leese & Co Ltd* [1920] 1 Ch 154, the court allowed such alteration to add the squeeze-out provision to the article of association as it found that the alteration was for the benefit of the company as an entity. See Mukwiri (n 239) 20.

[256] The CMA and KSA courts should allow modification of the article of association to include squeeze-out provisions only if it is for the benefit of the company as a whole, not just for the benefit of the majority, similarly to the approach adopted by the UK courts mentioned in note 253.

[257] Clerc (n 215) 87

[258] ibid 90.

[259] DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on takeover bids, Articles 15 and 16.

[260] UK Companies Act 2006, s. 983

[261] However, the EU Directive allows member states to adjust the sell-out threshold to between 90% and 95%. Article 15(2)(b) of the EU Directive on takeover bids.

6.6.3.1 The Rationale Behind the Sell-out Rule

The sell-out rule is the counterpart to the squeeze-out rule. The rationale for the sell-out rule is to provide protection to minority shareholders from potential abuse by the majority shareholder who secured a dominant position after the takeover, and who might obtain private benefits at the expense of the minority shareholders.[262] The fair price[263] obligation can also allow minority shareholders to acquire a higher price for their shares compared to the price that they can obtain from a potential illiquid market.[264] The sell-out rule can provide additional protection to minority shareholders even before the completion of a takeover bid. The rule reduces the pressure on shareholders to tender their shares at the offer period as they are unlikely to be in a situation after the successful takeover where they have a minority position and a great risk of exploitation of private benefits of control at their expense.[265] Indeed, the sell-out rule can work as an extension of the offer period[266] as shareholders who initially refused the offer, possibly in an attempt to make the offer fail, will be able to sell their shares after the acquirer has secured a controlling position and reached the rule triggering threshold.[267]

6.6.3.2 The Sell-out Rule in the UK[268]

The sell-out rule was firstly adopted in the UK takeover regulations after the enactment of the Companies Act 1928.[269] Now, the sell-out rule is regulated in the Companies Act 2006.[270] The UK adopted the 90% threshold as a trigger to the sell-out rule. Thus, when an acquirer secures 90% or more of a company's shares as a result of a takeover, the remaining minority shareholders can compel the acquirer to buy shares.[271]

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[262] Burkart and Panunzi (n 131) 20
[263] Fair price would be the same price as the takeover bid. See: Clerc, Demarigny, FabriceValiante and Aramendía (n 215) 90
[264] Clerc, Demarigny, FabriceValiante and Aramendía (n 215) 88
[265] ibid
[266] It should be noted that the right of squeeze-out and the right of sell-out can only be exercised within a certain period of time after the offer, usually three months after the end of the acceptance period. See for example Article 15(4) of the EU Directive on Takeover Bids 2004.
[267] Burkart and Panunzi (n 131) 20.
[268] The UK approach towards squeeze-out and sell-out rights was discussed in further detail earlier in sections 6.6.2.2 and 6.6.3.2.
[269] Section 50 of the Companies Act 1928. See note 238 for further detail.
[270] Chapter 3 Sections 983–985 of the Companies Act 2006.
[271] Section 983 of the Companies Act 2006.

6.6.3.3 The Sell-out Rule in KSA and Recommended Reforms

The KSA Companies Law and the CMA M&A Regulations did not include any articles allowing the sell-out rule despite the adoption of the rule in many developed jurisdictions such as the UK.

The author recommends the adoption of the sell-out rule in the KSA takeover system considering its important influence as a tool to protect minority shareholders. The benefits of the rule as a protective device for minority shareholders were discussed in detail at the beginning of this subsection.[272] Moreover, in 2015, the Gulf Cooperation Countries ('GCC') approved general non-compulsory guideline rules to regulate takeovers in the GCC states.[273] Article 26 of the GCC unified M&A rules states that if a shareholder acquires 90% or more of the voting shares in the company targeted by the offer, any of the other shareholders holding at least 3% of the capital may request the supervisory authority to notify the majority to purchase their shares.[274]

The rationale for requiring at least 3% to be held by a shareholder(s) to request the relevant authority to allow the sell-out right is not clear. The purpose of the rule is to protect all the remaining minority shareholders after the successful takeover. The 3% condition can eliminate one of the sell-out benefits, which is the reduction of the pressure on shareholders to tender their shares at the offer period, as some of the minority shareholders will not be able to know if they will reach the 3% threshold with the other shareholders.

Thus, the author recommends the adoption of the sell-out rule and implementation of the UK approach[275] by allowing any remaining minority shareholder, regardless of his number of shares, to request the enforcement of the rule once an acquirer reaches the ownership of 90%, to ensure fairness and equality to all shareholders.

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[272] Discussed in further detail in section 6.6.3.

[273] The GCC council decided to adopt the rules in an advisory capacity until completion of the preparation of a system of unified rules and principles for the integration of financial markets in the GCC countries, and to ensure their compatibility with each other. See Unified Rules for Acquisition in Financial Markets in The Cooperation Council for the Arab States of the Gulf (GCC) (guidelines) 2016 Arabic version, available at: <https://www.gcc-sg.org/ar-sa/CognitiveSources/DigitalLibrary/Pages/Details.aspx?itemid=732>.

[274] Article 26 of the GCC unified M&A rules. available at: <https://www.gcc-sg.org/ar-sa/CognitiveSources/DigitalLibrary/Pages/Details.aspx?itemid=732>. This approach was adopted by the Emirates Securities and Commodities Authority in 2017 when the rule was introduced in the country. The regulations required the ownership of at least 3% to allow to apply to the relevant authority to enforce the sell-out rule. See Article 11(1) Resolution No (18/RM) of 2017, regarding the Rules of Acquisition and Merger of Public Shareholding Companies. The Emirates Securities and Commodities Authority: <https://www.sca.gov.ae/en/regulations/regulations-listing.aspx#page=1>.

[275] Section 983 of the Companies Act 2006

6.6.4 Conclusion

This section has provided an analysis of the squeeze-out and sell-out rules and reviewed their importance in takeover systems. As the KSA has not yet adopted these rules in its takeover regulations, the author recommended the adoption of the squeeze-out and sell-out rules in KSA. Such recommendations were made because these rules would allow the KSA takeover regulation to better meet the economic needs of companies and minority shareholders involved in companies undergoing takeover transactions. This can maintain a balance between shareholders' rights protection and the economic needs of companies to grow their trades in a way that improves the KSA economy.

The author argued that the absence of the rules in KSA cannot be attributed to the assumption that the rules violate property rights. Similar company laws and regulations that share similar principles to those of the squeeze-out and sell-out rules have long existed in the KSA company law and M&A regulations. Moreover, the squeeze-out rule is considered an effective tool to overcome the free-rider problem that can occur after a takeover that resulted in substantial ownership of the target company in the presence of minority shareholders. It is also essential for the sell-out rule, as a counterpart to the squeeze-out rule, to be incorporated in the KSA takeover system to protect minority shareholders.

6.7 Chapter Conclusion

This chapter has analysed the minority shareholders' protection in takeovers in KSA. The ownership structure and the de facto control by some blockholders in KSA were viewed as major elements that need to be considered when providing recommendations to reform the mandatory bid rule and other rules such as the sell-out rule. Recommendations were provided in this chapter to lower the triggering threshold of the mandatory bid rule to 30% to increase the level of protection for minority shareholders. It was recommended that the sell-out and squeeze-out rules be adopted in the KSA takeover regulations to provide additional protection to minority shareholders and to strike a balance between minority protection and the market's need for flexibility.

The focus of the chapter was on regulations that protect minority shareholders in takeovers. However, other important matters that relate to the protection of shareholders in takeovers have not been discussed in this chapter, such as directors' duties and judicial

remedies provided to minority shareholders in takeovers, which will be analysed in the following chapter.

Chapter 7. Directors' Duties, Accountability, and Litigation in the Takeover Context

7.1 Introduction

7.1.1 Background

As the protection of shareholders in takeovers was discussed in the previous chapter, this chapter discusses topics that are closely related to the protection of shareholders, as it examines the directors' duties in takeovers, the standards for their accountability, and the methods for suing them when they commit an action harmful to the company or the shareholders.

In takeovers, especially in listed companies where there is a formal separation of ownership and control,[1] agency problems[2] can be aggravated, considering that directors are highly likely to be removed after a takeover (particularly in the case of hostile takeovers). Thus, they may be more likely to resist a takeover, even if it is in the best interests of the company and its shareholders. Therefore, legislation that provides clear directors' duties is highly important for governing the directors' role in this conflict-of-interest situation and providing strong protection to shareholders.

The chapter will argue that the legal framework governing directors' duties and their role in takeovers lacks clarity and comprehensiveness in the KSA. It will also address the litigation options in KSA that suffer vagueness and ambiguity, which undermines the protection of minority shareholders. Thus, recommended reforms will be provided to address these issues through implementation of some principles in this area drawn from the UK, considering the great influence on KSA of the UK's takeover system.

This chapter is divided into five main sections: the first section will introduce the topic and provide an overview of the board of directors and its structure, as well as the role of

[1] See Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (1932). This concept is discussed in further detail in chapter 2.
[2] See for example: Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) LII The Journal of Finance 52 <https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.1997.tb04820.x>; Eugene F Fama and Michael C Jensen, 'Separation of ownership and coontrol" (1983) 26 301 <https://www.jstor.org/stable/725104?seq=1#page_scan_tab_contents> Agency theory is discussed in further detail in chapter 2.

independent and non-executive directors. The second section will address directors' duties and the problems that the body of law suffers in KSA in this area. The third section examines the advisory role of directors and the importance of the clarity of this role being provided by the regulations to avoid short-term approaches by directors. The fourth section concerns board neutrality and the non-frustration rule in takeovers. It will analyse the two main different approaches adopted in the US and the UK in this regard and the rationale for such divergence, to pave the way to examine the rule and its efficiency in the KSA. The fifth section addresses the issues in the KSA's legal system regarding the litigation options provided for shareholders in the takeover system.

7.1.2 To Whom Directors Owe their Duties

Due to the fundamental premise that a corporation is an independent legal entity separate from its shareholders, directors in general only owe their duties to the company.[3] Directors do not owe their duties to the shareholders[4] of the company or to the creditors of the company.[5]

However, in certain circumstances where conflicts of interest are possible and shareholders depend highly upon directors for information and advice, directors' duties can shift towards the shareholders.[6] This situation can arise in the context of a takeover bid where shareholders rely on directors' advice to decide on the merits of the bid. In this scenario, an agency relationship is established, and directors can be seen as agents of the shareholders. This assumption is based on the position of directors in takeovers where they have undertaken or been required by law to counsel, negotiate, or otherwise serve as an intermediary between shareholders and a bidder, and thus owe a fiduciary duty to shareholders.[7] Indeed, some developed jurisdictions such as the UK have adopted this

[3] See for example the UK's Companies Act 2006, s 170(1): 'The general duties specified in sections 171 to 177 are owed by a director of a company to the company.'; *Sharp & Others v Blank & Others* [2015] EWHC 3220 (Ch).
[4] See for example *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324; *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606.
[5] See for example: *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258; *Sharp & Others v Blank & Others* [2015] EWHC 3220 (Ch).
[6] Brenda Hannigan, *Company Law* (3rd edn, Oxford University Press 2012) 157
[7] Jonathan Mukwiri, 'Directors' Duties in Takeover Bids and English Company Law' (2008) 19 International Company and Commercial Law Review 281, 2 <https://uk.westlaw.com/Document/I176F0A805D2111DD98DCA9DBEA2CCDB2/View/FullText.html?originationContext=document&transitionType=SearchItem&ppcid=67c6c882d8c74fd4b1f9c90fbd57bfa9&contextData=(sc.Search)&navigationPath=Search%2Fv1%2Fresults%2Fnavigation%2Fi>. accessed 25 May 2022. In *Bristol and West Building Society v Mothew* [1998] Ch 1, 18, Millet LJ described a fiduciary as: 'a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence'.

approach. According to Deakin et al., the UK's Takeover Code 'embodies in a particularly clear way the principle that, during the course of a takeover bid, directors of the target company are meant to act as the agents of the shareholders'.[8] Directors' roles and duties in takeovers are discussed in detail in sections 7.2 and 7.3 of this chapter.

Moreover, although directors only owe their duties to the company, in the case of a takeover bid, directors have two statutory obligations towards the employees. The first obligation is to consider the interest of the employees when providing recommendations on a bid.[9] This is a part of their general duty to promote the success of the company as a whole.[10] The second duty toward the employees is to inform them about the bidder's plans for the company and the employees.[11] Aside from takeovers, the view continues to be that directors have no general duty to employees except when a factual relationship is proven.[12]

7.1.3 Why a Board of Directors?

As a result of the separation of ownership and control as illustrated in the previous chapter, and due to practical obstacles, such as lack of expertise and the huge number of investors, shareholders are unable to participate in the day-to-day administration of a company's operations in almost all publicly traded companies; thus, management functions are transferred to the board of directors.[13] Assuming that some shareholders may have the knowledge and experience needed to carry out the responsibilities of managers, they generally do not have the incentives required to get involved in the day-to-day operations of the company or participate in the difficulties of optimum decision-making.[14] Thus, it is more cost-effective and time-saving to have a central decision-making board of directors to manage the firm.[15] To achieve a proper decision-making process, it is necessary for the board of

[8] Simon Deakin et al., 'Implicit contracts, takeovers, and corporate governance: in the shadow of the City Code' (2002) Centre for Business Research, University of Cambridge, Working Paper 254, 14 <https://www.cbr.cam.ac.uk/wp-content/uploads/2020/08/wp254.pdf> accessed 25 May 2022
[9] See M&A Regulations 2018 Article 3(m): 'It is the shareholders' interests taken as a whole, together with those of employees and creditors, that should be considered when the directors are giving advice to shareholders.'
[10] See the UK's Companies Act 2006, s 172(1).
[11] See M&A Regulations 2018 Article 39(b); and UK's Takeover Code 13th edn 2021 Rule 25.
[12] See Benjamin Pettet, 'Duties in Respect of Employees under the Companies Act 1980' (1981) 34 Current Legal Problems 199 <https://academic.oup.com/clp/article-abstract/34/1/199/345126> accessed 29 May 2022; Mukwiri (n 7) 2; *Sharp & Others v Blank & Others* [2015] EWHC 3220 (Ch).
[13] Hannigan (n 6) 105
[14] Bernard S Sharfman, 'What's Wrong with Shareholder Empowerment?' (2012) 37 Journal of Corporation Law 904, 907 <http://ssrn.com/abstract=2018715> accessed 30 May 2022
[15] ibid 904

directors to have wide discretionary authority while running the firm.[16] However, given human nature, directors may misuse this wide power to achieve self-interest goals at the expense of the shareholders and the company.[17] Therefore, it is necessary to provide certain measures[18] to ensure that this wide power is used properly and to hold directors liable if this power is misused. Directors' duties, enforcement methods and judicial remedies[19] are crucial components of the legal framework for protecting shareholders and holding directors accountable.

7.1.4 Board Structure

The purpose of this subsection and the following one (non-executive and independent directors) is to briefly set the scene in this chapter for provision of more understanding about boards of directors, in order to discuss directors' duties and accountability in the takeover context in the KSA.

Boards around the world generally fall into one of two main models: a unitary board or a dual board.[20] In corporate governance systems influenced by the Anglo-Saxon style, such as that of the US and the UK, board structures consist of a unitary board of directors.[21] In this structure, the board is comprised of both executive and non-executive directors.[22] The unitary board has oversight of all parts of the company's operations, and all directors strive towards the same goals.[23] At the annual shareholder meeting, the board of directors is elected by the company's shareholders.[24] The dual board, on the other hand, consists of two distinct boards. The first is the management board which usually consists of executive directors only and focuses on the running of the business and key operational issues.[25] The second board is a supervisory board, which is led by a non-executive chairman; its role is to monitor the business's direction and important strategic decisions and supervise the management board.[26]

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[16] Stephan M. Bainbridge, *Corporate Law* (3rd edn, Foundation Press 2015) 81
[17] ibid 82
[18] There are several mechanisms for supervising the actions and decisions of the board of directors that have been discussed in different sections and chapters of this thesis. For example, the shareholders' vote and the existence of independent non-executive directors can minimise the risk and possibility of directors misusing their power. The role of independent non-executive directors is discussed in the next subsection.
[19] Such as the derivative action which is discussed in this chapter in section 7.5.
[20] Jill Solomon, *Corporate governance and accountability* (4th edn, Wiley 2013) 79
[21] ibid
[22] Christine A Mallin, *Corporate Governance* (4th edn, Oxford University Press 2013) 166
[23] ibid
[24] ibid
[25] ibid
[26] ibid; Solomon (n 20) 79

In the KSA, listed companies have a unitary board structure.[27] In this structure, there is a likelihood of conflicts between the monitoring role and the management.[28] The two positions must be distinct because if there is no separation of these roles, there is a risk that directors will act in a self-interested manner.[29] To tackle this problem, the board should consist of a diverse range of directors: executive directors, non-executive directors, and independent directors.[30] The next subsection will illustrate the difference between these types of directors and will demonstrate the adoption of this composition of boards in the KSA's listed companies.

7.1.5 Non-executive and Independent Directors

The roles of different types of directors and the required number of non-executive ones that must be included in boards are not specified in the Companies Law 2015, and it makes no distinction between executive and non-executive directors. This means for non-listed companies that each company's bylaws should address these matters. However, for listed companies, the CG Regulations clearly recognise and distinguish between three different categories of directors: executive directors, non-executive directors, and independent directors. An executive director is defined as a member of the board 'who is a full-time member of the executive management team of the company and participates in its daily activities',[31] while 'non-executive director' refers to a member of the board who is not a full-time member of the company's management team and does not participate in its daily operations.[32] The regulations define independent directors as non-executive members of the board who maintain complete independence in their position and decisions, and to whom none of the issues affecting independence apply.[33] Article 20 of the CG regulations states that independent directors must communicate their opinions and vote on decisions objectively and without bias in order to assist the board in making accurate decisions that contribute to the

[27] See the Saudi Exchange website which shows the board structures of listed companies: <https://www.saudiexchange.sa/wps/portal/tadawul/home/> accessed 20 September 2022.
[28] David Kershaw, *Company Law in Context: Text and Materials* (2nd edn, Oxford University Press 2012) 191–192
[29] Iain Macneil, *An Introduction to the Law on Financial Investment* (Hart Publishing 2005) 271; The UK Corporate Governance Code July 2018. Available at <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf>
[30] ibid
[31] Corporate Governance Regulations 2021 Article 1
[32] ibid
[33] ibid

Company's interests.[34] The article also identifies a variety of issues affecting independence, including, for example: holding 5% or more of the company's shares or being a relative[35] or a representative of a legal person that owns such percentage;[36] being a relative of any of the company's board members[37] or the company's senior executives;[38] or having a direct or indirect benefit in the businesses and affairs performed on the company's account.[39]

All listed companies in the KSA are obliged to adopt a certain composition of boards by the CG Regulations. Non-executive directors shall constitute the majority of the board, and the number of independent directors shall be not less than two-thirds or one-third of the board, whichever is greater.[40] The reason for such an approach is that independent and non-executive directors are considered an important corporate governance solution through which to tackle the managerialism and agency problems arising from the potential divergence of shareholders' and directors' interests, considering the role played by the non-executives who provide objective criticism to the board; and the role performed by independent directors, who ensure that there are no management abuses that harm minority shareholders' interests.[41]

Observations on the effectiveness and independence of independent and non-executive directors in the KSA:

The CG Regulations aim to ensure the effectiveness and independence of independent directors. For example, article 20[42] states, in a non-exhaustive list, the conditions under which a director will be disqualified from being considered an 'independent director'. Moreover, the

[34] Corporate Governance Regulations 2021 Article 20(a).
[35] Article 1 of the CG Regulations identifies relatives as the following: Fathers, mothers, grandfathers and grandmothers (and their ancestors); children and grandchildren and their descendants; siblings, maternal and paternal half-siblings; Husbands and wives.
[36] Corporate Governance Regulations 2021 Article 20(c)(1) and (2)
[37] Corporate Governance Regulations 2021 Article 20(c)(3)
[38] Corporate Governance Regulations 2021 Article 20(c)(4)
[39] Corporate Governance Regulations 2021 Article 20(c)(7)
[40] Corporate Governance Regulations 2021 Article 16(2)
[41] See for example: Adrian Cadbury, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee Publishing 1992) 22; Barry Curnow and Jonathan Reuvid, *International Guide to Management Consultancy: Evolution Practice and Structure* (Kogan Page Publishers 2005) 138; Article 31 of the CG Regulations stipulates the role of independent directors as follows: 'Without prejudice to Article (30) of these Regulations, an Independent Director of the Board shall effectively participate in the following duties: 1) expressing his/her independent opinion in respect of strategic issues and the Company's policies and performance and appointing members of the Executive Management; 2) ensuring that the interest of the Company and its shareholders are taken into account and given priority in case of any conflicts of interest; 3) overseeing the development of the Company's Corporate Governance rules, and monitoring the implementation of the rules by the Executive Management.'
[42] Examples of these non-exhaustive conditions were provided at the beginning of this subsection.

nomination committee is obliged, each year, to ensure the independence of all independent directors.[43] However, despite these attempts, there have been concerns in the KSA regarding the criteria for determining the independence of directors and the effectiveness of independent and non-executive directors as monitors of the management of the company, and their role in protecting minority shareholders.[44]

There are doubts about the true independence of the independent director. Being a relative of a person who holds 5% or more of the company's shares, or a relative of any of the company's board members or its senior executives, disqualifies an individual from being independent.[45] However, although the CG Regulations expanded, to a certain extent, the meaning of the term 'relative' to include several family members,[46] the potential impact of additional relatives on the independence of directors, such as in-laws, cousins, and aunts and uncles, is not addressed in the CG Regulations. This observation is of high importance in the KSA cultural and social environment, considering that KSA society is classified as embodying strong family and tribal ties.[47] Moreover, the regulations do not address the potential impact of long-established friendships with other board members and controlling shareholders on the independence of directors.[48] Indeed, as illustrated by an empirical study, in many listed companies in the KSA, controlling families have members on the board or ensure that a 'friendly board' is in place.[49] This means that most non-executive and independent directors represent a de facto controller such as families and the government through its investment agencies.[50] Thus, the implementation of globally recognised standards

[43] Corporate Governance Regulations 2021 Article 65(7).
[44] See for example: Khalid Falgi, 'Corporate Governance in Saudi Arabia : A Stakeholder Perspective' (2009) <https://discovery.dundee.ac.uk/en/studentTheses/corporate-governance-in-saudi-arabia>; Khalid A Alamri, 'The Board of Directors in Listed Companies under the Corporate Governance System in Saudi Law as Compared to English Law and Global Standards' (2017) <https://eprints.lancs.ac.uk/id/eprint/124942/1/2018Khalidphd.pdf> accessed 5 October 2022; Abdullatif Mohammed Aleshaikh, 'Towards Legal Reform of Saudi Law of Directors' Duties and of Enforcement by Derivative Action' (2018) <https://theses.gla.ac.uk/30630/>; Maree Ali Alamri, 'Corporate Governance and the Board of Directors in Saudi-Listed Companies' (2014) <https://discovery.dundee.ac.uk/ws/portalfiles/portal/4451614/Alamri_phd_2014.pdf> accessed 5 October 2022.
[45] See Corporate Governance Regulations 2021 Article 20 on the issues affecting independence.
[46] Article 1 of the CG Regulations identifies relatives as the following: Fathers, mothers, grandfathers and grandmothers (and their ancestors); children and grandchildren and their descendants; siblings, maternal and paternal half-siblings; husbands and wives.
[47] Falgi (n 44) 128–129.
[48] Aleshaikh (n 44) 71.
[49] Jenifer Piesse, Roger Strange and Fahad Toonsi, 'Is There a Distinctive MENA Model of Corporate Governance?' (2012) 16, 645, 663 <https://libkey.io/choose-library/10.1007/s10997-011-9182-5> accessed 23 September 2022
[50] ibid 667

and principles, such as the OECD principles[51] or the UK regulations, considering their influence on the KSA's corporate law, may not be effective if these cultural considerations are not taken into account by the policymakers.

Furthermore, the effectiveness of non-executive and independent directors depends largely on the level of efficiency of the directors' duties and accountability regulations and the extent to which they are well formulated and comprehensive. Indeed, where directors' duties are not well regulated and adequately enforced, independent and non-executive directors are unlikely to play a significant role in disciplining under-performing management.[52] As illustrated in the next sections of this chapter, in the KSA, the regulations of directors' duties and the means to hold them accountable lack clarity and suffer from several issues that weaken the role and effectiveness of directors and reduce the protection for minority shareholders. It should be noted that non-executive and independent directors have the same general fiduciary duties to their companies as executives, despite the fact that they perform different roles within the company.

Based on the observations above, the role of the independent and non-executive directors in the takeover context may not achieve the anticipated purpose of acting as monitors of the company's management to prevent poor decisions or misconduct that could harm the company and minority shareholders. This concern will be further clarified in the analysis of directors' duties in takeovers in KSA in the following sections.

7.2 Directors' Duties

7.2.1 Introduction

Considering the wide power over the company that directors enjoy, to minimise the agency cost arising from the separation of ownership and control[53], and to protect shareholders from any misuse of power by directors, almost all jurisdictions adopt and apply fiduciary duties of directors in their body of law. The purpose of these duties is to ensure that directors aim to

[51] The Organisation for Economic Co-operation and Development (OECD) corporate governance principles are briefly addressed in chapter 2 (corporate governance and ownership structure).
[52] Julian Franks, Colin Mayer and Luc Renneboog, 'Who Disciplines Management in Poorly Performing Companies?' (2001) 10 Journal of Financial Intermediation 209, 245 <https://www.sciencedirect.com/science/article/pii/S1042957301903171> accessed 20 September 2022
[53] Christopher A Riley, 'The Company Director's Duty of Care and Skill: The Case for an Onerous but Subjective Standard' (1999) 62 Modern Law Review 697, 704 <https://onlinelibrary.wiley.com/doi/epdf/10.1111/1468-2230.00232?saml_referrer> accessed 3 April 2023.

promote the success of the company instead of their own benefit and to provide an opportunity for shareholders to hold directors accountable should they misuse their powers. The duties provide a general standard of behaviour that the courts can shape over time to fit specific situations.[54] In takeovers, as the interest of the shareholders and directors is likely to diverge, the need for these duties is integral to ensure that shareholders' interests and the promotion of the success of the company as a whole are the directors' objectives.[55]

There are no unified duties that all jurisdictions apply in the same way. However, there are general principles and concepts that form the main directors' duties; and jurisdictions' approaches vary in translating these concepts and principles into statutory duties. The duty of care and the duty of loyalty are the two main principles from which most directors' duties stem.[56] The duty of loyalty means that directors should always be loyal to the company's shareholders by avoiding any conflict of interest.[57] For example, if a director is on the boards of two companies with conflicting interests, the director should resign from one of the companies, as it is unfeasible to be loyal to both companies at the same time.[58] The duty of care means that directors should exercise due diligence in making decisions, acting within their powers, and promoting the success of the company.[59]

This section will argue that the regulations of directors' duties in the KSA suffer legal uncertainty and lack clarity. This leads to ambiguity for directors when they perform their role in takeover scenarios. It also creates difficulties for courts when they interpret and apply the legislation and reduces shareholders' opportunities to hold directors accountable due to the vagueness of the standards for measuring breaches of the duties. This section will briefly provide an overview of the directors' duties in the US before discussing in the following sections topics related to these duties, such as the business judgement rule. The section will also provide recommendations for reforms with which to address the legislative issues in the KSA by adopting relevant UK principles and standards.

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[54] ibid.
[55] See the discussion in subsection 7.1.2 (To whom directors owe their duties).
[56] Robert AG Monks and Nell Minow, *Corporate Governance* (5th edn, 2011) 268. Alternatively, these principles can be included under one main principle, the duty to act in the best interest of the company. See the Organisation for Economic Co-operation and Development, OECD, 'OECD Principles of Corporate Governance - 2004 Edition' (2004) 59 <www.SourceOECD.org,> accessed 2 June 2022. As mentioned in the previous paragraph, countries differ in their approach to adopting directors' duties.
[57] The duty of loyalty also encompasses other duties that will be discussed in further detail in this section, such as the duty to act bona fide in the interest of the company.
[58] Monks and Minow (n 56) 268
[59] OECD (n 56) 59

7.2.2 Directors' Duties in the US

This subsection provides an overview of directors' duties in the US in order to give the reader some background before addressing concepts that are entrenched within directors' duties in the US such as the business judgement rule, which will be discussed in the takeover context in the following sections.

Directors' fiduciary duties were initially developed by common law judges operating without formal written law guidance. The fiduciary duties of directors continue to evolve based on common law.[60] Directors' fiduciary duties and responsibilities originate primarily in state corporate law, both in the form of statutes and in evolving case law.[61] Generally, directors are subject to three fundamental fiduciary duties: the duties of loyalty, care, and disclosure.[62] The duty to act in good faith can be considered a subcomponent of the duty of loyalty.[63] However, this is a controversial issue considering the disagreement among court judges as to whether good faith is a separate duty owed by directors.

A key principle related to directors' fiduciary duties, which is recognised in the US to shield directors from judicial scrutiny regarding their business decisions, is referred to as the 'Business judgement rule'.[64] However, as Bainbridge concluded, in light of the potential conflict of interest in takeovers between the directors and the company, judicial review was to be more restrictive than the traditional business judgement rule.[65] Thus, the business judgement rule can only be granted after judicial scrutiny of heightened duties at the threshold.[66] These heightened duties, known as the *Unocal*[67] and *Revlon*[68] doctrines after the cases that gave rise to them, are applied to determine whether or not the actions of target

[60] Bernard S Black, 'The Principal Fiduciary Duties of Boards of Directors' (2001) 2 Third Asian Roundtable on Corporate Governance 1, 1 <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1872746.pdf> accessed 1 December 2022
[61] For example, the duties of loyalty and care are regulated by the Delaware Limited Liability Company Act (LLC Act).
[62] Black (n 60) 1
[63] Corporate Governance and Directors' Duties in the United States: Overview | Practical Law <https://uk.practicallaw.thomsonreuters.com/w-011-8693?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a114617> accessed 29 November 2022
[64] The Business Judgement Rule is discussed in further detail in section 7.4.2.
[65] Stephen M Bainbridge, 'Unocal at 20: Director Primacy in Corporate Takeovers' (2005) 26 UCLA School of Law, Law-Econ Research Paper No. 05-19 1, 33 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=946016> accessed 29 November 2022
[66] ibid
[67] *Unocal Corp v Mesa Petroleum Co* [1985] 493 A2d 946 (Delaware)
[68] *Revlon Inc v MacAndrews & Forbes Holdings* [1986] 506 A2d 173 (Delaware Supreme Court)

directors are appropriate in the takeover situation. This enhanced scrutiny test is essentially an examination of reasonableness to be applied on a case-by-case basis:

> The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decision-making process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing.[69]

The *Unocal* and *Revlon* doctrines are discussed in further detail in section 7.4.2.

7.2.3 Directors' Duties in the UK

The UK is viewed as one of the earliest jurisdictions to introduce directors' fiduciary duties and establish the notion of the director as a trustee.[70] Directors' duties in the UK are codified in the Companies Act 2006 under Sections 171 to 177. Even prior to the implementation of the CA 2006, it was well-established that directors owed fiduciary duties to the company, and the common law played a significant role in recognising and defining directors' duties. As a matter of fact, these codified duties are based on general common law rules and principles which established that directors owe duties to the company[71] and that once directors breach their duties, they can be held accountable, considering that a wrong has been done to the company.[72] Common law is still used to support the interpretation of statutory duties.

The codified duties require directors to act within their powers,[73] promote the success of the company,[74] exercise independent judgement,[75] exercise reasonable care, skill and diligence,[76] avoid conflicts of interest,[77] not accept benefits from third parties,[78] and declare interest in the proposed transaction or arrangement.[79] These detailed and comprehensive

[69] Bainbridge (n 65) 33.; QVC, 637 A.2d at 45
[70] *Great Easter Railway Company v Turner* [1872] 68 Ch App 149, 152; Jennifer Hill, 'Corporate Scandals Across the Globe: Regulating the Role of the Director' in Guido Ferrarini and others (eds), *Reforming Company and Takeover Law in Europe (*Oxford University Press 2004) 374
[71] Companies Act 2006, s 170(3)
[72] *Foss v Harbottle* [1843] 67 ER 189
[73] Companies Act 2006, s 171
[74] Companies Act 2006, s 172
[75] Companies Act 2006, s 173
[76] Companies Act 2006, s 174
[77] Companies Act 2006, s 175
[78] Companies Act 2006, s 176
[79] Companies Act 2006, s 177

codified duties in the Companies Act increase the accountability of directors[80] and provide clear grounds for shareholders to bring a claim against directors should they breach their duties.[81] It is noteworthy that there might also be situations where more than one duty may apply in any given case.[82] In other words, duties can be cumulative, and a director may be held accountable under one or more sections.

There are three duties that are especially relevant to the exercise of power by directors in the context of a takeover. The first is the duty to act within powers. Section 171 provides details of this duty, as directors are required to exercise their powers in accordance with the company's constitution[83] and to adhere strictly to the purposes for which those powers are conferred.[84] The purpose of these powers is to promote the success of the company rather than to pursue the directors' own interests.[85] Prior to the Companies Act 2006, this duty was known as the improper and proper purpose doctrine in the common law. Despite the codification of this duty, common law still plays an integral role in interpreting and applying directors' duties.[86] To determine whether this duty has been breached, courts will examine the company's articles and constitution to see if the director has been given the right to wield that authority and if the specific purpose for which they used that authority was proper.[87] Accordingly, a breach of this duty relies on the court's assessment of whether the substantial purpose for which the action was taken is proper. This means that even if a director acted in what he honestly believes to be the best interest of the company, and the constitution provides him with such power, courts will consider the action a breach of this duty if the substantial purpose of this action was improper.[88] An example of a breach of this duty and the improper purpose in the takeover context would be the allotment of shares for instance. Even if the constitution allows directors to allot shares, this allotment should be used for proper

[80] Although the Takeover Code and the Panel play an important role in the regulation of takeovers, the behaviour of the target directors for the main part is governed by directors' duties within the Companies Act. See Sarah Emily Morley, 'Takeover Litigation: The US Does It More than the UK, but Why and Does It Matter?' (2017) 75 <http://etheses.dur.ac.uk/12228/> accessed 3 September 2020.
[81] These claims can be brought under the derivative claim (s 260 of Companies Act) and the petition for unfair prejudice under s 994 of the Companies Act.
[82] Companies Act 2006, s 179
[83] Companies Act 2006, s 171(a)
[84] Companies Act 2006, s 171(b)
[85] *Hogg v Cramphorn Ltd* [1967] Ch 254, [1966] 3 All ER 420
[86] According to s 170(4): 'The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.'
[87] See for example: *Re Smith and Fawcett Ltd* [1942] Ch 304 [306]; *Galloway v Halle Concerts Society* [1915] 2 Ch 233.
[88] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821

purposes; using the allotment to frustrate a takeover bid will be considered an improper purpose.[89]

The second duty is to promote the success of the company. Section 172 of the Companies Act 2006 provides that directors must act in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole; the subsection continues by stating that directors must do so while considering a non-exhaustive list of factors such as considering the interest of employees, creditors, community, and the environment.[90] Accordingly, directors are prohibited from using their authority in a way that advances either their own interests or the interests of a third party.

This duty is particularly relevant in a takeover context, especially the requirement to consider the consequences of any decision in the long term.[91] This requirement by the Companies Act 2006 addresses an important issue in takeover transactions and answers the question of whether the director's advisory role regarding a bid should be based on the offer price as the determining factor. Based on this section, directors are required to consider the long-term consequences, not only regarding the bid price and the benefit of the current shareholders, but also that of future shareholders, considering that the interpretation of the shareholders' interest includes both present and future shareholders.[92] The advisory role of directors in takeovers and Short-termism are discussed in further detail in this chapter (section 7.3).

As mentioned earlier in this section, common law plays an important role in interpreting directors' duties; thus, an overview of the common law perspective will provide greater understanding of the elements that form this duty and will illustrate the mechanism used to determine breach of the duty.[93] Courts will apply subjective and objective tests to assess whether a director breached the duty to promote the success of the company. The subjective test is that a director must exercise his authority bona fide in the way he considers,

[89] Takeover bids frustration tactics by target boards are also prohibited under Rule 21 of the Takeover Code. Bid frustration is discussed in section 7.4.
[90] Companies Act 2006, s 172(1). This duty includes several elements and factors, but is considered as a single duty. See Hannigan (n 6) 184.
[91] Companies Act 2006, s 172(1)(a)
[92] *Brady v Brady* [1988] BCLC 579; David Kershaw, Principles of Takeover Regulation (1st edn, Oxford University Press 2016) 299
[93] Companies Act 2006, s 170(4)

rather than what a court may consider, most likely to promote the success of the company as a whole.[94] This approach echoes the words of Jonathan Parker J when he concluded that:

> The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director state of mind.[95]

The objective test is that courts will examine the compliance of the director with the requirement to act bona fide in terms of reasonableness as measured by reference to a reasonable, intelligent, and honest man in the position of the director, considering all existing circumstances.[96] Thus, if a director made a mistake or acted unreasonably, he will not be liable for breaching the duty to promote the success of the company if he acted in good faith and in what he honestly believed was for the interests of the company and was not deliberately blind to the company's interest.[97] However, the director can be held accountable for the breach of the duty of care discussed below.

The third duty is the duty to exercise reasonable care, skill and diligence.[98] The Companies Act provides further explanation of the meaning of this duty. A director is expected to exercise reasonable care, skill, and diligence that would be performed by a reasonably diligent individual with the general knowledge, skill, and experience that may reasonably be expected of someone carrying out the director's role.[99] The Companies Act added a further criterion to assess the fulfilment of this duty as it considers the director's particular role, skill, and experience.[100] This is particularly relevant in listed companies where the experience and skills of directors are above average, which increases the standard of care required by law.

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[94] *Re Smith and Fawcett Ltd* [1942] Ch 304 [306]
[95] Jonathan Parker J in *Regentcrest plc v Cohen* [2001] 2 BCLC 80, 105
[96] *Charterbridge v Lloyds Bank* [1969] 2 All ER 118, 119
[97] Alan Dignam and John Lowry, *Company Law* (9th edn, 2016) 331
[98] Companies Act 2006, s 174(1). There are also other directorial duties of care in takeovers imposed by the Takeover Code, such as the duty to present documents, announcement, and other information to shareholders with the highest standard of care and accuracy (Rule 19 of the Takeover Code).
[99] Companies Act 2006, s 174(2)(a)
[100] Companies Act 2006, s 174(2)(b)

The seven general duties set out in the Companies Act 2006 included the duty of care. However, it clearly states that the duty of care is not a fiduciary duty.[101] The difference between fiduciary and other duties is that fiduciary obligations are duties exclusive to fiduciaries, the breach of which has legal ramifications distinct from the breach of other duties.[102] Breach of fiduciary obligations results in equitable remedies that are mainly restitutive or restorative, while the breach of the duty of care attracts compensatory remedies.[103] Thus, the breach of the duty of care is governed by common law principles of negligence.[104]

To determine a breach of the duty of care, courts will apply a subjective and objective test. The objective test is that a director's act will be benchmarked to a hypothetical director who is reasonably diligent and possesses at least the skills and experience of an average director.[105] In addition to this objective minimum standard,[106] courts will take into account the special skills and experience that the director has.[107] Moreover, in assessing the breach of the duty of care, courts will consider other factors such as the size and complexity of the business and the role and position of the director.[108]

To summarise, this subsection has provided an overview of the directors' duties in the UK to illustrate the role of the codified duties and the role of common law in defining and interpreting the duties; and to provide a clear framework for the directors' duties to enable directors, courts, and shareholders to hold directors accountable. Although the Companies Act 2006 clearly refers to common law rules and principles by which to interpret and apply the duties,[109] the codification of the duties clarifies the elements of each duty.[110] The purpose of this section is to serve as a yardstick for assessing directors' duties and legal framework in KSA and to recommend reforms where applicable.

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[101] Companies Act 2006, s 178
[102] *Bristol and West Building Society v Mothew* [1996] EWCA Civ 533
[103] ibid
[104] Dignam and Lowry (n 97) 342
[105] Companies Act 2006, s 174 (2)(a)
[106] John Lowry, 'The Irreducible Core of the Duty of Care, Skill and Diligence of Company Directors: "Australian Securities and Investments Commission v Healey"' (2012) 75 249, 253 <https://www.jstor.org/stable/41415406?saml_data=eyJzYW1sVG9rZW4iOiJmNTdhMWY4Yi1jZTVkLTRmODEtYTZlYS1iYjJhYjI2NzBmN2MiLCJpbnN0aXR1dGlvbklkcyI6WyIxNWE0NDMwMC1hZDMxLTQ4M2YtOTQ2YS03OTU4NzQ4MmFjM2EiXX0#metadata_info_tab_contents> accessed 22 July 2022
[107] Companies Act 2006, s 174(2)(b); The Rt Hon Lady Justice Arden DBE, 'Regulating the Conduct of Directors' [2010] JCLS 1, 11; Lowry (n 103) 253
[108] *Re Produce Marketing Consortium Ltd* (No2) [1989] BCLC 520, 550
[109] Companies Act 2006, s 170(4)
[110] Hannigan (n 6) 159

7.2.4 Directors' Duties in the KSA

In a broad sense, the KSA adopts the same general directors' duties that apply in the UK and most other jurisdictions. However, directors' duties legislations suffer from ambiguity in KSA. Directors' duties are not enacted in the Company Law 2015. Instead, the duties can be found in the CMA implementing regulations that only apply to security markets. This issue, and other issues, are discussed in further detail in this section. The duties are stated in the Corporate Governance Regulations. According to the Regulations, directors, as representatives of all shareholders, have duties of care and loyalty and must manage the company in its general interest and maximise its value.[111] Directors must perform their duties in good faith with necessary care and diligence for the benefit of the company and all shareholders.[112]

7.2.4.1 An Evaluation of Directors' Duties and Gaps in Legislation

Considering the integral role played by directors in takeovers, clear and properly drafted directors' duties are essential to provide a clear framework and to minimise uncertainty among directors, shareholders, and judges. It also provides clear grounds for shareholders to hold directors accountable once there is a breach of duty, considering that these properly drafted duties will clarify how a breach is measured and determined.

It has been argued that legal uncertainty is proportional to the manner in which the legislation is drafted.[113] In KSA, there are several overlapping issues in the body of law governing directors' duties that lead to gaps in legislation and cause uncertainty.

The purpose of directors' fiduciary duties is to address issues arising from a fiduciary relationship; and to govern directors' actions to protect shareholders, other stakeholders, and the company, regardless of the nature and type of the firm, whether or not it is listed on the security market. The issue here is the absence of directors' duties in the KSA's core company law legislation, the Company Law 2015. As a practical consequence of this gap in legislation, the brief and poorly drafted directors' duties in the CMA regulations will only apply to publicly listed companies, leaving the majority of companies in KSA with no codified directors' duties. Unlike common law jurisdictions such as the UK, the judicial precedents

[111] Corporate Governance Regulations Article 21(a)
[112] Corporate Governance Regulations Article 30(17)
[113] Iain MacNeil, 'Uncertainty in Commercial Law' (2009) 13 Edinburgh Law Review 68, 72 <https://www.euppublishing.com/doi/full/10.3366/E1364980908000966> accessed 28 July 2022

are not a source of law in KSA, which increases the need for comprehensive drafted duties that apply to all companies. As a result of this gap in legislation, especially for unlisted companies, the assessment and treatment of directors' duties in KSA will vary between different cases, which is one of the forms and definitions of legal uncertainty.[114]

Furthermore, the body of law governing directors' duties in KSA lacks coherence and clarity in the standards of performing a duty properly and measuring breaches of the duties. As mentioned earlier in this section, the duties of care, loyalty, and promoting the success of the company are all combined in one brief article.[115] The article states that in performing their duties, directors must consider the interest of the shareholders and maximise the value of the company. Unlike the codified duties in the UK, the absence of clear guidance by the law on how to fulfil this duty can lead to several problems. Short-termist behaviour can be adopted by directors in order to maximise the value of the company as required by the article, whereas the UK counterpart codified duty states that directors must consider the long-term consequences in performing their duty to promote the success of the company.[116] Moreover, in contrast to the UK,[117] the article fails to require directors to consider the interest of other stakeholders, such as employees, suppliers, and customers, and other matters, such as community and environment, when performing their duties.

7.2.4.2 The Uncertainty of the Duty of Loyalty and Good Faith in KSA

Although the concept of acting in good faith is an essential element of the duty of loyalty,[118] the Company Law 2015 did not provide any such obligations or definition of the duties. Instead, the duty of loyalty is defined in the CG Regulations as avoiding conflicts of interest and ensuring 'fairness of dealing' by directors.[119] The Regulations did not provide further detail on how the fairness of dealing is achieved or how it is evaluated to determine breach. The article also limits the duty of loyalty to a narrow scope and implies that avoiding conflicts of interest is the only component of the duty of loyalty. Nonetheless, the duty of

[114] ibid 69.
[115] Corporate Governance Regulations Article 21(a): 'The Board represents all shareholders; it shall perform its duties of care and loyalty in managing the Company's affairs and undertake all actions in the general interest of the Company and develop it and maximise its value.'
[116] Companies Act 2006, s 172(1)(a)
[117] See Companies Act 2006, s 172.
[118] Rosemary Teele Langford, 'The Duty of Directors to Act Bona Fide in the Interests of the Company: A Positive Fiduciary Duty? Australia and the UK Compared' (2011) 11 Journal of Corporate Law Studies 215, 2015 <https://www.tandfonline.com/action/journalInformation?journalCode=rcls20> accessed 1 August 2022
[119] Corporate Governance Regulations Article 29

loyalty encompasses other principles and duties such as the duty to act bona fide and to act within one's power for a proper purpose.[120]

Furthermore, the same article defines the duty of acting in good faith as 'honesty' and 'truthfulness' and concludes that it can be achieved when 'the relationship between the Board member and the Company is an honest professional relationship, and he/she discloses to the Company any significant information before entering into any transaction or contract with the Company or any of its affiliates'.[121] Again, the article is poorly drafted and ambiguous; and it limits the duty of acting in good faith to avoiding conflicts of interest and the duty to declare interest in proposed transactions. Acting bona fide or in good faith can have two meanings. The first one is acting 'honestly, with the best of intentions', which is a subjectively applied approach.[122] The second definition, and more relevant to corporate law, requires that it be 'genuine', which necessitates taking into account objective aspects.[123] The CG Regulations wording implies the first, subjective approach. In contrast, the UK adopts the other approach by providing objective standards with which to evaluate the duty of acting in good faith, as discussed earlier in this chapter.[124]

The absence of a clear and comprehensive duty of loyalty and duty to act in good faith as essential fiduciary principles in the KSA corporate legislation can lead to several issues. The absence of clear fiduciary duties would place directors in a position where, when exercising their discretionary powers, they would lack a broad criterion of accountability by which to evaluate the overall appropriateness of their actions.[125]

Indeed, the poorly drafted duties of loyalty and acting in good faith in KSA will undermine the accountability of directors, considering that the evaluation of breaches of these duties is not clear as there are no clear criteria provided by law to measure the breach. The UK body of law on the other hand, as illustrated earlier in this chapter, provided several subjective and objective tests with which to measure and evaluate breaches of the loyalty and

[120] Langford (n 118) 216. See also Directors' duties in the UK section in this chapter. (7.2.3)
[121] Corporate Governance Regulations Article 29
[122] LS Sealy, '"Bona Fides" and "Proper Purposes" in Corporate Decisions' (1989) 15 Monash University Law Review 265, 269 <http://www.austlii.edu.au/au/journals/MonashULawRw/1989/16.html> accessed 29 July 2022
[123] ibid
[124] Discussed in section 7.2.3. These standards include, for example, the proper purpose test that was established in the UK to help evaluate the bona fide assessment. See LS Sealy, '"Bona Fides" and "Proper Purposes" in Corporate Decisions' (1989) 15 Monash University Law Review 265, 269 <http://www.austlii.edu.au/au/journals/MonashULawRw/1989/16.html>. accessed 29 July 2022
[125] Marc Moore, *Corporate Governance in the Shadow of the State* (Hart Publishing 2013) 218

acting in good faith duties. Courts will not place themselves in the position of the director to evaluate the merits of a judgement made on the company's behalf; instead, courts will examine the director's state of mind and the propriety of his conduct and motives.[126] In other words, courts will not ask whether the decision made advanced the company's success, but will examine whether the director acted in good faith in what he honestly believed would be the best interest of the company.

Returning to the KSA position on this matter, the Company Law 2015, the CMA regulations, and case law have not provided clear standards by which to evaluate and measure breaches of the duties of loyalty and of acting in good faith. This can lead courts to perform an objective evaluation of whether the directors acted in the best interests of the company. To illustrate this point, the court will be permitted to place itself in the position of the director to determine what is good for the company. This means that, unlike what is applied in the UK,[127] the directors' state of mind will be irrelevant in determining the best interest of the company. As a result, directors can be in a position where the possibility of being held liable for breaching their duty of loyalty is high. This rigorous approach, whereby courts place themselves in the position of directors to evaluate a decision on a business matter, can lead directors to make low-risk decisions to evade personal liability, which could consequently minimise shareholders' wealth.[128]

Furthermore, in the absence of clear fiduciary duties, the interpretation and application of the duties of good faith and loyalty and determining breaches can be derived from contract law principles, considering that directors have a contractual relationship with their companies. However, it may be accurate to say that the application of good faith in the context of contracts is different from its application in the context of fiduciary relationships,[129] and the incorporation of contract law into the process of determining the directors' duty of good faith may not be very beneficial. This is because directors are in a fiduciary relationship, which necessitates a higher level of good faith than that of

[126] Andrew Keay and others, 'Business Judgment and Director Accountability: A Study of Case-Law over Time' (2020) 20 Journal of Corporate Law Studies 359, 11 <https://eprints.whiterose.ac.uk/152808/3/AAM Case-Law Over time JCLS .pdf> accessed 3 August 2022

[127] See for example: Jonathan Parker J in *Regentcrest plc v Cohen* [2001] 2 BCLC 80, 105. The UK approach to this matter was discussed earlier in further detail in this chapter in section 7.2.3

[128] F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 93-94

[129] Elizabeth A Nowicki, 'A Director's Good Faith' (2007) 55 Buffalo Law Review 457, 481, 484 <https://digitalcommons.law.buffalo.edu/buffalolawreview/vol55/iss2/3/> accessed 9 August 2022.

contractually bound parties.[130] Moreover, another central difference is that contractual parties may endeavour to advance their own interests in good faith, but fiduciaries are prohibited from doing the same.[131]

7.2.4.3 An Evaluation of the Duty of Care and Fault

As mentioned earlier, the duty of care is not mentioned in the KSA Company Law 2105. Instead, the duty is mentioned in the CG Regulations,[132] which define the duty of care as 'performing the duties and responsibilities set forth in the Companies Law, the Capital Market Law and their implementing regulations and the Company's bylaws and other relevant laws'.[133] The CG Regulations fail to provide clear standards to measure the duty, unlike the UK's company law which provided objective and subjective standards that bring more clarity to directors on how to fulfil the duty, and to courts to determine breaches of the duty.[134]

This lack of legislative guidance on how to evaluate directors' duty of care will lead courts to apply a purely objective standard to evaluate directors' behaviour. This means that the actions of directors will be evaluated in accordance with the reasonable person test, meaning that in order to satisfy the duty of care requirement, directors must take the reasonable care that an average careful director would.[135] This implies that a highly skilled director can evade liability by merely acting as an average director would have done, and by not breaching any articles in the Companies Law and the CMA Regulations, even if the director did not act like a reasonable director with his own high skill and experience. This gap is covered in the UK company law as it provides a mixture of two tests, objective and subjective.[136] As discussed earlier in this chapter, the subjective test will allow courts to consider the special skills and knowledge that the director has.

Furthermore, bearing in mind that fault is a central ground for breaching the duty of care, the Companies Law 2015 provides that directors' fault is a ground to hold directors

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[130] ibid 484
[131] John C Coffee, 'The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role' (1989) 89 Columbia Law Review 1618, 1658 <https://www.jstor.org/stable/1122814> accessed 9 August 2022
[132] Corporate Governance Regulations Article 21(a)
[133] Corporate Governance Regulations Article 29(3)
[134] Companies Act 2006, s 174. The duty of care in the UK body of law was discussed earlier in this chapter.
[135] M Al-Jaber, Saudi Commercial Law (Arabic) (5th edn, Riyadh 2000) 339
[136] Companies Act 2006, s 174; *Re Westmid Packing Services Ltd, Secretary of State for Trade and Industry v Griffiths* [1998] 2 BCLC 646

accountable.[137] Fault will generally occur in this context in three situations: violating the provisions of Company Law 2015, violating the company's bylaws, and 'mismanagement of the company affairs'.[138] The mismanagement of the company's business is a scenario where the possibility of judicial difficulties is high, considering that courts will have to assess the fault that led to this mismanagement where no breaches of the statute or of the company's bylaws occurred. However, the meaning of fault, and standards to measure it, are not provided in the KSA company law; therefore, it is left to the courts to define and measure it.

7.2.5 Conclusion and Recommendations

Considering the central role that directors play in takeovers, properly drafted legislation that governs directors' duties is critical to provide a clear and coherent legal framework that would increase certainty in the body of law governing directors' duties. Legislation that suffers legal uncertainty and lacks clarity on directors' duties will lead to ambiguity for directors when they perform their role, especially in takeover scenarios. It will also create difficulties for courts when they interpret and apply the legislations, which leads to a variety of interpretations and applications that further increase uncertainty, and will reduce shareholders' opportunities to hold directors accountable due to the vagueness of the standards by which to measure breaches of the duties.

This section has illustrated the issues and gaps that exist in the directors' duties legislation in KSA. The absence of judicial precedents worsens the situation regarding this matter in KSA. In contrast to the UK, as a common law jurisdiction, where courts developed and established the principles of directors' duties prior to codification, courts in KSA have very limited contributions to offer to fill the legislative gaps, which has left the law governing directors' duties open to interpretations that are difficult to predict.

Enacting the general duties in the KSA's company law will ensure that these duties apply to all companies, instead of applying the duties to listed companies only through the CMA regulations. The adoption and implementation by the KSA body of law of the UK's general duties and standards to evaluate the fulfilment and breaches of the duties can fill the legislative gaps and increase the clarity and coherence of the system. This is attributed to the fact that the KSA company law and takeover system are highly influenced by the UK's

[137] Companies Law 2015 Articles 78 and 79
[138] Companies Law 2015 Article 78

counterparts in many aspects, as illustrated on several occasions in this thesis. The common law principles and interpretations of duties that have developed over many decades in the UK as a developed legal system can be of great importance as guidance to reform the KSA legal system, considering that the KSA security market is relatively new compared to that of the UK, and takeover transactions in this market are still less common.

The issues of the legislative framework of directors' duties in KSA that have been discussed in this section will also extend to other topics that will be discussed in this chapter, such as the role of directors in takeovers, short-termism issues, and the litigation options for shareholders against directors.

7.3 Directors' Advisory Role in Takeovers

7.3.1 Introduction

This section will address the directors' advisory role framework in KSA, and will argue that it lacks comprehensiveness and does not cover some legal loopholes. The M&A Regulations also fail to address short-termism, as they lack clear guidance to directors in several takeover situations such as the one that arises when there are two or more takeover bids. The section suggests the implementation of some of the principles found in the UK takeover system concerning directors' advisory role to tackle the issue in the KSA.

7.3.2 The Board Advisory Role in Takeovers and Short-termism

Once a takeover bid is offered, or when a bid is looming, directors are prohibited from making a decision on the bid or taking any actions that may frustrate the offer or result in shareholders being deprived of the opportunity to decide on the merits of the bid. This is based on the non-frustration rule that has been adopted by both the UK[139] and the KSA.[140] The rule has been designed to reduce the board of directors' role to that of mere advisors, making shareholders the ultimate decision-makers. Indeed, the rule tips the balance of power in favour of the shareholders. Thus, the role of directors is to give sufficient information and

[139] The Takeover Code Rule 21
[140] M&A Regulations Article 3 (J). The non-frustration rule will be discussed in further detail in this section.

advice to the shareholders in order to enable them to reach a properly informed decision on the merits of the bid.

Despite the severe restriction imposed by the non-frustration rule preventing the board from taking action against any takeover bids, they still owe fiduciary duties to the company as a whole and can be held liable for the advice they provide to shareholders.[141] Notwithstanding the limitations on the board of directors' traditional authority due to takeover-related restrictions, directors of the target company still have indirect power and some discretion as to how the target shareholders vote in response to an undesired bid by the board based on the board's recommendation.[142] Indeed, empirical studies have consistently stipulated that the board of directors' recommendations are the most critical factor in determining the outcomes of takeover bids.[143]

Therefore, to prevent misuse of the advisory role by directors in takeovers, and to encourage directors to avoid a short-term approach and conflict of interests when advising shareholders, proper legislation that provides a clear and coherent framework of the advisory role in this situation is necessary. The UK body of law provides a clearer framework for the advisory role than the KSA's system, as illustrated in the following subsections.

7.3.3 Overview of Directors' Advisory Role in the UK

It is noteworthy that in the UK, directors do not accept or reject takeover bids. The offer is made directly to the shareholders, who decide on an individual basis whether to accept or reject it. The directors are prohibited from frustrating a takeover bid[144] and must only include recommendations in their circular.[145] Before overviewing the UK's approach on the specific topic of the boards' advisory role in takeovers, it is important to mention that the general body of law governing corporations has a great influence on this specific matter. To explain

[141] Liza Rybak, 'Takeover Regulation and Inclusive Corporate Governance: A Social-Choice Theoretical Analysis' (2010) 10 Journal of Corporate Law Studies 407, 412 <https://www.tandfonline.com/action/journalInformation?journalCode=rcls20> accessed 13 August 2022
[142] Blanaid Clarke, 'Corporate Governance Regulation and Board Decision Making' in T Gopinath Arun and J Turner (eds), *Corporate Governance and Development – Reform Financial Systems and Legal Frameworks* (Edward Elgar Publishing 2009) 131
[143] Blanaid Clarke, 'Reinforcing the Market for Corporate Control' (2010) 22 UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper No 39/2010 11 <http://ssrn.com/abstract=1661620Electroniccopyavailableat:https://ssrn.com/abstract=1661620Electroniccopyavailableat:http://ssrn.com/abstract=1661620> accessed 13 August 2022
[144] The Takeover Code Rule 21. The non-frustration rule in the UK is discussed in 7.4.3.
[145] The Takeover Code Rule 25.1

this point, the general directors' duties in the UK illustrated earlier in this chapter will extend and influence the directors' advisory role. For example, section 172 of the Companies Act 2006 imposes a duty on directors to promote the success of the company and provide general guidance on how to fulfill this duty. These general guidelines also apply to the advisory role in takeovers. In addition to the general codified duties, common law and the Takeover Code provide specific principles and guidance on the advisory role matter.

The Takeover Code's specific requirements for directors must be considered when performing their advisory role in takeovers. For example, directors must provide shareholders with sufficient information and advice to allow them to reach an informed decision on the merits of the bid.[146] Also, directors must obtain 'competent independent advice' as to whether the financial aspects of the takeover bid, or any other alternative offers, are fair and reasonable, and this independent advice must be shared with the shareholders.[147] Furthermore, the Code requires directors to act in the interest of the company as a whole.[148]

However, as a result of the takeover of Cadbury by Kraft in 2010,[149] the legal framework that regulates takeovers has been called into question;[150] and specifically, the role of the directors, who are supposed to act as stewards and advisors rather than auctioneers promoting the highest bid to the shareholders.[151] Indeed, directors may wrongly consider the bid price as the sole determining factor on which to evaluate the bid and base the recommendation.[152] This is more likely when directors find it difficult to explain to shareholders why they should not accept a bid if the offer price is high.[153] As a result, short-

[146] The Takeover Code Rule 23.1
[147] The Takeover Code Rule 3.1
[148] The Takeover Code Principle 3
[149] The takeover of Cadbury, a popular UK old-fashioned company of family business origin, by Kraft, a foreign conglomerate, raised concerns over several issues such as the interest of employees and stakeholders, and national public interest. See, for example: Blanaid J Clarke, 'Directors' Duties During an Offer Period – Lessons from the Cadbury PLC Takeover' [2011] UCD Working Papers in Law, Criminology & Socio-Legal Studies <http://ssrn.com/abstract=1759953Electroniccopyavailableat:https://ssrn.com/abstract=1759953Electroniccopyavailableat:http://ssrn.com/abstract=1759953> accessed 14 August 2022; Roger Carr, 'Cadbury: Hostile bids and takeovers' (Saiid Business School, 15 February 2010). Available at https://podcasts.ox.ac.uk/roger-carr-cadbury-hostile-bids-and-takeovers
[150] Clarke (n 143) 1
[151] Clarke (n 143) 11
[152] Georgina Tsagas, 'A Long-Term Vision for UK Firms? Revisiting the Target Director's Advisory Role since the Takeover of Cadbury's Plc' (2014) 14 Journal of Corporate Law Studies 241, 244 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2379073> accessed 10 August 2022
[153] Department for Business, Innovation and Skills, Summary of Responses Document, 'Summary of Reponses, A Long-term Focus for Corporate Britain' (2011) 21 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/207536/11-797-summary-responses-long-term-focus-corporate-britain.pdf> accessed 13 August 2022

termism can be the approach that directors adopt when performing their advisory role in takeovers,[154] especially when there is short-term pressure from investors.[155]

A short-term approach can be adopted when a company receives more than one takeover bid, considering that directors may be pressured to recommend the highest bid price and only consider the price as the determining factor of the recommendation.[156] This can happen when legislations fail to provide clear guidance on the factors that directors must consider when performing their advisory role in takeovers.[157] One aspect of short-termism is the focus on the interest of the current shareholders and neglect of the interest of other stakeholders, such as employees.

Prior to 2010, the Takeover Code did not provide a clear illustration of the advisory role. The reformative response to the takeover of Cadbury by the UK legislators was the introduction of a new section that was added to the revised 10th edition of the Takeover Code in 2011, and remains in the latest edition. The Code states that the offeree board 'is not required by the Code to consider the offer price as the determining factor and is not precluded by the Code from taking into account any other factors which it considers relevant'.[158] This clarified that target directors are not required to provide advice that focuses solely on the financial aspects of the bid.

This reform clarifies the advisory role of directors. However, despite the clarification, the Takeover Code has provided neither specific nor general factors that directors must take into account when formulating their advice to shareholders. The reason behind this could lie in the intention to not limit directors' ability to make a judgement on a bid, considering that a company's financial state and its own strategic objectives, and other important factors, differ from one company to another. Nevertheless, the Takeover Code could have referred to the factors that should be considered without limiting them in line with the Companies Act 2006, which stressed that directors should consider the long-term consequences of any decision;

[154] Tsagas (n 152) 242
[155] Department for Business, Innovation and Skills, Summary of Responses Document, 'Summary of Reponses, A Long-term Focus for Corporate Britain' (2011) 7 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/207536/11-797-summary-responses-long-term-focus-corporate-britain.pdf> accessed 13 August 2022
[156] Kershaw (n 92) 303-305
[157] Tsagas (n 152) 241.
[158] The Takeover Code, notes on Rule 25.2, point 1

thus providing several factors that directors must consider when they perform any action to promote the success of the company.[159]

Common law also provided illustration of the board advisory role in takeovers. For example, in the case of two or more rival bids, Hoffmann J in *Re a company* stated that directors are not inevitably under 'a positive duty to recommend and take all steps within their power to facilitate whichever is the highest offer'.[160] Accordingly, directors are not obliged to recommend the highest bid; instead, they must consider all other aspects and recommend the bid that they believe would be in the best interest of the company as whole.[161]

It can be concluded from the overview of the UK's legal framework that the board advisory rule in takeovers has been clarified by the Companies Act 2006, the Takeover Code, and common law. This is not the case in KSA, as illustrated in the next section.

7.3.4 Directors' Advisory Role in the KSA: Issues and Recommendations

Directors' advisory role in takeovers in KSA is mainly regulated by the M&A Regulations. Directors of the target company are required to provide all relevant information to shareholders and make a recommendation to enable them to reach a properly informed decision on the merits of the bid.[162] In advising their shareholders, the board of directors must get competent independent advice from an independent financial advisor and provide their shareholders with the details of such advice.[163]

The KSA legal system is, to a certain extent, similar to the UK's in adopting the principle that only shareholders should decide on the merits of the bid and the role of directors is to provide advice, as they are prohibited by law from frustrating any bid without the approval of the shareholders. However, there are several issues in the KSA's body of law governing directors' advisory role in takeovers. Before addressing these issues, it is very important to mention the significance of proper and comprehensive drafting of laws governing directors' duties, as the impact of this extends to the advisory role of directors in

[159] The Companies Act 2006, s 172(1)
[160] *Re a company* [1986] BCLC 382
[161] ibid
[162] M&A Regulations Article 3(h)
[163] M&A Regulations Article 18

takeovers. As discussed earlier in this chapter,[164] unlike in the UK, the KSA legal framework governing directors' duties presents several concerning issues such as the unclarity of regulations, uncertainty in the standards that need to be followed to fulfill the duties, and standards by which to measure breach of duties. The absence of case law in KSA as a source of law, or as an interpreter of unclear legislation, increases the ambiguity of the role of directors as advisors in takeovers. The author examined judicial rulings in the field of company law and boards' advisory role in takeovers available on the website of the Board of Grievance[165] and did not find a reported court case in this regard. Therefore, directors' advisory role in takeovers can only be examined by reviewing the few brief articles provided by the M&A Regulations.

Some of the issues regarding the advisory role of directors are the inconsistency and incoherence of the M&A Regulations. As per the wording of Article 3 (General Provisions), the board of directors 'must always act in the best interests of its shareholders'.[166] The first issue with this sub-article is that it limits the directors' duties and objectives to maximising shareholders' value rather than focusing on broader aspects, i.e., the promotion of the success of the company as a whole. The wording of this sub-article also promotes short-termism because directors may not consider the interest of employees, creditors, and future shareholders; instead, they may only focus on the short-term interest of current shareholders. The second issue is that this sub-article may create confusion and contradiction with another sub-article of the same article, as the Regulations state that directors, in giving their advice to shareholders, must consider 'the shareholders' interests taken as a whole, together with those of employees and creditors'.[167] This sub-article also fails to require directors to consider the company's interest as a whole and to consider other factors when giving their advice, such as the impact of the action on the community or environment, and consideration of the long-term effect of their advice.

[164] Directors' duties in KSA are discussed in detail in section 7.2.3, and directors' duties in the UK are discussed in section 7.2.2.
[165] See the Board of Grievance website:
<https://www.bog.gov.sa/en//ScientificContent/JudicialBlogs/Pages/default.aspx>
[166] M&A Regulations Article 3(i)
[167] M&A Regulations Article 3(m).

7.3.5 Conclusion and Recommendations

Although the takeover regulations in KSA adopted the principle that only shareholders should decide on bids, and directors must provide them with informed advice, the directors' advisory role framework in KSA lacks comprehensiveness and may not cover some legal loopholes. The implementation of some of the principles found in the UK takeover system in relation to directors' advisory role in takeovers will increase the efficiency of the takeover regulations in KSA, enhance and clarify the role of directors when they perform their advisory role, and ensure the protection of the company as a whole and all its stakeholders, the environment, and society. The M&A Regulations should clearly state the factors that directors must consider when performing their advisory role. The need for such clear regulations is even greater in the absence of clear directors' duties in the Companies Law 2015, as discussed in section 7.2.2 of this chapter.

The M&A Regulations also fail to address a very important issue which is considered one of the factors of market financial crisis, i.e., short-termism.[168] The M&A Regulations should stress the importance of considering the short-term effect of the directors' advice to avoid a short-termism approach, especially in security markets where there might be pressure from shareholders to gain short-term profits.

Furthermore, the M&A Regulations have not addressed the situation where there are two or more takeover bids. In this situation, as discussed in the previous section, directors may determine the best offer based solely on the price of bids. The UK approach can be implemented in the KSA by stating in the Regulations that when directors perform their advisory role in takeovers, price should not be the only factor to be considered. This can prompt directors to take into account other important factors so that their advice is broader and more comprehensive, and the long-term impact of the advice on the company as a whole is taken into account.

[168] Lynne L Dallas, 'Short-Termism, the Financial Crisis, and Corporate Governance' (2011) 37 Journal of Corporation Law 264, 266 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2006556>.accessed 25 August 2022

7.4 Takeover Defences and the Non-frustration Rule

7.4.1 Introduction and Overview of Main Defensive Strategies

To prevent a takeover or make the target firm less appealing to a bidder by increasing the value of a takeover or increasing the complexity of the process, target companies employ a variety of techniques and strategies known as takeover defences.[169] These tactics can be used by the target company directors to frustrate undesirable takeover bids and thus maintain their positions in the target company.

Defences against a takeover might be implemented either before (pre-bid defences) or after (post-bid defences) an offer is made public.[170] The following is a set of countermeasures frequently taken in the face of an attempted takeover, but by no means exhaustive of the many options available. Indeed, as Banbridge states: 'as fast as new acquisition techniques are developed, new defenses spring up'.[171] There may be some overlap between the two lists of defences.

Pre-bid defences are implemented prior to any particular takeover attempt, with the aim of dissuading possible takeovers by limiting the purchase of shares in the target firm or obstructing shareholders from exercising their control during their meeting. Pre-bid defences encompass a range of strategies, such as staggered board, poison pills[172], and golden parachutes which oblige the target firm to largely compensate the current directors once a change in control occurs. Also, 'super-voting stock' may be employed in disparate share structures wherein certain equities have excessively stronger voting rights but minimal liquidity or dividend rights.

Post-bid defence strategies are employed in takeovers where an undesirable offeror has submitted a bid to the shareholders. The strategies mentioned in this context comprise the 'crown jewel', which refers to lessening the value of the target company by selling its most valuable assets, such as intellectual property rights that could be of specific relevance to the prospective acquiror; shares repurchase, referring to increasing the share price above the bid

[169] Marco Ventoruzzo, 'The Thirteenth Directive and the Contrasts between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?' [2005] Bocconi Legal Studies Research Paper No. 06-07 19 <ssrn: https://ssrn.com/abstract=819764> accessed 7 August 2022
[170] Patrick A Gaughan, *Mergers: What Can Go Wrong and How to Prevent It* (2005) 17
[171] Bainbridge (n 16) 416
[172] The poison pill strategy can be implemented at any time before, during, or after a hostile takeover offer, but is most often used beforehand to discourage a possible acquirer. The poison pill strategy is discussed in further detail in this subsection.

price brought about by the target company's repurchase of its own shares to make them less attractive to potential bidders; greenmail, which involves offering financial compensation to a possible acquirer as a means of preventing a hostile takeover; white knight strategy; Pac-Man strategy, which means that the target company makes a bid to acquire the bidder's company.[173]

Some of the most frequent and widely used takeover defences merit further discussion.

Poison pills:

Generally, poison pill strategies are applied by issuing a pro rata dividend to common stockholders of stock to purchase securities of the issuer.[174] Poison pills are usually not enforced until certain triggering circumstances occur such as a takeover bid, or once an acquirer secures a controlling block of the target company's shares.[175] In these events, the shareholders of the offeree company will automatically receive a significant number of newly issued shares at a discounted price.

A frequently used poison pill strategy involves the issuance of significant convertible preferred stock options to current shareholders of the offeree company in the event that a shareholder (or group of shareholders acting together) secures a certain controlling percentage of the offeree's share capital without seeking approval from the target company's board of directors.[176] Most often, such preferred stocks have the right to be converted into common stocks at a cost equivalent to fifty percent of the current market value.[177]

Thus, poison pills can now come in a wide range of forms; yet, regardless of their appearance, they all share a characteristic that is designed to preclude a hostile bidder.[178] Poison pill strategies are extensively employed by target boards and are considered the takeover defence strategy that is both the most potent and most effective in the US.[179]

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[173] For more details on takeover defences, see Ventoruzzo (n 169); John C Coates IV, 'Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence' (2000) 79 Texas Law Review <https://heinonline.org/HOL/Print?collection=journals&handle=hein.journals/tlr79&id=287>; Suzanne S Dawson, Robert J Pence and David S Stone, 'Poison Pill Defensive Measures' (1987) 42 The Business Lawyer 423 <https://www.jstor.org/stable/40687130>.
[174] Dawson, Pence and Stone (n 173) 423
[175] ibid
[176] Gaughan (n 170) 17
[177] ibid
[178] Stephan M Bainbridge, *Mergers and Acquisitions* (3rd edn, Foundation Press 2012) 239
[179] Stephen Kenyon-Slade, *Mergers and Takeovers in the US and UK* (Oxford University Press 2004) 333

White knight:

After receiving a hostile offer from an undesirable bidder, the target board may resort to the white knight defence to seek out a better, friendlier acquirer. 'White knight' refers to the alternative bidder who has been proposed by the target board.

The white knight should be willing to outbid the present bidder for the target company and acquire it in more favourable conditions, such as a higher offer price or the retention of the target's current board of directors. In the context of a hostile takeover bid, it is common that a shift in control of the acquired firm is likely to occur. Consequently, the board of the target company may propose an alternative acquirer.[180]

Staggered board:

The purpose of the pre-bid defence, known as a staggered board, is to increase the target director's capacity to maintain control.[181] Boards of directors are often split into three sections of similar size, with staggered years for removal and reelection.[182] As a consequence of this strategy, despite obtaining a majority of stocks in the acquired company, the acquirer is unable to secure a majority representation on the board of the acquired company until two successive elections have occurred. The reason for this is that, annually, just one-third of the board can be replaced.[183]

Considering that it is difficult to change the current board, it is plausible that the board may maintain its control for an extended duration. The prospect of postponement is sufficient to compel a potential acquirer to initiate contact with the current directors, considering that any potential acquirer would be disinclined to endure a minimum of two consecutive annual director elections in order to attain control of the acquired company board. The employment of a staggered board strategy along with poison pills is commonly applied to enhance the efficacy of the takeover defence strategy.[184]

[180] For more details on white knight strategy, see Dawson, Pence and Stone (n 173) 427; Bainbridge (n 63).;Tim Jenkinson and Colin P. Mayer, *Hostile Takeovers: Defence, Attack and Corporate Governance* (McGraw-Hill Book 1994) 32
[181] Lucian Arye Bebchuk, John C Coates IV and Guhan Subramanian, 'The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy' (2002) 54 Stanford Law Review 887, 887 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=304388> accessed 31 August 2022
[182] ibid
[183] ibid
[184] Bebchuk, Coates IV and Subramanian (n 181) 890

Most of these defensive strategies are prohibited in many jurisdictions, including the UK and the KSA, but they are permitted and used mainly in the US. The policy driver for such prohibition and the main two diverging approaches adopted by the US on one hand, and the UK and KSA on the other hand, with regard to these strategies, will be discussed in the following sections.

7.4.2 The US Approach

The subsection will briefly overview the US approach to anti-takeover strategies, considering that the US is the most significant jurisdiction that permits these strategies, an approach that differs significantly from the approaches adopted in both the UK and KSA. The general approach in the US is that target boards have wide discretion and power against unwelcome takeover bids. In other words, the non-frustration rule is not applicable in the US.

It is imperative for corporations operating within the US to adhere to the statutes of the state where they were registered. It is also possible that they may have an obligation to follow the regulations of other states in which they operate their company. Directors' ability to use anti-takeover strategies against unwanted bids is not regulated by the US federal authority.[185] Instead, the state in which a firm is incorporated regulates the conduct of target directors when confronted with hostile takeovers. Indeed, takeover regulations that are in place at the federal scale are a minor component of the whole set of regulations that regulate takeovers.[186]

Although there are fifty distinct states and the body of law that governs each one is distinct from the others, almost each state has adopted anti-takeover legislation intended to impede unwelcome takeover bids.[187] Furthermore, the case law of the State of Delaware had a significant impact on corporate law in the US, and the decisions of the Delaware Court of

[185] Alistair Alcock, 'The Regulation of Takeovers' (2001) 3, 1, 3 <https://uk.westlaw.com/Document/IC9E6BCD0E72111DA9D198AF4F85CA028/View/FullText.html?navigationPath=Search%2Fv1%2Fresults%2Fnavigation%2Fi0ad604ab00000182f8c28061c1aaafa8%3Fppcid%3D2cdc01cf499d42f58bae1cb3fa295929%26Nav%3DRESEARCH_COMBINED_WLUK%26fragment> accessed 22 August 2022

[186] William Magnuson, 'Takeover Regulation in the United States and Europe: An Institutional Approach' (2009) 21 Pace International Law Review 205, 214 <https://scholarship.law.tamu.edu/facscholar/758> accessed 1 September 2022

[187] John Armour and David A Skeel, 'Who Writes the Rules for Hostile Takeovers, and Why? - The Peculiar Divergence of U.S. and U.K. Takeover Regulation' 1727, 1735 <https://scholarship.law.upenn.edu/faculty_scholarship://scholarship.law.upenn.edu/faculty_scholarship/687> accessed 2 September 2021

Chancery have an impact beyond the borders of the state.[188] This is attributed to the flexibility and great experience of the court in corporate law matters,[189] which led the majority of significant publicly traded companies to choose Delaware as their place of incorporation.[190]

Despite the fact that boards in the US have wide discretion and power when determining on how to address a takeover offer, this power and discretion are not so unlimited as to allow them to use defensive strategies to merely entrench themselves in their companies. The following principles, derived from case law, provide a framework that governs the conduct of directors when using anti-takeover strategies.

'Business judgement rule':

The business judgement rule protected directors from judicial scrutiny for their decisions. Accordingly, courts will not intervene in how directors conduct their company's business operations if certain conditions are met.[191] Courts will ensure the fulfilment of the following conditions: the lack of personal interest or self-dealing by the directors in the business decision;[192] that the directors acted on an informed basis;[193] and that the directors acted in good faith in a reasonable belief that the decision was in the best interest of the company.[194]

After the *Unocal v. Mesa Petroleum*[195] case, the Delaware Supreme Court added further requirements to be met to enable directors to be protected by the rule; these additions are referred to as the '*Unocal* doctrine' or 'enhanced business judgement rule'.[196] The first requirement is that directors must prove that they have reasonable grounds to believe that the hostile takeover bid is considered dangerous and threatening to the company's policy or effectiveness, and harmful to the company as a whole.[197] The second requirement is for

[188] Magnuson (n 186) 214
[189] ibid
[190] Delaware incorporates more than half of publicly traded corporations in the US. See the State of Delaware official website. http://www.corp.delaware.gov/aboutagency.shtml
[191] Joseph Hinsey IV, 'Business Judgment and the American Law Institute's Corporate Governance Project: The Rule, The Doctrine and the Reality' (1984) 14 George Washington Law Review 610 <https://heinonline.org/HOL/Print?collection=journals&handle=hein.journals/gwlr52&id=619> accessed 1 September 2022
[192] *Lewis v SL & E, Inc* (1980) 629 F2d 764, 769 (2d Cir)
[193] *Aronson v Lewis* (1984) 473 A2d 805 812 (Delaware)
[194] *Treadway Cos., Inc. v. Care Corp* (1980) 638 F2d 357, 382 (2d Cir); Hinsey IV (n 189) 610
[195] *Unocal v Mesa Petroleum* Co (1985) 493 A.2d 946 (Del)
[196] Bainbridge (n 63) 31
[197] *Unocal v Mesa Petroleum Co* (1985) 493 A2d 946 (Del)

directors to prove that the anti-takeover tactic used is proportional and reasonable in relation to the threat presented by the bid.[198]

The Delaware Supreme Court developed a modified version of the *Unocal* principle, referred to as the *Revlon* rule.[199] This rule is the legal principle that when a takeover is imminent, a company's board of directors must make reasonable efforts to obtain the highest value for the company. This represents a shift in responsibility, as the board of directors' role becomes that of auctioneers rather than of defenders.[200] Nevertheless, once a takeover is deemed unavoidable, the *Revlon* rule kicks in, and the board focuses on securing the highest value for its stakeholders as part of its inherent fiduciary duty.[201] The *Revlon* standard should be viewed as an exception to the *Unocal* heightened scrutiny review standard.[202] *Revlon* requires that a board of directors must negotiate the best possible deal for its shareholders. [203] Thus, if there is any preference shown towards a particular bidder, it should be based on a genuine interest in enhancing shareholders' value and not be influenced by improper purposes.[204]

'Just say no':

Boards of directors cannot simply Just say no to a takeover bid. Only in specified circumstances is the board permitted to use this defensive strategy, which allows directors to reject an offer even if the majority of the target shareholders favoured the bid premium.[205] However, in addition to the *Unocal* test, this rejection must be on the grounds that the takeover attempt undervalues the target company;[206] if the target firm is following a long-term plan;[207] or to protect the interest of other stakeholders such as employees.[208] The board

[198] ibid
[199] *Revlon Inc v MacAndrews & Forbes Holdings* (1986) 506 A2d 173 (Del SC)
[200] Bainbridge (n 178) 258.
[201] ibid
[202] ibid 315
[203] ibid
[204] ibid
[205] *Paramount Communications Inc v Times Incorporated* (1989) 571 A 2d 1140 (Del)
[206] *Air Products & Chemicals Inc. v Airgas Inc* (2011) WL 806417 (Del Ch*)*
[207] ibid
[208] *Paramount Communications Inc v Times Incorporated* (1989) 571 A 2d 1140 (Del); Robert A Prentice and John H Langmore, 'Hostile Tender Offers and the Nancy Reagan Defense: May Target Boards Just Say No? Should They Be Allowed To?' (1990) Delaware Journal of Corporate Law 383 <https://heinonline.org/hol-cgi-bin/get_pdf.cgi?handle=hein.journals/decor15&section=14> accessed 27 August 2022

must perform a reasonable examination, retain independent outside specialists, and determine that at least the possibility of inadequate value exists before it can simply say no.[209]

Thus, target boards have the authority to 'just say no' to takeover attempts irrespective of the target shareholders' choice, if the board acted in good faith, conducted a rational evaluation and relied on the advice of independent consultants, proved to a court that a takeover bid presented a genuine threat to the company, and that the board responded to this perceived threat by obstructing the bid.[210]

7.4.3 The UK Approach

The UK adopts the non-frustration rule and places the decision to accept the takeover bid in the hands of the shareholders. Rule 21 of the Takeover Code prohibits directors from taking any actions, during an offer or before once a takeover bid is imminent, to frustrate any takeover bids and deny the shareholders the opportunity to decide on the merits of the bid.

It is noteworthy that, in general, defensive strategies in the UK are not prohibited considering that boards are still able to adopt them.[211] However, adoption of most of these strategies must receive the shareholders' prior approval at the general meeting.[212] Although directors are not permitted to take bid-frustration actions without the shareholders' approval in the UK, they can adopt the white knight strategy by searching for a competing and better bid even though this might frustrate the first takeover bid.[213]

To provide a wider understanding of the UK legal framework on bids frustration, it is important to overview this matter in situations where Rule 21 of the Takeover Code is not applicable, and in a hypothetical assumption of the absence of the rule. The scope of the rule is that it only applies during the takeover offer, or prior to the offer if 'the board of the offeree company has reason to believe that a bona fide offer might be imminent'.[214] Thus, the question is whether directors can adopt defensive strategies before any takeover bids that fall

[209] Bainbridge (n 178) 315.
[210] *Airgas Inc* (n 206) Per Chancellor Chandler [4]
[211] Federico M Mucciarelli, 'White Knights and Black Knights: Does the Search for Competitive Bids Always Benefit the Shareholders of "Target" Companies?' (2010) 3 European Company and Financial Law Review 409 <https://ssrn.com/abstract=981399> accessed 5 September 2022
[212] ibid
[213] ibid
[214] The Takeover Code, Rule 21(1)(a)

in the scope of the rule, i.e., adopting pre-bid defensive strategies when there is no offer looming without the approval of the shareholders.

The answer to this question is that directors have to follow the directors' fiduciary duties stipulated in the Companies Act 2006,[215] which means acting in good faith, using their powers for a proper purpose, and in the best interest of the company as a whole when adopting any bid-frustration strategy.[216] Thus, it is very difficult for directors in the UK to adopt such strategies without breaching their fiduciary duties. In *Criterion Properties plc v Stratford UK Properties LLC*[217] the board of directors employed poison pills as a defensive strategy when there was no bid offer, nor was a bid imminent, without the shareholders' approval. The court ruled that the use of poison pills was invalid because the directors exercised their powers for an improper purpose. As Hart J noted, 'the terms were motivated not by a desire to advance or protect the commercial interests of Criterion but from a desire contingently to cripple those interests so as to deter an unwanted predator'.[218] Also, in *Hogg v Cramphorn Ltd,*[219] an allotment of shares was performed by the directors for two reasons recognised by the court: to frustrate a takeover bid and to promote the company. The Court inquired not only about the existence of an improper purpose, but also about whether it was the primary purpose. The directors were found to have breached their fiduciary duties because the primary purpose of the allotment was to frustrate the bid.[220] Also, in *Howard Smith Ltd v Ampol Petroleum Ltd,*[221] directors allotted shares to raise capital and as a defensive strategy by favouring a preferred offeror. The action was held invalid by the court considering that the primary purpose of the allotment was improper.

Based on the common law approach illustrated above, it can be concluded that the primary purpose when directors make decisions is crucial in determining whether or not they breached their fiduciary duties during takeovers. Additionally, the common law approach suggests that most actions taken by directors to frustrate a takeover bid will probably amount to improper use of power even in the assumption of the absence of Rule 21 of the Takeover Code that prohibits bid-frustration actions. Indeed, the UK legal environment ensures that

[215] Directors' duties in the UK have been discussed previously in further detail in this chapter in section 7.2.2.
[216] Companies Act 2006, ss 171, 172
[217] *Criterion Properties plc v Stratford UK Properties LLC* [2004] UKHL 28
[218] *Criterion Properties plc v Stratford UK Properties LLC* [2002] 2 BC 151, para 38
[219] *Hogg v Cramphorn Ltd* [1967] Ch 254, [1966] 3 All ER 420
[220] Blanaid Clarke, 'Regulating Poison Pill Devices' (2004) 4 Journal of Corporate Law Studies 51, 63 <https://www.tandfonline.com/action/journalInformation?journalCode=rcls20> accessed 5 September 2022
[221] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821

shareholders must not be deprived of the opportunity to decide on the merits of takeover bids, and bid-frustration by directors is not permitted.[222]

The following section will examine the difference between the US and the UK approaches in allowing directors to adopt such strategies, and the policy driver behind each approach, before looking at the KSA approach on this matter.

7.4.4 Comparative Analysis of the Divergence of Approaches Between the UK and US

After overviewing the US and UK approaches to bid-defensive strategies, it is notable that both approaches addressed the conflict-of-interest dilemma between directors and shareholders during takeovers and sought to limit their authority in this situation. However, while both approaches place limits on what directors can do in response to unwelcome takeover bids, the extent of limitation and restriction differs significantly. Directors in the US enjoy a wide discretionary power to adopt defensive plans against unwanted bids, such as poison pills, without the approval of their shareholders. The UK, on the other hand, adopts a stricter approach and prohibits directors from frustrating takeover bids without prior approval of the shareholders, which, unlike the US approach, shifts to the shareholders the power to decide on takeover bids.

Before addressing the rationale behind the divergence, it is important to avoid looking at the advantages and disadvantages of takeover defences from a de-contextualised approach. This can be attributed to the fact that most of the understanding of bid-defence strategies and their operation in practice and the way they are regulated are based on the experience of one jurisdiction, which is the US.[223] Thus, it is important to consider the legal environment from a general perspective and the effect of background laws already in place in each jurisdiction.

As illustrated in the previous section,[224] the UK legal environment is more focused on the protection of shareholders' rights, which is described as a shareholder primacy system. The US, on the other hand, is described as a director primacy system, where directors as

[222] David Kershaw, 'The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition' (2007) 56 International and Comparative Law Quarterly 267, 267 <https://www.cambridge.org/core/journals/international-and-comparative-law-quarterly/article/illusion-of-importance-reconsidering-the-uks-takeover-defence-prohibition/C81C6028B2B18AE389FB42A146F2578E>. accessed 27 August 2022

[223] Kershaw (n 92) 334

[224] Also, chapter 2 of this thesis has provided further detail on the protection of shareholders in different corporate governance systems, including those of the UK and the US.

gatekeepers of the company have the authority to decide on the merits of takeover bids.[225] The main difference between the shareholder and director primacy systems is that shareholder primacy asserts that shareholders are the principals for whom corporate governance is established and that they should have authority over their company.[226] Director primacy, on the other hand, recognises the importance of shareholder wealth maximisation, but opposes the idea that shareholders have the right of direct or indirect decision-making control.[227] Thus it is not surprising that, even in the absence of the non-frustration rule provided by the Takeover Code in the UK, the legal environment will not allow such bid-frustration strategies as were discussed in further detail in the previous section.

Considering that most anti-takeover practices are regulated by state law, one of the explanations of the US approach which empowers directors with defensive strategies is that these state laws tend to favour in-state companies over those looking to expand into other states as acquirers.[228] The US approach could be attributed to reliance on the 'shareholders' welfare hypothesis'.[229] This suggests that when directors employ defensive techniques to thwart bids, their defensive approach is intended to be in the shareholders' best interest by preventing the bid that is not in their best interest.[230] The idea behind this assumption is that directors have greater knowledge and experience than shareholders, who may lack the requisite skills when evaluating the merits of an offer.[231]

However, the UK seems to adopt an opposite hypothesis: the 'managerial welfare hypothesis', which indicates that when directors employ defensive methods to thwart hostile takeovers, they do so to entrench themselves in their companies and further their own interests, regardless of the shareholders'.[232] This cynical perspective on directors is in line with the conventional Berle and Means view of them, which is that directors are a group of people who do not share the same interests as the shareholders and, as a result, grab the profits for themselves rather than giving it to the shareholders.[233] The assumption that directors should decide on the merits of takeover bids because they have more knowledge and

[225] Stephen M Bainbridge, 'Director Primacy in Corporate Takeovers: Preliminary Reflections', Stanford Law Review (2002) 792 <https://www.jstor.org/stable/1229670> accessed 7 October 2022
[226] Stephen M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 21 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=300860> accessed 7 September 2022
[227] ibid
[228] Magnuson (n 186) 216
[229] Clarke, 'Regulating Poison Pill Devices' (n 220) 54
[230] ibid
[231] ibid 55
[232] ibid 57
[233] Berle and Means (n 1)

experience than shareholders seems to be an invalid argument in some jurisdictions such as the UK, where regulations mandate that independent professional advice on the financial aspects of the bid be obtained and delivered to shareholders by the board of directors.[234] Thus, it seems logical that shareholders would have the ability to evaluate the merits of a bid and reach an informed decision when they are provided with independent financial advice, detailed information about the bid by the bidder, and the recommendation of the bid by their board of directors.

Furthermore, from the agency theory[235] point of view, when a takeover bid is made, directors are most likely to face a significant conflict of interest; their interest is in preserving their positions and reputation rather than increasing the value of the corporation for shareholders, and self-interest is likely to taint their claims to promote the interests of shareholders or other stakeholders.[236]

7.4.4.1 The Influence of Institutional Representatives in Shaping the Non-frustration Policy

Corporate governance in the UK is substantially impacted by institutional investors representing shareholders' interests as a group.[237] This influence, in turn, includes influencing policymaking and the establishment of formal and informal principles in the corporate governance system.[238] Thus, institutional investors were engaged in every stage of the Takeover Code's development.[239] This explains the pro-shareholder approach in takeover regulations, considering the institutional investors' influence as a major force in UK share ownership, due to the fact that institutional investors have a clear interest in policies that maximise the anticipated benefits to shareholders.[240]

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[234] The Takeover Code Rule 3.1

[235] Agency theory refers to the problem arising from the separation of ownership and control, so that directors as agents do not always act in the best interest of shareholders (the principals), especially in conflict-of-interest situations. See: Eugene F Fama and Michael C Jensen, 'Separation of ownership and control'' (1983) 26 301, 304 <https://www.jstor.org/stable/725104?seq=1#page_scan_tab_contents> accessed 20 February 2022. Agency theory is discussed in further detail in chapter 2 (Corporate governance and ownership structure).

[236] High Level Group of Company Law Experts Report on Issues Relating to Takeover Bids (2000) 21

[237] Armour and Skeel (n 187) 17771.

[238] ibid

[239] Joy Dey, 'Efficiency of Takeover Defence Regulations: A Critical Analysis of the Takeover Defence Regimes in Delaware and the UK' (2009) Social Science Research Network 9 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1369542> accessed 9 September 2022

[240] Armour and Skeel (n 187) 17771

On the other hand, the role of financial institutions in the US and the UK notably differ. As explained earlier (section 3.2.2), in contrast to the UK, due to the dual system and state rivalry, the US has not succeeded in developing a national system of takeover regulations comparable to the Takeover Code in the UK. On the federal level, the formation of US company law was driven more by politics than by economic efficiency,[241] as Roe concluded with a detailed description of the ways in which the political system in the US deterred large investors in a systematic way.[242] Thus, institutional investors were not influential in the formation of the takeover regulations which led to the continuation of management-friendly and large-shareholder-hostile policies.[243] Further, institutional investors' restricted power to shape the evolution of takeover regulations in the US was limited by the wider geographical dispersion of these investors across the country. Therefore, there were no strong shareholder protection regulations similar to those in the UK due to the weakness of institutional investors' role.[244]

Instead, target boards had a greater impact on the evolution of corporate policies in the US. Indeed, state rivalry generates a systematic propensity for states to shield existing managers from takeovers.[245] This is because directors have a crucial role in deciding to re-incorporate the company in any state they see fit.[246] Therefore, states may enact takeover regulations that protect the target board from unwelcomed takeovers in order to encourage other companies to incorporate there and to discourage their companies from re-corporating in different states.[247]

[241] Shleifer and Vishny (n 2) 771
[242] Mark J Roe, *Strong Managers Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1994) 21–22
[243] Shleifer and Vishny (n 2) 771
[244] Armour and Skeel (n 187) 17771.
[245] Lucian Arye Bebchuk and Allen Ferrell, 'A New Approach to Takeover Law and Regulatory Competition' (2001) 87 Virginia Law Review 111, 130 <https://www.jstor.org/stable/1073896?saml_data=eyJzYW1sVG9rZW4iOiI4MDFkMzA0YS1jZGU5LTQ4ZWYtYmIxOC01ODVkMDk4MWQ1YWYiLCJpbnN0aXR1dGlvbklkcyI6WyIxNWE0NDMwMC1hZDMxLTQ4M2YtOTQ2YS03OTU4NzQ4MmFjM2EiXX0#metadata_info_tab_contents> accessed 11 September 2022
[246] Mark Loewenstein, 'Delaware as Demon: Twenty-Five Years After Professor Cary's Polemic' (2000) 71 University of Colorado Law Review 497, 501 <https://scholar.law.colorado.edu/cgi/viewcontent.cgi?article=1601&context=articles> accessed 11 September 2022
[247] Lucian Arye Bebchuk and Allen Ferrell, 'Federalism and Corporate Law: The Race to Protect Managers from Takeovers' (1999) 99 Columbia Law Review 1168, 1173 <https://www.jstor.org/stable/1123454> accessed 12 September 2022

7.4.4.2 Conclusion

Both the US and the UK have a free market economy, distinguished by the separation of ownership and control, and takeovers are considered key tools for limiting management excesses. Nonetheless, the regulation of takeover-defence mechanisms differs significantly. This section has illustrated the policy drivers behind each approach and explained the importance of considering the legal environment in a broad sense and the effect of existing background laws in each jurisdiction when evaluating takeover defence regulations. Thus, implementing the US approach in a jurisdiction in which the shareholder primacy model is deeply rooted in its legal system, such as the UK, would not be expected, and vice versa.[248]

However, although the efficiency of defensive strategies has been discussed extensively in the literature and empirical evidence is mixed,[249] the author of this thesis supports the claim that the UK takeover system succeeded in producing a body of law that facilitates takeovers and protects the interests of shareholders at the same time.[250] The US approach seems to allow directors to entrench themselves at the expense of decreasing shareholders' value.[251] Moreover, the UK system succeeded in promoting certainty, a vibrant takeover market, and an increase in directors' accountability, considering that defensive strategies are prohibited and governed by the Takeover Panel, unlike in the US where these strategies are allowed and governed by courts to evaluate their legitimacy, which increases costs generated by litigation.[252]

Following this insight provided by this section regarding the rationale behind the divergence of the two main approaches dealing with bid-frustration tactics, the next section will address bid-defensive strategies and their legitimacy in KSA.

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[248] Alexandros Seretakis, 'Hostile Takeovers and Defensive Mechanisms in the UK and the US: A Case Against the US Regime' (2013) 8 The Ohio State Entrepreneurial Business Law Journal 35 <http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=1104212> accessed 12 September 2022.
[249] See, for example: Frank H Easterbrook and Gregg A Jarrell, 'Do Targets Gain from Defeating Tender Offers?' (1984) 59 New York University Law Review 277 <https://chicagounbound.uchicago.edu/journal_articles> accessed 12 September 2022; Paul Asquith, 'Merger bids, uncertainty, and stockholder returns' (1983) 11 Journal of Financial Economics 51 <https://www.sciencedirect.com/science/article/pii/0304405X83900053>; Peter Dodd, 'Merger Proposals, Management Discretion and Stockholder Wealth' (1980) 8 Journal of Financial Economics 105 <https://www.sciencedirect.com/science/article/pii/0304405X80900148> accessed 12 September 2022; Martin Lipton and Paul K Rowe, 'Pills, Polls and Professors: A Reply to Professor Gilson' (2003) SSRN Electronic Journal <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=398060>.
[250] Magnuson (n 186) 237
[251] ibid
[252] Seretakis (n 248) 1

7.4.5 The Non-frustration and Board Neutrality Rule in KSA

In relation to the controversial question of who should decide on takeover bids (directors or shareholders), the M&A Regulations in KSA have placed the power in the hands of shareholders to decide whether to accept or reject takeover bids. Hence, the non-frustration rule is adopted in the M&A Regulations, considering the fact that the KSA takeover system is highly influenced by the UK system and the similarity of the two regimes, which are both categorised as shareholder primacy regimes.

The rule is stipulated in several articles in the M&A Regulations. According to article 3 (General Provisions), the target company's board of directors must provide their shareholders with sufficient information and advice regarding the bid to 'enable them to reach a properly informed decision to accept or reject the offer'.[253] This is an implication that only shareholders should decide on the merits of the bid, and that directors are prohibited from rejecting the offer. A clear stipulation of the non-frustration rule is stated in the same article but in a different sub-article as follows:

> In case the board of the Offeree Company has reason to believe that a bona fide Offer might be imminent, the board of the Offeree Company may not take any action in relation to the affairs of the company, that may cause the rejection of the offer or preventing shareholders from making a decision on it, without the approval of the shareholders convened in a general assembly.[254]

Article 36, titled 'Restrictions on Frustrating Actions', lists several actions that the board of the target company must not take without the shareholders' approval:

> During the course of an Offer, or even before the date of the Offer if the board of the Offeree Company has reason to believe that a bona fide Offer might be imminent, the board must not, except in pursuance of a binding contract entered into earlier, and without the approval of the shareholders convened in a general assembly, effect any of the following:
>
> 1) issue any undisclosed unissued shares;
>
> 2) issue or grant rights in respect of any unissued shares;

[253] M&A Regulations Article 3(h)
[254] M&A Regulations Article 3(j)

3) create or issue, or permit the creation or issuance of, any convertible securities into shares or subscription for shares;

4) sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of a value equal to 10% of the net asset of the Offeree Company according to the latest reviewed interim financial statements or audited annual financial statements, whichever is later, whether through a transaction or various transactions;

5) buy-back of offeree company's shares; or

6) enter into contracts otherwise than in the ordinary course of business.[255]

7.4.5.1 Observations

There are two observations regarding the drafting of the non-frustration rule in the M&A Regulations. The first one is about the wording of the previous article (article 36) which implies that the prohibited actions are listed in the article in a way that may suggest that they are exclusive and not for the purpose of providing examples. Limiting the actions that are considered frustration actions is not practical on the regulatory level. This is because new defensive strategies might be adopted to overcome the restriction on the rule. Indeed, as Bainbridge concluded: 'as fast as new acquisition techniques are developed, new defenses spring up'.[256] The second observation is that the non-frustration rule is stipulated twice in different parts of the M&A Regulations with minor differences in the wording (articles 3(j) and 36) which indicates unnecessary repetition that may cause confusion and ambiguity. Thus, a recommended reform is to implement similar drafting of the same rule in the UK's Takeover Code which clearly states that directors are prohibited from taking any actions 'which may result in any offer or bona fide possible offer being frustrated or in shareholders being denied the opportunity to decide on its merits'.[257] This rule (Rule 21.1 of the Takeover Code) provides a list of prohibited actions in a sampling and non-exhaustive way that can be clearly understood from the wording of the rule.

[255] M&A Regulations Article 36(a)
[256] Bainbridge (n 178) 235
[257] The Takeover Code Rule 21.1

7.4.5.2 How Important is the Non-frustration Rule in KSA and is it Necessary?

Adopting the directors' neutrality principle and the non-frustration rule in the KSA's takeover system is a rational regulatory choice by the KSA's policymakers, considering that the regulations require directors to obtain independent financial advice and provide this advice and that their recommendations to their shareholders allow them to reach a properly informed decision to accept or reject the offer. The adoption of this rule is necessary for the KSA's takeover system for the following reasons.

As pointed out on several occasions in this thesis, the KSA corporate governance and takeover legal systems are highly influenced by the UK, a fact which categorises the KSA as a shareholder primacy corporate regime. Therefore, choosing the principle that is of great importance in tipping the balance of power, either in the interest of the shareholders or of the directors, when making the decision on bids will highly influence the shape and framework of the legal system governing takeovers; which means that the removal of the non-frustration rule and adoption of the US approach will not fit with the KSA's takeover system and other relevant background laws.

Moreover, considering that the KSA is a less developed jurisdiction than the UK, the need for efficient shareholders protection regulations is more urgent. There are several corporate governance[258] and minority shareholders' protection[259] concerns, such as the significant power of the government as a shareholder in the stock market,[260] in the KSA that necessitate the adoption of the non-frustration rule as a tool that provides protection to shareholders and increases directors' accountability.

Furthermore, as illustrated earlier in this chapter, unlike in the UK and other developed jurisdictions, the regulations of directors' fiduciary duties in KSA lack clarity and coherence, which lowers the level of directors' accountability. Thus, the board neutrality principle enforced by the non-frustration rule is a critical necessity, considering the ambiguity of the legal framework of directors' duties in KSA, to ensure the protection of shareholders by placing the decisions on takeovers in their hands rather than in those of the directors.

[258] Corporate governance in KSA is discussed in detail in chapter 2.
[259] Minority shareholders' protection in KSA is discussed in detail in chapter 6.
[260] The government holds 78.46% of the KSA's stock market. See: Quarterly Statistical Bulletin for the second quarter of 2022 on the CMA website: https://cma.org.sa/en/MediaCenter/PR/Pages/Bulletin_for_Q2-_2022_en.aspx. Further detail on government ownership in KSA can be found in chapter 6.

In this context, it is important to note that the takeover system in KSA is silent about the agency problem between controlling shareholders and minority shareholders, which is a noticeable feature of the KSA's market, as discussed in detail in the previous chapter (chapter 6). Nevertheless, it should be emphasised that this type of agency problem is not a valid justification for opposing shareholder primacy and board neutrality. On the contrary, the non-frustration rule should be an essential element of the takeover system as it would improve disclosure regarding the use of frustration measures, allowing non-controlling shareholders to express their views on the defences and acquire additional details from the directors.[261]

7.4.6 Conclusion

This section has examined the two main approaches regarding board neutrality and the non-frustration rule and has attempted to provide insight into such divergence in order to properly evaluate the efficiency of the rule in the KSA. The section illustrated the importance of the rule in KSA and provided several factors that support this claim.

7.5 Holding Directors Accountable and Litigation in the Takeover Context in KSA

7.5.1 Introduction

This section will discuss litigation options for shareholders against directors in the takeover context in the KSA. The section will argue that litigation in the takeover context is extremely rare in KSA; this rarity will be analysed and the factors behind it will be illustrated. The section argues that the statutory remedies and options for litigation for shareholders in KSA are insufficiently successful in safeguarding and protecting minority shareholders in publicly traded companies, as a result of which reforms to the related regulations are suggested.

7.5.2 The Judicial Authority

As illustrated in further detail in chapter 3 of this thesis, any commercial disputes fall under the Commercial Court authority. However, disputes related to directors' violations and

[261] Thomas Papadopoulos, 'Harmonization of takeovers in the internal market: An analysis in the light of EU law' (2009) 236 <https://ora.ox.ac.uk/objects/uuid:bc2e64c7-80ff-4707-b3f3-ff9804dd29bc/download_file?file_format=pdf&safe_filename=DEPOSITBODLEIAN.pdf&type_of_work=Thesis> accessed 13 September 2022

takeovers in listed companies fall under the CMA committees' jurisdiction. A two-tier litigation system was established. Disputes related to CMA's law or any of its implemented regulations will be heard by the Committee for the Resolution of Securities Disputes (CRSD),[262] and its decisions can be appealed against before the Appeal Committee for the Resolution of Securities Conflicts (ACRSC), whose decisions are final and definitive.[263]

The purpose of this brief subsection is to identify the authority concerned with directors and takeover disputes. This is because recognition of the authority concerned with settling disputes related to takeovers is of great importance in understanding the litigation mechanism and distinguishing between this mechanism among several jurisdictions such as the UK and the US, as discussed in the following sections.

7.5.3 Statutory Remedies and Identifying Forms of Action

This subsection identifies the common remedies and forms of legal proceedings that can be used by shareholders against directors, before analysing these remedies and actions in KSA in the following section.

Derivative action:

The derivative action is a claim commenced by a member of a company (the company's officers) or by its shareholders to protect the interests of the company and acquire a remedy on the company's behalf as a result of a wrong done to the company. The derivative claim is implemented in many legal jurisdictions worldwide as a corporate governance tool to protect minority shareholders by revealing corporate misconduct and resolving the imbalance of power resulting from the separation of ownership and control.[264] It also gives shareholders the legal authority to sue directors on the company's behalf for wrongs the company has suffered when the company (i.e., its directors or controlling shareholders) is unable or unwilling to do so.[265]

[262] Capital Market Law Article 25(a). The CRSD is one of the quasi-judicial committees discussed in chapter 1.
[263] Capital Market Law Articles 25(f) and (g)
[264] Melissa Hofmann, 'The Statutory Derivative Action in Australia: An Empirical Review of Its Use and Effectiveness in Australia in Comparison to the United States, Canada and Singapore' (2005) 1 Corporate Governance eJournal 1–2 <http://epublications.bond.edu.au/cgej/13> accessed 23 September 2022 ; Ailbhe O'Neill, Reforming the derivative suit. (2007) 157 (7263) New Law Journal <https://www.newlawjournal.co.uk/content/reforming-derivative-suit> accessed 23 September 2022
[265] Hofmann (n 264)

The main differences between the derivative action and individual direct shareholders' action are that the purpose of the action is to protect the shareholder(s)' plaintiff's interests and the interests of the company as a whole including all its members, to remedy the wrong done to the company, not to the shareholder(s) who brought the claim personally; and the indemnity for the wrong done is for the company, rather than going directly to the shareholders.

Personal action and the petition for unfair prejudice:

The personal direct action, referred to as the petition for unfair prejudice in the UK,[266] is an action by a shareholder(s) in his individual capacity to receive personal remedies as a result of harm directly affecting the petitioning shareholder.[267] This provides minority shareholders with the opportunity to bring a claim when their rights are violated or jeopardised by the conduct of the company's de facto controller.[268]

Class action:

A class action[269] lawsuit is a type of private action suit that is brought against one or more defendants by a group of plaintiffs who share the same legal grounds, claimed facts, and content of the requests.[270] Considering the huge number of investors in modern listed companies, class actions protect the defendant from inconsistent and overly numerous cases brought about the same matter.[271] Moreover, the class action serves as an economical legal tool to aid in conserving time and cost for both courts and plaintiffs, and through the distribution of litigation costs among a large number of plaintiffs with similar claims.[272]

[266] Sections 994–996 of the Companies Act 2006
[267] Bainbridge (n 16) 207
[268] Janet Dine and Marios Koutsias, *Company Law* (8th edn, Palgrave Macmillan Law Masters 2014) 198
[269] Class action is available in the US and the KSA. The action in the UK is referred to as Group litigation order and Representative action.
[270] Ashurst, 'Collective Actions: UK Guide' (2021). Available at <https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide-collective-actions---uk-guide/>
[271] Legal Information Institution, Cornell Law School, Class action: <https://www.law.cornell.edu/wex/class_action>
[272] ibid

7.5.4 Statutory Remedies in KSA

7.5.4.1 Introduction

The KSA legal system provides shareholders of listed companies with several statutory remedies and action tools when their personal rights or those related to the rights of the company are violated.

Before looking at the statutory remedies in the KSA's corporate legal system, it is worth noting that there are other means with which to litigate in the KSA system, such as litigation based on contract law and Sharia law. However, the scope of this section will focus on the remedies and actions provided in the corporate law system, considering that this falls within the scope of the thesis; and that the reliance on contract law and Sharia law is very rare in the context of takeovers of publicly listed companies, since the Company Law 2015 and the CMA implementing regulations will apply.

7.5.4.2 Suing Errant Directors

In general terms, only the company can sue the board of directors for any wrong done to the company as a whole. The exception to this principle is the derivative claim by shareholders on behalf of the company which is discussed in the following subsection. Article 79 of the Companies Law 2015 recognises the principle that the company can sue errant boards, as it states that:

> The company may file a liability suit against Board members for wrongful acts that may harm shareholders. The decision to file this suit is vested with the ordinary general assembly, which shall designate a representative on behalf of the company to pursue the suit.[273]

The first observation about this article is that it can be noted from its wording that it applies to board members who have committed a wrongful act. This raises the questions: can a director who is not a member of the board who committed a wrongful act be sued based on this article; and can a former member of the board be sued based on it? The answer to these questions depends on the intention of the legislators, which is difficult to identify with certainty. The author of this thesis believes that this vagueness is a result of poorly drafted legislation rather than an intention to relieve the director, who is not a member of the board,

[273] Companies Law 2015 Article 79

of liability for his mistakes that are harmful to the company. However, as per the wording of the article, it appears that the action provided by article 79 applies only to board members. Thus, directors who committed a wrongful act against the company but are not members of the board cannot be sued based on this article. It should be noted that article 79 will also not apply to a wrongful action by the board of directors against a single shareholder that caused personal loss or violation of his rights. However, there are other statutory remedies for such scenarios that will be discussed in the subsequent subsections.

In comparison with the UK, to illustrate the importance of clarity and properly drafted legislation[274] that can eliminate ambiguity and ensure proper protection to shareholders and increase accountability of directors, the wording of the regulations of the Companies Act 2006 reads, in relation to derivative claims: 'The cause of action may be against the director or another person (or both)'.[275] As an example of clarity and increasing accountability, the section states that the 'director includes a former director'.[276] The wording of this section widens the scope of this statutory remedy, unlike the KSA's counterpart which narrows the scope to members of the board only. Thus, a reform to article 79 is recommended to eliminate ambiguity and to ensure that all directors can be held accountable and sued in accordance with this article when they commit a wrongful act against the company.

The second observation about article 79 is that it confers the power to sue board members solely on the shareholders' general meeting. Consequently, there will be some shareholders who do not meet the legislative threshold that must be met in order to call for a shareholders' general meeting. The threshold to call for a general meeting is a number of shareholders representing at least 5% of the capital.[277] As illustrated on several occasions in this thesis, government agencies and families have great ownership and de facto control in many listed companies in KSA. Thus, conditioning the filing of the derivative action against directors on holding the shareholders' general meeting may weaken the position of minority shareholders. The derivative action should be a safeguarding tool for minority shareholders

[274] Despite the clarity and proper drafting of the derivative claim in the UK in comparison to the KSA, it has received some criticism. For example, Riley argued that the codification of the claim in the Companies Act 2006, after it was governed by common law rules prior to the act, failed to address the rules on the ratification of directors' breaches of duty, considering that a great deal of the uncertainty and inaccessibility related to derivative claims is a result of these rules. For further detail, see: Christopher A Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2013) 34 Legal Studies 582 <https://dro.dur.ac.uk/22019/1/22019.pdf?DDD19+DDC108+dla4jap> accessed 3 April 2023.
[275] The Companies Act 2006, s 260(3)
[276] The Companies Act 2006, s 260(5)(a)
[277] Companies Law 2015 Article 90(1)

by enabling them to sue directors on the companies' behalf in cases where the controlling shareholder(s) is(are) unable or unwilling to do so.[278] A reform is recommended to enable all shareholders regardless of their ownership percentage to bring an action against a wrongful act committed by directors to enhance the level of accountability and protection to minority shareholders.

7.5.4.3 Derivative Action in the KSA, and is it Really a Derivative Action?

As discussed in the previous subsection, article79 recognises the company's right to sue errant board members via a decision by the shareholders' general meeting. Article 80 of the Companies Law 2015 provides an exception to the principle that only the company has the right to sue errant boards and allow shareholders to bring a derivative action on behalf of the company. However, this subsection argues that derivative action is not available in the KSA corporate law in the genuine meaning of derivative actions discussed earlier in subsection 7.5.3 of this chapter. Instead, what article 80 represents is a combination of personal action and derivative action as a result of poorly drafted regulations.

According to article 80:

> Each shareholder shall have the right to file a liability suit against board members for any wrongful act that causes harm to him. The shareholder may file such a suit only if the company's right to file the same is still valid. The shareholder shall notify the company of his intention to file such suit, and his right to compensation shall be limited to the damage sustained by him.[279]

This article received criticism from several scholars,[280] considering the ambiguity it creates and the confusion between the derivative claim and the personal claim.

Based on the wording of the article, there are five conditions to be met in order to allow a shareholder to file this liability suit. The action can only be taken against board members and not against all directors who are not members of the board.[281] The plaintiff

[278] Hofmann (n 264) 1–2
[279] Companies Law 2015 Article 80
[280] Youseif A Al-Zahrani, 'Rights of Shareholders under Saudi Company Law 1965' (2013) <http://bura.brunel.ac.uk/bitstream/2438/8284/1/FulltextThesis.pdf> accessed 18 September 2022; Tariq AL Ibrahim, 'Claims of Liability in Joint Stock Companies', Journal of Law, Dar Tariq AL Ibrahim for publication 2010; Abdullatif Mohammed Aleshaikh, 'Towards Legal Reform of Saudi Law of Directors' Duties and of Enforcement by Derivative Action' (2018) <https://theses.gla.ac.uk/30630/>
[281] This issue was discussed in further detail in the previous subsection.

shareholder can bring this claim only if the board of directors' actions caused damage to his personal interests. Further, if the company does not have the right to sue on the same grounds, the shareholder has no legal standing to do so. A notification to the company must be made by the shareholder prior to filing the liability suit. Finally, the compensation request made by the plaintiff shareholder must be for the damage suffered by him only and must not seek to compensate the company.

There are two conditions among the above-mentioned that change the meaning of a derivative action. The first is the personal harm condition (claimants must suffer direct damage by board members). Although the article states that this action can be brought on behalf of the company, the action is deprived of a key element that it needs in order to be categorised as a derivative claim. The key element is that a derivative claim provides an opportunity to all shareholders to protect the company when there is a wrong done to the company and the de facto controller (directors or controlling shareholder in general meetings) did not take any action in response to this damage.[282]

Thus, a common feature between the direct claim by the company and the derivative action is that both claims aim to protect the company from harm and defend its rights. What the above condition does is to allow the lawsuit to be brought on behalf of the company, but for the shareholder's personal relief for a wrong done to the company. As a result of this condition, article 80 lacks the main elements needed for the action to be described as a derivative action and, to a certain extent, appears to be more similar to a personal claim. However, it cannot be described as a personal claim either, as discussed in further detail in the following subsection.

The second condition provided in article 80 that prevented the action from being a derivative one is the limitation of the compensation to the shareholder claimant only, not the company. This means that other shareholders and other stakeholders, such as creditors, will not benefit from the remedy given by the court because of wrongdoing committed against the company. This condition also makes the action look more like a personal action than a derivative claim.

From a practical point of view, the article poses significant difficulties to minority shareholders seeking to rely on this article to bring a claim. This is because, inter alia,

[282] Hofmann (n 264) 1–2

claimants will have the burden of proving that the board members committed a wrongful act harmful to the company; and that the same wrongdoing also caused damage to their personal interest. Indeed, breaches of directors' duties that are considered wrongdoing to the company do not always amount to personal harm to shareholders.

Based on the arguments above, it can be concluded that derivative action is not available in the KSA's legal system. In a market where many listed companies are controlled by government agencies and elite families, it is very important to provide minority shareholders with the legal means to litigate misconduct committed by any director against the company. The absence of a properly drafted derivative claim weakens directors' accountability and minority shareholders' position. Thus, reform of article 80 is highly recommended to allow all shareholders to use the derivative action against any director who commits an act that amounts to harm to the company, even if this act did not directly damage the claimants' personal interests, and to allow compensation to be provided to the company.

7.5.4.4 The Personal Action

A clear meaning of, or wording referring to, a personal claim cannot be found in the Companies Law 2015 or in the CMA regulations. A vague and unclear personal claim can be derived from two articles of the Companies Law 2015.

The first is article 80 which causes confusion between personal and derivative claims, as discussed in the previous subsection. The article cannot be considered a personal action because of the condition which stipulates that the claim cannot be brought unless the company's right to file the same action is still valid. This means that the wrongdoing must also affect the company, not only the shareholder's personal interests. Furthermore, the wording of the article states that shareholders have the right to file a liability suit 'specified to the company'[283] against board members. This means that this action is the same action as that in the preceding article (79), which gives the company the right to file the liability suit. Thus, article 80 cannot be considered a personal action; and it imposes difficulties on minority

[283] As discussed on several occasions in this thesis, many legislations in KSA suffer from translation issues that can change the meaning of articles. The English version of article 80 did not include the phrase 'specified to the company' as did the Arabic version. Thus, the author relied on the Arabic version to analyse this article. According to the Companies Law 2015 English version: 'In the event of any conflict between the Arabic version of these Laws and Regulations and any subsequent translation into any other language, the Arabic language version shall govern and control.'

shareholders seeking to rely on it as a litigation option, for the reason discussed in the previous subsection.

The second article that can be considered, in a limited sense, a private action is a sub-article under section 2 of the Companies Law 2015 titled 'Shareholder Assemblies'. According to the sub-article:

> The extraordinary general assembly shall have the power to amend the company's articles of association, except for the following: Depriving a shareholder of his fundamental rights derived from his capacity as a partner or making any amendment thereto, particularly the following: Requesting access to the company's books and documents, monitoring board actions, filing a liability suit against board members and challenging the validity of resolutions of general or special assembly meetings.[284]

Considering the context of the article, this sub-article allows shareholders who are deprived of their rights, such as accessing the company's documents, to sue the board members to enable them to enjoy their rights. However, the sub-article is vague and does not stipulate the principle of personal action explicitly, clearly, and comprehensively. This ambiguity can also be attributed to the wording of the sub-article as it does not mention personal action. Instead, the wording used in the Arabic version states that a shareholder can file 'the liability suit', which may imply that it is a reference to the liability suit stipulated in article 79 which gives the company the right to sue errant board members.

This unclarity of regulations places minority shareholders in a weak position considering that their litigation options are unclear and poorly drafted. This unclarity also minimises directors' accountability. Thus, reform is recommended to explicitly stipulate shareholders' personal action similar to the UK's petition for unfair prejudice, which allows shareholders to file a suit on the grounds that the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least himself), or that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.[285]

[284] Companies Law 2015 Article 88(1)(a)(5)
[285] Section 994 of the Companies Act 2006

7.5.4.5 Class Action

Class action is recognised and regulated in the KSA by the CMA's implemented regulations. The class action is governed by articles 52–77 of The Resolution of Securities Disputes Proceedings Regulations. Governing the class action by the CMA means that this action is permitted for listed companies only, considering that the CMA regulations apply only to publicly held corporations. Indeed, the class action is not addressed in the Companies Law 2015. The class action is defined by the regulation as the following: 'a private action suit filed by a group of plaintiffs against one or more defendants, where the group of plaintiffs' suit shares the same legal basis, alleged facts, and the subject matter of the requests'.[286]

The class action suit request must be submitted to the CRSD, which has the discretionary power to accept or reject the request.[287] The CRSD will consider three main factors in deciding whether to accept the class suit request. First, the CRSD must be convinced that legal matters and common facts of the class suit are greater than legal matters and facts specific to each member of the group of claimants.[288] The second factor to be considered is whether the class action suit would be more practically productive and effective than other types of litigation actions.[289] The third factor is that the CRSD will accept the class action suit if it believes that this action will guarantee compensation to more persons affected by the violations of the defendant.[290]

It should be noted that the KSA is adopting an opt-in approach in relation to joining the class action suit. The opt-in system essentially means that claimants are only regarded as members of the class action if they voluntarily opt to participate in the action and share equally in any compensations that are awarded.[291] In contrast, the opt-out approach means that, unless they opt out, members of a class of unnamed claimants are automatically included in a proceeding brought on behalf of the class.[292]

The opt-in approach in KSA can be concluded from the regulations as per the wording of article 57: 'A request for joining a Class Action Suit may be submitted within the period

[286] The Resolution of Securities Disputes Proceedings Regulations Article 1(c)(1)
[287] The Resolution of Securities Disputes Proceedings Regulations Article 55(a)
[288] ibid
[289] ibid
[290] ibid
[291] Ashurst 'Collective Actions: UK Guide' (2021). Available at <https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide-collective-actions---uk-guide/>
[292] ibid

mentioned in Paragraph (a)…'.[293] The opt-in approach is also adopted in the UK,[294] unlike in the US where the opt-out approach was adopted.[295]

In clear contrast to the regular use of the class action procedure in the US, the adoption of group litigation orders in the UK has been minimal.[296] This can be attributed to the lack of an opt-out approach in the UK, considering that this approach is a distinguishable feature of US class action lawsuits, which gives shareholders the opportunity to participate in the proceedings of the action without taking any active actions to receive court-sanctioned settlements, unless they opt-out explicitly.[297] Thus, the absence of an opt-out approach in the UK may create difficulties for shareholders seeking to commence collective actions.[298]

The situation in the KSA is similar to that in the UK regarding the obstacles presented by the opt-in approach. Therefore, adopting the US approach in the KSA can provide minority shareholders with a better opportunity to receive remedies when there is misconduct by directors. Indeed, the opt-out approach is in line with the general purpose of the class action as stipulated by the regulations in KSA, as per the wording of article 55, stating that the CRSD should accept the class action request when it 'guarantees compensating more persons affected by the violations of the defendant'.[299]

7.5.4.6 How Common are these Litigation Options in Takeovers in KSA, and Why?

There are many factors that shape the litigation system, and the reliance on litigation varies greatly from one sector to another and from one country to another. The focus of this subsection will be on the litigation procedures mentioned earlier in this chapter within the scope of takeovers of listed companies in KSA, with a brief reference to the UK and the US in order to clarify specific points related to this subject.

[293] The Resolution of Securities Disputes Proceedings Regulations Article 57(d)
[294] It should be noted that the UK refers to group litigation as Group litigation order and Representative action. See Rule 19 of the Civil Procedure Rules.
[295] See Rule 23 of the Federal Rules of Civil Procedure.
[296] Morley (n 80) 197
[297] ibid 198
[298] ibid
[299] The Resolution of Securities Disputes Proceedings Regulations Article 55(a)

In the takeover context, the US has a larger tendency to litigate against directors than the UK[300] and the KSA.[301] This can be attributed to several factors including the existence of the supervisory authority that governs takeovers and plays an integral role in the process of takeovers: the Takeover Panel in the UK, and the CMA in the KSA. Indeed, both mentioned bodies developed regulations governing takeovers that cover matters not directly addressed by other corporate regulations; and both bodies play a main role as an alternative to litigation, as both can provide counsel and resolve conflicts through official and informal procedures,[302] in contrast to the US where there is an absence of such authority that plays the same role in takeovers, which increases the reliance on courts to resolve disputes related to takeovers by litigation.[303]

Generally, directors are rarely held liable by their firms or their shareholders or sanctioned by relevant authorities for business decisions that cause damage.[304] Courts are reluctant to intervene in business judgements by directors if there are no clear violations or misconduct, and the process of proving this misconduct may be hindered by practical obstacles. The extent to which directors must be held accountable for company decisions is debatable[305] and varies from one jurisdiction to another. The scope of the directors' duties and obligations contributes significantly to determining their accountability level.[306] In other words, the greater the scope of these duties, the greater the possibility that directors will be in violation and hence subject to a lawsuit. Therefore, as illustrated earlier in this chapter,[307] the vagueness of directors' duties and the lack of properly drafted legislation governing them in

[300] For more detail, see: Morley (n 78) 267, 'Practical Law: Takeover regimes: A comparison between the UK and the US' <https://www.bclplaw.com/a/web/184719/3WJxKG/uk-us-comparison-of-takeover-regimes-8-585-4706.pdf>

[301] The author examined rulings related to litigations against board members regarding takeover actions or decisions on the CRSD website and did not find a case that was reported in this context. The General Secretariat of Committees for Resolution of Securities Disputes: <https://crsd.org.sa/en/Pages/default.aspx>

[302] UK courts are reluctant to interfere in takeover issues in the presence of the Takeover Panel, considering its regulatory and supervisory functions. Thus, litigation on takeover matters is discouraged, and rulings of the Takeover Panel would be overturned only in the extremely unlikely event that the panel acted in violation of natural justice norms. See: *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815. According to Lord Bingham MR, when taking into consideration the volatile and sensitive financial markets, 'courts will not second-guess the informed judgement of responsible regulators steeped in knowledge of their particular market'. See: *R v International Stock Exchange of the UK and Ireland, ex parte Else* [1993] QB 534, 545. Indeed, courts rarely alter the outcome of a takeover and the process of a takeover in the UK is rarely interrupted by litigation; Morley (n 935) 201.

[303] ibid

[304] Keay and others (n 126) 1

[305] ibid

[306] Morley (n 80) 172

[307] See section 7.2.3.

KSA reduce the possibility of directors being in breach of their duties, and less liable to litigation against them by shareholders.

Furthermore, unlike the US and more like the UK, the KSA's adoption of the non-frustration rule[308] and the mandatory bid rule[309] provided shareholders with more protection and minimised cases in which shareholders rely on litigation in takeovers. Indeed, the non-frustration rule placed the decision to accept or reject takeover bids in the hands of shareholders and limited the boards' role to only providing advice to shareholders – unlike in the US, where no such rule is in place and directors make the decisions on takeover bids, which exposes them to more court scrutiny.

Additionally, the expenses associated with litigation proceedings could potentially dissuade minority shareholders.[310] The cost obstacle can reduce the reliance on the use of litigation to enforce directors' duties.[311] In the case of a derivative claim, if the action against wrongful conduct by a director fails and a single shareholder is required to bear the expense of the litigation proceedings, it would be unfeasible for the individual investor to initiate a derivative action.[312] Even if the lawsuit is successful, any awarded remedies will go to the company, and the shareholder will thus only receive a pro rata part of the profits from a successful action.[313]

In the KSA, concerns were raised[314] about the cost of litigation against board members by shareholders, considering that neither the Companies Law 2015 nor the CMA regulations addressed this issue. However, in 2018, amendments to the Companies Law 2015 were implemented to address it and a new article was added to article 80 which regulates actions against board members. According to article 80 (bis):

> The company may be compelled to bear the expenses incurred by the shareholder in the filling of a lawsuit regardless of its outcome, subject to the following: a) If he files the lawsuit in good faith. b) If he submits to the company the lawsuit's cause of action and does not receive a response within 30 days. c) If filing such lawsuit is in

[308] The non-frustration rule in KSA is discussed in section 7.4 of this chapter.
[309] The mandatory bid rule is discussed in detail in chapter 6.
[310] A Reisberg, 'Funding Derivative Actions: A Re-Examination of Costs and Fees as Incentives to Commence Litigation' (2004) 4 Journal of Corporate Law Studies 345, 347 <https://www.tandfonline.com/doi/abs/10.1080/14735970.2004.11419923> accessed 2 October 2022
[311] ibid
[312] Reisberg (n 310) 345
[313] ibid
[314] Aleshaikh (n 44) 196

> the interest of the company, according to Article 79 of the Law. d) If the lawsuit is based on sound grounds.[315]

This reform can encourage minority shareholders to litigate against misconduct committed by board members, considering that the company may be compelled to bear the cost of the litigation regardless of its result. This reform avoided the uncertainty in the UK regulation that governs the funding of group litigation which left the power to the court, with wide discretion to issue compensation cost orders.[316] Indeed, as Keay concluded about this issue in the UK:

> The broad discretion that courts are granted on the issue of costs denies the successful applicant [at the permission hearing] the assurance that court recognition will result in the company becoming liable for the reasonable costs of litigating on its behalf.[317]

Returning to the newly added article in the KSA (article 80 (bis)), it is clear that the policymakers attempted to avoid uncertainty about when the indemnity costs are granted and provided clear grounds for assessing such requests.

7.5.5 Conclusion

This section addressed directors' accountability and litigation options in the takeover context in KSA. It is illustrated in this section that the regulations governing litigations as an accountability tool towards errant directors lack clarity and effectiveness in comparison with those of the UK. The section argued that article 80 of the Companies Law 2015 is not derivative action as it was intended to be. The action is a mixture of personal and derivative claims, which creates uncertainty and vagueness in the article and reduces the effectiveness of both derivative and personal actions in KSA as an accountability mechanism and minority shareholders' protection tool. Moreover, it was illustrated that litigation in the takeover context is very rare in KSA, and an explanation for this and the elements that contribute to minimising the reliance on litigation were discussed. The section argued that a reform of the

[315] Companies Law 2015 Article 80 (bis)
[316] See Civil Procedure Rule 19.9E: 'The court may order the company, body corporate or trade union for the benefit of which a derivative claim is brought to indemnify the claimant against liability for costs incurred in the permission application or in the derivative claim or both.'
[317] Andrew Keay, 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 Journal of Corporate Law Studies 39, 57 <https://www.tandfonline.com/action/journalInformation?journalCode=rcls20> accessed 2 October 2022

litigation options to address the vagueness and unclarity issues of some articles is necessary to increase the director's accountability and minority shareholders' protection.

7.6 Chapter Conclusion

This chapter has discussed several correlated topics. Directors' duties and their role as advisors in the takeover context in KSA suffer several issues and examples of ambiguity that this chapter illustrated, in addition to providing suggested reforms to address these issues by implementing related regulations from the UK to increase the efficiency of directors, clarify their role and grounds for accountability, and enhance the protection of minority shareholders.

The chapter also examined the divergent approaches in the US and the UK regarding board neutrality and the possibility of using defensive strategies to frustrate unwelcomed takeover bids by the target boards. This analysis helped to reach a better understanding of both approaches, to conclude that the non-frustration rule is necessary for the KSA in the absence of strong protection for minority shareholders and the lack of clear and properly drafted directors' duties in the KSA.

The chapter also addressed several issues with the body of law governing litigation in takeovers in the KSA and illustrated that the derivative action does not exist in the KSA. Instead, an unclear action is provided by the regulations that include elements of both private and derivative actions, which impose vagueness on the action and create practical difficulties in relying on it as a tool to hold errant directors accountable.

The issues discussed in this chapter demonstrate that the legal system in the KSA has failed to provide a clear framework for directors' duties and their role in takeovers and to provide clear litigation options for holding directors accountable. This can undermine the protection of shareholders, especially minority shareholders, and can lead to an unattractive market considering the issues that the regulations suffer from.

Chapter 8. Conclusions

8.1 Conclusion

The main objective of this thesis was to propose reform of the KSA takeover system of publicly traded companies, and thus to improve certain areas that the researcher found had issues, especially minority shareholders' protection and directors' roles and duties. The suggested reform, from the researcher's point of view, would contribute to the promotion of a sound takeover system, and more generally, to the development of the corporate governance system and commercial environment in the KSA. This work, which aimed to learn from the experience of a developed legal system such as that in the UK, proposed a framework that can contribute to the improvement of the CMA and the GAC roles, promote minority shareholders' protection, and provide well-defined and clear roles and duties of directors, as well as clearer and more accessible litigation options in the takeover context. The findings of this research and the reform recommendations were reached through the analysis of the KSA takeover system. The analysis took into consideration the unique features of the KSA's corporate governance system and the environment of its stock market, such as the ownership structure. It was also demonstrated that the KSA has a concentrated ownership structure in which government agencies and elite wealthy families control most of the listed companies in the country.

This thesis has argued that the CMA and GAC regulations and the Companies Law 2015 require reform to address the deficiencies in the takeover system of publicly traded companies. it also argued that minority shareholders lack a strong legal system to provide protection in the takeover context; and further, that there exist legal uncertainty and insufficiency in the legislation governing directors' duties and their role in takeovers, and in the accountability and litigation system.

The main reform suggestions presented in this work include addressing matters related to translating laws and regulations from Arabic to English. The author found several issues with translations that do not reflect the meaning of the original articles. The research also addressed the ambiguity in some definitions and concepts related to takeovers and corporate governance by adopting clear definitions and clarifications from the UK in particular, taking into account the suitability of adopting these definitions into the KSA's

legal environment. One of the most important concepts that suffers from unclarity is the M&A transactions. The regulations in KSA did not provide clear definitions to differentiate between mergers and the several acquisition types permitted in KSA. The thesis illustrated the importance of properly defining each concept and provided suggested definitions that reflect the legal elements of each transaction. A recommendation was also presented to reform the acquisition by compulsory share exchange, which was recently presented in Article 26 of the M&A Regulations. Amending the article to require the approval of courts or specialist legal committees for the transaction can ensure the fairness and reasonability of the transaction and provide more protection for minority shareholders, similar to the scheme of arrangement in the UK. Alternatively, to increase minority shareholders' protection, the article can raise the transaction approval threshold from 75% to 90% to approve the transaction.

This work also provided recommendations to limit the CMA's and the GAC's wide discretion to exempt from the regulations and suggested limiting their discretionary power by providing clear objective factors that justify exemptions. The purpose of this suggestion is to enhance fairness, certainty, and equality in the market. The abuse of dominant position is neither defined nor clearly explained in the KSA's legislation, and recommended reforms were presented aimed at defining this important concept by looking for a definition in another more developed system that can provide a better understanding of the concept.

The protection of minority shareholders in takeovers is one of the most important topics for which reform proposals were presented in this research. The thesis suggested lowering the triggering threshold of the mandatory bid rule to 30% to increase the level of protection for minority shareholders and to adopt the sell-out rule in the takeover regulations. These proposals are a result of the thesis's demonstration of the significance of these rules in protecting minority shareholders in takeovers. Reform was also suggested to adopt the squeeze-out rule to strike a balance between minority protection and the market's need for flexibility. To further increase minority shareholders' protection in takeovers, and considering that ownership is concentrated in many listed companies in the KSA where there is a noticeable presence of controlling shareholders, the thesis recommended the adoption of a fiduciary relationship between controlling and minority shareholders. This fiduciary relationship can be applied in practice in the takeover context by allowing minority shareholders to request the approval of the takeover transaction by the semi-judicial

committee in the CMA, in cases where the minority believed that their interests are exploited by a controlling majority.

This work also argued that the body of law governing directors' duties in KSA lacks coherence and clarity in the standards for performing a duty properly and measuring breaches of the duties, and suggested several reforms. Expanding the scope of the duties of care, loyalty, and promoting the success of the company and providing extensive statutory guidance were recommended to provide clarity by law on how to fulfil these duties and to determine how a breach of the duties is measured. A reform was recommended to expand the articles in the takeover regulations to require directors to consider the interests of other stakeholders, such as suppliers and customers, and other matters, such as community and the environment, when performing their duties. To cover the gap in the KSA's legislation in evaluating directors' duties of care, loyalty, and acting in good faith, a reform was presented to adopt the UK's approach, where a mixture of two tests, objective and subjective, were provided that allowed courts to consider influential factors, such as the special skills and knowledge that the director has.

Additionally, considering the importance of the directors' advisory role in the takeover context, this work suggested reforms to address some legal loopholes and the lack of comprehensiveness of the regulations in the KSA in this area. The M&A Regulations should clearly state the factors that directors must consider when performing their advisory role. Most importantly, similarly to the UK's regulations, the KSA's regulations should stress the importance of considering the short-term effect of the directors' advice to avoid a short-termism approach, which is considered one of the factors of a market financial crisis. The situation where there are two or more takeover bids is not addressed by the M&A regulations. Thus, a reform was presented to adopt the UK approach, where it is stated that when directors perform their advisory role in takeovers, price should not be the only factor to be considered to avoid short-termism and to consider the long-term impact of the advice on the company as a whole.

Reforms were also suggested in this work to address issues related to suing errant directors and litigation in the takeover context. A gap in Article 79 of the Companies Law 2015 can be addressed by stating that the 'director includes a former director' to avoid ambiguity and to clarify that a former member of the board who has committed a wrongful act can be sued. The same article should also enable all shareholders, regardless of their

ownership percentage, to bring an action against a wrongful act committed by directors to enhance the level of accountability and protection for minority shareholders.

The research demonstrated that derivative action is not available in the KSA's legal system in the genuine meaning of derivative actions. Instead, the regulations provide a vague action that combines elements of private and derivative actions, which imposes ambiguity on the action and creates practical difficulties in relying on it to hold errant directors accountable. The importance of this action to protect shareholders in a concentrated market with the presence of controlling shareholders such as the KSA was illustrated. Thus, reforming Article 80 of the Companies Law 2015 was recommended to allow all shareholders to use the derivative action against any director who causes harm to the company, even if this director's actions did not directly harm the shareholders' personal interests, and allow the company to be compensated. Furthermore, a recommendation was presented to implement the personal claim in the KSA legislation. The legislation should clearly stipulate shareholders' personal action, similar to the UK's petition for unfair prejudice. This allows shareholders to file a suit on the grounds that the company's affairs are being conducted in a manner that is unfairly prejudicial to the interests of its members generally or of some of its members (including the claimant), or that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.

To achieve the aims of the thesis, the author structured it by starting with a brief overview of the KSA's history and its political, legal, and judicial systems (chapter 1). The purpose of this chapter is to provide the reader with an overview of the country on which this work is based before examining, in the rest of the thesis, different aspects of the legal and judicial systems that are related to takeovers. The first chapter also provided an overall introduction to this research and illustrated its purpose and contribution, scope, thesis questions, methodology, and structure.

Chapter 2 provided a comprehensive understanding of the KSA's corporate governance system and its ownership structure by analysing its main features. The purpose of this chapter was to underline the key features of the KSA's corporate governance system as a starting point from which to analyse the KSA's takeover system. The chapter defined the concepts of corporate governance and ownership structure and demonstrated their importance in the takeover context analysis. Chapter 2 also illustrated that the KSA has a concentrated ownership structure where most listed companies are controlled by government agencies and

wealthy families. This unique ownership structure was relevant to the analysis of the takeover system in the following chapter, considering that it is essential to take this structure into account when analysing minority shareholders' protection and directors' duties legislation. Moreover, the chapter provided an overview of the US and UK corporate governance systems and ownership structures as predominant global corporate governance models before analysing the KSA's corporate governance system and ownership structure.

Chapters 3 and 4 laid the foundation for the chapters that follow by providing a comprehensive insight into the KSA's stock market and takeover system. Chapter 3 provides an understanding of the KSA's stock market as the platform where takeovers take place. The sudden increase in market liquidity between the years 2002 and 2006 under the supervision of a newly formed and inexperienced agency, and the large and unsophisticated participation by the public, created an inflated bubble which led to a perfect environment for corruption. The inefficiency of the CMA that contributed to the market crash in 2006, considering that it was an inexperienced agency facing a rapidly expanding market that overstretched its capacity, should be a lesson for the future to avoid similar consequences. Chapter 3 illustrated the importance of learning this lesson in the takeover context. Takeovers are considered a relatively new investment strategy in the KSA and the agencies governing the process of takeovers are either new or inexperienced. The chapter also examined the evolution of the stock market through the attempts to liberalise it and gradually allow the participation of foreign investors.

Chapter 4 provided an overview of the takeover regulatory framework by descriptively analysing the legal system of takeovers in the KSA. Different types of takeover transactions were identified and defined. The importance of clear definitions with which to distinguish between these types of takeover transactions was discussed, so as to understand the scope of regulations and avoid confusion among market participants. The fourth chapter provided recommendations to enhance takeover laws and regulations in terms of clarity of definitions and accuracy of translations of the original Arabic regulations into English. Also, the concept of control was drawn from the regulations to provide a better understanding of this important concept in the takeover context. Furthermore, the M&A Regulations were criticised with regard to the newly introduced Acquisition by compulsory share exchange. This new form of takeover is regulated by only one brief article, while it should have been explained extensively by the CMA. Thus, an overview of the UK's scheme of arrangement was presented due to its similarity to the acquisition by compulsory share exchange in KSA

to provide reform recommendations. The section provided a recommendation to require court interference and approval in the new transaction to ensure protection for minority shareholders where their rights might be compromised due to the nature and structure of the transaction. The chapter also provided an alternative reform to the newly introduced transaction to increase minority shareholders' protection by raising the shareholders' approval requirement to 90% instead of 75% to endorse the deal. An overview of takeovers governing agencies, laws, and judicial authorities was also presented.

Chapter 5 provided an overview of the Competition law and the General Authority for Competition (GAC). It illustrated and examined their importance and role in the takeover context. Furthermore, the chapter presented an illustration of how takeover transactions in the KSA overlap with the Competition Law and the GAC jurisdiction by analysing the merger control system embodied in the Competition Law. The analysis mainly focused on defining the concept of economic concentration as the cornerstone of merger control and identifying the threshold set by the Law that triggers the concentration situation. The GAC pre-notification requirement for takeover transactions and the process and assessment of the request have been also discussed in the chapter.

Chapter 6 illustrated the importance of protecting minority shareholders in takeovers, considering their vulnerable position in change of control transactions and the high possibility of conflict of interest in these situations. The chapter focused on protective rules on takeovers in the KSA that require reforms to enhance the protection of minority shareholders. This chapter analysed minority shareholders' protection in takeovers, and the ownership structure and de facto control by some blockholders in KSA were viewed as major elements that need to be considered when providing recommendations to reform the mandatory bid rule and the sell-out rule. Recommendations were provided in this chapter to lower the triggering threshold of the mandatory bid rule to 30% to increase the level of protection for minority shareholders. It was recommended that the sell-out and squeeze-out rules be adopted in the KSA takeover regulations to provide additional protection to minority shareholders and to strike a balance between minority protection and the market's need for flexibility.

Chapter 7 provided an overview of the board of directors and its structure and the role of independent and non-executive directors. It also provided a critique and analysis of the directors' duties, accountability, and litigation options in the takeover context of the KSA. The chapter examined the legal framework governing directors' duties and their role in

takeovers and argued that this legal framework lacks clarity and comprehensiveness in the KSA. Moreover, chapter 7 addressed board neutrality and the non-frustration rule in takeovers. It also analysed the two main different approaches adopted in the US and the UK in this regard and the rationale for such divergence, to pave the way for examination of the rule and its efficiency in the KSA. The chapter examined the litigation options in the KSA that suffer vagueness and ambiguity, which undermines the protection of minority shareholders. Recommendations for reform were provided to address the issues discussed in the chapter.

This thesis has provided an original contribution to the body of knowledge in the area of takeovers in the KSA, especially in areas concerning minority shareholders' protection and directors' duties in the KSA. The thesis provided recommendations that are intended to reform the role of the CMA and the GAC, minority shareholders' protection, directors' duties and their roles in takeovers, and litigation options, in a way that enhances the KSA's takeover system. Reforming the KSA's takeover system and addressing the issues in the areas mentioned above can contribute to the promotion of a sound takeover system, and, more generally, to the development of the corporate governance system and commercial environment in the KSA. The thesis relied primarily on legal transplantation, mainly from the UK, to improve the effectiveness of the KSA's takeover system and considered the market structure and the legal environment of the KSA to determine the suitability of these transplantations. The recommendations and findings of the work are relevant for a variety of legal participants such as lawyers, judges, and policymakers. The proposed reforms can be used when considering future reforms of the current takeover legislation.

Corporate law, corporate governance, and takeovers are wide topics. This thesis has focused on specific areas of these topics within the general framework of the takeover system of listed companies in the KSA, such as minority shareholders' protection and directors' duties, considering their importance and impact in takeovers. The thesis focused on particular problems and presented recommended reforms to address these issues by mainly using the UK takeover system as a benchmark and as a source of legal transplantation. Therefore, this thesis is limited in scope as it focuses on addressing specific gaps and issues within certain areas of the KSA's takeover framework rather than providing a comprehensive analysis of the entire system. Thus, this thesis can suggest several avenues for future research. Probably the most ambitious of these involves examining the takeover regime of joint stock non-listed companies and other types of companies in the KSA, considering that the CMA regulations,

especially the M&A Regulations, do not apply to these companies. Indeed, this is a grey area in the KSA's legislation that requires extensive research and development. In addition, issues related to takeovers, the protection of minority shareholders, and directors' duties can be discussed in a work that relies on comparative methodology and from the perspective of comparative law. Also, further research could be conducted to evaluate how legal transplantation from legal systems other than that of the UK can assist in the development of reforms to the KSA's takeover system.

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