

Client Alert

Middle East and Islamic Finance and Investment

JANUARY 04, 2024

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Saudi Arabia's New Civil Transactions Regulation

The Civil Transactions Regulationⁱ (the "CTR") was promulgated on 18 June 2023 and entered into force on 16 December 2023. The CTR was conceived as one of four key reforms announced in February 2021 to enhance the general operation of the Saudi legal system. These reforms include the new Personal Status Regulationⁱⁱ, the new Evidence Regulationⁱⁱⁱ and an anticipated new penal code. These regulatory changes are a key component of the reforms to the legal system under the umbrella of the Kingdom's Vision 2030 program which, inter alia, aims to stabilize contracts and in turn enhance business and consumer confidence in the Saudi economy.

The CTR itself had the specific aim of addressing what certain international investors have long expressed as concerns with the clarity and certainty of practice in the Saudi legal system. The absence of a civil code in Saudi Arabia had long stood in contrast to other regional jurisdictions which do have civil codes, and the introduction of the CTR aims to address this and enhance the clarity of the application of the law in the Kingdom. It is worth noting that the CTR is not a civil code, but is rather a statutory codification of civil transactions rules and principles.

The basis of the Saudi legal system is the application of the Islamic *Shari'ah*^{iv}. However, as the body of Islamic *Shari'ah* jurisprudence is uncodified, a commonly expressed comment has been the lack of certainty and clarity as to the applicable rules and principles in the Saudi legal system.

With the increased emphasis on opening-up the Saudi economy to international investors and efforts to further modernise the legal system, the CTR was therefore designed to bridge the gap between a full codification of the principles of the *Shari'ah* and providing a body of legal rules that would enhance the application of *Shari'ah* principles in a modern context. As such, the CTR does not depart from the *Shari'ah*, but rather makes the applicable principles clearer and more accessible while



enshrining them on a statutory footing where they had previously applied at the constitutional level or based on judicial practice and interpretation alone.

The CTR covers a broad range of topics from the basic formation of contracts to property rights, contracting, sales and dispute resolution. Before notable changes are considered, it is worth noting that, as it stands, the CTR is one step in a series of further regulatory changes.

Under Article 721 of the CTR, the CTR entered into force 180 days from the date of its publication in the official gazette, and it repeals all provisions of law that contradict the CTR. However, we note that Article 8 of the CTR preamble requires all related entities (ministries, regulatory authorities, etc.), each in their respective mandates, to revise all regulations, rules, etc. in light of the CTR and to suggest reforms or changes to their respective statutory instruments within 180 days. As such, we anticipate that further regulatory reforms are likely in the areas of law covered by the CTR. At present it remains unclear when such reforms will be actioned.

Finally, the CTR is a significant step in the continuing evolution of modern legal practice in Saudi Arabia but, as noted above, it is one step in a series of steps. It should be noted that the CTR itself does not contain a glossary of defined terms, leaving many concepts subject to interpretation, and it remains to be seen how these concepts and various provisions will be interpreted and applied in practice.

The CTR is a significant development in the Saudi legal system with a broad and timely impact. It is anticipated that it will facilitate a uniform application of law and increase judicial efficiency and consistency in judgments, which in turn will further enhance the attractiveness of the Kingdom for business, entrepreneurs and investors.

In the following section, we set out certain key features of the CTR.

KEY FEATURES

A. Statutory Hierarchy and *Shari'ah* Principles

The CTR is a statutory clarification of the application of established *Shari'ah* rules and principles. The CTR is intended to serve as a foundation for all civil transactions, and it creates a hierarchy of applicable rules. In the first instance the CTR, applies to all matters that are expressly or conceptually contemplated by the CTR. Where no applicable provisions are found, the CTR subjects the matter to general principles that are enumerated in Article 720. Where none of these enumerated principles are applicable Article 1 of the CTR stipulates that the *Shari'ah* principles that are 'best suited' to the CTR's provisions shall apply. As such, this hierarchy precludes the application of principles that may contradict with the implementation of the CTR.

B. Contract Formation and Terms

Shari'ah law as applied in Saudi Arabia recognizes and upholds the general principle of freedom of contract and the principle that "the contract is the law of the parties". The relevant articles of the CTR codify the applicable *Shari'ah* rules and places them on a modern and clear statutory footing. The CTR recognizes and codifies the classic requirements for the formation of contracts which will be familiar to both common and civil law practitioners. Articles 32 and 33 provide that a contract is created by offer and acceptance expressed by two or more parties who have the legal capacity to contract. Both agreements to agree and framework agreements are recognized under Articles 42 and 45 respectively.

The CTR also permits contracting parties to create valid contracts where certain contract elements are not fixed at the time of creation of the contract, subject to sufficient mechanisms being included in the contract that can allow for the



determination of such elements at a point in the future and thereby satisfy the *Shari'ah* requirements for certainty of contract terms.

Another noteworthy development is the clarity the CTR introduces under Article 46 which permits the incorporation of model contracts, policy documents or other contractually agreed terms by reference.

C. Contract Termination

The CTR provides that a contract may be terminated by (a) termination by mutual consent, (b) termination by exercise of an option to cancel the contract, (c) termination for breach of a contractual obligation, and (d) an automatic cancellation for impossibility to perform. In essence, these provisions clarify and codify the current legal position under *Shari'ah* law in the Kingdom, where parties are free to agree the terms of the contract, provided that those terms comply with *Shari'ah* law.

D. Good Faith Obligation

Article 41 recognizes an obligation on parties to negotiate contracts in good faith. It codifies the *Shari'ah* principle of good faith and provides that the party who unjustifiably interrupts negotiations could be liable to compensation from the other party for losses suffered.

Article 41.2 also provides for a pre-contractual duty of information; namely, that the contracting parties should be transparent about relevant facts and circumstances, and that a breach of law may occur where key information has been withheld intentionally by one party to the contract.

These provisions are in line with those of most other civil law jurisdictions, including France, Germany, the United States and Australia, which all, to one extent or another, impose some form of duty on contracting parties to act in good faith when agreeing and performing contracts.

E. Mistake

Articles 57 to 59 provide that a contracting party may rescind a contract provided that the mistake relates to a matter of substance (i.e., it is not a mathematical or clerical error) and the other party either makes the same mistake, knows of its occurrence, or could have easily detected the mistake. A unilateral mistake, on its own, will not therefore be grounds to rescind a contract. This is largely similar to the English position, which also requires the counterparty to have some kind of knowledge of the mistake.

One significant departure from English law is the relationship between mistake and good faith in the CTR. Under Article 60, a party cannot rely on a mistake to escape its obligations under a contract if this would contradict the principle of good faith. The CTR, therefore, through the duty it imposes on parties to act in good faith, essentially provides a back-door remedy for a party's mistakes or poor negotiation skills.

F. Mandatory and Optional Provisions of Law

As a general matter of statutory interpretation, the CTR contains a number of articles that are mandatory in their application and which cannot be varied by contractual agreement. For the purposes of this alert, we note that where a provision of an article does not explicitly prohibit deviation from the same, it may be permitted to vary the position by the contractual agreement of the parties.



G. Force Majeure

The CTR enshrines the concept of force majeure into application under Saudi law. Previously, this concept had applied to offer relief under general *Shari'ah* principles, whereas now it is recognized as a stand-alone concept in its own right. This contrasts with English law, for example, where the concept operates as a construct under contract provisions.

Note that the CTR does not specify what is meant by, and does not contain a definition for, the term 'force majeure'. However, it is illustrative that the text of the Arabic language provision uses the literal term for the concept القوة القاهرة (Al-Quwwa Al-Qahira) which provides some assistance in confirming the legislative intention behind the term.

Article 125 of the CTR provides: "A person shall not be liable if it is proven that the damage arose from a cause beyond his control, such as through force majeure, the fault of a third party, or the fault of the affected party, unless otherwise agreed". Based on this provision, force majeure would generally operate to relieve a party of the relevant obligation, but it should be noted that the CTR provides flexibility to agree otherwise under contract terms.

The CTR places force majeure on a statutory footing that allows contract parties the flexibility to agree the applicable provisions. Article 174 states that "It may be contractually agreed that the obligor shall bear the consequences of force majeure", This article allows the consequences of force majeure to be borne exclusively by the obligor, but this does not preclude an alternative allocation of liability by contractual agreement between the parties.

COMMERCIAL CONSIDERATIONS – APPLICATION TO EXISTING CONTRACTS AND DISPUTES.

The CTR applies with retroactive effect, subject to certain exceptions as transition arrangements. Article 5 of the CTR preamble states that the CTR shall apply to matters that occurred prior to its entry into force, with the following exceptions: (1) where there is a regulatory provision or judicial principle relating to the relevant matter that contradicts the provisions of the CTR and this is asserted by a party, or (2) if the provision in question relates to a statutory time bar that precludes the hearing of a case and the calculation of the relevant period commenced prior to the CTR's entry into force.

Therefore, the CTR will apply to all contracts that are subject to Saudi law (including existing contracts and contracts signed prior to 16 December 2023), subject to the exceptions referenced above.

The CTR appears to provide clear guidance on what constitutes a valid contract and what does not. However, it is important to note that, as useful as the CTR may be, as noted above, it remains to be seen how its provisions will be applied in practice. There is still scope for judicial interpretation and it will likely take a variety of judicial decisions before the specific application of the new provisions becomes known.



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ⁱ The Civil Transactions Regulation issued by Royal Decree No. (M/191) dated 29/11/1444 AH (corresponding to 18/06/2023 AD).
ⁱⁱ The Personal Status Regulation issued by Royal Decree No. (M/73) dated 06/08/1443 AH (corresponding to 09/03/2022 AD).
ⁱⁱⁱ The Evidence Regulation issued by Royal Decree No. (M/43) dated 26/05/1443 AH (corresponding to 03/12/2021 AD).
^{iv} The Basic law of Governance issued by Royal Decree No. (M/90) dated 27/08/1412 AH (corresponding to 01/03/1992 AD), Article 1 states that the Kingdom’s constitution is the Quran and Sunnah. This makes the Islamic *Sharia’ah* the font of all laws and regulations.