

Saudi Arabia's Transition to a Unified Civil Transactions Law: Promoting Investor's Confidence

I. Introduction

1. Overview of the Law
2. Impact on Contractual Relationships in terms of retroactivity

II. Main new Legal Aspects

1. Formation, Termination, Nullity and Assignment of the Contract:

- 1.1. Contract Formation
 - a) Offer and Acceptance
 - b) Capacity
 - c) Subject matter of the contract
 - d) Cause
 - e) Consent: Error, Deceit, Duress and Lesion
- 1.2. Termination of Contract
- 1.3. Nullity of Contract
- 1.4. Assignment of Contract

2. Lawsuit Restriction: Statute of limitations on obligations

3. Right to Compensation for Material and Moral Damages

4. Unjust Enrichment

5. Named Contracts

- 5.1. Sale Contracts
- 5.2. Loan Contracts
- 5.3. Speculation Contracts "Moudarabah"
- 5.4. Fictitious Contracts

III. Conclusion

I. Introduction:

Saudi Arabia is enacting radical legal reforms in many domains. On the 19th of June 2023, the long-awaited civil transaction law¹ (the Civil Transactions Law) that applies to all the aspects of civil transaction in Saudi Arabia was published in the official gazette “Umm Al-Qura”.

This new law is considered another important advancement in the Kingdom of Saudi Arabia’s (KSA) legal system, which until June 2023 relied significantly on uncodified principles of Islamic Law (Shari’a) for both criminal and civil matters.

The Saudi Cabinet approved this progressive legislation as a component of the legal reforms in 2021. It aims to support the ambitious goals of Vision 2030, Saudi Arabia's strategic roadmap for diversification and socioeconomic transformation. The Law represents Saudi Arabia's commitment to meet the challenges of the future while maintaining its unique cultural identity.

With a focus on ensuring contract stability and promoting transparency, it offers numerous advantages for both local and foreign investors.

1. Overview of the Law:

The Civil Transactions Law has been developed by incorporating the latest legal trends and international judicial practices into the law, while considering the provisions of Islamic Shari’a and its fundamental purposes by aligning them with international best practices.

The key principles of the law prioritize the protection of property ownership, contract stability and validity, identification of rights and obligations, and clarity of legal positions. This law will positively impact the business environment while enhancing transparency, raising the predictability level in judicial rulings, and reducing divergences in judicial reasoning, which will lead to prompt and predictable justice.

2. Impact on Contractual Relationships in terms of retroactivity:

According to article 721 of the Civil Transactions Law, the law becomes enforceable 180 days after its publication in the official gazette, thus establishing its effective entry date on 16 December 2023.

The Royal Decree No. M191/1444, states that this law has a retroactive effect². It applies to all events and facts existed prior to the effective date (16 December 2023), whether they were connected to contractual relationship or not, taking into consideration the exceptional cases where the Shari’a rules may still apply to certain legal aspects.

¹Adopted by Saudi Arabia Royal Decree No. M191/1444, published in the official gazette “Umm Al- Qura”

² Art. 5 Saudi Arabia Royal Decree No M191/1444.

II. Main New Legal Aspects:

The Civil Transactions Law introduces several new subjects and legal rights that were previously not elaborated or publicly declared, such as outlining the five sources of rights and obligations, including contracts, unilateral undertakings, harmful acts, enrichment without cause, and regulations.

Noteworthy aspects include:

1. Formation, Termination, Nullity and Assignment of the Contract:

1.1. Contract Formation:

The new Civil Transactions Law acknowledges the traditional contract formation standards. It outlines the conditions for the validity of contracts such as the **mutual consent, capacity, subject matter** and **cause**. Otherwise, the contract will be null or void; this is also the case when the consent is affected by any of the defects that will be elaborated under section 1.1.5 hereunder.

1.1.1. Mutual Consent:

Offer and acceptance: The new Civil Transactions Law recognizes the traditional contract formation standards, with expression of will that could be articulated verbally or through any other explicit or implicit implication, being considered as offer and acceptance.

Withdrawing the offer: The offeror will be able to withdraw the offer before it is accepted as long as there is no time period stipulated by the parties for the validity of the offer.

Silence and acceptance: According to article 37, silence on the part of the offeree shall not be considered acceptance unless a previous transaction of the same nature has already been made on that basis.

Promises: According to art 43, a promise announced by a party to reach a future agreement is binding if it meets the main following conditions:

- Defining the period during which the agreement must be concluded,
- Specifying the agreement's future conditions during the promise announcement.
- Including a formal condition required by the statutory provisions.

Consequently, in case the promising party refused to enact a promise, the court's judgement will bind him to execute his obligations.

Bad Faith and pre-contractual stage: To further increase investor protection, article 41 of the Civil Transactions Law provides that the person who negotiates or terminates the negotiation in bad faith shall be liable for the damage suffered by the other party. However, this does not include compensation for the lost benefits expected from the contract under negotiation. With bad faith being defined in the same article as follows "**to lack seriousness in negotiations or intentionally omit crucial information impacting the contract**", this legal aspect emphasizes

the good faith in contracts and precisely during the negotiations stage which should make investors confident in engaging with other parties.

Due to these well-defined provisions, investors can feel reassured by the contracts' nature and formation in the KSA.

1.1.2. Legal Capacity to contract:

The legal capacity of individuals is a fundamental concept in contract law. Thus, the Civil Transactions Law has connected the validity of the agreement to the capacity of the parties by specifying the age of majority explicitly to 18 years³. Moreover, article 47 considers that each person is eligible to engage in legal acts, unless deemed incapacitated or deficient pursuant to specific legal provisions.

These provisions impose possessing a sound mental state, the absence of coercion, and the adherence to a particular age threshold, especially that article 14 defines a natural person who does not have a full legal capacity as follows:

- Any person who is above 7 years but has not reached the age of majority (18 years old).
- Any person who is mentally deficient but has not reached insanity.

1.1.3. Subject matter of the contract:

- **Be possible:** The subject matter of a contract must be feasible and capable of being performed. This ensures that the terms of the contract are realistic and achievable. If the subject matter is impossible or beyond the realm of reality, the contract could be deemed unenforceable⁴.
- **Not be in breach of public order:** This refers to the requirement that the subject matter of a contract should not violate any laws or public policy. Contracts that involve illegal activities or go against established moral and societal norms are generally considered unenforceable due to their violation of public order.

This principle is meant to ensure that contracts do not contribute to the degradation of public values or undermine the legal system.

- **Be defined in nature, type, or quantity:** It is required that the subject matter of a contract is described with clear and definite terms. This clarity ensures that both parties understand the exact nature, type, or quantity of the subject matter they are agreeing upon. Vague or ambiguous terms can lead to misunderstandings and disputes, which may render a contract unenforceable. Providing specific and well-defined descriptions helps to establish the boundaries and expectations of the contractual relationship.

A contract will be void if its subject matter does not meet these requirements.

³ Art. 12 Civil Transactions Law

⁴ Art. 72 Civil Transactions Law

1.1.4. Cause of the contract:

The "cause" refers to the lawful reason or consideration for entering into a contract. If the cause of a contract is unlawful or against public policy, the contract can indeed be declared null and void. When the purpose of a contract is illegal, the contract is considered void ab initio, which means it is invalid from the beginning as if it never existed.

For example, a person is prohibited to rent his property for the purpose of using it for gambling that violate the public order.

This principle is essential to ensure that the legal system does not enforce agreements that involve illegal or immoral activities.

1.1.5. Consent must be free from defects (errors, deceit, duress):

The new Civil Transactions Law improves the stability of civil transactions and reduces the grounds for canceling or terminating contracts based on validity concerns. The Law indeed provides a clearer set of guidelines on the conditions under which contracts may be deemed invalid and establishes limitations on the cancellation or termination of contracts. This increased stability and clarity help parties to engage in contracts with greater confidence, as they are less likely to face arbitrary cancellations or terminations based on minor or technical issues related to contract validity, ensuring better protection for the investors. This covers **errors, forms of deceit and duress**.

The Law's similarity with the traditional legal systems is shown through its adoption of the same concepts and definitions as those present in international norms and standards, which furthers investment attractiveness.

Consent is crucial to ensuring that contracts are entered into freely and without any form of coercion, deceit, or duress.

- **Error:** A contracting party may ask to annul⁵ a contract as the result of an error in one of these following cases:

The error that can lead to the rescission of a contract must relate to a matter of **substance**. This means that the error must be about a fundamental and essential aspect of the contract, such as the nature of the subject matter, the terms of the agreement, or some other crucial element that goes to the heart of the contract. On the other hand, typographical or mathematical errors are generally considered minor and do not qualify as errors of substance that will affect the validity of the contract⁶.

Moreover, a party shall not rely on an error to escape his or her obligations under a contract if this will be in contradiction with the principle of good faith.

- **Deceit:** as mentioned in article 61, deceit involves one party intentionally deceiving another through fraudulent means, leading the innocent party to enter into the contract. Deceit is a form

⁵ Art. 57 Civil Transactions Law

⁶ Art. 59 Civil Transactions Law

of misrepresentation and is considered a wrongful act in contract law⁷. This definition implies that the deceiving party knowingly provides false information, conceals material facts, or engages in other dishonest practices to induce the innocent party into entering into the contract.

Article 61 expands the deceit concept, by stating that silence can be also considered deceitful: not disclosing material information that would significantly affect the other party's decision to enter into the contract, its acts and attitude can be considered deceitful.

For a claim of deceit to succeed, some material element in connection with fraud, cheating or unfair dealing must be proved.

Articles 62 and 63 provide that the deceived party may annul the contract if:

- The deceit is related and connected to an essential matter of substance.
- The deceit is committed by the other contracting party.

However, in case the deceit is committed by a third party, the innocent party seeking to annul the contract may only do so if the other contracting party knew about the deceit or should have been aware of it. This principle is known as the knowledge or awareness requirement.

- **Duress:** It is defined as an unlawful pressure or threat that leaves the innocent party with no reasonable choice but to enter into the contract⁸.

Duress in contract law can arise when a contracting party is confronted with circumstances that lead them to believe, that they will be subject to forthcoming danger to "life, honor, or property." The threat of imminent danger can be in various forms, such as physical harm, damage to reputation (honor), or financial harm to property or assets⁹.

In case the duress is committed by a third party, the contract may only be rescinded if the other contracting party was aware of it.

- **Lesion:** In case there is unfairness, an obvious weakness or urgent need related to the innocent party, the court may step in to provide relief to the innocent party based on such party's claim by increasing or reducing the obligations of the other contracting party¹⁰. The time limit for bringing an action to annul or modify a contract on the grounds of unfairness is 180 days from the time the contract is concluded.

It is worth noting in this context that reference is made to custom in determining injustice when compensation is raised or lowered to an amount other than the norm.

1.2. Termination of Contract:

According to article 105, contracts can be terminated by mutual consent. Moreover, the parties can include an optional condition to terminate the contract, by allowing one of them solely the termination option within a specified period of time upon notifying the other party.¹¹

⁷ Art. 61 Civil Transactions Law

⁸ Art. 64 Civil Transactions Law

⁹ Art. 65 Civil Transactions Law

¹⁰ Art. 68 Civil Transactions Law

¹¹ Art. 106 Civil Transactions Law

This aspect emphasizes the importance of mutual consent and contractual flexibility. These provisions empower parties to terminate contracts by mutual agreement and even allow for optional conditions regarding termination.

Furthermore, the law addresses breaches of bilateral contracts, granting parties the right to request execution or rescission with potential compensation¹². However, the discretionary authority of competent courts applies to ensure the protection of executed main obligations. Additionally, article 108 introduces the option for creditors to rescind contracts in cases of debtor's breaches, subject to the terms agreed upon in the contract.

This legal framework encourages clear and transparent agreements while also providing mechanisms for resolving disputes in a fair and efficient manner.

1.3. Nullity of the contract:

Article 81 addresses several cases where a contract is deemed void, such as illegality or other reasons. Any concerned party has the right to invoke the nullity of the contract. Alternatively, the court may declare the contract null on its own initiative. Proceedings to declare nullity must be initiated within 10 years from the contract's conclusion.

Articles 82 to 86 elaborate the consequences of nullity, outlining the following points:

- 1.3.1.** If a contract is either void or annulled, the involved parties should be returned, in their legal status, to the positions they held before entering into the contract. If this restoration is impossible, compensation for damages might be awarded.
- 1.3.2.** In cases where a specific provision within a contract is found to be invalid or voidable, only that particular provision will be void. However, if the entire contract would not have been formed without that provision, then the entire contract will be void.

These provisions ensure that the legal effects of nullity are appropriately addressed, aiming to restore fairness and balance in contractual relationships.

1.4. Assignment of the contract:

The provisions of the Civil Transactions Law related to assignment address the need for clarity and understanding of the legal effects connected to the assignment of contracts. They enable investors and dealers to manage their rights and obligations effectively, encouraging joint ventures, innovation, and foreign direct investment, in line with Vision 2030's goals. Such provisions ensure that the assignee replaces the assignor in executing all the rights and obligations of the assigned contract.

Assignment perception: Articles 255 to 258 of the Civil Transactions Law cover the concept of an assignment of contract, which is the voluntary and intentional assignment of a legal right or claim that arises from a contract. This assignment can be temporary or permanent and is done

¹² Art. 107 Civil Transactions Law

through a clear and explicit statement or action demonstrating the intention to assign the rights or obligations in question.

Necessity of approvals: Article 255 covers the process of transferring one's capacity as a party to a contract, subject to the consent of the other contracting party. This eventually allows the transfer of obligations to a third party that will replace the assignor in his rights and obligations and can be carried out with the other party's prior approval.

Obligations Limits: Article 256 outlines the multiple options to related to assignment: The assignor can be released of future obligations towards the other party to the contract if the latter agrees on the assignment. However, if he disagrees, the assignor shall remain jointly bound with the assignee, unless it is evident that the assignment's effectiveness is conditional upon the other contracting party's acceptance.

Defense Rights: Furthermore, according to article 257, the assignee is entitled to raise any defenses pertaining to the debt itself but cannot raise any defense related and connected to the person of the assignor.

The articles pertaining to the assignment of contract bolster the security of investors by governing the transfer of contract responsibilities and allowing them to be adapted to changing circumstances without the need to terminate the entire contract and consequently they ultimately reduce risk.

2. Lawsuit Restriction: Statute of limitations on obligations:

Statutes of limitations are introduced to prevent claimants from filing legal proceedings after an extended period of time, promoting legal certainty. In Shariah, there is no time limit for the claimant party to exercise its rights. Hence, even if the dispute happened a long time ago, the Shariah allows the claimant to file a legal case before the Saudi Arabian courts.

By adopting a general statute of limitations of ten years in articles 81 and 159 of the Civil Transactions Law, the Kingdom has introduced a major development before its courts, given that a claim might be dismissed if it has been filed after the statutory limitations period. However, there are other shorter statute of limitations periods varying between 1 year to 5 years in relation to some specific rights, as follows:

<i>STATUTE OF LIMITATIONS OF 1 YEAR</i>	<i>STATUTE OF LIMITATIONS BETWEEN ONE YEAR AND FIVE YEARS</i>
Contract annulment claims shall not be considered and will be rejected if the applicant files the case after one year from becoming aware of the reason of the annulment.	Unlawful enrichment cases will be rejected, in case they are filed three years after they become known to the creditor ¹³ .

¹³ Art. 159 Civil Transactions Law

Employees Rights in terms of their salaries will be rejected in case they are claimed after one year from their due date. ¹⁴	Periodic renewable rights , like allowances, real estate rent etc. will be rejected in case they are claimed after five years from their due date.
Traders Rights claims related to goods and services served to consumers will be rejected in case they are filed after one year from their due date ¹⁵ .	Professional rights/fees due for services provided by self-employed individuals, such as engineering and law firms, will be rejected in case they are filed after five years from their due date. ¹⁶

3. Right to Compensation for Material and Moral Damages:

The right to compensation for damages or for other instances is a vital step that ensures the protection of the parties' economic rights as well as their emotional wellbeing and reputation rights provided for under articles 136, 137 and 142.

Compensation for Moral Damages: The law introduces a groundbreaking provision by acknowledging, for the first time, the right to seek compensation for **emotional or psychological harm** which encompasses prejudice to an individual's body, freedom, reputation, honor and social status. This is further detailed in article 142 which provides that in the event the damages affect the soul, such as spiritual harm, compensation will be determined in accordance with Islamic Law.

Article 136 ensures that all compensation must be made in full to restore the injured party to the situation it was or could have been in.

Compensation for Material Damages: According to article 137, the amount of compensation shall be determined according to the loss **or loss of profit caused**, if it is as a natural consequence of the harmful act.

In fact, the Civil Transactions Law addresses the discrepancies in handling **lost profits** in civil transactions. Article 137 establishes a structure that enables the injured party to seek reimbursement for lost profits from the party responsible for the harm. However, it is crucial to satisfy the legal conditions specified in the law which include establishing a direct connection between the actions of the party causing the damage and the financial losses incurred by the damaged party.

These articles make the right to compensation abundantly clear and straightforward for investors to feel secure in their investments.

4. Unjust Enrichment:

Article 144 of the Civil Transactions Law addresses the concept of unjust enrichment. It provides that when any individual, regardless of his/her legal capacity, gains unjust enrichment at the expense of another person without a valid reason, he/she should compensate the aggrieved

¹⁴ Art. 297 Civil Transactions Law

¹⁵ Art. 297 Civil Transactions Law

¹⁶ Art. 296 Civil Transactions Law

party for the loss suffered up to the extent of the unjust enrichment. Importantly, this obligation persists even if the enrichment ends at a later point in time.

5. Named Contracts:

The new law has also introduced the concept of named contracts, which includes comprehensive clauses addressing various aspects related to many forms of contracts. These clauses cover elements of the contract, its legality, implications for the parties involved, as well as provisions on contract nullity and termination.

The contracts covered under this law are 17 named contracts including:

- Sale (Articles 307-360)
- Donation (Articles 366-381)
- Loan (Articles 382-390)
- Lease (Articles 407-450)
- Agency (Articles 480-505)
- Custody (Articles 517-527)
- Speculation “Moudarabah” (Articles 550-565)

With the introduction of named contracts, the Civil Transactions Law aims to provide a comprehensive framework that governs a wide range of contract types, ensuring legal clarity and consistency in contractual arrangements.

5.1. Sale Contracts

Sale and price: Article 307 defines sales as a contract whereby the seller transfers ownership of the thing sold to the buyer in exchange for a specified amount of money.

Article 308 adds that the item being sold must be identifiable and known to the purchaser. In the sale contract, the price of the item being sold is usually due immediately upon the conclusion of the contract, unless the parties agreed on delaying the payment or allowing payment in installments according to article 317.

Seller’s obligations: One of the main seller’s obligations is to transfer the ownership of the item being sold to the buyer. This means that the seller must take all necessary actions and precautions to ensure a valid and effective transfer of ownership from the seller to the buyer, and to refrain from any action that would make the transfer of ownership impossible or difficult according to article 319.

Buyer’s obligations: The buyer is required to pay the price before taking delivery of the item sold. This is known as "payment before delivery" or "payment on delivery." The buyer must fulfill the payment obligation as agreed upon in the contract before he/she is entitled to receive the purchased item unless otherwise agreed upon.

5.2. Loan Contracts

Articles 382 to 390 regulate loan contracts and articles 451-460 regulate loans for use.

Loans for consumption, are types of loans in which the borrower receives a specific, consumable item and is obligated to return an item of the same kind and quantity.

Loans for use, are loans in which the lender provides the borrower with the temporary right to use a non-fungible item for a specific duration and purpose, with the borrower agreeing to return the item after the agreed period has elapsed. A key takeaway is that this covers monetary loans and proprietary ones.

Interest, pursuant to article 385, any condition in the loan contract stating an increase on the borrowed amount upon reimbursement will be void. In case of defects in the borrowed goods, the lender will be liable for damages caused to the borrower.

Reimbursement aspect, according to article 388, at the expiry of the loan period, the borrower must refund the goods subject matter of the loan, and the refunded goods need to be equivalent in amount, type and capacity to the borrowed goods, failing which their equivalent value will be refunded to the lender.

The above-mentioned articles provide straightforward loan contract obligations and encourage investors to borrow in the KSA.

5.3. Speculation Contracts “Mudarabah”

Mudarabah contracts are often used for various financial activities, including investment, trade, and business ventures, while adhering to Shariah principles. It is important to note that the Civil Transactions Law codifies the Mudarabah for the first time. It is defined in the Law as a contract that refers to a type of partnership or investment arrangement between two parties: Rab al-Maal (the provider of capital) and the Mudarib (the entrepreneur or manager). In a Mudarabah contract, the Rab al-Maal provides the capital, while the Mudarib contributes with his/her expertise and management skills.

The Law established provisions related to the formation of the contract, its effects, and its termination.

5.4. Fictitious Contracts

The Civil Transactions Law also outlined the principle of fictitious contracts mentioning that in the event the parties enter into one fictitious and one real contract, then the real contract is the one that is enforceable between the parties.

III. Conclusion

Finally, it is important to highlight that in the absence of a text regulating a specific matter, the very first article of the Civil Transactions Law imposes to refer to the general rules of the law as mentioned in the last provision of the Civil Transactions Law (article 721) and, in case these still do not apply, to the provisions derived from the Islamic Shariah law.

The implementation of the Civil Transactions Law is a regulatory major shift towards judicial reforms and investment safety. The new regulations promote the efficiency of dispute settlement and provide clear rules between contracting parties to support and achieve the Saudi Vision 2030. The main goal of the Law is to expressly and clearly identify the different aspects and governing principles of contracts, rights and responsibilities and ensure fair dispute resolution mechanisms leading to improved legal protection for investors through transparency and reducing uncertainty in court rulings.

By aligning with international standards and increasing legal certainty, the Law encourages long-term investment projects in Saudi Arabia, makes it an attractive investment destination with reduced risks and encourages the growth of a robust private sector.

Steve Zouein

Senior Associate at Eptalex