

# The Applications of the Good Faith Principle in the Saudi Commercial Companies System: An Analytical Study

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## Abstract

*Undoubtedly, the principle of good faith in contracts is crucial, particularly in the context of commercial company contracts. Therefore, the adherence to this principle by the contracting parties is of paramount significance. Failure to adhere to it by either party could result in the contract being invalidated. Although not explicitly stated, the Saudi legislator has not overlooked the application of this principle as a fundamental one. Upon examining the general and specific objective elements of the company contract, it becomes evident that they are closely intertwined with this principle. Any deficiency in these elements could have serious repercussions, including the partial or absolute nullification of the contract. Furthermore, it may lead to the imposition of specific penalties on those who fail to uphold this important principle. This study employed the inductive and analytical approach. The research has concluded that there are implications within the Saudi system stemming from the breach of this principle, resulting in the imposition of specific penalties on individuals found to have acted in bad faith. The research recommends that the Saudi legislator explicitly incorporate this principle in one or more articles, whether within the commercial companies' system or in other relevant regulations.*

**Keywords:** *Company, contract, corporate system, good faith.*

## Introduction

When the Saudi legislator formulated the commercial companies' system, similar to other legislators, it took into account the application of the principle of good faith. While not explicitly stated in many provisions, the legislator's attention to this principle is evident in the discussion of various company provisions. This is notably demonstrated in the judgment of either partial or absolute nullity of the company contract. The consequences of breaching this principle go beyond contract nullity, leading to the imposition of specific penalties on those who fail to uphold it. Therefore, the focus of the research is to analyze the impact of the good faith principle in the Saudi commercial companies.

### Research significance

This study is significant due to its focus on uncovering the level of interest of the Saudi legislator in the principle of good faith and its acknowledgment, along with illustrating the consequences of its violation through the imposition of specific penalties on offenders. The

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research significance also stems in illustrating the repercussions of breaching the principle of good faith in commercial company contracts and the extent to which it can manifest.

#### Research objectives

The objectives we aim to accomplish, God willing, are as follows:

1. Disclosing the extent of the impact of violating the principle of good faith in commercial company contracts.
2. Demonstrating the role of the principle of good faith in promoting justice, safeguarding rights, and combating fraud and deception.

#### Research problem

The issue with the research is that the effects of the principle of good faith have not been evident in various legal texts; they have only been evident in a limited number of texts. This necessitates research beyond the text to showcase its effects as desired.

### **Methodology**

This study employed the inductive and analytical approach. We gathered an extensive array of research sources and references. Our initial step involved defining terms in both languages and within the legal framework. We presented the information in a personalized manner, prioritizing meaning over strict adherence to the original wording, except when direct quotation was essential.

The research comprised two main sections and a conclusion. The first section covered the definition of terms related to the research topic, with three sub-sections: the definition of "good faith" in the Saudi legal system, the definition of contracts in the Saudi legal system, and the definition of companies in the Saudi legal system. The second part focused on the practical applications of violating the principle of good faith in the Saudi legal system, with two sub-sections: corporate crimes related to the violation of the principle of good faith and penalties for crimes involving the violation of the principle of good faith. The conclusion summarized the most significant findings and recommendations.

#### Good faith

##### Good faith in the Saudi legal system

The Saudi legal system, along with other legal frameworks, does not offer an independent definition of "good faith." Despite the absence of a direct definition, it is regarded as an essential principle in all legal relationships and is presumed to be implicit in all circumstances. Legal scholars have presented various definitions for "good faith," each facing its share of criticism. One notable definition by Dr. Shirzad Sulaiman characterizes good faith as a "commitment to directing the will to achieve the direct purpose of concluding the contract in a manner that aligns with the legitimate justifiable interests of the other party." Scholars have shown considerable differences in defining "good faith," with each definition receiving criticism. To be concise, I have highlighted the most notable definition by Dr. Shirzad Sulaiman, who regards good faith to one's intentions which are aimed at fulfilling the contract's direct purpose in a way that respects the legitimate and justifiable interests of the other party.

##### Contracts in the Saudi legal system

The Saudi regulations address the aspect of contracts by specifying their provisions and various principles, as evident in the Commercial Companies Law. However, there is no specific definition of a contract as a source of obligations. Nevertheless, we can refer to legal scholars' opinions to clarify the definition of a contract. There are various definitions, but I will mention the prevailing one, which is the agreement of two or more wills, leading

to a legal consequence, whether it be the establishment, transfer, modification, or termination of an obligation.

#### Companies in the Saudi legal system

A company is an institution in which people carry out joint work; In order to make a profit. The term "company" procedurally refers to a legal entity that is established according to the provisions of the Saudi Companies Law (SCL) based on an incorporation contract or articles of association. It involves two or more individuals committing to contribute either money, work, or both, with the aim of making a profit and sharing the resulting profits or losses.

#### The practical applications of the principle of good faith in the Saudi legal system

Undoubtedly, adhering to this principle good faith when concluding corporate contracts is of paramount importance, as it signifies the honesty of the contracting parties and their intention to achieve the true purpose of the contract. Therefore, anyone who violates its application is considered to have committed a real crime and is subject to punishment. This will become apparent through the following two sub-sections:

#### Corporate crimes related to the violation of the principle of good faith in the Saudi legal system

The Saudi regulatory contract includes a section on penalties, detailing a range of serious and less serious crimes. Upon reflection, we will notice their relevance to this important principle. we will present them in light of the following two sub-sections:

#### Serious crimes

The Saudi regulator has outlined serious crimes related to the corporate system, which include the following:

1. Any director, officer, board member, auditor, or liquidator who intentionally records false or misleading data in the company's financial statements or reports, or deliberately omits to disclose material facts with the intention of misrepresenting the company's financial position.
2. Any director, officer, or board member who misuses the company's funds, powers, or voting rights for personal gain, knowing that it is against the company's interests.
3. Any liquidator who misuses the company's funds or intentionally harms partners, shareholders, or creditors for personal gain.

These serious crimes share a common thread: the disregard for the important principle of good faith. Each of these offenses is motivated by either personal gain or the intent to harm others, and all stem from bad intentions.

#### Less serious crimes

The Saudi regulator has also highlighted less serious corporate crimes, which include the following:

1. Failure of an auditor to report discovered violations to the company, which appear to be criminal offenses.
2. Receipt of benefits or promises in exchange for voting in a specific direction or abstaining from voting to the detriment of the company's interests.
3. Making false declarations or announcements to create the impression that a company has not completed its registration with the commercial registry.
4. Unauthorized disclosure of company secrets by a public employee to unauthorized individuals.
5. False publication of names associated with the company.

6. Dishonest distribution or receipt of profits or returns.
7. Exaggeration or provision of false statements from partners, shareholders, or others.
8. Failure to convene the general assembly of partners upon reaching legally estimated loss limits.
9. Exploitation or disclosure of company secrets with the intention of causing harm.
10. Intentional obstruction of individuals authorized to view the company's papers, documents, accounts, records, and documents.
11. Intentional establishment of false facts or omission of essential facts during an inspection.

These less serious crimes are all linked by a common thread: the neglect of the important principle of good faith. As mentioned in the previous section, each of these offenses is motivated by either personal gain or the intent to harm others, and all stem from bad intentions.

#### Penalties for violations of the good faith principle in the Saudi system

After identifying serious and less serious crimes, the Saudi regulator has decided to impose penalties that are commensurate with the magnitude of the offense committed. These penalties are explained in light of the following two subcategories:

##### Penalties for serious crimes

The Saudi regulator stipulates that the punishment for a perpetrator of one of the serious crimes mentioned in the previous section is imprisonment for a period not exceeding three years, a fine not exceeding five million Saudi riyals, or one of these two penalties. It is noteworthy that these penalties serve as a deterrent and a form of punishment. The severity of these penalties is proportional to the magnitude of the crime, and the application of either penalty to the perpetrator, or the combination of both, is sufficient to deter them from committing such offenses again. At the same time, it serves as a warning to others against committing these crimes or any one of them.

##### Penalties for less serious crimes

The Saudi regulator specifies that the punishment for a perpetrator of one of the less serious crimes is imprisonment for a period not exceeding one year, a fine not exceeding one million Saudi riyals, or one of these two penalties. It is apparent that these penalties are less severe than those mentioned in the previous subcategory, indicating the variance in the severity of the offenses. Upon assessing the harm resulting from these crimes, it is evident that it does not compare to the anticipated harm from the more serious crimes. Furthermore, there is a proportional correlation between the severity of the offense and the prescribed penalty.

Detailed discussion of the elements of the crime is not relevant to this research but falls under criminal law. May success be granted by Allah.

## **Discussion**

The key findings: This modest research has led to some significant conclusions:

1. The principle of good faith in interpersonal dealings and contract conclusion holds immense importance. It fosters transactions conducted with peace of mind, reducing the necessity for judicial intervention in dispute resolution.

2. The violation of the principle of good faith in company contracts within the Saudi system is evident as a punishable offense. This emphasizes the paramount importance of this principle and the necessity to prioritize its implementation.

## Recommendations

Based on the findings of this humble research, we have formulated the following recommendations for constructive critique:

1. In light of the paramount importance of the principle of good faith, as established in this research, we recommend that the Saudi regulator explicitly references it independently in one or more articles, whether within the commercial companies' system or in other relevant regulations.
2. We further recommend that the Saudi regulator establish a provision for this principle, as outlined in the first section, stipulating that the principle of good faith in commercial law obliges the direction of will to achieve the direct purpose of contract conclusion, in alignment with the legitimate and justifiable interests of the counterparty.

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