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Key Features of the New Saudi Civil Transactions Law

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An Article providing an overview of the new Civil Transactions Law (CTL) that enters into force in the Kingdom of Saudi Arabia (KSA) on 16 December 2023. The Article highlights key features of the CTL that will impact the resolution of disputes arising under commercial contracts that are governed by KSA law.

Saudi Arabia's New Civil Code Comes into Force

On 19 June 2023, the KSA published its new Civil Transactions Law (CTL), which was signed into law by Royal Decree M/191. The CTL enters into force on 16 December 2023 (Jumada II 3, 1445 AH) (Effective Date).

The CTL, which is effectively Saudi Arabia's first-ever Civil Code, consists of 721 Articles covering the law applicable to civil legal relationships. It includes provisions covering, among other matters, the parties' rights and obligations under both general and specialist (such as construction and employment) contracts, property rights, financial transactions, and dispute resolution.

The CTL is a welcome development for businesses operating in KSA under contracts governed by Saudi law. It is expected to provide greater certainty, predictability, and reliability in the application of Saudi law to contractual rights and obligations by courts and arbitral tribunals.

The CTL is the third of four key judicial reform legislations in KSA announced on 8 February 2021, which include the Civil Status Law, the Law of Evidence, and the proposed Penal Code for Discretionary Sentences. This judicial reform is part of a broad legal modernisation trend in KSA that has, over the past six years, included specialised courts, a new class action regime, a book of legal principles and court judgments published by the Supreme Judicial Council, and the enhanced use of technology in the Saudi courts, among others.

Against the backdrop of KSA's Vision 2030, together these developments demonstrate KSA's commitment to modern international business practice.

As to the CTL specifically, His Royal Highness Mohammed bin Salman, the Crown Prince and Prime Minister of the Kingdom of Saudi Arabia, reportedly said that:

> "The law will have a positive impact on the business environment and increase its attractiveness, and will also contribute to regulating economic movement and the stability of financial rights, in addition to facilitating decision-making with regard to investment. It will also enhance transparency and increase the ability to predict judgments in the field of civil transactions and reducing discrepancies in judicial reasoning to reach prompt justice, apart from contributing to bringing down disputes."

This Article identifies several key features of the CTL that are expected to have an important impact on the commercial risk profile of companies doing business in KSA. Parties should consider conducting a careful and systematic review of any existing or prospective contracts governed by KSA law to identify the potential impacts of the CTL on their pre-existing contractual rights and obligations, as well as on any actual or potential disputes.

CTL Codifies Sharia Law Principles

Until now, the law in KSA has been based primarily on uncodified Sharia legal principles (or Islamic law), which is derived from religious texts and traditions and does not rely on judicial precedent. The CTL codifies important legal principles, integrating many established maxims of the Sharia into a civil code.

If the CTL is silent on a specific issue, the 41 Sharia principles set out in the CTL's final provisions will apply.

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If none of these 41 Sharia principles are relevant, then the broader principles of the Sharia that are most appropriate for the purposes of the CTL will apply to determine the issue.

Retrospective Effect

The CTL will apply retrospectively to all contracts and relationships that existed before the Effective Date. The fifth recital to the CTL identifies two exceptions to its retrospective effect:

- Where a party invokes an existing statutory provision or judicial principle that conflicts with the provisions of the CTL.
- A limitation period that was triggered before the Effective Date.

Mandatory Provisions

The CTL contains a limited number of mandatory provisions that apply regardless of the agreement between the parties, including for example, in respect of the object of the contract (Article 72, CTL; see Object), hardship (Article 97, CTL; see Hardship), and liquidated damages (Article 179, CTL; see Liquidated Damages). Any conflicting agreement by the parties is null and void.

Good Faith

Article 95(1) of the CTL codifies the principle of good faith. It provides that the parties must execute the contract in accordance with its provisions and in a manner consistent with the requirements of good faith.

Additionally, Article 41 of the CTL prohibits parties from negotiating in bad faith, for example by entering into negotiations without an intention to reach an agreement. A party who negotiates in bad faith may be liable in damages, excluding damages for unrealized revenue that the other party expected to gain from the negotiated contract.

Contract Formation

The CTL enunciates important principles of contract formation under KSA law.

Offer and Acceptance

Article 33 of the CTL requires that offer and acceptance be made by an expression of will between the parties, either verbally, in writing, or implicitly (for example, by the parties' conduct), unless the contract, a statutory provision, or the nature of the underlying transaction requires otherwise.

According to Article 37, silence by one party does not constitute acceptance of the other's offer except in limited circumstances, such as where the parties agree or the offer is connected to a former course of dealings between the parties.

Certainty

Article 43 promotes the principle of certainty over the parties' legal relationship. It provides that an undertaking by the parties to enter into a future contract is only binding if the following conditions are met:

- The essential elements of the contract and the timeframe for executing the contract are both specified.
- The formality conditions, including any conditions required by statutory provisions under KSA law, must be agreed in advance.

If these elements are satisfied, but a party refuses to fulfil its promise, the counterparty can request that the court render a judgment in lieu of the contract.

Article 42 provides that if the parties do not agree on any non-essential matters, this will not affect the execution of the contract unless the parties have agreed otherwise. That is, failure to agree on non-essential matters does not prevent the parties from forming a valid and enforceable contract unless they have agreed otherwise. The court can determine non-essential matters on which the parties fail to agree.

Object

Under Article 72 of the CTL, the object of a contract must fulfil the following requirements:

- It must be achievable.
- It must not violate public order. (The CTL does not define "public order.")
- It must be clearly defined, for example concerning its type or value.

The contract is null and void if these requirements are not satisfied.

A party can request that an invalid provision be severed from the remainder of the contract without causing the entire contract to be invalidated under Article 74 if the requesting party can prove that it would not have entered into the contract without that particular condition.

Illegality

The object of a contract must not violate public order (see Object). In addition, under Article 75 of the CTL, if the contract's underlying object is illegitimate, either expressly, or impliedly by the circumstances surrounding the contract, then the contract is null and void.

Consent (Mistake, Deceit, and Duress)

The parties must have capacity to consent to the contract under Article 47 of the CTL. Article 48 states that minors, as well as insane and mentally deficient persons, do not have capacity to enter into contracts. The contract may be invalidated if there has been an important defect in a party's ability to consent. The CTL identifies multiple circumstances where a party can apply to the court to invalidate (or rescind) the contract, including where a party:

- Has made a fundamental mistake, without which that party would not have consented to entering into the contract, and which relates to the characteristics of the contract or the capacity of one of the parties (Articles 57 to 60, CTL).
- Fraudulently induces the other party to enter into the contract (Articles 61 to 62, CTL).
- Coerced the other to enter into the contract (also known as duress) (Articles 64 to 68, CTL).

Notification of Claims

Commercial contracts often contain provisions for the notification of a claim that may arise out of or in relation to that contract. An issue that frequently occurs is whether a claimant validly served a notice of claim.

Article 175 of the CTL states that "compensation shall only be due after serving a notice to the debtor [that is, the defaulting party], unless the parties agree otherwise." However, Article 176 specifies certain circumstances where a notice of claim is not required, for example, if the parties agreed explicitly or impliedly that the defaulting party is considered to be notified by the passage of a specific period of time.

Limitation Periods

Article 295 of the CTL sets out a general limitation period of ten years within which claims must be raised. The CTL also specifies shorter limitation periods for particular types of claims. For example, Article 296 applies a five-year limitation period to the rights of self-employed professionals (such as medical doctors, lawyers, and engineers) in relation to their work and related expenses, and to periodic renewable rights, such as property rent and wages, subject to limited exceptions. Under Saudi law, until recently, there were no limitations of actions. At present, the legal position as to triggers for commencing the limitation period remains uncertain.

As per the fifth recital of the CTL, the retrospective effect of the CTL does not alter a limitation period that was triggered before the Effective Date of the CTL, even if the CTL applies a different limitation period for the same category of claim (see Retrospective Effect).

The Sharia doctrine that rights are not lost due to the passage of time is codified by Article 295 of the CTL. The language used in Article 295 indicates that a party must deny the claim or right in dispute, in addition to invoking a defence based on the expiry of a limitation period. The wording of Article 295 is unclear about the practical implications for parties litigating a dispute that is time barred, given that the right is not extinguished. At this stage, the authors cannot predict how the courts are likely to interpret this provision.

Limitations of Liability

Article 173 of the CTL confirms that, as a general principle, limitation of liability clauses are valid and enforceable under KSA law. This is subject to the important proviso that the party whose liability is limited by the clause has not committed deceit, gross error, or a wrongful act.

Damages

Article 136 of the CTL sets out the general position that a party is entitled to claim damages that will restore it to its pre-harm position. Article 137 of the CTL requires that these damages are "proportional" to the loss sustained, and it requires the claimant to take reasonable steps to mitigate its loss. Article 137 includes a reference to lost profits, which indicates that these losses are potentially recoverable under KSA law. The court or tribunal will make a final assessment of a party's damages.

The CTL also confirms the availability of liquidated damages and damages for moral harm under KSA law.

Liquidated Damages

Liquidated damages (LDs) are a pre-agreed, fixed sum payable by one party to another in the event of a failure to complete a specified milestone by a contractually agreed date. LDs are common in construction contracts but can also arise in other commercial contracts.

Sharia principles generally prohibit the recovery of LDs that grossly exceed a party's actual damages. Article 178 of the CTL clarifies the availability of LDs under KSA law, expressly permitting parties to include LDs clauses in their contracts. However, Article 179 of the CTL imposes several important limitations on the recovery of LDs:

- The agreed rate of LDs does not apply if a party can show that the party levying LDs did not suffer loss.
- The court or arbitral tribunal may **reduce** the rate of LDs if the paying party can show that the contractual rate is unreasonably high or the obligation was partially fulfilled.
- The court or arbitral tribunal may **increase** the rate of LDs to the actual harm suffered if the receiving party can show that the actual harm exceeded the amount of LDs as a result of fraud or gross error.

Damages for Moral Harm

Article 138 of the CTL expressly permits a court, in its discretion, to award damages for intangible "moral harm," such as damages for loss of reputation. The language of the CTL suggests that moral harm damages can only be claimed by natural persons rather than legal persons (that is, companies). Natural persons can claim moral harm damages for harm suffered to the individual's reputation, honour, or social standing, and for physical and psychological harm.

Force Majeure

Commercial contracts often entitle a party to seek relief from performing its contractual obligations, either temporarily or permanently, without incurring liability, on the occurrence of specific circumstances beyond its control. These are referred to as force majeure events.

Article 125 of the CTL provides that a party is not liable for damages arising due to circumstances beyond their control, such as force majeure events, the fault of a third party, or the default of their counterparty, unless otherwise agreed.

Hardship

The hardship doctrine permits the re-balancing of a contract when the circumstances underlying the contract have changed and one party has become unduly burdened.

Article 97 of the CTL permits a party to request the re-negotiation of the contract if exceptional circumstances arise that result in that party's performance of its contractual obligations becoming burdensome to the extent that it threatens that party with a heavy or grave loss. The circumstances must have been unforeseeable when the contract was entered into.

The requesting party must request the re-negotiation without undue delay and must continue to perform its contractual obligations during the re-negotiation process. If the parties cannot reach an agreement within a reasonable period of time, the affected party can apply to the court to reduce the onerous obligation to a reasonable level.

Importantly, this provision of the CTL is mandatory, and any contrary agreement between the parties is void.

Suspension of Contractual Performance

Article 114 of the CTL permits a party to suspend the performance of their contractual obligations as a result of their counterparty's breach or failure to perform its corresponding obligations.

Additional Payments for Variations

Commercial contracts for the supply of goods or services, particularly construction contracts, may contain a contractual entitlement for the supplying party to request an extension of time, an additional payment, or both as a result of a valid variation to the original scope of the contract.

In the absence of an express contractual price adjustment mechanism, Article 471 of the CTL restricts a party's ability to claim additional payments from its counterparty in the event of a variation:

- If the parties have agreed to a lump sum contract, a party cannot claim for a price increase, even if the costs of materials, wages, or other expenses have increased.
- A party cannot claim an increased payment where the scope of a contract has been modified or added to, unless due to a default by its counterparty or if the counterparty consents.

Termination

The CTL provides for a range of termination rights.

Termination by Mutual Consent

Article 105 of the CTL permits the parties to terminate a contract, in whole or in part, by mutual agreement.

Termination for Convenience

Article 106 of the CTL allows the parties to include a withdrawal option in their contract, permitting termination for convenience. The party exercising a contractual right to terminate must provide notice to its counterparty within a time limit that is stated in the contract or, in the absence of an express contractual time limit, specified by the court.

Termination for Default

Article 107 of the CTL provides that, where a party fails to perform a contractual obligation, the other party may, after providing notice to the defaulting party, request that the court order performance or termination of the contract. In either case, the innocent party can claim damages.

The availability of this right is subject to the court's discretion. Although currently untested, the wording of Article 107 indicates that a court may reject a request to terminate the contract if the default is minor when compared to the obligation in question.

As an alternative to making a judicial request for termination under Article 107, Article 108 of the CTL confirms that a contract may include provisions permitting termination, without judicial intervention, if either party fails to perform its obligations.

Termination for Impossibility

The CTL permits a party to terminate a contract where the performance of a party's contractual obligations becomes impossible due to a reason beyond their control (Article 110, CTL).