

## Third Wave of Codification: Saudi Civil Code

As part of its modernization of the Saudi legal system, the Kingdom of Saudi Arabia has revamped its Civil Code governing contracts and related matters. Pursuant to Royal Decree No. M191, dated 29/11/1444H (18 June 2023) (the "Royal Decree"), the Kingdom enacted the Saudi Civil Code<sup>1</sup> (the "Code"). With 721 articles, this is the first code in Saudi Arabia and incorporates the most modern trends and best legal practices. A number of high-ranking committees and respected experts have contributed to its drafting.

The Saudi Civil Code is expected to increase transparency and predictability, to streamline civil transactions, and to strengthen protection of ownership rights. It is the latest in a series of significant economic and legal reforms mandated by the Kingdom of Saudi Arabia as a hub for international business.

The Saudi Civil Code is the third of four major laws that the Kingdom announced in 2021: the Law of Evidence, the Personal Status Law, the Civil Transactions Law, and the Penal Code on Sentences. All have been enacted with the exception of the Penal Code on Sentences, which is expected to issue soon.

Confirming the Kingdom's commitment to international provisions of the Saudi Civil Code shall be without prejudice to any treaty or convention to which the Kingdom is party.

### I. Effective Date and Retroactive Application

The Saudi Civil Code will enter into effect on 16 December 2023,<sup>1</sup> and it will apply retroactively to events that took place prior to its effective date. However, the Royal Decree provides two exceptions to the retroactive application of the Saudi Civil Code:<sup>2</sup>

1. Where there exists a statutory provision or judicial principle concerning a matter that is contrary to the provisions of the Saudi Civil Code, and one of the parties to the matter has relied on the prior statutory provision or judicial principle.
2. Where a provision concerns a statutory limitations period that started prior to the Saudi Civil Code becoming effective.

The Saudi Civil Code applies to both natural and legal persons. Legal persons include the State and public authorities and institutions.<sup>3</sup> This is important to keep in mind for companies and international corporations that have contracts with the State or with public authorities and institutions. The Saudi Civil Code covers matters pertaining to, among other things, types and exercise of rights, sources of obligations, (e.g., contracts, personal liabilities, and ownership rights, including ownership of real estate units).

This Note focuses on some of the articles of the Saudi Civil Code pertaining to contracts that may be relevant to business entities.

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<sup>1</sup> This is pursuant to Article (721) of the Saudi Civil Code.

<sup>2</sup> See Article 5 of the Royal Decree.

<sup>3</sup> See Article 17 of the Saudi Civil Code.

## II. Pillars of Contract

The Saudi Civil Code confirms the classic pillars of contract, which are consent, object, and cause.

### Consent

The Saudi Civil Code provides that offer and acceptance shall be recognized, with some exceptions, in any form showing intent to commit to an agreement. Contracts, generally speaking, do not have to be in writing, and consensual exchange, historically known as *bai*, may form a contract.<sup>4</sup> An offeree's silence shall not be regarded as acceptance unless the offer pertains to a prior dealing between the contracting parties or the offer is purely for the offeree's

One of the challenges to consent is duress.<sup>5</sup> Duress occurs when the compelled party is threatened by grievous and imminent danger to his or her person or property and the party would not have executed the contract but for such duress.<sup>6</sup> Duress imposed by a third party shall not invalidate a contract unless the compelled party proves that the other contracting party was or should have been aware of the duress.<sup>7</sup>

Another challenge to consent is exploitation of a counterparty. A court may, at the affected party's request, consider the effect of the contract on the counterparty's obligations and reduce the obligations of the counterparty. *Ghabn* is a Shari'ah concept that gives a buyer the right to rescind a contract if it is discovered that the price paid significantly exceeds the market price. This right is available only if the buyer is unaware of the price-gouging at the time of contract execution. The definition of *Ghabn* under the Saudi Civil Code is in line with the consideration being out of the ordinary.<sup>8</sup> The determination of *Ghabn* will be based on *Urf*, i.e., custom. The statutory limitations period to bring suit claiming *Ghabn* is 180 days after contract execution.<sup>9</sup> It is important for large corporations to consider *Ghabn* when contracting with smaller companies with weaker bargaining power.

### Object and Cause

A contract shall be void if its object fails to meet any of the three conditions below:<sup>10</sup>

1. It is possible in itself.
2. It does not violate public policy.
3. It can be identified by itself, its type, or its quantity, or is capable of being identified.

If the quality of the subject of the contract is not expressly agreed in the contract, and there is an absence of custom or other indication, a contractual obligation shall be discharged with average quality.

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<sup>4</sup> See Article 33 of the Saudi Civil Code.

<sup>5</sup> See Article 67 of the Saudi Civil Code.

<sup>6</sup> See Article 65 of the Saudi Civil Code.

<sup>7</sup> See Article 67.2 of the Saudi Civil Code.

<sup>8</sup> See Article 69.1 of the Saudi Civil Code.

<sup>9</sup> See Article 68.1 of the Saudi Civil Code.

<sup>10</sup> See Article 72 of the Saudi Civil Code.

Therefore, it is important for contracting parties to specify in the contract the quality of, for example, the subject product or service, particularly if they expect a product or service of above-average quality.<sup>11</sup>

The Saudi Civil Code resolves ambiguities about whether a void or unlawful contractual term invalidates an entire contract. The Saudi Civil Code confirms that an entire contract is not invalidated unless one of the contracting parties proves it would not have accepted the contract without the void or unlawful term.<sup>12</sup> The statutory limitations period to bring suit seeking contract invalidation is one year from becoming the plaintiff becoming aware of the basis for invalidation capacity or the cessation of duress if invalidation is sought on the grounds of lack of capacity or duress.<sup>13</sup> Other than in cases of lack of capacity, no case seeking to invalidate a contract shall be heard more than ten years after execution of the contract.<sup>14</sup> In a contract is invalidated, the parties will be restored to their status prior to entering into the contract. If this is not possible, compensation may be awarded.<sup>15</sup>

The Saudi Civil Code recognizes framework agreements and incorporation of model documents or specific rules by reference.<sup>16</sup> Further, deferring agreement on non-material matters does not render the contract invalid.<sup>17</sup> If the parties are unable to agree on the non-material matters after execution of the contract, the court shall determine these matters, taking into account, among other things, the nature of the transaction and the relevant custom.<sup>18</sup>

With more parties harnessing technology in contractual transactions, a question arises about the time and place of a contract when the parties enter into it from different jurisdictions. The Saudi Civil Code answers this question. For contracts concluded through live/direct communications, the time and place of execution of the contract shall be where acceptance is issued, unless otherwise agreed.<sup>19</sup>

### III. Parties' Ability to Claim Damages

Negotiation of a contract does not place the negotiating parties under an obligation to conclude the contract. However, a party that negotiates or terminates negotiations in bad faith shall be liable for damages incurred by the other negotiating party.<sup>20</sup> Bad faith is regarded as a lack of seriousness in negotiating or deliberately not disclosing information material to the contract.<sup>21</sup> Damages shall not include loss of profit anticipated from the contract being negotiated;<sup>22</sup> however, it is reasonable to assume that costs may include legal and advisory fees spent on negotiations.

It is important to maintain accurate and separate records of costs spent in negotiating a contract in case the negotiations reach an impasse, it becomes evident that the other party was acting in bad faith, and the negotiating party that sustained damages decides to pursue claims.

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<sup>11</sup> See Article 73 of the Saudi Civil Code.

<sup>12</sup> See Article 74.2 of the Saudi Civil Code.

<sup>13</sup> See Article 79 of the Saudi Civil Code.

<sup>14</sup> See *id.*

<sup>15</sup> See Article 82 of the Saudi Civil Code.

<sup>16</sup> See Articles 45 and 46 of the Saudi Civil Code.

<sup>17</sup> See Article 42.1 of the Saudi Civil Code.

<sup>18</sup> See Article 42.2 of the Saudi Civil Code.

<sup>19</sup> See Article 38 of the Saudi Civil Code.

<sup>20</sup> See Article 41.1 of the Saudi Civil Code.

<sup>21</sup> See Article 41.2 of the Saudi Civil Code.

<sup>22</sup> See Article 41.1 of the Saudi Civil Code.

## IV. Inability to Perform Due to Exceptional Circumstances

Parties to contracts sometimes encounter situations in which they are unable to perform and discharge their contractual obligations due to unforeseen circumstances. The Saudi Civil Code sets a mechanism to deal with these circumstances:<sup>23</sup>

1. The party must, without unjustified delay, notify the counterparty and call for negotiation.
2. The request for negotiation shall not relieve the party who encountered exceptional circumstance from performance.
3. If no agreement is reached within a reasonable period, the court may, giving regard to the circumstances and after weighing the interests of the parties, reduce the burdensome obligation to a reasonable level.

The Saudi Civil Code makes clear that any agreement contrary to the mechanism above shall be void.<sup>24</sup> This mechanism applies to circumstances that (i) are exceptional, (ii) are of a general nature, (iii) could not have been foreseen at the time of contract execution; and (iv) render performance of the contractual obligation unduly burdensome, such as threatening a contracting party with exorbitant loss.<sup>25</sup>

## V. Contract Interpretation

The Saudi Civil Code makes clear that the terms of the contract shall be respected and shall not be departed from under the pretext of implementing the will or intention of the contracting parties if the contract wording is clear.<sup>26</sup> If contract interpretation is needed, it is then necessary to go beyond the literal meaning of the contract terms to look for the intention of the parties, taking into account the following factors:

1. *Urf*, i.e., custom;
2. The circumstances of the contract;
3. The nature of the transaction; and
4. The course of dealing between the parties (and the honesty and trust existing between them), if any.

Doubt in interpreting contractual terms shall be resolved in favor of the party responsible for the contractual obligation.<sup>27</sup> Moreover, in adhesion contracts, doubt is interpreted in favor of the party of weaker bargaining strength.<sup>28</sup>

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<sup>23</sup> See Article 97 of the Saudi Civil Code.

<sup>24</sup> See *id.*

<sup>25</sup> See *id.*

<sup>26</sup> See Article 104 of the Saudi Civil Code.

<sup>27</sup> See Article 104.3 of the Saudi Civil Code.

<sup>28</sup> See *id.*

## VI. Contract Termination

If a counterparty fails to perform, the injured party, after serving notice of default on the breaching party and allowing a grace period, may ask the court to compel the breaching party to perform or to terminate the contract.<sup>29</sup> The court may dismiss a request for termination if the unfulfilled part of the contract is of little significance with respect to the entirety of the obligation(s).<sup>30</sup> It can reasonably be inferred that, in such a scenario, the court may compel the breaching party to perform rather than terminating the contract. The injured party is entitled to claim compensation in both scenarios.<sup>31</sup>

The Saudi Civil Code makes it clear that parties may agree in a contract to give the non-breaching party the right to terminate the contract without involving a court.<sup>32</sup> Such an agreement shall not eliminate the requirement of notice to the breaching party unless notice is expressly waived.<sup>33</sup> Depending on the nature of the contract and the parties, it could save the parties significant cost and time to include a right of termination without the need for a court order. However, the possibility of such a clause being abused by the counterparty, and of the parties' eventually ending

## VII. Concluding Comments

Issuance of the Saudi Civil Code is a significant step toward creating an attractive business environment in the Kingdom and making the outcome of contractual disputes more predictable. Companies may wish to seek proper legal advice on whether their standard contract templates need to be updated, the impact of the Saudi Civil Code on their existing contracts (and whether amendments should be considered, such as agreeing to termination without a need for court order), the effects on contracts being negotiated and drafted, and the impact on existing contractual disputes.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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<sup>29</sup> See Article 107 of the Saudi Civil Code.

<sup>30</sup> See *id.*

<sup>31</sup> See *id.*

<sup>32</sup> See Article 108 of the Saudi Civil Code.

<sup>33</sup> See *id.*