

An Evaluation of Piercing the Corporate Veil Within a Corporate Group under Saudi Corporate Laws

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Abstract

The objective of this paper is to examine the issue of piercing the corporate veil within corporate groups. Overall, the Saudi law is less developed on this topic. In accordance with the traditional limited liability doctrine, in Saudi Arabia, individual shareholders are generally not liable for a company's debts. Under Saudi corporate law, the holding company is regarded as a shareholder of its subsidiaries. However, the dynamic between parent companies and their subsidiaries differs from that of a shareholder in relation to a single corporation. According to the traditional limited liability doctrine, a holding company can only be held liable if the criteria for piercing the corporate veil are satisfied.

Keywords:

Piercing the veil, corporate group, Saudi Law, Company Laws.

1. Introduction:

The term corporate group is not used in Saudi Arabia. However, although the concept of a corporate group is not expressly mentioned in Saudi corporate laws and literature, SCL 2015 & 2022 recognize the idea of the corporate group, under the terms "holding and subsidiary companies." In Saudi Arabia, the corporate group relationship is mainly based on two companies: the holding company and the subsidiary. A holding company corresponds to the parent company in U.S. corporate law.

SCL 2015 defines the holding company as: 'a joint-stock or limited liability company that aims to control other joint-stock or limited liability companies by owning more than half of their capital

or controlling their board of directors.' Later, SCL 2022 defined the holding company as: 'A joint-stock company (JSC), simplified joint-stock company (SJSC), or limited liability company (LLC) which incorporates companies or owns interests or shares in existing companies that become subsidiaries thereof.'¹ So, the new SCL 2022 has added a new company form, SJSC, that can act as a holding company.² The holding company in Saudi Arabia must fulfill all conditions related to the validity of its type. For instance, if a holding company decides to be JSC or SJSC, it must have a board of directors chosen and working under the same conditions as JSC or SJSC, respectively.³ Likewise, if the holding company is established as an LLC, it must meet all requirements of the LLC establishment.⁴

Under SCL 2015, there are two methods by which a company may be considered a holding company.⁵ One is by owning a percentage of the subsidiary company's capital, and according to the law, the percentage may not be under 51%.⁶ The second method is for the holding company to have control over the board of directors of their subsidiary company,⁷ whereby a contract is concluded between the subsidiary company and the holding company, according to which the holding company takes over the supervision, management, and direction of the subsidiary company, even if it does not own a large percentage of the subsidiary's shares.⁸ Despite the subsidiary company being under the control of the holding company, under either method, it is still regarded as a separate legal entity with its own name,

¹ SCL 2022, art. 216, Part 9, Holding Company and Subsidiary Company.

² *Id.*

³ SCL 2022, conditions for establishing JSC, art. 61-66, and SJSC, art. 140-141.

⁴ SCL 2022, conditions for establishing LLC, art. 158-159.

⁵ SCL 2015, art. 182, Part 9, The holding company.

⁶ SCL 2015, art. 182/1.

⁷ *Id.*

⁸ SCL 2015, art. 182, Part 9, The holding company.

objectives, and financial obligations against third parties.⁹

SCL 2022 updated and broadened the concept of a Saudi holding company. Under SCL 2022, if a company meets any one of the following conditions, it may now be considered a holding company in Saudi Arabia: 'a) the holding company is a partner or shareholder in the subsidiary company and owns sufficient interests or shares in its capital that grant the holding company the majority of voting rights; b) the holding company is a partner or shareholder in the subsidiary company and solely controlling the subsidiary by appointment or removal of the manager or the majority of board members; c) the holding company is a partner or shareholder in the subsidiary company and solely controlling the subsidiary company by majority of voting rights pursuant to an agreement with the other partners or shareholders; d) the subsidiary company is affiliated with a subsidiary of the holding company.'¹⁰ The first case involves controlling majority voting rights through a holding company's ownership of its own shares. However, the third case involves controlling majority voting rights through an agreement between the holding company and the shareholders or partners who own the shares representing those rights.¹¹ Any one of these conditions is currently sufficient to define a holding company in Saudi Arabia.

2. Methodology

The methodology in this paper utilizes the critical analysis approach to analyze statutes and cases in Saudi.¹² This methodology aims to conduct a comparative analysis of corporate laws under the Saudi Company Law (SCL 2015 and SCL 2022). Further, other methods of similarities and differences

will also be evaluated to provide a comprehensive understanding of the PCV within the corporate group. These similarities and differences approach helps to understand the theoretical and practical aspects of piercing the group in Saudi jurisdiction.

3. The Nature of Holding and Subsidiary Companies in SCL 2015 & 2022

Saudi courts consider the holding a separate legal entity and apply the limited liability doctrine in the holding and subsidiary context. Accordingly, the Saudi Commercial Court held that the holding company was not liable for the actions of its subsidiary in *Manar Al-Omran Company vs. Majed Alharbi Holding Company*.¹³ To provide more details, Article (14) of the SCL 2015 respected the legal status of the subsidiary to present in its own capacity and defend its own interests. Article 14 states, "Except for a joint venture company, a company acquires a legal personality after its registration in the commercial register; and that company has a legal personality to the extent necessary for its establishment, provided that the incorporation process is complete." The court determined that the lawsuit should have been filed against the subsidiary directly instead of the *Alharbi Holding Company*. Thus, no "corporate veil" of the subsidiary company was pierced in this case.

The separate legal personality between holding and subsidiary companies is fundamental in Saudi commercial law. In the previous case, the Saudi court clarified that the separation between the holding and its subsidiaries must be respected. This principle prompts the question of what the basis of the relationship is that binds holding and subsidiaries in the corporate group framework under Saudi corporate law. It is essential to examine the extent of liability of the holding company for its subsidiaries,

⁹ KHALID AL-RUWAIS, COMMERCIAL COMPANIES ACCORDING TO SAUDI CORPORATE LAW AND JUDICIAL APPLICATION 554-555 (Al-Shaqra Library, 2019).

¹⁰ SCL 2022, art 217.

¹¹ *Id.*

¹² Critical analysis is a contextual model that is specialized in legal studies. This method combines the study of the legal application, the existing laws stipulated, and the courts' opinions. For more about critical analysis, see: Markus D. Dubber, *Critical Analysis of Law: Interdisciplinarity, Contextuality, and*

the Future of Legal Studies (January 26, 2014) (Faculty Paper, University of Toronto), CRITICAL ANALYSIS OF LAW: AN INTERNATIONAL & INTERDISCIPLINARY LAW REVIEW, vol 1, no 1 (2014), Available at SSRN: <https://ssrn.com/abstract=2385656> or <http://dx.doi.org/10.2139/ssrn.2385656>.); Kai Schwalbach, *The Benefits of Comparative Law: A Continental European View*, 16 B.U. INT'L L. J. 331, 422 (1998).

¹³ See Saudi Commercial Court in Jeddah, Scientific Judicial Portal, case issued by No.: 4430573818. Dated 7/15/1444 H.

including tort and debt liability under Saudi law. The following two hypothetical situations will illustrate the nature of the legal relationship between holding and subsidiary companies in Saudi Arabia.

First, imagine that a holding company wholly owns all the shares of its subsidiary. Despite the holding company wholly owning the shares of the subsidiary company, the subsidiary has a separate personality, as mentioned above.¹⁴ Consequently, the holding company will not be liable for the subsidiary company's debt, regardless of the size of the share the holding owns in its subsidiary.¹⁵ On the other hand, even if the holding company owns all shares of the subsidiary, but shows apparent interference in the operational, administrative, and financial management of the subsidiary, those manifestations of interference in the business of the subsidiary company and participation in the management of its activities may result in a finding of liability for the holding company.¹⁶

Saudi commentators explain that the holding company that wholly owns its subsidiary would still be liable where the financial management of the holding appears in decisions affecting the subsidiary, without leaving any significant margin for the subsidiary company to manage itself, thus making the board of directors of the subsidiary a mere agent to implement the instructions and directives of the holding.¹⁷ Moreover, the holding would be considered liable when the holding commingles funds with its subsidiary, making it difficult to organize the account of each company individually and to treat their money independently.¹⁸

Saudi courts consider the subsidiary's financial, legal, and administrative independence as the most critical factors in determining the extent of the holding company's liability. Thus, the degree of the holding company's interference with those factors in the subsidiary would determine the extent of the holding's liability for the subsidiary's debts

against third parties.¹⁹ Since the principle of the independence of each holding company and subsidiary must be respected, the holding company's liability is found when these standards are violated.²⁰ In the second situation, when the holding company does not own at least half of the shares of the subsidiary, the holding would not be liable because it would not be able to control the subsidiary's decision due to the percentage of shares of the other owners. Thus, the subsidiary company alone would be financially liable since the subsidiary in Saudi Arabia is separate from the holding company.²¹

4. Control as a Primary Factor under SCL 2015 & 2022

Under SCL 2015 & 2022, control can be from an individual, such as the control of a shareholder who owns more than half of the company's shares, or control can be from a legal entity, such as a company that owns another company and thus has control over it. Both of these cases show the control of one entity over another entity. However, to determine whether control may be considered a primary factor in the holding and subsidiary relationship, the following points will illustrate a guideline based on the definitions of holding companies in SCL 2015 & 2022:

- SCL 2015 determined the holding company to be a company that aims to control other companies. According to this statute, the exercise of control is a primary condition for being considered a holding company.²²
- SCL 2015 simply required holding companies to include "Holding" in their name, indicating their intent to control.²³
- SCL 2022 specifies that a company will only be considered a holding company in four situations.²⁴ Including: "B) If the

¹⁴ AL-RUWAIS, *supra* note 88.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ TAWFIQ HUSSAM ELDINI, COMMERCIAL COMPANIES ACCORDING TO THE SAUDI COMPANIES LAW 369, 415 (Center for Arab Studies, 2016).

¹⁸ AL RUWAIS, *supra* note 9, at 555.

¹⁹ HUSSAM, *supra* note 16.

²⁰ ABDULLAH AL-AYADI, THE RELATIONSHIP BETWEEN THE HOLDING COMPANY AND THE SUBSIDIARY, at 25-26.

²¹ *Id.*

²² SCL 2015, art. 182.

²³ *Id.* para. (2).

²⁴ SCL 2022, art. 217 states: ("Subsidiary Company. A company shall be deemed a subsidiary of a holding company in any of the following cases: a) If the holding company is a partner or shareholder in the subsidiary company and owns interests or shares in its capital that grants it the majority of voting rights therein; b) If the holding company is a partner or shareholder solely

holding company is a partner or shareholder solely controlling the appointment of the manager or the majority of board members, or if it has the power to remove the manager or the majority of board members. C) If the holding company is a partner or shareholder solely controlling the majority of voting rights pursuant to an agreement with the other partners or shareholders". Thus, the concept of control between holding and subsidiary companies is clarified in the SCL 2022, which provides more specific conditions for determining control than SCL 2015.

- Under SCL 2015, the holding company can exercise control in two ways: (1) Financial control, that is, owning more than 50% of the shares of the subsidiary company, which results in possession of the voting right in the amount of the percentage owned. The holding company may then form the board of directors or most of it unilaterally and gain full administrative authority to control the board of directors.²⁵ 2. Controlling the board of directors by stipulating in the articles of the holding's incorporation that it has the right to form the board.²⁶

5. When Can a Holding Company be Liable for its Subsidiaries in Saudi Arabia?

As discussed more fully above, Saudi corporate law has adopted the principle of limited

controlling the appointment of the manager or the majority of board members, or if it [the holding company] has the power to remove the manager or the majority of board members [of the subsidiary]; c) If the holding company is a partner or shareholder solely controlling the majority of voting rights [of the subsidiary] pursuant to an agreement with the other partners or shareholders; or d) If the subsidiary company is affiliated with a subsidiary of the holding company.")

²⁵ See SCL 2015, art. 182/1.

²⁶ *Id.*

²⁷ See SCL 2022, art. 58, 138, 156.

²⁸ See SCL 2022, art. 217/A.

²⁹ *Id.*

liability for shareholders in joint stock companies, simplified joint stock companies, and limited liability companies. The liability is limited to the amount of shares the shareholders own in the company's capital.²⁷ Accordingly, the basis for the liability of a holding company for the debts of its subsidiaries is as follows: 1) where the holding company is a shareholder or partner in its subsidiaries,²⁸ so that the limited liability for shareholders rule applies to the holding company, and 2) the holding company is a manager or participant in the management of its subsidiaries (most holding companies have significant financial and administrative control over their subsidiaries), the holding company may be liable if its management involves error, fraud, negligence, or arbitrariness. Under such circumstances, the holding company shall be liable for the debts of its subsidiaries, even if those debts exceed the amount of the share or contribution provided by the holding company in the subsidiary capital.²⁹ In essence, the holding company's veil of limited liability will be pierced.

6. Control as a Factor in U.S. and Saudi Corporate Law

Both U.S. and Saudi corporate laws identify the criterion of control as the basis for determining the obligations of the holding company. The ownership of shares by the holding company in its subsidiaries necessarily entails control over their boards of directors. This leads to control as an inevitable concept in the context of corporate groups.³⁰ Both Saudi and U.S. legal systems

³⁰ Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, (1990), at 329. Professor Blumberg illustrates some examples from the U.S. statutes for the *percentage of control* as follows: "Many statutes contain numerical definitions of control, often supplemented by statutory presumptions about the extent to which ownership of a minority of voting stock of a regulated corporation will be deemed to represent 'control' for purposes of the statute. The Bank Holding Company Act of 1956 thus utilizes five percent stock ownership as a benchmark to establish a rebuttable presumption and twenty-five percent to establish a conclusive presumption of control. The Public Utility Holding Company Act of 1935 provides that ten percent creates a rebuttable presumption of control. The

consider control a fundamental effect of the relationship between the holding and subsidiary and a standard measure for examining whether the holding company exercises excessive or reasonable control.

Notably, Saudi and U.S. courts tend to examine the control between the holding and subsidiaries to ensure that the subsidiaries are real entities, not fake ones created by the holding company, to avoid their obligations. In cases where the holding company uses its subsidiary as a cover or sham, the subsidiary company's veil will be pierced. In fact, it is essential for Saudi judges to provide elements when considering control as a factor in holding and subsidiary cases.

Although control is a fundamental factor in both Saudi and U.S. corporate laws, it is questionable whether U.S. and Saudi laws mean precisely the same by 'control.' What is the extent of control in each of the two different legal systems? In this context, recalling the Saudi and U.S. perspectives on control is appropriate. Under Saudi law, control is an element that determines the subsidiary companies. SCL 2022, art. 217, states that the subsidiary company is deemed a subsidiary if: 'the holding company has exercised control by...B) controlling the appointment of the manager or the majority of board members, or if it has the power to remove the manager or the majority of board members [of the subsidiary]; [or] C) controlling the majority of voting rights [of the subsidiary] pursuant to an agreement with the other partners or shareholders [of the subsidiary].'³¹

Thus, according to SCL 2022, control is found when the holding company exercises these two conditions over the subsidiary; the court, therefore, solely examines these two conditions. In contrast, the interpretation of control in the U.S. is not as precise, according to the cases investigated above. U.S. courts have various views in determining what 'control' is. In the case of *Steven v. Roscoe*

Turner Aeronautical Corp.,³² eleven factors were selected by the United States Court of Appeals for the Seventh Circuit in determining when a holding company exercises control over its subsidiary, and the plaintiff lost.³³ Although fewer elements were examined by the Delaware Court of Chancery in *In re Tesla Motors*, plaintiffs failed to prove executive control on the part of Elon Musk because his control was '[not] so potent that independent directors ... [could not] freely exercise their judgment.'³⁴ Furthermore, the Supreme Court in Missouri set up extremely high conditions in considering a holding company's control, and finding no fraud in the holding company's relationship to the subsidiary, the court decided not to pierce the corporate veil.³⁵ Thus, from this case, it could be said that proving 'control' of a holding company in the U.S. might be quite difficult, not only because of precedents like the above, but because even among these, the reasoning of factors for finding 'control' differ.

U.S. courts and commentators have compiled comprehensive lists of factors to consider in PCV cases involving corporate groups.³⁶ While Saudi courts consider control as the only factor a holding company exercises, and SCL 2015 illustrates that control can be financial or administrative, Saudi law would do well to develop a more elaborate and comprehensive scheme, informed by U.S. law, for determining when a creditor may pierce the corporate veil of a holding company. This development, which can be achieved by expanding the factors of piercing the veil within the corporate group, holds the potential to bring about a more effective and successful application of PCV. The fact that a holding company may serve as a shareholder of its controlled subsidiaries is worth considering in Saudi courts as a potential reason to apply the PCV as justice requires. Just as SCLs have expanded the factors of traditional PCV doctrine with individual shareholders, SCL 2022 must also recognize expanded factors in the corporate group.

Investment Company Act of 1940 uses twenty-five percent to establish a rebuttable presumption of control." Nonetheless, under SCL 2015, art. 182/1 A holding company will exercise control only when the holding company owns more than the subsidiary's capital."

³¹ SCL 2022, art. 217 (b) (c).

³² *Steven v. Roscoe Turner Aeronautical Corp.*, 324 F.2d 157, 161 (7th Cir. 1963).

³³ *Id.*

³⁴ *In re Tesla Motors, Inc. S'holder Litig.*, No. CV 12711-VCS, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

³⁵ *Kar v. Safeco Ins. Co. of Am.*, No. 4:23-CV-207 RLW, 2023 WL 4706008, at *4 (E.D. Mo. July 24, 2023).

³⁶ See for example, RB Thompson, *Piercing the Veil within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, (1999).

7. The Separation Between Companies in the Corporate Group

In both Saudi Arabia and the United States, the core idea in the corporate group context is that each company maintains its legally separate personality, unlike when a company merges with others. Further, in both jurisdictions, shareholders traditionally are not liable for a company's obligations beyond their investment.³⁷

One core question that emphasizes the separation between companies in corporate groups is whether the holding company has excessive control over its subsidiary. Excessive control leads to ignoring the subsidiary's entity. When U.S. courts assess the independence of a subsidiary from its parent company, they typically evaluate the level of control exerted by the parent over the subsidiary's operations and decision-making. They also examine whether the parent recognizes the subsidiary as a separate entity.³⁸

Notably, the definition of a subsidiary company in SCL may be confusing, due to the lack of distinction between the concept of control as a condition to recognize the subsidiary company³⁹ and the concept of separation between companies with corporate groups. From one point of view, in SCL 2022, art 217, the law recognizes the subsidiary company as under the control of a holding company. Paragraphs B and C of Article 217 define the subsidiary company in respect to the holding company's practice of control by several methods.⁴⁰ Although holding control is an element for recognizing the subsidiary under Saudi law, the law

also emphasizes the separation of corporate entities in a relationship.

8. Companies Can Own Shares in Other Companies

Robert Thompson points out a particular dilemma in piercing the veil within corporate groups in 1999. He writes: 'On the cusp of a new century, we struggle with two issues defined in the dying days of the last century: judicial recognition of a corporation as separate from its individual proprietor, and legislative recognition that corporations could own shares in another corporation.'⁴¹ The primary effect of this principle, allowing corporations to own shares in another corporation, is that large corporations seek to control smaller corporations by owning shares in the smaller corporation. This principle of owning shares by larger corporations emerged over the twentieth century.⁴² Since then, U.S. corporate laws have allowed huge corporations to virtually absorb smaller corporations.⁴³ In the Saudi scenario, SCL 2015 recognized the principle of owning shares in other corporations, particularly Art 182, which defines the holding company as one that seeks to control other corporations by owning more than half of their capital.⁴⁴

3.6 Adoption of the Concept of the Corporate Group

The concept of corporate groups was adopted and recognized in U.S. legal academic life as far back as the 1920s.⁴⁵ In Saudi Arabia, on the other hand, the concept has received virtually no attention. Saudi scholars and Saudi corporate laws

³⁷ Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, (2005), at 640.

³⁸ *Id.* at 638.

³⁹ As to the definition of the term "subsidiary" in SCL 2022, see Art. 217.

⁴⁰ "B) If the holding company is a partner or shareholder solely controlling the appointment of the manager or the majority of board members, or if it has the power to remove the manager or the majority of board members; C) If the holding company is a partner or shareholder solely controlling the majority of voting rights pursuant to an agreement with the other partners or shareholders. See SCL 2022, art. 217, B & C.

⁴¹ Thompson, *PCV Within Corporate Groups*, *supra* note 35, at 76.

⁴² Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV., 605, (2005), at 59.

⁴³ *Id.* Starting in 1889, U.S. jurisdictions started passing laws that overturned the rule that it was illegal for a corporation to acquire shares in another corporation. This change began in New Jersey and eventually spread throughout the U.S., allowing holding companies to purchase assets from other corporations and transfer more of the risks associated with a business to those outside the enterprise. *Id.* Professor Blumberg has traced the progression of this development, starting with the initial New Jersey statutes from 1888 to 1893, then expanding to 13 states by 1910, and eventually gaining universal recognition among jurisdictions in the United States. See: *Id.* at 59.

⁴⁴ SCL 2015, art. 182/1.

⁴⁵ Gwynne Skinner, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law*, 72 WASH. & LEE L. REV. 1769, (2015).

deal with the topic, if at all, under holding and subsidiary companies. SCL 2015 was, in fact, the first Saudi law adopted to address the relationship between holding and subsidiary companies. While the corporate group has become a classic concept under U.S. law, in Saudi corporate law, it is essentially still absent.

9. Conclusion:

The purpose of this paper was to address the issue of piercing the corporate veil in corporate groups. Under Saudi law, individual shareholders are not typically liable for a company's assets. For the most part, in Saudi legal systems, the holding company is considered a shareholder of its subsidiaries. However, the relationship between parent companies and their subsidiaries differs from that of a shareholder and a single corporation. Under the traditional limited liability doctrine, the holding company cannot be held liable unless the criteria for piercing the veil are met. In corporate groups, the holding company is responsible for its subsidiaries' debts and wrongdoing, primarily when the parent corporation exercises executive control over its subsidiary. Executive control is the most common factor for which the parent company may be held liable. Secondly, liability may also be determined when there is evidence of shared ownership between the two entities. However, the courts decide the extent to which the parent company will be held responsible for a subsidiary's debts and obligations.

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