

Construction and projects in Saudi Arabia: overview

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OVERVIEW OF THE CONSTRUCTION AND PROJECTS SECTOR

1. What are the main trends in the local construction and projects market? What are the most significant deals?

Main trends

Saudi Arabia is the largest exporter of oil in the world. As a result, the Saudi economy is constantly on the rise and the construction sector specifically has seen significant increases in activity. The main trends within the construction sector are as follows:

- The Saudi government has always been actively concerned with growing the Saudi infrastructure. Indications show that this concern will remain at the forefront of Saudi decision making.
- The government's focus has increasingly turned to the housing shortage in Saudi Arabia, which is occurring as a result of the increasing growth to the population.
- The huge demand for construction services is evidenced by a large demand for cement and other building materials, as well as the number of ongoing and new projects in Saudi Arabia. Indeed, in order to meet this demand and keep the economy progressing, the Ministry of Commerce and Industry reports SAR3 billion in capitalisation for the construction of three to four cement plants over the next three years.
- The Saudi Government has recently begun to tighten restrictions on foreign investment by implementing more restrictive requirements for obtaining a foreign investment licence.
- Most recently, severe restrictions have been placed specifically on foreign entities seeking to engage in construction activities in Saudi Arabia.

Major projects

While the construction of infrastructure forms a large part of Saudi Arabia's development ambitions, many other commercial, medical, and otherwise non-infrastructure projects are underway. The following are just a few examples of these developments:

- **Aldara Hospital.** A joint venture between a UAE and a Greek company won a contract from Aldara Medical Corporation to build a six story, 107,000 square metre hospital in Riyadh for SAR404 million. Completion is set for early 2015.
- **King Khalid International Airport, Terminal 5.** Saudi Arabia's General Authority for Civil Aviation awarded a SAR1.5

billion contract to a Turkish and Saudi joint venture to build the Terminal 5 building as an expansion of the King Khalid International Airport in Riyadh. The new Terminal 5 will be part of a larger expansion of the Airport aimed at increasing its capacity from 14 million passengers to 24 million passengers.

- **Jeddah Corniche.** Real estate development on the Jeddah Corniche is growing. In March 2013, Amias Real Estate Group in Jeddah received bids for the construction of a 65 story hotel. Recently, however, Lamar Investment and Real Estate Development Company awarded a SAR1.73 billion contract to a joint venture to build two towers of 57 and 49 stories on the Corniche. The towers will contain 242 hotel rooms and 104 apartments.
- **King Fahad Medical City Hospital.** Dubai's Drake & Scull will partner with Habtoor Leighton Specon to complete work on a contract worth SAR522 million. The contract entails construction of a hospital within the overall SAR2.3 billion King Fahad Medical City in Riyadh.
- **Abraj Kudai Development.** A SAR13 billion contract to build a mixed use development complex in Mecca. The contract was awarded to the Saudi Binladin Group and entails construction of 12 towers ranging in height from 30 to 45 stories. The complex will include a bus station, residential apartments, hotel rooms, a mall, restaurants, a conference centre and a car park.
- **King Abdullah Financial District Museum.** The USD300 million construction package entails construction of a science centre as well as the Kingdom's first National Aquarium.
- **Jeddah hotel.** Two local Saudi contractors are building a luxury hotel in the northern district of Jeddah. It will contain 150 rooms.
- **King Saud University Expansion.** King Saud University is inviting tenders on a contract involving an expansion and rehabilitation of its arts education department.

PROCUREMENT ARRANGEMENTS

2. Which are the most common procurement arrangements if the main parties are local? Are these arrangements different if some or all of the main parties are international contractors or consultants?

The majority of procurement contracts that occur in Saudi Arabia are general agreements where the client has a planned design; engineering, procurement, and construction agreements (EPC agreements); and

build-only agreements involving just one contractor. A procurement arrangement in Saudi Arabia will generally consist of the following:

- A contractor.
- An employer or client (in most cases this will be a Saudi Arabian government entity).

Contractor

Most contractors that engage in procurement arrangements in Saudi Arabia are large, Saudi companies such as the Saudi Bin Ladin Group, Saudi Ogeir, El Seif, and others. These Saudi contractors tend to dominate the local construction market, perhaps because of Saudi Arabia's preference to deal with Saudi firms as much as possible.

However, international firms have increasingly edged into the construction market in Saudi Arabia. For the most part, Chinese contractors tend to win many procurement contracts when international contractors make bids.

While local and international contractors operate successfully in the construction sector, the sector is beginning to see many consortium contractors. These consortia can consist of many different local/international and solely international partnerships. For example, the aforementioned Aldara Hospital was awarded to a wholly international consortium consisting of a UAE and Greek joint venture, while the contract to build the Terminal 5 building as an expansion of the King Khalid International Airport was awarded to a local/international consortium consisting of both Saudi and Turkish entities.

Employer/client

Most procurement projects that occur in Saudi Arabia occur as a result of a need in the public sector for construction services. Because Saudi Arabia's main export and largest source of income is its oil reserves, the most important procurement client is Saudi Aramco, the state-owned oil company.

However, other governmental bodies also need construction services and a demand for construction services can be found throughout the public sector. For example, another important client in the construction industry is the Saudi Railways Organisation, which oversees Saudi Arabia's massive construction projects of railways throughout Saudi Arabia. Additionally, plans for a metro system in the major cities of Saudi Arabia are in progress and bidding has already begun on many of the necessary details.

TRANSACTION STRUCTURES

3. What transaction structures and corporate vehicles are most commonly used in both local and international projects?

Local projects

Most local contractors are organised as either limited liability companies (LLCs) or sole proprietors. Large local contractors tend to be organised as LLCs and are capable of fully carrying out large projects. In contrast, the vast majority of small local contractors tend to be organised as sole proprietors and carry out very small, specific tasks within larger projects for single entity government agencies. At the same time, there are many public sector, project-specific entities that tend to engage local contractors on small projects. Even the smaller sized local contractors have the technical ability and volume capacity to be competitive bidders on these small projects.

International projects

For foreign entities wishing to do business in Saudi Arabia, a commercial presence must be registered with the authorities. It is necessary to obtain a foreign investment licence from the Saudi Arabian General Investment Authority (SAGIA), and once this licence has been received foreign entities must then register with the Ministry of Commerce and Industry. Until June of 2013, foreign entities engaging in construction projects in Saudi Arabia could register a commercial entity using several corporate structures, the most common of which were LLCs, branch offices, and Temporary Commercial Registrations (TCRs). As of June 2013, however, SAGIA has restricted foreign investors engaging in construction activity in Saudi Arabia so that they must be organised as either an LLC or a joint stock company (JSC) in order to obtain the requisite foreign investment licence.

LLCs and JSCs are principally the same in that shareholder liability is limited. Essentially, the only advantage of a JSC over an LLC is that a JSC can be publicly listed and traded.

FINANCE

4. How are projects financed? How do arrangements differ for major international projects?

In Saudi Arabia, projects are financed using a variety of methods including conventional finance, *Shari'a*-compliant finance, and project finance.

In public sector projects, any financing of the public sector project must be approved by the Saudi Ministry of Finance. Assuming that the Ministry of Finance has approved the public sector project for government financing, the underlying government entity client pays the contractor for its services.

In private sector projects, both conventional and Islamic financing structures are used. International banks as well as local Saudi banks engage in private sector project financing. While most international banks that finance private sector Saudi projects generally stick to conventional financing structures, local Saudi banks are required to use only *Shari'a*-compliant methods for financing private sector projects.

SECURITY AND CONTRACTUAL PROTECTIONS

5. What forms of security and contractual protections do funders typically require to protect their investments?

Security

Funders typically require security to protect their investments in the form of:

- Bank guarantees.
- Promissory notes.
- Parent company guarantees.
- Share pledges.

These securities are held by the bank until all obligations under the contract have been completed by the contractor.

Contractual

Typically, contractual protections will include penalty clauses for delays and defaults.

STANDARD FORMS OF CONTRACTS

6. What standard forms of contracts are used for both local and international projects? Which organisations publish them?

For public works projects carried out by both local and international contractors, the Saudi Arabian government uses its own standard contract at all times. The standard form contracts are generally available at government offices and on the Internet (www.saudiembassy.net). For example, the Saudi Arabian embassy in Washington DC maintains a website on which standard forms are available for public works contracts as well as design and supervision contracts for engineering consultants (www.saudiembassy.net). However, these standard form contracts are for guidance only as the Arabic translation is the governing document.

The standard form of contracts used by private sector entities for local projects tend to be the same for both local and international contractors. While private sector entities can write their contracts in any language they choose, if a dispute arises, the Arabic translation of the document will be the only version that will be considered by a Saudi Arabian court.

CONTRACTUAL ISSUES

Contractors' risks

7. What risks are typically allocated to the contractor? How are these risks offset or managed?

Contractors must act in good faith when executing procurement contracts and any suspicion of fraud, bribery, deceit or bad faith must be reported to the Ministry of Finance (*Article 77 of the Government Tenders and Procurement Law*).

Further, any delay or default by a contractor can be subject to penalties. For a contractor's delay in executing a contract, the penalty is 10% of the value of the contract. Any default by a contractor can result in a penalty of 10% of the contract price and a deduction equal to the value of the uncompleted work.

In addition to these penalty provisions, the government retains substantial rights to terminate the contract under certain circumstances laid out in Article 53 of the Procurement Law 2006. These include:

- Where it is discovered that the contractor has committed bribery.
- Any delay or breach of the contract, and failure to rectify the activity within 15 days of the government's notice to do so.
- Assigning or subcontracting the contract (or any portion of it) without permission from the government.
- The contractor's bankruptcy.
- The contractor's death (where his personal qualifications were of substantial value to the bid).

If the government chooses to terminate the contract, it has the right to retain all monies paid to it by the contractor in bonds and guarantees.

Excluding liability

8. How can liability be excluded or restricted under local law?

Saudi Arabia is an Islamic law jurisdiction that generally enforces the conservative Hanbali school of jurisprudence. As a result, any kind of transaction involving usury (*riba*) or excessive risk (*gharar*) will not be enforced by a Saudi court. Saudi policy forbids the granting of speculative, consequential or otherwise dubious damages on parties, even if the party is grossly negligent and clearly liable. Therefore damages cannot be claimed for:

- Indirect or consequential losses.
- Loss of business or loss of profits.
- Any other loss that is uncertain.

Further, a contractor's liability can be limited depending on the corporate structure in which the contractor operates. Shareholders of LLCs and JSCs are only liable for debts up to their capital contributions.

Caps on liability

9. Do the parties usually agree a cap on liability? If yes, how is this usually fixed? What liabilities, if any, are typically not capped?

Under Articles 48 and 49 of the Government Tenders and Procurement Law contractors are liable for penalties where the contractor has either delayed or defaulted in carrying out the project (*see Question 7*). The Procurement Law does not cap liability in any respect for the following matters:

- Death.
- Personal injury.
- Property damage.

For private sector clients engaged in projects with contractors, caps on liability are subject to negotiation between the parties. Generally, liability is capped at an amount equal to between 100% and 200% of the value of the contract. However, most contracts do not cap liability for:

- Death.
- Personal injury.
- Property damage.
- Infringement of intellectual property rights.

Clauses in private sector construction contracts may contain provisions for liquidated damages. However, such liquidated damages are ultimately subject to the *Shari'a* (*see Question 8*). That is, any amount of money sought to compensate a party with liquidated damages must accurately reflect the actual damages suffered by the damaged party.

Force majeure

10. Are force majeure exclusions available and enforceable?

Force majeure provisions are recognised in Saudi law and policy to a certain extent. However, the Saudi default definition of force majeure generally includes only circumstances that make performance

absolutely impossible, rather than just unduly burdensome, with those being exceptional events beyond a party's control which excuses the obligation to perform.

Material delays

11. What contractual provisions are typically negotiated to cover material delays to the project?

Under the Procurement Law, the contractor can be liable for penalties in the case of delays (see Questions 7 and 9).

In private sector projects, the parties tend to include similar provisions concerning material delays in performance.

Material variations

12. How are material variations to the works usually dealt with in the contract?

Variation of the terms of the contract is possible under the Procurement Law. Article 36 provides that the government can both increase and decrease the obligations of the contractor under the contract. However, any increase in the obligations is limited to an additional 10% of the contract value. Further, any decrease in the obligations is limited to an amount equal to 20% of the contract value.

In addition to the government's ability to change the contractor's scope of work, the government also has the ability to extend the length of the contract. Article 52 of the Procurement Law provides that the government can extend a contract's length when the contractor's scope of work has been increased (provided that the length extension is narrowly tailored to the scope of work), when the government suspends the work for reasons not attributable to the contractor, and when the allocated funds for the project are not sufficient to meet the timeframe of the contract.

Other negotiated provisions

13. What other contractual provisions are usually heavily negotiated by the parties?

Contractors involved in private sector projects can negotiate all aspects of the contract. However, for public works contracts, the potential for negotiation is very small. Government entity clients are generally required to use the Saudi Arabian government's standard form contracts. Further, the Procurement Law governs almost all construction projects purchased by the government and the requirements within that cannot be altered or waived.

In some cases, contractors may be able to negotiate some terms of a public works contract. This usually only occurs when the construction project is of a unique nature, for example, where the competition in bidding is sparse or when the government engages a construction specialist on a direct purchase basis. However, when the government engages in a direct purchase, it must obtain written offers from at least three contractors.

In any case, the most heavily negotiated contract terms in construction contracts tend to be:

- The qualification of personnel.
- Liquidated damages.
- The quality of construction materials.
- Exclusions and caps on liability.

When contracting with a local Saudi party, the foreign counterparty generally does not negotiate forum selection, choice of law, or arbitration for the following reasons:

- First, Saudi courts generally do not eschew jurisdiction, as Saudi policy does not recognise the doctrine of the conflict of laws. Therefore, even if forum selection, choice of law and arbitration clauses are laid out in the contract, if a Saudi party sues its foreign counterparty in a Saudi court, the Saudi court will likely exercise jurisdiction.
- Second, the vast majority of Saudi contractors and clients only have assets in Saudi Arabia and enforcing a foreign judgement or arbitral award against a Saudi party in Saudi Arabia essentially requires a re-litigation of the dispute under Saudi law. Therefore, foreign parties may seek to place forum selection, choice of law and arbitration clauses in the contract in the rare hope that a Saudi court will refuse jurisdiction. Even so, enforcing the resultant foreign judgment or arbitral award in Saudi Arabia will be cumbersome.

ARCHITECTS, ENGINEERS AND CONSTRUCTION PROFESSIONALS

14. How are construction professionals usually selected? Following selection, how are they then formally appointed?

Construction professionals are generally selected by means of a formal tender process. The process may or may not involve an intermediary.

The Procurement Law provides that all duly licensed individuals, establishments and companies can engage in the tender process. Any government purchase that exceeds SAR1 million must generally be submitted to public tender. However, under Article 6 of the Procurement Law, where very unique construction services are required and there is no other available professional to carry out the services, the government can make a direct purchase to a qualified professional after receiving three offers, irrespective of the price of the project.

While not required, bidders often engage Saudi procurement agents to help with submitting winning bids for projects. These agents can sometimes provide invaluable knowledge of the Saudi market and procurement process. Under the Commercial Agencies Law and its Implementing Regulations, Saudi agents of a foreign principal must register their agency relationship with the Ministry of Commerce and Industry. If the agent fails to register the agency agreement, most, if not all, governmental entities will refuse to accept the foreign principal's bid.

15. What provisions of construction professionals' appointments are most heavily negotiated? Are liabilities routinely limited or capped in construction professionals' appointments?

The most heavily negotiated provisions of construction professionals' appointments vary depending on the nature of the client.

For private sector clients, the negotiations related to the appointment of construction professionals tend to involve the following:

- Liquidated damages.
- Exclusions and caps on liability.

For government entities engaged in public works contracts, contractual terms, including the terms concerning the appointment of construction professionals, are generally not subject to negotiation (see *Question 13*). However, some circumstances allow for greater bargaining power on behalf of construction professionals in public works contracts with the Saudi government (see *Question 13*).

PAYMENT FOR CONSTRUCTION WORK

16. What are the usual methods of payment for construction work? Are there ways for the contractor and consultants to secure payment or mitigate risks of non-payment under local law?

Methods of payment

Under the Procurement Law, certain tenders can provide for an advance payment by the government prior to beginning work. In such a case, an advance payment guarantee must be made. Under Article 38 of the Procurement Law and Cabinet Resolution No. 23, a contractor is entitled to an advance payment of either 10% of the contract price or SAR50 million (whichever is the smaller figure applies).

Securing payment

There is no provision in Saudi Arabia which is similar to the "constructor's lien". The only manner in which contractors can secure payment for their work is through the contract. For example, a construction contract with a private sector entity can allow the contractor to suspend work until payment is made.

However, when working with the Saudi government on public works, the Procurement Law specifically forbids contractors from suspending work due to the government's failure to pay. The only remedy available to a contractor in this situation is to petition an *ad hoc* committee for relief. The Procurement Law does not provide any further guidance in this regard concerning damages.

SUBCONTRACTORS

17. How do the parties typically manage their relationships with subcontractors?

Under Article 53 of the Procurement Law, a contractor must first obtain written approval from the relevant government agency with which it has contracted in order to subcontract or assign any of the

work under the contract. Failure to receive that approval gives the government the right to unilaterally terminate the contract and seek damages from the contractor for any faulty work completed by the subcontractor or assignee.

Private parties typically manage their relationships with subcontractors according to the contract between them. Saudi Arabian contract law allows for subcontracting by assignment of rights and duties.

LICENSING

18. What licences and other consents must contractors and construction professionals have to carry out local construction work? Are there any specific licensing requirements for international contractors and construction professionals?

Foreign entities seeking to work on construction projects in Saudi Arabia must have a foreign investment licence from SAGIA and some kind of commercial presence in Saudi Arabia (see *Question 3*).

19. What licences and other consents must a project obtain?

Licences related to environmental concerns are required in Saudi Arabia (see *Question 25*).

PROJECTS INSURANCE

20. What types of insurance must be maintained by law? Are other non-compulsory types of insurance maintained under contract?

Compulsory insurance

There are at least two forms of compulsory insurance of which foreign entities engaging in construction services in Saudi Arabia should be aware:

- Health insurance.
- SAGIA-required insurance.

First, all entities that employ persons in Saudi Arabia must pay for the health insurance of all employees and their dependents in Saudi Arabia in accordance with the standards promulgated by the Ministry of Labor. This includes contractors formed as LLCs and JSCs. The health insurance company that the employer engages to provide the insurance must have a commercial registration in Saudi Arabia.

Second, under new standards adopted by SAGIA as of June 2013, foreign entities seeking to engage in construction projects in Saudi Arabia must "obtain insurance against the company's errors in implementation of the project" after receiving a foreign investment licence. These new requirements are not specific about the type of insurance, the amount of liability that it must cover, or any other aspects relating to the insurance.

Non-compulsory insurance

While not required, contractors generally tend to maintain all risks insurance, employer's liability insurance and third party liability insurance while operating in Saudi Arabia.

LABOUR LAWS

21. Are there any labour law requirements for hiring (local and foreign) workers?

Local workers

Saudi policy strongly favours the hiring of local workers over expatriates and various disincentives are implemented in the law to achieve this goal. Under the *Nitaqat* programme, which is colloquially referred to as Saudisation, employers are required to maintain a certain amount of Saudi Arabian nationals as employees. Companies are classified on a colour-coded scale based on how many Saudi Arabian persons they employ. There is no established, statutory percentage of Saudi Arabian employees that an employer must maintain, but failure to maintain a reasonably satisfactory amount of Saudi Arabian employees could result in, for example, the Ministry of Labor refusing to renew the residency permits of expatriate workers and/or the Ministry of Commerce and Industry refusing to renew the employer's commercial registration certificate or cancelling it altogether.

Hiring local Saudi workers obligates the employer to make certain payments to the General Organization for Social Insurance (GOSI) for the public pension system. Under the GOSI system, employers are required to pay 9% of the Saudi Arabian employee's wages out of pocket and the employee is required to pay 9% of his wages.

Foreign workers

Hiring foreign workers is a difficult process in Saudi Arabia. First, the Ministry of Foreign Affairs will only issue an official invitation to employers in Saudi Arabia that meet all applicable labour and tax law requirements (that is, Saudisation as well as withholding and income tax and *Zakat*).

Further, foreign workers are required to undergo substantial medical evaluations and must submit a significant amount of legal documentation in order to finally receive a visa. Employers are also required to execute an employment contract with foreign workers, the duration of which must be specified in the contract. Foreign workers are only allowed to work within the scope of the employment contract and cannot work for any other employer in Saudi Arabia.

22. Which labour laws are relevant to projects?

Under the Council of Ministers Resolution No. 124 (Resolution 124), foreign entities engaged in public works contracts are required to give 30% of the work under the contract to Saudi Arabian nationals. This can include, for example, subcontracting 30% of the work to Saudi Arabian nationals or maintaining a workforce comprised of at least 30% Saudi Arabians. Notwithstanding these provisions, Saudi policy holds that any entity that is at least 51% owned by a Saudi Arabian natural or juristic person is exempt from Resolution 124.

The Labor Law provides that employees generally must not work more than eight hours per day or 48 hours per week. However, Muslim employees during the month of Ramadan must not be required to work more than six hours per day or 36 hours per week. Nevertheless, the Labor Law provides statutorily defined exceptions to these limits

where employees can be required to work up to ten hours per day or 60 hours per week. Whenever an employee works beyond the statutorily prescribed hours or on a national holiday, he must be compensated at his regular wage plus 50%.

While there is no minimum wage law in effect in Saudi Arabia, there is a national dialogue taking place on the subject. The head of the Ministry of Labor has announced an intention to pursue talks with both employers and employees in the private sector about setting a minimum wage.

23. Must an employer pay statutory redundancy or other payments at the end of a project? Are all employees eligible?

The Labor Law requires employers to pay an end of service award to certain employees. The award is based on an amount equal to half a month's wages for each month of the first five years of the employee's employment, and a full month's wages for each month of the employee's employment beyond five years. The amount used in the calculation is the employee's wage for the final month of his employment. However, the award is less for employees that voluntarily resign. Further, if the employer fires the employee for a statutorily defined reason, the employee forfeits his end of service award.

HEALTH AND SAFETY

24. Which health and safety laws apply to projects?

The General Environmental Law (GEL) (enacted in 2001) and its Implementing Regulations (IR) (enacted in 2003) as well as the Environmental Protection Standards (EPS) (enacted in 1982) govern all activities that could have a substantial environmental impact in Saudi Arabia.

The GEL and IR proscribe activity that is harmful to the environment in the following very general terms:

- All people in Saudi Arabia have a duty to exercise objectively reasonable care. Under the environmental laws and specifically to persons undertaking projects, this duty entails:
 - using the best and most suitable technology available;
 - using materials that cause the least amount of contamination;
 - taking all appropriate steps to decrease the impact on the environment;
 - preventing the contamination of water;
 - preserving the soil and land;
 - limiting noise.
- Contractors seeking to carry out projects must submit an Environmental Impact Assessment (EIA) and receive environmental accreditation for a project (*see Question 25*).

The government will also send out an inspector to conduct a site visit. After all of this has occurred, the applicant will receive conditional approval, unconditional approval, or denial of the permit.

For the construction of new facilities, the environmental laws require builders to submit information regarding the planning and design of the facility, including pollution control measures for the new facility.

Breach of the GEL and IR by causing environmental damage can result in imprisonment for up to five years as well as monetary fines of up to SAR500,000. Breach of the EPS by undertaking projects without submitting an EIA and/or receiving a permit can result in fines of between SAR5,000 to SAR15,000. Further, the Board of Grievances can also apply penalties for violations of these laws.

ENVIRONMENTAL ISSUES

25. Which local laws regulate projects' effects on the environment?

Environmental regulations are governed by the general provisions of the environmental laws (*see Question 24*). There are no special regulations for pollution of air, water and waste other than the rules pertaining to noise and special rules for disposing of hazardous and poisonous wastes.

Environmental impact assessments (EIAs)

Any project that could possibly have an adverse impact on the environment must first be approved before implementation. The relevant agency assesses the project using a method based on whether the proposed project poses a limited, significant or serious danger to the environment. The EIA will examine the project in detail and study the possible effects on:

- Air quality.
- The coastal and marine environment.
- Surface and groundwater.
- Land use and urban development.
- Natural resources.

The EIA will also include an estimate of the expected damage to the surrounding area of the project and possible ways to mitigate that damage (*see Question 24*).

Sustainable development

Presently, there are no laws requiring construction projects to maintain a certain degree of sustainability or ecological protection. However, the government is slowly beginning to recognise the need for sustainable and renewable energy. Saudi Arabia is attempting to reduce its domestic dependence on oil by encouraging the production of solar, wind, geothermal and nuclear energy. Presumably, as a result, construction projects will be subject to more environmental scrutiny in the future.

26. Do new buildings need to meet carbon emissions or climate change targets?

New buildings do not need to meet carbon emissions or climate change targets.

CORRUPT PRACTICES

27. Are there any rules prohibiting corrupt business practices and bribery (particularly any rules targeting the projects sector)? What are the applicable civil or criminal penalties?

Rules

The Combating Bribery Law (CBL) 1992 seeks to counter both the offer and receipt of bribes among public officials in Saudi Arabia. Under the CBL, bribery entails a public official soliciting receipt for himself, or for a third party, or actually receiving, a promise or gift in exchange for any of the following:

- Performing his duties.
- Not performing his duties.
- Violating the functions of his duties.
- Using his position to obtain any kind of benefit or advantage.
- Lobbying a governmental body using his position of influence.

While the public official's acceptance or solicitation of the bribe is a strict liability offence, the briber's offence in offering or making the bribe requires some degree of intent for liability to arise.

Penalties

Public officials soliciting or accepting bribes, and private individuals offering or making bribes, can be punished based on the severity of the corrupt practice for which the bribe was given or offered.

The highest punishment is imprisonment for up to ten years and/or a fine of up to SAR1 million. However, less severe practices can only be punished by imprisonment for up to two years and/or a fine of SAR50,000,000. Any company whose employee [has been] convicted of bribing a public official can be subject to a fine of up to ten times the amount of the bribe. Further, the company can be permanently banned from doing business with the Saudi government.

BANKRUPTCY/INSOLVENCY

28. What rights do the client and funder have on the contractor's bankruptcy or insolvency?

The Procurement Law provides that bankruptcy or insolvency can be grounds for termination of the contract. Under Article 53(d), a government agency involved in a contract with a contractor that becomes bankrupt can immediately withdraw the work from the contractor and rescind the contract, without prejudice to the agency's right to seek any resulting damages from the bankrupt contractor.

For private sector clients and funders, nothing in the law of Saudi Arabia provides that a contract between two private parties is immediately void or voidable in the event of a contracting party's bankruptcy or insolvency. However, contracting parties can negotiate in this regard, and frequently do so. For example, many clients and funders insist on including clauses in the contract that allow for the termination of the contract upon the contractor's bankruptcy or insolvency.

PPPs

29. Are public private partnerships (PPPs) common in local construction projects? If so, which sectors commonly use PPPs?

From time to time, Saudi Arabia engages in public private partnerships (PPPs). The Supreme Economic Council (SEC) oversees the privatisation of public projects and states that the Saudi Arabian government's criteria for entering PPPs are, among other things, the following:

- To improve the efficiency of the national economy and enhance its competitive ability to meet the challenges of regional and international competition.
- To enlarge the ownership of productive assets by Saudi citizens.
- To increase employment opportunities, optimise the use of the national workforce, and ensure the continued equitable increase of individual income.
- To provide services to citizens and investors in a timely and cost-efficient manner.

Examples of PPPs that Saudi Arabia has implemented (or seeks to implement) include such projects and services as:

- Water and sewerage provision.
- Desalination plants.
- Telecommunications.
- Airport and seaport services.
- Railroads.
- Building and operating public markets, slaughterhouses and parks.
- Building and maintaining education buildings.

30. What local laws apply to PPPs?

There are currently no local laws in Saudi Arabia that specifically govern PPPs.

31. What is the typical procurement/tender process in a PPP transaction? Does the government or another body publish standard forms of PPP project agreement and related contracts?

There is no specific procurement/tender process for a PPP transaction. Further, there are no standard forms of PPP agreements or contracts. The PPP tender process operates under the Procurement Law in the same way that typical procurements do.

DISPUTE RESOLUTION

32. Which are the most common formal dispute resolution methods used? Which courts and arbitration organisations deal with construction disputes?

Formal dispute resolution methods

Under the Procurement Law, an *ad hoc* committee will be formed to hear a dispute which concerns either:

- The situation where a contractor believes that a governmental body has breached the terms of a contract.

- The situation where a government body believes that a contractor has:
 - breached the terms of the contract;
 - performed the contract defectively; or
 - engaged in fraud, deceit or manipulation.

Either party can appeal the committee's ruling to the Board of Grievances within 60 days of the decision.

Courts and arbitration organisations

Domestic arbitration in Saudi Arabia is essentially the same as litigation. The Board of Grievances (the commercial court in Saudi Arabia) oversees the arbitration process. For this reason, domestic arbitration does not offer many advantages to litigation because it can be just as time-consuming, costly and sensitive as litigation (see *Question 13*).

However, two or more international parties involved in a dispute with each other will often engage in international arbitration. The most commonly used arbitration bodies in solely foreign disputes include the International Chamber of Commerce, the London Court of International Arbitration and the International Centre for the Settlement of Investment Disputes.

33. What are the most commonly used alternative dispute resolution (ADR) methods?

The most commonly used forms of alternative dispute resolution (ADR) in Saudi Arabia consist of negotiation and arbitration. Mediation and conciliation are usually only used when they are mandatory under statutory requirements.

Negotiation is simply the initial communication between two parties to amicably settle a dispute, and frequently occurs in Saudi Arabia. Arbitration involves a third party whose decision is binding on the dispute and the parties (see *Question 13*).

TAX

34. What are the main tax issues arising on projects?

Lawyers are not permitted to give specific tax advice in Saudi Arabia. Rather, only licensed tax professionals can give specific advice. Lawyers can only give general guidance as to the current state of the tax laws.

There are only three taxes imposed in Saudi Arabia: a withholding tax, a corporate income tax and *Zakat*:

- The withholding tax only applies to transfers of monies from a payor within Saudi Arabia to a payee residing outside of Saudi Arabia (the payor must be either a Saudi Arabian resident or a Saudi Arabian permanent establishment of a foreign entity).
- Corporate income tax is paid on all gross income received by an individual or entity doing business in Saudi Arabia. An increase in the value of land after completion of a project may be considered taxable income.
- *Zakat* is a wealth tax imposed only on Gulf Co-operation Council (GCC) individuals and entities (the GCC comprises Saudi

Arabia, Qatar, Kuwait, Bahrain, Oman and the UAE) who are shareholders of companies registered in Saudi Arabia. The *Zakat* tax is calculated by determining the sum value of all the assets of a company registered in Saudi Arabia. The sum value is then divided and allocated to each shareholder of the company. Finally, each GCC individual or entity shareholder is taxed at 2.5% of the portion that is allocated to him.

The withholding tax rates vary and are charged as follows:

- 5% for:
 - rents paid to lessors;
 - payments for air tickets;
 - air-freight and maritime freight;
 - payment of international telecommunications services;
 - payments for technical and consulting services (including legal services);
 - dividends;
 - loan charges;
 - insurance or reinsurance premiums.
- 20% for management fees.
- 15% for royalties or proceeds and payments for services to a head office or related company, and for all other payments.

The corporate income tax rate is generally 20%. However, natural gas investment activities are taxed at 30%, and oil and hydrocarbons production activities are taxed at 85%.

Finally, it is important to note that any contract executed in Saudi Arabia whose value exceeds SAR100,000 must be registered with the Department of *Zakat* and Income Tax.

35. Are any methods commonly used to mitigate tax liability on projects? Are there any tax incentives to carry out regeneration projects?

There are only three kinds of taxes imposed in Saudi Arabia, none of which have any major bearing on the construction sector specifically (see *Question 34*). For this reason, parties do not generally implement any methods to mitigate tax liability on projects, nor does the Saudi government provide tax incentives to carry out regeneration projects.

OTHER REQUIREMENTS FOR INTERNATIONAL CONTRACTORS

36. Are there any other specific requirements that international contractors or construction professionals must comply with?

It is important to note that the Saudi Council of Engineers (SCE) oversees engineering/architecture professionals in Saudi Arabia. According to the SCE's website and foundational law, all individuals and businesses "practicing any kind of engineering profession" must register with the SCE.

MAIN CONSTRUCTION ORGANISATIONS

Society of Construction Law (Gulf) (SCLG)

Main activities. The SCLG promotes the study and understanding of construction law among members of the construction industry. It promotes individual business interests and acts as a forum for the better understanding of construction law and its practical application in the industry in the Gulf region. The SCLG is affiliated with the Society of Construction Law (UK). It is open to everyone with an interest in construction law and how it affects their work. The SCLG is strictly independent of commercial interests.

W www.scl-gulf.org

Saudi Council of Engineers (SCE)

Main activities. The SCE oversees the engineering profession in Saudi Arabia. The SCE operates under the Ministry of Commerce and Industry. The responsibilities of the SCE include setting the standards for the engineering profession in Saudi Arabia, setting the standards for the licencing of engineering professionals, conducting examinations for licencing, and contributing to the professional development of engineering professionals in Saudi Arabia.

W www.saudieng.sa (Arabic only)

There are five subcategories for businesses to register under, including:

- Engineering Offices (General).
- Engineering Support Services.
- Engineering Consultancy.
- Professional Engineering Company.
- Multi-national Engineering Company.

As well as registering as an engineering business, individuals must register as either:

- Saudi engineers.
- Non-Saudi engineers.

Finally, "practicing any kind of engineering profession" entails:

- Working as an engineer.
- Running an engineering office.
- Running an engineering consultancy firm.
- Administering an engineering arbitration.
- Forming any kind of engineering chapter or group in the Saudi Arabia.

REFORM AND TRENDS

37. Are there any proposals to reform construction and projects law? Are there any new legal or regulatory trends affecting projects?

Reform proposals

Rulemaking in Saudi Arabia is a very opaque process and reforms are made in closed door meetings involving members of the Saudi

Arabian royal family and certain elites of society. As a result, it is difficult to predict new legislation. There are therefore currently no known proposals to reform the construction and projects laws that currently apply in Saudi Arabia.

Trends

The major trend in the construction industry, and in all sectors of Saudi Arabia, is to restrict foreign investment. In this regard, SAGIA has adopted certain requirements for foreign entities seeking to engage in the construction industry in Saudi Arabia. Apart from the corporate formation requirements previously mentioned (*see Question 3*), the new measures require the following:

- Approval of the project by the Ministry of Municipal & Rural Affairs.
- A plan setting out how the project will increase revenue, supply jobs and contribute to the promotion of competition in Saudi Arabia.
- Proof that the applicant has previously implemented a project outside of Saudi Arabia.
- At least three, but no more than ten, years' of balance sheets prepared by a duly licensed accountant in the home country of the foreign entity seeking a licence (known as a CPA), attested by the commercial/taxing authority of the applicant's home country, and attested by the Saudi Arabian embassy in the applicant's home country showing that the applicant has had a profit every year.
- The applicant must commit to hiring no more than a 25% non-Saudi workforce "if necessary".
- Non-Saudi workers must have at least three years' experience in their current position.
- Foreign investment licences for maintenance and operation must be obtained separately from licences for construction.

ONLINE RESOURCES

National Anti-Corruption Commission

W www.nazaha.gov.sa

Description. The anti-corruption commission website maintained by the Saudi Arabian government. This site contains official and unofficial copies of the Combating Bribery Law as well as the Procurement Law in both English and Arabic. English language documents are for guidance only. In all cases, only the Arabic version of laws are binding.

Royal Embassy of Saudi Arabia, Washington DC

W www.saudiembassy.net

Description. The website is maintained by the Saudi embassy in Washington DC, US. This site contains unofficial copies of Saudi Arabia's Basic Law of Governance, Arbitration Law, Corporate Income Tax Law, and Labor and Workmen Law in English only. English language documents are for guidance only. In all cases, only the Arabic version of laws are binding.

- The applicant must provide SAGIA with an unconditional and irrevocable bank guarantee in an amount mandated by the Ministry of Municipal and Rural Affairs.
- After receiving or renewing a licence, the applicant must obtain insurance (*see Question 20*).
- The applicant must commit to submitting an annual report detailing all of the projects it has executed or been awarded, and the value of each one.
- The applicant must commit to submit to an audit carried out by an auditor of SAGIA's choosing and must provide all data requested by SAGIA to the auditor.

Practical Law Contributor Profiles

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Professional qualifications. Admitted to practice in Washington, DC, US, 2001; Admitted to practice in Ohio, US, 1998.

Areas of practice. Infrastructure and power projects.

Non-professional qualifications.

- Cleveland-Marshall College of Law, Cleveland State University, Cleveland, Ohio: Juris Doctor (1995 – 1998).
- College of Business Administration, Cleveland State University, Cleveland, Ohio: Master in Business Administration (1995 – 1998).
- College of Business Administration, Kent State University, Kent, Ohio: Bachelor of Business Administration (Major - Finance) (1992 – 1995).

Recent transactions

- Sumitomo Corporation: advising on all aspects of entry and participation in the Ras Az Zawr IWPP with the Saudi Arabian Government. Advice included establishment of the consortium as well as the operational agreements.
- EADS Deutschland GmbH: advising the client, part of European Aeronautic Defence and Space Company, on the high-profile multi-billion dollar Saudi Arabian Ministry of Interior border fence security project. Advice included a wide range of Saudi Arabian law and practice issues (government procurement rules and regulations, companies law and construction).
- Suhail Bahwan Automobiles LLC: advising on various corporate issues arising out of its joint venture in Saudi Arabia (for example, joint venture shareholders' agreement issues; articles of association; Saudi Arabian regulatory issues; compliance and general restructuring of its Saudi Arabian operations; acquisition of distribution rights; negotiating transaction documents with various parties).

- MMC International Holdings Limited: advising this Malaysian-based company on its acquisition of a 20% stake in a consortium to develop and operate a terminal at the Jeddah Islamic Port. Advice included all aspects of Saudi Arabian law relating to the purchase of the shares from the vendor. After completion of the successful purchase, the team in Riyadh also assisted with post-closing regulatory formalities. We also advised MMC with regards to investment in Jazan Economic City, which is a massive industrial project development in the southwest part of Saudi Arabia.
- Dimetronic SA: advising the client as the lead member of a consortium of Spanish companies bidding on the Haramain High Speed Rail Project, which is a high speed train between Makkah and Medina, Saudi Arabia. Reviewing and commenting on the transaction documents such as, the consortium agreement between the various parties; Saudi Arabian law and practice regulatory and procurement advice; and reviewing and commenting on the proposed Saudi Arabian Ministry of Transportation project documentation.

Languages. English

Professional associations/memberships. Washington, DC Bar Association; Ohio State Bar Association.

Publications.

- *Understanding the Intricacies of Saudi Arabian Bankruptcy Law, Inside the Minds, Aspatore Books (2011).*
- *A Legal Guide to Doing Business in Saudi Arabia, Thomson Reuters (forthcoming) (co-authored with John Balouziyeh).*
- *Employment Law Review, Law Business Research Limited (2013) (co-authored with John M B Balouziyeh and Fadil Bayyari).*
- *The Legal Framework for Privacy and Data Protection in Saudi Arabia, American Bar Association International Law News (Fall 2012) (co-authored with John M B Balouziyeh).*