Overview of Saudi Domestic and Foreign Corporate Laws

LEGAL FRAMEWORK: Saudi law is based on Islamic Law, or Sharia. In Islamic law, there are four main schools of jurisprudence: Hanbali. Hanafi. Shafai and Maliki. The Saudi courts and judicial committees generally apply the Hanbali school. The Saudi government, from time to time, issues rules and regulations to supplement Islamic law when the need arises. In the event of a conflict between Islamic law and government rules and regulations, Islamic law will generally prevail.

GENERAL PRINCIPLES OF ISLAMIC LAW: According to Islamic law, the payment or receipt of sums in the nature of interest is not enforceable. Contracting parties must maintain principles of fairness and equity in their dealings. Contracts where one party gains unjustly at the expense of another could be considered void especially if the party gaining unjustly has a monopoly or market dominance in the subject matter of the contract. In each contract. the commercial substance of the transaction must be analysed to evaluate whether or not the party's actions would amount to unjust enrichment under Islamic law.

Contracting parties are free to negotiate the terms of their contracts unless those terms are prohibited and/or relate to activities that are prohibited under Islamic law. There should be no element of deception or uncertainty in contracts. Where there is uncertainty as to the fundamental terms of a contract, such as the subject matter or price, such contracts could be considered as void. Contracts that involve speculation are not permissible and are therefore considered void. The speculation prohibited under Islamic law is not general business speculation, but speculation akin to gambling, particularly gaining something by chance rather than by productive effort.

Saudi courts and judicial committees may not award damages representing loss of profits, indirect losses or other forms of consequential loss. Neither will they enforce a foreign judgement awarding such damages. Any contract provision for liquidated damages should be considered in this context. If challenged by the party responsible for the payment of liquidated damages, a Saudi court or judicial committee is unlikely to enforce a contract provision for the payment of liquidated damages where the agreed liquidated damages are very excessive, notwithstanding the fact that the parties agreed to such a provision.

One of the features of Islamic law is that the owner of an item bears the risk of loss or damage in relation to that particular item. Accordingly, it should be noted that risk of loss or damage cannot pass unless ownership passes. That said, risk could actually pass without ownership passing where either (i) a person is in the business of looking after/protecting/maintaining the asset left in his care; or (ii) the asset is lost or damaged by a negligent/wrongful act.

JUDICIARY: In Saudi Arabia there is no concept of judicial precedent, which means that the decisions of a court or a judicial committee have no binding authority with respect to another case. In general, there is also no system of court reporting in the Kingdom. So, it is not always possible to reach a conclusion on how a Saudi court or judicial committee would view a particular case. There are a number of courts and judicial committees in Saudi Arabia that have jurisdiction in relation to certain types of claims. Documents submitted to Saudi courts need to be in Arabic. Otherwise, they are inadmissible. An action in the courts or judicial committees of the Kingdom may be brought on a document executed in a language other than Arabic if an Arabic translation thereof, certified by an authorised translator, is submitted to the court or committee.

Recently the Saudi Arabian government enacted a new judiciary law that aims to reform the judiciary system and provide for an improved two-level appeals process (adding one level to the existing regime). This is being implemented in stages during the next few years.

GENERAL COURTS: Criminal and civil cases that are not specifically assigned to any other court or judicial committee and disputes relating to land and personal property are generally heard before general courts.

Appeals against decisions of the circuit level of the general courts may be made to the appellate court. Where a sentence of capital punishment is issued, this is automatically referred to the Supreme Judicial Council for review. Under the recently approved regime, general courts would have jurisdiction over commercial and labour disputes in addition to the current jurisdiction, and special circuits would be designated for commercial, criminal, labour and other types of disputes. Under the new regime, the appellate court would also be a trial court and its judgements/awards are appealed before the new high court.

SAMA COMMITTEE: Disputes of a banking nature involving Saudi or foreign banks or between banks and their customers that are of a banking nature are usually resolved before the Banking Disputes Settlement Committee of the Saudi Arabian Monetary Agency (SAMA). The government is currently reviewing the jurisdiction of the SAMA Committee.

FOREIGN DISPUTES: The courts and judicial committees of Saudi Arabia may not respect provisions related to (i) the choice of non-Saudi law as the governing law of a contract and (ii) the submission by contracting parties to non-Saudi jurisdiction.

A judgment obtained in a foreign country that is a signatory to the Arab League Treaty for the reciprocal enforcement of judgments, or the Agreement on Enforcement of Judgments, Delegations and Judicial Summonses in the member states of the Gulf Cooperation Council (GCC), may be submitted to the Board of Grievances. The board will enforce all or part of such a judgment, provided that the judgment is not inconsistent with Islamic law and/or the laws and regulations of Saudi Arabia as well as certain other procedural conditions have been satisfied.

A foreign judgment in a country that is not a member of either the treaty or the agreement may be submitted to the Board of Grievances for enforcement. The grievances board may enforce all or part of such a judgment provided that (i) the judgment is not inconsistent with Islamic law and/or the laws and regulations of Saudi Arabia and (ii) the judgment creditor can demonstrate to the Board of Grievances that the courts of the jurisdiction granting the judgment will reciprocally enforce the judgments of the Saudi courts in such foreign jurisdiction.

Reciprocity may be demonstrated by way of the existence of a treaty or protocol between Saudi Arabia and the foreign jurisdiction or by requesting the parties seeking to enforce the judgment to provide either a previous Saudi judgment that has been enforced by the court issuing the judgment to be enforced or a letter from a competent authority such as the Ministry of Justice of the originating country of the judgment which is sought to be enforced, confirming that they would enforce a Saudi judgment.

The Board of Grievances may refuse to enforce a foreign judgment if a final judgment had been rendered by a Saudi court or judicial committee in proceedings between the same litigants over the same subject matter or if an action was commenced before a Saudi Arabian court or other judicial committee between the same litigants and involving the same subject matter prior to the commencement of the proceeding in the country where the foreign judgement was issued and the decision of the Saudi Arabian court or other judicial committee is still pending. Saudi Arabia has acceded to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However. it invoked a “reciprocity reservation” in order to limit its recognition of awards made in foreign jurisdictions. A foreign arbitral award may be submitted to the grievances board, which will enforce all of such an arbitral award, or a part thereof, provided that the award is not inconsistent with Saudi laws and regulations.

ARBITRATIONS: Any agreement to arbitrate must be filed with the authority originally competent to decide on the dispute (the competent court of law or judicial committee, for instance). The parties are bound by the arbitration agreement and cannot avoid it by resorting to the originally competent court or judicial committee without the consent of all parties. The arbitrators must fix a date for the hearing within five days of the date of approval of the arbitration agreement by the competent authority. The competent authority must approve the arbitration agreement and notify the panel within 15 days of the arbitration agreement being submitted to it. Additionally, all documentation must be in Arabic. The secretary of the panel must provide a written copy of the minutes of the hearing. In Saudi arbitration, there may be any number of arbitrators, provided that the number is an odd number. The arbitrator(s) must be Saudi nationals or expatriate Muslim(s) or, with approval, employee(s) of the Saudi government. The parties may represent themselves or be represented by a lawyer. If represented by a lawyer. the lawyer needs a notarised power of attorney evidencing his appointment. This requirement applies to all forms of litigation and instances where a non-Saudi national is involved. The power of attorney will need to be legalised by the relevant foreign office of the non Saudi's home country and certified by the Saudi embassy in that country and then attested by the Saudi Ministry of Foreign Affairs and the Saudi Ministry of Justice.

WTO ACCESSION: Saudi Arabia became the 149th member of the WTO on December 11, 2005. It made certain commitments with regard to a variety of economic activities. Some of Saudi Arabia's WTO commitments simply reflect existing provisions of Saudi law while others represent changes to existing Saudi laws.

The Saudi Arabian Foreign Investment Law stipulates that the Saudi Arabian General Investment Authority (SAGIA) must license all foreign investment in Saudi Arabia. Foreign capital is allowed in all investment activities, except those areas expressly excluded by the list issued by the Supreme Economic Council pursuant to its authority in accordance with Article 3 of the Saudi Arabian Foreign Investment Law. This “negative list" is updated regularly. It should be noted that as a result of Saudi Arabia's accession to the WTO. new fields of business activity have been opened up to foreign investment. SAGIA has the jurisdiction to license foreign investment in Saudi Arabia, unless the licensing of a particular type of foreign investment is entrusted to another state agency. Minimum investment thresholds for Saudis and non-Saudis are identical. except for the minimum investment thresholds as pre-conditions to obtaining foreign investment licences in the following sectors: (i) SR25m ($6.75m) for agricultural projects and (ii) SR30m ($8.1m) for real estate projects.

LOCAL BRANCHES: Foreign investors can open local branches of a foreign parent company. As a matter of practice, a branch is a common business structure for foreign entities with business in Saudi Arabia relating to a contract with the Saudi government. A branch of a foreign firm would need a foreign investment licence from SAGIA and it would not be a separate legal entity from the entity it represents. Only a limited number of business activities in Saudi Arabia would require the foreign investor to establish a legal entity in Saudi Arabia. This in particular applies to securities businesses.

SCIENTIFIC AND SUPPORT OFFICES: Foreign investors who have products in Saudi markets and who have registered Saudi commercial agents or distributors can establish a scientific office in Saudi Arabia without any capital requirements or local equity participation. The purpose of the scientific office has to be to support the foreign company's agent(s) or distributor(s) and to assist the end users of the products. Therefore, the scientific office cannot operate as a profit centre.

SUBSIDIARY COMPANIES: The Saudi Foreign Investment Law permits registration of 100% foreign-owned companies. For various practical reasons, the limited liability company (LLC) is generally considered the most appropriate corporate form available to foreign companies under the Saudi Arabian Companies Law. Other available vehicles include the joint-stock company (JSC). Although Saudi law recognises sole proprietorships and general partnerships as business vehicles, due to the liability risks associated with them, they are generally not the entities of choice for foreign investors.

LIMITED LIABILITY COMPANIES: LLCs are commonly referred to as limited liability partnerships, which should not be confused with genuine partnerships. These types of companies cannot offer their shares to the public and are generally not permitted to undertake business activities in commercial banking or insurance. An LLC must not have less than two or more than 50 shareholders, and the liability of each shareholder in the LLC is generally limited to their capital contributions in the company. The shares of an LLC are of equal value and must each be fully paid up in cash or kind.

Article 180 of the companies law provides that if a limited liability company incurs losses amounting to 50% or more of its share capital, the shareholders must resolve, within 30 days of such losses reaching the 50% threshold, either to continue the company on the basis that they will be responsible for its debts or liquidate the company, otherwise the protection afforded by limited liability status will be lost.

Each shareholder will be fully responsible (limited only by the extent of that shareholder's private assets) for the company's debts. Article 8 of the companies law provides that dividends may not be distributed to shareholders except from net profits. Furthermore, if any distributions are made to shareholders other than from net profits, the creditors of the company may claim from such shareholders the amount by which distribution exceeded net profits. This applies even though the shareholders may have received the distribution in good faith.

The ability of a limited liability company to distribute profits to shareholders is limited by Article 176 of the companies law, which states that such a company must transfer at least 10% of its annual net profits into a reserve fund until the amount is equal to and not less than 50%. of the company's share capital.

JOINT STOCK COMPANIES: Unlike an LLC, a JSC can offer its shares to the public and can raise debt from the public. A JSC allows foreign investors to limit their liability to their equity contribution. By contrast, investors of an LLC do not enjoy this protection under certain circumstances as in the aforementioned Article 180.

COMMERCIAL AGENCY: Foreign nationals may now participate in wholesale or retail business activities in Saudi Arabia. SAGIA's position is that Saudi Arabia's WTO entry commitments must be met, which include the following:

- Foreign equity is limited to 51% upon Saudi Arabia's accession to the WTO and to 75% after three years from the date of accession;
- Minimum foreign investment of SR20m ($5.4m);
- Minimum of 15% Saudi employees to be trained each year; and
- Minimum size of outlet may be prescribed by SAGIA.

Non-Saudi producers of goods are also allowed to appoint local Saudi agents as their representatives to sell their products and/or services in Saudi Arabia. Whether they act as distributors, sales agencies, or otherwise, the Saudi Arabian Commercial Agencies Law governs the arrangement. An appointment of a Saudi commercial agent often enables the foreign business to penetrate Saudi Arabia's market without establishing a direct presence in Saudi Arabia. The Saudi Arabian Commercial Agencies Law establishes a comprehensive framework for the protection of the Saudi agent that is complementary to the agreement between the producer and the Saudi agent. Registration of commercial agency agreements generally gives the parties protections of the Saudi Arabian Commercial Agency Law.

PROPERTY LAW: The Basic Law protects the freedom to hold private property and provides that no one may be deprived of their property by the government unless it serves the public interest and with fair compensation. The law governing ownership and investment in real estate by non-Saudis sets out the principles of foreign ownership of real estate. Foreign individuals who are legal residents of Saudi Arabia may own real estate for use as a residence (subject to obtaining a permit from the Ministry of Interior). Foreign companies licensed to conduct business in Saudi Arabia may own real estate for the purpose of their business and for housing employees. Foreign companies licensed to purchase and develop real estate may do so in accordance with their licence, provided the minimum investment is SR30m ($8.1m) per project and development occurs within five years of the acquisition of real estate. Foreign diplomatic missions may own their land for official purposes and employee housing (provided there is reciprocity), and international and regional organisations may own their premises subject to their agreements and with the approval of the Ministry of Foreign Affairs. Special rules apply with respect to the ownership of land in the Two Holy Cities of Mecca and Medina. Non-Saudi Muslims may lease real estate in the holy cities for a period of up to two years (renewable). Non-Muslims may not obtain title, easement or use of such land, other than rights or property obtained through a transfer upon inheritance.

LABOUR LAW AND SAUDIISATION: The maximum number of working hours for employees is generally eight hours per day. or 48 hours per week, with the exception of the holy month of Ramadan, when actual working hours for Muslim employees may not exceed six hours a day or 36 hours a week. The number of working hours may be raised to nine hours a day in respect of certain categories of employees or in certain industries and operations. The number of daily working hours may be reduced to seven hours for certain categories of employees or in certain industries or operations that are of a hazardous or harmful nature. Hours of work must be arranged so that no employee works more than five consecutive hours without an interval of rest, prayer and meals. Which shall not be less than 30 minutes each time. The employee cannot be required to remain in the place of work for more than 11 hours per day and in their first five years of employment, employees are entitled to an annual leave of at least 21 days. After the first five consecutive years, this period increases to 30 days. When an employee's employment ends, the employer must pay an end-of-service payment to the employee. Saudiisation regulations require that all private sector entities employ Saudi nationals. Certain positions are restricted solely to nationals, such as: receptionists. treasurers and civil security guards, However, Saudiisation is not rigorously enforced.

PATENT LAW: A new Saudi patent law, enacted by royal decree in 2005, is overseen by the King Abdulaziz City for Science and Technology. The law provides protection within the Kingdom for industrial designs, inventions, layout designs of integrated circuits and plant varieties. A Saudi patent is valid for a total of 20 years. The law specifies the annual fees required to maintain validity of a patent. Violating the patent law results in fines of up to SR50,000 ($13,500), with an additional SR50,000 for every repeated violation. As a signatory to several international conventions, the Kingdom extends patent protections to foreigners from any World Intellectual Property Organisation member state.

COPYRIGHTS: The 2003 Saudi copyright law protects original literary, artistic and scientific works as well as computer programmes, designer clothing, books, audio recordings and derivative works, such as translations and encyclopaedias. Unprotected items include judicial decisions and daily reports carried out by the print media and radio. Visual, audio and photographic works, along with movies and computer programmes, are protected for 50 years from the date of first production, while protection for other creative works lasts for the creators lifetime plus 50 years. The copyright law stipulates severe penalties for violators including (but not limited to) six months in jail, a maximum fine of SR250,000 ($67,500) and business shut down. To strengthen copyright protection, the Kingdom has become a signatory to the Berne Convention for the Protection of Literary and Artistic Works and the Universal Copyright Convention.

TRADEMARK: Under Saudi Arabia's 2002 trademark law, protected trademarks include names of distinct shapes, signatures, words, letters, numbers, drawings, Symbols, stamps and protruding inscriptions. Items that may not be registered as trademarks include (but are not limited to) public emblems, flags, misleading geographic names, signs without any specific distinction, signs or drawings violating Islamic law or those that are inconsistent with public morality. Trademark protection in the Kingdom lasts for 10 years and may be renewed. The Ministry of Commerce and Industry is responsible for supervising this law. If the ministry denies a trademark application, the applicant has the right to appeal to the Board of Grievances. The Saudi Trademark law provides for punishments with imprisonment for up to one year and fines of up to SR1m ($270,000) for violations.

SOLVENT LIQUIDATION: The legislative treatment of the liquidation of a corporation is contained in the companies law. The provisions of the companies law relating to liquidation are brief and do not address many of the issues that might arise. They do not apply to insolvent companies until either the company reaches a composition with its creditors, or the Board of Grievances declares the company to be bankrupt and appoints a liquidator. The companies law provides that a solvent company may be liquidated, inter alia, by an agreement of all the partners or shareholders or by an order of the grievances board on the application of any creditor/interested person and for “serious reasons that justify such a step”. It is within the power of the Board of Grievances to invite the shareholders to enter into voluntary or compulsory liquidation.

CORPORATE INSOLVENCY: The commercial court law (CCL), enacted by royal decree in 1931, codifies Islamic law principles and appears to cover personal rather than corporate insolvency. It is therefore unclear as to what extent the CCL bankruptcy provisions will be applied for corporate insolvency. In bankruptcy proceedings, the courts seem to rely on Islamic legal principles of fairness. Saudi law recognises preferential debts, such as employee wages, social contributions, and certain Customs duties and expenses incurred in the bankruptcy process. Secured debts are to be paid from the sale of the secured assets of the party or parties in question. Any surplus left over after the sale of the assets should be added to the bankrupt party's estate.