

## Joint ventures in KSA



When conducting a business in the Kingdom of Saudi Arabia (the **KSA**) an international investor will often partner with a KSA investor for commercial, legal or practical reasons. In most cases the joint venture partners will need to establish some form of legal entity in the KSA which is duly licensed to conduct the business (the KSA Entity). The KSA Entity will often take the form of a limited liability company.

The KSA Entity will usually need to adopt a standardised form of constitutional documents e.g. articles of association and/or bye-laws (Articles). In our experience, these standardised documents will not address many of the issues that an international investor will encounter when entering into a joint venture. Additionally, there are many aspects of a co-operative relationship between an international investor and a KSA investor which are more effectively dealt with in a direct agreement between the relevant parties. Accordingly, we usually recommend that the relationship is documented and governed by some form of agreement that supplements the Articles. This document is usually referred to in the KSA as either a shareholders' agreement or as a joint venture agreement (JV Agreement).

### International investors

The Foreign Investment Act and the Executive Rules (collectively, the Foreign Investment Law) provide the ground rules for foreigners wishing to establish a legal entity, or acquire an interest in a KSA Entity. The Saudi Arabian General Investment Authority (**SAGIA**) is the body responsible for granting licenses to foreign investors.

The Foreign Investment Law permits up to 100% foreign ownership of a KSA Entity unless the proposed activities appear on a "negative list" which restricts any foreign ownership. Certain activities which do not appear on the negative list may still fall into a sector where foreign ownership is restricted in amounts ranging from 25% to 75%. It is important that a thorough examination of the proposed activities is undertaken to ascertain if any of these restrictions apply. In general, foreign investment is permitted in most manufacturing, technical services and trading activities.



“The lawyers get straight down to the nitty-gritty details of a deal and are always willing to provide precise advice.”

Chambers Global 2010

## JV agreements

In practice, the various KSA agencies that license a KSA Entity will have a great deal of say in the form of its Articles and in many cases minimum changes will be able to be made to these standard documents. Accordingly, it is typical for investors in a KSA Entity to enter into a JV Agreement in order to address respective investor rights and options in more detail than would be found in the Articles.

The areas that are commonly included in a KSA JV Agreement include:

- provisions relating to the management and decision making process;
- plans for the KSA Entity’s business, including strategic plans for the company’s first few years;
- plans for the future restructuring of the KSA Entity, such as planned capital increases;
- shareholders’ review of the KSA Entity’s annual budget and plan;
- the distribution between the founding shareholders of the responsibilities and expenses involved in the incorporation and operation of the KSA Entity;
- dispute resolution and governing law provisions;
- non-competition provisions preventing the shareholders in the KSA Entity from competing with, or from owning a competing business;
- confidentiality provisions requiring the shareholders in the KSA Entity to keep confidential the KSA Entity’s information; and
- provisions dealing with exit and dead lock.

## Conflict between the JV Agreement and the Articles

Where parties to a JV Agreement are faced with a conflict between the terms of the Articles on one hand and the terms of the JV Agreement on the other hand (and where the JV Agreement does not specify which document will prevail in the event of such a conflict) then the terms of the document that is later in time will typically prevail. That said, the parties to the JV Agreement can specify in the JV Agreement which document shall prevail in the event of such a conflict.

## Practical issues

There are a number of additional practical issues to consider when entering into a potential joint venture in KSA. Some of these are highlighted below:

**Visas** – A visa is required for every foreign visitor to the KSA. The type of visa will depend upon the purpose for entering the KSA. For example, in common with other GCC countries, employers in KSA are required to secure work permits and residence permits (Iqama) for foreign employees.

**Legal and court system** – The fundamental law of the KSA is the Shariah. The Shariah is a collection of principles derived from different sources, but principally the Holy Qur’an and the Sunnah (the witnessed sayings and actions of the Prophet Mohammed, peace be upon him). Shariah principles are often expressed in general terms, which provides the KSA courts with considerable discretion as to how to apply those principles. The practical consequences of the application of Shariah should be considered in respect of:

- financing (the prohibition of interest payments in the KSA may mean that Islamic financing is insisted upon although options for conventional financing may also exist);
- the prohibition against uncertainty (which may exclude the use of derivative contracts or the inclusion of a liquidated damages clause for potential economic losses);
- the inability to provide a waiver in respect of future rights (powers of attorney are always revocable, regardless of any language to the contrary in the instrument); and
- there is no recognition of “self-help” remedies and it is not possible to obtain effective security over future assets.

**Saudization** – There are minimum requirements in terms of the nationality of the workforce to be employed by businesses in the KSA and advice should be sought in respect of employment requirements for KSA citizens. In practice the minimum number depends on the type of company and industry. In general 30% of the workforce is required to be Saudi unless the business relates to a particular sector (e.g. construction companies can in certain circumstances have a requirement as low as 5%).



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**Further information**

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**Tax** – Income tax on business profits and Zakat (a form of wealth tax based on Shariah law principles) are levied by the Saudi Arabian Department of Zakat and Income Tax. In summary, the key tax requirements are:

- any person that is not a national of one of the GCC countries (or a corporate entity that is not owned, directly or indirectly by nationals of one of the GCC countries) must pay tax at the rate of 20% of the taxable income that is attributable to its shareholding in the KSA company. For example, a UK national who owns 50% of a KSA company that makes USD 1 million profit will pay tax at the rate of 20% of USD 500,000 (i.e. USD 100,000) – assuming that all profits are distributed to shareholders;
- the tax laws also provide for withholding tax, at varying rates, from 5% to 20%, to be charged on certain payments which are made by companies registered in the KSA to any company established outside the KSA; and
- nationals of GCC countries pay Zakat on ownership interests in KSA Entities (at the rate of 2.5% of the capital employed).

**Governing law, dispute resolution and enforcement** – Prospective foreign investors in KSA should note that:

- the laws of the KSA will generally be applied to contracts entered into in the KSA with KSA parties regardless of the parties choice of governing law;
- unless from a country covered by the relevant GCC or Arab League treaties, enforcement of a foreign arbitral award or court judgment can be very difficult in the KSA (despite the KSA having signed up to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1994);
  - for any arbitral award to be enforceable, it must:
    - be given by a male, Muslim arbitrator;
    - be in compliance with Shariah law; and

-must not contravene KSA public policy;

-the KSA will not enforce any foreign arbitral award or court judgment unless a judgment from that country would be reciprocally enforced; and

-the chance of being able to enforce an arbitral award is greatly increased if the legal seat of the arbitration is the KSA.

Due to the difficulties associated with enforcing awards, regardless of the dispute resolution forum, consideration should be given to other forms of security if there is a likelihood of a claim arising (eg the retention of sale proceeds for the duration of the warranty period or a bank guarantee).

**Summary**

The GCC countries, particularly KSA, are enjoying a period of sustained economic growth despite the world wide economic downturn. Accordingly, doing business in KSA through a joint venture represents an enormous opportunity for foreign investors when the economic outlook for other parts of the world is not as positive. It is vital that any planned move into the KSA market accounts for complications which may arise as a result of the local business law and practice by dedicating sufficient time and resources to ensure that any investment in the KSA is safe, secure, legal and profitable going forward.