
Frederick W. Taylor Jr.
THE THRESHOLD DECISIONS for every United States company seeking entry into the Middle East markets is the form the effort should take, the alternatives available and the legal requirements and restrictions for each alternative. This paper will discuss in some detail each of the alternative structures available for doing business in Saudi Arabia.

Saudi Arabia is by far the largest market in the Middle East in terms of disposable income. It has been the most active in pursuing large scale development programs. There is a consistency of approach in the capitalist economies of the Middle East, particularly in the Gulf area. For example, it is generally the case that commercial agents can only be nationals of the country concerned or juristic persons controlled and majority-owned by nationals in Saudi Arabia, Lebanon, Kuwait, Qatar, Jordan, Abu Dhabi, and the Yemeni Arab Republic. The socialist countries do not favor commercial agents or middlemen and either forbid them altogether, as in Algeria and Libya, or strictly limit and control them, as in Iraq and Syria.

* B.A. (1957), University of Florida; M.A. (1959), University of Michigan, (Near Eastern Studies); J.D. (1967), New York University School of Law, Cum laude. The author is a partner in the law firm of Burt and Taylor, Marblehead, Massachusetts. He is a member of the New York and California Bars.

1 Much of the information detailed herein has been garnered from the author's personal knowledge and dealings in this area. Hence, documentation of authority is not attributable to existing sources but rather to Mr. Taylor's expertise.

2 Royal Decree No. 11 of 20.2.1382 A.H. (1962), art. 1.

3 Legislative Decree No. 34 of 1967 as amended by Decree No. 9639 of 1975, art. 1.

4 Regulation of Commercial Agencies, Law No. 36 of 1964, art. 1.

5 Law No. 6 of 1964, art. 1.

6 Commercial Agents and Intermediaries Law, Law No. 20 of 1974, art. 4.

7 Law No. 11 of 1973, art. 2.

8 Regulating the Agencies and Branches of Foreign Companies and Commercial Firms, Decree No. 6 of 1976, art. 2.

9 State Monopoly on External Trade, Law No. 78-02 of 1978, arts. 15, 16.

10 Commercial Agency Activities, Law No. 87 of 1975, art. 2. Recent Decrees of the Libyan Government have completely eliminated all private agents in Libya.

11 Punishment of Illegal Intermediaries, Law No. 8 of 1976, art. 2.

12 Establishment of a Branch or Agency, Legislative Decree No. 151 of 1972, as
Equally important, but beyond the scope of this discussion, are the restrictions of U.S. law on American companies doing business in Saudi Arabia and elsewhere. The most notable restrictions are: (a) the Foreign Corrupt Practices Act of 1977;\(^\text{13}\) (b) anti-boycott legislation\(^\text{14}\) and the related rules contained in the Treasury Guidelines\(^\text{15}\) and in the Export Administration Regulations;\(^\text{16}\) and (c) the United States' approach to taxation of its citizens abroad.\(^\text{17}\) This overlay of U.S. law has created considerable difficulties for U.S. companies attempting to compete with European, Far Eastern and Third World companies. These restrictions add costs and complications. Although these may not be the only competitive disadvantages, it is worth noting that U.S. companies have obtained only a minority share of the total business allowed in Saudi Arabia today.\(^\text{18}\)

In approaching the business decision choice as to which legal framework to employ, a clear determination of the type of business the company intends to engage in is required. The pertinent categories are: (a) import and resale of goods, materials and equipment; (b) construction; (c) architectural and engineering consulting; (d) assembly and manufacture of products; and (e) operations, maintenance and other services.

These various categories of activities are treated differently because of the underlying policy of Saudi Arabia and other developing countries to encourage activities which support economic development goals and which entail a transfer of technology while reserving for nationals general merchant and trading activities. This differentiation will become apparent from an examination of the legal structure regulating these activities as discussed below. Accordingly, most Middle Eastern countries do not provide a legal structure which permits foreign companies to engage in trading activities such as the import and resale of goods, materials and equipment. However, many of the Middle Eastern capitalist countries provide incentives such as tax holidays,\(^\text{19}\) inexpensive leasing of real es-

\(^{16}\) 15 C.F.R. § 8369 (1979).
\(^{19}\) Royal Decree No. M/4 of 2.2.1399 A.H. (1979), art. 7(b). See also, Royal Decree No. 35 of 11.10.1399 A.H. (1964), art. 8(b) and Egypt’s Law on the Investment of Arab and
relief from exchange controls and the like, for limited periods of time, to encourage foreign participation in development schemes and in ventures involving a transfer of technology.

Once the line of business is categorized, the choices of form for doing business in Saudi Arabia are generally: (a) distributorship; (b) representation or agency; (c) local branch; (d) professional offices; and (e) joint venture. Both local and U.S. tax considerations greatly influence the economics of each choice.

II. DISTRIBUTORSHIP AND AGENCY IN SAUDI ARABIA

The restrictions found in the Commercial Register Law and implementing regulations, and the Regulation for Commercial Agencies, effectively reserve imports for resale in Saudi Arabia to Saudi nationals or to companies 100 percent owned by Saudi nationals. Consequently, there is no legal way for foreign companies to engage in buy/sell distributorship activities in the Kingdom. They must sell to a Saudi dealer who takes title to the goods and assumes the risk of loss before they enter the Kingdom. Dealership is a common vehicle for sales of equipment, appliances and consumer goods.

Another approach, which constitutes a violation of the regulations but nevertheless is a common practice, is to appoint an agent who acts as sponsor for the company importing goods rather than as a true distributor. Instead of purchasing goods for resale, the Saudi sponsor clears the goods through customs with invoices and documents as if he had purchased them. The foreign company retains actual title and all financial risk. On sale, the sponsor takes a flat percentage fee of the gross value of the goods sold. The Saudi sponsor avoids the out-of-pocket financing costs and any risk of loss that exist in a true distributorship. More often than not, the foreign manufacturer puts his own sales staff in Saudi Arabia so that the agent really does very little beyond providing his name (and hence a vehicle) for doing business. The Saudi sponsor clears the goods involved in his name, gets the visas and establishes bank accounts in his name. The foreign company has no legal presence in the King-
dom—it does not exist in the eyes of the law.

One can plainly see that this takes the risk off the Saudi's shoulders. He receives his fee off the top with no downside risk. However, this arrangement greatly increases the foreign company's risks. It has no legal presence in the Kingdom; everything, including the goods and bank accounts, is in the sponsor's name. Legally the Saudi sponsor's employees comprise the sales force, since he arranged the visas. In the event of a dispute, the foreign company is completely at the sponsor's mercy, as the foreign company's status under the law is no more than that of an employee. Last year it was not uncommon for a disgruntled Saudi sponsor to have the local manager of his sponsored company incarcerated and then seize all the assets as the first step in asserting his point of view in any controversy. The leverage is obvious. Prudent counsel will advise clients not to expose themselves under illegal distributorship arrangements, even where signed agreements exist, and despite the fact that they are common practice.

In lines of business other than the import and resale of goods, sales representation, or "agency" as it is commonly called, is a perfectly legitimate vehicle well-suited for foreign companies, particularly those seeking contracts with the government or with private sector parties. It is also a necessity for foreign branch office operations (see Section III below). Under the terms of Royal Decree M/2 of January 1978, a foreign company must have a Saudi partner or agent for all government work. A carefully drafted agency agreement is a necessity to protect both parties. From the Saudi government's point of view, the problem with agencies has been to control outrageous fees and to eradicate influence peddling while preserving the legitimate need for support services. Royal Decree M/2 was reportedly a response to a number of overpriced bids which contained very high agency fees. In 1977, the Minister of Industry and Electricity threw out all the bids for a power generation facility because they were well above all reasonable estimates.

Royal Decree M/2 applies prospectively and requires a foreign company to have a Saudi partner or services agent for all government con-

25 Id.
26 Id.
28 Royal Decree M/2, supra note 28, arts. 1, 8.
29 Id. art. 7, requires a written contract between the Saudi agent and the foreign contractor.
30 Umm al-'Qura, No. 2664, Feb. 25, 1977.
tracts, except government-to-government deals and armament contracts; no agents are allowed for the sale of armaments and related services. The term “armaments” is generally held to mean weapons or ordnance and services, that are specifically connected with such contracts, leaving other kinds of Saudi Ministry of Defense and Aviation contracts open to agency arrangements. Contracts in Saudi Arabia with the U.S. Corps of Engineers and the U.S. Department of Defense do not require agents as they fall within the government-to-government exception.

Royal Decree M/2 outlaws influence peddling and pure brokerage in securing government contracts. It is generally held to apply prospectively to contracts with the government entered into after January 20, 1978, and to have amended by operation of law all existing agency agreements. Thus, under Article 8, fees of five percent or less are required of all contracts with the government, even if a preexisting agency agreement calls for a higher fee.

While requiring the use of agents in government contracts and agreements with government organizations such as Saudi Arabian Airlines (SAUDIA), General Petroleum and Mineral Organization (PETROMIN), and the like, the Decree limits agents’ fees to a maximum of five percent of the price of the contract. There have been instances where officials of various ministries have excluded ancillary items such as ocean freight and other costs from the contract price used as a base for computing the maximum fee. The price term of any government contract requires careful drafting to achieve the desired result and to avoid any misunderstanding over fees.

The agent must be registered under the Regulations for Commercial Agencies and must be a Saudi national, residing in Saudi Arabia. To avoid conflict of interest situations, an agent may not represent the con-

33 Royal Decree M/2, supra note 28, art. 4.
34 Id.
36 Royal Decree M/2, supra note 28, art. 4.
37 Id. art. 10.
38 Undated form issued by the Ministry of Commerce to be completed by all foreign companies applying for registration entitled: “A Form Concerning the Statement of Saudi Services Agent Non-existence.” [hereinafter cited as Agent Non-existence Form]. This form, issued in September 1979, allows temporary registration without an agent for all contracts with government ministries or agencies entered into and signed before 11.2.1398 A.H. corresponding to January 20, 1978.
39 Id. art. 8.
40 Id.
41 See note 1, supra.
42 Royal Decree No. 11 of 20.2.1382 A.H. (1962) as amended, art. 3.
43 Royal Decree M/2, supra note 28, art. 5.
sulting contractor and the performance contractor on a single project. For example, government construction jobs are structured so that a consulting engineer oversees the work on the government’s behalf and issues the required completion certificate before the construction contractor can be paid. The consultant notes any deficiencies in the work. If the Saudi agent had a financial interest in the construction work—usually many times the value of the engineering consulting work—and also in the consultant contract, the opportunities for mischief are obvious.

There are heavy penalties for violation of Royal Decree M/2: loss of license for the agent and withdrawal of the privilege of doing business for the foreign company. Various other controls on local agents are contained in the Decree such as limiting the number of firms that any one agent can represent to ten and requiring disclosure in tender documents of the agent’s name and fee.

A point of controversy arising under Royal Decree M/2, is whether it applies to subcontractors working on government jobs, or only to the first tier prime contractors. The issue is not entirely settled. Some local attorneys have advised their clients that since the word used in the decree is “contractor” and not “subcontractor”, the Decree does not apply to the latter. The administration of a subsequent ministerial resolution by the Ministry of Commerce seems to point in this direction.

Resolution No. 680 of October 1978 addressed the situation existing prior to its issuance whereby many companies were performing government contracts in the Kingdom, yet had not registered under the terms of the “limited” or “temporary” registration procedure to legitimize their presence as a branch of a foreign firm. This procedure applies only to specific contracts with government organizations. Foreign companies were given a thirty day period to complete registration or face penalties. The procedure is comparatively simple, involving the filing of a letter from the contracting ministry or agency along with certain other documents with the Ministry of Commerce. Temporary registration establishes a juridical presence in the Kingdom for the duration and scope of

---

44 Id. art. 9.
45 Id. art. 12.
46 Id. art. 6.
47 Id. art. 8.
48 See note 1, supra.
49 Id.
50 Council of Ministers Resolution No. 680 of 8.11.1398 A.H. (1978) [hereinafter cited as Resolution No. 680 in text and footnotes] and Agent Non-existence Form, supra note 38.
51 Resolution No. 680, supra note 50.
52 Id.
53 Id.
54 Id.
the contract only; it is not a blanket license to solicit other business. It does allow one to secure a telephone, open a bank account and have a post office box. It further requires that a firm pay Saudi company taxes on the contract profits.

Under Resolution No. 680, an approved subcontractor on a government contract could for the first time take advantage of a temporary registration process. Previously, there was no explicit authority allowing a subcontractor to obtain a temporary registration. Therefore, this is an important change. To obtain a temporary license under Resolution No. 680, a subcontractor must file either the designation of a Saudi agent or the Agents Non-existence Form. Before the new Agents Non-existence Form was issued, the Ministry had asked for the agent’s name in registering a foreign temporary branch. However, with the appearance of the new form in September, 1979, it appears that the Ministry of Commerce supports the view that Royal Decree M/2 does not require a Saudi service agent for government subcontractors. The decree does not prohibit a subcontractor from using an agent, and he may in fact need one for his services. In such a case one must be concerned about the overall five percent agency fee on a single government contract.

Private sector contracts are outside the purview of Royal Decree M/2 and Resolution No. 680; the language of both specifically limits their application to government contracts. Accordingly, a foreign company is free to contract with a private concern without an agent. The private concern will normally act as sponsor for any of the contractor’s activities while performing work in the Kingdom. Also, the Saudi Basic Industries Company (SABIC) which undertakes responsibility for government industrial projects will act as the Saudi partner in any projects undertaken with it, so there is no need for an agent in contracts with SABIC.

III. Local Branch Offices in Saudi Arabia

Under the provisions of Section 228 of the Regulation for Companies and under the Foreign Capital Investment Codes of 1964 and

---

55 See note 1, supra.
56 Id.
57 Id.
58 Agent Non-existence Form, supra note 38.
59 See note 1, supra.
60 Royal Decree M/2, supra note 28.
61 Id.
62 Resolution No. 680, supra note 50.
64 Regulations for Companies, Royal Decree No. M/6 of 22.3.1385 (1968) [hereinafter cited as Royal Decree M/6].
1979, a branch of a foreign company may register without any Saudi participation. From mid-1978 until approximately April, 1979, the Foreign Capital Investment Committee did not process any foreign branch registrations; an effective moratorium existed. During this period the committee undertook a study of the policy with respect to foreign branches. Recently it once again began to grant branch licences. The stated reason for the moratorium was to inventory the number of foreign branches in the Kingdom in various categories. One can speculate that in crowded fields it might be difficult to register another foreign branch. It must be kept in mind that the foreign branch is not eligible for any of the incentives, such as a tax holiday, which are reserved to companies with at least twenty-five percent equity ownership by Saudi nationals. Thus it has limited utility as an in-Kingdom vehicle for obtaining and performing work.

Besides the lack of a tax holiday, there is another significant drawback to doing business as a branch. The Tender Regulations allocate preferences for government contracts in the following order: (a) 100 percent Saudi companies; (b) Majority Saudi owned companies; (c) 50/50 Saudi/foreign companies; (d) Minority Saudi owned companies; (e) Foreign companies with no Saudi capital. This is of considerable importance in light of the fact that the government is by far the biggest purchaser in the Kingdom. The other significant purchaser of goods and services, the Arabian American Oil Company (ARAMCO) will always as a matter of policy provide business to a local company in preference over a foreign company. Thus, a foreign company doing business as a branch receives lowest priority on most contract bids; and as noted earlier, Royal Decree M/2 requires a foreign company to have a Saudi agent for government contracts.

While under Resolution No. 680 a branch registration is required for government contracts undertaken by foreign companies with no local of-

---

66 See note 1 supra.
67 Id.
68 Id.
69 Discussions with Ministry of Industry and Electricity officials in April, 1979.
70 1979 Code, supra note 65, art. 7(b).
71 Id. art. 7(b).
72 Id. art. 1(d), (3).
73 See note 1, supra.
74 Id.
75 Id.
76 Royal Decree M/2, supra note 28, art. 3; with exceptions for armaments and related services and government-to-government contracts in art. 4.
fice," this merely facilitates performance of the contract and does not provide a satisfactory structure for long term operations in the Kingdom. The most viable use of a branch is in private sector projects and in government contracts where the competition is so minor as to be nonexistent, for example in the case of a unique or specialized technology.

IV. PROFESSIONAL AND CONSULTING ORGANIZATIONS

One of the most confusing areas of the law for practitioners is the regime for registering various professional organizations and the proper procedure for legitimizing a foreign consulting company's activities in Saudi Arabia. Except for architects and engineering consulting offices, the professional may only register as an individual and only do business in his own name. For each profession, there is a slightly different twist in the regulations and only certain professional groups are recognized, namely accountants, lawyers, architects and engineers.

Management consultants are not recognized as professionals in the regulations. Moreover, the Foreign Capital Investment Committee considers professionals and consultants such as management consultants to be outside its jurisdiction. As a result, there is no clear method of registering a foreigner as a management consultant professional in Saudi Arabia.

A non-Saudi individual with the requisite professional qualifications may register as an auditor/accountant. A member of one of the major U.S. accounting firms recently received a license to practice and open an office as an individual. There is some doubt as to whether the Ministry of Commerce, which controls professional registrations, will permit him to use the firm name on his stationery.

Lawyers may be licensed as individuals, but Ministry of Commerce sources contend that there is an outstanding Ministry of the Interior order to the effect that only Muslims may become licensed attorneys. The logic of this is no doubt grounded in the Islamic law known as the Shari'ah, the legal system of Saudi Arabia. According to the Shari'ah, the Holy Qur'an is the fundamental source of all law. Hence there is justification for the view that only Muslims are qualified to interpret the religious law. Modern regulations and codes are considered to be administrative rulings entirely consistent with and interpreted according to the

---

76 Resolution No. 680, supra note 50, art. 1.
77 See note 1, supra.
78 Ministerial Resolution No. 1776 of 27.6.1397 A.H. (1977) promulgated by the Ministry of Commerce. Note that only architects and engineers are recognized by this Ministerial Resolution. There is no statutory basis for recognition of accountants and lawyers.
79 See note 1, supra.
Shari'ah. Accordingly, non-Muslim lawyers can only function in the Kingdom in association with a licensed Saudi attorney. In fact, a number of foreign law firms have associated with Saudi firms in order to serve clients doing business in Saudi Arabia.

The regulation of architecture, and engineering consultation operations is also under the exclusive jurisdiction of the Ministry of Commerce. As it now stands, a Saudi engineer, with the requisite experience, may obtain an engineering license in his own name. He must, under Ministerial Resolution No. 1776, have an office with the following divisions: (a) Architecture Division; (b) Civil Engineering Division; and (c) Electrical Engineering Division.

A second method of organization is to establish a consulting engineering office that encompasses the above-mentioned three skills and is in the name of a group of engineers with one Saudi engineer as a partner. Under the provisions of Resolution No. 1766, it does not appear possible to establish an office without a Saudi engineer being involved. Conversations with responsible officials in the Ministry of Commerce confirm that this is the current policy. This is true even though a circular of the Ministry entitled “Documents Required from Person Desiring to Obtain a License for Setting Up Engineering and Consulting Offices” distinctly states that non-Saudi engineers can set up branch offices.

The confusion in this area stems from the Ministry’s moratorium, imposed last year, on registration of architect and consulting engineering firms’ foreign branch offices. At the time it was reported that a study was under way to determine whether such foreign branches should be allowed to register. The conclusion of this study was reportedly that no provision should be made for foreign consulting firms to establish branch offices. The rule remained that non-Saudi consultants can only be licensed as individuals where there is a partnership with a Saudi in an integrated consulting office.

---

81 Resolution No. 1776, supra note 78.
82 Id. art. 2.
83 Id. art. 3.
84 Resolution No. 1776, supra note 78.
85 Discussions with officials of the Department of Foreign Trade, Ministry of Commerce, during the week of January 14, 1979.
86 An unnumbered circular of the Department of Companies and Registration of the Ministry of Commerce. [A copy of this circular is on file in the office of the Case W. Res. J. Int’l L.].
87 Id. In addition, a footnote in the circular on documentation required, id. indicates that no license will be issued to a non-Saudi to open an engineering office in Riyadh, Jeddah or Dammam.
88 See note 1, supra. The moratorium began approximately in April 1978 and was lifted in September 1978.
89 See note 1, supra.
90 Discussions with officials, supra note 85.
What can a foreign engineering firm do if it cannot register *qua* a foreign firm? Individual partners, officers, or employees from the firm, if qualified professionally, can form a partnership with a Saudi to open a consulting office. This makes the arrangements more complicated than the situation where a foreign firm and a Saudi enter into a straight forward joint venture, but the complications are manageable. As a solution to the problem, a foreign firm can, through its individual members, be involved in a consulting office in the Kingdom to obtain and perform work, by use of properly drafted agreements between: (a) the individual partners, officers or employees of the foreign firm and their own firm to cover the fact the individuals are acting as agents of the firm in the Saudi consulting office and to cover professional liability; (b) the foreign individuals and the Saudi engineer who is a partner, to cover operating procedures and subcontracting; and (c) the foreign firm and the Saudi engineer who is a partner which set forth the intent of the arrangements. A second alternative would be for the foreign firm to work with a Saudi consulting firm through a management and technical services contract. Of course this leaves operations in Saudi Arabia under the name of the Saudi office only.

For management consultants, the picture is less clear. Not being professionals in the eyes of the law, such organizations have generally worked from contract to contract under the temporary license procedure for branch offices, or as a division of an accounting office registered in the Kingdom.

Professional groups of whatever type do not qualify under the Foreign Capital Investment Code for any of the incentives provided therein, such as a tax holiday.

V. JOINT VENTURES

It is permissible under the regulations of the Kingdom of Saudi Arabia for a foreign company to form a joint venture with a Saudi person in Saudi Arabia and register the venture as a juristic person. This is the most commonly used form of doing business in the Kingdom for construction contractors, manufacturers, assembly plant owners, and for operations, maintenance and service contractors. Manufacturing operations may qualify for special incentives in addition to a tax holiday, such as

---

91 Resolution No. 1776, supra note 78, art. 3.
92 See note 1, supra.
93 1979 Code, supra note 65, art. 7(b).
94 Royal Decree M/6, supra note 64.
95 See note 1, supra.
96 1979 Code, supra note 65.
land in the industrial estates at a low rental rate, a degree of protected status and favored treatment in government purchases.

There must be a minimum of twenty-five percent Saudi equity partnership in a joint venture entity along with foreign ownership in order to qualify for the various incentives allowed under the Foreign Capital Investment Code of 1979 [hereinafter 1979 Code]. The primary change between the 1964 and the 1979 Code was to make a distinction between “industrial” and “agricultural” projects and all other projects. The industrial and agricultural projects are granted a ten year tax holiday while projects falling outside of this definition are granted only a five year tax holiday as previously provided in the 1964 Code. The new policy apparently involves a determination that projects outside the industrial and agricultural area do not require further incentives. For example, there are already a good number of construction companies in existence and there is no real need to provide added incentives for them.

There is a great range of interpretive possibilities, however, between a straight manufacturing plant and a construction company. Industrial projects are those which involve the processing of raw or semi-finished materials or the fabrication of finished or semi-finished products for industrial or consumer use. The further definition of activities included

---

98 Royal Decree No. M/14 of 7.5.1397 A.H. (1977), art. 1(d), (e) provides:
(d) Saudi individuals and companies licensed to operate in accordance with the existing laws and regulations shall have priority in dealing with the government followed by establishments consisting of Saudis and non-Saudis whenever Saudi interests in the capital amounts to 50% or more.
(e) Manufactured goods and products of Saudi origin shall be preferred over similar foreign goods and products if they serve the purpose for which the tender was announced, even though they possess lower qualities than similar foreign goods and products.

When such goods and products are available, they may be purchased directly if they are produced by a single factory; if more than one factory produces them, a tender shall be arranged among them provided that the Ministry of Industry defines the appropriate purchase price in both cases.

Manufactured goods and products shall not be considered of Saudi origin unless they are produced by a Saudi industrial establishment licensed to operate inside the Kingdom and the said establishment has submitted a certificate from the Ministry of Industry and Electricity testifying that local raw materials or local manpower have contributed, in a reasonable percentage, to the production of these goods and products.

See also text accompanying notes 71, 72 and 75 supra.

99 1979 Code, supra note 65, art. 7(b).
100 Royal Decree No. 35 of 11.10.1383 A.H. (1964) [hereinafter cited as 1964 Code in text and footnotes].
101 1979 Code, supra note 65, art. 7(b).
102 1964 Code, supra note 100.
103 See 1979 Code, supra note 65, art. 7(a) and Royal Decree No. 50 of 23.12.1381 A.H. (1962), art. 2.
under the 1979 Code will have to await the case by case determination of
the Foreign Capital Investment Committee (FCIC) established by the
1979 Code to pass on license applications. However, foreign capital in-
vestment is limited to projects included in the Five Year Development
Plan, which requires foreign technical know-how, and are specified in the
Code by lists proposed by the FCIC and decreed by the Minister of In-
dustry and Electricity.\textsuperscript{104}

The 1979 Code requirement that foreign investment be accompanied
by "foreign technical know-how" is not further defined in the 1979 Code
Rules issued by the Minister of Industry and Electricity.\textsuperscript{106} Although the
intent of fostering technology transfer is clear, a case by case definition of
this new term in the 1979 Code remains to be worked out. It has also long
been Saudi policy to stipulate that Saudis be trained in all government
projects.\textsuperscript{108} In keeping with this policy, it is possible that projects involv-
ing research and design done in the Kingdom will be favored.

The ten year tax holiday provided by the 1979 Code is an attractive
inducement particularly since, when coupled with an appropriate invest-
ment structure, it is possible for companies to operate in Saudi Arabia
free of local as well as home country taxation.

The definition of "foreign capital" in the 1979 Code\textsuperscript{107} and in the
1979 Code Rules\textsuperscript{108} is essentially the same as in the 1964 Code\textsuperscript{109} and in-
cludes money, commercial paper, machines and equipment, spare parts,
raw materials, products, means of transportation and incorporeal rights
such as patents, trademarks and similar valuables.\textsuperscript{110} Foreign companies
investing capital in the Kingdom are eligible to be licensed under the
1979 Code.\textsuperscript{111} Securing the license is the first step in the process of form-
ing a joint venture. The second step is to form and register an entity with
Saudi equity participation under the Regulations for Companies [herein-
after Companies Regulations].\textsuperscript{112}

The tax holiday was generally held to begin on the issuance of the
Foreign Investment License prior to the promulgation of the 1979 Code
Rules.\textsuperscript{113} However, the 1979 Code Rules altered this so that the tax holi-

\textsuperscript{104} Implementation Rules of the Foreign Capital Investment Code, Minister of Industry
and Electricity Decision No. 323 of 10.6.1399 A.H. (1979), art. 2 [hereinafter cited as 1979
Code Rules in text and footnotes].
\textsuperscript{105} 1979 Code, supra note 65, art. 2(b).
\textsuperscript{106} See note 1, supra.
\textsuperscript{107} 1979 Code, supra note 65.
\textsuperscript{108} 1979 Code, supra note 104.
\textsuperscript{109} 1964 Code, supra note 104.
\textsuperscript{110} Id. art. 1.
\textsuperscript{111} Id.
\textsuperscript{112} Royal Decree M/6, supra note 64.
\textsuperscript{113} Unpublished Private Ruling of the Minister of Finance and National Economy
day for agricultural and industrial projects begins on the date of the start of production. For other projects, it begins on the date of registration in the Commercial Register which is deemed to be the date of the start of production.

Once licensed, steps to implement the project must be taken within six months of notification, or the Minister of Industry and Electricity has the right to cancel the license. The project must also be implemented in accordance with the documents submitted to the FCIC for a license. Any modifications must be approved by the FCIC and the Minister of Industry and Electricity.

Once the 1979 Code license is secured, an investor must form a company and register it with the Ministry of Commerce. There are a number of partnership or corporate forms available under the Companies Regulations, but the most widely used entity is the Saudi Limited Liability Company or Partnership (SALLP). The SALLP can be structured as either a corporation or a partnership under the fourfold test of the U.S. Internal Revenue Code, Section 7701. For United States tax purposes, most companies prefer to use a partnership form which, when coupled with the Saudi tax holiday, offers significant tax planning advantages.

The SALLP is an extremely flexible vehicle which permits resolution of management, profit sharing and other issues to suit the needs of the partners and of the projects to be obtained. Of course, the key issue is the resolution at the outset of the major objectives of the business relationship between the foreign party and the Saudi partner. It is prudent to document this relationship in a detailed joint venture agreement prior to obtaining a license from the FCIC and registering the Saudi Company with the Ministry of Commerce. A check list of major items to be included in such an agreement would include:

(a) capitalization and voting rights;
(b) objects of the venture;
(c) term of the venture;
(d) management and operations;
(e) profit sharing and distribution;
(f) dissolution rights; and
(g) settlement of disputes.

---

114 1979 Code Rules, supra note 104.
115 Id. art. 18.
116 Id. art. 10.
117 Id. art. 11.
118 Implementation Rules of the Foreign Capital Investment Code, Royal Decree No. 714 of 15.6.1399 (1979) and Commercial Register Law, Resolution No. 54 of 1955, art. 2.
120 I.R.C. § 7701 and regulations thereunder.
Capital can be in the form of any of the items set forth in the Foreign Capital Investment Code.\textsuperscript{121} For example, the foreign company may put in equipment such as cranes, bulldozers or trucks. The Companies Regulations require cash shares to be paid in full and shares in kind to be turned over before the formation of the SALLP has been completed.\textsuperscript{122} Often one party may lend the other party funds to capitalize the SALLP.

The objects of the SALLP must be clearly defined in the Memorandum of Association required under the Companies Regulations.\textsuperscript{123} This memorandum must be submitted in draft form with the documents to the FCIC. This is the Company’s Charter or Partnership Agreement. It is not enough to draft, as we are accustomed in the United States, a broad, all encompassing objectives clause which gives every possible power to the entity. The FCIC generally requires a specific and limited definition in the Memorandum of Association so as to ensure that the foreign capital is truly devoted to a development project as required by the 1979 Code.\textsuperscript{124} Another reason for the FCIC’s requirement of specificity is its interest in the strict control of the activities of foreign companies in the Kingdom. Time and again, applications are returned for having objectives that are too broad and ambiguous. Only after a more narrow-based redefinition of this clause in a draft Memorandum of Association will an application be accepted.

The term of the venture is normally chosen to equal the tax holiday period with limited renewal rights. U.S. companies desiring partnership status for the SALLP for U.S. tax purposes are advised to avoid any suggestion of “continuity of life” as that term is defined in Treasury Department Regulations under Internal Revenue Code Section 7701.\textsuperscript{125}

Provisions governing management and operations are the heart of the joint venture agreement. If the foreign company has the technical expertise in the particular endeavor or project and the Saudi partner has the ability to provide financial and support services, such as the furnishing of office space, visas, permits, clearances, housing, transportation, medical care and the like, then the foreign company will be the logical party to provide the management level employees, including the chief operating executive who is usually called the General Manager or the Managing Director. The joint venture agreement should clearly spell out who appoints and replaces the General Manager, what his powers are and what limitations there are on his authority. The obligations of both parties to the venture should be detailed and a decision should be made on whether a

\textsuperscript{121} 1979 Code, \textit{supra} note 65, art. 1.

\textsuperscript{122} Royal Decree M/6, \textit{supra} note 64, art. 162.

\textsuperscript{123} \textit{Id.} art. 161.

\textsuperscript{124} See note 1, \textit{supra}.

\textsuperscript{125} I.R.C. § 7701(a)(2) and (3); Treas. Reg. § 301.7701.2 (1960).

\textsuperscript{126} Royal Decree M/6, \textit{supra} note 64, arts. 167, 170.
Board of Directors is desired. A Board is optional under the Companies Regulations if there are less than twenty partners in the venture.\textsuperscript{128}

In addition, if the intent is to create a partnership, when drafting with an eye toward U.S. tax consequences, centralization of management must be avoided.\textsuperscript{127} In order to achieve this result, certain decisions such as decisions on the sale of assets or the pledging of joint venture property to secure debts should be specifically reserved either to the partners or the partners and General Manager jointly.

Profit sharing in a SALLP need not correspond strictly to the equity participation of the partners. Article 171 of the Companies Regulations provides that shares shall confer equal rights in the net profits, “unless the Memorandum of Association provides otherwise.”\textsuperscript{128} However, this right to agree to distribution of profits on a basis disproportionate to equity ownership is not without restriction. For example, Ministry of Commerce Circular 11-1088 issued by the Committee for the Classification of Contractors points out that to qualify under the Foreign Capital Investment Code, the Saudi partner must share proportionally in the ownership of fixed assets and have an effective role in the management of the enterprise.\textsuperscript{129} It would follow that the Saudi partner cannot be cut out of the profits altogether. Some justifiable share must be allocated to the Saudi partner in accordance with the allocation of duties with respect to the project.

Moreover, the Department of Zakat and Income Tax has expressed the view that a disguised agency arrangement cast as a joint venture in order to get a tax holiday falls short of meeting the requirements of the Companies Regulations.\textsuperscript{130} Hence allocation of a percentage of the gross revenue to the Saudi partner would not only be looked upon as a scheme to evade taxes but would also fail to meet the benefit sharing test of Article 171 of the Companies Regulations which speaks in terms of “profits.”\textsuperscript{131} The payment of a flat sum to the Saudi partner without reference to profit would also be contrary to Article 171 of the Regulations.\textsuperscript{132} Nevertheless, a reasonable adjustment of profits between the partners authorized by a carefully drafted clause of the Memorandum of Association is in accordance with the Regulations.\textsuperscript{133}

Provisions to dissolve the SALLP automatically in the event one partner dies, or becomes bankrupt or otherwise insolvent, are advisable, particularly if partnership status for U.S. tax purposes is desired. In

\textsuperscript{128} Id. art. 171.
\textsuperscript{129} See note 1, supra.
\textsuperscript{130} Author's knowledge of private unpublished cases.
\textsuperscript{131} Royal Decree M/6, supra note 64, art. 171.
\textsuperscript{132} Id.
\textsuperscript{133} See note 1, supra.
Saudi Arabia, inheritance of the partnership share of the Saudi partner would be governed by the Shari’ah. This could well result in the equity being split among a number of relatives who may or may not have business acumen or interest in the venture. Moreover, the joint venture agreement should contain provisions allowing one or more parties to withdraw from the venture if that proves desirable at any time. Where such provisions do not exist, a foreign company can find itself locked into an unsatisfactory relationship that can only be resolved by withdrawing from the Saudi Arabian market altogether.

Settlement of disputes between joint venture partners is another area requiring provisions in the initial agreement. As of June 7, 1980, Saudi Arabia is a signatory to the International Centre for the Settlement of Investment Disputes (hereinafter “ICSID”) Convention. The Centre is a forum for the resolution of disputes between governments and private contracting parties. Parties signing the Convention waive local jurisdiction and agree that ICSID arbitration decisions are binding in the courts of the 82 member states.

Companies wishing to use ICSID must indicate such in their contracts. National membership in the Convention is not sufficient in itself. Once such language is in the contract, neither party may repudiate it unilaterally. However, a party may qualify its consent.

In their instrument of ratification, the Saudis reserved the right not to submit to ICSID questions “pertaining to oil and pertaining to acts of sovereignty. . . .” “Acts of sovereignty” is a vague term of art referring to the discretionary rights of a government.

Prior to Saudi ratification of the ICSID Convention, Saudi Arabia had a record of refusing to acknowledge foreign arbitration institutions and their decisions. As recently as February 13, 1979, Arab News, a Jeddah English language daily newspaper, reported that the Ministry of Commerce had taken the position that clauses in contracts for work in Saudi Arabia specifying arbitration outside of Saudi Arabia were “null and void.” The article said such disputes should be settled before the Grievance Board (an autonomous agency of the Saudi Arabian government).

Saudi Arabia’s ratification of the ICSID Convention would appear to contradict an existing Resolution of the Council of Ministers prohibiting any Saudi government agency from including in a contract a clause which would submit it to jurisdiction of a foreign commission or court. Moreover, it forbids arbitration by government agencies with foreign contractors except in special cases. In all government contracts, resolution of disputes is subject to the jurisdiction of the Grievance Board.

1980 DOI NG BUSINESS IN SAUDI ARABIA

1980

134 Saudi Arabia: Into ICSID—With Reservations, Middle East Executive Reports, vol. 3, no. 6 at 13, 24 (June 1980).
135 Id.
As yet, the Saudis' willingness to apply all elements of the ICSID Convention has not been tested. Full application of ICSID's provisions would permit the typical Saudi joint venture company doing business with the Saudi government, to make use of ICSID, so long as management is substantially foreign controlled, even though it is technically a Saudi juridical person. Also, a foreign participant, regardless of its management role in a joint venture, may include in its contract that it has the right to ICSID arbitration with respect to its interest in the venture.\footnote{136}

In the private sector, no legal restrictions exist with respect to foreign arbitration. If a party were to seek enforcement in Saudi Arabia of a foreign arbitral award, it would be by petition to the Commission for the Settlement of Commercial Disputes (Commercial Court). Not being bound by any legal constraint to enforce the award, the Commercial Court could, and very often does, consider the whole case \textit{de novo} and decide whether the award, or any part of it, is consistent with the laws, regulations and policies of the Kingdom of Saudi Arabia. It may decide to enforce only part or none of the award.

Until ratification of the ICSID Convention, the Ministry of Commerce had reportedly taken the position that it would not approve contracts or memoranda of association which contained foreign arbitration provisions. Therefore, it had been and in some instances may still be, desirable to use an arbitration panel sitting in Saudi Arabia as the dispute resolution mechanism. In drafting such a clause, it is desirable to pick a Saudi Arabian official to appoint an arbitrator if one party refuses to cooperate in the selection process. ARAMCO uses a clause in all contracts with local companies designating the Minister of Industry and Electricity as the one to select arbitrators in default of action by a party.

Local arbitration has many favorable aspects. First, since the Kingdom is the seat of most disputes, fact finding and the production of evidence and witnesses is facilitated. Second, local arbitration conforms to trends in Saudi policy, and this should make enforcement by the Commercial Court more readily available. Third, it avoids the unnecessary expense of a foreign arbitration, which, as we have seen, may not be enforced in Saudi Arabia and which may, therefore, necessitate proceedings before the Commercial Court. And last, in order to register a SALLP, its Memorandum of Association must be approved by the Ministry of Commerce which had stated, prior to ratification of the ICSID Convention, that it would not sanction arbitration outside the Kingdom.

Once a joint venture agreement is hammered out between the parties, they must apply for a license on a form stipulated by the FCIC.\footnote{137}

\footnote{136} Id.  
This application must be accompanied by a group of documents listed on the form, such as resolutions of the Board of Directors of the foreign company, financial statements, and the like. All of these documents must be notarized and attested by the proper state officials including the U.S. Secretary of State when a U.S. firm is involved, and then consularized by a Saudi Embassy or Consulate. After a foreign investment license is granted by the Minister of Industry and Electricity, the SALLP must be registered with the Ministry of Commerce under the provisions of the Companies Regulations. The SALLP is the most common and most extensively used form of organization for construction, manufacturing and service enterprises.

VI. CONCLUSION

Before entering a foreign market a business must first determine those alternatives open to it and then determine which form of investment will be most advantageous. This choice greatly depends upon the legal requirements and restrictions the foreign nation has placed upon the different investment opportunities. These requirements and restrictions are in turn greatly affected by the internal requirements of the foreign nation.

In Saudi Arabia there is no need for foreign expertise in merchant and trading activities, therefore import for resale and distribution operations are not open to foreign investment. However, the Kingdom encourages foreign involvement in areas such as manufacturing operations. Those activities may qualify for special incentives, such as tax holidays, low rental rates for land in industrial estates, some protected status, and favored treatment in government purchases. The usual vehicle for forming such a venture is a Saudi Limited Liability Partnership which has considerable flexibility to accommodate the partners' needs and which also has U.S. tax planning advantages.

Branch registration without Saudi equity participation is another alternative form of investment, but it has limited utility since it is subject to Saudi company taxes and receives lowest priority on government bids.

In order to take full advantage of investment opportunities offered by foreign countries, and in particular Saudi Arabia, the potential investor must evaluate closely both its needs and the country's regulations. Careful planning can maximize the benefits for all involved.

138 See note 1 supra.
139 Royal Decree M/6, supra note 64, art. 164.
140 See note 1 supra.
141 Royal Decree No. 11, supra note 23. Council of Ministers Resolution No. 54, supra note 22.