

Construction in Saudi Arabia: the next big thing?

By Ben Cowling



With the decline in the economies of the developed world, many construction and infrastructure companies are broadening their horizons. In particular, there has been huge interest in construction the Kingdom of Saudi Arabia (KSA) as ‘the next big thing’ – and with good reason.

The KSA is the largest construction market in the Arabian Gulf region by some margin. In 2011, contracts worth US\$66 billion were awarded in the KSA, a 6 percent increase on the previous year (source: *MEED*). The Kingdom’s ‘Ninth Development Plan’ forecasts public spending of US\$384 billion between 2010 and 2014. While a large proportion of the KSA economy is driven by oil exports, the Government is making significant efforts to promote other industries (for example, the recent strategic joint venture between Saudi Aramco and Dow Chemicals).

From the in-house lawyers’ perspective, this begs the question: what is the contractual landscape for the construction industry in the KSA? Not surprisingly, the answer is not straightforward but this article provides an overview of some ‘big picture’ issues.

First, it is useful to understand a few things about the legal system generally. The KSA is an Islamic state with a system of Shari’ah law. In contrast to surrounding countries, however, the KSA has not enacted a ‘civil code’ that codifies rights and obligations arising from contracts and other commercial relationships. This means that, subject to some significant areas where regulations have been passed (such as government procurement), the law applying to commercial transactions is a set of broad Islamic principles. Fortunately, such principles recognise parties’ freedom to contract on whatever terms they see fit, subject to matters that are expressly prohibited by Shari’ah.

In this context, the first question for in-house counsel to ask is whether the prospective construction contract concerns a government project or a private project. If it is the former, government procurement regulations will impact on the contractual relationship and the underlying risk allocation. If it is the latter, such

regulations will not apply but Shari’ah law principles may still impact on the contract terms.

It is worth considering the position in each case by reference to what international contractors are used to – say an FIDIC (International Federation of Consulting Engineers) ‘Red Book’ arrangement. In the case of a government project, significant features of the contract may include the following:

- ‘Employer’s risks’ are much narrower.
- 10-year warranty against partial or full collapse.
- Grounds for EOT (extension of time) are much more limited.
- Variations are limited to a maximum increase of 10 percent and a maximum decrease of 20 percent in the total Contract value.
- Contractor has no right to suspend the works and the Employer has broader termination rights.
- Contractor loses various rights and entitlements if he does not make a claim or give a notice within a defined period of time.

In the case of a private project, even if the parties contract on the basis of a FIDIC ‘Red Book’ contract, Shari’ah law may adjust the rights and obligations of the parties as set out in the contract, including:

- Restrictions on the availability of compensation for loss of profit, indirect loss or other consequential loss.
- Potential unenforceability of deeming clauses that say that rights are lost or waived if proper notice is not given within a specified time and of clauses which limit or exclude liability.
- Potential unenforceability of agreements to set compensation payable in the event of future defaults.
- Risks in *force majeure* clauses may be reallocated.

There are many more issues that contractors need to think about before they enter the KSA construction market. These include local establishment, teaming / JV arrangements, licensing, visas, labour, insurance, tax / zakat issues and dispute resolution processes. It has not been possible to cover all of these issues in this article, hence contractors should seek specific advice if required.

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