

## So You Want to Do Business with the Saudi Government

Doing business with the Saudi government can be as cumbersome and time consuming as dealing with any national government. Moreover, doing business with the Saudi government raises a host of issues not often encountered in other jurisdictions. Nonetheless, for those businesses that are willing to invest the time and effort, doing business with the Saudi government can be a rewarding experience.

The 2013 budget of the Government of the Kingdom of Saudi Arabia anticipates expenditures of SAR 820 billion (approximately US\$ 218.67 billion). Spending plans for key public sector areas outlined in the budget include:

- (a) **Education and training** was allocated SAR 204 billion (approximately US\$ 54.4 billion), a 21% increase over the 2012 allocation, the highest increase since 2007. This will be used to finance work on 539 new schools and 1,900 existing school-construction projects as well as the necessary funds to refurbish 2,000 schools. The allocation also included 15 new colleges and further work to be undertaken on the construction of facilities at newly-opened universities. SAR 13.4 billion (approximately US\$ 3.57 billion) has been appropriated for an electronic university; no other new universities are planned. In addition, SAR 4.25 billion (approximately US\$ 1.13 billion) has been allocated to build three new college hospitals. Finally, SAR 21.6 billion (approximately US\$ 5.76 billion) has been allocated for the over 120,000 Saudi students studying abroad and their families.
- (b) **Health and social affairs** was awarded a 16% rise in its budget, to SAR 100 billion (approximately US\$ 26.67 billion), accounting for 12.2% of total spending. New projects in this area will include construction of 19 new hospitals and healthcare centers, adding to the 102 already in progress. Social projects will include construction of 20 new sport club centers and 15 social and rehabilitation centers and social security offices at a cost of SAR 29 billion (approximately US\$ 7.73 billion).
- (c) **Water, agriculture and (related) infrastructure** spending is budgeted at SAR 57 billion (approximately US\$ 15.2 billion), an increase of 11%. Funds have been set aside for new silo projects, in addition to enhancing water and related utility services supply and improving the water and water treatment networks.
- (d) **Transport and telecommunications** received the third largest increase of any of the areas announced. Spending is budgeted to rise by 16% to SAR 65 billion (approximately US\$ 17.3 billion). New projects in the transport sector include finishing work on existing road projects, finishing industrial cities' and Ras Al-Khair's infrastructure projects, in addition to new sea ports and construction of railways.
- (e) **Municipality services** were given a 23% increase in budget, the highest increase of any of the areas announced. The total allocation thus increased to SAR 36 billion (approximately US\$ 9.6 billion) of which SAR 4 billion (approximately US\$ 1.07 billion) will be financed from municipality services. The spending retains the same focus as previous years.
- (f) Although not disclosed in the budget announcement, it is likely that **defense and security** accounted for the largest component of government spending. According to the Saudi Arabian Monetary Agency, defense and security spending accounted for 30.8% of the budgeted total in 2012, the lowest proportion

since 1984. Several multi-billion dollar defense contracts have been signed in last few years, and media reports of new agreements appear periodically. These payments tend to be spread over many years, so the additional impact on spending in 2013 should not be too great.<sup>1</sup>

If your business is considering bidding for some of the work anticipated by the Saudi government's 2013 budget, there are a variety of issues of which you should be aware.

## 1. LEGAL CONTEXT

Speaking generally, the procurement of products and services by the Saudi government is governed by the Saudi Arabian Government Procurement Regulations<sup>2</sup> (the **GPR**) and their implementing regulations<sup>3</sup> (the **GPIR**). That said, although the GPR and GPIR do generally apply to most Saudi government entities, certain Saudi government entities are not subject to the GPR and the GPIR.<sup>4</sup>

## 2. PUBLIC BIDS

### 2.1 Public Tender

Speaking generally, the GPR and the GPIR require Saudi government entities to procure products and services through public bids.<sup>5</sup> A Saudi government entity seeking to procure a product or service (the **Government Agency**) is obliged to prepare and advertise a request for tenders (the **RFT**). Where the value of the project is less than SAR 50 million (about US\$ 13,333,333), the RFT must be advertised for at least 30 days; where the value of the project is SAR 50 million (about US\$ 13,333,333) or more, the RFT must be advertised for at least 60 days.<sup>6</sup>

### 2.2 Exceptions to the Requirement for Public Bids

#### (a) Direct Procurement

<sup>1</sup> Jadwa Investment. "Saudi Arabia's 2013 Budget." 29 December 2012. [http:// www.jadwa.com/en/download/2013-saudi-arabia-s-budget/economic-research-12-1-1-1+saudi+arabia+government+budget+2013&cd=3&hl=en&ct=clnk&gl=sa](http://www.jadwa.com/en/download/2013-saudi-arabia-s-budget/economic-research-12-1-1-1+saudi+arabia+government+budget+2013&cd=3&hl=en&ct=clnk&gl=sa); see also Saudi Arabian Ministry of Finance. "Press Release: Recent Economic Developments and Highlights of Fiscal Years 1433/1434 (2012) & 1434/1435 (2013)" 29 December 2012. <http://www.mof.gov.sa/English/DownloadsCenter/Budget/Statement%20by%20the%20Ministry%20of%20Finance%202013%20Final.pdf>

<sup>2</sup> The Government Tenders and Procurement Regulations, as enacted by Royal Decree No. M/58 dated 4/9/1427 H / 27 September 2006 (the **GPR**).

<sup>3</sup> The implementing regulations of the Government Tenders and Procurement Regulations, as enacted by Minister of Finance Resolution No. 362 dated 20/2/1428 H / 10 March 2007 (the **GPIR**).

<sup>4</sup> See Article 69 of the GPR.

<sup>5</sup> See Article 6 of the GPR.

<sup>6</sup> See Article 10(5) of the GPIR.

In urgent cases<sup>7</sup> where the value of the contract is not more than SAR 1 million (about US\$ 266,667), a Government Agency can procure works, services, or products by direct procurement.<sup>8</sup> Where a Government Agency resorts to direct procurement,

- (i) the Government Agency must solicit at least three bids; and
- (ii) the successful bidder will be determined by the Minister or head of the Government Agency.<sup>9</sup>

(b) Works and Products Excluded From Public Bids

The following works and products do not need to be procured by public tender and can be procured by direct procurement even if the value of the works or product exceeds the SAR 1 million (about US\$ 266,667) limit imposed on direct procurements.<sup>10</sup>

- (i) arms, military equipment, and their spare parts, which must be procured by direct procurement from the manufacturer;
- (ii) consultancy services, which must be procured by inviting five specialized and licensed offices to submit their offers within a deadline set by the Government Agency. The resulting tenders are reviewed by a review committee in the same way that publicly tendered tenders would be reviewed and awarded;
- (iii) spare parts for mechanical, electrical, and electronic machines and equipment, which must be procured by inviting at least three specialized businesses to submit their offers within a deadline set by the Government Agency. The resulting tenders are reviewed by a review committee in the same way that publicly tendered tenders would be reviewed and awarded;
- (iv) any works or products that are available only from a single contractor and for which there is no alternative shall be obtained through direct procurement, subject to certain conditions precedent;<sup>11</sup> and
- (v) medical supplies required on an urgent basis to respond to an epidemic.<sup>12</sup>

### 3. WHO CAN SUBMIT A BID?

#### 3.1 Single Bidder

<sup>7</sup> Works that need to be carried out on an ongoing basis (such as maintenance, cleaning, operation, catering, transportation, and other contracts that need to be provided on a periodic and repeated basis) and public works whose conditions, plans, and specifications are prepared beforehand do not generally qualify as “urgent cases”; see Article 69 of the GPIR.

<sup>8</sup> See Article 44 of the GPR.

<sup>9</sup> See Article 45 of the GPR.

<sup>10</sup> See Article 47 of the GPR.

<sup>11</sup> Before procuring the product from the sole provider, an RFT must be published as if the project were open for public tender just to confirm that no alternative providers are available; see Article 72(2) of the GPIR.

<sup>12</sup> See Article 47 of the GPR.

Generally,

- (a) the bidder must be licensed to do business in Saudi Arabia;<sup>13</sup>
- (b) in the case of public works contracts (i.e., generally construction, maintenance, and operation contracts), the bidder must have the classification necessary to undertake the project;<sup>14 15</sup> and
- (c) subject to certain exceptions, the bidder cannot be a Saudi government employee.<sup>16</sup>

### 3.2 A Consortium

A consortium of bidders can submit a single bid provided that:

- (a) the consortium members enter into a consortium agreement prior to submitting the bid;
- (b) the consortium agreement must be submitted with the bid and must:
  - (i) commit the consortium members jointly and severally to execute the project;
  - (ii) identify the consortium's representative;<sup>17</sup>

<sup>13</sup> See Article 2 of the GPR and Article 12(1) of the GPIR, which requires the bidder to hold a variety of certificates that can only be held by a Saudi business, including a commercial registration certificate, classification certificate (for public works contracts), tax certificate, social insurance certificate, Saudization certificate, Chamber of Commerce and Industry membership certificate, and foreign investment license (if the bidder has foreign capital).

<sup>14</sup> The Contractors Classification Regulations, as enacted by Royal Decree No. M/18 dated 20/3/1427 H / 18 April 2006 (the **CCR**) and its implementing regulations (the **CCIR**) require (subject to certain exceptions) contractors undertaking public works contracts to be classified under the CCR by reference to the contractor's financial, technical, administrative, and execution abilities. A contractor can be classified in class 1, 2, 3, 4 or 5 (class 1 being the highest classification) in up to:

- (a) 12 construction activities (e.g., construction of buildings, roads, water and sanitary projects, industrial projects, electrical projects, marine projects, etc);
- (b) 13 maintenance activities (e.g., building maintenance, road maintenance, etc); and
- (c) 9 operation activities.

The contractor's classification(s) will determine the type and value of public works contracts that the contractor can undertake. For example, a contractor classified in class 1 for the construction of industrial projects can undertake a public works project to construct an industrial project with a value of more than SAR 300 million (about US\$ 80 million), while a contractor classified in class 5 for the construction of industrial projects can undertake a public works project to construct an industrial project up to a value of SAR 10 million (about US\$ 2,666,666).

<sup>15</sup> Where a foreign contractor classified in its home jurisdiction participates in a Saudi company, the foreign contractor's classification can be considered when classifying the Saudi company provided that the foreign contractor has committed in the constitutional documents of the Saudi company to support the Saudi company financially, technically, and administratively so to guarantee the Saudi company's performance and fulfillment of its obligations; see Article 15(1) of the CCR. However, the fact that the foreign contractor has a foreign classification is no guarantee that the Saudi company will be similarly classified.

<sup>16</sup> See Article 13(1) of the GPIR. Article 13 of the GPIR also prohibits bidders who have been imprisoned for criminal acts in the course of contracting, bankrupts, minors, and persons not legally competent.

<sup>17</sup> The consortium agreement will also typically deal with:

- (a) the various responsibilities of the consortium's members;
- (b) the financial, technical, and personnel contributions of each consortium member to the consortium;

(continued...)

- (iii) none of the consortium members submit a separate or additional bid; and
- (iv) the consortium agreement cannot be amended after the submission of the bid without the consent of the Government Agency.<sup>18</sup>

#### 4. THE CONTRACT

The format of the contract between the Government Agency and the party selected to provide the desired product or service (the **Contractor**) will typically follow a standard form prepared by the Ministry of Finance.<sup>19 20</sup> The content of the contract will be largely subject to negotiation. However, there are number of issues that are almost invariably addressed in any procurement contract with a Government Agency.

##### 4.1 Delay

The contract will provide that delay by the Contractor in completion of the works will give rise to both delay penalties and supervision cost and fees.

If the Contractor fails to execute the contract within the stated deadline, it shall be subject to a delay fine of not more than 6% of the value of a supply contract<sup>21</sup> and of not more than 10% of the value of any other contracts.<sup>22</sup> The Contractor will also bear the cost of supervision of the project's execution during the period subject to the delay fine.<sup>23</sup>

The duration of the contract will be extended and the fine waived if the Government Agency and the Ministry of Finance agree that the delay was caused by factors beyond the Contractor's control.<sup>24</sup>

##### 4.2 Dispute Resolution

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- (c) future contractual arrangements between the consortium members if the consortium's tender is successful;
- (d) the appointment of each consortium member's representative for the purpose of dealing with other consortium members;
- (e) intellectual property;
- (f) termination and withdrawal; and
- (g) confidentiality.

<sup>18</sup> See Article 18 of the GPIR.

<sup>19</sup> See Article 72 of the GPR.

<sup>20</sup> A standard form of public works contract was issued pursuant to Council of Ministers Resolution No. 136 dated 13/6/1408 H / 1 February 1988. In June 2010, the Ministry of Finance circulated for comment a draft revised public works contract. However, so far as we are aware, no new form of public works contract has yet been adopted.

<sup>21</sup> The delay fine for a service contract will accrue at the rate of 1% of the contract value per week of delay, provided that the value of such delay fine cannot exceed 6% of the supply contract's value: see Article 77 of the GPIR. No delay fine shall be applied for periods of delay of less than one week: see Article 78(2) of the GPIR.

<sup>22</sup> See Article 49 of the GPR.

<sup>23</sup> See Article 50 of the GPR.

<sup>24</sup> See Article 51 of the GPR.



Any dispute arising from or in connection with the contract will be resolved by a three member committee established by the Ministry of Finance (the **MOF Committee**), the decisions of which can be appealed to the Saudi Arabian Grievances Board.<sup>25</sup>

Arbitration is not usually an option. Saudi Arabia's new Arbitration Regulations provide expressly that government agencies shall not agree to arbitration except after obtaining the consent of the President of the Council of Ministers (i.e., The King).<sup>26 27</sup>

In the event of a dispute arising from or in connection with the contract, the Contractor does not have the right to stop work. Rather, the Contractor must continue work and file a claim for compensation with the MOF Committee against the Government Agency.<sup>28</sup>

#### 4.3 Duration

Contracts for continuous service (e.g., maintenance, operation, catering) cannot have a duration of more than five years.<sup>29</sup> There is no specific limit on the duration of public works contracts, although the duration of such contracts must be proportionate to the volume and nature of the works and the value of the project.<sup>30</sup>

#### 4.4 Language

The contract must be executed in the Arabic language. It can be executed in a bilingual format with Arabic and another language, but in that case Arabic will be the governing language.<sup>31</sup>

Where the Contractor is a foreign business, it's not unusual for the contract to be negotiated in English and ultimately executed in a bilingual Arabic-English format. In this case, it's in the Contractor's interest to arrange for the Arabic-language translation of the contract. Although the Arabic-language version of the contract will need to be approved by the Government Agency (and perhaps others), preparing the Arabic-language translation should give the Contractor comfort that the Arabic-language translation of the contract accurately reflects the English-language version.

#### 4.5 Law

The contract will be governed by Saudi law. This means that the contract will be governed not only by Saudi legislation but also by Islamic law as enforced in Saudi Arabia.

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<sup>25</sup> See Article 78 of the GPR.

<sup>26</sup> See Article 10(2) of the Saudi Arabian Arbitration Regulations, as enacted by Royal Decree No. M/34 dated 24/5/1433 H / 16 April 2012.

<sup>27</sup> The restriction on the Saudi government's ability to participate in arbitration finds its roots in Council of Ministers Resolution No. 58 of 1963, which was supplemented by a Ministry of Commerce and Industry Resolution of 1979. Council of Ministers Resolution No. 58 of 1963 was issued in response to the loss of Saudi Arabia in a dispute with Aramco that was submitted to *ad hoc* arbitration in Switzerland.

<sup>28</sup> See Article 54 of the GPR and Article 49 of the GPIR.

<sup>29</sup> See Article 28(1) of the GPR and 42(1) of the GPIR.

<sup>30</sup> See Article 28(2) of the GPR.

<sup>31</sup> See Article 27 of the GPR.

One of the consequences of the contract being governed by Saudi law is that the Contractor's liability cannot be excluded or directly limited. Speaking generally, Islamic law as enforced in Saudi Arabia provides that where one party (**Party A**) is the direct cause of an actual loss suffered by another party (**Party B**), then Party A is strictly liable to indemnify Party B for the value of such actual loss.

This inability to directly limit or exclude liability often alarms first time Contractors, but it is not as bad as it might first seem. For while Party A's liability to indemnify Party B is strict, Party A's indemnification obligation extends only to the actual losses directly caused by Party A to Party B. "Actual losses" are perhaps most easily understood to be the out-of-pocket expenses that Party B has incurred as a result of Party A's actions. Accordingly, Party A will not usually be liable to indemnify Party B for intangible losses (e.g., lost profits, damage to reputation, pain and suffering) and will not typically be subject to punitive damages. So while Party A's liability to indemnify Party B is strict, the degree of Party A's liability to Party B is limited to actual losses only.

#### 4.6 Ministry of Finance

If:

- (a) the term of the contract exceeds one year; and
- (b) the value of the contract is SAR 5,000,000 (about US\$ 1,333,333) or more,

the contract must be reviewed and approved by the Ministry of Finance before the contract can be executed.<sup>32</sup> This can be particularly frustrating to the Contractor, as the Contractor will be negotiating the contract with a Government Agency that does not have final approval in respect of the contract. However, if the Ministry of Finance does not respond with comments on the contract within two weeks from the date of submission of the contract to the Ministry by the Government Agency, the Ministry of Finance will be deemed to have approved the contract.<sup>33</sup>

#### 4.7 Payment

The contract will typically provide for the payment of the contract's value in Saudi Riyals. However, the contract can specify payment in almost any other currency or even in multiple currencies, provided that the prior consent of the Ministry of Finance is obtained.<sup>34</sup>

If the RFT specified that an advanced payment to the Contractor would be available, then an advance payment of up to 10% of the value of the contract may be paid to the Contractor provided that:

- (a) the value of the advance payment does not exceed SAR 50,000,000 (about US\$ 13,333,333); and
- (b) the Contractor provides a bank guarantee<sup>35</sup> for the value of the advance payment.

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<sup>32</sup> See Article 32 of the GPR.

<sup>33</sup> See Article 32 of the GPR.

<sup>34</sup> See Article 37 of the GPR.

<sup>35</sup> The advance payment guarantee must follow the standard form prepared by the Saudi Arabian Monetary Agency.

A portion of the value of any advance payment will then be deducted from each payment made to the Contractor.<sup>36</sup>

Payment will be made to the Contractor in installments in accordance with the completed work as will be specified in the contract.<sup>37</sup> The last payment to the Contractor shall be not less than 10% of the value of the contract where the contract is a public works contract, and not less than 5% of the value of the contract where the contract is not a public works contract. The last payment to the Contractor will be paid only after preliminary acceptance of the works or delivery of the products.<sup>38</sup>

#### 4.8 Subcontracting

The Contractor can only subcontract some or all of the contract with the prior consent of the Government Agency, and the Contractor will in any case remain liable for the performance of its subcontractors.<sup>39</sup> However, where the Contractor is a foreign business or a Saudi business with less than 51% Saudi capital participation, the Contractor must subcontract not less than 30% of the value of the contract to wholly Saudi owned firms.<sup>40</sup>

#### 4.9 Tax

Generally, the contract cannot exclude the Contractor's obligation to pay Saudi tax.<sup>41</sup>

If the work is done by a Contractor in Saudi Arabia, then the Contractor will be subject to pay:

- (a) Saudi income tax at the rate of 20%<sup>42</sup> on a portion of the Contractor's tax base equal to the portion of the Contractor's capital that is held by non-GCC persons or entities;<sup>43</sup> and/or
- (b) *zakat* at the rate of 2.5% on a portion of the Contractor's taxable income equal to the portion of the Contractor's capital that is held by GCC nationals or entities.<sup>44</sup>

If the work is done by a Contractor outside of Saudi Arabia, then the Government Agency's payment to the Contractor will be subject to Saudi withholding tax at a rate of between 5% - 20% of the gross amount of the payment, depending on the nature of the payment.<sup>45</sup>

<sup>36</sup> See Article 38 of the GPR as amended by Council of Ministers Resolution No. 23 dated 17/1/1428 H / 5 February 2007.

<sup>37</sup> See Article 39 of the GPR.

<sup>38</sup> See Article 40 of the GPR.

<sup>39</sup> See Article 71 of the GPR.

<sup>40</sup> See Council of Ministers Resolution No. 124 dated 25/9/1403 H / 14 March 1983, as clarified by Ministry of Finance Circular No. 5767/404 dated 9/11/1404 H / 6 August 1984, Minister of Finance Circulars Nos. 3/1742 and 3/1743 dated 12/3/1406 H / 24 November 1985, and Council of Ministers Resolution No. 145 dated 7/7/1406 H / 17 March 1986.

<sup>41</sup> See Article 42 of the GPR.

<sup>42</sup> See Article 7(a) of the Income Tax Regulations, as enacted by Royal Decree No. M/1 dated 15/1/1425 H / 7 March 2004 (the **ITR**).

<sup>43</sup> See Article 6 of the ITR.

<sup>44</sup> See Minister of Finance Resolution No. 393 dated 6/8/1370 H / 13 May 1950.



#### 4.10 Variations

The contract will give the Government Agency the right:

- (a) to increase unilaterally the Contractor's obligations (within the scope of the contract) by not more than 10% of the value of the contract; and/or
- (b) to decrease the Contractor's obligations by no more than 20% of the value of the contract.<sup>46</sup>

The Contractor should not carry out any works or services that are not covered by the bills of quantity and the terms of the contract unless such works or services have been previously approved in writing by the Government Agency. If the Contractor carries out such works or services without the prior written approval of the Government Agency, the Contractor will not be paid for such works or services.<sup>47</sup>

#### 5. PERFORMANCE BOND

Within 10 days of the date of the award,<sup>48</sup> the Contractor must provide the Government Agency with an unconditional and irrevocable performance bond equal to 5% of the contract value.<sup>49</sup> The performance bond must follow the standard form prepared by the Saudi Arabian Monetary Agency.

The 10-day period may be extended by an additional 10 days. However, if the performance bond is not provided by the successful bidder before the expiration of the second 10-day period, the bidder's bid bond shall not be returned to the bidder and the government shall commence negotiations with the next best bidder. The performance bond must be kept until the successful bidder completes its obligations under the contract.<sup>50</sup>

Generally, the performance bond must be issued by a Saudi bank or by a foreign bank through a Saudi bank.<sup>51</sup> The performance bond must be valid for the term of the contract or, in the case of public works

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<sup>45</sup> See Article 68 of the ITR and Article 63 of the implementing regulations to the ITR. By way of example, the rate of withholding tax on payments for technical services or consulting services is 5%; the rate of withholding tax on payments for management services is 20%; the rate of withholding on royalty payments is 15%.

<sup>46</sup> See Article 36 of the GPR.

<sup>47</sup> See Article 59 of the GPIR.

<sup>48</sup> The Ministry of Finance has advised on an informal, no names, and nonbinding basis that "the date of the award" referred to in Article 33 of the GPR is the date on which a "notice of award" that the Government Agency will send to the successful bidder confirming that the successful bidder has been awarded the contract. [Does this mean the date of the notice? The date received? I'm confused][We understand it to mean the date of the signing of the contract, as until the contract is signed, the Government Agency can always choose another contractor if it can't agree terms with the preferred contractor] In practice, such notice is typically issued soon after the signing of the contract.

<sup>49</sup> See Article 33(1) of the GPR.

<sup>50</sup> See Article 33(1) of the GPR.

<sup>51</sup> See Article 34 of the GPR.

contracts, until completion of the maintenance period / defects notification period and final acceptance of the works.<sup>52</sup>

## 6. WITHDRAWAL OF CONTRACT

The Government Agency can withdraw the work from the Contractor and revoke the contract, or have the work completed at the Contractor's expense, with a right to claim any damages from the Contractor, where:

- (a) the Contractor, directly or indirectly, tries to bribe an official of the Government Agency or wins the tender by bribing an official of the Government Agency;
- (b) the Contractor fails to remedy any breach of the contract within 15 days of being instructed to do so;
- (c) the Contractor subcontracts some or all of the contract without the prior written consent of the Government Agency; or
- (d) the Contractor goes bankrupt, files for bankruptcy, is placed in receivership, or is dissolved and liquidated.<sup>53</sup>

If the Government Agency withdraws the contract from the Contractor, the Government Agency can unilaterally extend the duration of the Contractor's performance bond pending a final decision by the MOF Committee regarding the Contractor's liability.<sup>54</sup>

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<sup>52</sup> See Article 33(3) of the GPR.

<sup>53</sup> See Article 53 of the GPR.

<sup>54</sup> See Article 99 of the GPIR.