

## The Use of Local Representatives in Saudi Arabia

Recent disclosures with respect to the amount and type of payments made by certain multinational companies abroad in order to stimulate sales have raised questions with respect to the practice of using local marketing representatives who are compensated on a commission basis.<sup>1</sup> One solution to the problem might be to dispense with the use of such representatives entirely.<sup>2</sup> In Saudi Arabia, however, legal considerations often make the use of local representatives advisable, and in some cases even mandatory. This article will explore some of the legal considerations involved in the use of local representatives in Saudi Arabia and will propose guidelines designed to make their use less subject to the kinds of questions referred to above.<sup>3</sup>

It is perhaps appropriate at the outset to mention briefly the economic justification for the use of local representatives on a commission basis, particularly in a potential market like Saudi Arabia. In any new market, there are always the dual problems of becoming familiar with different cultural, sociological, economic and linguistic patterns, and developing a demand in the market for the products and services to be sold. Such a process, if independently

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<sup>1</sup>See, for example, SECURITIES AND EXCHANGE COMMISSION, REPORT ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES (May 12, 1976) (submitted to the Senate Banking, Housing and Urban Affairs Committee); MESSAGE FROM THE PRESIDENT URGING ENACTMENT OF PROPOSED LEGISLATION TO REQUIRE THE DISCLOSURE OF PAYMENTS TO FOREIGN OFFICIALS, H.R. DOC. 572, 94th Cong., 2d Sess. 3 (August 3, 1976); *Hearings on S. Res. 265 Before Subcomm. on Int'l Trade of the Senate Comm. on Finance*, 94th Cong. 1st Sess. (1975); and *Hearings on the Activities of American Multinational Corporations Abroad Before the Subcomm. on Int'l Econ. Policy of the House Comm. on Int'l Relations*, 94th Cong. 1st Sess. (1975).

<sup>2</sup>See Saudi Arabian Council of Ministers Resolution No. 1275, restricting payments of commissions to any middleman, sales agent, representative or commission agent in connection with any contract for the supply of arms or undertaking necessary installation therefore.

<sup>3</sup>A consideration of the effect of the various boycott and anti-boycott restrictions imposed on United States companies doing business with Saudi Arabia is not within the scope of this article.

pursued by a foreign company, requires extensive commitments of time, people and money. Use of a local representative, who is compensated only if and when sales are actually made, substantially decreases the level of such initial investment.

In the Saudi Arabian market, these considerations are particularly appropriate. Current estimates place the cost of putting a single American marketing executive with family in Saudi Arabia at somewhere around \$250,000 for the first year.<sup>4</sup> Beyond this, there are the time consuming qualification requirements and establishment procedures, as well as the time necessary for such executives to acclimatize themselves to the local customs and practices and potential local customers.<sup>5</sup>

### **I. Legal Considerations**

The legal considerations involved in the use of a local representative are complex, and vary with the type of activity envisaged. As with most foreign jurisdictions, it is not possible for a foreign company to simply lease space in Saudi Arabia, send in expatriate employees and begin to operate. Beyond this, unlike many foreign jurisdictions, there are certain restrictions on foreign operations in Saudi Arabia which require that the proposed Saudi Arabian operations meet certain substantive criteria, which often involve some form of participation by Saudi interests. Two basic restrictions are found in the Regulations for Commercial Agencies and the Foreign Capital Investment Regulations.<sup>6</sup> More specific restrictions are found in the Tenders Regulations and the Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis.<sup>7</sup>

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\*The main components of this cost are: housing, *e.g.*, an unfurnished three-bedroom house or apartment currently costs between \$30,000 and \$40,000 a year, payable two to three years in advance; a car and driver (women are not allowed to drive); transportation in and out of the country at fairly frequent intervals; education for the children, often outside of the country because of limited local facilities; general relocation expenses, often including the local purchase of new furniture and appliances at relatively high cost; and substantial pay differentials to compensate not only for the different environment but also for the added tax burdens resulting from the provision of the foregoing benefits and the negative effect of the recently enacted tax reform legislation relating to United States citizens working abroad.

<sup>4</sup>See generally, Mahlon Apgar IV, *Succeeding in Saudi Arabia*, HARVARD BUS. REV., January-February, 1977; and JOHN L. NESVIG, *THE SAUDI ARABIAN MARKET—A GUIDE FOR U.S. BUSINESSMEN*, published by the United States Department of Commerce.

<sup>6</sup>Regulations for Commercial Agencies, Royal Decree No. 11, 20 Safar 1382 (22 July 1962); Foreign Capital Investment Regulations, Royal Decree No. 35, 15 Shawal 1383 (25 February 1964).

<sup>7</sup>Regulations Governing Bids for Government Procurement, Sales and Leases, Royal Decree No. M/6, 24 Safar 1386 (13 June 1966); Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis, Royal Decree No. M/22, 12.7.1390 (September 13, 1970).

A. Regulations for Commercial Agencies

The Regulations for Commercial Agencies provide in Article 1 that:

Non-Saudis, whether in their capacity as natural or juristic persons, shall not be permitted to act as commercial agents in Saudi Arabia, and Saudi Companies acting as commercial agents shall have completely Saudi Capital and their directors and those authorized to sign for them shall be Saudis.

The term "commercial agent" is not otherwise defined in the regulations. However, a subsequent release relating to such regulation, interprets it as requiring that:

[a]ll imports to the Kingdom [be] carried out through Saudi merchants and agents and not through any other sources regardless of their headquarters.<sup>8</sup>

These regulations are generally construed, by those foreign companies currently operating in Saudi Arabia, to prohibit them from directly selling imported goods in the country. The prevailing practice is therefore to sell goods imported into Saudi Arabia only through Saudi-owned entities, usually pursuant to distribution agreements.<sup>9</sup> Such regulations have not been construed to prohibit direct sales from outside the Kingdom to purchasers, including the government, within the Kingdom.<sup>10</sup>

B. Foreign Capital Investment Regulations

There are several types of activities in which a foreign company might want to engage which are not covered by the Commercial Agencies Regulations. Thus, the foreign company may desire to have an office in Saudi Arabia only to provide after-sales service. Or, a foreign company might want to construct a facility to manufacture or assemble its products in Saudi Arabia, for sale to the government, for use in its own projects or for sale to non-governmental entities. To the extent that a foreign company intends to derive a profit from any of these activities, it cannot engage in them unless it complies with the provisions of the Foreign Capital Investment Regulations which require that:

Application for permission to invest foreign capital shall be submitted to the Committee for the Investment of Foreign Capital in the appropriate form together with the statements which the Ministry . . . may request.<sup>11</sup>

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<sup>8</sup>Release of Ministry of Commerce and Industry, February 3, 1971.

<sup>9</sup>See M. FIELD, A HUNDRED MILLION DOLLARS A DAY, pp. 178-84, Sedgwick and Johnson, 1975.

<sup>10</sup>In this connection, Article 2 of The Tenders Regulations, discussed *infra*, prohibits the use of brokers and intermediaries in certain types of sales to the government. There is also a tax reason for consummating sales outside of the country since foreign companies which derive income from activity within Saudi Arabia are subject to a tax on such income at rates of up to 45 percent for income in excess of 1,000,000 Riyals, unless they are the beneficiaries of a tax holiday as the result of a license granted under the Foreign Capital Investment Regulations. See Royal Decree No. 17/2/28/3321, as amended.

<sup>11</sup>Article Three of Foreign Capital Investment Regulations. The Committee is attached to the Ministry of Industry and Power and consists of representatives from such Ministry, and from the Ministries of Finance, Agriculture and Petroleum and of the Ministry of Planning.

“Foreign Capital” is defined in the Code as anything of value, such as money, equipment, spare parts, products or means of transport, when owned by a natural or corporate person who is non-Saudi.<sup>12</sup>

In order to obtain a license to make such investment, a showing, satisfactory to the Committee, must be made that the investment is for an “economic development project.”<sup>13</sup> Such a showing involves the submission of a relatively lengthy application and a feasibility study together with a variety of undertakings including one with respect to the funding of the project.<sup>14</sup> The Committee makes its decision on the basis of this application. Although a Saudi Arabian partner is not required by the Regulations unless a tax holiday is sought, in practice, the Committee’s decision appears often to be conditioned on at least a 25 percent Saudi participation in the project and, as noted elsewhere herein, higher percentages of Saudi ownership entitle the project to certain significant additional benefits.<sup>15</sup>

In view of the foregoing, it is certainly possible to conceive of projects for which a foreign investment license will not be granted either because they do not meet the test of being “economic development projects” or because they do not contemplate the requisite level of Saudi participation. If such a license is not granted, it will not thereafter be possible, with two exceptions, for a foreign company to operate within Saudi Arabia, except through a local representative.<sup>16</sup> The two exceptions are (i) operating under a limited license which would be granted to any person or company for the purposes of performing a contract with a specific governmental agency and which would expire upon completion of such contract; and (ii) operating through a Saudi sponsor, who would act as employer of the foreign company’s personnel while operating within Saudi Arabia. The Saudi sponsor would have to provide for the deportation of such persons upon expiration of their residence permits, and justify the presence of such persons by establishing the need for their services and non-availability of nationals to do their work.<sup>17</sup> The former exception is less

<sup>12</sup>Article One of Foreign Capital Investment Regulations.

<sup>13</sup>Article Two of Foreign Capital Investment Regulations.

<sup>14</sup>There are different forms for such application depending upon the nature of the project. It is important to note that although the minimum capital required for a limited liability company under the Regulations for Companies is only 50,000 Riyals, the Committee reviewing the application requires that the legal entity through which the project is to be carried out should have a capital sufficient to meet the estimated capital needs of the project, even though such figure may exceed the minimum amount required by the Regulations for companies.

<sup>15</sup>See, B. Nelson, *Tax Planning for Middle East Operations*, TAX PLANNING INT’L. Vol. 4, No. 2, February 1977, p. 23.

<sup>16</sup>In order for any business, whether Saudi or foreign, to operate within Saudi Arabia, it must be registered in the Commercial Register. Commercial Register, Royal Decree No. 21/1/4470, 9 Qida 1375 (June 18, 1956). A foreign company will not be registered in the Commercial Register and get a Commercial Register number, unless it has a valid license from the Committee for the Investment of Foreign Capital.

<sup>17</sup>Article 43, Residence Regulations, Royal Decree No. 17/2/5/1337 of 11.9.1371 A.H. Safar.

than satisfactory for a foreign company committed to a full-scale effort within Saudi Arabia and may, as hereinafter noted, require at least the limited use of a Saudi representative. With the latter exception, there does not seem to be any way to avoid the use of a Saudi entity as sponsor.

### C. *The Tenders Regulations*

The Tenders Regulations cover the purchase of materials and the issuance of work requisitions by ministries and independent agencies of the government through competitive bidding, negotiation and direct procurement.<sup>18</sup> Article 32 of the Regulations requires that:

A bidder must either be a resident of the Kingdom or have a (resident) agent therein. Otherwise, he must state in his bid the (the name) and address of his authorized agent in the Kingdom, so that the latter may be contacted if the contract is awarded to such bidder.

The various interpretations relating to the Article indicate that, in spite of the language used, designation by the foreign bidder of a local commercial agent is not in fact required.<sup>19</sup> Rather, the bidder must name a person or give an address within Saudi Arabia by whom or with which, contact can be made with the foreigner.

### D. *Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis*

In another specialized area, that of real estate development projects, a problem is often caused in mortgaging and financing such projects by the Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis. The regulations provide, with certain exceptions, that:

A Non-Saudi shall not be allowed by any means other than inheritance to acquire the rights of ownership or any other corporeal and original right with regard to real estate located within the Kingdom of Saudi Arabia.<sup>20</sup>

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<sup>18</sup>These Regulations are currently in the process of being reviewed and possibly revised, although as of the date of this article, no new regulations have been formally approved.

<sup>19</sup>Article 2 of such Regulations, and the interpretations thereof, discussed *infra*, would appear to discourage the use of brokers and therefore support this view. Further, Royal Order No. 477, dated 12.1.1388 A.H., addressed to the Minister of Finance and National Economy provides only that foreign companies must "choose a place of residence in the Kingdom to address all official correspondence . . ." Finally, in Circular No. 4330/12/1 dated 23.3.1389 A.H. the Minister of Finance has indicated that it:

[w]ishes to explain that the Tenders Regulations do not stipulate that a bidder residing abroad should have a commercial agent. It will suffice if he provides a name and address to which correspondence related to the bid will be sent.

<sup>20</sup>Article One of Regulations for Ownership of Real Estate in the Kingdom by Non-Saudis. The exceptions relate to: (a) diplomatic missions; (b) agricultural use; (c) land required by businesses which have obtained foreign capital investment licenses; and (d) where a Royal Decree has been obtained.

*E. Conclusion*

The foregoing general and specific legal restrictions make two points clear. First, almost any attempt by a foreign company to operate in the Saudi Arabian market will probably require the injection, at some point, of a Saudi Arabian individual or Saudi-owned entity. Second, the Saudi entity selected must be an organization of some substance, with a capacity, among other things, to assist in obtaining visas and residence permits, to act as a distributor of the foreign company's products, to represent the foreign company in governmental tenders, to locate residential housing, to make available office space, transportation and communication, and to own land.

## **II. Guidelines for Agreements with Local Representatives**

If it is difficult for a foreign company to commence any sustained operations in Saudi Arabia without some form of local representation, it is therefore necessary for United States companies to develop procedures which will insure that their relationships with such local representatives and the activities resulting therefrom are not subject to question either in the United States or in Saudi Arabia.

In this connection, the Saudi Arabian Regulations for Combatting Bribery, which are general in their language and wide in their application, are of primary importance.<sup>21</sup> Such regulations relate to public servants and provide punishment for, among other things, the performance or non-performance by such officials of even legitimate acts, if done in return for promises or gifts, or as the result of requests, recommendations or intercessions. Such regulations punish the briber, intermediary and any one who agrees on, instigates, or knowingly assists in, the commission of bribery. Penalties include jail sentences and fines.<sup>22</sup> A "promise or gift," includes any benefits or privilege of whatever kind or name, whether financial or otherwise.<sup>23</sup>

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<sup>21</sup>Regulations for Combatting Bribery, Royal Decree No. 38, 22 SHAWWARD 1377 (11 May 1958).

<sup>22</sup>Article 1 of the Regulations for Combatting Bribery provides that:

Any public servant who solicits for himself or for others, or who accepts or obtains a promise or a gift for the performance of one of the duties of his office or one which he alleges to be so, even though the act involved be legitimate, shall be considered a bribee and shall be liable to imprisonment for a term of one to five years and to a fine of five thousand to one hundred thousand Saudi riyals, or to one of these two penalties. The public servant's intention not to perform the promised act, shall not affect the existence of the crime.

and Article 8 provides that:

Whoever offers a bribe which is not accepted, and whoever uses force, violence, or threat without attaining his purpose, shall be liable to imprisonment for a term of six to thirty months and to a fine of two thousand five hundred to fifty thousand riyals, or to one of these two penalties.

<sup>23</sup>Article 11 of Regulations for Combatting Bribery.

In addition, Article 82 of the Tenders Regulations provides that:

If the supplier or contractor is proven to have personally or through an intermediary, either directly or indirectly, offered or attempted to offer a bribe to any Government official or employee connected with the work forming the subject of the contract, his contract shall be immediately cancelled and the deposit forfeited in full. In addition, his name shall be crossed out from [the list of] suppliers and contractors, and necessary action shall be taken to bring him to court.

As the foregoing would suggest, even without giving effect to the growing number of restrictions imposed in the United States on payments to foreign governmental officials, the multinational company which elects to operate in Saudi Arabia has a powerful incentive to structure its relationship with its local representative so as to minimize questions with respect to a violation of any local laws. In drafting agency and representation agreements, there are four general rules which help to achieve this result.<sup>24</sup> These rules are:

- (a) Use of a Saudi Arabian representative with an established reputation.
- (b) Description of services to be provided by the representative.
- (c) Control over payments to be made to the representative.
- (d) Negative covenants by the representative with respect to prohibited and questionable activity.

#### *A. Use of a Saudi Arabian Representative With An Established Reputation*

The reasons for emphasizing that the local representative should have an established reputation are twofold. First, a representative with an established reputation will have a vested interest in a continuing presence in Saudi Arabia, and will be less likely to jeopardize its past and future ability to do business by engaging in questionable practices on any particular transaction. Secondly, if the representative is established it will presumably have an organization which will be capable of providing a wide range of services such as local office and communications facilities, translation services, information on potential markets, legal information and advice and housing facilities.

The reasons for the use of a Saudi Arabian entity as a local representative are presumably manifest from the analysis set forth above under "Legal Considerations."

Beyond this, there is also a tax reason. Often the parties may wish to compensate the local representative for its services in currencies other than Riyals and in locations other than Saudi Arabia.<sup>25</sup> If the local representative is a

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<sup>24</sup>There are other basic components of such agreements which should not be overlooked such as provisions relating to time of payment, description of territory, arbitration, governing law and language. Such matters are, however, outside the scope of this article.

<sup>25</sup>For example, the local representative may want to use its receivables to secure bank borrowings outside of Saudi Arabia, or it may want to fund investments or operations in other locations.

Saudi-owned entity, it is not, under the income tax regulations, subject to taxes on its income in Saudi Arabia.<sup>26</sup> If the representative is not a Saudi entity, it is subject to Saudi Arabian taxes on income derived from its operations within the country.<sup>27</sup> Consequently, use of a Saudi Arabian rather than a foreign representative will enable the foreign company to compensate such representative outside of Saudi Arabia, without being concerned with whether such a procedure might be viewed as assisting the local representative to avoid Saudi income taxes. It should also be noted that there are currently no exchange control restrictions in Saudi Arabia, and payments outside Saudi Arabia would not be subject to challenge on those grounds.

Because of the importance of having an established Saudi Arabian entity act as local representative, any agreement between the foreign company and the local representative should not be assignable by the representative without the consent of the foreign company, even if such assignment is only to party controlled by or related to the representative.

#### *B. Description of Services To Be Provided by the Representative*

In any local representation agreement the services to be performed by the local representative should be clearly articulated for two reasons. First, if a foreign company pays substantial commissions to a local representative under an agreement which is not specific as to the services to be performed, there is always the question of the *quid pro quo* for which the foreign company is compensating the representative. Secondly, as a principle of general contract law, the foreign company is better able to determine whether an agreement has been breached, if it has specific standards by which to test the representative's performance.

Specificity as to services to be provided is encouraged by Article 2 of the Tenders Regulations, which provides that:

Brokerage shall be prohibited in contracting for the procurement of materials which are usually sold to the Government alone, such as locomotives, railroad cars; telephones, arms and ammunition, whether or not the contract is to be concluded through the invitation for bids,

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<sup>26</sup>Royal Decree No. 17/2/28/3321, 21 Muharram 1370 (November 2, 1950), as amended. Article 1 of the Regulations provides in part that:

Saudi nationals and Saudi companies, whose capital, partners and shareholders are entirely Saudi, shall not be liable for income tax.

<sup>27</sup>Article 1 of the Income Tax Regulations provides that:

A tax is . . . levied on the profits of non-Saudi companies operating inside the Kingdom or inside and outside the Kingdom simultaneously. A tax is also imposed on the profits distributed to non-Saudi nationals for companies jointly formed with Saudi and foreign capital.

as well as by the circular of the Ministry of Finance relating to Article 78 of the Tenders Regulations, which states that:

[c]ontracts (covered by the regulations) should include a provision by which the contractor declares that he has not paid any commission to any broker or intermediary for the purpose of securing the contract; and if it is proven otherwise, the competent department may deduct an amount equivalent to the commission from the amounts due to the contractor.<sup>28</sup>

Although the matter is not free from doubt, a letter from the Deputy Minister of Finance provides some guidelines as to the types of activities which are sought to be prohibited by the foregoing restrictions:

Prohibition of brokerage in contracting for the procurement of materials mentioned in Article 2 of the Tenders Regulations means that purchase of such materials by the Government through a broker is not permissible; i.e. no broker should act as intermediary between the producer of such materials and the Government. . . . Only companies that manufacture the materials subject to tender, whether public or restricted, may submit bids to supply such materials; any offer presented by any other party shall be considered illegal.<sup>29</sup>

The use of the terms "broker" or "intermediary" in the regulations, as well as the explanation contained in the interpretive material cited, suggest that what is prohibited is not the receipt of compensation for actual services, even though such compensation is contingent upon actual sales, unless such services involve acting merely as a broker or intermediary. Consequently, in order to lessen the risk of having the local representative classified as a "broker" or "intermediary," the nature of the other services to be provided should be specified.<sup>30</sup>

The foreign company should seek from its local representative provision of at least the following services:

1. Provision of information on local marketing opportunities, including proposed tenders and the activity of competitors.
2. Assistance in submission of bids and contacts and potential customers, including governmental agencies.
3. Advice with respect to local law and customs.
4. Assistance with the arrangement of local financing.
5. Provision of distribution facilities.
6. Agreement not to act for competitors.
7. Sponsorship of personnel and assistance with visas and residence and work permits.

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<sup>28</sup>Ministry of Finance and National Economy Circular No. 9818/4/1, dated 7.8.1388, ¶ 6.

<sup>29</sup>Deputy Minister of Finance and National Economy letter No. 5262/12, dated 2.5.1387.

<sup>30</sup>In this connection, Crown Prince Fahd has indicated that, even in situations involving armament sales, where the payment of commissions to local representatives is apparently banned,

We have no objection to the fact that companies manufacturing arms appoint Saudi agents who would be compensated for their services to these companies in the fields of maintenance, services and construction. Text of Al Anwar article, November 28, 1975.

8. Provision of local office space, clerical help, translation services, transportation and communication facilities.
9. Assistance with customs clearances and in the location of hotel and residential accommodation.

*C. Control Over Payments Made to Representatives*

As noted above, payment to the local representative, in foreign currency, outside of Saudi Arabia is not, in and of itself, prohibited. However, a foreign company should understand the form in which the payments will be made and the recipient thereof. There is, of course, no way to control the use of the funds after they are paid to the representative; but the foreign company should insist that the agreement specify the account to which payments will be made, and that such account will be owned and operated by the representative, rather than some third party. Further, the provisions as to payment of the representative should not be subject to unilateral alteration by the representative. Instead, any changes should be subject to prior consent of the foreign company.

*D. Negative Covenants by the Representative With Respect to Prohibited and Questionable Activity*

As noted above, it is important that the foreign company not be in a position where it could be deemed to have agreed on, instigated or knowingly assisted in, the making of any questionable payments. One way is to control the method of payment. Another is to include, in the representation agreement, covenants and representations by the local representative as to its past and future actions and its past and future relationships. Such covenants and representations should cover:

1. The ownership of the accounts into which payments to the representative are to be made.
2. The non-existence of any direct or indirect payments by the representative to directors, officers or employees of the foreign company.
3. The non-existence of any direct or indirect payments by the representative to any government officials or any employees of any purchaser, or any direct or indirect payments which are illegal under any applicable law.<sup>31</sup>
4. The non-existence of any relationships between the representative and any government officials or employees of or holders of beneficial interests in, any purchaser.
5. The fact that the representative has and will conduct its activities in compliance with all applicable laws.

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<sup>31</sup>In connection with representations 3 and 5, it is perhaps advisable to obtain an opinion of an independent, qualified, local counsel to the effect that the representation agreement and the performance contemplated thereunder are lawful and proper.

The function of such covenants and representations is threefold. First, it gives the local representative guidance as to what is expected of it by the foreign company. Secondly, it gives the foreign company cause for terminating the relationship should the representative violate any of such provisions. Thirdly, it helps to negate any argument that the foreign company agreed on, instigated, or knowingly assisted in the activity, or countenanced the relationships, covered by such covenants or representations.

### **III. The Joint Venture as an Alternative to The Representation Agreement**

The joint venture is a more permanent method of establishing the relationship between the foreign company and the local representative. It has several advantages over the use of the traditional representation agreement, if the foreign company concludes that it knows the local representative well enough to be confident of such a permanent relationship.

As has already been suggested, various Saudi Arabian regulations encourage participation by Saudi individuals or entities in most business transactions which take place within Saudi Arabia. The joint venture is one of the areas in which Saudi participation is encouraged.<sup>32</sup> If a foreign company wants to develop an operation within Saudi Arabia which qualifies as an economic development project, and it has a local representative who is appropriate and willing to act as a joint venturer, the foreign company can receive much more favorable treatment for its operations if pursued through the joint venture format than if pursued through the more traditional foreign company-local marketing representative relationship.

The range of what constitutes an economic development project has been expanded by the Committee for the Investment of Foreign Capital since the Regulations were approved. Currently, such projects include not only manufacturing and construction projects, but also some service projects. Consequently, except for pure commercial sales operations, where the Regulations on Commercial Agencies would still control, there is a good probability that most properly conceived and funded projects will qualify for a license under the Regulations although, as noted above, the application process is complicated and time-consuming and as a matter of practice, ownership of at least 25 percent by a Saudi partner or partners will probably be required.

At this point, it is perhaps useful to comment on the most appropriate legal form for the joint venture to take. Under the Regulations for Companies in

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<sup>32</sup>For example, Crown Prince Fahd has stated that:

[w]e encourage our businessmen to form Saudi foreign joint ventures specialized in executing construction and maintenance programs and to train Saudi manpower to qualify them in future to handle these technical jobs after having gained the necessary experience. Text of Al Anwar article, November 28, 1975.

Saudi Arabia there are several possible forms provided for, ranging from the loose "joint adventure," to a general partnership, to a limited partnership, to a limited liability company, to, finally, a joint stock company.<sup>33</sup> Primarily because the joint stock company requires a royal decree, it is not recommended. Likewise, because all of the other forms except the limited liability company result in unlimited liability for all or at least some of the investors, they are not advisable. Thus, the limited liability company (*Société à Responsabilité Limitée*) is the form recommended and most often used, since it allows limited liability for all of the investors, it is relatively easy to form, and it can have operating procedures which are, by and large, as simple or as complex as the investors desire.<sup>34</sup> Further, unlike limited liability companies in most jurisdictions, the articles of association governing the formation of a Saudi limited liability company may provide for profit distribution among the investors which does not necessarily correspond to their respective ownership interests.<sup>35</sup>

The resulting joint venture is not so very different from the foreign company-local representative arrangement, in terms of what each party will probably be contributing. The foreign company will usually supply management, technical expertise and the bulk of the financing, and the local representative will usually supply local supervisory personnel, local skilled and unskilled labor, and assistance in handling local business and governmental affairs.

After the foreign capital investment license has been granted, the resulting entity will be entitled to a variety of benefits, depending on the type of project and the percentage of the entity which is Saudi-owned. To the extent that an industrial project is contemplated, the venture may be entitled to exemptions from customs duties and export taxes, land at nominal rent, possible import restrictions on competing products and financial assistance.<sup>36</sup> Further, if at least 25 percent of the entity is Saudi-owned, the profits from the venture will be entitled to a five-year tax holiday; if at least 50 percent is Saudi-owned, the venture may bid for government contracts; and if at least 60 percent is Saudi-owned, the venture may be exempt from certain provisions of the Tenders Regulations requiring performance bonds.

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<sup>33</sup>Regulations for Companies, Royal Decree No. M6, 22 RABĪ 1385 (July 20, 1965).

<sup>34</sup>This form is also sometimes called a "limited liability partnership." It must have at least two investors and may not have as its purpose the conduct of an insurance, savings or banking business.

<sup>35</sup>See Article 171 of Regulations for Companies.

<sup>36</sup>This latter concession includes possible financial assistance from the Saudi Industrial Development Fund. Such financial assistance takes the form of loans of up to 50 percent of the total funds required for the fixed capital of the project. Such loans are repayable over periods of up to fifteen years, and carry bank charges at a rate of 2 percent per annum.

There are also substantial benefits in using the joint venture as a mechanism to monitor and control the operations by or on behalf of the foreign company in Saudi Arabia. For example, it is customary to have the managing director or one of the co-managing directors of such an entity be a representative of the foreign company. It is also customary to provide for a board of directors consisting of designees from both the foreign company and the Saudi representative. Such a board would meet regularly to review past and proposed future activity. In addition, the articles of association governing such an entity often provide that certain actions such as the operation of bank accounts cannot be taken without the consent of the foreign company's representative.

The joint venture form does not however remove the incentive of the local representative. Just as the representative's commissions were based on sales under the representation agreement, so the profits of the joint venture, and the portion of such profits representing the local representative's interest, would likewise continue ultimately to be based on sales.

#### **IV. Conclusion**

Although the practice of using local representatives in Saudi Arabia is currently undergoing a reappraisal, such representatives are probably still advisable, both for economic and legal reasons. The procedures and structures described in this article represent possible methods by which United States companies can continue to use such local representatives and still feel confident that they will not be subject to possible questions with respect to direct or indirect participation in questionable business activity.

