THE STRUCTURING OF AN ARBITRATION CLAUSE IN A CONTRACT WITH A SAUDI PARTY

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Introduction
The non-Saudi party will not need to consider how to structure an arbitration clause with a Saudi party, if the Saudi party is forbidden by law to enter into an arbitration agreement. According to Article 3 of the Arbitration Regulations enacted by Royal Decree M/46 and Article 2 of the Council of Ministers Resolution No. 58, it is prohibited for any Saudi Arabian governmental body to accept arbitration as a means of settling disputes. Under the Arbitration Regulations, enacted 20 years after the Council of Ministers Resolution No. 58, there can be an exception to this if the Prime Minister authorises the settlement of a dispute by arbitration. Furthermore, this ban on arbitration does not apply to government corporations, even if they are 100 per cent state-owned.

When structuring an arbitration clause the key problem is the enforceability of the arbitration award.

Firstly, one must determine whether the award, should it become necessary, has to be enforced in Saudi Arabia or elsewhere. In the following analysis on the individual parts of an arbitration clause, I assume that the arbitration award is to be enforced in Saudi Arabia.

The choice of law clause
An arbitration clause is usually connected with a so-called choice of law clause. The question of whether a foreign, that is a non-Saudi Arabian law, can be agreed on, is of significance, because Saudi Arabian law is made up of Sharia, and Saudi Arabian regulations implemented by royal decrees and Council of Ministers’ resolutions. Compared with Western legal systems, Sharia has certain unusual characteristics, in particular the prohibition of riba, which is defined as a pecuniary advantage gained without providing an appropriate quid pro quo. The ban on taking interest also derives from the prohibition of riba. Compensation for anticipated lost profit is unknown. According to Sharia law of frustration any unknown and unforeseeable circumstances at the time of agreement, which result in a profit for one party and a corresponding loss for the other party, constitute a valid reason for a rescission of the contract.

According to Article 3 of the Council of Ministers Resolution No. 58, Saudi

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Arabian government agencies are forbidden to agree on a foreign law if the Saudi Arabian state itself is a contractual party. The law applied must be determined according to the recognised general principles of private international law, including the principle of applying the law of the place of performance. This likewise leads to the application of Saudi Arabian law.

There is also a practical obstacle to the choice of non-Saudi Arabian law. Certain types of contract must be registered with the Ministry of Commerce. One can assume that the Ministry of Commerce will, for example, refuse to register service agency contracts, commercial agency contracts and articles of association, if they contain a provision stating that non-Saudi Arabian substantive laws shall govern the contract.

Furthermore, there are different enforcement procedures in Saudi Arabia for foreign and domestic arbitration awards and it depends on the nationality of the substantive law being applied, whether the Saudi Arabian authorities regard the award as Saudi Arabian or non-Saudi Arabian.

It is unusual to refer to the substantive law being applied when classifying the arbitration award as foreign or domestic. This distinction is usually made with reference to the place of arbitration or the law of procedure being applied. This unusual reference is to be attributed to the fact that Islamic law does not distinguish between different nations but rather between that part of the world in which Islamic law prevails (the dar al-Islam), and the rest of the world in which Islamic law does not prevail (the dar-al-Harb).

The effect of Saudi substantive law

If the arbitration award will be classified by the Saudi Arabian authorities as a Saudi Arabian one because Saudi substantive law is applied, what must be taken into account when structuring an arbitration clause?

(a) Regarding the requirements to be fulfilled by the agreement itself, Article 1 of the Arbitration Regulations states that, not only are those arbitration agreements recognised which are concluded after the dispute has arisen, but also contractual arbitration clauses; in other words, arbitration agreements made before the dispute began.

(b) According to Article 7 of the Arbitration Regulations the existence of an arbitration clause has the effect of staying judicial proceedings, if the state court with original jurisdiction has validated the arbitration agreement according to Articles 5 and 6. Until this validation has been granted, an arbitration clause will probably not have this effect. Therefore it may be useful to stipulate in the arbitration clause that the contractual partners explicitly waive their right to assert mutual claims before state courts. The validation will be granted by the state court at the request of both parties. However, it is not laid down in the Arbitration Regulations if a party, willing to proceed with the agreed arbitration, has a legally enforceable claim against the other party, not willing to do so. But it may be possible to base such a claim on the generally accepted legal principle of good faith.

(c) The foreign non-Muslim party is not in a worse legal position than the domestic