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Legal Update

Arbitration in the Kingdom of Saudi Arabia – Part 4

Drafting and Concluding Effective Arbitration Agreements in Saudi Arabia

An effective, well-drafted arbitration clause (or arbitration agreement)[1] provides parties with a contractual mechanism through which they can enforce their legal rights. Therefore, it is an essential part of any contract pursuant to which the parties have agreed to resolve their disputes by arbitration.

Arbitration clauses need to be properly drafted to be valid, effective and enforceable. Poorly drafted arbitration clauses may be challenged at the stages of initiating arbitration or enforcing arbitral awards, and defective or "pathological" arbitration clauses may even deprive the parties of access to arbitration.

In Part 4 of this Legal Update, we:

- outline the requirements for drafting a valid and effective arbitration agreement in the Kingdom of Saudi Arabia ("**KSA**"); and
- provide practical tips to avoid common drafting errors.

In KSA, domestic and international arbitration is governed by an arbitration law which came into effect on 9 July 2012 (Royal Decree No. M/34 dated 24/5/1433 AH) (the "**Arbitration law**"). The Arbitration Law removed the heavy constraints that existed under the previous law,[2] by broadly encompassing the UNCITRAL Model Law, albeit adapted to incorporate *Sharia* Law, and changing the nature in which legal practitioners practiced arbitration in KSA. The Arbitration Law is further supported by its Implementing Regulations, which came into force on 9 June 2017. Arbitration clauses in KSA need to comply with the mandatory provisions of the Arbitration Law, including the principles of *Sharia*.

All references below are to the Arbitration Law, unless stated otherwise.

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1 The terms arbitration clause and arbitration agreement are used interchangeably to refer to the binding contractual arrangement to submit disputes to arbitration.

2 Saudi Arabia Royal Decree No. M34/1433 replaced the arbitration law issued by Saudi Arabia Royal Decree No. M46/1403, dated 12/07/1403AH.

A valid arbitration agreement

To be formally valid under KSA law, an arbitration agreement must meet the following criteria:

1. It must be in **writing** (Article 9(2)) and may take the form of an **arbitration clause** in a contract or a **separate arbitration agreement** (Article 1(1)). The latter may be concluded after a dispute has arisen even if the dispute has been the subject of court proceedings provided that it determines the scope of matters that are within the arbitral tribunal's jurisdiction (Article 9(1)) or if the parties agree during court proceedings to refer the dispute to arbitration (Article 12).

2. It needs to be between two or more parties, who agree to refer to arbitration their disputes in respect of a defined legal relationship, whether contractual or non-contractual (Article 1(1)). This must be natural or legal persons having legal capacity to dispose of their rights (Article 10(1)).

   Government bodies require special approval from the Prime Minister to enter arbitration agreements, subject to specific laws specifying otherwise (Article 10(2)). Also, specific approval processes shall be followed in KSA in relation to (i) disputes between government bodies or state-owned entities and foreign investors; (ii) government tenders and procurement; and (iii) privatisation contracts.

3. Article 2 of the Arbitration Law states that personal status disputes and matters not subject to reconciliation are not arbitrable. This includes disputes concerning criminal law, administrative law, and public policy matters.

The Arbitration Law recognises the separability of the arbitration agreement. This means that should the underlying contract be null, void or otherwise terminated, the arbitration clause will nonetheless remain valid (Article 21).

An effective arbitration agreement

An arbitration agreement also needs to be effective. Effectiveness means that it will be enforceable and result in the constitution of the tribunal.

All arbitration agreements should include the following **seven key elements**, which are vital to ensure their legal and practical effectiveness. Alongside each element, we also include a practical drafting tip to help avoid drafting pitfalls, as signalled with the  image:

1. ***Exclusivity***

The arbitration clause should provide that arbitration is the exclusive dispute resolution mechanism. The use of the wording "***shall*** *be settled by arbitration*" is recommended instead of "***may*** *be settled by arbitration*", which would make the clause non-exclusive.

Asymmetric clauses (or unilateral option clauses) are an exception to exclusivity. Often they take the form of a default arbitration provision with **one** party (or group of parties) having the right to litigate the dispute. Different jurisdictions take different views on the validity and enforceability of asymmetric clauses. These clauses are not recommended for KSA contracts because uncertainty remains as to their validity. Traditionally, Saudi courts interpreted these clauses in accordance with *Sharia* law, which would deem such clauses unreasonable. However, since the new Civil Transaction Law (due to come into force in December 2023) permits unilateral termination clauses (Article 106), Saudi courts could, in future, interpret unilateral option clauses differently, applying similar reasoning to that underpinning Article 106[3].

2. *Scope*

The clause must specify what disputes will be subject to arbitration. Except in the rarest of circumstances, the clause should cover "all disputes arising out of or in connection with" the contract or something to similar effect, which could be taken from the model clause issued by the institution selected for the arbitration clause. For example, one of the model clauses of the Saudi Center for Commercial Arbitration refers to "*[a]ny dispute, controversy or claim arising out of or relating to this contract, or a breach, termination or invalidity thereof*".

Avoid carving out disputes in the arbitration clause. However, if carve outs are needed, they should be carefully considered with arbitration lawyers since they need to be clearly defined to avoid ambiguity as to whether a particular dispute can be referred to arbitration.

3. *Arbitration Rules*

The clause must refer to, and incorporate, procedural rules to govern the arbitration. We recommend adopting the rules of an arbitral institution, the name of which needs to be correctly stated in the clause. The selected institution must always match with the selected set of arbitration rules – never name one institution to administer proceedings under the rules of another institution.

The parties can subject their arbitration to the procedures of any arbitral institution, either within or outside KSA, and select any rules to govern their dispute, as long as such procedures and rules do not contravene *Sharia* law.

Some of the major arbitration institutions in the MENA region include:

- the Saudi Center for Commercial Arbitration ("**SCCA**"),
- the Dubai International Arbitration Centre ("**DIAC**"),
- Cairo Regional Centre for International Commercial Arbitration ("**CRCICA**"),

[3] The provision allows for parties to "*contract on the condition of the option to abandon the contract. The one who has the option has the right to withdraw within the specified period, provided that the other contracting party shall be notified…*".

- the Abu Dhabi Commercial Conciliation and Arbitration Centre ("**ADCCAC**");
- Oman Commercial Arbitration Centre ("**OAC**"); and
- the Bahrain Arbitration Centre ("**BAC**").

Parties in the region may also wish to use international institutions such as the International Chamber of Commerce ("**ICC**"), London Court of International Arbitration ("**LCIA**"), Singapore International Arbitration Centre ("**SIAC**") or Hong Kong International Arbitration Centre ("**HKIAC**") (to name just a few of the most popular institutions among the users according to the Queen Mary Survey).

Work with arbitration lawyers to compare the institutions and their rules and ascertain which choice best suits your contract and needs.

Examples of areas where the rules may differ include: confidentiality (while some are silent, others include express confidentiality provisions), third party funding (some rules may require disclosure of the funding arrangement and funder's identity), expedited procedures and emergency arbitrators, scrutiny of awards (a key feature of ICC arbitration), and fee structure (while the fees are most often based on the amount in dispute, hourly rates apply in LCIA arbitration).

4. ***Seat***

Specify the seat, or legal place, of the arbitration, which will determine the law governing the arbitration proceedings and local courts with supervisory jurisdiction over the arbitral proceedings. Parties can choose a seat anywhere in the world, regardless of the rules adopted. The choice of seat will be guided by strategic considerations such as neutrality, confidentiality, the national arbitration law, and judicial attitudes to arbitration (i.e., how supportive/interfering the local courts are during the arbitral process and what their approach is when it comes to annulling and enforcing awards). Work with arbitration lawyers to analyse and determine the most appropriate seat for your contract and needs.

For parties selecting a UAE seat, it is important that the clause clearly specifies whether the onshore or offshore courts have supervisory jurisdiction. It should thus mention that "the seat of the arbitration shall be onshore [Abu Dhabi/Dubai]" (as applicable), or that "the seat of the arbitration shall be [the Abu Dhabi Global Market/the Dubai International Financial Centre]" (as applicable).

5. ***Number of Arbitrators and Selection Procedure***

The selection of the arbitrators will be governed by the arbitration rules, unless the clause specifies otherwise. It is often preferrable for parties to be able to nominate an arbitrator or to have control over the selection of the sole arbitrator or chairperson of the tribunal. The clause should state whether the tribunal will comprise one arbitrator or three arbitrators. It may need to specify how the parties' nomination process is to take place, including a default mechanism if one or both "sides" fail to nominate a candidate, and clear timings for the process. This will be particularly the case if the default process under the rules is that the institution (not the parties) picks and appoints the arbitrator(s).

Let's take the SCCA Rules 2023 as an example (see Part 3 in this series for more details about these rules). Absent the parties' agreement on the number of arbitrators, the tribunal shall consist of a sole arbitrator. Where there is a three-member tribunal, the parties are to nominate their co-arbitrators within 30 days of the commencement of the arbitration, failing which the SCCA shall proceed to appoint the tribunal. The SCCA Rules 2023 set out in detail the nomination and appointment process for (i) a sole arbitrator and (ii) three-member tribunals. Provided parties are content with that process, they only need to state in their SCCA clause as follows: "*There shall be [one/three] arbitrator[s]", who shall be appointed in accordance with the SCCA Rules.*"

6. ***Law Governing the Arbitration Agreement***

It is highly recommended to specify the law which shall govern the arbitration agreement. The law of the arbitration agreement is relevant to matters relating to the formation, existence, validity, scope, legality, interpretation, termination, effects, and enforceability of the arbitration agreement. When choosing this law, parties tend to mirror the law of the seat or the law of the matrix contract. However, the best choice will depend on numerous factors, and therefore should be discussed with arbitration lawyers.

If parties fail to specify the law of the arbitration agreement, there may be a high risk of satellite disputes around the proper determination of this law, as well as potential enforcement problems. See our Legal Update on this topic.

7. ***Language of the Arbitration***

Under Article 29 of the Arbitration Law, the default language is Arabic unless the parties or the tribunal agree otherwise. Under many institutional rules, where the clause is silent, the institution and/or the tribunal will determine the language, meaning this is outside of the parties' control. In KSA-seated arbitrations, the institution or the tribunal may need to give effect to the default language provision in the Arbitration Law absent the parties' agreement on the language of the arbitration.

However, to avoid any ambiguities in interpretation, it is important to state the language of the arbitration in the arbitration clause, especially if the parties wish to use a language other than Arabic.

We recommend selecting a single language unless there is a compelling reason to opt for a bilingual arbitration. This will avoid translation-related costs and inefficiencies.

In practice, international arbitration tribunals and counsel may accommodate different languages into the procedure. For example, witnesses and experts may often give testimony in their native language, which will be translated.

Concluding remarks

In summary, each of the above seven elements is important in ensuring a valid and enforceable arbitration agreement in KSA. Even though at the contract negotiation stage, disputes may be far from anyone's mind, it is worth spending time to draft and negotiate the arbitration clause. Indeed, omitting crucial elements in your arbitration clause could lead to increased legal costs, disputes over the clause's interpretation and enforceability issues.

Parties should work with their arbitration lawyers to draft their arbitration clauses and tailor them to the circumstances of their contract and business needs. Sometimes, it may be necessary to explore and include bespoke provisions in the arbitration clause. For instance, in a multi-party or multi-contract context, issues such as the joinder or consolidation may need to be addressed in the arbitration clause.

Mayer Brown's International Arbitration team, and members of Al Akeel & Partners, have extensive experience in drafting arbitration clauses and can assist in preparing tailored clauses to meet the needs of all types of parties (States, State-owned entities, commercial entities and individuals).