

Privatisation and PPP in the Kingdom of Saudi Arabia: Major projects and emerging investment opportunities

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With a thriving economy, high projected population growth and a reformed regulatory environment conducive to foreign investment and privatisation, the Kingdom of Saudi Arabia has become a regional “hot spot” for major privatisation projects, particularly in the IWPP/IPP and transport sectors. Significant opportunities are emerging for international developers, lenders and consultants in future industrial and infrastructure projects.

Saudi Arabia's economy, although largely dominated by the oil sector which accounts for approximately 45% of GDP, has seen consistent growth across all sectors, which is evident in the annual increase of GDP of over 5% in the past few years. The Kingdom experienced real GDP growth of 5.3% in 2004 and 6.5% in 2005.¹ With annual inflation remaining stable at approximately 0.5% in recent years, the Kingdom's economic prosperity is expected to continue well into the next decade.

Supplementing the Kingdom's economic growth is Saudi Arabia's expanding population. In 2004, the Saudi population was estimated at 22.7 million and has been steadily growing at an annual rate of approximately 3%, which is expected to continue at 2.5% per annum over the medium term.² It is anticipated that the Kingdom's population will reach 29.6 million by 2015 and 33.4 million by 2020.³

National privatisation objectives

Saudi Arabia's forecasted demographics and healthy economy has resulted in an increase in demand for essential resources, especially energy and water, as well as a call for industrial diversification and infrastructure development. The Saudi Government has recognised the economic indicators and projected demand and consequently has opened the way for privatisation and private sector participation in its infrastructure. Since 1994, the Saudi Government's official economic strategy has been to increase private sector participation, particularly in all non-oil sectors of its economy, including power, water and transport. This strategy has already led to the partial privatisation of some state-owned firms and to the introduction of competition in sectors previously under state monopolies.

The Government has implemented significant legislative and regulatory reform and has adopted national policy programmes to facilitate private sector participation in its economy. In 1999, the Supreme Economic Council (SEC) was established,

whose mandate includes “increasing the participation of the private sector in developing the national economy through the Government's privatisation programme”. Following the creation of the SEC, in 2000 the Government established the Saudi Arabian General Investment Authority (SAGIA) at the same time that it introduced the new Foreign Investment Act (FIA).

Both SAGIA and the FIA are the catalysts for direct foreign investment in the Kingdom. SAGIA's mission is to create a pro-business environment, to facilitate exchange of best business practice between the public and the private sectors and to act as an intermediary between the global community and the Saudi Government. The FIA permits foreigners to invest in all sectors of the economy, with the exception of specific activities contained in the “negative list”, and allows international companies the possibility of 100% ownership of the projects and real property in which they invest. The FIA also provides significant tax advantages for foreign companies and enables them to retain the same incentives given to national enterprises.

Privatisation and PSP framework

In its 2002 decision to formally approve the Government's privatisation objectives, the SEC issued a list of public utilities, economic activities and services targeted for privatisation. The “privatisation list” includes, among others, water, desalination, transport, and airport/seaport services. In addition to the privatisation list, the SEC also released its official “privatisation strategy”, which provides for the policies necessary to achieve the Government's goals and also sets out privatisation techniques and controls. These privatisation techniques constitute a ready-to-use roadmap and approval process for privatisation and PSP projects.

The process involves essentially all potentially relevant governmental authorities, from ministries to

the SEC to the Council of Ministers and, ultimately, the King (in his capacity as Prime Minister). It is therefore extremely valuable in the context of major and politically sensitive projects. In this respect, it should be noted that the Saudi political and business culture - and the substantial concentration of powers under the Kingdom's institutional framework - call for early and major government involvement in large projects.

However, foreign stakeholders wishing to undertake projects of a smaller scale and sensitivity may find that legal options other than the SEC-based roadmap are available, such as simple ministerial approvals and/or a royal approval. Of course, a royal approval may seem out of place in the context of a discussion on flexible legal bases as alternatives to the more procedural, SEC-based process. This is not so contradictory, though. Many PSP projects will at some point require some form of high-level endorsement from very high-ranking authorities (e.g. ministerial or royal), and such endorsement may in fact be obtained rather straight-forwardly. Project advisors generally find this satisfactory since they are able to assist with the preparation of tailor-made processes and approvals which may, ultimately, be sanctioned by the highest executive authorities in the country.

In addition, it is important to note that Saudi law generally permits the implementation of international PSP standards and principles, and that local law has been steadily evolving to accommodate such standards where required. While an in-depth discussion of Saudi law is beyond the scope of this article, a few remaining hurdles should be brought to the attention of international investors, however.

Firstly, arbitration (both international and domestic) is not available in PSP projects, since public bodies may not arbitrate disputes (i.e. except with the government's prior approval, which is rarely - if ever - granted). Secondly, land titles may be unclear and conflicting claims on land are rarely finally settled before a unified judiciary. Thirdly, a fundamental Shari'ah principle - as in many non-Islamic legal systems - is that one may only recover actual and provable damages. Difficulty may arise from local courts' rigid application of such principle. As a result, the enforceability of penalty-based clauses which are standard in PSP contracts may be doubtful in the Kingdom. For example, there is doubt as to the enforceability of compensation clauses relating to wrongful and early termination of projects, and even of liquidated damages. Fourthly, court decisions are insufficiently recorded and available, and not necessarily binding on other courts of similar level, so local law is not securely settled on

certain contractual issues.

Despite such hurdles, however, it must be noted that some of the world's largest project financings are being implemented or structured in the Kingdom. Project stakeholders and their advisors and consultants have often devised alternate, "tailor-made" features accommodating international practice and local requirements.

Several major projects summarised below, in various stages of development, confirm that international developers and lenders have recognised the attractive conditions for investment opportunities in the Kingdom and that significant privatisation and PSP projects are emerging.

IWPP programme

The Saudi IWPP market takes the lead in terms of signature projects and arguably is the most significant in terms of capital invested. With high demand for water and power and maturing installed capacity, the Government has implemented a specific IWPP programme consistent with its national privatisation objectives.

The first legislative reform in executing the programme was the passing of SEC resolution 5/23 in 2002, which sets out the framework for private sector participation in four specific saline water desalination and power projects: the Shuaibah, Shuqaiq, Raz Azzour and Jubail IWPPs. The resolution calls for close cooperation between the Saline Water Conversion Corporation (SWCC) and the Saudi Electricity Company in order to implement these important projects. It also charges the Water and Electricity Company (WEC), a special purpose limited liability company whose only shareholders are the SWCC and the Saudi Electricity Company (50/50), to be the contractual off-taker and fuel provider for the water and electricity produced by the plants.

In addition, the resolution provides for State participation in the ownership of the project companies for each IWPP at the rate of 32%, versus 8% for the Saudi Electricity Company and the remaining 60% for the developer. Each IWPP is to be developed on a build-own-operate (BOO) basis, will adopt the energy conversion agreement (ECA) model for the provision of fuel and will benefit from credit support provided by the Ministry of Finance.

The WEC's first and most important undertaking, the 900MW and 880,000 m³/d Shuaibah IWPP, is also the first of its kind in the Kingdom and the largest new build IWPP in the world. Shuaibah also represents the template for the Government's IWPP programme for future projects developed by the WEC. As the world's first oil-fired IWPP (with the

utilisation of light crude for fuel), Shuaibah's desalinated water production will serve demand in nearby Jeddah, Mecca, Taif and Al-Baha, while power will be provided to the western regional grid.

In July 2004 the RFP for the project was issued and in June 2005 the WEC selected a Saudi-Malaysian Consortium (a joint venture comprising Tenaga Nasional Berhad, Malakoff Berhad, Khazanah Nasional Berhad and ACWA Power Projects) as first-ranked bidder. The consortium is supported by a bank group comprising ABN Amro, Arab Bank, Kexim, Riyad Bank and Saudi Hollandi Bank. A Royal Decree was subsequently issued approving the setting-up of the Shuaibah Water & Electricity Company as the project company and in November 2005 the WEC signed the power and water purchase agreement (PWPA) for the project company to build, own and operate the SR9bn (US\$2.5bn) facility. With the project company's issuance of the Notice to Proceed to the EPC contractor (a joint venture comprising Siemens AG and Doosan Heavy Industries and Construction) in January 2006, it is anticipated that first unit production will commence in the first quarter of 2009.

The WEC's second major project to be tendered is the 850MW and 212,000 m³/d Shuqaiq IWPP. With an estimated project cost of US\$1.25bn, the crude oil-fired plant will be located on Saudi Arabia's west coast and will supply water and power to the cities of Abha and Jizan. In June 2005, the WEC issued RFQ to 53 companies and in November 13 pre-qualified international, regional and Saudi developers for the project were selected. The RFP for the project was issued to the pre-qualified bidders in December and the bid submission deadline has been set for July 2006. It is expected that Shuqaiq's project structure will be modelled on the successful Shuaibah template.

While the Shuaibah and Shuqaiq IWPPs are both oil-fired and located on the west coast of Saudi Arabia (Red Sea), the WEC's Raz Azzour IWPP (2500MW and 800,000 m³/d) and Jubail IWPP (1100MW and 340,000 m³/d) are gas-fired and will be located on the Kingdom's east coast (Arabian Gulf). However, the contractual structure and risk allocation for both projects will closely resemble that of the Shuaibah and Shuqaiq IWPPs. The projects are still in the early stages of development but the WEC anticipates that the RFP for the Raz Azzour and Jubail projects will be issued by mid-2006.

Outside of the WEC's IWPP programme, Marafiq (the Power and Water Utilities Company for Jubail and Yanbu) has, as part of the Kingdom's expansion

projects in the power and water sector, developed advanced plans for the construction of two major plants. The project will consist of the construction of a 2500MW power plant with 800,000 m³/d desalination capacity at Jubail and a second plant in Yanbu with a capacity of 1500 to 2000MW and 100,000 m³/d desalination capacity. Like the WEC IWPPs, the Marafiq projects will also be guaranteed by the Ministry of Finance and the successful bidder will take a 60% stake in the new project company, with the remaining 40% held by Marafiq. Marafiq issued a revised RFP for the Jubail IWPP in December 2005, inviting developers to submit bids by April 2006.

Under the project schedule, Marafiq expects to shortlist bidders by June, sign the 20-year PWPA in August, and reach financial closing by the end of 2006. Full plant commissioning is scheduled for the last quarter of 2009. The RFP for the Yanbu IWPP is only expected to be issued once the Jubail contract has been awarded.

IPP development

With one of the world's highest per capita electricity consumption rates, the Kingdom views the development of the power sector as a crucial element in its economic growth. To support ambitious industrialisation plans and to meet the needs of a growing population, the Government has resolved to expand its generation capacity. The Kingdom's 25-year electrification plan calls for US\$115bn in capital investment to increase its total capacity from approximately 17,000 MW per year to more than 66,000 MW by 2023.⁴ With significant expansion plans for generation capacity, Saudi Arabia is viewed as a lucrative market by both domestic and foreign power generation companies.

The first IPP project in Saudi Arabia (SADAF IPP - Jubail Electricity Company) was tendered in 2003 by SADAF (a 50/50 joint venture between SABIC and Shell). The project was won by a consortium consisting of National Petrochemical Company and the US developer, CMS Energy. Under a 20-year Energy Conversion Agreement, SADAF will supply the project company with required natural gas fuel and purchase all electricity and steam output, while the project company will produce 250MW and 510 tph steam.

The second IPP project (Tihama Power Generation Co.), which was tendered in 2003 by Saudi Aramco, concerns four plants with a total capacity of 1074 MW and 4.5m/lb steam. The project was won by a consortium consisting of UK developer International Power plc, and its local

partner, Saudi Oger. The plants are all scheduled for completion in 2006. For each 20-year Energy Conversion Agreement, Saudi Aramco will supply each project company with required natural gas fuel, in return for which it will purchase all electricity and steam output.

Both of the above projects are important for future IPPs/IVPPs in the Kingdom as they demonstrate:

- that there is an appetite among international players for IPPs within Saudi Arabia;
 - that it is possible to structure contractual mechanisms and remedies sufficient to meet bank requirements whilst being acceptable to the Saudi tendering authorities; and
 - the core aspects of the Saudi Arabian IPP model, which includes long-term power/water purchase agreements covering 100% of capacity (on a take-or-pay basis) and output, contractual risk mitigation against political *force majeure*, negligible fuel supply risk being borne by the project company, indexation of tariffs against foreign exchange risk, and long-term limited recourse debt facilities.
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Transport projects

The transportation sector in Saudi Arabia holds great potential for development and growth. Industry sources expect close to US\$50bn will be invested in this sector over the next 20 years, especially in airport, railway and road projects.

Airports

As part of its economic development plan and national privatisation initiative, the Saudi Government has resolved to expand, develop and improve its airport infrastructure to meet the demands of increased passenger traffic and larger aircrafts, such as the new Airbus 380. In this context, the General Authority for Civil Aviation (GACA) has proposed three major projects concerning the King Abdulaziz International Airport (KAIA), Saudi Arabia's main international airport.⁵

GACA's first project, announced in September 2000, is to expand the existing facilities at KAIA. This project includes the construction of a new large terminal for international and domestic passengers, new support service buildings, modifications to the existing terminals and upgrades to the existing runway and airfield systems to accommodate the

new Airbus 380. It is expected that with the completion of the project, the airport's annual passenger capacity will have been increased from 13 to 21 million. In 2003, GACA signed a US\$1.5bn agreement with Bechtel-Saudi Arabia and Dar Al-Riyadh to implement the project. Construction commenced in the second quarter of 2004 and the expansion is scheduled for completion by the final quarter of 2010.

GACA also owns and operates the Hajj terminal at KAIA, which is solely dedicated to processing Hajj and Umrah pilgrims throughout the year. The terminal was opened in 1981 and the growth of Hajj pilgrims, currently reaching 1.2 million people annually, compounded by the increase in Umrah passenger traffic, has rendered the existing facilities sub-standard and insufficient. The result for passengers is long processing and waiting times and poor convenience facilities.

To alleviate this situation and accommodate the future growth of pilgrimage-related traffic (as there are currently 2.3 million Hajj passengers and 2.4 million Umrah passengers and that Umrah passengers are expected to reach 6.8 million by 2025), GACA intends to rehabilitate and expand the Hajj terminal through private sector participation. The prequalification process for the private operator commenced in November 2005. The selected investor will enter into a 20-year build-transfer-operate (BTO) agreement with GACA. The scope of the activities to be transferred to the private operator will include: (i) the investments in expansion and rehabilitation of the Hajj terminal facilities; (ii) the operations and maintenance of the terminal; and (iii) the commercial activity within the Hajj terminal complex.

Gide Loyrette Nouel is currently advising and assisting GACA and International Finance Corporation (IFC) with respect to structuring issues, tendering the project and BTO contract matters. (IFC is the private sector arm of the World Bank and is acting as lead transaction adviser to GACA.)

GACA also operates three desalination plants supporting KAIA. The desalination plants have matured and are in poor physical condition due to their age. As a result, they are unable to provide reliable water supply in sufficient quantities. GACA has invited private sector participation to undertake a BOT project for a new 30,000 m³/day seawater desalination facility that would supply potable water to the airport. Under the BOT structure, the private sector investor will be responsible for financing, designing/constructing, and operating/maintaining a reverse osmosis desalination plant to sell water for a

20-year term. GACA will be responsible for energy supply and will purchase production.

Gide Loyrette Nouel is advising IFC, as adviser to GACA, with respect to PSP, the water purchase agreement, bidding procedures and construction, operation and maintenance contracts.

Railways

The State-owned Saudi Railways Organisation (SRO) is planning a number of projects, including the construction of an overland bridge (the Land Bridge Railway Project) and a rail link between Riyadh and the northern provinces, which are rich in mineral deposits and offer numerous mining venture opportunities.

The SRO has proposed private sector participation in the Land Bridge Railway Project, the first rail link between the Red Sea and the Arabian Gulf. For this project, the public sector will provide the land and in-kind contributions. It will also set policies and establish regulations and the regulatory authority. This US\$4bn project will be one of the largest BOT projects ever undertaken in the Middle East. With over 1,000 km of new railway for both freight and high-speed passenger service, it will link Saudi Arabia's three largest ports: from Jeddah Islamic Port in the west through Riyadh's Dry Port to Dammam's King Abdulaziz Port in the east.

In 2005, the SRO initiated the investor prequalification process and issued tender documents to the pre-qualified consortia. During the first quarter of 2006, it will receive and evaluate the bids. The aim is to award the concession in the third quarter of 2006 after having negotiated with the preferred bidder.

Roads and public transport

The Saudi Government plans to establish road tolls on 20 major highways throughout the Kingdom. The move is expected to generate US\$500m by 2010, offering significant investment opportunities for private highway operators, engineering firms, and road services companies.

The Government is also developing plans to improve its public transport system by adding new buses for regional service and to ease traffic congestion. It is establishing an international transport centre at Jeddah's old airport to operate bus services to a number of Middle Eastern, North African and East European countries. The land transportation committee of the Jeddah Chamber of Commerce and Industry is developing the project, which involves a total capital investment of more than US\$1bn. Some 2,000 buses will be needed for the project, which will accommodate over 400,000 passengers annually.⁶

Future opportunities

With an expanding population and a resilient economy, the Kingdom of Saudi Arabia is witnessing ever increasing demand on its resources, particularly for water and power, and the corresponding need to develop its infrastructure. The Government has recently announced that national electricity and water authorities plan to develop 21 new water and power projects, with an estimated cost of SR48bn (US\$13bn) over the next 10 years.⁷

To meet these requirements, the Government has established key initiatives to privatise its corporations, thus making the private sector the locomotive of its economic growth. The range of activities targeted include, among others, water and drainage, desalination, air transport and aviation services, railways, roads and seaport services. The Saline Water Conversion Corporation has also recently revealed that it has retained financial, technical and legal advisors to develop a strategy to privatise the State-owned company as early as 2008.

Other opportunities for the private sector come from the strong development of the Kingdom's petrochemical sector. Petrochemical investments exemplified by the Jubail and Yanbu industrial cities have been a resounding success, promoting investor confidence. Over 70% of the first wave of projects in 2004 came in the form of joint ventures with global names such as ExxonMobil, Shell and Mitsubishi followed by newcomers Chevron Phillips, Sumitomo, Basell and Acetex.

Saudi Arabia has become the regional leader in

terms of privatisation and major PSP projects. The Shuaibah project is considered by both domestic and international investors as the project of reference for future investments in the Kingdom. As new projects continue to emerge, developers, lenders and project consultants would be wise to pay close attention to the Kingdom's water, power and transport markets for future investment opportunities.

Notes:

- ¹ Economist Intelligence Unit, Saudi Arabia, August/September 2005.
- ² National Commercial Bank, Economic Department, April 2005, Saudi Demographic Trends.
- ³ Ibid.
- ⁴ www.us-saudi-business.org
- ⁵ MEED, November 25, 2005.
- ⁶ www.buyusinfo.net
- ⁷ www.saudinf.com (2005)

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