

Water Resources in Saudi Arabia

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Saudi Arabia has obvious water resource challenges. It also has a plan to sustainably address these issues and is a global leader in this regard. At the G20 hosted by the Kingdom in November 2020 the organisation agreed, for the first time, to embed flexible and sustainable water management as part of its future plans and to enhance cooperation on water issues between G20 members and the rest of the world. Ensuring availability and sustainable management of water and sanitation is also one of the seventeen United Nations Sustainable Development Goals (SDGs). The Intended Nationally Determined Contribution (INDC) of Saudi Arabia under the United Nations Framework Convention on Climate Change (UNFCCC) recognised these challenges in November 2015.

Under the Saudi INDC two development baseline scenarios were identified – one reliant on heavy industrialization; the other envisaging economic diversification with a robust contribution from oil and its derivatives with revenues channelled into investments in high value-added sectors such as financial services, medical services, tourism, education, renewable energy and energy efficiency technologies to enhance economic growth. The Kingdom’s Vision 2030 programme has since then turbo-charged the latter economic diversification agenda. Since its promotion in 2016 a wide range of legal measures have been adopted which underpin these aspirations.

This article will provide a brief dive into two of the more important new laws and how they will relate to water resource management. In particular, we look at new Water^[1] and Privatization^[2] Laws and some tangential sources which are also relevant. Each of these new laws are, to some extent, a work-in-progress, with implementing regulations and ancillary documentation yet to be widely available. However, they provide a strong indication for the direction of travel as regards water assets and services. They will need to be assessed by international investors as an ensemble – the regulatory regimes envisaged remain to be fully articulated and will be iterative upon each other (and other sources of law). How these laws harmonise in the context of a whole-country water regime is crucial but remains to be tested. Investors will need to understand the intricacies of these interlocking regulatory frameworks and have a sound appreciation of the basis of Saudi law, the Sharia’h.

As a starting point, it is important to note that the Privatization Law introduces a definition for “PPP.” This usage applies to any contractual arrangement relating to infrastructure or a public service containing the following elements:

- A term of five years or more;
- A private sector party performing two or more of: asset design, construction, administration, operation, maintenance or funding, whether such asset is owned by the government, the private sector party or both;
- A risk matrix allocating risks between the parties; and
- A financial return of the private sector party based primarily on performance levels.

Many water infrastructure projects will fall under this definition and, accordingly, two (at least) interlocking regimes will apply. Water has long been a priority for private sector participation in the Kingdom and is included in the Vision 2030 Privatization Program promoted by the National Center for Privatization (NCP), along with (*inter alia*) agriculture, environment, education, housing, public transportation, *hajj/umra*, and natural resources.

The water law

The new Water Law is consistent with previously published announcements by the government. In particular, the INDC was very clear on what the priorities would be for the Kingdom:

“(a) water saving, recycling, capture, irrigation and sustainable management for agriculture purposes;

(b) early warning system against meteorological extreme events (such as floods, storms and droughts); and (c) transportation technologies that are resilient to the adverse effects of climate change while reducing and/or capturing transportation-related emissions.”

Consistent with the INDC, the new Water Law is a comprehensive whole-country resource management, investment, licensing and tariff-raising law which asserts its application across the Kingdom (excepting only the ZamZam well at the Haram in Makkah).

Minister of Environment, Water and Agriculture Eng. Abdul Al-Fadhli said that the National Water Strategy (which identifies 10 separate programs and 47 initiatives in the sector) will integrate directives, policies, legislation, and practices in the water sector at the national level with the main goal of meeting challenges and exploiting opportunities:

“The new water law comes within a series of steps that the ministry is taking to conserve and develop water resources and work toward their sustainability in accordance with the goals of the Kingdom’s Vision.”

These steps include a unified reference framework for the water sector in the Kingdom based on a careful assessment of available water resources and projection of demand rates through to 2030. Any special derogations would have to be consistent with that whole country approach – perhaps not least as regards matters related to cost-reflective tariffs and leakage performance. As a particular exception from the governance of other water resources under the new Water Law, sea water can be developed and used through establishing a desalination plant at a specific location on the coast, with prior approval from MEWA. Desalinated water production is a significant domestic consumer of hydro-carbons – the Kingdom has 16.5% of global desalinated water production. Whilst the production of water is well understood – the national water strategy will look more closely at how this, and other sources of water (whether from aquifers or dams), are managed efficiently and sustainably.

Minister Al-Fadhli also emphasized that the law will promote the participation of private players in the sector and effective governance and access to clean and safe water conforming to approved standards, plans, and programs. The new Water Law also signposts strategic water storage plans and programs and encourages active participation by the private sector to attract investment in development and conservation projects. It also expressly provides the power to declare a state of emergency during natural and other disasters affecting water resources of the Kingdom. The declaration of a state of emergency by the Ministry in the event of natural and abnormal disasters that would cause scarcity or pollution of water or one of its sources would be in coordination with the National Risks Unit. The goal would be to regulate the water reserve, supply, use and treatment. The law also ensures the priority of provision of water supplies to the agricultural sector underpinning the sustainability of this sector.

Under the new Water Law significant primary functions and powers are vested in the Ministry of Environment, Water and Agriculture (MEWA) and its Minister. However, close coordination is also required with a range of other ministerial stakeholders, including the Ministry of Industry and Mineral Resources, Minister of Economy and Planning, Minister of Finance and Minister of Municipal and Rural Affairs. The Electricity and Cogeneration Regulatory Authority (ECRA) also as a critical role as further elaborated below.

Under the new Water Law, MEWA has a variety of rights and duties which include:

- Determining the means for the use of water resources and treatment in the short, medium or long term and efficiently working towards achieving these aims;
- Suspending any license issued to use a water source;
- Reducing the allowance of permitted water quantities if these quantities may cause water availability constraints within a specified period (determined in coordination with the Electricity and Cogeneration Regulatory Authority (ECRA)).
- Suspending or revoking a license to use water sources if found unfit for use;
- Transferring the license from the licensee to another license applicant;
- Promoting the rationalization of water use and the authority to delegate another party to do so; and
- Conducting measurement and monitoring operations of water consumed by the licensees – likely to be a particular early focus for private sector involvement.

The Minister must also:

- Establish a Violations Review Committee to look into violations of the law and the Ministry's regulations;
- Appoint a Disciplinary Officer to investigate violations of the law;
- Appoint a Control Commissioner who will have the powers of inspection and seizure to a violator's books and records.

Under the new Water Law ECRA is the competent authority to approve the implementation plans prepared by a licensee to provide services in accordance with the plans approved by the Ministry. ECRA is also responsible, on initiation of the liquidation procedures of the bankruptcy law or other cessation of the licenced activity, for establishing the fair value of the assets owned by the licensee on a transfer to either the Ministry or to another licensee (which would have to be approved under the Law).

The new privatization law

The Privatization Law will enter into force on 24 July 2021. It will not apply to contracts that were executed prior to the law's entry into force, unless they are amended, extended or renewed after its entry into force.

It applies to all contracts entered into by government ministries or government entities, companies established by the government or companies in which the government (directly or indirectly) owns more than 50 percent of the capital where the purpose is a privatisation project.

As already indicated, both the new Water Law and the Privatization Law have implementing regulations which remain to be published so the precise governance and regulatory structure remains to be fully articulated, however the Council on Economic and Development Affairs (CEDA) will retain the authority to decide, at the recommendation of NCP, whether to exclude a project from the application of the Privatization Law.

The Privatization Law envisages a binary approach to project development (under the rubric of "Organising Rules" to be published subsequently by the Council of Ministers) and provides for:

An "Approving Authority," with the authority to issue the required approvals for the privatisation project including the power to approve/award a tender, to execute contracts and to exercise any other powers or mandates under the applicable regulations, as well as guidelines for the exercise of such mandate; and

A "Contracting Authority" responsible for the study and preparation of privatisation projects, the power to approve /award a tender, to execute contracts and to exercise any other powers or mandates under the applicable regulations, as well as guidelines for the exercise of its mandate.

The intended Organising Rules will also provide a pathway to identify the government entities that relate to a particular privatisation project and the authority and ongoing role of these government entities as regards that project.

As we have been seen in the discussion of the new Water Law, the licensing framework will become more complex in that sector – the issue of permitting and licensing is already a key project risk. The Privatization Law aims to ameliorate this risk by formalising a mechanism to coordinate government licensing and approvals. If issuance of a license, permit or approval for a privatisation becomes problematic, CEDA will have the power to make appropriate directives on the basis of a report to be prepared by the Contracting Authority in coordination with the relevant government entity.

Of direct relevance to the water sector – and especially perhaps the ability to collect tariffs – the new Privatization Law also grants the private sector party the right (with approval from the Approving Authority), subject to the specific terms of the approved privatization contract, to directly collect public revenue – including fees and taxes – from end users and account for the same to the relevant authority. There is, as might be expected, a prohibition on the private sector demanding additional fees from end-users

This innovation is especially interesting in the context of an economy which has historically enjoyed significant subsidies as regards certain key public goods, including water. Moving to anything approaching cost-reflective tariffs for water is likely to be a gradual, but ultimately necessary adjustment, if the value in the primary asset of the Kingdom (oil) is to be realised and invested (and not dissipated in its own domestic market). Achieving that goal will require a gradual shift in pricing and subsidy strategy across many sectors (not just water). The introduction of these measures under the Privatization Law will potentially enable direct payment mechanics to achieve those ends to be included in privatisation contracts. However, the ability to collect revenue will likely be conditioned by the achievement of key performance targets as regards wastage. If the water that is produced and distributed via a privatization contract is subject to significant leakage, then it will become not only “non-revenue water” but actually “anti-revenue water” as these performance indicators bite. The combination of the new Water Law and the Privatization Law certainly seem to signpost a significant and immediate opportunity for metering businesses, which will probably be amenable to some form of PPP.

One of the most welcome innovations in the Privatization Law comes with the provision for some form of loss-of-profit compensation on termination. Article 28 captures this innovation. It provides:

Subject to the relevant provisions of the Contract, the Contract may define the scope of compensation for loss of profits in the event of termination of the PPP Contract for a reason related to the Contracting Authority without any breach from the Private Party.

How this will work with the powers of ECRA under the Water Law, discussed above, remains to be considered and fully developed. Whilst for well-understood commodity types of projects – such as IWPPs and ISTPs – the position should be reasonably straightforward to determine, the more complex distribution type schemes which look not just at the production or treatment of water/waste water but holistically at the relevant networks (and leakage in particular), will require deeper financial modelling, sensitivity analyses and, ultimately, legal drafting.

Disputes and sanctions

Both the new Water Law and the Privatization Law provide measures for sanction and disputes resolution. The standout development occurs in the Privatization Law which for the first time contemplates the use of arbitration in this particular category of government contract. The adoption of arbitration is not however automatic and will be governed by rules to be promulgated by the NCP in due course relating to the

location and choice of forum. There remains some conjecture as the vexed topic of substantive law – the better view is that the default position will likely continue to be Saudi law with any derogations from that position having to be approved at a high level. It should also be noted that Saudi Supreme Court issued a decision in January 2020^[3] on the judicial interpretation of force majeure under COVID-19 circumstances – that decision (which is expressly based on Sharia’h principles) indicates a series of gateways that should be applied to any claim presented before the Court^[4]. It is entirely foreseeable that, having being prompted to issue a decision on the issue of COVID-19, similar directives may subsequently be issued relating to specific climate events. In this regard, please also see our article on new ICC measures as regards climate and arbitration which will add a further tier of available expert input.

Set against this advance in the Privatization Law, the Water Law also provides various measures as regards contract regulation and sanctions. How this law (and other laws of sectoral application) knit with the Privatization Law will be a matter for further development. However, by way of example, the new Water Law provides for a Violations Review Committee (VRC) which has a variety of functions. Constituted by a decision of the Chairman of the Board of Directors of the ECRA its Chairman must be a specialist in Sharia’h and Saudi laws. Of its five members, two should be specialists in Sharia’h and Saudi laws and one should be an expert in water resources. The basis on which the VRC will be empowered to adjudicate on matters arising under PPP contracts remains to be seen – for instance, where a performance indicator relating to leakage rates is infringed, would that be a matter for the VRC to determine, or would it be governed solely by the NCP regulated agreement (which should, given the holistic whole-country approach on water resources be consistent with the National Water Strategy)? If the latter, what measures will be put in place to ensure a competitive level playing field for the private sector across projects in the Kingdom? Decisions taken by the VRC are also referable to the Administrative Court – how this might work in the context of an international investment also remains to be seen. What is clear is that the disputes mechanisms will require careful legal crafting.

This fine detail of these laws remains to be sifted and developed – not least in the context of the increasingly urgent climate crisis. It is clear that the Kingdom is determined to advance quickly in this regard – the opportunities are significant for the private sector, but an appreciation of the risks will need a holistic legal, risk and compliance approach.

^[1] Royal Decree M159 of 141H Approving the Law of Water, 7 July 2020

^[2] The Privatization Law was issued by Ministry Decree no.436 dated 03/08/1442H in corresponding to 16/03/2021 and was approved by Royal Decree no.63/M dated 05/08/1442H in corresponding to 18/03/2021

^[3] Decision No. M/45, Dated 8/5/1442H

^[4] We have previously looked at the treatment of COVID 19 under Sharia’h Law – see <https://www.tamimi.com/law-update-articles/covid-19-force-majeure-under-saudi-law-and-shariah/>. The recent Supreme Court decision was consistent with what we said at that time.