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# Understanding Employment Law in the Kingdom of Saudi Arabia

## Background

Understanding employment law in the Kingdom of Saudi Arabia is important for any business operating in, or seeking to enter, the Saudi market. The legal regime regulating employment in the Kingdom may be seen as relatively employee-friendly and, in some key aspects, such as termination of employment, regulation of working hours and employment of women, differs markedly from what is considered standard practice in other jurisdictions. Establishing and implementing human resources policies that ensure compliance with, and minimise the risks associated with, the intricacies of the employment legislation in the Kingdom will assist any prospective business when employing staff in the Kingdom.

## Legislative Framework

The Kingdom's employment legislative framework is based on the twin pillars of the "Labour Law" (approved by Royal Decree M/51 in 2005, as amended) and the "Implementing Regulations" of the Labour Law. The Labour Law contains detailed provisions that address matters such as recruitment, employment of Saudi and non-Saudi personnel, training and qualification requirements, employment contracts, disciplinary processes, termination of employment, working conditions, matters specific to professions requiring distinct treatment, such as seamen and miners.

The Labour Law also provides a dispute resolution framework and sets out a fines and punishment regime for specific offences under the Labour Law. The Labour Law applies to the employers and employees in the private and charitable sectors, with limited exceptions for part-time workers and qualification and training contracts, which are governed by special provisions. While the Labour Law states that it also applies to the public sector, "Government employees" (a term that covers a very wide variety of occupations from teachers to doctors and beyond) are subject to a different regime, a regime which is beyond the scope of this article.

The Labour Law and the Implementing Regulations override any explicit contractual provision in an employment contract that is contrary to the provisions of the Labour Law.

Additionally, all businesses in the Kingdom are subject to "Saudisation" requirements, which vary depending on the type of business and the number of employees. The Saudisation program ("**Nitaqat**") is administered generally by the Ministry of Labour but there are additional local Saudisation requirements in certain areas such as those within the jurisdiction of the Royal Commission of Jubail and Yanbu (i.e. the industrial and economic cities of Jubail, Yanbu, Ras Al-Khair and Jizan).

## **Key Provisions of the Labour Law**

### Written Contract

The Labour Law provides that an employee must be provided with an employment contract. Failure to provide a written contract will result in any term of the agreement being interpreted in favour of the employee.

The Labour Law mandates all records and data kept by the business in relation to its employees, including employment contracts, disciplinary notices and instructions issued by the employer to the employees shall be in the Arabic language. While the language of instructions to the employees will, in practice, vary from business to business, companies operating in English or other languages must ensure that, as a minimum, employment contracts, internal policies, disciplinary and other formal notices issued by the company to the employees include an Arabic version. In addition to complying with the law, by producing its own Arabic/bi-lingual version, the employer controls the Arabic text ensuring that the Arabic text correctly reflects the intended meanings and terms since the Arabic text will prevail in case of any dispute.

The Labour Law permits two types of contracts: term contracts and project-based contracts. Term contracts are further divided into fixed-term contracts and indefinite contracts. Indefinite contracts are contracts that: (a) exceed four years; (b) have no provisions for renewal but have been renewed by course of conduct; or (c) have been renewed three consecutive times. Where the employee is a foreign national, the indefinite contract is limited by the length of the work permit granted to the employee, which means that, in practice, indefinite contracts exist only for employees who are Saudi nationals.

### Working Hours, Leave and Overtime

The maximum number of employee working hours is generally eight hours per day or 48 hours per week, with the exception of the holy month of Ramadan, when actual working hours for Muslim employees may not exceed six hours per day or 36 hours per week.

The number of working hours may be raised to nine hours a day for certain categories of employees or in certain industries and operations. The number of daily working hours may be reduced to seven hours for certain categories of employees or in certain industries or operations that are of a hazardous or harmful nature. Hours of work must be arranged so that no employee works more than five consecutive hours without a rest, prayer and meal break, which must not be less than 30 minutes in duration. Employers are prohibited from requiring employees to work more than 11 hours per day and in their first five years of employment, employees are entitled to annual paid leave of at least 21 calendar days. After the first five consecutive years, this period increases to 30 calendar days.

The Labour Law mandates that overtime is paid on the basis of the basic hourly rate (pro-rated, if applicable) plus 50%. Typically, employers in the Kingdom that regularly require their employees to work overtime pay a fixed monthly amount in lieu of the actual overtime payment, calculated by reference to the overtime worked, as it can save money and reduces the administrative burden of keeping track of overtime worked. However, as a recent labour case has shown, such payments will be treated under the Labour Law as a bonus requiring payment irrespective of overtime actually worked and the employer may still be required to make additional payments to employees for the overtime worked. Furthermore, as it is impossible to unilaterally change such a policy once established, consent of employees will need to be obtained to abolish any such policy once it is in place.

### End-of-Service Benefit

When an employee's employment ends, the employer must pay an end-of-service benefit to the employee. The provisions relating to payment of end-of-service benefits vary depending on the circumstances, like the length of service, whether the employee resigned or the term of employment has expired or the employee was made redundant. Higher end-of-service benefits are paid in cases where the term of employment has expired or there has been a permissible redundancy.

Where employment is terminated as a result of redundancy or expiry of the term of employment, the employer is obliged to pay the employee an end-of-service benefit equal to the sum of (a) one half month's wage for each of the first five years of employment; and (b) one month's wage for each additional year of employment.

The end-of-service benefit is calculated on the basis of the last wage and the employee is entitled to an end-of-service benefit for the portions of the year, pro-rated annually. The employer and employee may contractually agree that the wage used as a basis for calculating the end-of-service benefit would not include all or some of the commissions, sales percentages and similar wage components paid to the employee, which are, by definition, variable in nature.

Where employment is terminated as a result of the employee's resignation, the employee is entitled to:

- one third of the award after a term of employment of no less than two consecutive years and no more than five years;
- two thirds of the award if the term of employment is in excess of five successive years but less than ten years; and
- the full award if the term of employment amounts to ten or more years.

### Probation Period

The Labour Law permits an employee to be hired on a probationary basis, provided that this is expressly stated in the contract of employment. The probation period may be up to a maximum of 90 days, excluding public holidays and sick leave. The probation period may be extended up to 180 days, if agreed in writing by the employer and the employee.

An employee is not permitted to be subject to more than one probation period with the same employer. The only exception to this requirement, subject to the written consent of both parties, is where a current employee is offered a new position that involves a different profession or nature of work to the one that employee is currently employed in.

The probation period permits either party to terminate the contract of employment during such period unless the contract of employment expressly grants the right of termination to only one of the parties. Termination of the contract of employment during the probation period does not entitle the employer or the employee to compensation nor does it entitle the employee to receive an end-of-service benefit.

### Internal Regulations

The Labour Law requires every employer to prepare internal regulations, which must be based on the draft regulations provided by the Ministry of Labour. The internal regulations must be approved by the Ministry of Labour. The employer is responsible for ensuring that its employees are aware of the internal regulations of the employer and are able to access the internal regulations easily. The internal regulations generally include the disciplinary procedures outlined within the Labour Law and the Implementing Regulations as well as the employers' policy in relation to sick leave, annual leave and other administrative matters.

### Disciplinary Matters

Employers are not permitted to take disciplinary action against employees until:

- the employee has been notified in writing of the basis for such disciplinary action;
- the employee has been questioned by the employer and been given the opportunity to present a defence, if any; and
- the minutes of the employee's responses to the questions of the employer and the employee's defence (if applicable) have been recorded and placed in the employee's file.

The employer's questioning of the employee may be verbal in cases of minor violations and the penalty for minor violations must not go beyond a warning or a one day deduction of the employee's salary. The employee must be notified in writing of any decision by the employer to impose a penalty.

The Labour Law provides an exhaustive list of disciplinary penalties that an employer may utilise in dealing with breaches of employee conduct and other issues. The permitted penalties include warnings, fines, the ability to withhold an allowance or postpone it for a period not exceeding one year, postponement of promotion for a period not exceeding one year, suspension from work and withholding of wages and dismissal from work in certain situations.

Each potential disciplinary measure that an employer may impose on its employees must be set out in the employer's internal regulations approved by the Ministry of Labour. The Ministry of Labour's model regulations set out clear procedures in respect of each penalty and the circumstances under which the penalties may be applied. It is typical in the Kingdom for internal regulations of employers to closely reflect the model regulations.

### Termination of Employment

#### *General*

The Labour Law does not explicitly permit unilateral termination of employment without cause and termination for redundancy is highly restricted. Termination of employment for cause is subject to strict rules and procedures which, if not followed, are likely to result in wrongful termination giving rise to compulsory compensation awards against employers, in addition to the obligation to pay out end-of-service benefit, unused holiday pay and any allowances and bonuses. This is particularly important in relation to indefinite term contracts as compensation awards are calculated by reference to the length of service and may be significant.

An employment contract may be terminated in the following situations:

- by mutual consent of the employer and the employee;
- upon expiry of the employment term specified in the contract, unless the contract has been explicitly, contractually or statutorily renewed. Statutory renewal relates to the situation where the employee commences employment under a fixed term contract and continues to work after the original contract term has expired. In such a case, the contract will convert into an indefinite term contract and will not require further renewal;
- when the employee reaches the age of retirement;
- upon the occurrence of a force majeure event;
- where the business permanently closes (i.e. permitted redundancy);
- where the employer terminates the entirety of the activity in which the employee is employed (i.e. permitted redundancy);
- for cause;
- for other reasons permitted by law.

*Termination Without Notice for Cause*

The Labour Law provides an exhaustive list of circumstances under which an employer is permitted to terminate an employment contract without prior notice. In such circumstances, the employee also loses the entitlement to an end-of-service award or an indemnity. The employee must be given the opportunity to state its objections to such termination and “be heard” in order for any such termination of employment to be lawful.

Any employment contract may be terminated, without an award, prior notice or indemnity, if:

- during or by reason of the employment, the employee assaults the employer, the manager in charge or any of their superiors;
- the employee fails to perform essential contractual obligations or obey legitimate orders, or if, in spite of written warnings, the employee deliberately fails to observe the instructions related to the safety of work and employees as may be posted by the employer in a prominent place;
- it is established that the employee has committed an act of misconduct or an act infringing on honesty or integrity;
- the employee deliberately commits any act or omission with the intent of causing material loss to the employer, provided that the latter shall report the incident to the appropriate authorities within twenty-four hours from being aware of such occurrence;
- the employee commits forgery in order to secure employment;
- the employee is hired on probation;

- the employee is absent without valid reason for more than 30 days in one year or for more than 15 consecutive days, provided that the dismissal is preceded by a written warning from the employer to the employee issued where the latter is absent for 20 days in aggregate or for ten consecutive days;
- the employee unlawfully takes advantage of his/her position for personal gain; or
- the employee discloses work-related industrial or commercial secrets.

#### *Redundancy*

The Labour Law permits termination of employment contracts by employers due to redundancy in two circumstances: permanent closure of the business and termination of a particular activity within the business. It should be noted that the “termination of particular activity” contemplates redundancies resulting from closure of departments or divisions within the business rather than downsizing a particular department or a division.

#### *Compensation for Wrongful Termination / Dismissal*

The Labour Law sets out the minimum compensation payable by employers to employees who have been dismissed without valid reason. The parties may agree higher amounts but are not able to contract out of the minimum compensation provisions. For indefinite contracts, compensation is calculated at 15 days’ pay for every year of employment or two months’ pay, whichever is greater. For fixed term contracts, compensation is calculated as wages for the remainder of the employment term or two months’ pay, whichever is greater. Compensation in project-based employment contracts will depend on the nature of the work, term of employment and the expected duration of the contract.

#### *Notice Periods for Indefinite Contracts*

Employers intending to terminate indefinite employment contracts must give employees at least: (a) 60 days’ notice where the employee is paid monthly; and (b) 30 days’ notice where the employee is paid fortnightly, weekly or daily. Payment in lieu of notice is permitted upon agreement by both parties.

#### *Effects of Termination Notice*

If an employer serves a termination notice on an employee, the employee obtains a statutory right to paid time-off in order to seek alternative employment. The Labour Law mandates that such period shall be one full day or eight hours per week, as a minimum. The employee may determine such days at their own discretion upon at least one day’s notice to the employer. The employer may also excuse the employee from work obligations during the notice period, provided that the employee’s employment term runs until the end of the notice period and the employer commits to pay the employee’s end-of-service benefit calculated up to the end of the notice period.

#### **Non-Compete and Non-Solicitation Clauses**

The Labour Law expressly permits inclusion of non-compete and non-solicitation clauses in employment contracts. Such clauses must meet stringent conditions to be enforceable, are limited to a maximum of two years and must have a one year “after the event” limitation period.

#### **Transfer of Employees on Sale of the Business**

The Labour Law provides that if a business, or a part of it, is assigned/transferred to another person, whether it is an individual or a corporate entity, the new owner must provide the employees with all the rights and privileges

which the original employer provided. Neither the unilateral change of terms of employment nor compulsory redundancy are permitted by law, other than in limited circumstances. For this reason, any potential business acquisition should not be completed before a thorough due diligence of employment contracts, accumulated end-of-service benefits and bonuses and allowances that have been granted to employees either contractually or customarily as the employer may not withdraw such benefits, bonuses and allowances without the consent of the employee(s) affected.

### Disputes

Disputes are dealt with by the local Commissions for Settlement of Labour Disputes which, as practice shows, are generally pro-employee. A labour dispute would generally originate with the local Labour Office, which is part of the Ministry of Labour. The Labour Office would ordinarily attempt to explore the possibility of resolving the dispute with the employer. If no amicable resolution can be reached, the dispute will progress to the First Instance Commission for Settlement of Labour Dispute. The decision of the First Instance Commission may be appealed to the Higher Commission for Settlement of Labour Disputes.

Ordinarily, limited cost awards are made against the losing party in a labour dispute. Practice shows that, in most cases, no costs are awarded and when such awards are made they seldom reflect the actual costs incurred. As the costs of a labour dispute are potentially significant for an employer and are not usually recoverable in full or at all, employers must implement and follow robust HR policies and procedures and obtain professional legal advice where necessary to mitigate this cost risk.

### Saudisation

The current Saudisation regulations require all private sector entities to employ a minimum percentage of Saudi nationals. Certain positions are restricted solely to Saudi nationals, such as human resources personnel, receptionists, treasurers and civil security guards. The Saudisation regulations are administered by the Ministry of Labour under the “Nitaqat System.”

Under the Nitaqat System, each employer is awarded a rating (red, yellow, low green, mid green, high green or platinum) that is based on specific requirements for the industry, size of the employer’s enterprise and other factors. These requirements are subject to regular change. The Saudisation program is being implemented in stages and implementation of the third stage, named “Balanced Nitaqat,” is due to commence from 11 December 2016.

Under the current proposals for the third stage, it is envisaged that a points based system will be implemented with points awarded for the percentage of staff who are Saudi, the average salary of Saudi staff, percentage of women staff, the number of years of service of Saudi nationals and the percentage of Saudi nationals with a higher salary. This represents a significant change from the current system which uses only the number of Saudi employees as a determining factor in the calculation of Nitaqat rating of the employer. Additionally, there are concurrent Saudisation plans that operate in industrial areas such as Jubail and Yanbu and Saudi Aramco has different targets for Saudisation to the national targets.

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