

Saudi Arabia Franchise Law

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On 2 September 2019, the much-anticipated Saudi Franchise Law was issued by Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441 on the approval of the Commercial Franchise Law), which will come into effect six months following its issuance on 8 April 2020. While the Implementing Regulation is yet to be issued six months after the issuance of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441), current law has provided a general framework and guideline to any and all contracting parties to a franchise agreement to be applicable in Saudi Arabia.

Prior to the issuance of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441), franchise agreements were subject to Saudi Arabia Royal Decree No. M11/1382 Related to the Approval of the Commercial Agencies' Law (Saudi Arabia Cabinet Decision No. 89/1382 on the Approval of the Commercial Agencies' Law). Due to the fact that Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) does not address specific regulations relating to franchise, the franchise agreement was very much regulated by the agreement of the parties. As such and upon the implementation of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441), Saudi Arabia will notice a major change in the franchise sector as it will be properly and clearly regulated by keeping the parties' best interests and basic rights protected.

This commentary proposes to analyse Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) and provide guidance on its terms, provisions, application, and effects upon its implementation.

Analysis

In order to effectively analyse Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) and the application of franchise in Saudi Arabia, it is important to primarily understand how Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) defines franchise. Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) details that a franchise is attained when a person called the franchisor, grants another person called the franchisee, the right to perform the work of the franchisor for the franchisee's account by using the franchisor's trademark or tradename in exchange for a monetary or non-monetary compensation. The franchise must also include the provision of technical expertise and know-how to the franchisee. Additionally, the franchise must specify the mechanism of how the franchisee will perform the work. As such, the three most important elements to a franchise is the franchisor, the franchisee, and the work to be franchised which includes the tradename and trademark.

Applicability and jurisdiction

Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) is applicable upon any franchise agreement that is being executed in Saudi Arabia. While Article 25 of Saudi Arabia Royal Decree No. M22/1441 H (Article 25 of Saudi Arabia Cabinet Decision No. 122/1441) details that the parties may resort to resolve any dispute arising as a result of the franchise by arbitration, mediation, or conciliation, the committee having jurisdiction of the disputes in cases of litigation is yet to be formed which will be consisting of three members. Although franchises are of a commercial nature, the Commercial Courts will not have jurisdiction over their disputes. Any party wishing to appeal the decision rendered by the committee having jurisdiction over the franchise disputes must do so through the Board of Grievances.

Exceptions

Article 4 of Saudi Arabia Royal Decree No. M22/1441 H (Article 4 of Saudi Arabia Cabinet Decision No. 122/1441) sets out the agreements that are not considered to be a franchise agreement. It further details that such agreements are any of the following:

- franchises that are granted or issued by virtue of royal decrees;
- agreements that are subject to Saudi Arabia Royal Decree No. M11/1382 (Saudi Arabia Cabinet Decision No. 89/1382) in Saudi Arabia;
- agreements that are restricted to the sale or purchase of goods or provision of services with certain trademarks;
- agreements that grant the right of using trademarks or intellectual property rights in relation to a good or service;
- arrangements in which the franchisor becomes completely owned by the franchisee directly or indirectly; and
- any other agreements or arrangements prescribed in the Implementing Regulation of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441).

It is vital to note that with the issuance of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441), franchise agreements no longer became subject to Saudi Arabia Royal Decree No. M11/1382 (Saudi Arabia Cabinet Decision No. 89/1382) and accordingly the difference between distribution or agency agreements and franchise became very clear in terms of regulations as well as in terms of implementation and effects.

Conditions of granting a franchise

In order for a franchisor to grant a franchise, Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) imposed certain conditions that must be primarily met. Article 5 of Saudi Arabia Royal Decree No. M22/1441 H (Article 5 of Saudi Arabia Cabinet Decision No. 122/1441) details that the franchisor may not offer or grant a franchise until after practicing the work to be franchised as per the franchise work model for a minimum of one year by two people or in two separate stores. Following the eligibility of the franchisor to grant a franchise and the signature of the franchise agreement, the franchise agreement must be registered at the Ministry of Commerce and Investment along with the document for

disclosure. The document for disclosure consists of the basic and most significant rights, obligations, and major risks that are in relation to the franchise. Seeing as how the franchise agreement may consist of the technical and general know-how and seeing as how the franchise agreement must be registered with the Ministry of Commerce and Investment, the franchisor must be aware that the confidentiality of the know-hows may be affected. Accordingly, it is highly recommended to apply precautionary measures to this regard.

Obligations of the parties

Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) applies certain obligations on the franchisor and franchisee during their contractual relationship. Such obligations, which are detailed in Article 8 and 9 of Saudi Arabia Royal Decree No. M22/1441 H (Article 8 and 9 of Saudi Arabia Cabinet Decision No. 122/1441), are obligatory on the parties unless agreed otherwise in the franchise agreement. In such way, Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) is providing the basic obligations on the parties but is also granting them the flexibility and autonomy to set their own obligations as per their agreement.

Obligations on the franchisor

Article 8 of Saudi Arabia Royal Decree No. M22/1441 H (Article 8 of Saudi Arabia Cabinet Decision No. 122/1441) details that the franchisor is obligated to do the following, except if agreed otherwise with the franchisee:

- determine the rights granted to the franchisee in relation to the franchise;
- determine the franchise work template in a specific manner, including the standards and instructions that the franchisee must abide by when practicing the franchise as well as providing the franchisee with the manual books;
- training the staff of the franchisee;
- providing technical and marketing support as well as any other support that is required for the franchise;
- providing the franchisee, directly or via a third party, with the items or services of the franchise during the term of the franchise agreement, except for the items and services that the franchisee is allowed to purchase from a third party;
- protecting the confidentiality of the accounting and financial information related to the franchise;
- providing the franchisee with a detailed breakdown of the monetary compensation to be paid for the franchise; and
- not incorporating any entity that practices the same activities as the franchisee in the geographical territory specified for the franchise or grant any other party the right to franchise during the term of the franchise agreement.

The obligations set forth herein are obligatory on the franchisor unless the franchisor and franchisee agree otherwise in the franchise agreement. As such, Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) is providing the basic structure for all parties that contract with or without tackling the obligations detailed herein above.

Obligations on the franchisee

Article 9 of Saudi Arabia Royal Decree No. M22/1441 H (Article 9 of Saudi Arabia Cabinet Decision No. 122/1441) details that the franchisee is obligated to do the following, except if agreed otherwise with the franchisor:

- get the approval of the franchisor upon changing any of the items or services or the way of practicing the franchise;
- providing the franchisor with the necessary franchise information, including the accounting and financial information, that allows the franchisor to develop the franchise work template;
- allowing the franchisor or the designated representatives to visit the worksite used for the franchise as long as it does not cause disruption to the work or any damages; and
- getting the approval of the franchisor in case of changing the place designated for practicing the franchise.

Similarly to the obligations on the franchisor, the franchisee is obligated to perform the obligations set forth in Article 9 of Saudi Arabia Royal Decree No. M22/1441 H (Article 9 of Saudi Arabia Cabinet Decision No. 122/1441) unless it was agreed otherwise with the franchisor. If there is no agreement stating otherwise with the franchisor, the franchisee is required to adhere to the points mentioned herein above.

The franchise agreement

General clauses

In order to ensure that the franchise agreement to be signed between the parties tackles the most important elements of franchise, Article 11 of Saudi Arabia Royal Decree No. M22/1441 H (Article 11 of Saudi Arabia Cabinet Decision No. 122/1441) outlines the basic clauses that must be agreed upon by the franchisor and franchisee. Firstly, the franchise agreement must detail the work of the franchise and its description, the term of the franchise, the franchise agreement amendment mechanism, and the geographical territory. In addition, the franchise agreement must explain the compensation that the franchisee must pay the franchisor including the monetary compensation in exchange for the franchise, the training of

employees, technical support, and items or services. Further, the parties must address the obligations of the parties in relation to the training of employees, the franchisor's obligation of providing technical and marketing support, and the franchisee's obligation of adhering to the instructions pertaining to the branding and showcasing the item or service.

Furthermore, the franchise agreement must entail the obligation on the franchisor for providing the items or services as well as the franchisee's right to use the intellectual property rights in connection with the franchise and the effect of any infringement thereto. One of the most important clauses in a franchise agreement is the dispute resolution clause which can include litigation, arbitration, mediation, or conciliation as means to resolve any anticipated dispute. An important clause for both parties, but mainly the franchisor, is the exclusivity right which details whether or not a franchisee has the right to sub franchise or not. Such clause is vital to be included in the franchise agreement to ensure the elimination of any disputes to that regard and to protect the franchise work of the franchisor. Lastly, the franchise agreement must include the effects arising as a result of the change of ownership of the franchisee or franchisor or the party controlling them.

Taxes

While Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) does not obligate the parties to agree on the party responsible for paying the taxes arising as a result of the contractual relationship of franchise, it is of utmost importance for the parties to tackle this matter. Such agreement can include the payment of the withholding tax fully by the franchisor or franchisee or the equal payment of the tax amount by both parties. It is up to the parties to decide on the best suitable way to handle the tax implications arising accordingly, keeping in mind the high necessity of doing so prior to contracting to avoid any possible disputes.

Novation

Article 13 of Saudi Arabia Royal Decree No. M22/1441 H (Article 13 of Saudi Arabia Cabinet Decision No. 122/1441) details that in case of change of the ownership of the franchisee or in case the franchisee desired to novate the agreement to a third party, the franchisee must obtain the prior written approval of the franchisor. Following the franchisor's approval, the franchisor may not object to the change of ownership or novation nor is it possible to retract the approval except in accordance to the circumstances outlined by Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441). In case the franchisee requested the approval of the franchisor and the franchisor did not respond, it will be considered as if the franchisor accepts such request. It is important to note that Article 13 of Saudi Arabia Royal Decree No. M22/1441 H (Article 13 of Saudi Arabia Cabinet Decision No. 122/1441) allows the parties to agree otherwise in the franchise agreement. As such, if the parties desired on another mechanism, they must detail it in the agreement.

Renewal

Unless agreed otherwise in the franchise agreement, in case the franchisee desired to renew the franchise agreement or extend it, the franchisee must communicate with the franchisor in writing 180 days prior to the expiration of the franchise agreement and such agreement will be renewed or extended for equal terms and identical provisions except in the following cases:

- if the franchisor or franchisee agreed on new provisions;
- in case any of any of the circumstances outlines in Article 18 of Saudi Arabia Royal Decree No. M22/1441 H (Article 18 of Saudi Arabia Cabinet Decision No. 122/1441) happened;
- in case the franchisee did not pay the franchisor the monetary compensation outlined in the franchise agreement;
- if the franchisor approved the novation of the franchise agreement prior to its expiration to a party fulfilling the necessary requirements;
- if the franchisor no longer desired to conduct the franchise work or no longer desired to franchise in Saudi Arabia; and
- if the franchisor did not agree on the renewal or extension as per the reasonable requirements of the franchisee 60 days prior to the expiration of the franchise agreement.

Termination of the franchise agreement

The franchise agreement can end by either termination or expiration. Both give rise to certain effects post the end of the contractual relationship between the parties. Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) provides a framework regulating the rights and obligations of the parties in such cases in order to decrease potential disputes that may become long overdue.

Expiration

Similarly to any other types of contracts, the franchise agreement will expire upon the end of its designated term, if the franchisor and franchisee did not agree to renew or extend its term. In such case, Article 22 of Saudi Arabia Royal Decree No. M22/1441 H (Article 22 of Saudi Arabia Cabinet Decision No. 122/1441) outlines that upon the expiry of the franchise agreement, any agreement pertaining to the use of the franchise trademark or tradename will also come to an end. Further, Article 16 of Saudi Arabia Royal Decree No. M22/1441 H (Article 16 of Saudi Arabia Cabinet Decision No. 122/1441) details that the franchise agreement will expire if the franchisee went into bankruptcy as per Saudi Arabia Royal Decree M50/1439 H (Saudi Cabinet Decision No. 264/1439 on the Approval of the Bankruptcy Law) or due to the death, loss of capacity, or health

problem occurring to the franchisee. Article 16 of Saudi Arabia Royal Decree No. M22/1441 H (Article 16 of Saudi Arabia Cabinet Decision No. 122/1441) will be applicable upon the parties except if agreed otherwise. It is important to note that the franchise agreement shall not expire in cases of mergers and acquisitions by the franchisee.

Termination

The franchisor may not terminate the franchise agreement prior to the expiration of its term without the written approval of the franchisee unless the termination was due to a justified legitimate reason which can be either of the circumstances outlined in Article 18 of Saudi Arabia Royal Decree No. M22/1441 H (Article 18 of Saudi Arabia Cabinet Decision No. 122/1441) as follows:

- if the franchisee breached the material obligations set forth in the franchise agreement and did not solve such breach within 14 days from the date of the franchisor's notice;
- if the franchisee was liquidated, dissolved, or novated the agreement or its benefit to its creditors;
- if the franchisee stopped working on the franchise for a period of more than 90 consecutive days;
- if the franchisee was constantly non-compliant with the franchise agreement or any other agreement signed with the franchisor even after the franchisor's written notification requesting the adherence to the obligations;
- if the practicing of the franchise resulted in public health and safety risks;
- if the franchisee lost any of the required licenses to practice the work;
- if the franchisee commits a major breach to any of the laws in Saudi Arabia that will affect negatively to the franchise's reputation;
- if the franchisee committed an act of commercial fraud during the practicing of the franchise;
- if the franchisee infringes or misuses the intellectual property rights of the franchisor during the franchise agreement term; and
- any other reason outlined by the franchise agreement to be considered as a justified reason for termination.

Damages

Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) explained the arising damages due to the unjustified termination of the franchise agreement. Article 19 of Saudi Arabia Royal Decree No. M22/1441 H (Article 19 of Saudi Arabia Cabinet Decision No. 122/1441) prescribes that in case the franchisor breached any of the obligations ascribed by Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) relating to the registration of the franchise or disclosure, the franchisee will have the right to claim compensation for any damages that it incurs without terminating the franchise agreement.

Further, the franchisor must compensate the franchisee for any losses incurred as a result of the incorporation, acquisition, or operation of the franchise work in Saudi Arabia and any other damages incurred thereto only if the termination was not due to the franchisor's intention to not renew or extend the franchise agreement or only if the termination was not as per Article 15 (2) to Article 15(5) of Saudi Arabia Royal Decree No. M22/1441 H (Article 15(2) to Article 15(5) of Saudi Arabia Cabinet Decision No. 122/1441).

Conversely, if the franchisee terminated the franchise agreement in violation of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) provisions, the franchisor will have the right to claim compensation for any damages incurred accordingly.

It is important to note that any party violating the provisions of Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) or its Implementing Regulation will be fined with a fee not exceeding SAR 500,000.

Limitation period

In addition to outlining the provisions pertaining to termination and damages, Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) also detailed the limitation period for any damages claim to be filed by either the franchisor or franchisee. This is a very important provision in Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) as it provides clear regulations on franchise claims limitation periods and therefore limits any issues arising as that result in cases of disputes.

Article 21 of Saudi Arabia Royal Decree No. M22/1441 H (Article 21 of Saudi Arabia Cabinet Decision No. 122/1441) details that in case the franchisor terminated the franchise agreement in violation of Article 18 of Saudi Arabia Royal Decree No. M22/1441 H (Article 18 of Saudi Arabia Cabinet Decision No. 122/1441), the claims may not be adjudicated after three years from the date of the franchise agreement termination. Additionally, in cases of a breach of the obligations set forth in the franchise agreement or Saudi Arabia Royal Decree No. M22/1441 H (Saudi Arabia Cabinet Decision No. 122/1441) by either the franchisor or franchisee and the arising of damages accordingly, the claims to that regard may not be heard after one year from the date the non-breaching party knew of the breach or after three years from the date the breach occurred, whichever comes first.

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