

## Client Alert

October 2019

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## Saudi Arabia's New Franchise Law

The long-awaited Saudi Arabian franchise law will take effect on 22 April 2020 and will apply to all franchises operating wholly or partly within the Kingdom, including franchise agreements entered into before the effective date of the Law (with certain of the law's provisions not applying to pre-existing agreements) and including those between foreign franchisors and local franchisees.

### Introduction

The long anticipated new Saudi Franchise Law (the "**Law**"), M/22 of 1441H (2019) was approved by the Council of Ministers on 09/02/1441H (corresponding to 8 October 2019) and will come into effect on 22 April 2020.

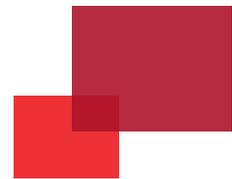
With the introduction of the Law, we assume that the Decision of the Minister of Commerce number 1012 of 17/09/1412H (corresponding to 22 March 1992) which determined that franchising would be considered a form of "commercial agency" governed by the Commercial Agencies Law ("**CAL**"), has been repealed. This view is supported by Article 27 of the Law which provides that "any provisions conflicting with the Law shall be repealed". Furthermore, Article 4(2) of the Law provides that agreements or contracts subject to the Kingdom's Commercial Agency Law are not considered as franchise agreements.

### Application to Existing Franchise Agreement

The Royal Decree provides that Articles 5 (franchisor experience required), 6 and 7 (registration and disclosure), 8(2)\* and 9(2) (franchisor obligations), 11 (franchise agreement contents) and 17 and 19 (termination and compensation for franchisor breach of its disclosure and registration obligations) do not apply to franchise agreements entered into prior to the Law taking effect ("**Pre-existing Agreements**"). As a result, franchisors which actually enter into franchise agreements prior to the effective date of the Law would not, for example, be subject to the default non-competition provision in Article 8 is one of those Articles that the Law provides does not apply to Pre-existing agreements. On the other hand, the renewal provisions contained in Article 15 will apply to Pre-existing Agreements and hence some franchisors will presumably wish to consider including in their agreements to be entered before 22 April 2020 adequate opt-out language as invited by the opening phrase of Article 15. See the discussion below under Commercial Requirements.

It is also worth noting that the Royal Decree pursuant to which the Law was issued provides that the Council of Ministers may exempt certain categories of franchisors and franchisees from some of the requirements under the Law based on criteria to be proposed by the Minister of Commerce and Investment (the "**Ministry**"). Such criteria should take into account the status of the relevant sector, type of activity and the size of market players.

\* While the Royal Decree refers to Article 8(2), we understand that the intention is for the entire Article 8 not to apply to franchise agreements entered into prior to the Law taking effect. We will continue to monitor any guidance issued by the Ministry in this regard.



**George Sayen**  
george.sayen  
@bakermckenzie.com



**Mohammad Al Rasheed**  
mohammad.alrasheed  
@bakermckenzie.com



**Robert Cartwright**  
robert.cartwright  
@bakermckenzie.com



**Christiana O'Connell-Schizas**  
christiana.o'connell-schizas  
@bakermckenzie.com



**Penny Ward**  
penny.ward  
@bakermckenzie.com

## Disclosure and Registration

As an early draft franchise law that was circulated for public comment in January 2017 foreshadowed, the Law as promulgated is, in common with most similar laws around the world, a statute that principally requires full disclosure of material information to prospective franchisees. The Law itself does not provide what disclosure statements must contain, but rather provides at Article 6 that the Ministry, the regulator under the Law, will issue implementing regulations (the "**Implementing Regulations**") that will set out the information required to be provided. The Law also requires the registration with the Ministry of franchise agreements to be offered in the Kingdom and that the procedures for accomplishing registration will also be provided in the Implementing Regulations. Under Article 26 of the Law, the Implementing Regulations must be issued by the time the Law takes effect. We will of course provide clients with a supplemental alert when the Implementing Regulations are issued.

## Commercial Requirements

In addition to registration and disclosure, the Law contains a number of substantive commercial provisions that intrude on the parties' freedom to conclude franchise agreements containing such terms as they like. The Law does however allow the parties to opt-out of many of its provisions, which allows the parties the liberty to regulate their relationship in a manner they see appropriate.

The Law includes substantive commercial requirements that essentially benefit franchisees. This is particularly evident in the non-competition, transfer, renewal and termination Articles though, as noted, a careful franchisor drafting or adapting its standard agreement for Saudi Arabia may opt-out of some of them or become subject to the default provision in the Law.

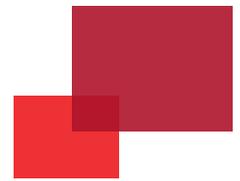
On the other hand, Article 18 on termination provides, with no similar opt-out language, that a franchisor may not terminate a franchise agreement before expiry except in certain specified cases; e.g., for material or persistent breach, but also under Article 18(10) "for any other matter deemed a legitimate cause for termination pursuant to the franchise agreement". Presumably, the intent is to provide franchisors somewhat less leeway than a blanket opt-out would accomplish to expand in their standard agreements additional "legitimate" causes for termination than appear in Article 18.

## Termination rights and compensation due to franchisees in various circumstances

Articles 15, 17, 19, 20 and 21 of the Law are all the more worthy of attention in that they relate to the Articles on disclosure and registration, termination and non-renewal that are mandatory (though the non-renewal provision (Article 15) may be effectively opted-out of by carefully drafted agreements) and they apply to Pre-existing Agreements.

Article 17 for example provides that a material breach of a Franchisor's disclosure and registration obligations gives rise to a right on the part of franchisees (subject to the limitation periods stated) to terminate the agreement without liability to the franchisor. Article 20 provides that if a franchisee "requests termination" in accordance with Article 17, then under sub-article (a) the franchisor incurs a repurchase of assets obligation as provided (which is presumably regarded not as "compensation") and under sub-article (b) must compensate the franchisee "for any losses suffered in relation to setting up, acquiring or operating the franchise business in the Kingdom and any other damages suffered by the franchisee".

On the other hand, under Article 19, if a franchisor materially fails to comply with the same disclosure and registration requirements, the franchisee may claim compensation



for any loss suffered as a result but shall not be entitled to terminate. There is a potential conflict between Articles 17 and 20 (on the one hand) and Article 19 on the other. The Implementing Regulations may shed some more light on how these Articles should be interpreted and applied in practice.

## Law and Dispute Resolution

The Law provides at Article 23 that parties may agree to settle disputes arising under "franchise agreements or the application of the Law" by alternative dispute resolution. The Law does not address what law governs the franchise agreement and therefore the parties may agree a governing law of the franchise agreement subject however to the mandatory provisions of the Law. Therefore, though perhaps not free from doubt, the parties' agreement on a foreign law to govern the franchise agreement (a law that does not provide for example for a right of action for repurchase of assets and damages on termination without cause as provided in Article 18), presumably accompanied by a non-Saudi forum selection clause, would presumably not render a franchisee so terminated without the remedies provided by Article 20 at least in a Saudi forum.

## Penalties

Violations of the Law will be subject to a fines not exceeding SAR 500,000. A committee of three members will be established by the Ministry to consider violations and penalties. Appeals may be taken to the Board of Grievances, the Saudi court with jurisdiction to hear claims against the government.

## The Franchise Center

The Royal Decree under which the Law was promulgated establishes a Franchise Center as part of the General Authority for Small and Medium Size Enterprises which in cooperation with the Ministry among other things may set requirements for engaging in franchise mediation and conciliation activities and endeavor to amicably settle disputes between franchisors and franchisees, organize events to spread awareness about franchising activities, relationships and opportunities and prepare educational documents relating to franchising.

## Next Steps

In view of the promulgation of the Law, members of the franchise community already with operations in Saudi Arabia, as well as those contemplating entry in this growing market, should take advantage of the 180 day period prior to the effective date of the Law to review with counsel their existing and prospective agreements relating to Saudi operations in light of the rights and obligations that the new Law will confer and impose. Where appropriate, they may wish to adjust their agreements to take advantage of the opportunities the Law affords to opt out of, or otherwise ameliorate, certain of the Law's provisions.

**Legal Advisors  
in association with  
Baker & McKenzie Ltd.**

**Riyadh Office**  
Olayan Complex,  
Tower II, 3rd Floor  
Al Ahsa Street, Malaz  
P.O. Box 69103  
Riyadh 11547  
Saudi Arabia  
Tel: +966 11 265 8900  
Fax: +966 11 265 8999

**Jeddah Office**  
Bin Sulaiman Center, 6th Floor,  
Office no. 606  
Al Khalidiyah District,  
P.O. Box 40187  
Prince Sultan Street and  
Rawdah Street intersection  
Jeddah 21499  
Kingdom of Saudi Arabia  
Tel: +966 12 606 6200  
Fax: +966 12 692 8001