

# A Brief on the New Saudi Franchise Law

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## Background

The new Franchise Law (“**Franchise Law**”) of the Kingdom of Saudi Arabia (“**Kingdom**”) was promulgated by Royal Decree No. M/22 dated 09/02/1441 Hijri (corresponding to 8 October 2019). The Implementing Regulations of the Franchise Law (**IRFL**) were approved by Ministerial Resolution No. 00591 dated 18/09/1441H (corresponding to 11 May 2020).

This article provides a brief overview of some of the key provisions of the Franchise Law and the IRFL.

## What is franchising?

The Franchise Law defines franchising as “the granting by a person referred to as the franchisor to another referred to as the franchisee of the right to carry out the activities - subject of the franchising - for its own account under the trademark or the trade name owned by the franchisor or licensed to it, providing technical expertise and know-how to the franchisee and determining the manner of operating the franchised business, against monetary or non-monetary consideration, which consideration shall not include the amounts paid by the franchisee to the franchisor for goods and services supplied.”<sup>1</sup>

In order to qualify for franchising, the activity that is subject of franchise must have been carried on by two persons (who may be the franchisor or one of its group members) for at least one year, or at least in two different locations.<sup>2</sup>

## Scope of application

The Franchise Law applies to any franchise that is to be implemented in the Kingdom.<sup>3</sup> Certain contracts and arrangements are excluded from the

<sup>1</sup> Franchise Law, Art. 1

<sup>2</sup> Franchise Law, Art. 5.

<sup>3</sup> Franchise Law, Art. 3. The Royal Decree, which promulgated the Franchise Law, disapplied Articles 5 (franchisor experience required), 6 and 7 (registration and disclosure), 8(2) and 9(2) (franchisor’s obligations), 11 (content of franchise agreement) and 17

scope of the Franchise Law such as contracts that are regulated by the Commercial Agencies Law and contracts for the use of trademarks or any other intellectual property rights in relation to goods and services.<sup>4</sup>

### Summary of key provisions

- **Mandatory disclosure:** The franchisor now has a statutory obligation to disclose the information specified in the IRFL to the franchisee at least 14 days before the conclusion of a franchise agreement.<sup>5</sup> The IRFL sets out a detailed checklist of information<sup>6</sup> required to be included in the disclosure document of the franchisor which must be in Arabic and, if it is written in another language, the franchisor must provide its certified Arabic translation. In the event of any material change in the information included in the disclosure document after it has been provided to the franchisee and before the signature of the franchise agreement, the franchisor must provide the franchisee with a new updated disclosure document or a separate document that outlines the material changes as soon as possible before the franchisee signs the franchise agreement or pays any consideration related to the franchise, whichever is earlier. Any change in facts or circumstances that has a material impact on the value of the franchise business or the franchisee's decision to conclude the franchise agreement is deemed a material change.

and 19 (termination and compensation for the franchisor's breach of its disclosure and registration obligations) to franchise agreements existing prior to the Franchise Law take effect in April 2020.

<sup>4</sup> Franchise Law, Art. 4 and IRFL, Art. 2. The list of excluded contracts which are not considered to be franchise agreements includes: (i) franchises granted or issued under royal decrees; (ii) arrangements under which the franchisee is wholly owned by the Franchisor directly or indirectly; (iii) agreements or arrangements concluded by the franchisor with the franchisee regarding the implementation of the franchise agreement (including: (a) agreements or arrangements concluded between the landlord and the tenant, and between the tenant and the sub-tenant; (b) agreements or arrangements concluded between partners or shareholders; (c) loan agreements or arrangements concluded between creditors and debtors; and (d) agreements or arrangements concluded between the employer and the worker regarding the work relationship between them); (iv) agreements or arrangements whereby a non-profit organisation buys goods for its employees, provides them with services, or helps them to purchase goods or use services; and (v) governmental licences or permits.

<sup>5</sup> Franchise Law, Art. 7 and IRFL, Art. 6.

<sup>6</sup> The disclosure document must include, among other things, information about (i) the franchisor and its group; (ii) the franchisor's track record for the last five years; (iii) the master franchisor if the franchisor is a master franchisee; (iv) current litigation and arbitration proceedings against the franchisor and members of its group in connection with the franchise business; (v) amounts to be paid by the franchisee; (vi) whether or not the franchise is exclusive; (vii) current franchisees; (viii) intellectual property rights associated with the franchise business; (ix) parties' obligations relating to marketing and advertising; and (x) the parties' obligations on expiry or termination of the franchise agreement (e.g. compensation payable to the franchisee and the franchisor's repurchase of remaining stock).

- **Mandatory registration:** The franchisor must register a signed franchise agreement and related disclosure document with the Ministry of Commerce (**MOC**) within 90 days from the date of signing the franchise agreement by depositing their copies with the Commercial Agency Department at the MOC. The registration requirement also applies to any amendments to a registered franchise agreement. The registration of the franchise agreement and the relevant disclosure document will be valid for the duration of the franchise agreement. The registration will be cancelled upon termination or expiry of the franchise agreement or issuance of a court ruling declaring the agreement null and void. The franchisor must apply for the cancellation of the registration within 90 days of the occurrence of the above-mentioned events.<sup>7</sup>
- **Terms of franchise agreement:** The Franchise Law requires a franchise agreement to include a number of substantive provisions.<sup>8</sup> Among such mandatory provisions are the franchisor's obligation to transfer of know-how, obligations of supply and purchase of goods or services from a specific source, the franchisee's right to grant sub-franchises and consequences of change of control of either party. The parties may include restrictions on the franchisor and the franchisee regarding carrying on any business which competes with the franchised business during the period of the franchise agreement or after its expiration or termination. Any such non-compete provisions are subject to Saudi competition regulations. The Franchise Law allows the parties to contract out from number of default provisions which provides the parties with flexibility.<sup>9</sup> The franchise agreement must be prepared in Arabic and, if it is prepared in another language, its certified Arabic translation must be made available.<sup>10</sup> The Franchise Law requires the franchisor and the franchisee to fulfil their obligations under the franchise agreement in good faith.<sup>11</sup>
- **Renewal or extension of the franchise agreement:** Unless the franchise agreement provides otherwise, the franchisee must

<sup>7</sup> IRFL, Art. 5.

<sup>8</sup> Franchise Law, Art. 11 (2) and IRFL, Art. 8.

<sup>9</sup> E.g. Art. 8 and 9 of the Franchise Law.

<sup>10</sup> Franchise Law, Art. 11 (1).

<sup>11</sup> Franchise Law, Art. 10.

provide the franchisor with at least 180 days' written notice prior to the expiry date of the franchise agreement of its intention to renew or extend the franchise agreement.<sup>12</sup>

- **Termination rights and compensation:** The franchisor may terminate the franchise agreement on a limited number of grounds considered to be legitimate under the Franchise Law such as:<sup>13</sup>
  - the franchisee's breach of material contractual obligations;
  - winding up or insolvency of the franchisee;
  - suspension by the franchisee of the franchised business for more than 90 consecutive days;
  - the franchisee's conduct posing a risk to public health or safety;
  - the franchisee's material violations of laws of the Kingdom by the franchisee or infringement of the franchisor's intellectual property rights; and
  - other circumstances agreed in the franchising agreement.

Under Article 17 of the Franchise Law, the franchisee is entitled to terminate the franchise agreement if the franchisor is in material breach of its disclosure and registration obligations under the Franchise Law without any liability to the franchisor for such termination.<sup>14</sup> Termination of the franchise agreement under Article 17 has two implications: (i) the franchisor must within 60 days of the franchisee's demand, re-purchase any asset bought by the franchisee for the franchised business on the basis of instructions from the franchisor (irrespective of whether such assets were bought from the franchisor or third parties); and (ii) the franchisor must compensate the franchisee "for any losses suffered in relation to setting up, acquiring or operating the

<sup>12</sup> Franchise Law, Art. 15.

<sup>13</sup> Franchise Law, Art. 16, 17 and 18. The franchisor may also terminate the franchise agreement if the franchisee: (i) loses any licences necessary for carrying on its business; (ii) commits material violations of Saudi Arabian laws that would negatively affect the reputation of the franchise business; and (iii) commits any act of commercial fraud when carrying on the franchise business.

<sup>14</sup> It is worth noting that Article 19 of the Franchise Law allows the franchisee to claim compensation (without terminating the franchise agreement) if the franchisor materially breaches its disclosure and registration obligations.

franchise business in the Kingdom and any other damages suffered by the franchisee.”<sup>15</sup>

- **Change of control:** Unless agreed otherwise in the franchise agreement, any change of control of the franchisee or assignment of the franchise agreement by the franchisee requires the prior approval of the franchisor.<sup>16</sup> The franchisor is not permitted to withdraw and withhold its consent save in certain situations (e.g. the assignee lacks sufficient financial resources or does not have the necessary licences or approvals to conduct the franchise business, or the franchisee owes money to the franchisor, or the franchisee has breached any of its material obligations under the franchise agreement which has not been remedied within 14 days of the franchisor’s default notice). If the franchisor fails to respond within 30 days to the franchisee’s request to approve a change of control or assignment, such approval is deemed to have been approved by the franchisor.<sup>17</sup>
- **Trademarks:** If the franchise agreement includes a licence to use the franchisor’s trademarks or trade names by the franchisee, the franchise agreement will need to be registered with the Saudi Authority for Intellectual Property (**SAIP**) in accordance with the procedure of registration of trademark licences. The assignment, termination, expiry or non-renewal of the franchise agreement will result in expiry of the agreement for the use of any trademark or trade name associated with the franchise business, in which case the franchisor is required to notify the SAIP regarding the same.<sup>18</sup>
- **Dispute resolution:** The parties may agree on using arbitration, mediation or conciliation to resolve any disputes regarding the franchise agreement or the application of the Franchise Law.<sup>19</sup> The Franchise Law contemplates the establishment of a committee comprising three members with jurisdiction over matters involving violations of the Franchise Law. The committee may impose fines not exceeding SAR 500,000 for violations of the Franchise Law.<sup>20</sup> Decisions of the committee can be appealed to the Board of Grievances which adjudicates claims against the government.

<sup>15</sup> Franchise Law, Art. 20. The re-purchase obligation of the franchisor will also be triggered if the franchisor does not extend or renew the term of the franchise agreement (the Franchise Law, Art. 20(1)(A)).

<sup>16</sup> Franchise Law, Art. 13 and IRFL, Art. 10.

<sup>17</sup> Franchise Law, Art. 14 and IRFL, Art. 11.

<sup>18</sup> Franchise Law, Art. 22 and IRFL, Art. 13.

<sup>19</sup> Franchise Law, Art. 25.

<sup>20</sup> Franchise Law, Art. 24.

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