

UNDERSTANDING SAUDI FRANCHISE LAW: KEY LEGAL CONSIDERATIONS

Franchising is a widely adopted commercial model that enables businesses to expand their activities by granting third parties the right to operate under an established trademark and an approved operating system, in accordance with defined contractual terms and conditions.

This model is based on achieving a balance between enabling the franchisee to invest in an established brand and a proven system, and allowing the franchisor to retain an appropriate level of supervision and control to ensure consistency of standards and protection of the brand's reputation as well as capitalize on its brand.



Introduction

Given the composite contractual and regulatory nature of franchising, and the mutual rights and obligations arising therefrom, effective regulation requires a clear legal framework that governs the relationship between franchisors and franchisees, defines the scope of their respective rights and obligations, and promotes legal certainty and stability.

In the Kingdom of Saudi Arabia, the Saudi Franchise Law (Law) issued pursuant to Royal Decree No. (M/22) of 2019 constitutes the principal regulatory framework governing franchise relationships. The Law addresses the core aspects of franchising, including disclosure and registration requirements, the regulation of the contractual relationship between the parties, and the determination of their respective rights and obligations. This article examines the key legal aspects of franchising regulations in Saudi Arabia within the Kingdom's regulatory framework.



What is a Franchise Agreement?

A franchise agreement is the document that outlines the terms and conditions between the franchisor and the franchisee. However, defining the franchise agreement in Saudi Arabia requires addressing different types of franchise contracts recognized under the Saudi Franchise Law.

Clarifying these contractual models is essential to establish a clear understanding of legal relationship between the parties, distinguish franchise agreements from other contractual arrangements, and define the regulatory boundaries of the rights and obligations of both the Franchisor and the Franchisee.

The most common types of franchise agreements Saudi Arabia include

- **MASTER FRANCHISE AGREEMENT:**

This agreement grants the Franchisee the authority to operate the franchise within a wide geographical region and to grant sub-franchise rights to others, a process known as sub-franchising.

- **SINGLE-UNIT FRANCHISE AGREEMENT:**

The traditional and most common model, where the Franchisee is granted the right to operate a single unit within a designated territory.

- **MULTI-UNIT FRANCHISE AGREEMENT:**

This model enables the Franchisee to open and operate several units within a defined territory.

- **AREA DEVELOPMENT FRANCHISE AGREEMENT:**

Under this agreement, the area developer is granted the right to establish and operate a specified number of units within a particular area and timeframe. The developer is obligated to meet the agreed-upon development schedule in exchange for enjoying the franchise rights within that territory.

In Saudi Arabia, franchise agreements must include fundamental elements to ensure clarity and compliance with local laws, such as rights and obligations, fees and payments, duration of the franchise and renewal, and protection of consumers.



Understanding Saudi Franchise Law: Key Legal Considerations

Registration & Franchise Disclosure Requirements Saudi Arabia

Franchisors must provide a Disclosure Document at least fourteen (14) days before signing a franchise agreement. Article (3) of the Implementing Regulations requires the franchisor to register every signed franchise agreement and the disclosure document with the Ministry of Commerce within ninety (90) days from the date of signing. The same requirement applies to any amended agreement.

Intellectual Property Protection in Franchising and the Right of Priority

Intellectual property rights, particularly trademarks, constitute a fundamental pillar of a franchise agreement, as the essence of franchising lies in enabling the franchisee to use the franchisor's trademark and business system. Accordingly, the primary responsibility for registering and protecting the trademark rests with the franchisor, as the actual owner of the mark and the party entitled to license its use.

Registering the trademark in the Kingdom of Saudi Arabia is considered essential prior to granting the franchise, or at least concurrently therewith, in compliance with the Trademark Law and to ensure the sound legal position of both the franchisor and the franchisee.

The Trademark Law provides in Article (4), paragraph (a), that the right to register a trademark is exclusive to natural or legal persons holding Saudi nationality. This means that trademark registration within the Kingdom is not tied to a specific party to the franchise agreement, but rather to the party who meets the statutory requirements for registration.

Accordingly, if the franchisor is a foreign company that does not have a prior trademark registration in the Kingdom, granting a franchise without taking the necessary legal steps to register the trademark constitutes a legal risk. In such a case, the foreign franchisor must either register the trademark in the Kingdom through a duly qualified Saudi agent or entity, or contractually agree with the franchisee in the Kingdom to register the trademark in the name of franchisor, provided that this arrangement is expressly regulated in a manner that preserves the ownership of the trademark and the rights of the franchisor.



Difference Between a Trademark License & a Franchise System

Both intellectual property licensing and franchising are legal arrangements that allow one party to use rights owned by another party. However, they differ fundamentally in terms of the scope of the relationship, the level of control, and the nature of the obligations.

Trademark / Intellectual Property License

A license grants a specific permission by the rights holder (the licensor) to another party (the licensee) to use a particular intellectual property right under agreed terms and conditions.

A key characteristic of licensing is that it is usually limited to the use of a specific intellectual property right, such as trademarks, patents, copyrights, trade secrets, software, or technical products. The relationship focuses primarily on the lawful use of the licensed intellectual property, without transferring a complete business model. Accordingly, the scope of the relationship is narrow and defined, and it does not involve the transfer of operational expertise or comprehensive training.

Full Franchise System

A franchise, on the other hand, is an integrated business model that grants the franchisee the right to operate an independent business using the franchisor's trademark, together with its operational system and comprehensive business model.

The franchise system is characterized by the use of the trademark in addition to business models, provision of operating manuals, technical know-how, systems and policies, marketing, and brand identity.

In terms of scope, franchising is broad and ongoing and is not limited to the use of a trademark or a product alone. The franchisor exercises close supervision and control over business operations, pricing, store design, visual identity, supplier selection, marketing methods, and compliance with unified standards.

Accordingly, a franchise should not be regarded as merely a license to use a trademark, but rather as a comprehensive commercial system that extends beyond intellectual property to the management and operation of the business activity.



Royalties and Franchise Fees in Franchising and Their Relationship to Withholding Tax on Franchise Royalties KSA

In franchise agreements, royalties and franchise or licensing fees constitute some of the most significant components of the financial consideration that the franchisee is obligated to pay to the franchisor, in return for the use of the trademark, the business system, and the approved operating model.

Royalties are defined as a recurring and ongoing financial consideration that is typically paid throughout the term of the franchise agreement. They are often calculated as a percentage of gross sales or net sales, depending on what is stipulated in the contract. There is no statutory provision that sets a fixed percentage for royalties; however, practical experience in the franchising sector indicates that royalty rates generally range between five percent (5%) and twelve percent (12%).

From a legal perspective, royalties essentially represent consideration for the use of intellectual property rights and an operating system. Accordingly, where such payments are made to a non-resident entity, they are subject to withholding tax under the tax regulations applicable in the Kingdom of Saudi Arabia.

Franchise fees, on the other hand, are typically paid as a one-time amount upon execution of the franchise agreement. These fees correspond to granting the franchisee the right to join the franchise network, use the trademark, and obtain the operating system and technical know-how associated with the business model.

Franchise fees vary significantly from one brand to another and are not subject to a uniform standard. They are primarily determined based on the strength of the trademark and its market value, the type of franchise model agreed upon, the scope of the granted territory, and the size of the target market.

Accordingly, franchise fees are not determined based on a fixed percentage but rather are structured in accordance with the contractual framework, the franchise model, and the nature of the rights and obligations arising therefrom.



Post-Termination Obligations and Risks for Franchisors

Upon the termination of franchise agreement in Saudi Arabia, regulatory and legal risks do not automatically come to an end with the termination of the contractual relationship. Rather, a more sensitive phase begins, relating to the post-termination effects, which may expose the franchisor to legal liabilities if not managed with due regulatory care.

The Franchise Law has regulated the termination and expiration of franchise agreements, specifying the legitimate grounds for termination and emphasizing the strict obligation to comply with statutory procedures, particularly with respect to the existence of a legitimate cause, the issuance of written notices within the prescribed timeframes, and the remediation of breaches prior to proceeding with termination.

Among the most significant risks that may arise for the franchisor following termination of the agreement is the potential allegation of wrongful or arbitrary termination where such termination is not based on a legitimate cause or does not adhere to the statutory procedural sequence prescribed by law.

There is also the risk that the former franchisee may continue to use the trademark, elements of the operating system, or exploit the technical know-how acquired during the term of the agreement, which would constitute an infringement of intellectual property rights and adversely affect the reputation of the franchise network.

Furthermore, inadequate regulation of post-termination obligations may result in unlawful competition by the former franchisee or in the former franchisee presenting itself in the market as still being affiliated with the franchise brand.

Accordingly, the protection of the franchisor following the termination of a franchise agreement is not achieved merely by providing for termination in the contract, but rather requires a legally informed and diligent management of the post-termination phase. This includes ensuring the immediate cessation of trademark use, the protection of trade secrets and technical know-how, the prevention of unlawful competition, and strict compliance with applicable statutory procedures.