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A New Era in International Franchising

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**NEWS FROM AROUND THE WORLD:
MIDDLE EAST**

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In this paper I will look at recent developments relevant to franchising that have occurred in the Middle East. This concerns principally the application of commercial agency laws to franchising, a long-standing area of concern for foreign franchisors. Where a franchisee has successfully registered as a commercial agent, they enjoy certain benefits including:

- Protection from termination and non-renewal;
- Compensation payable at the end of the contract; and
- Ability to prevent the appointment of another franchisee often through confiscation of imported products at customs

Generally, to benefit from the protections of the law the agency needs to meet three requirements:

- It needs to be exclusive;
- It needs to be registered; and
- Typically only 100% locally owned companies are able to make a registration.

Oman, Kuwait and Qatar have recently amended their commercial agency laws. The changes differ by country but all three countries have introduced a level of liberalization. Except for Oman, where the statutory right to claim compensation for termination has been abolished, franchisors need to continue to exercise great caution when faced with requests from franchisees to support an agency application. The UAE on the other hand has even taken a step back (in 2010) by removing the right of foreign franchisors to unilaterally apply to have registered franchisees removed from the register.

Oman

There is good news for franchisors in Oman, which continues to liberalize its agency regime. The agency law of the Sultanate of Oman, which was originally introduced by Royal Decree 26/1977, was amended in 2014 with Royal Decree 34/2014. The original law contained typical agent protection provisions. In 1996 the law was first liberalized to allow for multiple agents appointed on a non-exclusive basis. The 2014 amendments abolished a number of agency protections.

- The first change involves abolishing mandatory compensation for registered agents and is excellent news for franchisors. Compensation is no longer expressly required by law. Franchisors and franchisees are now free to decide the terms of renewal and termination. Obviously, an agent can still make a claim for breach of contract. Somewhat unhelpfully the law provides that the courts shall decide all disputes between principals and agents and “may decide on appropriate compensation depending on commercial and local practices.” This leaves some uncertainty hanging over the repeal of the previous law.
- The second change abolished the prohibition on the foreign principal from selling or distributing its goods or services itself or through a third party. As a consequence the registered agent no longer has rights to claim commission from parallel imports. Foreign franchisors can now sell their products directly to customers in the country, for example online.
- Finally, the import of goods, that are the subject matter of an agency dispute can no longer be banned by the Minister of Commerce & Industry. This relaxes the strangle hold registered agents previously had over principals such as franchisors and makes Oman the most liberal country in the GCC when it comes to the commercial agency regime. This change implements Oman's obligations as a WTO member not to place bars on the freedom of contractual trade.

Kuwait

The State of Kuwait has one of the oldest commercial agency laws in the Gulf region. The original law dates back to 1964 (Law No. 36 of 1964). As of 13 March 2016 this law was replaced by a new Commercial Agency Law (Law No. 13 of 2016).

The law makes it clear that registered agents can be non-exclusive. This removes the monopoly previously held by registered agents. The original law was silent as to exclusivity, but in practice, it was common for the Ministry of Commerce and Industry to refuse to register more than one agent regardless of whether the contract was exclusive. The new law expressly states that the principal may appoint more than one agent. Franchises are expressly covered within the scope of the law. There often is uncertainty as to whether a franchisee is a commercial agent as the franchisee does not typically sell goods and service on behalf of and for the account of the franchisor as its principal. The new law clarifies that franchise agreement may be registered as commercial agency agreements. Registered agents cannot block the import of goods. Previously, registered agents had the right to stop imports by other persons. They often actively used customs authorities to stop shipments. The new law clarifies that any local company may import goods and services regardless of whether there is a registered and exclusive agent for such goods and services.

The agency law does not contain an express provision for compensation upon termination. However, agents can make a claim for compensation under the commercial code.

Only registered agents enjoy protection. However, the law makes registration mandatory and provides that an unregistered agency is not valid and no claim can be brought pursuant to an unregistered agency agreement. This may have been intended to prevent compensation claims by unregistered agents but it can also be read to mean that franchise agreements that have not been registered are not enforceable. The new commercial agency law makes it clear that only commercial agencies registered with the Ministry of Commerce and Industry will be protected. It remains to be seen whether unregistered agents will no longer be permitted to bring claims. Under the old regime the law contained a comparable provision, but the Kuwaiti courts allowed claims from unregistered agents under the commercial code, which does not contain a registration requirement.

Qatar

A new law was passed in 2016 amending the original commercial agency law which dates back to 2002. The amendment introduced three major changes.

Distributors are expressly afforded the protection of the law. This can capture franchise agreements that involve the sale of the franchisor's products by the franchisee. Before the amendment, the Commercial Agency Law and its protection applied only to commercial agents, but not to distributors. However, protection and registration is still limited to exclusive arrangements. An exclusive franchisee that is similar to a product in that it sells the franchisor's products and services is likely to be protected.

Certain goods may be exempted: The Council of Ministers may exempt certain goods and services from the application of the law. Franchisors should check the list of exempted goods to see if they benefit from it.

Similar to Oman and Kuwait, there will be no more commission for parallel imports: Before the amendment, the law provided that the registered agent could claim commission on sales by other importers. This provision was deleted.

Unfortunately the right to claim compensation for termination or non-renewal remains.

The UAE Commercial Agencies Law¹

Federal Law No. 18 of 1981 on the organisation of Commercial Agencies (as amended in 1988 and further amended in 2006 and 2010) regulates the rights of Commercial agents in the UAE. The law has potential application not only to what would be considered as agency agreements in many foreign jurisdictions but also to franchise agreements.

The Commercial Agencies Law only applies to contracts that are registered with the UAE Federal Ministry of Economy. In order for a contract to qualify for registration with the Ministry the franchisee must be a UAE national or an entity that is wholly owned by UAE nationals. The franchise agreement must grant exclusivity over all or a part of the UAE and the franchise agreement must be notarized.

Franchisees may argue that the franchise agreement needs to be registered with the Ministry to be legally valid. This is not correct. There are many franchise agreements in the UAE that have been entered into between foreign franchisors and local limited liability companies including companies that are not 100% owned by UAE nationals or that are non-exclusive which are valid arrangements notwithstanding that they do not qualify for registration with the Ministry. Even franchise agreements, which meet the qualifying criteria for registration do not have to be registered and a well advised franchisor will resist any request for such registration. However, it is not unheard of that a franchisee may later approach the UAE courts for an order that the agreement be registered in order to obtain the protections offered by registration. Unregistered arrangements are governed by the UAE Civil Code and the UAE Commercial Transactions Law. In general terms, these laws recognize the right of parties to contract with each other on such terms as they may agree including under foreign governing law.

If an agreement has been successfully registered the main consequences of registration are:

1. The agreement cannot be terminated by the franchisor without “just cause” even if the franchisor has a clear contractual right to terminate in the franchise agreement itself;
2. The franchisee can prevent parallel imports for the products in respect of which it is a registered agent;
3. The franchisee may be entitled to compensation upon termination or non-renewal; and
4. Any disputes are subject to local law and can be brought by the franchisee before the UAE courts.

There is much uncertainty as to what it needed to establish “just cause”. For example the franchisor could argue that repeated material breaches of the terms of the franchise agreement or the breach of restrictive covenants in the franchise agreement amount to just cause. The ability of the franchisee to block imports puts a registered franchisee in an extremely strong negotiating position in the event that a franchisor wants to terminate an agreement and appoint a replacement franchisee. Removing a registered franchisee through the court system can take up to 3 years. The level of compensation payable is based on a number of factors including the performance of the franchisee, how long the arrangement has been in place and whether the expenditure incurred by franchisee in establishing the franchised business.

Attempts to liberalise the regime have been unsuccessful. The UAE Commercial Agencies Law was amended in 2006 to make it less protectionist by inter alia allowing principals to unilaterally deregister fixed term registered agreements upon the expiry of their term. However, in 2010 the UAE reverted to the prior position by removing the right of principals to de-register

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agents. The old commercial agencies committee has also been reactivated and franchisors will again be forced to apply to the committee to remove a registered agent.

Potentially Relaxation of Foreign ownership restrictions in the UAE

A local majority shareholding is required to obtain a trade license and to enter into a lease for real estate. As a rule only a company that has 51 per cent UAE national shareholding or 100 per cent GCC shareholding can obtain a retail trade license. Various trust and nominee structures are in use to circumvent these restrictions but it is not clear if these are enforceable. There is a significant risk that a UAE court may consider such agreements circumvention of UAE foreign ownership restrictions and as a breach of Law on Combating of Commercial Concealment which makes the practice of enabling foreign nationals to trade in areas that are reserved to UAE nationals a criminal offence. The new Companies Law will enable foreign ownership of up to 100 per cent in some areas. This may enable those brands that are reluctant franchisors to restructure their arrangements in the UAE.

Introduction of VAT in the UAE

VAT at a rate of 5 % has been introduced in the UAE with effect from 1 January 2018. Current practice suggests that VAT is being added to absolutely everything. Very few supplies are exempt or zero-rated. Franchisors should assume that VAT will apply to all their products and services. Franchise fee and product supplies will attract VAT at a rate of 5 %. The VAT will be payable by the Franchisee under a reverse charge regime. Problems arise where the franchisor has assumed that the UAE is a zero tax country and the franchise agreement does not specify who will bear the cost of VAT. Where the contract is silent the franchisee will argue that the franchisor has to absorb the VAT. To deal with this potential gap, the UAE law had allowed suppliers to serve a VAT notice on their UAE customers and franchisees requiring them to start paying VAT. However, such notices should have been given by 1 January 2018, so where the franchisor has not served a notice and the contract is silent it may have to absorb the VAT.

Saudi Arabia proposed new Franchise Law²

The Saudi authorities have recently released a draft franchise law (the “Draft Law”) to govern the franchising relationship in Saudi Arabia and to replace the current franchising regime that has existed since 1962.

The Commercial Agency Law (“CAL”) enacted by Saudi Arabia Royal Decree No. M/11/1382, dated 20/02/1382 H., corresponding to 22/7/1962G and its Implementing Regulations (“IRs”) issued under Saudi Arabia Ministerial Decision No. 1897/1401, dated 24/05/1401 were enacted broadly to govern any principal-agent commercial relationship in Saudi Arabia, including distributors, retailers, and any party providing, representing, or otherwise overseeing the distribution of another party’s goods in the Kingdom such as franchisees. Thus, along with general uncodified Sharia principles and rules of contract, the CAL and IRs have been the sole set of statutory rules governing the franchise relationship in Saudi Arabia. When the CAL was enacted, however, franchising was not a significant part of the economy. Thirty years later, franchising was officially brought under the umbrella of the CAL and IRs by virtue of Saudi Arabia Ministerial Order No. 1013/1412³ The CAL and IRs, like most Saudi statutory law, are drafted broadly and generally, leaving room for flexibility and interpretation, perhaps due to business-friendly Sharia principles which seek to uphold freedom of contract between

² Thanks to Jonathan Burns from our Saudi Arabian office for his detailed analysis and translation of the draft law

³ [Saudi Arabia Ministerial Order No.1013/1412, issued 17/09/1412 H., corresponding to March 22, 1992G.].

competent parties. The most significant rules created by the CAL and IRs pertain to nationalisation and registration.

- First, only Saudi Arabian nationals may serve as commercial agents in Saudi Arabia.
- Second, a commercial agent must be registered at the Commercial Agents⁴.

The duty to register lies solely on the Saudi commercial agent although the foreign principal's cooperation is required in order to have the agency agreement properly notarised, legalised, and consularised. Failure to register does not render the agency agreement unenforceable against the agent in Saudi Arabia, but it does subject the agent to potential fines and penalties⁵ although it is rare that these are enforced. Thus, most parties agree to keep their relationship unregistered because, among other reasons, the process of registering and de-registering is not worth the effort. Otherwise, Saudi Arabian law does not provide any specific statutory protections to franchisors or franchisees as in many other jurisdictions.

The Draft Franchise Law

On 1 January 2017, the Draft Law was released for public comments for a period of 25 days. While the status of the Draft Law is not yet known, its entry into force provision states that it will enter into force 180 days after the date of its publication in the Official Gazette. The Draft Law is a clear set of rules governing franchising operations and consists of a succinct 34 articles. However, its provisions (if adopted) would mark a sweeping change to Saudi Arabia's existing franchising legal framework. Whereas the CAL and IRs are drafted broadly and generally and with little statutory protections, governmental involvement, or oversight, the Draft Law provides for substantially more default and mandatory principles, as well as a significant increase in the government's regulatory oversight of the franchise relationship. It is interesting to note that nowhere in the Draft Law is the role of franchisee limited to Saudi Arabian nationals only, as is the case under the CAL and IRs. Rather, "Franchisee" is defined as "any natural or legal person authorised to engage in the business of franchising in the Kingdom." In addition, Saudi Arabia's foreign investment Negatives List⁶ (a list of commercial activities that are banned to any foreign investment and, thus, may only be performed by Saudi nationals or wholly Saudi-owned companies) does not specifically mention franchising as a blacklisted activity. Thus, the door has ostensibly been opened to allow foreign investors to operate as franchisees in Saudi Arabia.

Registration Process

Whereas under the CAL and IRs the Saudi commercial agent was responsible for registering the agency at the CAR, the Draft Law shifts this burden to the franchisor. However, in addition to shifting the burden to the franchisor, the Draft Law also adds additional registration burdens. Namely, the franchisor must also register in Saudi Arabia any trademarks that will be used in the franchise business. Given that trade mark registration in Saudi Arabia is an expensive and time consuming process, this is bad news for franchisors and could slow down many franchise deals. The franchisor must register the franchise agreement and a Disclosure Document with the MOCI prior to execution, which must be supported by further documentation, including evidence of the registration of any trademarks used in the franchise business. If there is ever a "substantial change"⁷ in the franchise relationship, the franchisor is further required to register a statement of such changes and a new Disclosure Document with the MOCI. Finally, it is

⁴ Registry ("CAR") at the Ministry of Commerce and Investment ("MOCI") [Ibid., Art. 3; supra note 3 at Art. 6.]

⁵ [Ibid., Art. 4; supra note 3 at Art. 20.]

⁶ [SAGIA Business Center, https://sagia.gov.sa/en/InvestorServices/InvestorLibrary/SubCategory_Library/Business_not_permitted.pdf.]

⁷ ["Substantial change" is defined as: any change in information or circumstances that may reasonably have a substantial negative impact on the value of the franchise business or on the decision of the franchisee to enter into the franchise agreement., ibid., Art. 1.]

important to note that all documents provided to the MOCI in the registration process must be drawn up in Arabic.

Under current Saudi Arabian law commercial agency, franchise agreements and distribution agreement are treated the same. The Draft Law recognizes the unique nature of the franchise relationship and that it is different from the agency and distribution models. Franchising is defined as:

“...any arrangement under which a Franchisor grants to a Franchisee, for monetary or non-monetary consideration, the right to operate a franchise business for the Franchisee’s own account, including the provision to the Franchisee of technical knowhow and training as well as determination of the method of operation by the Franchisee of the franchise business in association with the trademark of the Franchisor or of the licensor granting the Franchisor the right to use the same.”

A New 2+1 Rule!

Saudi Arabia appears to follow the lead of China in formalizing the level of business experience that a franchisor must have with their system before they may grant franchises to others. In order to have a valid franchise, the franchise concept must have been carried out by at least two companies in at least two locations for a period of at least one year. This certainly has a familiar sound and it will be interesting to see how this rule will be applied once it has come into force.

Disclosure Document

The Draft Law makes several references to a Disclosure Document, which the franchisor must provide to both the MOCI and the franchisee prior to executing the franchise agreement. In addition, in the event of any “substantial change” in the franchise relationship, an updated Disclosure Document must be provided to both the MOCI and the franchisee. The Draft Law does not specify in detail what disclosures must be made by the franchisor in the Disclosure Document, but only states that subsequent implementing regulations shall set out the requirements. It appears that one item that must be included in the Disclosure Document pertains to past or anticipated financial performance of the franchise business. All earning claims must be based on certain reasonable assumptions in accordance with further requirements set out in the Draft Law and carry a prominent warning. Without the required detail it is possible that the authority would reject the registration.

Minimum Content

The franchise agreement must include the typical minimum content such as obligations on the franchisor to provide training, technical and marketing expertise to the franchisee. As regards a central marketing fund the law requires that the franchisor must deposit such monies into an “independent bank account” and provide a yearly statement of such sums to the franchisee. The geographical exclusivity of the franchisee is a default rule under the Draft Law. Thus, unless agreed otherwise by the parties in writing, the franchisor shall not set up a competing business in the franchisee’s territory designated in the franchise agreement or license any other franchisee to do so. The franchisor may not object to a change in control of the franchisee except on “reasonable” grounds. Further, the franchise agreement must describe any restrictions on the franchisee’s ability to assign any of its rights to a third party. Thus, it can be assumed that the franchisor may not completely forbid assignment to a third. The Draft Law does not describe any notification obligations on the franchisee if a change of control or assignment occurs, but presumably the parties would include this in the franchise agreement. In that regard, the franchisor must object to the franchisee’s notice of a change in control or proposed assignment within 60 days and, if no objection is given, the franchisor’s consent will be implied.

All franchise agreements shall have a duration of not less than five years. However, it may be terminated earlier only in certain narrow circumstances listed in the Draft Law.

Cooling off Right

The franchisee has the sole right to cancel the franchise agreement within seven days after it is signed, in which case the franchisor must refund any sums received from the franchisee less “reasonable expenses” incurred, the franchisee must return any property received to the franchisor, and no damages will accrue to either Party.

Renewal Right

The franchisee has a statutory right to renew the franchise agreement for a similar term with written notice not less than 180 days before its expiry. The franchisor can only refuse a mandatory renewal of the franchise agreement only if certain narrow conditions set out in the law are met. In the event of a “wrongful termination” or non-renewal by the franchisor, the franchisor must compensate the franchisee.

Remedies for Failure to comply

The Draft Law provides that a committee set up by the MOCI shall be authorised to impose fines up to SAR 1 million (USD 266,667) for violations of the Draft Law. In addition to damages for wrongful termination and non-renewal, the franchisee has a statutory cause of action against the franchisor for any damages sustained as a result of any inaccuracy in the Disclosure Document. Further, the franchisee may terminate the franchise agreement if the franchisor fails to timely submit or update the Disclosure Document or if the franchisor fails to register the franchise agreement and Disclosure Document with the MOCI and request a full refund.

Choice of Law and Jurisdiction

The Draft Law provides that the courts of Saudi Arabia shall have jurisdiction to interpret and settle disputes under the franchise agreement, although the Parties may agree to use alternative dispute resolution (“ADR”) methods. Notably, the Draft Law does not state whether or not ADR in a non-Saudi forum is acceptable.

When will the law enter into force?

Saudi authorities typically do not release a draft law for public commenting unless there is a strong intent to adopt the law in the substantial form in which it was released—perhaps with minor variations based on public comments. Thus, it is important to understand the provisions of the Draft Law and prepare for a new franchising law framework to apply in Saudi Arabia in due course. Existing franchisors and franchisees should be prepared to come into compliance with the Draft Law provisions.