

## **Saudi Arabia: Agency and Distribution**

*Law Office of Howard L. Stovall*

In general, Saudi Arabian law does not prevent a multinational company from making off-shore export sales directly to customers in Saudi Arabia, on a case-by-case basis, and the Saudi-based customer can directly import the goods. Thus, at least in some instances, a multinational can successfully sell goods to customers in Saudi Arabia without any local marketing assistance or formal presence. If structured properly, such off-shore sales arrangements can minimize the seller's exposure to various Saudi Arabian laws and commercial risks (including Saudi Arabian income taxation).

Nevertheless, many multinational companies selling into the Kingdom decide to appoint a local commercial agent or distributor. Multinational companies often have good practical reasons for using Saudi Arabian commercial agents and distributors. For example, given the increased competition in the Saudi Arabian market, multinational suppliers may need local sales promotion, customer liaison, servicing and "on-the-ground" market analysis. In addition, Saudi Arabian customers are generally more at ease dealing with a local commercial agent or distributor, whether because of long-standing friendships, business arrangements, or simply a shared language, customs and culture.

### **Applicable Law**

For many years, Saudi Arabia had two separate regulations applicable to, respectively, "service agency" and "commercial agency" relationships.

Saudi Arabian Royal Decree M/2 (1978), the so-called "Service Agency Regulations", generally required a foreign company to appoint a Saudi service agent when entering into a contract to perform in-Kingdom services for a Saudi government ministry or department. However, Royal Decree M/2 (1978) was repealed, in its entirety, in August 2001.

Saudi Arabian Royal Decree No. M/11 (1962) as amended, the Commercial Agency Regulations, governs the relationship between a commercial agent and its foreign principal. Commercial agencies are also subject to various administrative practices and policies of the Ministry of Commerce (the "Ministry").

## **Definitions**

The Commercial Agency Regulations were promulgated to regulate both commercial agency and distributorship arrangements. Under a 1992 amendment, franchise agreements are also officially considered as a type of "commercial agency" subject to the Commercial Agency Regulations. For purposes of this summary, therefore, references to commercial agents will also generally include distributors (who buy and resell products for their own account) and franchisees.

## **Qualification Requirements**

The Commercial Agency Regulations contain a number of qualification requirements applicable to commercial agents. For example, the Commercial Agency Regulations state that only Saudi nationals or companies organized under Saudi law and wholly owned and managed by Saudi nationals may act as commercial agents.

In 2000, however, Saudi Arabia enacted new Foreign Investment Regulations that are designed to gradually open additional sectors of the Saudi Arabian economy to foreign participation. Although commercial agency generally remains outside permissible foreign investment, there has been a more favorable rule for "franchise rights classified internationally under number (8929), provided that the foreign ownership shall not exceed 49% and subject to economic requirements, and provided that only one franchise is granted for each [Saudi Arabian geographical] region". More recently (in March 2007), the Saudi government announced that foreign investment would be allowed in "distribution services, wholesale and retail trade" but with certain conditions -- such as a minimum investment of Saudi Riyals 20 million (approx. US\$5.3 million), and initial permissible foreign equity ownership limited to 51% of the relevant local company.

Commercial agents must be properly registered in the Commercial Registry, and are required to submit each of their commercial agency agreements for registration at the Ministry (as discussed further, below). The Commercial Agency Regulations also require the commercial agent to guarantee the quality of the products, and supply necessary maintenance and spare parts to consumers during the term of the commercial agency and for one year thereafter (or until a new commercial agent is appointed, whichever occurs first).

## **Direct and Exclusive Relationship**

The Commercial Agency Regulations require the commercial agent to have a direct contractual relationship with the producer of the relevant product(s), or with the representative of the producer located in the latter's country. The Commercial Agency Regulations

also permit a commercial agent to appoint sub-agents, unless prohibited or restricted by the commercial agency agreement.

The Commercial Agency Regulations do not require a Saudi Arabian commercial agency to be exclusive as to the relevant products or territory. In the past, the Ministry would treat any registered agreement as exclusive, refusing to register additional commercial agents for the same product(s) and territory -- even if the registered agreement was expressly non-exclusive. More recently, the Ministry generally seems to be registering either exclusive or non-exclusive agreements, thereby recognizing that more than one non-exclusive commercial agency may operate concurrently for the same foreign principal, territory and products.

Saudi Arabia has recently enacted a Competition Law, which could affect some distributorship matters (such as resale price controls and territorial sales restrictions) after implementing regulations are enacted and the law begins to be enforced.

### **Mandatory Use of Commercial Agents**

Despite repeal of the Service Agency Regulations, foreign contractors bidding on Saudi Arabian government (non-armament) tenders are still well-advised -- as a practical matter in at least some circumstances -- to use the services of a Saudi sales agent, partner or the like. For example, a number of recent Saudi Arabian government tenders require foreign contractors to submit joint bids with Saudi "associates".

In addition, Saudi Arabian law has required government entities to purchase products through the registered Saudi commercial agent for such products. Although this requirement is not always strictly observed, some foreign companies have faced obstacles making sales to the Saudi Arabian government directly from abroad or through unregistered commercial agents.

Otherwise, as a legal matter, a foreign company should be able to make direct sales to customers in Saudi Arabia without needing to appoint a local commercial agent. Saudi Arabian law does not generally require a foreign supplier to use a commercial agent for sales to private sector customers. For example, imported goods currently do not need to be cleared from customs by a registered commercial agent. As a practical matter, however, in many instances a foreign supplier is most successful selling into the Saudi market with the assistance of a local commercial agent.

## **Restrictions on Use/Payment**

The Service Agency Regulations had prohibited foreign companies from using any agent or intermediary in connection with the Saudi government's armament procurement contracts, and in contracts when the Saudi Arabian government contracts directly with a foreign government (such as United States Foreign Military Sales ("FMS") transactions). In addition, the Service Agency Regulations had prohibited a foreign contractor in other Saudi government procurement transactions from paying a commission to its service agent in excess of 5% of the total value of the contract between the Saudi Arabian government customer and the foreign contractor.

Despite repeal of the Service Agency Regulations, foreign contractors should be circumspect about using a sales agent contrary to those earlier rules. For example, the prohibition against agency and commissions in the Saudi Arabian government's armament procurement pre-dates the Service Agency Regulations, and was contained in Council of Ministers Resolution No. 1275 (1975). That 1975 resolution has not been expressly repealed. Moreover, the Saudi Arabian government may include such prohibitions in its tender documents to foreign defense contractors.

Otherwise, we are unaware of any Saudi Arabian regulation that would impose an explicit limit on commission rates. For example, the Commercial Agency Regulations do not generally limit the amount of commission payable to commercial agents in private sector sales. In addition, Saudi Arabia has not enacted any general foreign exchange restrictions on the transfer or retention of foreign currency into or outside the country.

## **Registration Requirements**

The Commercial Agency Regulations require a commercial agent to submit its commercial agency agreement for registration at the Ministry, within three months of commencement. The agreement must be drafted in Arabic or, if drafted in a foreign language, then accompanied by an authorized Arabic translation. In general, the obligation to register, and the penalties for the failure to do so, are legally imposed on the Saudi Arabian commercial agent rather than the foreign principal. (As a practical matter, such penalties do not seem to be imposed on an otherwise qualified Saudi Arabian commercial agent. Moreover, registration is not a prerequisite to the enforceability of a commercial agency agreement in Saudi Arabia.)

The Ministry will review the agreement to determine whether it complies with the Commercial Agency Regulations and any relevant Ministry policies/practices. The Ministry issued a model (or perhaps more accurately, sample) commercial agency contract in 1981, which has

been subsequently revised on at least a few occasions. Although the Ministry has most recently taken the position that the use of the model contract is not mandatory, registration officials have sometimes refused to register agreements which include provisions contravening the spirit of the model contract. For example, the Ministry has insisted in the past on at least a few requisite provisions, such as a clause expressly confirming the application of the Saudi Arabian Standards Organization's product standards.

(Incidentally, the Ministry's model contract is drafted unfavorably for the foreign principal, and would contractually provide a Saudi Arabian commercial agent with various 'dealer protections' that would not otherwise exist under Saudi Arabian law.)

Some multinational companies promote and sell their products in Saudi Arabia through local commercial agents on the basis of unregistered agreements. Such unregistered commercial agents are technically in violation of the registration requirements of the Commercial Agencies Regulations, but the penalties for failure to register are not substantial and are seldom if ever actually imposed in practice (assuming, of course, that the Saudi commercial agent is otherwise qualified to conduct such business in the Kingdom -- e.g., possessing Saudi nationality and a commercial registration). From the foreign principal's perspective, the most serious disadvantage of such an unregistered arrangement might be the commercial agent's inability to sell products to some Saudi government ministries and public sector entities. Such government and public sector purchasers have been required, at least in the past (by regulations that are not always strictly enforced), to purchase products only from commercial agents that are properly registered under the Commercial Agency Regulations.

## **Termination or Non-renewal**

Unlike many other Middle Eastern countries, Saudi Arabia has not enacted any statutory "dealer protection" legislation entitling a commercial agent to extra-contractual compensation upon the non-renewal or termination of a commercial agency. Under Saudi Arabian law, contractual parties are generally free to negotiate the terms of their commercial agency, including the grounds upon which the agreement expires or may be terminated. The Saudi Arabian courts have not typically awarded special compensation to a terminated commercial agent unless there has been a breach of the contract, the contract calls for such compensation to be paid, or the court is convinced there has been a serious abuse of rights.

In those cases where the Saudi courts have awarded compensation to the terminated commercial agent, awards have generally been limited to direct, actual and readily quantified damages. In some recent instances, however, the Saudi courts have issued decisions compensating terminated commercial agents for "goodwill" deemed

created for the principal. In such instances, "goodwill" was calculated as a percentage of sales achieved by the terminated commercial agent or (if known) sales by the foreign principal's replacement commercial agent. Otherwise, the Saudi courts normally neither award compensation for loss of anticipated profits, other consequential damages, interest, nor substantial attorneys' fees.

The Ministry has discretion to refuse registration of a "replacement" commercial agency until all disputes with the prior commercial agent are resolved. In this context, the Ministry established a special Committee for the Settlement of Commercial Agencies Disputes, authorized to function primarily as a mediator. Many terminated (or non-renewed) commercial agents have filed complaints before this special committee, effectively blocking the registration of replacement commercial agents for lengthy periods of time. However, some replacement commercial agents have obtained temporary registrations from the Ministry, pending resolution of the prior commercial agent's dispute, if such temporary registration is in the public interest -- for example, if the principal's products are crucial to the Saudi Arabian market. Given the Ministry's recent policy permitting the registration of multiple non-exclusive agreements, a non-exclusive registered commercial agent presumably might have difficulty blocking the registration of another non-exclusive commercial agent.

## **Choice of Law and Dispute Resolution**

As discussed above, the Ministry has registered commercial agency agreements that contain provisions for foreign (non-Saudi) governing law and dispute resolution outside Saudi Arabia. However, substantial questions arise when the Saudi courts are asked to recognize and enforce such foreign governing law and dispute resolution clauses.

The Saudi Board of Grievances is empowered as the judicial authority responsible for hearing commercial disputes between a Saudi Arabian (government or private) party and a foreign company. In at least some instances, the Board of Grievance has declined to take jurisdiction (upon motion from the foreign principal) over claims by a terminated commercial agent arising under an agreement containing a foreign governing law clause and/or foreign dispute resolution clause. Otherwise, we are unaware of any instance in which the Board took jurisdiction over a dispute and then applied the parties' contractually agreed foreign governing law clause. Rather, in such circumstances, the Board will apply Saudi Arabian law to the dispute. Moreover, we are aware of only one instance in which the Board of Grievance issued a decision to enforce a foreign judgment from a country outside the Arab League, and the Board subsequently reversed its decision on appeal.

Saudi Arabia is a party to the 1958 U.N. Convention on Recognition and Enforcement of Foreign Arbitral Awards. However, there is not yet any well-established practice showing that the Saudi Arabian courts will enforce foreign (particularly non-Arab) arbitral awards.

## **Conclusion**

At a Middle East business conference a number of years ago, one of the participants began his presentation by announcing "Welcome to Saudi Arabia -- the Land of Milk and Honey!" No country, not even Saudi Arabia, is likely to live up to such hyperbole. Nonetheless, the Kingdom offers opportunities to businesses that accept the commercial challenges, respect the country's special cultural and religious values, and carefully plan for the legal issues which may arise in the Saudi Arabian market.