

# Franchise 2022

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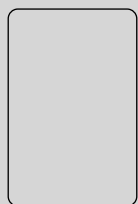
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# Franchise

## 2022

**Contributing editor**

**Mark Kirsch**  
Lathrop GPM

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Lexology Getting The Deal Through is delighted to publish the sixteenth edition of *Franchise*, which is available in print and online at [www.lexology.com/gtdt](http://www.lexology.com/gtdt).

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, India and United States.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at [www.lexology.com/gtdt](http://www.lexology.com/gtdt).

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Mark Kirsch of Lathrop GPM, for his assistance with this volume.



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# Malaysia

Jin Nee Wong and Siau Kee Pua

Wong Jin Nee & Teo

## MARKET OVERVIEW

### Franchising in the market

- 1 | How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

Franchising is very common and popular in Malaysia, and is considered one of the most effective and successful methods of business growth and expansion. Common sectors include food and beverages, education and learning centres, health and wellness, retail, and services. The halal franchise business is gaining momentum in Malaysia and offers good prospects in the international markets.

The Malaysian government strongly believes that the franchise industry plays a pivotal role in contributing to the national gross domestic product and, as such, it has taken a leading role in developing and nurturing the growth of the franchise industry. The government, through the Ministry of Domestic Trade and Consumer Affairs (MDTCA) together with Perbadanan Nasional Berhad (PNS) and supported by the Malaysian Franchise Association (MFA), has introduced and implemented many programmes and initiatives that are designed to provide a conducive environment to accelerate the development of competitive and high-quality 'fran-preneurs', and to create strategic network and alliances with the private sectors. The various incentives and schemes for franchisors and franchisees include the Franchise Financing Scheme, the Franchise Development Assistance Fund, the Small Franchise Financing Scheme, and the Franchise Development and Local Franchise Product Development Programme.

In the 2021 budget, the Malaysian government allocated 5 million ringgit to the MDTCA to implement the Micro Franchise Development and the Affordable Franchise programmes, which aim to motivate entrepreneurs to venture into the franchise sector with a capital scale ranging from 20,000 ringgit to 100,000 ringgit. Such initiatives are intended to facilitate the growth of micro-franchises and affordable franchise business models that the government believes will help to alleviate the effects of the covid-19 pandemic, paving the way for economic recovery.

### Associations

- 2 | Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The MFA was formed in 1994 to support the implementation of government programmes that promote entrepreneurship through franchising. The MFA provides a useful platform to engage with industry players,

government agencies and supporting institutions. It also functions as a resource centre for the public, as well as existing and prospective franchisors and franchisees. The MFA provides input and liaises with government departments and agencies on matters concerning franchising. In addition to setting guidelines and standards of ethical practice among its members, it serves as a forum through which the expertise and experiences of members may be exchanged. The MFA also conducts seminars, exhibitions and educational programmes on franchising.

## BUSINESS OVERVIEW

### Types of vehicle

- 3 | What forms of business entities are relevant to the typical franchisor?

In Malaysia, a business may exist in a number of different forms, including sole proprietorships, partnerships (including a limited liability partnership) and companies or representative, regional or branch offices of foreign companies. The principal form of business organisation that is most relevant and common to a typical franchisor would be a private limited company.

### Regulation of business formation

- 4 | What laws and agencies govern the formation of business entities?

Where incorporation of a company is concerned, the relevant laws are the Companies Act 2016 and the Companies Regulations 2017, which came into force on 31 January 2017 (except for certain provisions including corporate voluntary arrangements and judicial management), repealing the Companies Act 1965. The relevant agency is the Companies Commission of Malaysia (SSM).

### Requirements for forming a business

- 5 | Provide an overview of the requirements for forming and maintaining a business entity.

The Companies Act 2016 and the Companies Regulations 2017 (the 2016 Act) have simplified the company incorporation and decision-making process by introducing Superform – a single, electronic incorporation template. All incorporation and registration procedures are processed through SSM's online portal, MyCoLD 2016. A notice of registration serves as conclusive evidence of incorporation. This is intended to reduce incorporation, maintenance and operational costs.

Briefly, the requirements for incorporating a company with the SSM and maintaining the company are as follows:

- the applicant must first apply to the SSM to confirm the availability of the proposed company name (section 27(1) of the 2016 Act);

- if the proposed name is available, the application will be approved and the name will be reserved for the applicant for a period of 30 days (instead of three months under the repealed Companies Act 1965); and
- the applicant must then lodge an application containing the following particulars:
  - the name of the proposed company;
  - whether the company is private or public;
  - the nature of business of the proposed company;
  - the proposed address of the registered office;
  - the name, identification, nationality and the ordinary place of residence of every person who will be a member of the company and, where any of these persons is a body corporate, the corporate name, place of incorporation, registration number and the registered office of the body corporate;
  - the name, identification, nationality and the ordinary place of residence of every person who will be a director;
  - the name, identification, nationality and the ordinary place of residence of the secretary;
  - in the case of a company limited by shares, the details of class and number of shares to be taken by the member; and
  - any other information that the Registrar of Companies may require.

### Restrictions on foreign investors

#### 6 | What restrictions apply to foreign business entities and foreign investment?

Generally, a foreign company cannot carry on business in Malaysia unless it incorporates a company as its subsidiary, sets up a branch office or registers a representative office in Malaysia. In certain circumstances, a foreign company may wholly own a Malaysian company; for example, if the foreign company has been granted Multimedia Super Corridor status or has been granted the status of International Procurement Centre, Operational Headquarters or other special statuses that can be granted by various ministries.

The Guidelines for Foreign Participation in the Distributive Trade Services (the Guidelines), among others, include:

- the opening of new branches;
- the relocation or expansion of existing branches or outlets;
- buying or taking over of other operators' outlets; and
- the purchase of land, premises and assets prior to obtaining approval or a licence from the local authority to operate distributive trade activities.

Distributive traders include wholesalers, retailers, franchise practitioners, direct sellers, product manufacturers and suppliers who channel their goods in the domestic market and commission agents or other representatives, including those of international trading companies of all nationalities.

The Guidelines impose a general requirement that all proposals for foreign participation in distributive trade must obtain the approval of the Distributive Trade Committee of the Ministry of Domestic Trade and Consumer Affairs.

One of these approvals is known to many as a wholesale and retail trade (WRT) licence, which must be obtained by all foreign-owned companies dealing in the wholesale, retail, trading, import or export, restaurant and franchise businesses before they can operate in Malaysia. In order for a foreign company to apply for a WRT licence, the general requirement is that the company must have at least a minimum paid-up capital of 1 million ringgit.

The Guidelines provide that all franchise businesses with foreign equity must be incorporated locally under the 2016 Act.

### Taxation

#### 7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

All of a company's or individual's income that is accrued in, derived from or remitted to Malaysia is liable to tax. Nevertheless, income derived from outside Malaysia and remitted to Malaysia by resident companies (except those involved in the banking, insurance, and air and sea transportation business), non-resident companies and non-resident individuals are exempted from tax. A corporation is resident in Malaysia if its management and control are exercised in Malaysia.

With effect from year of assessment 2021, the standard corporate tax rate is 24 per cent, while the rate for resident small and medium-sized companies (namely companies incorporated in Malaysia with paid-up capital of 2.5 million ringgit or less) is 17 per cent on the first 600,000 ringgit, with the balance taxed at the 24 per cent rate. Income tax is imposed at progressive rates up to 30 per cent for resident individuals. Non-residents are taxed at a flat rate of 30 per cent.

Apart from income tax, there are other direct taxes such as stamp duty and real property gains tax, and indirect taxes such as excise duty, import duty and export duty.

A withholding tax is charged to non-resident companies or individuals that derive income from a Malaysian source on payments for services rendered, technical fees or other payments including royalties and interest (at 10 and 15 per cent respectively).

Sales tax and service tax came into force on 1 September 2018, replacing the goods and services tax under the Goods and Services Tax Act 2014. The implementation of sales tax and service tax are primarily governed under the Sales Tax Act 2018 and Service Tax Act 2018 respectively. Sales tax is charged on all goods manufactured in or imported into Malaysia unless exempted. It is an ad valorem tax whereby different rates (ie, 5 per cent, 10 per cent or exempted) apply to different groups of taxable goods. On the other hand, service tax is imposed on any taxable services provided in Malaysia by a registered person in carrying on his or her business. Some of the taxable services include provision of accommodation, food and beverages, telecommunication services, services in health and wellness centres and professional services. The service tax rate is 6 per cent for all taxable services.

### Labour and employment

#### 8 | Are there any relevant labour and employment considerations for typical franchisors?

The Employment Act 1955 governs all matters relating to employment. It applies to all employees whose wages do not exceed 2,000 ringgit per month. All other workers are governed by their employment contracts and common law principles developed through case law. Such common law principles impose certain basic obligations on employers and employees.

The risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor is minimal. Notwithstanding this, to further reduce any risk, it should be expressly provided in the franchise agreement between the franchisor and franchisee that no such relationship exists, and the franchisee should display appropriately worded signage at the franchised location clearly indicating its status as an independent undertaking. The franchisor may wish to adopt the following practices to avoid being seen as exercising controls over the employees of its franchisees and, accordingly, to minimise the risks:

- the franchisor should not be involved in the management of the franchisees' employees or the day-to-day operations of the franchised outlets;
- the franchisor should not control the employment terms of the franchisees' employees, for example, by setting the wages, termination, promotion or demotion of the employees; and

- the franchisor should not set employment policies for franchisees' employees.

## Intellectual property

### 9 | How are trademarks and other intellectual property and know-how protected?

Under the Trademarks Act 2019 (TMA) (which repealed the Trademarks Act 1976), trademarks (including service marks) can be protected with the Malaysian Intellectual Property Office (MyIPO) by way of registration. Registration is the best method of protection, as it provides an exclusive right to use the trademark for the goods or services covered by the registration in Malaysia. The TMA came into force on 27 December 2019.

Registration of a trademark is available to an individual, partnership or company that intends to use or is using the trademark in the course of trade in Malaysia. All registered owners, whether local or foreign, are entitled to the same protection. Malaysian law also accords rights to unregistered trademarks or service marks under common law through the tort of passing-off. It is possible to register a trademark that is in a foreign language. A person's registration as the registered proprietor of a trademark in respect of any goods or services under the TMA shall, if valid, give or be deemed to have given to that person the exclusive right to the use of the trademark or service mark in relation to the goods or services in the whole of Malaysia, subject to any conditions, amendments, modifications or limitations entered in the register.

Under the TMA, no one is entitled to sue for infringement unless the trademark has been duly registered. The registered proprietor's exclusive right to the mark is effective from the date of registration, which is deemed to be the date that the application to register is filed.

Malaysia acceded to the Paris Convention on 1 January 1989. Applicants may claim priority from their basic application in a member country of the Paris Convention, provided that the application in Malaysia is filed within six months of the date of basic application. Malaysia is also a signatory of the Nice Agreement and adopts the 11th edition of the Nice Classification of Goods and Services and the TMclass. Malaysia also acceded to the Madrid Protocol on 27 September 2019. With the implementation of the Madrid Protocol in the new TMA, trademark owners in Malaysia are now able to file trademarks in over 124 designated member countries by filing one international trademark application with a single set of fees. Similarly, trademark owners in a member state can designate Malaysia in an international trademark application.

Know-how, trade secrets and confidential information are generally protected by secrecy agreements, undertakings, or both, that bind the recipient personally. Where no such agreements or undertakings exist, the common law of breach of confidence applies. The requirements for an actionable breach of confidence are:

- the information itself must 'have the necessary quality of confidence about it';
- the information must have been imparted in circumstances importing an obligation of confidence; and
- there must be unauthorised use of that information, to the detriment of the party communicating it.

The Franchise Act 1998 (as amended by the Franchise (Amendment) Act 2012) (FA) expressly provides for the protection of confidential information.

## Real estate

### 10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Most franchised outlets are leased or tenanted properties rather than being owned by franchisees or franchisors. In Malaysia it is common for owners to enter into a tenancy agreement for a period not exceeding three years so as to avoid having to register the lease at the relevant land office. One has to fall back on general contract law – the Contracts Act 1950 – for much of the Malaysian law governing landlords and tenants.

## Competition law

### 11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

The Malaysian Competition Act 2010 (CA) came into force on 1 January 2012. The Malaysia Competition Commission (MyCC) is an independent body established under the Competition Commission Act 2010 to enforce the CA. MyCC issued numerous guidelines, including the Guidelines on Anti-Competitive Agreements and Market Definition (which came into force in 2012) as well as the Guidelines on Intellectual Property Rights and Competition Law (which came into force on 5 April 2019) that set out a list of factors and circumstances that MyCC may consider in deciding whether certain agreements are anticompetitive.

These guidelines are non-exhaustive and are not a substitute for the CA or any regulations made thereunder, and may be revised should the need arise. In applying these guidelines, the facts and circumstances of each case must be considered. MyCC has indicated that it has plans to issue specific guidelines dealing with franchise agreements but no specific timeline has been given.

The CA prohibits two broad categories of anticompetitive activities: 'anticompetitive agreements' and 'abuse of a dominant position'. A franchise agreement, which is a vertical agreement, would be prohibited by the CA if it has the goal or effect of significantly preventing, restricting or distorting competition in any market for goods or services (section 4(1) of the CA). To this end, MyCC not only examines the common intentions of the parties to an agreement but also assesses the aims pursued by the agreement in light of the economic context of the agreement. If the goal of an agreement is highly likely to have a significant anticompetitive impact, then MyCC may find the agreement to have an anticompetitive goal. If an anticompetitive goal is not found, the agreement may still breach the CA if there is an anticompetitive effect. In general and as a starting point, MyCC adopts the following basis for assessing whether an anticompetitive effect is 'significant'. Anticompetitive agreements are not considered significant if, as laid out in paragraph 3.4 of the Guidelines on Anti-Competitive Agreements:

- the combined market share of the parties to the agreement is less than 20 per cent of the relevant market; and
- the parties to the agreement are not competitors and their individual market share in any relevant market is not more than 25 per cent.

It should be noted that the CA does not apply to agreements that comply with legislative requirements. Thus, if certain provisions in the franchise agreements are inserted to comply with the FA (for example, the provision against the franchisee to conduct a similar business during the franchise term and for two years thereafter), arguments could be made that they are not anticompetitive.

Apart from these guidelines, there are currently no reported decisions that would be instructive as to how MyCC or the Malaysian courts would consider various contractual restrictions in franchise

agreements. In applying these guidelines, the facts and circumstances of each case must be considered.

## OFFER AND SALE OF FRANCHISES

### Legal definition

#### 12 | What is the legal definition of a franchise?

Under section 4 of the Franchise Act 1998 (as amended by the Franchise (Amendment) Act 2012) (FA), the statutory definition of a franchise is a contract or an agreement, either expressed or implied and whether oral or written, between two or more persons, by which:

- the franchisor grants to the franchisee the right to operate a business according to the franchise system as determined by the franchisor during a term to be determined by the franchisor;
- the franchisor grants the franchisee the right to use a mark, or a trade secret, or any confidential information or intellectual property owned by the franchisor or relating to the franchisor, and includes a situation where the franchisor who is the registered user of, or is licensed by another person to use, any intellectual property grants such right that it possesses to permit the franchisee to use the intellectual property;
- the franchisor possesses the right to administer continuous control during the franchise term over the franchisee's business operations in accordance with the franchise system; and
- in return for the grant of rights, the franchisee may be required to pay a fee or other form of consideration.

To fall within the purview of the FA, the arrangement must consist of all of the above elements and the franchisee must operate the business separately from the franchisor and the relationship must not at any time be regarded as a partnership, service contract or agency. This arrangement would then be regarded as a franchise, whether it is called a franchise or otherwise.

### Laws and agencies

#### 13 | What laws and government agencies regulate the offer and sale of franchises?

The FA came into force on 1 January 2013. The Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs is the governmental agency that regulates the offer and sale of franchises, and the approval or registration of franchisors and franchisees in Malaysia.

If a person is able to demonstrate that his or her business model does not fall within the definition of a franchise, in that it does not satisfy all the ingredients in the definition of the franchise, such business would not come under the purview of the FA.

Under the Franchise (Exemption) Order 2004, any person who has sold a franchise in Malaysia or to any Malaysian citizen prior to the commencement of the FA (8 October 1999) would be exempted from complying with section 54 of the FA, namely the requirement to submit an application to the registrar.

Pursuant to section 58 of the FA, the Minister of Domestic Trade and Consumer Affairs may, under the authority granted by an order published in the Malaysian Gazette, exempt (subject to such conditions as he or she deems fit to impose) any person or class of persons, business or industry from any or all of the provisions of the FA. To date, the only industry that is exempted under this provision is the petroleum industry.

Under the Franchise (Exemption) Order 2001 (PU(A) 27/2001), the minister has exempted from the provisions of the FA:

- petrol station businesses; and

- any other business operating together with a petrol station business, subject to the condition that the business operating together with a petrol station business:
  - is operated in the same premises as the petrol station; and
  - is franchised by the same petroleum industry that franchises the petrol station business.

### Principal requirements

#### 14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

The Malaysian government has long been aware that franchising is one of the fastest ways to create and increase the number of local entrepreneurs and promote growth in the franchise industry in Malaysia. Essentially enacted to facilitate and monitor the growth of the franchise industry, the FA applies throughout Malaysia and to the sale of any franchise in Malaysia. Pursuant to the FA, franchisors, master franchisees and foreign franchisors are required to seek approval from or register with (or both) the Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs before they can offer to sell or buy franchises in Malaysia.

Under the Franchise (Amendment) Act 2012, a franchisee of a foreign franchisor must register the franchise before commencing the franchise business. A franchisee of a local franchisor or a local master franchisee must register the franchise within 14 days of signing the franchise agreement.

### Franchisor eligibility

#### 15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

One requirement that is highly unpopular among franchisors and local master franchisees is that they must operate their own outlets profitably for at least three years before they are permitted to appoint sub-franchisees. While this requirement is not expressly provided in the FA or any of the regulations, the authorities have taken the view that it is one of the prescribed requirements in law due to section 18 of the disclosure document, which requires the franchisors or master franchisees to submit audited financial statements for the past three years.

### Franchisee and supplier selection

#### 16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

Although the FA does not expressly restrict the manner in which a franchisor recruits franchisees or selects its suppliers, the government does exercise some form of control and impose certain conditions (when granting its approval during the approval application or registration process). For instance, if the territorial area granted to a potential franchisee is considered to be too small or restrictive, the Registrar of Franchises (ie, the Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs (MDTCA)) would request the applicant to extend the territorial right to a larger area (usually by reference to a radius in kilometres). The Registrar of Franchises may also require the franchisor to submit a list of its suppliers in granting approvals. If the franchisor has not shown profitability or healthy growth in its financial statements for the franchise business, the Registrar of Franchises is likely to refuse the approval

application or registration on the basis that the franchisor is not ready to sell its franchise systems to franchisees in Malaysia.

### Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

In the case of a sub-franchising structure (namely where the foreign franchisor appoints a local master franchisee who then, in turn, appoints sub-franchisees in Malaysia), the local master franchisee is the one providing pre-sale disclosures to sub-franchisees. The local master franchisee must disclose the fact that it is a master franchisee, not the franchisor of the franchise in question, and that the trademarks belong to the foreign franchisor. As the foreign franchisor should have submitted an application for the franchise prior to the sale of the franchise to the master franchisee pursuant to section 54 of the FA, all relevant information pertaining to its operations and experiences would have been provided to the Registrar of Franchises (ie, the Franchise Development and Direct Sales Division of the MDTCA) during such application. It should also be noted that the Franchise (Amendment) Act 2020 (ie, gazetted on 6 March 2020, but not in force yet as at the date of the publication of this chapter) has imposed a mandatory requirement on foreign franchisors to seek approval applications under section 6 of the FA before they are able to make an offer to sell the franchise to any person in Malaysia.

Section 16 of the FA provides that an updated disclosure document must be filed annually by the franchisor, within six months of the end of the financial year of the franchise business.

### Pre-contractual disclosure – content

18 | What information is the disclosure document required or advised to contain?

The disclosure documents contain a large amount of information, including but not limited to the following:

- the name, business address and type of business, including the franchisor's business experience;
- details of the intellectual property rights granted to the franchisee;
- the types and amount of fees imposed on franchisees;
- details of other financial obligations, including advertising, training or service fees payable;
- whether the franchisee is required to purchase equipment or products from the franchisor or from a source designated by the franchisor and, if so, to identify the source;
- the obligations of the franchisor, prior to operating or during operation, in determining the business site;
- the territorial rights granted to the franchisee and circumstances of when the boundary of the territory may be altered; and
- the franchise term, and the terms for renewal and termination of the agreement by the franchisor or franchisee, and the parties' obligations upon termination.

The franchisor is required to submit audited financial statements for the past three financial years and financial forecasts for five years. The requirement for financial forecasts for five years (instead of three years previously) was amended pursuant to the Franchise (Forms and Fees) (Amendment) Regulations 2007, which came into force on 15 December 2007.

### Pre-sale disclosure to sub-franchisees

19 | In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

A local franchisor must submit to a franchisee a copy of the franchise agreement, together with the disclosure documents, at least 10 days before the franchisee signs the franchise agreement with the franchisor. Basically, disclosure documents provide a full overview of the franchise business system that will be franchised to the franchisee. A franchisor's failure to submit these documents is an offence under the FA. If there is any material change in the disclosure documents, they must be amended and filed with the Franchise Development and Direct Sales Division of the MDTCA (Registrar of Franchises). The franchisor must submit an annual report with the Registrar of Franchises within six months of the end of the financial year of the franchise business. Failure to do so is an offence. The report must contain updated disclosure documents.

### Due diligence

20 | What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

Both franchisors and franchisees should undertake due diligence before entering into a franchise relationship. Although there is no specific process or exhaustive checklist for the due diligence, it can entail taking a number of action items or steps, namely from checking if the franchise in question has been registered and approved by the Franchise Development and Direct Sales Division of the MDTCA to operate in Malaysia, to speaking with other franchisees in the network and conducting desktop research online. An important and relevant source of information would be the disclosure document and franchise agreement, which must be provided by the franchisor at least 10 days before the franchisee signs the franchise agreement. The franchisor should conduct a company or business search (on the legal entity) and credit checks on the franchisee (or its key person).

### Failure to disclose – enforcement and remedies

21 | What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

It is a criminal offence under the FA to make false statements of material fact or to omit a material fact that renders the statement misleading in the disclosure documents. It is also a criminal offence if the franchisor fails to submit copies of the disclosure documents to the franchisee at least 10 days before the franchisee signs the franchise agreement. Failure to update the disclosure documents when submitting an annual report would also amount to an offence.

In the event of any violations of disclosure requirements, franchisees may lodge a complaint against the franchisor with the Registry of Franchises.

A contract induced by misrepresentation is voidable at the choice of the innocent party. The innocent party may rescind the contract by giving notice to the other party. Any party that has received any advantage under the contract is bound to restore the innocent party to the situation it was in before the violation occurred, or compensate the other party.

The general rule governing the extent of damages payable is laid down in section 74 of the Contracts Act 1950:



*When a contract has been broken, the party who suffers by the breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from the breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.*

### Failure to disclose – apportionment of liability

22 | In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Unless the franchisor is a party to the contract between the master franchisee and sub-franchisees, the franchisor is not liable to the sub-franchisees as there is no privity of contract between them. Nevertheless, in most agreements between the franchisor and sub-franchisor, there would be appropriately drafted warranty and indemnity clauses to address this issue. Individual officers, directors and employees of the franchisor or sub-franchisor, as the case may be, are not liable unless they are personally party to the contract or if the other party is able to lift the corporate veil to impute liability to them personally.

### General legal principles and codes of conduct

23 | In addition to any laws or government agencies that specifically regulate offering and selling franchises, what general principles of law affect the offer and sale of franchises? What industry codes of conduct may affect the offer and sale of franchises?

Apart from the FA, the provisions in the Contracts Act 1950 would be relevant and may affect the offer and sale of franchises.

### Fraudulent sale

24 | What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

If the franchisor engages in any act, practice or course of business that operates or would operate as a fraud or deceit upon any person in relation to an offer to sell or a sale of a franchise, the franchisor commits a criminal offence under the FA that will entitle the franchisee to lodge a complaint against the franchisor with the Registrar of Franchises. If convicted, the franchisor may be liable for a maximum fine of 250,000 ringgit for the first offence. Further, the court may declare the franchise agreement null and void, and may order the franchisor to refund any payments obtained from any franchisee, prohibit the franchisor from making any new franchise agreement or prohibit the franchisor from appointing any new franchisee.

## FRANCHISE CONTRACTS AND THE FRANCHISOR/ FRANCHISEE RELATIONSHIP

### Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The Franchise Act 1998 (as amended by the Franchise (Amendment) Act 2012) (FA) is the most specific and relevant law. The contractual relationship of the parties would also be governed by the contractual terms of the franchise agreement and, accordingly, the provisions of

the Contracts Act 1950 would be relevant. The Franchise (Amendment) Act 2020, which will make further amendments to the FA, was gazetted on 6 March 2020 but is not in force as at the date of the publication of this chapter.

### Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

In order for the franchisor to ensure and enforce stringent compliance by franchisees with the operational compliance and standards of its franchise system, the franchisor would usually incorporate provisions such as inspection with or without prior notice, audit rights, a mystery shopper programme and reporting requirements in the franchise agreements. In the event a franchisee fails to meet the required standards, the franchisor would give the franchisee a specific time frame to remedy the failure, failing which the franchisor may be entitled to terminate the franchise agreement. In addition, the franchisor should ensure that the operations manual, policies and procedures for other operational compliance and standards are incorporated into the franchise agreements by reference.

Other mechanisms may include the installation of web-based accounting and point of sale systems to enable the franchisor to monitor the franchisee's compliance closely without having to inspect the outlet physically. It is also important for the franchisor's team members to visit the outlets periodically to keep the franchisees on their toes, and continuously support and train the franchisee on the job to improve performance.

### Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Although a franchisor may not unilaterally change the terms of the franchise agreement without the prior consent of the franchisees, the franchisor may state in the franchise agreement that the contents or terms of the operations manual may be updated, varied or amended by the franchisor from time to time and they must be adhered to by the franchisee.

Any material changes to the disclosure documents after the registration of the franchise should be submitted for approval by the Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs (MDTCA). Such material changes may cover operational terms and standards of the franchise business and franchise system.

### Policy affecting franchise relations

28 | Do other government or trade association policies affect the franchise relationship?

As well as the policies expounded by the Franchise Development and Direct Sales Division of the MDTCA, other government policies such as the Distributive Trade Guidelines may have an impact on the franchise industry and franchise relationship.

The National Franchise Development Master Plan (PIPFN) 2021 – 2025, which is currently being developed by the MDTCA, aims to boost local and overseas franchise businesses as well as increase franchise sales value by 2025. The PIPFN 2021 – 2025 is expected to be launched by June 2021. This five-year strategy is part of the post-covid-19 recovery plan to revive the franchise industry which had been adversely affected by the various movement control orders and their variations (MCO, CMCO) imposed to curb the covid-19 pandemic.

In addition to the MDTCA, the Malaysian Franchise Association (MFA) – which was formed to support the implementation of government programmes to promote entrepreneurship through franchising – serves as a useful resource centre for current and prospective franchisors and franchisees, as well as for the media and public. The MFA provides input and liaises with government departments and agencies on matters concerning franchising. In addition to setting guidelines and standards of ethical practice among its members, it serves as a forum through which the expertise and experiences of members may be exchanged. The MFA also conducts seminars, exhibitions and educational programmes on franchising.

The Perbadanan Nasional Berhad (PNS) is an agency under the Ministry of Entrepreneur Development and Cooperatives with the mandate to lead the development of Malaysia's franchise industry. The PNS aims to develop the franchise industry while increasing the number of franchise entrepreneurs through its expertise in providing quality services and products. The PNS plays a pivotal role in identifying and acquiring foreign franchises and launching them in Malaysia, and acquires master franchisee rights to famous foreign brands such as Gloria Jean's Coffee. The PNS also provides financial assistance to bumiputra entrepreneurs (that is, entrepreneurs from an indigenous origin in Malaysia) venturing into franchise businesses via equity investment and franchise business financing. The PNS has also set up a franchise academy to conduct various franchise-related training programmes. The PNS also provides guidance and special schemes for franchisors and franchisees in Malaysia.

### Termination by franchisor

**29** | In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

A franchisor may only terminate a franchise relationship under certain circumstances prescribed by the FA that would have been incorporated into the franchise agreement. For instance, section 31 of the FA provides that no franchisor may terminate a franchise agreement before the expiration date, except for good cause.

Good cause includes:

- the franchisee's failure to comply with any terms of the franchise agreement; and
- the franchisee's failure to remedy a breach committed within the period stated in a written notice given by the franchisor, which must not be less than 14 days.

Good cause also includes – without the requirement of notice and an opportunity to remedy the breach – instances in which the franchisee:

- assigns the franchise rights for the benefit of creditors or a similar disposition of the assets of the franchise to any other person;
- voluntarily abandons the franchised business;
- is convicted of a criminal offence that substantially impairs the goodwill associated with the franchisor's mark or other intellectual property; or
- repeatedly fails to comply with the terms of the franchise agreement.

In addition, section 32 of the FA may restrict the franchisor's ability to terminate a franchise relationship, in that a franchisor commits an offence if it refuses to renew a franchise agreement or extend a franchise term without compensating a franchisee either through repurchase or by other means at a price to be agreed between the franchisor and the franchisee, after considering the diminution in the value of the franchised business caused by the expiration of the franchise where:

- the franchisee is barred by the franchise agreement, or by the refusal of the franchisor at least six months before the expiration date of the franchise agreement, to waive any portion of the franchise agreement that prohibits the franchisee from continuing to conduct substantially the same business under another mark in the same area subsequent to the expiration of the franchise agreement; or
- the franchisee has not been given written notice of the franchisor's intention not to renew the franchise agreement at least six months prior to the expiration date of the franchise agreement.

Notwithstanding these provisions of the FA, a franchise term may be terminated before the expiry of the minimum term of five years in the following circumstances:

- where both parties mutually agree to terminate the franchise agreement; or
- where a court has decided that there are certain conditions in the franchise agreement that merit the agreement being terminated earlier than the minimum term.

Nothing in the FA precludes the franchisor from taking over and operating the business formerly operated by the franchisee after the franchise agreement has been terminated or has expired.

### Termination by franchisee

**30** | In what circumstances may a franchisee terminate a franchise relationship?

Section 31 of the FA expressly provides for good cause circumstances in which a franchisee may terminate a franchise relationship.

A franchise agreement must provide for a cooling-off period of not less than seven working days during which the franchisee has the option to terminate the agreement and be refunded all monies paid to the franchisor, save for reasonable expenses incurred by the franchisor in preparing the agreement (sections 18(4) and 18(5) of the FA).

A franchisee may also terminate the franchise agreement before the expiry of the term with the mutual consent of the parties (section 33 of the FA).

### Renewal

**31** | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

Most, if not all, franchise agreements contain renewal provisions and conditions for renewing the franchise agreements. In addition, there are provisions in the FA that regulate the renewal and non-renewal of franchise agreements. If the parties agree that there will be no change to the terms of the franchise agreement during the renewal period, it will be sufficient for the parties to execute a side letter without having to enter into a fresh agreement for the renewal term.

### Refusal to renew

**32** | May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

The franchisor may refuse to renew the franchise agreement with a franchisee if:

- the franchisee has breached the terms of a previous franchise agreement;
- the franchisee fails to give written notice to the franchisor to renew the term at least six months prior to the expiry date;
- the franchisee is compensated through repurchase or by other means at a price to be mutually agreed between the parties

after considering the diminution in the value of the franchised business; or

- the franchisor has waived the section of the franchise agreement that prohibits the franchisee from conducting substantially the same business under another mark in the same area subsequent to the expiration of the franchise agreement.

Unless the franchisor is able to establish any of the above circumstances, it appears in section 32 of the FA that the franchisor must renew the franchise agreement for another period if the franchisee has applied for such renewal. Apart from the renewal of the franchise agreement, it should also be noted that the franchise agreement must be extended by the franchisor if the franchisee gives notice to extend the franchise agreement. Such an extended term must contain conditions that are similar or not less favourable than the conditions in the current franchise agreement. The term 'another period' in this provision seems to suggest that the extended period for a franchise agreement based on similar or not less-favourable terms is limited to one additional term from the initial term.

### Transfer restrictions

- 33 | **May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?**

Yes, provided that such restrictions are contained in the franchise agreement.

### Fees

- 34 | **Are there laws or regulations affecting the nature, amount or payment of fees?**

Although there is no express provision in the FA or any other law affecting the nature or amount of fees, there is a general provision in the FA that provides that a franchisor and a franchisee, in their dealings with one another, shall avoid:

- substantial and unreasonable overvaluation of fees and prices;
- conduct that is unnecessary and unreasonable in relation to the risks to be incurred by one party; and
- conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system.

In addition to the above general provision, if a franchisor requires the franchisee to pay the franchise fee before signing the franchise agreement, including a payment that is part of a franchise fee, the franchisor must state in writing the purpose of the payment and the conditions for use and refund of the monies. If the franchise agreement is terminated during the cooling-off period, the franchisor must refund all monies, including the initial fees paid by the franchisee, after deducting the reasonable expenses incurred to prepare the franchise agreement for the franchisee. The franchisor is committing a criminal offence if it fails to do so.

If the fees or other charges imposed by the franchisor are, in the opinion of the Registrar of Franchises, unreasonably or unjustifiably high, the Registrar may seek further information or explanations from the franchisor before the application or registration is approved or granted.

### Usury

- 35 | **Are there restrictions on the amount of interest that can be charged on overdue payments?**

The amount of interest charged on overdue payments should not be excessively high or it may not be recoverable.

### Foreign exchange controls

- 36 | **Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?**

There is no restriction on payments by a franchisee to a foreign franchisor in the franchisor's domestic currency (foreign currency) subject to withholding tax on royalty payments derived from within Malaysia.

### Confidentiality covenant enforceability

- 37 | **Are confidentiality covenants in franchise agreements enforceable?**

Yes, they are enforceable. In addition, section 26(1) of the FA provides that a franchisee must give a written guarantee to a franchisor that the franchisee, including its directors, the spouses and immediate family of the directors (as inserted by the Franchise (Amendment) Act 2012) and its employees may not disclose to any person any information contained in the operation manual or obtained while undergoing training organised by the franchisor during the franchise term and for two years after the expiration or earlier termination of the franchise agreement. Failure to provide such a written guarantee or to comply with the guarantee provided is an offence. Apart from being an offence under the FA, in the event of the franchisee breaching confidentiality obligations, the franchisor may commence civil proceedings or proceedings regarding breach of the franchise agreement.

### Good-faith obligation

- 38 | **Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?**

Under the provisions of the FA, it is provided that a franchisor and a franchisee must act in an honest and lawful manner and endeavour to pursue the best franchise business practice of the time and place. Nevertheless, failure to comply with these provisions is not an offence.

### Franchisees as consumers

- 39 | **Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?**

There is no law (including the Trade Descriptions Act 2011 and Consumer Protection Act 1999) that treats franchisees as consumers for the purposes of consumer protection.

### Language of the agreement

- 40 | **Must disclosure documents and franchise agreements be in the language of your country?**

Disclosure documents and franchise agreements may be in English. The Registrar of Franchises (ie, the Franchise Development Division of the MDTCA) expects a translated copy of the franchise agreement in Bahasa Malaysia to be submitted for approval by the franchisors or master franchisees.

## Restrictions on franchisees

### 41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Pursuant to the FA, there are various restrictions in relation to these provisions in the franchise contracts, including but not limited to:

- the duration of the franchise agreement must be at least five years;
- the franchisee must give a written guarantee that it and its employees will not carry on any other business similar to the franchise business during the franchise term and for two years after the expiry or termination of the franchise agreement; and
- the franchisor must not unreasonably and materially discriminate between franchisees where charges are offered or made for franchise fees, royalties, goods, services, equipment, rentals or advertising services if such discrimination will cause competitive harm to the franchisees.

While the FA does not impose any restrictions on the franchisees regarding soliciting other franchisees' employees, it is common for the franchisor to insert such a restriction in the franchise agreement to ensure that its other franchisees will not encounter such challenges in having their employees being solicited by other franchisees. This provides the franchisor with an option to terminate the franchise agreement of a franchisee found to be soliciting employees of other franchisees.

## Courts and dispute resolution

### 42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Malaysian legal system is based substantially on the English legal system and the principles of common law. English judicial decisions and other Commonwealth judicial decisions are considered by the Malaysian courts, but only as a persuasive rather than conclusive authority. Although Malaysia is federally constituted, its judicial system is a single-structured system consisting of superior and subordinate courts. The superior courts are the High Court of Malaya, the High Court of Sabah and Sarawak, and the Court of Appeal. The subordinate courts are the magistrates' courts and the sessions courts. The Federal Court is the highest judicial authority in Malaysia and is the final court of appeal.

The law offers equal protection for foreigners and foreign-owned companies. Commercial disputes may be resolved by arbitration. Malaysian law gives effect to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Unlike arbitration, which enjoys statutory recognition (the Arbitration Act 2005 came into force on 15 March 2006, repealing the Arbitration Act 1952 and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards Act 1985), there is no statute providing for dispute resolution by way of mediation, as is found in some other jurisdictions. Nevertheless, in recent times mediation has been increasingly encouraged as an alternative mechanism for dispute resolution.

The Registrar of Franchises (ie, the Franchise Development and Direct Sales Division of the Domestic Trade and Consumer Affairs) has also increasingly encouraged franchisors and franchisees to adopt mediation clauses in franchise agreements.

## Governing law

### 43 | Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract's enforceability?

It is acceptable to adopt other governing laws in Malaysia and Malaysian courts give effect to such clause in franchise agreements (unless the party challenging such a clause is able to demonstrate exceptional

circumstances amounting to a strong cause that warrants a refusal to enforce the clause). That said, it may be more practical and cost-efficient to adopt Malaysian laws in franchise agreements, given that the franchised business would be conducted and the franchisees located in Malaysia.

## Arbitration – advantages for franchisors

### 44 | What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

Arbitration is often promoted and considered as better and more efficient than litigation when resolving franchise disputes, saving both money and time. Arbitration's rules of evidence and procedures are more relaxed and simple, which usually means it takes less time and less money to bring a franchise dispute to resolution.

It is particularly attractive for foreign franchisors, as the proceedings and documents can be conducted in English. In addition to flexibility regarding the choice of arbitration location, hearing dates can be scheduled around the needs and availability of the parties involved, unlike trial dates, which are fixed by the courts and beyond the control of those involved. Arbitration proceedings are generally held in private, and parties keep the proceedings and terms of the final resolution confidential.

Despite its many benefits, arbitration may not always be the best option. In certain circumstances, it may have various drawbacks and shortcomings that do not exist in litigation. The costs may be higher than anticipated, as the arbitrators' fees, administrative fees and other expenses to be borne by the parties are higher than those incurred in litigation. The arbitrator's decision-making power is more discretionary and flexible than that of a judge and the hearing is private, meaning the ramifications of choosing a wrong or unskilled arbitrator could be more serious. The less well-defined rules and fewer procedural safeguards adopted in arbitration may sometimes result in mistakes. Owing to the arbitrator's final and binding decision being generally unappealable (except in special circumstances), the decision can result in serious and unfortunate repercussions for one of the parties involved.

In addition, the Registrar of Franchises (ie, the Franchise Development and Direct Sales Division of the Domestic Trade and Consumer Affairs) has increasingly encouraged franchisors and franchisees to adopt mediation clauses in franchise agreements.

## National treatment

### 45 | In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Under the current practices of the Registrar of Franchises (ie, Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs), foreign franchisors are only required to seek franchise approval under section 54 of the FA whereas local franchisors and local master franchisees are required to register as franchisors under section 6 of the FA.

However, under the Franchise (Amendment) Act 2020 (which has yet to come into force as at the publication date of this chapter), in addition to the requirement under section 54 of the FA, foreign franchisors will be required to obtain approval under section 6 of the FA before they are able to make an offer to sell the franchise to any person in Malaysia. While it is still unclear as to whether the foreign franchisors will be able to apply for sections 54 and 6 applications simultaneously or consecutively, this amendment in essence means the foreign franchisors will have to undertake a more tedious process than previously required. Based on the current checklist of information required for the section

6 application, it seems that the foreign franchisor may have to submit more extensive information regarding business operation, management, staff, marketing strategy, business projections, and the submission of training and operation manuals as well as the franchise agreement in the national language. Additional fees may also be incurred for the additional registration.

## UPDATE AND TRENDS

### Legal and other current developments

**46** Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

The Franchise (Amendment) Act 2020 (2020 Amendment Act), which was gazetted on 6 March 2020 and has yet to come into force as at the publication date of this chapter, will bring about various changes to the franchise landscape, some of which are discussed below.

#### Additional registration procedure for foreign franchisors

Currently, foreign franchisors are only required to seek franchise approval under section 54 of the Franchise Act 1998 (as amended by the Franchise (Amendment) Act 2012) (FA) whereas local franchisors and local master franchisees are required to register as franchisors under section 6 of the FA. There are certain differences in the information required to be submitted under the section 6 application. The 2020 Amendment Act is intended to impose a mandatory requirement for foreign franchisors to obtain approval under section 6 of the FA in addition to the section 54 application. It is unclear at this stage if the sections 54 and 6 applications can be done simultaneously or consecutively. Such matters are likely to be addressed either in the regulations or based on the guidelines implemented by the Franchise Development and Direct Sales Division of the Ministry of Domestic Trade and Consumer Affairs (MDTCA). In view of these new requirements, it now appears that a foreign franchisor has to undergo a more tedious process than earlier. Further, the failure to comply with such a requirement would be an offence under the FA. It is also yet to be determined with certainty if foreign franchisors are expected to file annual reports under section 16 of the FA.

#### Registration of franchisees

Under the 2020 Amendment Act, a franchisee that fails to register with the Registrar of Franchises (ie, Franchise Development and Direct Sales Division of the MDTCA) before it commences its franchised business or within 14 days from the date of signing the agreement would be committing an offence.

#### Validity period and renewal of franchise registration

Currently, all franchise registrations obtained by franchisors and franchisees continue to be effective until such registrations are suspended, terminated or cancelled. The 2020 Amendment Act, however, introduces a validity period for all franchise registrations. After such period, franchisors and franchisees may apply to the Registrar of Franchises to renew their registrations upon payment of the requisite renewal fees. The validity period and renewal fees that have not been specified in the 2020 Amendment Act are likely to be addressed in the regulations. The Franchise Development and Direct Sales Division of the MDTCA is currently preparing various regulations as a result of the 2020 Amendment.

#### Salient terms to be included in a franchise agreement

The FA has imposed the mandatory requirement to include various salient terms in a franchise agreement, such as the name and description of the franchised business, territorial rights, fees imposed, parties'



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obligations, intellectual property rights, etc, as failure to do so would render the franchise agreement null and void. Interestingly, the 2020 Amendment Act has removed this requirement. This would mean that a franchise agreement without any such salient terms would not be deemed null and void, but rather it would be an offence under the FA. The Franchise Development and Direct Sales Division of the MDTCA has plans to introduce new regulations to address the consequences for franchisors or franchisees that fail to comply with the franchise agreements or disclosure documents.

#### Enforcement

One of the goals of the 2020 Amendment Act is to strengthen the powers given to franchise enforcement officers. For instance, the 2020 Amendment Act clarifies that the items seized under the FA, such as accounting books, etc, are liable to forfeiture in accordance with stipulated procedures. Further, no person would be entitled to the costs of the proceedings, damages or any relief in respect of the seized items unless the seizure was made without reasonable cause. In the case of a conviction leading to a fine, the 2020 Amendment Act further provides for a reward to the person who gave such information leading to the conviction, which shall not exceed half the fine imposed.

#### Display of certificate of franchise registration

Under the 2020 Amendment Act, all franchisors and franchisees will be required to display their certificates of franchise registration at their business premises. Failure to comply with this requirement would be an offence under the FA.

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