



Franchise

in 30 jurisdictions worldwide

2014

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Malaysia

Jin Nee Wong

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Overview

1 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 and companies 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.

2 What laws and agencies govern the formation of business entities?

Where incorporation of a company is concerned, the relevant law is the Companies Act 1965 (CA). The relevant agency is the Companies Commission of Malaysia (SSM) (www.ssm.com.my).

3 Provide an overview of the requirements for forming and maintaining a business entity.

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 determine whether the proposed name for the intended company is available;
- if the proposed name is available, the application will be approved and the name will be reserved for the applicant for a period of three months;
- the applicant must then lodge the following documents with the SSM within three months in order to secure the use of the proposed name;
 - memorandum and articles of association (which documents the company's name, objectives, the amount of its authorised capital (if any) proposed for registration and its division into shares of a fixed amount);
 - statutory declaration of companies (form 6);
 - statutory declaration by a person before appointment as a director, or by a promoter before incorporation of a company (form 48A), together with a copy of the identity card or passport (for a foreign director); and
 - a declaration by the named secretary in the form as provided, together with the identity card;
- a company must maintain a registered office in Malaysia, where all books and documents required under the provisions of CA are kept. The secretary of a company must be a natural person of full age who has his or her principal or only place of residence in Malaysia. The company must also appoint an approved company auditor to be the company auditor in Malaysia. In addition, the company shall have at least two directors whose principal or only place of residence is within Malaysia; and
- directors are required to lay before the company at its annual general meeting: a profit and loss account, a balance sheet as at the date to which the profit and loss is made up, and a director's

report. The first meeting must be no later than 18 months after the incorporation of the company and subsequently there must be at least one in every calendar year. The company is also required to keep accounting and other records in order to sufficiently explain the transactions and financial position of the company and enable true and fair profit and loss accounts and balance sheets to be prepared from time to time.

4 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 (MSC) status or has been granted the status of International Procurement Centre, Operational Headquarters or other special statuses which can be granted by various ministries.

As of 1 December 2004, all proposals for foreign involvement in distributive trade must obtain the approval of the Committee on Distributive Trade under the Ministry of Domestic Trade, Co-operatives and Consumerism (the Committee).

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

- opening of new branches;
- relocation or expansion of existing branches or outlets;
- buying or taking over of other operators' outlets; and
- purchase of land, premises and assets prior to obtaining the approval or 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 Committee. In line with the national development policy, the Committee requires at least 30 per cent Bumiputra participation in the projects.

It should be noted that the Guidelines provide that all franchise businesses with foreign equity must be incorporated locally under the CA.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

All of a company 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, air and sea transportation business), non-resident companies and non-resident individuals are exempted from tax.

Whether resident or not, a company is assessable on income accrued in or derived from Malaysia. A company is considered resident in Malaysia if control and management of its affairs is exercised in Malaysia. A tax rate of 25 per cent applies to resident companies. Non-resident individuals are subject to a final withholding tax of 10 per cent on royalties and 15 per cent on interest.

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

- 6** Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

The Employment Act 1955 governs all matters relating to employment. It applies to all employees whose wages do not exceed 2000 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 the franchisee's status as an independent undertaking.

- 7** How are trademarks and know-how protected?

Under the Trademarks Act 1976 (TMA), 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.

Registration of a trademark is available to an individual, partnership or company who 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 been 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. Malaysia has indicated it will accede to the Madrid Protocol in 2014.

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 will apply. The requirements for an actionable breach of confidence would be:

- 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 (FA) expressly provides for the protection of confidential information (see question 35).

- 8** What are the relevant aspects of the real estate market and real estate law?

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, namely, the Contracts Act 1950, for much of the Malaysian law governing landlords and tenants.

Laws and agencies that regulate the offer and sale of franchises

- 9** What is the legal definition of a franchise?

Under section 4 of the FA (as amended by the Franchise (Amendment) Act 2012), 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 to 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.

In order to fall within the purview of the FA, a franchise must consist of all of the above elements.

- 10** Which laws and government agencies regulate the offer and sale of franchises?

The FA, as amended by the Franchise (Amendment) Act 2012 came into force on 1 January 2013. The Franchise Development Division of the Ministry of Domestic Trade, Co-operatives and Consumerism (MDTCC) is the governmental agency that regulates the offer and sale of franchises and approval or registration of franchisors in Malaysia.

- 11** Describe the relevant requirements of these laws and agencies.

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, foreign franchisors and franchisees of foreign franchisors are required to seek approval from or register with (or both) the registrar of franchises 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 from the date of signing the franchise agreement.

12 What are the exemptions and exclusions from any franchise laws and regulations?

If a person is able to demonstrate that its 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 be covered by the provisions and 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, namely the requirement to submit an application to the registrar.

Pursuant to section 58 of the FA, the minister may, by 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 or 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 the petroleum industry's franchising:

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

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

One requirement that is highly unpopular among franchisors and local master franchisees is that they must operate profitably for at least three years before they are permitted to appoint sub-franchisees. While this requirement is not expressly provided in the Franchise Act 1998, or any of the regulations, the authorities have taken the view that it is one of the prescribed requirements under 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.

14 Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

Although the Franchise Act 1998 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/registration process). For instance, if the territorial area granted to a potential franchisee is considered to be too small or limited, the Registrar would request that the applicant extend the

territorial right to a larger area. The Registrar of Franchises would also assess various other factors in granting approvals. One essential factor taken into account by the Registrar is that if the franchisors have not shown profitability or healthy growth in their financial statements, the Registrar is likely to refuse the approval application or registration on the basis that the franchisors are not ready to sell their franchise systems to franchisees

15 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?

In the case of a sub-franchising structure (namely where the foreign franchisor appoints a local master franchisee who will in turn will appoint sub-franchisees in Malaysia), the local master franchisee must provide disclosure to the foreign franchisor of the fact that it is a master franchisee and is not the franchisor of the franchise in question or of the trademarks owned by the foreign franchisor. As the foreign franchisor would have submitted an application for the franchise prior to the sale of the franchise to the master franchisee, relevant information pertaining to its operations and experiences would have been provided to the registrar during its application.

16 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

The franchisor must submit to a franchisee a copy of the franchise agreement, together with the disclosure documents (form BAF1), at least 10 days before the franchisee signs the 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 such 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 registrar of franchisees. The franchisor must submit an annual report (form BAF6) with the registrar. The report must contain updated disclosure documents.

17 What information must the disclosure document contain?

The disclosure documents contain a large amount of information, including, without limitation, the following:

- name, business address and type of business, including the franchisor's business experience;
- details of the intellectual property rights granted to the franchisee;
- types and amount of fees imposed on franchisees;
- 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 when the boundary of the territory may be altered;
- the franchise term, terms for renewal and termination of agreement by the franchisor or franchisee, and the parties' obligations upon termination; and
- 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) were amended pursuant to the Franchise (Forms and Fees) (Amendment) Regulations 2007 which came into operation on 15 December 2007.

18 Is there any obligation for continuing disclosure?

Section 15 of the FA provides that a franchisor shall submit to a franchisee a copy of the franchise agreement and disclosure documents at least 10 days before the franchisee signs the agreement with the franchisor. This seems to suggest that if the franchisors were to sign new franchise agreements (for the renewed terms) with the current franchisee, they would have to provide such disclosure documents.

19 How do the relevant government agencies enforce the disclosure requirements?

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.

20 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

In the event of violations of disclosure requirements, the 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 and any party who has received any advantage under the contract is bound to restore it, or compensate the other party for it.

The general rule governing the extent of damages payable is laid down in section 74 of the Contract 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.

21 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 will not be 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 an 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, will not be liable unless they are personally party to the contract or if the other party is able to lift the corporate veil to impute liabilities to them personally.

22 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or 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.

23 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

Apart from the requirement to provide the franchisee with the disclosure documents and the franchisee's right of termination under section 18(5) of the FA during the cooling off period, as well as the provision in section 37 of the FA which provides that a person who, whether directly or indirectly, makes any untrue statement of a material fact or omits to state a material fact which renders his statement to be misleading commits an offence, no other general obligations for pre-sale disclosure would cover franchise transactions.

24 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

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 Registry of Franchises. If convicted, the franchisor may be liable for a fine of between 5,000 ringgit and 50,000 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 or prohibit the franchisor from making any new franchise agreement or appointing any new franchisee.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship**25** Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

The 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.

26 Do other laws affect the franchise relationship?

The Contracts Act 1950 also affects the franchise relationship. In addition, the provisions of the Competition Act 2010 should be taken into account.

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

As well as the policies expounded by the Franchise Development Division of the Ministry of Domestic Trade, Cooperatives and Consumerism, other government policies such as the Distributive Trade Guidelines may have an impact on the franchise industry and franchise relationship. The Ministry of Domestic Trade, Cooperatives and Consumerism launched the National Franchise Development Blueprint 2012-2016 (NFDB), which is a long-term development plan to further develop the franchise industry. The NFDB has three objectives:

- to evaluate the franchise industry development based on main indicators (sales, employment and entrepreneur participation);
- to review current policy, strategy and development programmes; and
- to determine the direction of the national franchise industry towards the goal of Malaysia being the franchise hub in South East Asia by 2020.

The Malaysian Franchise Association (MFA) was formed in 1994 to support the implementation of government programmes to promote entrepreneurship through franchising. The MFA serves as a 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. As well as setting guidelines and standards of ethical practice among its members, it serves as a forum through which expertise and experiences of members may be exchanged. The MFA also conducts seminars, exhibitions and educational programmes on franchising.

Perbadanan Nasional Berhad (PNS) is an agency under the Ministry of Domestic Trade, Cooperatives and Consumerism (MDTCC), with the mandate to lead the development of Malaysia's franchise industry. PNS aims to develop the franchise industry while increasing the number of franchise entrepreneurs through its expertise in providing quality services and products. 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. PNS also provides financial assistance to Bumiputera entrepreneurs venturing into franchise businesses via equity investment and franchise business financing. PNS has also set up a Franchise Academy to conduct various franchise related training programmes.

28 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. For instance, section 31 of the FA provides that no franchisor shall 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 the breach committed within the period stated in a written notice given by the franchisor, which shall not be less than 14 days, for the breach to be remedied.

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 which 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 by a 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 which 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 the court has decided that there are certain conditions in the franchise agreement which 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.

29 In what circumstances may a franchisee terminate a franchise relationship?

With the arrival of the Franchise (Amendment) Act 2012, Section 31 of the FA now expressly provides for circumstances in which a franchisee may terminate a franchise relationship. It is now clear that the rights of the franchisee to terminate the relationship would be based on good cause as provided to the franchisor, as provided in question 28.

30 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 in the following circumstances:

- the franchisee has breached the terms of a previous franchise agreement;
- the franchisor has given at least six months' written notice to the franchisee prior to the expiration date of the franchise agreement; or
- the franchisor has waived the restraint of trade clause against the franchisee under section 32 of the FA.

31 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.

32 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 the following conduct:

- substantial and unreasonable overvaluation of fees and prices;
- conduct which 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 make payment of the franchise fee before signing the franchise agreement, including a payment which 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 would commit a criminal offence if it fails to do so.

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

33 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.

34 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).

35 Are confidentiality covenants in franchise agreements enforceable?

Yes, they are enforceable. Section 26(1) of the FA provides that a franchisee must give a written guarantee to a franchisor that the franchisee and its employees shall 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 the confidentiality obligations, the franchisor may commence civil proceedings or proceedings regarding breach of the franchise agreement.

36 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

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

37 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

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

38 Must disclosure documents and franchise agreements be in the language of your country?

Disclosure documents and franchise agreements may be in English. The Franchise Development Division expects a translated copy of the franchise agreement in Bahasa Malaysia to be submitted for approval.

39 What restrictions are there on provisions in franchise contracts?

Pursuant to the FA, there are various restrictions in relation to such provisions in the franchise contracts. They include, without limitation, the following:

- the duration of the franchise agreement must not be less than 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 expiration 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.

40 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

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. The MyCC issued three Guidelines that came into force on 1 January 2012, including the Guidelines on Market Definition as well as the Chapter 1 Prohibition (ie, on anti-competitive agreements), which sets out a non-exhaustive list of factors and circumstances that the MyCC may consider in deciding whether certain agreements are anti-competitive. These Guidelines are non-exhaustive and 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 will be considered. MyCC has indicated that it has plans to issue specific guidelines dealing with franchise agreements but no specific timeline has been given.

CA prohibits two broad categories of anti-competitive activities, namely 'anti-competitive 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 object or effect of significantly preventing, restricting or distorting competition in any market for goods or services (Section 4(1) of CA). Towards this end, the MyCC will not just examine the common intentions of the parties to an agreement but will also assess the aims pursued by the agreement in the light of the economic context of the agreement. If the object of an agreement is highly likely to have a significant anti-competitive impact, then MyCC may find the agreement to have an anti-competitive object. If an anti-competitive object is not found, the agreement may still breach the CA if there is an anti-competitive effect. In general and as a starting point, MyCC will adopt the following basis for assessing whether an anti-competitive effect is 'significant'. Anti-competitive agreements will not be considered significant if (Paragraph 3.6 of the Guidelines on Chapter 1 Prohibition):

- the combined market share of the parties to the agreement is less than 20 per cent of the relevant market;
- 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 which 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 in conducting a similar business during the franchise term and for two years thereafter), arguments could be made that they are not anti-competitive.

Apart from these guidelines and given that the CA has just come into force, there are no decisions that would be instructive on how the MyCC or the Malaysian courts would consider various contractual restrictions in franchise agreements. In applying these guidelines, the facts and circumstances of each case will be considered.

Update and trends

All applications for approval and registration have to be submitted online at Malaysian Franchise Express System (MyFex) via www.myfex.gov.my/portal/. The online process is rather long and onerous.

- 41** 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 and repealed 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 has recently adopted a practice that would require franchise agreements to incorporate a mediation clause.

- 42** Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business 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. As well as 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 a more discretionary and flexible decision-making power than a judge's and the hearing is private, meaning the ramifications of choosing the 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. Due 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.

- 43** In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Although the requirements for registration under the Franchise Act 1998 differ between foreign and domestic franchisors, recent trends seem to show that the MDTCC has adopted the approach that a foreign franchisor should provide as much information and data as a local franchisor before it is approved to appoint franchisees in Malaysia, in order to create a level playing field for these players. The approval requirements for a foreign franchisor under section 54 of the Franchise Act 1998 have therefore increased significantly of late. A foreign franchisor is now required to submit various information and documents including, without limitation, its profile, extent of experience and knowledge in the franchised business and the number of franchise outlets, the financial forecast of the franchise business for five years, audited accounts for the last three years, etc. A foreign franchisor does not have to submit a disclosure document as yet.

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