

April 7, 2015

*Franchising in Malaysia* is the 12th article in Wiley Rein's International Franchise Development Series. The International Franchise Development Series offers a broad overview of franchise regulation and the legal issues confronting franchisors seeking to expand into certain countries from the combined legal perspective of U.S. and local counsel.

## Franchising in Malaysia

By Robert A. Smith, Adhuna Kamarul Ariffin, and Maureen A. O'Brien

Malaysia is the third largest industrialized market economy country in Southeast Asia. With a Gross Domestic Product that has grown at an annual rate of 6.5% for 50 straight years and a multi-ethnic and multi-cultural population of over 30 million (75% of whom live in urban areas), the country, not surprisingly, has attracted franchisors seeking to expand their businesses. The government regulation of franchising in Malaysia, however, can be daunting.

### Statutory and Regulatory Structure

In response to the increasing popularity of business format franchising in Malaysia, the country enacted the Malaysian Franchise Act 1998. The Act and its accompanying 1999 Regulations sought to regulate franchising, and the 2012 Franchise Amendment Act (which became effective on January 1, 2013) further strengthened these rules. The regulatory body in charge of regulating franchising is the Franchise Development Division (Registry) of the Ministry of the Domestic Trade Cooperatives and Consumerism (MDTCC).

The 2012 amendment defines a "franchise" as an oral or written agreement, express or implied, under the terms of which: **(1)** the franchisee is granted **(a)** the right to operate a business according to the franchise system during the term, and **(b)** the right to use a mark, or a trade secret, or any confidential information or

intellectual property, owned by or licensed to the franchisor; **(2)** the franchisor exercises continuous control over the franchisee's business operations in accordance with the franchise system; and **(3)** the franchisee may be required to pay the franchisor a fee or other form of consideration.

Prior to the 2012 amendment, to meet the definition of a "franchise," the franchisor had to be obligated to provide operations assistance to the franchisee (for example, providing materials and services, training, marketing and business or technical assistance), the franchisee had to operate the business separately from the franchisor and the relationship could not be a partnership, service contract or agency. The last two concepts have now been incorporated into the provisions of the Act relating to conduct of the parties.

At its core, the Act (as amended) and the Regulations provide for a system of registration as a means to control and track the performance of franchises, franchisors and franchisees—regardless of whether the franchisor is local or foreign. Franchisors must register with the Registry prior to operation or sale of a franchised business, and franchisees must register the franchise within a certain time period after obtaining the franchise. While the Act's requirements are essentially identical for a

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Malaysian franchisor and a master franchisee of a foreign franchisor, foreign franchisors may be treated less favorably under Malaysia's franchise regulatory regime. In 2014, foreign franchisors made up about 35% of all registered franchisors, and there were approximately 56 registered master franchisees.

### **Foreign Franchisor Registration under Section 54—Prior Approval**

While the requirements for a franchise agreement (discussed below) are strictly governed by the Act, the requirements for foreign franchisor registration

under Section 54 are rather fluid, leaving the details of any conditions to be imposed to the discretion of the Registrar. This has resulted in an ever-changing set of requirements. In fact, the conditions imposed in 2015 bear little resemblance to those originally enforced in 1999.

Approval is now obtained by submitting an application to the Registry via the online

registration system, Malaysian Franchise Express (MyFEX), and providing specified information and documents. Among the "new" requirements is the submission of the franchisor's audited financial statements for the last three fiscal years, as well as details regarding domestic and international franchised outlets. A foreign franchisor is also now required to supply a copy of the proposed franchise agreement to be used in Malaysia (an English language version is acceptable). That agreement must comply with the Act's minimum requirements (discussed below).

### **Franchise Agreement and Pre-Sale Disclosure**

Under the Act, a franchise agreement must be in writing. Certain mandatory issues must be addressed, and if not, the agreement is deemed null and void. These mandatory provisions include:

- Cooling-off period of not less than seven working days;

- Minimum term of five years and terms of renewal;
- Territorial rights granted to the franchisee must be clearly stated or identifiable;
- All fees payable by the franchisee;
- Obligations of the parties;
- Rights to the trademark associated with the system;
- Type and particulars of assistance provided by the franchisor; and
- Effect of termination or expiration of the agreement.

In addition, if the franchisor requires the franchisee to make payments for advertising, the franchisor must establish a promotional fund managed in a separate account to be used solely for the promotion of the franchised products and services. The franchisee must agree in writing not to disclose confidential information and to refrain from carrying on a similar trade for the duration of the agreement and for two years thereafter. This post-term non-compete also extends to the franchisee's directors (and their spouses and immediate family members) and employees. Any provision in the agreement purporting to bind either a franchisor or franchisee to waive compliance with the Act is void. In addition, if the franchisee is required to purchase supplies only from the franchisor, the franchisor's profit margin for those supplies generally cannot exceed 10% of the cost of the product.

A franchisor must provide the franchisee a copy of the franchise agreement and the disclosure document at least 10 days before the franchisee signs the franchise agreement. While some of the required content of the disclosure document is similar to that required in a U.S. Franchise Disclosure Document, a franchisor is also required to disclose the awards and recognitions it has received and the organizations in which it is a member, and provide an organizational chart of its management structure, a list of suppliers, and a list of all franchisees.

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A foreign franchisor is also now required to supply a draft copy of the proposed franchise agreement to be used in Malaysia.

### Registration of the Franchise

Once the Section 54 approval has been obtained, the local franchisee must apply for registration of the franchise under the Act. There are more stringent requirements for a master franchisee of a foreign franchisor than for a single franchisee. The documents required to be uploaded for registration of the franchise include the following:

- A sample of the Franchise Agreement in Bahasa Malaysia as well as English;
- Certified true copy of the trademark applications or registrations in Malaysia;
- The last three years of audited financial statements for the franchised business;
- The operations manual;
- Obligations of the franchisor and the franchisee;
- The training manual; and
- Pictures of a prototype outlet.

Other required information regarding the franchisee includes:

- Corporate information, including an organizational chart;
- The capital and equity of the company;
- Bankruptcy search results for all directors; and
- Other details of the franchise such as industry, uniqueness, supporting technology.

### Registration of Disclosure Document

With the online registration now being made through MyFEX, the information regarding the franchise previously required in the form of a disclosure document (former Form 1) and the information regarding the franchisor required to be disclosed in the application form (former Form 2) have effectively been merged. Accordingly, all the information provided in applying for online registration of a franchise is also effectively

contained in the “disclosure documents” filed with the Registry.

While neither a foreign franchisor, nor the single franchisee of a foreign franchisor, has an obligation to file the complete “disclosure documents” with the Registry, a master franchisee and a local franchisor are required to do so. In addition, amendments to the disclosure document for a master franchisee and a local franchisor must first be approved by the Registrar.

### Sale of Franchise to a Non-Citizen

Section 53 of the Act requires that the Registrar’s approval be obtained when a foreign franchisor intends to sell a franchise to a non-Malaysian for operation in Malaysia. Where there is “foreign participation” in the distributive trade services (which includes non-Malaysian citizens, foreign companies or local companies majority owned by a foreign individual or company), a separate application (for Wholesale and Retail Trade (WRT)) must first be filed with the MDTCC. Only upon approval by the MDTCC would the application be referred back to the Registry for approval.

All franchised businesses with foreign equity must be incorporated locally under the Companies Act 1965, although there are business sectors that are specifically excluded from foreign involvement. Such WRT approval given is valid for only two years and must be renewed prior to expiration.

### Halal Requirements

U.S. franchisors have had considerable success in Malaysia’s food and beverage industry. For franchisors that wish to tap into this market, it is essential to keep in mind that over 60% of the Malaysian population is Muslim. Consequently, food and beverage franchisors need to be aware of the requirements for and guidelines relating to the preparation and handling of Halal food—*i.e.*, what is permissible under Islamic

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Shariah Law.

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Bob Smith and Chris Connelly will be attending the 48<sup>th</sup> Annual International Franchise Association Legal Symposium in Chicago, IL from May 3-5,

2015, where Bob will be speaking on international franchising.

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