

Legal 500

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Malaysia

Franchise & Licensing

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This country-specific Q&A provides an overview of franchise & licensing laws and regulations applicable in Malaysia.

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Malaysia: Franchise & Licensing

1. Is there a legal definition of a franchise and, if so, what is it?

Yes, there is a legal definition of a franchise in Malaysia. Under Section 4 of the Franchise Act 1998 ("the Act"), a franchise is defined as "a contract or agreement, either expressed or implied, whether oral or written, between two or more persons by which:

- a. 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;
- b. 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 he possesses to permit the franchisee to use the intellectual property;
- c. 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
- d. in return for the grant of rights, the franchisee may be required to pay a fee or other form of consideration."

2. Are there any requirements that must be met prior to the offer and/or sale of a franchise? If so, please describe and include any potential consequences for failing to comply.

Yes. Under Section 6 of the Act, both domestic and foreign franchisors are required to register their franchise with the Registrar of Franchises before operating the franchise business or offering to sell the franchise to any person for operations in Malaysia. Failing to comply with this requirement is a serious offence under the Act. Upon conviction, the penalties set out under Section 6(2) of the Act are as follows:

- a. if the offender is a body corporate: a fine not exceeding RM250,000 (approximately USD59,000) for the first offence, and for a second or subsequent offence, a fine not exceeding RM500,000 (approximately USD118,000); or

- b. if the offender is an individual: a fine not exceeding RM150,000 (approximately USD35,000) or imprisonment of up to 1 year, or both, for the first offence, and for a second or subsequent offence, a fine not exceeding RM250,000 (approximately USD59,000) or imprisonment for a term not exceeding 3 years, or both.

It is important to note that this is a non-compoundable offence, which means that the Registrar of Franchises has no authority to permit settlement by way of a monetary payment without going through prosecution in Court. In other words, any contravention must proceed through prosecution in court.

Franchise registration applications must be submitted to the Registrar of Franchises through the MyFEX2.0 portal. Each application must be accompanied by various supporting documents, including the Franchise Disclosure Document, a template franchise agreement incorporating the mandatory provisions of the Act, the franchisor's audited accounts for the latest 3 financial years, the certificate of incorporation, a brochure on the franchise business, management accounts for a prototype outlet, the operations and training manuals to be provided to franchisees, results of bankruptcy searches on franchisor's directors and copies of the registered trademark certificates in Malaysia.

3. Are there any registration requirements for franchisors and/or franchisees? If so, please describe them and include any potential consequences for failing to comply. Is there an obligation to update existing registrations? If so, please describe.

There are registration requirements under the Act for both franchisors and franchisees. As regards the registration requirements for franchisors, please refer to our responses in No.2 above. It is important to note that under Section 4 of the Act, the term "franchisor" also includes a master franchisee with regard to its relationship with sub-franchisees. Accordingly, master franchisees are likewise required to register their applications as the master franchisee under Section 6 of the Act, as mentioned above. However, they may only do so after having operated for at least 3 years, as the application must be accompanied by the master

franchisee's audited accounts for the preceding 3 financial years.

For franchisees of foreign franchisors, Section 6A of the Act requires the franchisee to register the franchise with the Registrar of Franchises before commencing the franchise business. As for franchisees of local franchisors or master franchisees, Section 6B requires the franchisee to register the franchise with the Registrar of Franchises within 14 days from the date of signing of the franchise agreement.

Failure to comply with these requirements is an offence under the Act. As there is no express penalty for contravening Sections 6A and 6B of the Act, the general penalty provision under Section 39 of the Act will be applicable. Under this provision, any person who commits an offence under the Act for which no specific penalty is provided shall, upon conviction, be liable as follows:

- a. if a body corporate: a fine of not less than RM10,000 (approximately USD2,400) and not more than RM50,000 (approximately USD119,000) for the first offence, and for a second or subsequent offence, to a fine of not less than RM20,000 (approximately USD4,800) and not more than RM100,000 (USD24,000); or
- b. if an individual: a fine of not less than RM5,000 (approximately USD1,200) and not more than RM20,000 (approximately USD4,800) or imprisonment for a term not exceeding 6 months for the first offence, and for a second or subsequent offence, a fine of not less than RM10,000 (approximately USD2,400) and not more than RM50,000 (approximately USD119,000) or imprisonment for a term not exceeding 1 year.

Franchisors are obliged to renew their existing registrations with the Registrar of Franchises. Under Section 10A of the Act, a franchise registration is valid for a period of 5 years from the registration date and must be renewed within 30 days from its expiration date.

All applications for franchise registration, franchisee registration and renewal must be submitted through the MyFEX2.0 portal.

4. Are there any disclosure requirements (franchise specific or in general)? If so, please describe them (i.e. when and how must disclosure be made, is there a prescribed format, must it be in the local language, do they apply to sales to sub-franchisees) and include any

potential consequences for failing to comply. Is there an obligation to update and/or repeat disclosure (for example in the event that the parties enter into an amendment to the franchise agreement or on renewal)?

Under Section 15 of the Act, a franchisor is required to provide to each franchisee, at least 10 days prior to the execution of the franchise agreement, a copy of the Franchise Disclosure Documents, the franchise agreement template and all other documents submitted to and approved by the Registrar of Franchises for the franchise registration. Failure to comply with this compulsory practice is an offence under Section 15 of the Act. In instances involving sub-franchisees, the master franchisee is required to also comply with Section 15 of the Act by providing all disclosure documents submitted to and approved by the Registrar of Franchises for the master franchisee registration, again at least 10 days before the execution of the sub-franchise agreement.

Based on our reading of Section 15 of the Act, the disclosure requirement does not apply to the renewal of a franchise agreement nor when the parties execute an amended franchise agreement. However, as a matter of prudence, it is advisable for the franchisor to provide the franchisee with any updated documents, including the Franchise Disclosure Documents, at the time of renewal or amendment. This promotes transparency and helps minimise the risk of future disputes.

There is no disadvantage to the parties waiting at least 10 days after providing the updated documents before signing the renewal or amended agreement, as this demonstrates good faith and compliance with best practices.

5. If the franchisee intends to use a special purpose vehicle (SPV) to operate each franchised outlet, is it sufficient to make disclosure to the SPVs' parent company or must disclosure be made to each individual SPV franchisee?

Considering that each SPV will execute a separate franchise agreement to operate its respective franchised outlet, the disclosure documents must be provided to each individual SPV franchisee in accordance with Section 15 of the Act, as explained in No.4 above. Disclosure to the SPV's parent company alone would not be sufficient as it will not satisfy the statutory disclosure requirement under Section 15 of the Act.

6. What actions can a franchisee take in the event of mis-selling by the franchisor? Would these still be available if there was a disclaimer in the franchise agreement, disclosure document or sales material?

In Malaysia, although the franchise regime is heavily regulated under the Act, the Registrar of Franchises is unlikely to initiate investigations or enforcement action, unless a complaint is lodged by one of the parties to the franchise arrangement.

In the event of any mis-selling by the franchisor, the franchisee may have the following recourse:

- a. Terminate the franchise agreement on the basis of misrepresentation. However, whether this right can be successfully exercised will depend on the specific facts and the terms of the franchise agreement. If misrepresentation is not established, the franchisee's unilateral termination could amount to repudiatory breach, exposing the franchisee to potential contractual consequences for premature termination of the franchise agreement, including claims for damages by the franchisor;
- b. Lodge a complaint with the Registrar of Franchises if the franchisor has deliberately provided false or misleading information in the Franchise Disclosure Documents, which is an offence under Section 7(6) of the Act, or alternatively for the franchisor's contravention of Section 29(1) of the Act, which requires franchisors to act in an honest and lawful manner; and/or
- c. Initiate legal proceedings against the franchisor for mis-selling and misrepresentation.

While franchisees have the legal right to pursue claims against the franchisor, the presence of express disclaimers, whether in the franchise agreement or the FDD, that seek to waive or exclude the franchisor's liability for misrepresentation or to disclaim responsibility for the performance of the franchise outlet, may potentially weaken their legal position. Similarly, an entire agreement clause, commonly included in franchise agreements, may restrict a franchisee's ability to bring claims based on pre-contractual representations. Under Malaysian contract law, the parol evidence rule generally prohibits the use of extrinsic evidence (oral or written) to alter, contradict or supplement a written contract unless an exception applies. An entire agreement clause reinforces this principle by expressly stating that the written contract constitutes the full and final agreement between the parties. This promotes contractual certainty by excluding prior discussions and representations and

minimizing disputes. The effect of such clauses is to limit reliance on pre-contractual statements or assurances not incorporated into the franchise agreement. However, reliance on pre-contractual representations is not automatically barred. Malaysian Courts will examine the wording of the clause and applying the contra proferentum rule, will usually construe any ambiguity against the franchisor as the drafting party. Taken together, disclaimers and entire agreement clauses make it more difficult for a franchisee to rely on statements outside the four corners of the agreement and may be regarded as evidence that the franchisee accepted and agreed to the contractual terms. This, in turn, reduces the franchisor's exposure to mis-selling claims.

7. Would it be legal to issue a franchise agreement on a non-negotiable, "take it or leave it", basis?

Yes, it is permissible in Malaysia to issue a franchise agreement on a non-negotiable, 'take it or leave it' basis. During the registration process, the Registrar of Franchises reviews the franchise agreement to ensure that it incorporates the mandatory provisions of the Act and that its terms are practically acceptable. Once approved, franchisors are required to adopt the same approved franchise agreement template for execution with all franchisees. Any material change to the franchise agreement must be submitted to and approved by the Registrar of Franchises. Although the Registrar of Franchises has not issued formal guidelines on what would constitute a "material change", amendments that affect the franchisee, particularly those with financial implications are generally regarded as material. Accordingly, it is prudent to adopt a conservative approach, that any proposed amendments to the franchise agreement, apart from editorial changes, should first be submitted to the Registrar of Franchises for approval before implementation.

As such, franchisors must adopt the standard franchise agreement template for all franchisees to avoid contravening the Act. Customising or negotiating separate terms for individual franchisees may lead to violations of the Act, including (1) Section 11 which requires any amendments to the franchise agreement to be approved by the Registrar of Franchises before implementation; and (2) Section 20 of the Act, which prohibits a franchisor from engaging in discriminatory practices. Adopting different franchise agreements with varying terms for different franchisees could be construed as discriminatory, particularly where the differences in franchise fees, royalties, goods, services,

equipment, rentals or advertising services causes competitive harm to a franchisee who competes with a franchisee who receives the benefit of the discrimination.

8. How are trademarks, know-how, trade secrets and copyright protected in your country?

A. Trademarks

In Malaysia, trademarks are protected primarily through direct filing with the Intellectual Property Corporation of Malaysia (MyIPO) or by designating Malaysia under Madrid Protocol. Upon successful registration, a trademark is protected for an initial period of ten years from the registration date and can be renewed indefinitely in further ten-year periods. During the period of registration, the trademark proprietor enjoys exclusive rights to use the trademark in relation to the specific goods or services listed in the registration. While registration provides the strongest form of legal protection, unregistered trademarks may still be protected under the common law, specifically through the tort of passing off. Malaysia adopts a "first to use" principle, which recognises prior use of a mark that has acquired goodwill and reputation in the Malaysian market, even if it is not formally registered.

Importantly, under Section 24 of the Act, a franchisor must register the trademark associated with the franchise before applying to register the franchise itself. This requirement ensures that the franchisor holds the necessary rights over the brand being licensed to franchisees.

B. Know-How and Trade Secrets

In Malaysia, confidential information such as know-how, trade secrets, and proprietary systems is not protected under a specific statute. However, legal protection is available through contractual obligations and common law principles.

An obligation of confidentiality may arise through an express clause in an agreement (e.g. a non-disclosure agreement or confidentiality provisions) or from a relationship of trust and confidence between the disclosing party and the receiving party.

Under common law, the tort of breach of confidence is established if the following 3 elements are proven:

1. The information possesses the necessary quality of confidence;
2. The information was imparted in circumstances giving rise to an obligation of confidence; and

3. There has been an unauthorised use of that information to the detriment of the disclosing party.

One of the most effective ways of protecting know-how and trade secrets is to include an express clause in the agreement or to enter into a separate non-disclosure agreement (NDA). These should expressly provide that the know-how or trade secrets disclosed are strictly confidential and must not be disclosed or used with the disclosing party's consent, except in limited circumstances expressly permitted by the disclosing party.

C. Copyright

In Malaysia, copyright is governed by the Copyright Act 1987, which grants owners exclusive rights to control and exploit their original works for a limited period. Copyright applies to a broad range of works, including literary works such as training manuals and operational guidelines, computer programs, musical and artistic works, including marketing materials and graphic elements, films, sound recordings, and broadcasts, provided they meet the requirements of originality and are reduced to material form.

Unlike trademarks, copyright protection in Malaysia arises automatically upon creation, as long as the work is original and expressed in material form. While registration is not mandatory, copyright owners may choose to file a copyright voluntary notification (CVN) with MyIPO or prepare a statutory declaration under Section 42 of the Act. Both methods serve as prima facie evidence of copyright ownership and subsistence and are admissible in court. The duration of protection depends on the category of work; for most literary, musical or artistic works, protection lasts for 50 years after the author's death. For films, sound recordings and broadcasts, copyright protection lasts for 50 years, calculated from the beginning of the calendar year following the year in which the work was first published or broadcast.

9. Are there any franchise specific laws governing the ongoing relationship between franchisor and franchisee? If so, please describe them, including any terms that are required to be included within the franchise agreement.

Yes, in Malaysia, the Act governs the ongoing relationship between franchisor and franchisee and the franchise agreements must incorporate mandatory statutory terms to be valid.

Section 18(2) of the Act requires the following mandatory

terms to be included in the franchise agreement:

- a. the name and description of the product and business under the franchise;
- b. the territorial rights granted to the franchisee;
- c. the franchise fee, promotion fee, royalty or any related type of payment which may be imposed on the franchisee, if any;
- d. the obligations of the franchisor;
- e. the obligations of the franchisee;
- f. the franchisee's rights to use the mark or any other intellectual property;
- g. the conditions under which the franchisee may assign the rights under the franchise;
- h. a statement on the cooling off period, which shall be no less than 7 working days, during which the franchisee has the option to terminate the franchise agreement;
- i. a description pertaining to the mark or any other intellectual property owned or related to the franchisor which is used in the franchise;
- j. if the agreement is related to a master franchisee, the franchisor's identity and the rights obtained by the master franchisee from the franchisor;
- k. the type and particulars of assistance provided by the franchisor;
- l. the term of the franchise, and the terms of renewal and extension of the franchise agreement; and
- m. the effect of termination or expiration of the franchise agreement.

Failure to incorporate any of these provisions constitutes an offence.

Apart from these mandatory provisions, the Act also prescribes various other requirements that govern the ongoing relationship between franchisor and franchisee. These include, without limitation, the prohibition against discrimination as set out in No. 7 above, the obligation on the franchisee, including its directors, spouses and immediate family members, and employees not to disclose confidential information contained in the operational manual or obtained during training, both during the franchise term and for a period of 2 years after the expiration or termination of the franchise agreement, and the prohibition against similar business whereby during the franchise term and for a period of 2 years after its expiration or termination, the franchisee, including its directors, spouses, immediate family members of directors and employees, is prohibited from carrying on any business that is similar to the franchised business.

Further, under Section 29(1) of the Act, franchisors are required to act in an honest and lawful manner and to endeavour to adopt the best franchise business practice

applicable at the time and place. In addition, the Act contains several provisions that regulate the ongoing relationship between franchisor and franchisee, including the obligations of both parties (Section 30), the renewal of the franchise term (Section 32), the extension of the franchise term (Section 34) and the termination of the franchise agreement (Section 31).

10. Are there any aspects of competition law that apply to the franchise transaction (i.e. is it permissible to prohibit online sales, insist on exclusive supply or fix retail prices)? If applicable, provide an overview of the relevant competition laws.

In Malaysia, the Competition Act 2010 ("CA") is the primary legislation governing competition laws. The Act contains two main prohibitions, namely (i) anti-competitive agreements under Section 4(1) of the CA; and (ii) abuse of dominant position under Section 10(1). Section 4(1) prohibits any horizontal or vertical agreement between enterprises that has "the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services". Section 2 of CA defines a vertical agreement as "an agreement between enterprises each of which operates at a different level in the production or distribution chain". On this basis, it is clear that franchise transactions in Malaysia are subject to the CA. One common concern in franchise agreements is retail price maintenance ("RPM"). The imposition of minimum or maximum resale prices, or even recommended retail prices will generally be regarded as anti-competitive under CA. However, arguments can be made that the imposition of RPM in franchise agreements serve to maintain uniformity and consistency across the franchisor's franchised network, thereby safeguarding brand reputation which will ultimately benefit consumers.

The Malaysian Competition Commission (MyCC) has recognised that certain provisions in franchise agreements that may prevent, restrict, or distort competition are often incorporated to safeguard the franchisor's brand reputation. Therefore, as long as such provisions are justifiable with the aim of protecting the franchisor's brand reputation, MyCC may be less inclined to treat them as anti-competitive.

It should also be noted that under the CA, the prohibitions do not apply to "an agreement or conduct to the extent to which it is engaged in order to comply with a legislative requirement" (Second Schedule of the CA). Accordingly, if certain provisions are included in franchise agreements

to comply with the FA, for example, the non-compete clause prohibiting a franchisee from carrying on a similar business during the franchise term and for 2 years thereafter, arguments can be made that such clauses are not anti-competitive.

To-date, provisions that could arguably be considered anti-competitive such as imposition of RPM or mandating exclusive supply obligations, remain common in franchise agreements and are widely practiced in the franchise industry. MyCC has not raised objections to these practices at this juncture. Currently, there are no guidelines issued by MyCC or reported decisions that provide guidance on how MyCC or Malaysian courts would assess such contractual restrictions in franchise agreements. In practice, the facts and circumstances of each case will be critical in determining whether a particular provision is anti-competitive.

11. Are in-term and post-term non-compete and non-solicitation clauses enforceable and are there any limitations on the franchisor's ability to impose and enforce them?

Section 27 of the Act specifically prohibits a franchisee from conducting a similar business as the franchise business during the franchise term and for a period of 2 years after the termination or expiration of the franchise agreement. This non-compete provision not only applies to franchisees but also to the directors, spouses and immediate family members of the directors, as well as employees. A contravention of this provision is a criminal offence. It is mandatory for franchisors to include this non-compete provision in the franchise agreement, to ensure compliance with the Act. While the Act does not expressly provide for a non-solicitation obligation, it is common practice for franchise agreements in Malaysia to incorporate non-solicitation clauses for a certain period of time. Such provisions are generally enforceable, provided they are reasonable in scope and duration.

12. Is there an obligation (express or implied) to deal in good faith in franchise relationships? If so, what practical effects does this have on the relationship between franchisor and franchisee?

Yes, there is an obligation for parties to deal in good faith in franchise relationships. While there is no express use of the term "good faith", Section 29(1) of the Act expressly states that the franchisor and franchisee shall act in an honest and lawful manner and shall endeavour to pursue the best franchise practice of the time and

place. Further, section 29(2) of the Act sets out that their dealings with one another, must avoid the following conduct: (1) substantial and unreasonable overvaluation of fees and prices; (2) conduct which is unnecessary and unreasonable in relation to the risks to be incurred by one party; and (3) conduct that is not reasonably necessary for the protection of the legitimate business interests of the franchisor, franchisee or franchise system. Beyond statute, common law principles also recognise a duty of good faith, requiring contractual parties to conduct their respective contractual obligations.

As for practical effects, franchisors must: (a) be transparent with their dealings with franchisees, including providing accurate information regarding the franchise business; (b) exercise contractual rights reasonably and avoid exploiting their stronger bargaining position; (c) refrain from imposing unfair terms, implementing arbitrary policy changes throughout the franchise term, which could be of detriment to franchisees, imposing unfair penalties or increasing fees exorbitantly during the franchise term; and (d) adopt and maintain consistent and fair franchise management practices in overseeing all franchisees.

As for the franchisees, they should (a) operate the franchise business in a manner that is consistent and in compliance with the franchise agreement; (b) act honestly and diligently in carrying out obligations to operate the franchise business; (c) avoid abusing the rights granted under the franchise, and adhering to the franchisor's brand standards and directions.

13. Are there any employment or labour law considerations that are relevant to the franchise relationship? Is there a risk that the staff of the franchisee could be deemed to be the employees of the franchisor? What steps can be taken to mitigate this risk?

While in principle the franchisor and franchisee are legally independent entities, there remains a risk that employees of the franchisee could, in certain circumstances, be deemed employees of the franchisor. This risk arises under the Employment Act 1955 and common law principles, particularly where the franchisor exercises significant control over the employment terms or daily operations of the franchisee's staff.

There are various factors that may increase the risk. They include but not limited to the franchisor (a) becoming directly involved in instructing, training or disciplining the franchisee's employees; (b) exercising control over

employment matters such as hiring, firing or making wage decisions; or (c) intervening in employment related matters beyond brand or operational standards.

To mitigate or minimise this risk, franchisors should consider (1) including an express clause in the franchise agreement stating that the franchisee is an independent contractor, an agent or employee of the franchisor, and that the franchisor shall not be deemed as the employer of the franchisee or its employees; (2) avoiding direct involvement in employment related matters, including refraining from managing or interfering in the franchisee's hiring, firing, payroll or disciplinary processes; (3) limiting operational control over the franchisee's employees; and/or (4) focusing on direct monitoring efforts toward the franchisee's operations of the franchise business and adherence to brand standards, rather than directly evaluating or managing the franchisee's workforce.

14. Is there a risk that a franchisee could be deemed to be the commercial agent of the franchisor? What steps can be taken to mitigate this risk?

In Malaysia, the risk of a franchisee being deemed a commercial agent of the franchisor is generally low, as franchise and agency relationships are legally distinct. Further, Section 29(3) of the Act expressly provides that a franchisee shall operate its business separately from the franchisor and that the relationship between the parties shall not at any time be regarded as a partnership, service contract or agency.

That said, this risk may arise if the franchisor grants the franchisee broad authority to act or make representations on its behalf, or if the franchisee's conduct creates the impression that it has the authority and power to bind the franchisor in commercial dealings. To mitigate this risk, the franchise agreement should clearly state that the franchisee is an independent contractor and not an agent, employee, or legal representative of the franchisor. It should also expressly prohibit the franchisee from entering into contracts, making representations, or incurring obligations on behalf of the franchisor. In practice, both franchisor and franchisee should ensure that their conduct reflects this legal separation.

15. Are there any laws and regulations that affect the nature and payment of royalties to a foreign franchisor and/or how much interest can be

charged? Are there any requirements for payments in connection with the franchise agreement to be made in the local currency?

In Malaysia, the payment of royalties to a franchisor, including a foreign franchisor is regulated under the Act, which requires all fees, including royalties, to be clearly stated in the Franchise Disclosure Documents and the franchise agreement. Section 21 of the Act provides that the rate of the royalty must be the same as that provided in the Franchise Disclosure Documents. There are no statutory caps on the royalty amounts payable to a foreign franchisor, which allows franchisors the flexibility to impose their preferred royalty percentage or rate. In practice however, the Registrar of Franchises during the registration process will review the fees imposed by the franchisors, including royalty rates. In the event the Registrar of Franchises takes the view that the royalty rate imposed is relatively high, it may require the franchisor to provide clarification and justification before granting approval.

There is no statutory limit under Malaysian law on the interest rate that may be charged on late payments under a franchise agreement. However, any interest imposed must be reasonable and not operate as a penalty. In practice, contractual interest rates usually range between 8% to 10% per annum. To ensure enforceability, it is prudent to include wording such as "or to the maximum rate permitted under applicable law" after the specific rate in the franchise agreement.

Payments made by a Malaysian resident to a non-resident, which may include a foreign franchisor, are subject to the rules and requirements under the Foreign Exchange Policy ("FEP") administered by the Central Bank of Malaysia, Bank Negara Malaysia ("BNM").

In accordance with Notice 4 (Payment and Receipt) of the FEP Notices effective 1 June 2025:

- a non-resident may make or receive payments in Malaysian Ringgit in Malaysia, to or from a resident or another non-resident, for income earned or expenses incurred in Malaysia, or for settlement of goods and services transactions, except for payments between non-residents for offshore trades.
- a resident may make or receive payments in foreign currency to or from a non-resident for any purpose, except for restricted transactions, none of which affect franchise arrangements.

For transactions between residents (i.e., Malaysian individuals or entities), payments are generally required to be made in Malaysian Ringgit. However, the FEP does

allow the use of foreign currency if both parties mutually agree, provided such transactions comply with the relevant provisions of the FEP.

16. Is it possible to impose contractual penalties on franchisees for breaches of restrictive covenants etc.? If so, what requirements must be met in order for such penalties to be enforceable?

Yes, it is legally permissible to impose contractual penalties (liquidated damages) on franchisees for breaches of restrictive covenants in Malaysia. While the Act does not expressly address liquidated damages, their enforceability is governed by Section 75 of the Contracts Act 1950, which states that "when a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for".

In recent years, Malaysian courts have adopted a more liberal approach towards the enforceability of liquidated damages clauses. Malaysian Court has clarified the principles applicable under Section 75 of the Contracts Act 1950¹:

- a. Reasonable compensation may be awarded regardless of whether actual loss or damage is proven, although evidence of loss is a useful starting point.
- b. A stipulated sum will be deemed unreasonable if it is extravagant or unconscionable compared with the highest conceivable loss likely to flow from the breach.
- c. The concepts of legitimate interest and proportionality are relevant in determining what amounts to reasonable compensation.
- d. Once a breach and the existence of a liquidated damages clause are established, the claimant is prima facie entitled to a sum not exceeding the stipulated amount.
- e. Where reasonableness is disputed, the burden lies on the defaulting party to prove that the stipulated amount is excessive.

When incorporating liquidated damages into franchise agreements, franchisors should ensure that the stipulated amounts represent a reasonable estimate of likely losses, rather than serving as punitive measures. Clauses should

be carefully drafted to state that the sum represents liquidated damages as a genuine pre-estimate of loss, while avoiding any reference to "penalties." It may also be prudent to adopt differentiated amounts for different types of breaches: for example, higher sums may be justified for breaches of non-compete or confidentiality clauses, whereas lower amounts may be appropriate for late payment obligations.

Liquidated damages are a powerful tool to safeguard franchise systems in Malaysia, but they must be proportionate, well-documented, and precisely drafted to withstand judicial scrutiny. By adopting these practices, franchisors can significantly enhance the enforceability of such provisions while protecting their long-term commercial interests.

Footnote(s):

¹ Federal Court decision in Cubic Electronics Sdn Bhd (in liquidation) v MARS Telecommunications Sdn Bhd [2019] 1 AMR 737; [2018] MLJU 1935

17. What tax considerations are relevant to franchisors and franchisees? Are franchise royalties subject to withholding tax?

Fees payable by franchisees to franchisors under a franchise agreement, including royalties may be subject to Sales and Services Tax ("SST") in accordance with the Sales Tax Act 2018 and Service Tax Act 2018. However, where such payments are made to foreign franchisors, SST is generally not imposed as SST is a domestic tax and is not directly imposed on payments to non-residents for income earned outside Malaysia.

Payments of royalties from a Malaysian resident to a non-resident franchisor are subject to withholding tax under the Income Tax Act 1967. The standard withholding tax rate is 10% of the gross royalty payment (subject to any reduction under an applicable Double Taxation Agreement (DTA) between Malaysia and the franchisor's jurisdiction). The tax must be withheld by the Malaysian franchisee and remitted to the Inland Revenue Board of Malaysia (LHDN).

18. How is e-commerce regulated and does this have any specific implications on the relationship between franchisor and franchisee? For example, can franchisees be prohibited or restricted in any way from using e-commerce in their franchise

businesses?

The relevant legislation on e-commerce in Malaysia is the Consumer Protection (Electronic Trade Transactions) Regulations 2024 ("ETTR"), made under the Consumer Protection Act 1999 (CPA 1999), which are intended to strengthen consumer protection in online transactions. While the ETTR does not have any direct implications on the franchise relationship itself, it applies to any party offering goods or services online to consumers in Malaysia, whether through a website, mobile application, or third-party platform. Accordingly, if franchisees are required to sell goods or services directly to consumers online in Malaysia, or if they operate e-commerce channels as part of the franchise system, they must comply with the requirements of the ETTR.

Franchisees may be prohibited or restricted from engaging in e-commerce depending on the commercial terms set forth in the franchise business. Franchise systems are usually strictly controlled by franchisors, and it is not uncommon for franchisors to either prohibit e-commerce entirely or to impose strict implications for its use. Furthermore, in Malaysia, it is a statutory requirement that each franchisee is granted an exclusive territorial right to operate the franchise business (i.e. within a specific area, district, or city) subject to any carve-outs imposed by the franchisor. In light of this requirement, franchisors often limit e-commerce activities to ensure that online sales do not encroach upon the territorial rights of other franchisees. That said, this restriction may not apply in a master franchise arrangement, where the master franchisee is typically expected to operate a website dedicated to Malaysian operations, which serves the entire market rather than being limited by territorial divisions.

Under the Personal Data Protection Act 2010 ("PDPA"), data users must comply with several key data protection principles, including obtaining consent from data subjects; processing data only for lawful and specified purposes; implementing adequate security measures against loss, misuse, or unauthorised access; providing individuals with rights to access and correct their personal data; and complying with restrictions on cross-border data transfers, unless exceptions apply (e.g. consent, contractual necessity, or Ministerial approval of destination countries).

These obligations have specific implications in the franchisor-franchisee relationship, particularly where (a) customer or employee data is shared between franchisor and franchisees; (b) data is centralised through franchisor-managed systems (e.g. loyalty programmes, POS systems, HR databases); or (c) data is transferred

abroad, such as where a foreign franchisor requires access to Malaysian customer information.

Recent amendments to the PDPA have strengthened compliance requirements, including the mandatory appointment of a Data Protection Officer (DPO) by every data user, the introduction of data breach notification requirements, requiring data users to notify the Commissioner and affected individuals within prescribed timelines, and increased penalties and extended liability to directors and officers of the entity in breach.

Accordingly, the franchise agreement should clearly allocate responsibilities for data protection, particularly in relation to cross-border transfers, centralised systems, and data breach management. Both franchisors and franchisees should implement robust technical and organisational safeguards and maintain ongoing cooperation to ensure compliance.

19. What are the applicable data protection laws and do they have any specific implications for the franchisor/franchisee relationship?

In Malaysia, the principal legislation governing data protection is the Personal Data Protection Act 2010 (PDPA). The PDPA applies to any person or entity that processes or controls personal data, referred to as a "data controller." This broad definition includes both franchisors and franchisees, who collect, use, or store personal data of customers, employees, or other individuals in the course of their business operations. Under the PDPA, data controllers must comply with important data protection principles, including obtaining consent from data subjects, using data only for lawful and specified purposes, ensuring security measures to safeguard personal data and establish procedures to manage potential data breaches, and allowing individuals to access and correct their personal data.

In the franchisor-franchisee relationship, these obligations have specific implications where personal data of customers and employees is shared between franchisors and franchisees, personal data is centralised through franchisor-managed system (e.g. loyalty apps or POS systems) or where personal data is transferred across borders, for example, where a foreign franchisor requires access to Malaysian customer data. Data controllers can transfer personal data to countries with substantially similar data protection laws or those providing an adequate level of protection, requiring a Transfer Impact Assessment (TIA) to verify compliance. The Cross Border Personal Data Transfer Guidelines provide further guidance on these new conditions and the

performing of TIAs.

The franchise agreement should clearly outline the respective obligations and responsibilities of both franchisor and franchisee regarding data protection, including data collection, storage, transfer and breach management. Both franchisors and franchisees should implement robust security measures, such as encryption, access controls, and incident response protocols. Where data is transferred outside Malaysia, parties must ensure compliance with the PDPA's cross-border transfer restrictions and secure appropriate consents or safeguards. Each franchisee should designate a Data Protection Officer to oversee compliance and act as liaison with the authorities. Failure to comply with the PDPA can lead to significant penalties, including fines and potential liability for key officers such as directors of the data controller entity. Therefore, compliance with the PDPA is a critical aspect of the franchisor-franchisee relationship, requiring clear contractual provisions and ongoing cooperation to ensure lawful and secure handling of personal data.

20. Is the franchisor permitted to restrict the transfer of (a) the franchisee's rights and obligations under the franchise agreement or (b) the ownership interests in the franchisee?

Yes, the franchisor is generally allowed to restrict the transfer of the franchisee's rights and obligations under the franchise agreement or ownership interests in the franchisee. However, such restrictions must be expressly and clearly set out in the franchise agreement to be enforceable.

In practice, franchisors usually require franchisees to obtain prior written consent before transferring their rights or ownership interests. Such consent is often subject to conditions, which may include the proposed transferee meeting the franchisor's training, financial and operational requirements, as well as the payment of a transfer or administrative fee prescribed by the franchisor.

21. Does a franchisee have a right to request a renewal on expiration of the initial term? In what circumstances can a franchisor refuse to renew a franchise agreement? If the franchise agreement is not renewed or it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the

compensation payment calculated?

The Act distinguishes between the concepts of "extension" and "renewal", although neither term is expressly defined in the Act. They are however generally understood to carry different meanings. Extension usually refers to continuing the franchise for a shorter period, under the same terms as the existing franchise agreement. Renewal generally refers to granting the franchise for the same duration as the initial term, and may be subject to updated terms. Section 34 of the Act specifically regulates extension term and provides that a franchisee may, at its option, apply for an extension of the franchise term by giving the franchisor at least 6 months' written notice before expiry. Unless the franchisee has breached the terms of the franchise agreement, the franchisor is obliged to grant the extension. The extended franchise agreement must contain terms that are similar to or not less favourable than those in the previous agreement.

Renewal is treated differently from extension under Section 32 of the Act. A franchisor commits an offence if it refuses to renew a franchise agreement without compensating the franchisee in certain circumstances. Compensation (by way of repurchase or other mutually agreed means) is required where the franchisee is barred by the agreement or by the franchisor's refusal, at least 6 months before expiry, to waive such restriction from continuing a similar business under another mark in the same area after expiry, or the franchisor fails to provide the franchisee with written notice of its intent not to renew at least six months before expiry.

In light of these provisions of the Act, the conditions and terms for renewal should be expressly set out in the franchise agreement. Subject to those terms, the franchisor reserves the right to either allow or reject the renewal of the franchise agreement based on its evaluation of the franchisee's performance and compliance during the initial term. Franchisor will usually refuse renewal in the event the franchisee has committed breaches of the franchise agreement during the initial term. It is also prudent for franchisors to issue franchisees a written notice at least 6 months before the expiry date if they do not intend to renew the franchise agreement, in order to avoid contravening Section 32 of the Act.

22. Are there any mandatory termination rights which may override any contractual termination rights? Is there a minimum notice period that the

parties must adhere to?

Save for Section 33 of the Act, which allows a franchise agreement to be terminated upon parties' mutual consent, termination is primarily regulated through Section 31 and the contractual terms set out in the franchise agreement. Section 31 stipulates that a franchise agreement shall not be terminated before the expiration date except for good cause. The Act recognises two categories of "good cause", setting out specific grounds, while also indicating that the list is not exhaustive, meaning other circumstances may also qualify as good cause depending on the terms inserted in the franchise agreement.

The first category of good cause includes the following:

- a. the failure of a franchisor or a franchisee to comply with any terms of the franchise agreement or any other relevant agreement entered into between the franchisor and franchisee; and
- b. the failure of a franchisor or the franchisee to remedy the breach committed by him or any of his employees within the period stated in a written notice given by the franchisor, which shall not be less than fourteen days, for the breach to be remedied.

The second category of good cause covers circumstances where the franchisor or franchisee may terminate the agreement without the requirement of notice and an opportunity to remedy the breach, including the following:

- a. makes an assignment of the franchise rights for the benefit of creditors or a similar disposition of the assets of the franchise to any other person;
- b. becomes bankrupt or insolvent;
- c. voluntarily abandons the franchised business;
- d. is convicted of a criminal offence which substantially impairs the goodwill associated with the franchisor's mark or other intellectual property; or
- e. repeatedly fails to comply with the terms of the franchise agreement.

Based on decided case law stipulating that statutory safeguards in the Act take precedence over contractual terms, statutory termination rights under the Act will override contractual termination provisions where the latter contradict or fail to meet the minimum standards prescribed by the Act. For example, if a franchise agreement provides the franchisee with less than 14 days to remedy a curable breach, such a clause may be unenforceable and open to challenge, as it falls short of the statutory requirement. Franchisors should therefore ensure that their franchise agreements are drafted to

align with, or provide more favourable terms than, the minimum standards set out in the Act.

As explained earlier, the Act prescribes a minimum notice period for termination in cases of remediable breaches. Under Section 31 of the Act requires that the breaching party must be given at least 14 days' written notice to remedy the breach. In the event the breach is not remedied within this period in accordance with the notice of default, the aggrieved party is entitled to terminate the franchise agreement. For serious breaches, such as insolvency, abandonment of the franchise business or criminal conviction for a criminal offence substantially impairing the goodwill associated with the franchisor's mark or other intellectual property, termination may be effected immediately, without the need to provide a notice or cure period.

Separately, under Section 18(4) of the Act, a franchisee is entitled to terminate the franchise agreement within 7 working days from the date of signing (the statutory "cooling-off period"), without giving any reason and without incurring any penalty.

23. Are there any intangible assets in the franchisee's business which the franchisee can claim ownership of on expiry or termination, e.g. customer data, local goodwill, etc.

This depends on the terms of the franchise agreement between the franchisor and franchisee. Generally, franchisors retain ownership of intangible assets such as customer data, brand goodwill and IP rights. Unless expressly granted, consented to, or transferred by the franchisor, franchisees do not acquire ownership rights over such intangible assets upon termination or expiration of the franchise agreement. In practice, it is uncommon for franchisors to grant or transfer the ownership rights of intangible assets to franchisees post termination or expiration of the franchise agreement. It is common for franchise agreements to expressly provide that franchisees are not entitled to any goodwill associated with the franchise business or its trademarks, nor to any compensation for such goodwill. These agreements also usually provide that all intellectual property rights, which are often broadly defined to include customer data, goodwill and any other materials created, developed, or collected during the operation of the franchise business, shall vest exclusively in the franchisor.

24. Is there a national franchising association? Is

membership required? If not, is membership commercially advisable? What are the additional obligations of the national franchising association?

Yes, the national franchising association in Malaysia is the Malaysia Franchise Association ("MFA"). Membership with MFA is not legally required to operate a franchise business in Malaysia. membership may be commercially advantageous, particularly for franchisors or franchisees seeking to expand their presence and strengthen their network within the franchise industry, gain industry insights and updates, access local and international franchise exhibitions, workshops, courses, seminars and trade events and/or receive support and guidance from MFA regarding franchise matters.

MFA serves as a resource centre, particularly for both franchisors and franchisees with the aim of promoting and supporting the growth of franchising in Malaysia. Apart from organising trainings, workshops, courses, exhibitions, trade events and seminars, MFA also often collaborates with the Ministry in-charge of the franchise portfolio in Malaysia, which is the Ministry of Cooperatives and Entrepreneur Development to carry out its role of promoting franchising in Malaysia.

In short, MFA membership offers several practical and strategic benefits, including:

- Networking opportunities with franchisors, franchisees, and industry professionals in Malaysia and abroad;
- Access to industry insights and updates on developments in franchising, including regulatory changes and market trends;
- Participation in local and international exhibitions, workshops, training programmes, seminars, and trade events, providing valuable exposure and capacity building;
- Support and guidance from MFA on franchise-related matters, including compliance, operations, and market entry strategies;
- Enhanced credibility and visibility within the Malaysian franchise ecosystem, which may assist in building trust with potential franchisees and partners.

25. Are foreign franchisors treated differently to domestic franchisors? Does national law/regulation impose any debt/equity restrictions? Are there any restrictions on the capital structure of a company incorporated in

your country with a foreign parent (thin capitalisation rules)?

Under Section 54 of the Act, foreign franchises are required to first obtain franchise approval under Section 54 prior to registering their franchise under Section 6. In contrast local franchisors are only required to register under Section 6 of the Act. However, in practice, foreign franchisors submit a single application for franchise registration, which encompasses approvals under both Section 54 and Section 6.

It should be noted that Section 53 of the Act provides that "a franchisor who intends to sell a franchise to a person who is not a Malaysian citizen shall obtain the approval of and be subject to the conditions which may be imposed by, the Registrar". This provision indicates that franchisors must obtain prior approval from the Registrar of Franchises before selling a franchise to a person who is a non-Malaysian citizen, which can be interpreted to include both individuals and corporate entities, such as foreign corporations. On this basis, Section 53 approval would also be required where a Malaysian franchisor proposes to sell its shares to a foreign entity.

Apart from these registration requirements under the Act, foreign franchisors must also comply with the Guidelines on Foreign Participation in the Distributive Trade Services Malaysia 2022 ("the Guidelines"), issued by the Ministry of Domestic Trade and Cost of Living (MDT or KPDN). These guidelines apply to franchising as part of the distributive trade sector (encompassing wholesale, retail, and related activities) and require approval from KPDN's Distributive Trade Committee for foreign participation, including activities such as opening new branches, relocations, expansions, acquisitions, mergers, or takeovers. This approval process, often referred to as the Wholesale and Retail Trade (WRT) license or permit, ensures alignment with national policies on foreign investment in distributive trade.

Once these approvals are obtained, foreign franchisors are otherwise treated similarly to domestic franchisors in operational terms under the Franchise Act 1998.

26. Must the franchise agreement be governed by local law?

No, it is not legally required for a franchise agreement to be governed by Malaysian laws. However, any franchise agreement intended to be implemented in Malaysia must comply with the provisions of the Act, including incorporating the mandatory terms of the Act. Accordingly, while a franchise agreement may be

governed by foreign laws, it must nonetheless comply with the requirements of the Act.

27. What dispute resolution procedures are available to franchisors and franchisees? Are there any advantages to out of court procedures such as arbitration, in particular if the franchise agreement is subject to a foreign governing law?

Franchisors and franchisees may resolve disputes either through litigation or by adopting alternative dispute resolution (ADR) mechanisms such as arbitration or mediation, provided these mechanisms are agreed upon or expressly stated in the franchise agreement. The Act does not mandate any specific dispute resolution method, leaving parties free to choose their preferred mechanism. Section 28(2) of the Act expressly recognises the rights of parties to submit franchise-related disputes to arbitration.

In practice, the Registrar of Franchises, when reviewing franchise agreements for approval under the registration process, generally expect the agreement to include an ADR clause, either through mediation or arbitration.

Both mechanisms have their advantages. Mediation allows disputes to be resolved amicably, cost-effectively, and without damaging the ongoing franchise relationship. Arbitration offers advantages, particularly where a franchise agreement is governed by foreign law.

Arbitration proceedings are confidential, which protect sensitive commercial information as well as protect the reputation of parties. Furthermore, arbitration offers a neutral venue which can be reassuring where a foreign party is involved. Arbitration also allows for more flexible procedures compared to litigation. Malaysia is also a signatory to the New York Convention, which means that foreign arbitration awards are generally enforceable in Malaysia.

Franchisors may adopt a tiered dispute resolution clause, requiring the parties to first attempt mediation, and if unsuccessful, proceed to arbitration. This approach balances the benefits of amicable settlement with the assurance of finality through binding arbitration.

That said, it is also advisable for franchisors to include a carve-out clause expressly preserving their right to seek injunctive reliefs in court, particularly in urgent cases such as breaches of non-compete or confidentiality provisions, where immediate court intervention may be necessary.

28. Must the franchise agreement and disclosure documents be in the local language?

No, there is no requirement for the franchise agreement or the disclosure documents to be in the local language.

29. Is it possible to sign the franchise agreement using an electronic signature (rather than a wet ink signature)?

Yes, franchise agreements can be signed using electronic signatures. The Digital Signature Act 1997 and Electronic Commerce Act 2006 provide the legal framework in recognising electronic signatures as valid and enforceable in Malaysia. It is advisable for franchisors to include an express provision in the franchise agreement confirming that the parties agree to electronic execution, to avoid any uncertainty and to ensure consistency in practice.

30. Do you foresee any significant commercial or legal developments that might impact on franchise relationships over the next year or so?

At present, there are no major commercial or legal developments anticipated that would significantly affect franchise relationships in Malaysia over the next year. The National Franchise Policy 2030 (DFN 2030), launched on February 7, 2025, by the Ministry of Entrepreneur and Cooperatives Development (MECD), has introduced a strategic roadmap to enhance Malaysia's franchise ecosystem and broaden market access both domestically and internationally. This policy emphasizes enhanced governance, market expansion, and capacity building, which may indirectly influence compliance requirements.

A key practical challenge that may impact the franchise sector remains the detailed procedural steps, extensive documentation requirements and long processing time taken for franchise registration. The high volume of applications, coupled with stringent compliance checks, may result in longer processing times for registration approvals. As registration is a prerequisite for offering or operating a franchise in Malaysia, these delays can hinder franchisors' ability to commence operations within their expected timelines. Businesses looking to enter or expand into Malaysian market should proactively plan ahead for potential administrative delays, factoring these into their launch strategies, contractual commitments, and resource planning.

In an attempt to circumvent these delays, some businesses have adopted licensing models as an

alternative to franchising. However, if not carefully structured, these arrangements may still fall within the scope of the Act and risk being treated as unregistered franchises. This could expose franchisors and licensees to significant legal and regulatory consequences, including criminal liability.

While these compliance requirements are designed to maintain regulatory standards and transparency in the sector, early preparation, accurate structuring of franchise agreements, and proactive engagement with the registration process remain the most effective strategies to facilitate smoother market entry and ensure compliance with Malaysian law.

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