
High Court Decision in Dr Fong's Case: Registrations under Section 6 and Section 54 of the Franchise Act 1998

Introduction

The recent High Court decision in *Dr HK Fong BrainBuilder Pte Ltd v SG-Maths Sdn Bhd & Ors* has plagued the franchise industry with uncertainty and confusion.

The aforesaid arose from the Court's interpretation of the term "franchisor" appearing in a provision of the Franchise Act 1998 ("FA") on the requirement to register a franchise with the Registrar of Franchises ("the Registrar"). As a result of this case, in addition to the need to obtain the Registrar's approval or consent under Section 54 of the FA, foreign franchisors are now required to register their franchises with the Registrar under Section 6 of the FA.

We seek to examine the above issue and to shed light on the same.

Brief Background Facts

This case concerned "Dr Fong's Method" of teaching mathematics to students in primary and secondary school, which was developed by Dr Fong. He incorporated Dr HK Fong BrainBuilder Pte Ltd, in Singapore ("Plaintiff"). The Plaintiff entered into a master license agreement ("MLA 2013") with SG-Maths Sdn Bhd ("First Defendant"), for the operation and management of the "BrainBuilder business" ("BB") in Malaysia.

The second and third defendants owned a total of 85% of the paid-up shares in the First Defendant, while Dr Fong held 15%.

The Plaintiff claimed, among others, that the First Defendant had breached the MLA 2013 when a sub-license was awarded to a third party, Mr Suhaimi, to operate a BB centre. On the other hand, the First Defendant, along with the second and third defendants, counterclaimed against the Plaintiff for, among others, a declaration that the MLA 2013 was invalid.

There were several issues that the Court had to consider, including:

- i. whether the FA applied to the MLA 2013; and
- ii. if the FA applied to the MLA 2013, whether Sections 6(1) and/or 6A(1) of the FA had been breached.

Whether the Franchise Act 1998 Applied to the MLA 2013

Despite the fact that the MLA 2013 was not named a "franchise" contract nor did the MLA 2013 use the word "franchise", it was held that courts were not bound by labels or descriptions given by the parties in the contract.

After perusing the MLA 2013, the Court was of the view that it fulfilled all the four cumulative conditions of a “franchise” as defined in Section 4 of the FA.

Further, the First Defendant was required to comply with a “franchise manual operation” provided by the Plaintiff.

Therefore, the Court held that the MLA 2013 was a franchise agreement.

Whether Sections 6(1) and/or 6A(1) of the FA had been Breached

Section 6 of the FA provides that:

- 1) A franchisor shall register his franchise with the Registrar before he can operate a franchise business or make an offer to sell the franchise to any person.
- 2) Any franchisor who fails to comply with this section, unless exempted by the Minister under Section 58, commits an offence and shall, on conviction, be liable—
 - a. if such person is a body corporate, to a fine not exceeding RM250,000.00, and for a second or subsequent offence, to a fine not exceeding RM500,000.00; or
 - b. if such person is not a body corporate, to a fine not exceeding RM100,000.00 or to imprisonment for a term not exceeding 1 year or to both, and for a second or subsequent offence, to a fine not exceeding RM250,000.00 or to imprisonment for a term not exceeding 3 years or to both.

Section 6A(1) of the FA provides that:

Before commencing the franchise business, a franchisee who has been granted a franchise from a foreign franchisor shall apply to register the franchise with the Registrar by using the prescribed application form and such application shall be subject to the Registrar’s approval.

In adopting a purposive interpretation of Sections 6 and 6A(1) of the FA, the Court was of the view that the purpose of these provisions, as intended by Parliament, was for all franchises, local and foreign, to be registered with the Registrar. Consequently, the Court rejected the Plaintiff’s argument that Section 6(1) was only applicable to local franchisors and reasoned (among others) that “*if a foreign franchisor is not required to register the foreign franchise with the Registrar under Section 6(1) of the FA, the foreign franchisor may wriggle out from compliance with mandatory provisions legislated by Parliament in FA for the protection of franchisees of foreign franchises*”.

The Court further held that the said interpretation of Section 6(1) could also be supported by applying a literal interpretation of the provision, read together with the definition of “franchisor” in Section 4 of the FA.

Consequently, it was held that the Plaintiff’s failure to register its business franchise with the Registrar under Section 6(1) of the FA amounted to a contravention of the provision. Similarly, the First Defendant had breached Section 6A(1) of the FA due to its failure to register the franchise with the Registrar.

In view of the breaches of Section 6(1) and Section 6A(1) of the FA, the MLA 2013 was found to be void in its entirety.

Uncertainty and Confusion

Based on this decision, all franchisors (local and foreign) are required to register their franchise with the Registrar under Section 6(1).

The decision on this point has created uncertainty and confusion in the industry as it runs counter to the interpretation and practice that had hitherto been adopted by the Registrar and followed by the industry since the FA came into force, namely the registration requirement under Section 6(1) only applied to local franchisors and foreign franchisors needed only comply with the requirement under Section 54 which is to obtain the Registrar's consent or approval to sell a foreign franchise in Malaysia or to a Malaysian citizen.

Section 54 of the FA provides that:-

Section 54: Sale of franchise by foreigner in Malaysia

- (1) A foreign person who intends to sell a franchise in Malaysia or to any Malaysian citizen shall submit an application to the Registrar.
- (2) The Registrar may approve or refuse an application under subsection (1) without giving any reason for the refusal.
- (3) An application which is approved under this section may be subject to such conditions as the Registrar may impose.

It would appear that Section 54 of the FA was not brought to the attention of the Court as there was neither any discussion nor mention of the provision in the grounds of judgment.

The Registrar has yet to issue any formal statement, circular or directive regarding the impact of this case on the Registrar's aforesaid interpretation and practice.

For a period of time since this case was reported, it was unclear whether foreign franchisors are required to comply with both Section 54 and Section 6(1). However, after our continuous efforts in seeking clarification from the Franchise Development Division ("FDD"), we have just been informed by the FDD that such compliance is indeed required now. This effectively means that we have a situation of 'double registrations' for foreign franchisors.

Unfortunately, it is unclear how such compliance can be achieved by foreign franchisors as the current registration system used by the Registrar does not provide an option for a foreign franchisor to submit an application under Section 6. We have been informed by the FDD that it is in the midst of discussion with its IT team to change the system.

Another quandary that has arisen as a result of this decision is whether other provisions in the FA (apart from Section 6) containing the term "franchisor", which were thought to be applicable to only local franchisors, would now also apply to foreign franchisors.

The decision of the Court is the subject matter of an appeal in the Court of Appeal. The appeal was

recently heard, and the Court of Appeal has reserved its decision. So, watch this space.

We trust that the above provides you with a quick update in relation to Dr Fong's case.

If you would like to discuss any of the above or if you have any questions regarding Franchising, please get in touch with any of the individuals listed below.

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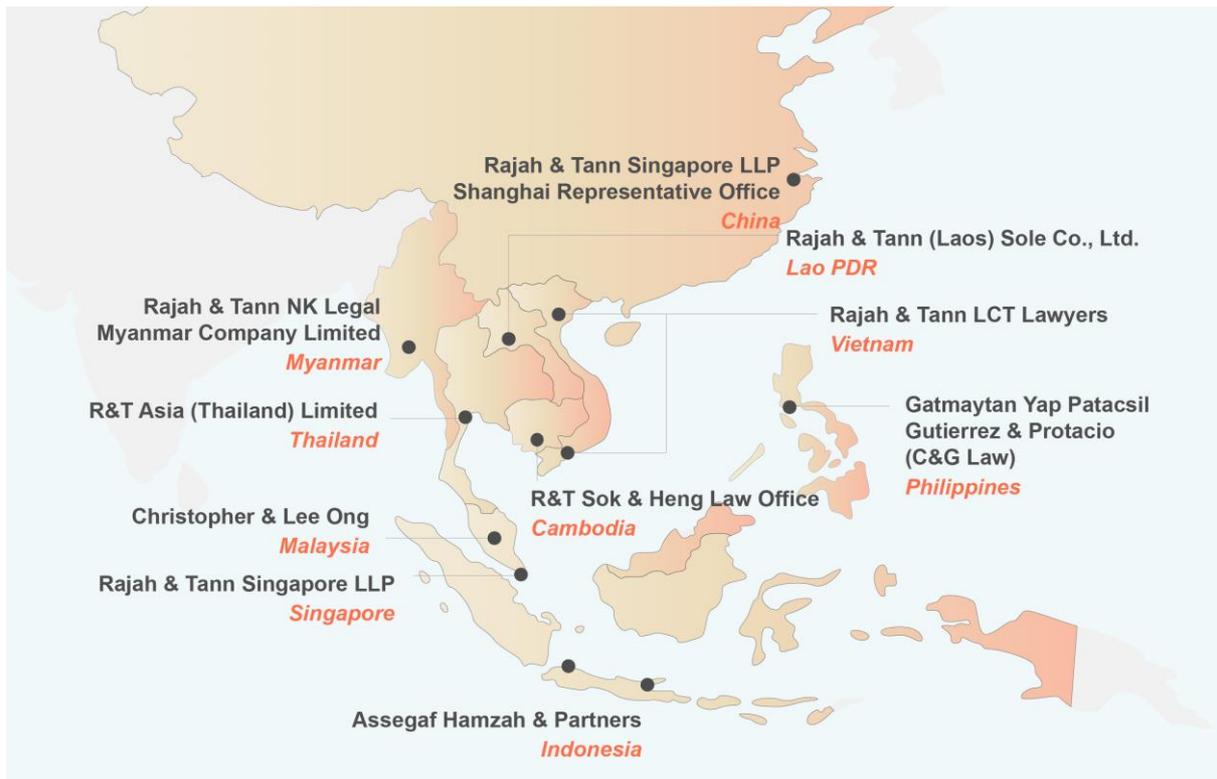
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