

# Legal 500

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### Mexico

### Franchise & Licensing

### Contributor

Regalado & Galindo



#### Oliver Galindo

Partner | [ogalindo@rgl.mx](mailto:ogalindo@rgl.mx)

#### Gael Cruz

Court Clerk | [gacruz@rgl.mx](mailto:gacruz@rgl.mx)

#### Sinuhe Garcia

Court Clerk | [sgarcia@rgl.mx](mailto:sgarcia@rgl.mx)

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

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# Mexico: Franchise & Licensing

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

Yes, a definition can be found in Article 245 of the Federal Law on Protection of Industrial Property (Ley Federal de Protección a la Propiedad Industrial -LFPPI-).

According to this provision, a franchise will exist when a license for the use of a trademark is granted in writing, and technical knowledge is transferred or technical assistance is provided, so that the person to whom it is granted can produce or sell goods or provide services in a uniform manner and with the operational, commercial, and administrative methods established by the trademark owner, aimed at maintaining the quality, prestige, and image of the products or services that it distinguishes.

## 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, there is a requirement that the franchisor must fulfill before the sale of a franchise, which is regulated in Article 245 of the LFPPI. The same article points out in its second paragraph that the franchisor must provide, at least thirty days in advance of the signing of the franchise agreement, the information specified in the law regarding the status of their company. The potential consequences for not complying with this legal requirement are the nullification of the contract, payment for damages and losses, as well as the penalty for administrative infringement indicated in Article 386, clause XXV of the LFPPI.

## 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.

Yes, it is advisable for the parties to register the franchise agreement with the Mexican Institute of Industrial Property, as registration is intended to make the contract enforceable against third parties in the event of a future

dispute. The registration request can be submitted by any of the parties involved in the franchise agreement. However, the United States-Mexico-Canada Agreement (USMCA), in its Article 20.26 a), states that none of the parties will require the registration of trademark licenses to determine the validity of the license. Updates of agreements must be recorded as well to make them enforceable against third parties.

## 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)?

Yes, the franchise holder must provide any interested party (franchisee or sub-franchisee), at least 30 days before the execution of the agreement, the following technical, economic, and financial information:

I.- Name, trade name, or legal entity, address, and nationality of the franchisor;

II.- Description of the franchise;

III.- Seniority of the franchising company of origin and, if applicable, the master franchisor in the business subject to the franchise;

IV.- Intellectual property rights involved in the franchise;

V.- Amounts and items of payments that the franchisee must cover to the franchisor;

VI.- Types of technical assistance and services that the franchisor must provide to the franchisee.

VII.- Definition of the territorial operating zone of the business to be operated under the franchisee;

VIII.- Right of the franchisee to grant or not sub-franchises to third parties and, if applicable, the

requirements it must meet to do so;

IX.- Obligations of the franchisee regarding confidential information provided by the franchisor, and

X.- Generally, the obligations and rights of the franchisee arising from the execution of the franchise agreement.

There is no prescribed format for the disclosure, it is recommended to do the disclosure in Spanish to avoid future controversy concerning a potential misunderstanding or mistake from the franchisee.

Failure to disclose in these terms could conduct to the annulment of the contract, and the imposture of fines for infringements to the LFPPI.

Mexican legislation does not impose an obligation on the parties to update the disclosure requirements in case of contract renewal. However, when the parties terminate the contract and enter into a new one, there will be an obligation to once again comply with the disclosure requirements.

### **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?**

The LFPPI does not stipulate that a notification or disclosure to the parent company is deemed to have been made to its subsidiaries. Therefore, it is advisable to notify each franchisee individually to avoid committing an infringement.

### **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?**

Mis-selling from the franchisor would lead to the annulment of the contract and the payment of damages stemming from such conduct.

A disclaimer against liability from a mis-sale would be null given that Article 1822 of the Federal Civil Code states that it is not permissible to waive, for the future, the nullity resulting from fraud or coercion.

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

Yes, it would be legal, however, a non-negotiable agreement could be deemed as a "*contrato de adhesión*" governed by the Federal Law for Consumer Protection (FLCP) and thus would have to be written in Spanish, with characters easily readable at first glance and in a uniform size and typeface. Moreover, it may not entail disproportionate obligations on the part of franchisees, inequitable or abusive duties (Art. 85 FLCP).

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

Registered trademarks are protected by the rights set forth in the LFPPI and in international treaties, the owner must obtain a registration before the Mexican Institute of Industrial Property. Such registration grants the owner exclusive rights over the trademark. Know-how and trade secrets are protected through confidentiality agreements, they can also be safeguarded with regulations on trade secrets. Regarding copyrights, original works fixed in some material medium gain automatic protection of the Federal Copyright Law. However, it is advisable to register the work before the Copyrights Office (INDAUTOR). For all these rights, mechanisms exist to claim damages and losses, with possible administrative and even criminal infringements depending on the misconduct.

### **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, within the LFPPI there are various provisions regarding the relationship between franchisor and franchisee. For matters not foreseen in this regulation, the parties must observe the general rules for contracts provided in the Commercial Code (Código de Comercio) and the Federal Civil Code (Código Civil Federal).

The minimum requirements of a franchise agreement are:

- a. Be in writing.
- b. The geographical area where the franchisee will carry out the activities.
- c. Location, minimum size, and characteristics of the infrastructure of the establishment in which the activities subject to the contract will

- be carried out.
- d. Policies on inventories, marketing, and advertising, provisions regarding the supply of goods and contracting with suppliers.
- e. Policies, procedures, and timelines related to reimbursements, financing, and other considerations to be made by the parties under the terms agreed upon in the contract.
- f. The criteria and methods applicable to determining the profit margins or commissions of the franchisees.
- g. Features of the technical and operational training of the franchisee's staff, as well as the method or manner in which the franchisor will provide technical assistance.
- h. Criteria, methods, and procedures for supervision, information, evaluation, and performance rating, as well as the quality of services provided by the franchisor and franchisee.
- i. Terms and conditions for sub-franchising, if agreed upon by the parties.
- j. Reasons for the termination of the franchise contract.
- k. The scenarios under which the terms or conditions related to the franchise contract may be reviewed and, if necessary, modified by mutual agreement.

**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.**

Yes, the Federal Economic Competition Law applies to certain franchise transactions, especially when the franchisor is considered to have substantial power in the given relevant market.

Anticompetitive practices are any act, contract, or agreement carried out by one or more Economic Agents who individually or jointly have substantial power in the same relevant market in which the practice takes place.

The impact of the Federal Economic Competition Law varies heavily depending on the characteristics of each case, for instance, this law can impact franchises in terms of setting maximum prices, as the legislation in Article 9 states that the Ministry of Economy is authorized to establish maximum prices for specific goods and services determined by the Federal Executive,

thus affecting franchises whose products or services fall within those categories subject to price ceilings set by the Executive.

**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?**

Non-compete and non-solicitation clauses lack precise regulation in Mexico, which can lead to ambiguity in their understanding and application. Article 5 of the Political Constitution of the United Mexican States establishes that no person can be prevented from engaging in any lawful profession, industry, trade, or work. Therefore, such clauses can represent a restriction on the rights of the franchisee.

However, the Federal Economic Competition Commission has established in its Guide for the Notification of Concentrations that non-compete and non-solicitation clauses may be valid but must justify their implementation as long as there is little likelihood of affecting competition and free competition between the parties. These clauses should be analyzed in four main dimensions:

**Obligated parties:** When the obligated parties are the seller and the companies that are part of the economic interest group to which the seller belongs.

**Product or service coverage:** When it is limited to the products and/or services offered through the subject business.

**Duration:** When the duration extends up to three years after the transaction's closure, and this duration is justified.

**Geographic coverage:** It will be considered that the clauses are unlikely to affect competition and free competition when they cover the territory served by the company or when they include regions where the subject business of the transaction is in an advanced expansion phase.

Based on this analysis, we can conclude that non-compete and non-solicitation clauses can be valid as long as they adhere to the points described above and their application does not constitute a significant detriment to competition and free competition between the parties.

## 12. Is there an obligation (express or implied) to deal in good faith in franchise relationships?

Yes, the parties have an obligation to act in good faith, primarily in pre-contractual negotiations where the franchisor has the obligation to disclose information about the status of its company to the franchisee. Regarding the contract, the parties have an obligation to act in good faith, as Article 1816 of the Federal Civil Code states that fraud or bad faith on the part of one of the parties will nullify the contract if it has been a determining cause of that legal act.

## 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?

Yes, in Mexico there is a substantial risk that the franchisee's employees are considered employees of the franchisor if the franchisor benefits from their work, as Article 10 of the Federal Labor Law establishes that the employer is the individual or legal entity that uses the services of one or more workers. Additionally, if the worker, according to the agreement or custom, provide services that benefit the franchisor directly it would be deemed to be an employee of the later.

One measure to mitigate the risk that the parties can take is to include a clause in the franchise agreement regarding labor relations, stipulating that the franchisor has no employment relationship with the franchisee's employees and that the franchisee will assume any costs associated with the defense of any labor dispute concerning the employees of the franchisee.

## 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?

While there may be similarities between the franchisee and the commercial agent, it is essential to consider the distinct legal nature underlying the obligations of each. While the agency contract focuses on an intermediary acting on behalf of another to carry out transactions, the franchise encompasses the granting of exclusive rights that enable the management of a business under a brand, as well as the license to use it, which represents a completely distinctive feature of this contract.

Therefore, it is advisable that the franchise agreement be recorded before the IMPI, complying with all the requirements and formalities stipulated by the LFPPI, as well as its Regulations. This way, legal certainty is provided to the parties, and the potential risk that may exist is minimized.

## 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?

Yes, Mexico, as a member of the Organization for Economic Cooperation and Development (OECD), has adopted international guidelines on transfer pricing in its tax legislation. These guidelines include the "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations," commonly known as Transfer Pricing Guidelines. They are designed to ensure that transactions between related parties adhere to reality and are not merely speculative or internal agreements aimed at obtaining tax benefits.

According to the OECD, related parties arise when one or more individuals participate directly or indirectly in the management, control, or capital of others.

Transfer pricing refers to the price that two associated companies agree upon to transfer goods, services, or rights between them. It becomes relevant in the tax context when the entities setting the price have ownership or management ties, as is the case within a franchise. The purpose of this concept is to prevent profits or losses generated in one country from being shifted to another through chargeable transactions, such as interest, dividends, and/or royalties, with the aim of minimizing the tax burden by transferring it to another region.

Article 8 of the Monetary Law of Mexico, states that obligations of payment in foreign currency incurred either inside or outside the Republic, to be fulfilled in Mexico, will be settled by delivering the equivalent in national currency at the exchange rate prevailing in the place and on the date the payment is made. The exchange rate will be established by the Bank of Mexico.

## 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 possible to impose contractual sanctions on franchisees as long as the agreed penalty does not exceed the amount stipulated as the main consideration under the agreement, e.g., it must not exceed the total franchise fees to be paid by the franchisee.

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

In Mexico, there are several tax provisions regulating both individuals and legal entities. Below are some considerations that a franchisor and franchisee should take into account when entering into a franchise agreement:

#### **Value Added Tax (VAT) Law:**

Both individuals and legal entities are obliged to pay the Value Added Tax when they carry out acts or activities such as the sale of goods, provision of independent services, granting the use or temporary enjoyment of goods, and the importation of goods or services. Therefore, franchise parties are generally obliged to pay this tax since franchises typically involve the sale of goods or provision of services.

To calculate this tax, a rate of 16% is applied to the values described within this law, and this tax is then passed on to the individuals who acquire the goods or receive the services from the franchisee.

#### **Income Tax Law:**

Income tax is calculated by applying a rate of 30% to the fiscal result obtained in the fiscal year.

Additionally, a tax regime is established for individuals who receive dividends and, in general, for profits distributed by legal entities. In the case of franchises, this regime applies, which means that individuals must include income from dividends or profits with their other income. As a result, they must pay an additional tax of 10% on the dividend amount. This tax is withheld by the company making the dividend payment and is considered a final payment.

Regarding the franchisee as an individual, it is important to note that when it comes to income from royalties for the use or temporary enjoyment of trademarks and trade names, as well as for advertising, the applicable rate for

the income obtained by the taxpayer will be the maximum rate on the excess over the lower limit contained in Article 152 of the Income Tax Law.

As for the franchisee as a legal entity, it should be emphasized that the accrual system applies to legal entities, whereby they must declare and accrue income even if it has not been received physically, as legal entities are presumed to have a greater economic capacity to meet such obligations.

### **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?**

Currently, there are several laws that contain chapters on the digitalization of commercial processes. These provisions can be found in legislations such as the Commercial Code, the Federal Civil Code, the Federal Code of Civil Procedures, the Federal Consumer Protection Law, and the Advanced Electronic Signature Law.

With the aim of providing clear guidelines for the execution of e-commerce in the country, the Mexican Standard NMX-COE-001-SCFI-2018 was published in the Official Gazette of the Federation in 2019. This regulation sets out requirements that must be met by individuals or legal entities engaged in the marketing and sale of products or services through e-commerce. Its primary focus is on security and the protection of consumer data.

It is likely that the franchisor and franchisee, through the contractual freedom provided by the franchise agreement, can establish certain restrictions within the franchise in relation to e-commerce. However, in accordance with the Federal Economic Competition Law, which seeks to protect and guarantee free competition and economic competition, as well as prevent restrictions on the efficient functioning of markets, it is essential not to irrationally and wholly prohibit the implementation of e-commerce, as this could result in anti-competitive behavior.

### **19. What are the applicable data protection laws and do they have any specific implications for the franchisor/franchisee relationship? Does this have any specific implications in the franchising**

**context? 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?**

The applicable law regarding data protection is the Federal Law on the Protection of Personal Data Held by Private Parties. This law does have implications for the relationship between the franchisor and franchisee since, before and during the execution of contracts, the parties will transfer personal data, which will be protected through privacy notices (aviso de privacidad) regulated by the aforementioned law.

The franchisee can restrict the transfer of rights and obligations of the franchise in the contract. Also, the LFPPI specifically regulates in Article 248 the obligation of the franchisee to maintain confidentiality about the information they have come to obtained and which is owned by the franchisor, both during the term of the contract and after its termination.

**20. 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 if it terminates or expires, is the franchisee entitled to compensation? If so, under what circumstances and how is the compensation payment calculated?**

The franchisee has the right to request the renewal of the contract, but it will only be obligatory for the franchisor to grant it when this right has been stipulated in the franchise agreement.

The franchisee does not have a right for compensation if the contract is not renewed or expires; however it may claim compensation for damages when the agreement was terminated for causes attributable to the franchisor, the compensation will be calculated according to the damages and losses of profit that the franchisee can prove in Court.

**21. 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?**

Neither the franchisor nor the franchisee can unilaterally terminate the contract, except in cases, such as when the

contract has been agreed upon for an indefinite period or when there is a "fair cause" to do so. Both parties must adhere to what has been agreed upon regarding the reasons and procedures for the early termination of the contract.

In the event of violations by either the franchisor or the franchisee concerning the agreed-upon terms for the early termination of the contract, this will lead to the payment of contractual penalties or compensation for damages.

In addition to the above, the franchisee can sue for the nullity of the contract and claim compensation for damages caused due to contractual non-compliance, in the event that the franchisor fails to provide relevant information about the state of their company. Therefore, this right of the franchisee supersedes any contractual agreement.

There is no specific period established by law to provide advance notice (forewarning), so this must be determined in the contract. In common practice, the span to provide such notice usually ranges between 15 and 30 days.

**22. 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.**

Yes, and that is the reason why the franchise agreements must take on this kind of issues, such as the return of information on know-how or manufacturing, sales, or provision of the franchise's services procedures. It is also important for the parties to agree on the franchise's clientele, as both parties have rights in this regard. Usually non-compete and non-solicitation clauses are used to prevent the franchisee from taking advantage of the good will gained during the performance of the franchise agreement.

The Federal Law on the Protection of Personal Data Held by Private Parties regulates in Article 37 that data transfer can be carried out without the consent of the owner when it involves transfers made by companies from the same responsible group operating under the same processes and policies. Therefore, the franchisee may transfer customer data to the franchisor at the end of the contractual relationship.

**23. 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, since 1989 the Mexican Franchise Association (AMF) has served as a private entity aiming to be a representative body for franchises established in Mexico. It is not mandatory to be a member, but it is advisable to join in order to gain connections and leverage at both the national and international level with more franchisees.

Among the obligations that arise when joining this association is the duty to respect the code of ethics, which in turn outlines the minimum standards that should govern the relationships between the members and the AMF, as well as the sanctions that can result from the breach of these rules. It is also established that the Mediation Center of the Mexican Franchise Association will be the instance for addressing and resolving disputes in the sector. However, it should be clarified that this Center is an alternative dispute resolution mechanism aiming for the judicial instance to be the last resort to be used.

### **24. 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)?**

Article 4 of the Foreign Investment Law stipulates that foreign investment can participate in any proportion in the capital stock of Mexican companies.

The Foreign Investment Law allows foreign investment for most businesses that operate as a franchise, even allowing for the possibility of a franchisor establishing a Mexican company with 100% foreign investment. The franchisor can have Mexican subsidiaries and affiliates as its franchisees.

The economic activities in which foreigners cannot participate are set forth in Article 6 of the Foreign Investment Law. This article states that they cannot participate in activities related to national ground transportation of passengers, tourism, and cargo, excluding courier and parcel services; development banking institutions, and in providing certain professional services.

The Political Constitution of the United Mexican States, in

its Article 27, determines that foreigners may acquire assets within Mexican territory as long as they agree before the Secretary of Foreign Affairs to be considered as nationals concerning those assets and not to invoke the protection of their governments concerning the same. Failing to comply with this agreement will result in the loss of the acquired assets to the benefit of the Nation.

Moreover, foreigners may not acquire assets in a strip of one hundred kilometers along the borders and fifty kilometers along the coastlines. However, Article 10 of the Foreign Investment Law states that companies whose bylaws include the agreement referred to in constitutional Article 27 can acquire assets in the restricted zone as long as the property is intended for non-residential activities, and they must notify the Secretary of Foreign Affairs (SRE).

### **25. Must the franchise agreement be governed by local law?**

The franchise agreement may be governed by a foreign law and jurisdiction; however, the contract must also comply with the provisions set out in the LFPPI. This is because these provisions are non-waivable due to the law being of public order and social interest.

### **26. 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?**

The parties can resort to the judicial route through an ordinary commercial trial, which is regulated by the Commercial Code. However, Article 1051 of the Commercial Code states that the preferred commercial procedure is the one freely agreed upon by the parties, which could be a conventional procedure before Courts or an arbitration procedure. Moreover, Article 1424 of the same code stipulates that arbitration will prevail over the procedure carried out before Courts when an arbitration clause is included in the contract.

International arbitration or mediation offer advantages for resolving disputes related to the franchise contract, as they are confidential, fast, and there are some institutions with extensive experience that provide higher quality resolutions.

### **27. Must the franchise agreement and disclosure**



### documents be in the local language?

No, however, for the franchise contract to be effective against third parties, it must be recorded before the IMPI (Mexican Institute of Industrial Property). To do this, if the contract in question is written in a foreign language, it must be accompanied by its respective translation (Article 13 LFPI). It is also advisable for the contract to be in Spanish so that neither party can claim that there was an error or difference in interpretation regarding its content.

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

Yes, it is possible to sign the franchise agreement using an electronic signature, as based on Article 89 of the

Commercial Code, the electronic signature has the same legal effects as a handwritten signature and is admissible as evidence in a trial.

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

Some recent trends have emerged that could impact the franchise sector, such as nearshoring. Through this phenomenon, companies outsource business activities to suppliers in geographically nearby countries, aiming to externalize some of their operations in order to improve efficiency, reduce costs, and take advantage of the benefits offered by the countries where it is carried out, this could increase the number of franchise agreements and foreign investment in Mexico.

## Contributors

**Oliver Galindo**  
Partner

ogalindo@rgl.mx



**Gael Cruz**  
Court Clerk

gcruz@rgl.mx



**Sinuhe Garcia**  
Court Clerk

sgarcia@rgl.mx

