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**NEW APPROACHES AND CHALLENGES IN INTERNATIONAL FRANCHISING**

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**RECENT DEVELOPMENTS IN MEXICAN LAW THAT MAY AFFECT FRANCHISING**

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## Recent Developments in Mexican Law that May Affect Franchising

Franchising in Mexico is essentially regulated by the Industrial Property Law, its Regulations, the Commerce Code and the Federal Civil Code. Not since the 2006 amendment to certain legal provisions regulating Franchising in the Industrial Property Law, has there been a significant franchising-related development in México.\*

This year, however, there are two developments worth discussing.

First, a new Federal Law for the Protection of Personal Data in Possession of Private Persons (*Ley Federal de Protección de Datos Personales en Posesión de los Particulares*) (the “**Law**”) was passed in Mexico and is currently in force. The Law may be relevant to franchise systems in Mexico, since the scope of the Law consists in protecting all kinds of personal data processed by companies and it requires implementing diverse measures that will impact their operation, structure and risk administration.

Second, there is a recent landmark case in the enforcement of confidentiality and non-competition clauses in México. This case is important due the low number of judicial decisions related to franchise agreements in Mexico.

### **1. Federal Law for the Protection of Personal Data in Possession of Private Persons.**

The Federal Law for the Protection of Personal Data in Possession of Private Persons has been in force since July 6, 2010. The Law is considered a public order law; therefore, it is mandatory for private persons and entities doing business or carrying out activities in Mexico.

The main objective of the Law, as stated in Article 1, is to protect personal data that can be possessed by private parties in order to regulate the rightful, controlled and informed use of such data, so privacy and self-determination of people in relation to their private information can be guaranteed.

#### **1.1 Law Analysis**

##### **(i) *Applicability and Scope***

- ***Protected Information***

The Law protects all personal data (“**Personal Data**”), which is defined as all information related to an identified or identifiable individual (the “**Proprietor**”).

The Law differentiates between Personal Data and sensitive personal data (“**Sensitive Personal Data**”), stating that the latter is the personal data that affects Proprietor’s most personal sphere or such information that, if not used properly, could lead to discrimination or could entail a serious risk to the Proprietor. Sensitive Personal Data includes particularly the information that can reveal racial or ethnic origin, present or future health status, genetics, religion, philosophic and moral beliefs, union membership, political opinions and sexual preference.

- **Regulated Subjects**

As stated in Article 2 of the Law, the regulated subjects are private individuals or entities that handle Personal Data (the “**Responsible Party**”). “Handling” or “treating” as defined by the Law, includes obtaining, using, revealing or storing Personal Data through any means available.

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The exempted subjects are credit information companies (credit bureau), as regulated in the applicable legislation, as well as persons who collect and store Personal Data for personal use, with non-disclosure and non-commercial intentions.

(ii) ***Regulated Subjects' Obligations***

The Responsible Party responsible for handling Personal Data must abide by the principles of legality, consent, information, purpose, loyalty, proportionality and responsibility. Those principles are the foundation of the Law's main obligations which are described hereinafter.

• **Acquisition and Handling of Personal Data**

Personal Data should be acquired and handled in a lawful manner, without employing fraudulent or deceitful methods. There is a presumption of privacy, a presumption that Personal Data will be handled as agreed by the parties involved, that is, according to the Proprietor's consent and the terms established in the Law.

The Responsible Party needs to take all necessary actions to make sure the mentioned principles are abided, even if a third party handles Personal Data under the Responsible Party's request. Those actions include, establishing and keeping security, administrative, technical and physical measures that allow the protection the Personal Data from any harm, loss, alteration, destruction or non-authorized handling. Those security measures should be no less than the ones the Responsible Party exercises for its own information and should be established according to the risk related to such information, its sensitivity and the technological advancements.

Personal Data must be treated as confidential at all times, even after the relationship between the Proprietor and the Responsible Party ends.

• **Proprietor's Consent, Privacy Notice, and other Proprietor's Rights**

All information treatment is subject to Proprietor's consent. Consent can be granted verbally, in writing, electronically or through any technology available. It can be explicit, through the means stated above, or implied, if Proprietor has access to a Privacy Notice, as explained hereinafter, and no opposition is expressed. Financial information or any other related to a person's patrimony shall require explicit consent; meanwhile, Sensitive Personal Data shall require explicit and written consent, through handwritten or digital signature. No Sensitive Personal Data databases can be created without a reasonable justification.

Exceptions for the foregoing are few; the most relevant are disassociation of the information and information that is publicly available.

A Privacy Notice shall be made available to Proprietors, to let them know what the purpose for acquiring the Personal Data is. It should include the following:

- Identity and address of the Responsible Party;
- Purpose for handling the Personal Data;
- The option and means made available by the Responsible Party to limit the use or disclosure of Personal Information;
- The means available to access, rectify, cancel or oppose the use of Personal Data by the Responsible Party, and revoke Proprietor's consent;
- If the information will be transferred and to whom;
- The procedure and means that will be used by the Responsible Party to inform Proprietors of changes in the Privacy Notice; and

- If the information to be acquired is Sensible Personal Data, if applicable.

The Privacy Notice shall be provided:

- If Personal Data is acquired directly from the Proprietor, when the Proprietor provides such information;
- If the data is acquired through electronic means, the Responsible Party shall provide, at least, the information established in points 1 and 2 of the preceding paragraph when the Proprietor provides such information so the Proprietor can have access to the complete Privacy Notice text.

The Responsible Party has to make sure that the Privacy Notice is respected at all times, by him or any related third parties.

The Law establishes that Proprietors have the right to revoke their consent, and access, rectify, cancel or oppose the use of Personal Data in possession of the Responsible Party. Responsible Parties shall establish a person or a personal data department who will process such requests.

- **Use and Transfer of the Information**

Responsible Parties shall handle and use Personal Data solely for the purpose stated in the Privacy Notice; if the Responsible Party desires to use Personal Data for other purpose that is not comparable or similar, new consent is needed from the Proprietor. When the Personal Data is no longer useful for such purpose stated in the Privacy Notice, Personal Data must be cancelled (deleted).

The purpose stated in the Privacy Notice shall direct how the Personal Data should be handled and, if a database is created from such information, what Personal Data should be included.

The Privacy Notice shall state if the Responsible Party intends to transfer the Personal Data to national or foreign third parties and the use that the latter shall give to them. Furthermore, the Privacy Notice shall state that even if the Proprietor does not accept Personal Data transfers, the third party that receives such information shall assume the same obligations that the Responsible Party. The Law does not state the consequences if Proprietor does not accept Personal Data transfers.

There are some exceptions to the foregoing rule, being the most relevant that no consent is needed for transfers to holding companies, affiliates and subsidiaries or any other company of the Responsible Party that operates under the same processes and policies.

(iii) **Surveillance**

- **Authorities**

The Federal Information Access and Data Protection Institute (*Instituto Federal de Acceso a la Información y Protección de Datos*) (the “**Institute**”) is the authority responsible for supervising the fulfillment of the obligations established in the Law, its main attribution is to supervise and verify the Law’s compliance, in which case the Institute shall have access to any information or documentation considered as necessary. Such supervision can be made *ex parte* or *ex officio*.

The Law gives the Ministry of Economy (*Secretaría de Economía*) the faculty to issue normative guidelines, administrative provisions and other parameters necessary for the application and fulfillment of the Law.

- **Sanctions**

Sanctions for infringements to the Law range from mere fulfillment requirements from the Institute, to fines from approximately the equivalent to US\$500 (Five Hundred Dollars Currency of the United States of America) to US\$3,000,000 (Three Million Dollars Currency of the United States of America), depending on the type of infringement and if it is a recurring infringement to the Law. Furthermore, the economic fines will be imposed without prejudice to any civil or criminal liabilities that may derive from such infringement.

Moreover, imprisonment from three months to five years can be imposed if a Responsible Party, looking for profit, causes a security breach in its Personal Data database or if someone, through deception, acquires or handles Personal Data for such reason. These sanctions will double for Sensible Personal Data.

## **1.2 Conclusions**

### **(i) *Applicability Issues***

- **Applicable Regulations**

According to the Law, the Federal Executive Branch has one year from the date the Law came into force to issue the corresponding regulations.

This creates a significant problem for the Law's application, since there are many pending issues which need to be solved. For example, the Law states that the regulations will specify the form and terms for the procedure of protection of the rights established in the Law, the surveillance procedure by the Institute and the procedure to impose sanctions. Without this, the Law is basically inapplicable.

Moreover, the surveillance procedure and the Institute's power under the Law are very vague. It is expected (hopefully) that the applicable regulations to the Law will provide the necessary details and specifications to avoid arbitrary verifications and acts by the authority.

- **Extraterritoriality**

The Law states that it is applicable in all the Mexican Republic. Taking into consideration the technology available today, international data transfer is not only possible but probable, and Personal Data transfers in Mexico may involve individuals and equipment located in other jurisdictions. The Law even addresses partially this issue, stating that the Privacy Notice should state if the Responsible Party has the intention to transfer Personal Data to national or international third parties. The application of the Law beyond the Mexican territory seems unlikely, since it could be almost impossible for the Institute to determine those cases where foreign entities in effect acquire Personal Data in Mexico and are subject to the Law.

### **(ii) *Application in Franchising and Suggested Actions***

In our opinion, the Law could be especially relevant to the hotel franchising industry and any other franchise systems handling loyalty programs. Treatment of the information acquired and maintained in Mexico under such programs should comply with the Law; particularly, consent should be obtained and the Privacy Notice should be made available to its members.

Consequently, certain measures must be implemented, as a first step to start complying with the Law:

- **Consent**

The Law establishes a vast number of options to obtain Proprietor's consent. Unless otherwise stated in the applicable regulations to be issued, the most common procedure to obtain consent of the Proprietor is by through the method known as "click to accept", which, in principle, should be enough to comply with the Law.

Responsible Parties should provide clear and comprehensive procedures that allow Proprietors to access, rectify, cancel or oppose the use of their Personal Data. Furthermore, a person or a personal data department should be named as responsible for such requests.

Finally, gathering Sensitive Personal Data should be avoided, if possible, since a special consent procedure should be established for this kind of information.

- **Privacy Notice**

In regards to the Privacy Notice, the Law is very clear about its requirements. Companies who gather Personal Data in Mexico should make sure that the Privacy Notice is available to the Proprietor when he/she expresses his/her consent. It should state: who the Responsible Party is; the purpose for acquiring the information; to whom it may be transferred to; and all other requirements previously explained.

Furthermore, franchisors that have Mexican franchisees should also consider the provisions stated in the Law; especially, if the franchisor requires its franchisees to provide information regarding its costumers. The Privacy Notice should state that the acquired Personal Data may be transferred to the franchisor and the use the latter will give to such information.

Pieces of legislation such as the Law are essential to protect private information. Nevertheless, the Law's inconsistencies and its ambiguity may complicate its application and compliance, especially by the companies who already have a privacy policy.

Furthermore, the lack of regulations of the Law makes it difficult to come to a conclusion regarding its efficiency and the necessary means to fulfill its provisions. Once the regulations are issued several questions may find a specific response and, in consequence, more concrete suggestions.

For now, a Privacy Notice and consent procedure in accordance to what has been explained before should be enough to comply with the Law. Nevertheless, the regulations, when issued, will probably (and hopefully) establish clear means to fulfill the Law.

## **2. Recent landmark case on the enforcement of a non-competition clause.**

Cases and court decisions in Mexico related to non-compete obligations derived from franchise agreements are few and, as mentioned before, they are not sufficient to establish a clear precedent or criteria regarding the subject. Nevertheless, there is a recent landmark resolution in 2010 regarding the enforcement of confidentiality and non-competition clauses.

### **2.1 Background**

The franchisor, a deli and coffee chain store, accused a former franchisee of infringing the franchisor's system after the termination of the franchise agreement, as well as for violating the non-competition and confidentiality obligations established in the franchise agreement. The franchisor proved in court that the former franchisee was operating a similar, if not identical, business to its franchise through his spouse and a former employee, with a different name.

The franchisor evidenced the foregoing, mainly through an application of trademark registration by the former franchisee in the Mexican Institute of Industrial Property (*Instituto Mexicano de la Propiedad Industrial*); the trademark was used in his wife's and former employee's

new business. The Court considered that this proved that the former franchisor had a direct relationship with such business. The fact that the menu of the new business was similar to the franchise's menu and that the wife's and former employee's business was conducted in the same places the former franchisee ran the franchise restaurants strengthened the foregoing proof.

The franchisor petitioned the Court for the recognition of the foregoing obligations, required their fulfillment by the franchisee and the award of damages.

## **2.2 Court Decision**

In its decision, the Court recognized the existence of a breach of the confidentiality and the non-compete obligations, which were accepted by the franchisee on the settlement agreement executed by the parties. The former franchisee was absolved in regards to the breach of the obligation to refrain from using franchisor's trademarks, interests, titles, recipes, etc. after the termination of the franchise agreement; the Court considered that franchisor did not have sufficient proof in that regard.

The Court considered that, according to certain settlement agreement the parties executed when the franchise agreement was terminated the franchisee's confidentiality obligation consisted in:

- Not revealing, at any time and to any third party, any of franchisor's confidential information; and
- Abstaining from conserving, copying, duplicating, and recording or in any other manner reproducing, totally or partially, franchisor's manuals and/or confidential information.

The Court granted an order of specific performance of the confidentiality obligation, and sentenced the franchisee to not revealing the confidential information provided by the franchisor and such confidential information that resulted from the franchise agreements.

The Court considered that, according to the above mentioned settlement agreement, the former franchisee's non-compete obligation constrained franchisee from, among other things, participating in any business identical or similar to the one described in the franchise agreements, directly or indirectly, by means of participating in the capital stock of a company, entity, organization, association, joint-venture, trust, or in any other way. It also impeded franchisee from possessing, managing, counseling or investing in an establishment providing goods sharing similar characteristics with those of the franchise system.

The Court also granted an order of specific performance of the non-compete obligation, and sentenced the franchisee to abstain from competing with the franchisor, directly or indirectly, in a business identical or similar to the franchise. The Court considered that indirect competition should be understood as the franchisee's participation in any company or activity similar to the franchise, through any person or company related in any manner to the franchisee, including the activities of his spouse and ex-employee.

Therefore, the Court ruled that the former franchisee was liable for payment of damages in favor of the franchisor, per to the Franchise Agreements.

## **2.3 Conclusions**

Recognition of the validity and enforceability of the non-compete and confidentiality clauses in franchise agreements are essential in any jurisdiction. They provide franchisors the means to prevent infringement of their intellectual property rights and know-how by franchisees.

Although the foregoing resolution was appealed, if we consider the low number of Court decisions related to this matter, this may still be an important precedent for franchisors in Mexico, guaranteeing protection of their franchise system before judicial courts, even after the agreement is terminated.