

How Attys Can Prep Latin American Brands For US Entry

By **Marc Lieberstein** (January 25, 2023)

Attorneys representing Latin American brands in the U.S. should understand that entry into the U.S. market requires careful strategy, planning and due consideration for the variety of legal issues that arise from compliance with overlapping or conflicting U.S. federal, state and local laws.

This article will address legal, business and marketplace considerations for inbound Latin American franchise systems entering the U.S. in 2023, and the numerous issues U.S. attorneys should be prepared to address.



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The Franchise Structure

Although the master franchise structure prevails outside the U.S. and allows for the nonlocal franchise brand owner to enlist a local company to operate and sell franchises, there are several other franchise relationship structures that a Latin American franchisor can consider for the U.S., namely:

- Direct-owned units;
- Joint venture;
- Multi-unit development; or
- Unit-by-unit.

U.S. attorneys should be mindful that master franchising is rare in the U.S. because it usually involves a dual regulatory requirement.

This means the master franchisor and master franchisee must each have separate franchise disclosure documents, and the master franchisor relationship usually provides the master franchisor significantly less control over the master franchisee-sub franchisee relationship.

Fast-Growing Hispanic Population Affects U.S. Franchise Marketplace

U.S. attorneys should have a good understanding of the franchise marketplace in the U.S. Latin American brands should know that the U.S. franchise marketplace is likely to welcome their business for a variety of reasons.

Franchising in the U.S. continues to grow with 792,014 franchise establishments, \$827 billion in economic output and supporting 8.5 million jobs, according to the International Franchise Association's 2022 report.

The largest segment of the franchising industry is quick-service restaurants, comprising over \$276 billion of the industry's total economic output, followed by business services with around \$100 billion.

Rounding out the top five categories are franchises in full-service restaurants, real estate, and commercial and residential services.

And most relevant to Latin American brands is that the U.S. Hispanic population reached

62.1 million in 2020, an increase of 23% over the previous decade, which outpaced the nation's 7% overall population growth, according to Statista. By 2030 the U.S. Hispanic population is expected to hit over 74 million people.[1]

And several top states for franchising — such as Texas, Florida, Arizona, South Carolina, Tennessee, North Carolina and Nevada — are in the easier-to-reach southern states in the U.S., where the Hispanic populations are also on the rise.[2]

Business Considerations Before Entering the U.S. Market

On the business side, U.S. attorneys should counsel their Latin American franchise clients to consider taking several steps in the U.S. before expansion, namely:

- Begin the process to register trademarks and to secure protection for other intellectual property and register relevant domain names;
- Conduct market studies and perhaps test the marketplace with pop-ups or attendance at trade shows; and
- Consider prototype development of products/services that may fit better for the U.S. marketplace.

Indeed, Latin American franchisors should consider a joint venture with a U.S. partner to assist in such development in the U.S. so they can take advantage of the local U.S. partner's experience and knowledge.

Latin American franchisors should also investigate what their U.S. competitors are doing with their quality control processes, franchisee fees and royalty rates.

They should also look into how they address operational matters like product and supply chain issues, training employees, and providing franchisee support.

Taking these steps, among others, before entry to the U.S. marketplace should educate the Latin American franchisor and facilitate success after entering the U.S. franchise community.

The U.S. Dual-Regulatory Franchise Scheme

U.S. franchise laws and regulations vary from those outside the U.S.

There is a federal franchise law that governs all the U.S. and mandates a franchise disclosure document, but no filing or registration requirement. And there are state franchise laws, of which 14 states require that the franchisor comply with state disclosure and registration requirements.

There are also 25 states with business relationship statutes that may have additional state filing or notice requirements, especially if the Latin American franchisor does not own a U.S. trademark registration, federal or state.

U.S. attorneys should be especially aware of federal and state laws that may each allow for Latin American franchisor exemptions from their respective disclosure requirements and, in

some states, the mandated registration requirements. For example, there are exemptions for:

- Large franchisees who meet a minimum net worth level;
- Large transactions that meet a minimum dollar threshold;
- Isolated franchise sales in a state, e.g., less than two franchises in New York; and
- Fractional franchise sales where a prospective franchisee has a minimum level of experience in the same type of business as the franchisor and the new business will account for less than a certain percentage of the prospective franchisee's first year of gross sales.

If Latin American franchisors can enter the U.S. market under any of these exemptions, they could save significant fees and costs associated with preparation of a franchise disclosure document and state registration compliance.

The Importance of Intellectual Property Protection in the U.S.

From the start, and if possible, well before the Latin American franchisor comes to the U.S., it is crucial to first select, clear and take steps to register for a strong trademark to serve as the franchise brand to distinguish the Latin American franchise from U.S. competitors.

This also gives U.S. consumers a way to remember and recognize the franchise.

U.S. attorneys should first recommend a comprehensive clearance search for the selected franchise mark to ensure that it can be safely adopted, used, and registered in the U.S.

And before the Latin American franchisor heavily invests in its franchise brand in the U.S. — a large marketplace hosting many different cultures, languages and customs — the Latin American franchise owner should be counseled to take the time to consult with marketing/industry professionals to make sure the franchise and brand fit in the marketplace.

Once selected and cleared, immediate steps should be taken to register the trademark in the U.S. Patent and Trademark Office.

U.S. attorneys would be remiss if they ignored the other forms of intellectual property protection that Latin American franchises can seek in the U.S. that may not be available in their own countries. These include copyrights, trade secrets and patents.

In the U.S., copyright protects any form of original expression found in many franchise assets such as menus, advertising, graphic design, photos, architectural designs, software applications, operations annuals and training materials.

Although registration of a work is not required for copyright protection in the U.S., a lawsuit for copyright infringement cannot be filed without first obtaining a copyright registration from the U.S. Copyright Office.

If timely filed within three months of the work's publication, the Latin American franchisor may be entitled to seek statutory damages and attorney fees if it prevails in an infringement

action.

Trade secrets are another device for franchisors to use to protect confidential or proprietary aspects of a business that are not covered by a patent or a copyright. But to own a trade secret, a franchisor and its franchisees or employees must define the trade secrets, and maintain and keep them, and all related information, secret.

Trade secrets are not registered but can be protected under federal law and some state laws.

And although not a frequently used asset in the field of franchising, utility patents protect novel inventions for mechanical and electrical products, and processes that the franchise may develop or use.

Design patents protect the ornamental appearance of original product designs, packaging or signage used in the franchise business. Applications for any patent are filed in the USPTO.

Be advised that all material intellectual property licensed to the franchisee must be disclosed in Item 13 and Item 14 of the franchise disclosure document.

Other U.S. Laws That May Affect Franchising

U.S. attorneys should prepare Latin American franchisors for other U.S. laws that may affect operating in the U.S.

There are federal antitrust laws — the Sherman Antitrust Act and the Clayton Antitrust Act — and the Federal Trade Commission Act that regulate franchising and require fair competition, truthful advertising and render invalid any business activity that serves as a restraint on trade.

For example, recently no poaching, nonsolicitation provisions found in many franchise agreements to prevent one franchisee from taking employees from another franchisee are now considered illegal.

And on Jan. 5, the Federal Trade Commission proposed a new rule that could affect franchisor and franchisee entities and their respective employee relationships.

The FTC noted in its proposal that noncompete clauses between franchisors and franchisees would remain subject to federal antitrust law as well as other applicable law.[3]

Many states have franchise relationship laws, as well as state unfair competition acts and state antitrust laws, and laws that regulate pricing, noncompetition and nonsolicitation arrangements.

Other federal and state laws governing employment and labor relationships and privacy and data security also need to be assessed before the Latin American franchisor can determine how to structure the franchise to operate in compliance with such U.S. laws.

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[1] See <https://www.statista.com/topics/5048/franchising-in-the-us/#dossierKeyfigures>.

[2] See <https://www.thefranchiseking.com/best-states-start-franchise-2022>.

[3] See proposed FTC rule at Non-Compete Clause Rulemaking | Federal Trade Commission (ftc.gov).