Insights: Perspectives

5 Key Takeaways | Franchising in the USA: Challenges for Latin American Brands

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5 KEY TAKEAWAYS

Franchising in the USA: Challenges for Latin American Brands

On December 6, 2022, at the Asociacion Interamericana de law Propiedad Intelectual (Inter-American Association of Intellectual Property (ASIPI)) 23rd Work Sessions and Administrative Council meeting in Medellin, Colombia, Marc A. Lieberstein, Partner at Kilpatrick Townsend LLP spoke with Emiliano Jocker, Senior Consultant at iFranchise Group to present *Franchising in the U.S.A.: Challenges for Latin American Brands*.

Latin American brands often consider the United States as a vast challenging marketplace to enter, with its distinctly different and complex federal and state franchise laws and regulations, as well as its variety of available forms of intellectual property. Marc and Emiliano addressed the legal, business and marketplace considerations for in-bound Latin American franchisors looking to come to the U.S.

Here are five takeaways from their discussion:

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Latin American brands should know that the U.S. franchise marketplace is likely to welcome their business. Franchising in the U.S. continues to grow with 792,014 franchise establishments; $827 billion in economic output; and supporting 8.5 million jobs. The largest segment of the franchising industry is quick-service restaurants, comprising over $276 billion of the industry's total economic output. This is followed by business services with around $100 billion. 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. By 2030 this population is expected to hit over 74 million people. And several of the top states for franchising are in the easier to reach southern states in the U.S., e.g., Texas, Florida, Arizona, South Carolina, Tennessee, North Carolina, and Nevada, where the Hispanic populations are also on the rise.

U.S. franchise laws and regulations vary from those outside the U.S., but with assistance from a U.S. franchise attorney and a business consultant they can be navigated to enter the U.S. marketplace. There is a federal franchise law that governs all the United States and mandates a franchise disclosure document (FDD), 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. In addition, there are 25 states with business relationship statutes that may have additional state filing/ notice requirements, especially if you do not own a trademark registration (federal or state). Federal and state laws each allow for exemptions from their respective disclosure requirements and, in some states, the mandated registration requirements. The exemptions vary, but there are exemptions for large franchisees who meet a minimum net worth level; large transactions that meet a minimum dollar threshold; isolated franchise sales (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.

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On the business side, successful franchisors should take several steps in the U.S. before

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expansion, namely: register your trademarks and other intellectual property and secure relevant domain names; conduct market studies and perhaps test the marketplace with pop ups or attendance at trade shows; consider prototype development of products/ services that may fit better for the U.S. marketplace. Indeed, consider a joint venture with a U.S. partner to assist in such development. Latin American franchisors should also investigate what their U.S. competitors are doing with their quality control processes, franchisee fees and royalty rates; addressing 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 allow it to succeed more easily after entering the franchise community.

Regarding trademarks, it is crucial to first select a strong trademark to serve as the franchise brand so you can distinguish your franchise from your competitors and give consumers a way to remember and recognize you. Prior to operating your franchise in the U.S., one should clear their selected franchise mark to make sure that it can be safely adopted, used, and registered in the U.S. Words, names, logos, music, sounds, smells, characters, packaging, and trade dress make up several trademark forms available for protection in the U.S. But before you heavily invest in your franchise brand in the U.S.—a large marketplace hosting many different cultures, languages, and customs—take the time to consult with marketing/industry professionals to make sure your franchise and brand fit in the marketplace; consider opening pop-up stores to test the market and consumers for acceptance of your brand, product, or service. Once selected and cleared, a trademark(s) should be registered in the United State Patent and Trademark Office (USPTO).

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Trademarks are a crucial franchise asset. But franchisors would be remiss if they ignored their prospective copyrights, trade secrets and patents. 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. While registration is not required for copyright protection in the U.S., if you want to bring lawsuit for copyright infringement, you must first file for and obtain a copyright registration from the U.S. Copyright Office. If you timely file for a copyright within three months of its publication, you are entitled to seek statutory damages and attorney fees if you prevail in your infringement action. Trade secrets are another device for franchisors to use to protect much of which is covered by a patent or a copyright—but to own a trade secret a franchisor, and its franchisees/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 in some state laws. While not a frequently used asset, patents protect novel inventions for mechanical and electrical products and processes that your franchise may develop or use; and design patents protect the ornamental appearance of original product designs or packaging/signage used in your franchise business. Applications for any patent are filed in the USPTO. Be advised that all intellectual property licensed to the franchisee must be disclosed in Item 13 and Item 14 of the FDD.

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