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5 KEY TAKEAWAYS

Takeaways from Coming to America: So You Think Your Franchise Is Ready for the U.S. Market?

On November 3-4, 2022, at the American Bar Association's 45th Annual Forum on Franchising, Marc A. Lieberstein, Partner at Kilpatrick Townsend, and Lee Plave, Partner at Plave Koch PLC, presented Coming To America: So You Think Your Franchise Is Ready For The U.S. Market? The United States is often looked at as a target marketplace for non-US franchisors. But the vast US marketplace can be a challenge to enter, with its distinctly different federal and state franchise laws and regulations, as well as its variety of available forms of intellectual property. Marc and Lee addressed the legal, business and marketplace considerations for in-bound franchisors looking to come to the U.S., along with the numerous issues U.S. lawyers should be prepared to address. Here are some takeaways from their discussion:

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Unlike the master franchise structure that prevails outside the U.S., there are several alternative franchise relationship structures that franchisor's use in the U.S., namely:

(a) direct-owned units;
(b) joint venture;
(c) multi-unit development; and,
(d) unit-by-unit.

Master franchising is rare in the U.S. because it usually involves dual regulatory requirements, i.e., both master franchisor and master franchisee must each have separate franchise disclosure documents (FDD), and the master franchisor relationship usually provides the master franchisor significantly less control over the master franchisee-sub franchisee relationship.

U.S. franchise laws and regulations vary from those outside the U.S. There is a federal franchise law that governs all of 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 (subject to nuances in state law as well as the possibility of filing requirements in some cases) for large franchisees that 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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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 of 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).

Trademarks are a crucial franchise asset. But franchisors would be remiss if they ignored their 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 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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Outside of intellectual property, franchisors should be prepared for other laws that may impact their business in the U.S. There are federal laws like antitrust laws (Sherman Act/ Clayton Act), and the Federal Trade Commission Act that regulate and require fair competition/truthful advertising and render invalid any business activity that serves as a restraint on trade. Many states have franchise relationship laws, as well as state unfair competition acts and state antitrust laws, as well as laws that regulate pricing, non-competition, and non-solicitation arrangements. Other federal and state laws governing employment/labor relationships and privacy/data security also need to be assessed so you can structure your franchise to operate in compliance with such laws.

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