

**American Bar Association  
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**COMING TO AMERICA: SO YOU THINK YOUR FRANCHISE IS  
READY FOR THE U.S. MARKET?**

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## I. INTRODUCTION<sup>1</sup>

The United States is fortunate to have a vigorous economy, a diverse and vibrant population, and consumers that have the literal appetite to try new brands and ideas. Although the businesses quintessentially associated with American franchising are durable brands like *McDonald's*, *A&W*, *Duraclean*, *InterContinental Hotels*, *Dairy Queen*, *Carvel*, *Baskin-Robbins*, *Midas*, *KFC*, and *Holiday Inn*, the sector has been branching out rather considerably.

Notably, many of the best-known brands in the U.S. are owned, in whole or in part, by parties outside the United States. This includes the franchisors of household brand names such as *7-Eleven*, *Kumon*, *Burger King*, *Popeyes*, *H&R Block*, *Panera*, and *Einstein Bros. Bagels*. At varying times in the past years, the franchisor of *Dunkin' Donuts* and *Baskin-Robbins* was owned by Allied Domecq of the United Kingdom (primarily a spirits and wine entity) and later by Pernod Richard (the French parent of *Perrier-Jouët* champagne, *Wyborowa* vodka, and *Jameson Irish Whiskey*).

The distinction between brands that are “domestic” and “international” is blurred to the point of being inconsequential. *IKEA*, *Tim Horton's*, *H&R Block*, *Body Shop*, *InterContinental Hotels & Resorts*, *Pirtek*, *Caffe Illy*, *L'Oréal*, and *Segafredo* coffee are all successful franchised brands in the United States with their origins outside the country. This of course is in addition to iconic businesses that are not always considered to be retail franchises (but that are nonetheless), such as *Audi*, *Mercedes-Benz*, *British Petroleum* (BP), *Toyota*, *Hyundai*, and *Volvo*. (*The Volvo* brand proves the point that cross-border ownership is almost irrelevant; the classic Swedish automaker is presently owned by Geely of Hangzhou, China, which purchased the brand from Ford Motor Company of Dearborn, Michigan.)

This paper addresses some, but not all, of the key considerations that an international franchisor must consider when entering the U.S. market. These include the regulatory environment, trademark rights, antitrust laws, and other key considerations to consider and evaluate before making the jump into the American market.<sup>2</sup> This paper focuses on key issues in how a franchisor would approach expansion in the U.S., although we note that the many of the same strategic considerations also apply where a U.S. franchisor considers growth through franchising in another country, even though implementation of those plans differs on a country-by-country basis.

## II. FRANCHISE PRACTICAL CONSIDERATIONS

Having made the decision to expand into the United States, a foreign-based franchisor needs to consider various facets in order to make the leap into the American market.

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<sup>1</sup> The authors wish to thank the following people who were instrumental in providing their assistance to research and support the content in this paper: Stephanie Clemente, 2022 Summer Associate, Kilpatrick Townsend & Stockton LLP; and Amy Weber, Paralegal, Kilpatrick Townsend & Stockton LLP.

<sup>2</sup> See, e.g., Renee Bailey, *Is Your Franchise Fit for the U.S.?* FRANCHISE DIRECT <https://www.franchisedirect.com/information/is-your-franchise-fit-for-the-us> (last visited July 12, 2022); Joyce Mazero & Michael Seid, *What Foreign Franchises Coming to the U.S. Should Know*, FRANCHISING.COM (Apr. 26, 2019), [https://www.franchising.com/articles/what\\_foreign\\_franchises\\_coming\\_to\\_the\\_us\\_should\\_know.html](https://www.franchising.com/articles/what_foreign_franchises_coming_to_the_us_should_know.html).

First, what kind of a franchise expansion does the franchisor want to undertake? There are various possibilities – including unit-level franchising, multi-unit development agreements, master franchise arrangements, the area representative structure, and even joint ventures.

Second, if a franchisor has agreements that it has used outside the United States, the franchisor and its counsel may want to consider whether those forms of contract should be used or whether to start with a U.S.-based form of agreement.

Third, the legal landscape must be considered. Because there are dual layers of regulation in the United States – federal and state – an international franchisor should consider where it wishes to expand. Although some expansion is planned and strategic, there are surely situations in which there is an opportunity to grow that draw the franchisor’s attention and become the focal point for development. In this context, consideration of which laws apply, what they require, and whether there are exemptions available that might help the franchisor more efficiently explore growth – at least initially – in the U.S. market.

#### **A. Different Vehicles for Expansion**

Depending upon the type of business, capital requirements, the nature of the operator that the franchisor seeks to become a franchisee, and where the franchisor is based, there are different approaches to expansion that might be viable. Because there are costs to the franchisor of adopting any system for recruiting, servicing, and maintaining a franchise system remote from the franchisor’s location, the franchisor will need to consider which approach makes the most sense. None are cost-free and each requires the franchisor to either lay out funds (*e.g.*, hiring staff) or enter agreements to allow some revenues to be captured by parties that will provide certain services to the franchise network (*e.g.*, a master franchise or area representative).

- Unit-by-Unit franchising is at the heart of any franchise system. In some systems, the unit-level franchisee has to make a significant investment (*e.g.*, a fine dining restaurant, a hotel, or a heavily-capitalized retail business), and so a single-unit franchise is optimal, and likely preferred by the franchisor, as there are limitations to risk (*e.g.*, finding out how the franchisee operates its location, pays its bills, or handles potential capital issues). This approach may require engaging local staff and dealing directly with a unit-level franchisee in the target market on operational issues, which – while costly – may be more efficient and effective than other methods.
- Multi-unit development agreements are well-suited when a franchisor is seeking a highly-capitalized and capable operator to develop and operate a multiple number of outlets, usually in a specific area, such as a city, county, or state. Each specific unit would be operated under a unit-level franchise agreement. In this scenario, the same operational considerations that are present in the unit-by-unit approach will be present, although a strong developer will eventually accumulate the understanding of procedures to take on some of these burdens on its own.
- Master franchise agreements are used most often where there are various characteristics present. These include factors such as whether there is a significant cultural difference between the franchisor’s home market and the target market, whether the target market is so specialized that a local party with superior knowledge of the commercial circumstances is integral to success, and whether there are capable prospective master franchisees with experience and the

disposition to function in that capacity. Master franchise arrangements take on in many respects the characteristics of a multi-unit development agreement and may succeed or fail based on the viability of the master franchisee as a second-tier franchisor. A drawback to master franchising in a regulated market such as the United States is that two levels of franchise law compliance will be required: the franchisor would need to comply with franchise laws in offering the master franchise to the master franchisee, and the master franchisee, in turn, would be required to also comply with the same franchise laws when offering subfranchises.<sup>3</sup> Additionally, the franchisor is attenuated from having a direct relationship with the unit-level subfranchisee and usually enjoys no contractual privity with that subfranchisee. (In a multi-unit arrangement - whether a master franchise or a development agreement - because the U.S. is large, marked by diverse population centers, and reflecting regional tastes and preferences in many segments, care should be given to considering whether any single party could effectively take on the right and obligation to develop the entire United States market. Rather, individual contracts are most often awarded for cities, states, or regions that can be managed and developed efficaciously by a single party.)

- Area representative arrangements take on some characteristics of master franchising mixed with unit-by-unit franchising and multi-unit development. In these arrangements, the franchisor appoints an “area representative” who is charged with recruiting and providing service to the unit-level franchisees – which sign a franchise agreement directly with the franchisor. In the U.S., the same two-tiered regulatory compliance requirement that is a downside to master franchising would also apply to an area representative setup. First, the franchisor would have to comply with the regulatory requirements when offering the area agreement, and then the franchisor would still have to comply with the regulatory requirements when offering the unit-level or development agreements.<sup>4</sup> While there can be disadvantages to the area representative approach, this method does not create a formal layer between the franchisor and the unit-level franchisee. So if the area representative is not capable of performing, it is less complicated to remove the area representative than would be the case in a master franchise agreement.
- Joint ventures are characterized as agreements among parties to work together on a specific endeavor or project, for a profit. A joint venture is a contractual undertaking: Because “JVs” are creatures of the contract that create them, the status of any joint venture typically depends on the parties’ mutual intent as expressed in their agreement.<sup>5</sup> In a franchise context, the franchisor and a local

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<sup>3</sup> N. AM. SEC. ADM’R ASS’N, MULTI-UNIT COMMENTARY (2014), <https://www.nasaa.org/wp-content/uploads/2011/08/Franchise-Multi-Unit-Commentary-effective-Adopted-Sept.-16-2014.pdf> (In 2014, NASAA issued its “Multi-Unit Commentary,” which most state franchise regulators follow in connection with multi-tiered franchise offerings.).

<sup>4</sup> These regulatory requirements include compliance with the FTC Franchise Rule, 16 C.F.R. Part 436, and applicable state franchise laws, which are discussed in Section II.C. *infra*.

<sup>5</sup> *Hannah Bros. v. OSK Mktg. & Commc’ns, Inc.*, 609 F. Supp. 2d 343, 348-49 (S.D.N.Y. 2009). In *Hannah Bros.*, the court noted that there are five factors generally determine whether two or more persons have entered

(footnote continued)

entity in the target country jointly form a new entity for purposes of executing franchise development in the region. There are significant issues associated with creating, governing, and dissolving a joint venture entity that require careful and detailed examination, and which are considerably beyond the scope of this paper.<sup>6</sup>

## **B. What Agreement to Use**

For a franchisor that already has a franchise agreement in its home jurisdiction, the opportunity to simply amend that agreement to adapt it to U.S. law may provide a simple and uncomplicated way to enter the market.<sup>7</sup> Where the franchisor will be offering a franchise to a fellow countryman even though operated in the United States, and where the agreement will be governed by the law of the home country – and especially if an exemption is available from U.S. franchise laws – that approach has advantages in terms of time, cost, and familiarity.

However, where the franchisor wishes to consider expanding beyond a toe-in-the-water first foray into the United States, the home country agreement might not be the right vehicle. For example, well-drafted U.S. franchise agreements tend to be more consumer-oriented than in some other countries, easier to read, and yet, no less protective of the franchisor – precisely for the reasons that one would expect. That is, that well-drafted and understandable agreements protect the *franchise system* as much as they protect the *franchisor*. Perhaps because of the U.S. disclosure regime, as well as the intense competition among franchisors, a U.S.-format franchise agreement may be a preferable approach to rolling-out U.S. franchise expansion.

## **C. Franchise Laws**

International franchisors need to consider many factors when looking at the legal landscape in the United States. Principally, these include the various applicable laws. But how the laws apply begs the question of whether they apply in the first place. The two primary sets of laws, as explained below, are the Federal Trade Commission Franchise Rule (“FTC Franchise Rule”)<sup>8</sup> – which applies throughout the country – and the laws of the fourteen states with franchise

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into a joint venture. They are: (i) whether the putative joint venturers entered into a specific agreement to carry on an enterprise for profit; (ii) whether their agreement evidenced an intent to be joint venturers; (iii) whether each putative joint venturer made a contribution of property, financing, skill, knowledge, or effort to the alleged joint venture; (iv) whether each putative joint venturer exercised some degree of control over the venture; and (v) whether the putative joint venturers agreed to share the profits and losses of the venture.

<sup>6</sup> See also Srijoy Das, Anup Kumar & Harsahib Chadha, *A Primer on Franchising in India*, 38 FRANCHISE L.J. 607 (2019); Rose Marie Reynolds, *Good Cause for Franchise Termination: An Irreconcilable Difference Between Franchisee Fault and Franchisor Market Withdrawal?*, 1992 B.Y.U. L. REV. 785, 785 (1992).

<sup>7</sup> For example, amendments along these lines will typically involve attention to cross-border considerations (including currency, tax, and related points), U.S. antitrust concerns, choice of law and dispute resolution clauses, as well as other factors.

<sup>8</sup> 16 C.F.R. Part 436 [hereinafter “Amended FTC Rule”]. The Federal Trade Commission issued an explanation of its reasoning when considering and adopting the Amended FTC Rule in the form of a formal “Statement of Basis and Purpose.” Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities; Final Rule, 72 Fed. Reg. 15444 (Mar. 30, 2007) [hereinafter “2007 Statement of Basis and Purpose”].

laws, which are collectively the “Registration States”.<sup>9</sup> The primary requirements of these laws are disclosure (a requirement under the FTC Franchise Rule and the state franchise laws) and registration (only in the fourteen Registration States, if those laws apply at all).

## 1. Federalism

Because of the two-tiered “federalism” structure of government in the United States, some transactions may be subject to both federal and state law. Although this may seem daunting, the laws largely act in harmony and not every transaction will be subject to all of these requirements, due to: (a) the jurisdictional scope of the state laws; and (b) the possibility that there may be one or more exemptions for a transaction that can apply to a transaction so that either the federal requirements or state requirements (or both) will not actually apply.

An overall review of these laws requires consideration of the basic structure, which consist, primarily, of the following:

- Pre-Sales Laws:
  - The FTC Franchise Rule
  - State-level franchise sales laws of the Registration States
  - State-level business opportunity laws
- Post-Sale Laws:
  - State relationship laws

## 2. The FTC Franchise Rule

The FTC Franchise Rule is the primary disclosure requirement that applies throughout the United States, including all fifty states and all other U.S. jurisdictions (such as the District of Columbia, Puerto Rico, and the U.S. Virgin Islands).<sup>10</sup> The FTC Franchise Rule requires disclosure of certain details in a prescribed format, but does not require filing with the FTC or any other federal agency.

The FTC Franchise Rule had its origins in a rulemaking proceeding that began in November 1971. At that time, the FTC began the painstaking process of determining whether it was necessary to regulate the franchise sector of the U.S. economy and, if so, how.<sup>11</sup> Seven

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<sup>9</sup> See Section II.C.3. *infra* for a discussion on the Registration States.

<sup>10</sup> Amended FTC Rule, *supra* note 8.

<sup>11</sup> A concise historical summary of the rulemaking proceedings can be found in the Commission’s original 1978 Statement of Basis and Purpose, which was published in the Federal Register with the newly-issued regulation. The record of the seven-year rulemaking was voluminous, including over 30,000 pages, some from hearings held in Washington, DC, letters from consumers, materials from industry members, comments from other government agencies and academics, and material (including congressional hearings) inserted by Commission

(footnote continued)

years later, In 1978, that process culminated in the Commission's issuance of a detailed "Statement of Basis and Purpose" and the final Franchise Rule (technically, the "Trade Regulation Rule on Disclosure Requirements and Prohibitions Concerning Franchising And Business Opportunity Ventures").<sup>12</sup> The Franchise Rule was subsequently revised in various parts over time, including the issuance of a fundamentally amended regulation in 2007 (the "Amended FTC Rule").

The Federal Trade Commission issued the Amended FTC Rule in 2007 at the conclusion of a twelve-year review and rulemaking process.<sup>13</sup> The Amended FTC Rule took effect in phases over the 2007-08 period. Again, the Commission's Statement of Basis and Purpose for the Amended FTC Rule provides an excellent summary of the rulemaking proceedings as well as the detailed rationale as to why the FTC Franchise Rule was revised, the proposals that the Commission adopted, the comments that it received, and the alternatives that it chose not to adopt.<sup>14</sup>

The Amended FTC Rule also followed a period of substantial consultation between the Commission and state regulators. As a result, the FTC version of the disclosure document – known as a "Franchise Disclosure Document" or "FDD" – has become the standard approach to disclosure in the United States. All fourteen of the Registration States (those with laws requiring some form of registration and disclosure before a franchisor may offer a franchise) will accept the FDD format for pre-sale disclosure, although some of those registration states require additional disclosures and amendments.<sup>15</sup>

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staff, as well as material that the Commission obtained by compulsory process. Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. 59614 (Dec. 21, 1978).

<sup>12</sup> *Id.* The Commission published the Statement of Basis and Purpose and the text of the final rule in the Federal Register. The 1978 Statement of Basis and Purpose provides a detailed explanation of the Commission's reasoning for the provisions that it adopted at that time.

<sup>13</sup> Amended FTC Rule, *supra* note 8.

<sup>14</sup> *Id.*

<sup>15</sup> Previously, states required franchisors to provide disclosure in the "Uniform Franchise Offering Circular" format (called a "UFOC"), which had to be prepared under the North American Securities Administrators Association UFOC Guidelines. See N. AM. SEC. ADM'R ASS'N, THE UNIFORM FRANCHISE OFFERING CIRCULAR – GUIDELINES – GENERAL INSTRUCTIONS, <http://www.nasaa.org/wp-content/uploads/2011/08/14-UniformFranchiseOfferingCircular.doc> (last visited Aug. 21, 2022). The Commission specifically that the Amended FTC Rule, in part, would reduce inconsistencies between the FTC Franchise Rule and the UFOC Guidelines. 2007 Statement of Basis and Purpose, *supra* note 8, at 15540.

The FTC has been active in providing industry guidance,<sup>16</sup> conducting investigations, and enforcing the Franchise Rule.<sup>17</sup> A violation of the Franchise Rule is, derivatively, a violation of Section 5(a) of the Federal Trade Commission Act.<sup>18</sup>

To comply with the FTC Franchise Rule, a franchisor must prepare a disclosure document (an FDD), unless there is an applicable exemption. Preparing an FDD is neither complicated nor complex, but requires an experienced practitioner to prepare disclosures that are proper, appropriate, well-considered, and coordinated with the text of the relevant franchise agreement.

In addition to the disclosure requirements of the FTC Franchise Rule, there are some prohibited practices. In practical terms, the most significant of those are the rules concerning providing a financial performance representation (“FPR”), which the FTC defines as:

[A]ny oral, written, or visual representation, to a prospective franchisee, including a representation in the general media, that states, expressly or by implication, a specific level or range of actual or potential sales, income, gross profits, or net profits. The term includes a chart, table, or mathematical calculation that shows possible results based on a combination of variables.<sup>19</sup>

In effect, almost any statement concerning the operational performance of a franchise falls within the definition of what is a “financial performance representation.”

Franchisors are not required to make an FPR, although a 2017 study found that approximately two-thirds of franchisors do so.<sup>20</sup> However, if a franchisor wishes to make an FPR,

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<sup>16</sup> For example, the FTC staff publishes “FAQs” on the FTC’s website. See *Frequently Asked Questions*, FTC (Jan. 2022), <https://www.ftc.gov/business-guidance/resources/amended-franchise-rule-faqs> (last visited Aug. 4, 2022). Additionally, the FTC staff has issued advisory opinions of which a partial list is found at <https://www.ftc.gov/legal-library/browse/rules/franchise-rule>, and a more complete list can be found at Bus. Franchise Guide (CCH) ¶ 6380. FTC staff opinions are not binding on the Commission and carry no legal weight, but they do reflect the staff’s then-current perspective on the regulations that they enforce.

<sup>17</sup> In 1984, the FTC published an explanation of the factors it would consider in deciding whether to initiate an enforcement action. Administrative Interpretations, General Policy Statements, and Enforcement Policy Statements, 49 Fed. Reg. 50632 (Dec. 31, 1984). See also U.S. GOV’T ACCOUNTABILITY OFF., GAO-01-776, FEDERAL TRADE COMMISSION: ENFORCEMENT OF THE FRANCHISE RULE (July 2001), <https://www.gao.gov/assets/gao-01-776.pdf>. The FTC typically prevails in actions to enforce the Franchise Rule. See, e.g., *FTC v. Network Servs. Depot, Inc.*, 617 F.3d 1127 (9th Cir. 2010); *FTC v. Minuteman Press*, 53 F. Supp. 2d 248 (E.D.N.Y. 1998).

<sup>18</sup> *FTC v. Transnet Wireless Corp.*, 506 F. Supp. 2d 1247, 1269 (S.D. Fla. 2007) (“A violation of the franchise rule constitutes a violation of 15 U.S.C. § 45(a). Section 57a(a)(1)(B) of [15 US Code] provides the FTC with authority to promulgate rules which define with specificity acts or practices which are unfair or deceptive within the meaning of section 45(a). The franchise rule represents an exercise by the FTC of that authority. Section § 57a(d)(3) of [15 US Code] states that a violation of a rule promulgated pursuant to section 57a(a)(1)(B), like the franchise rule, constitutes a violation of the prohibition against deceptive and unfair trade practices in section 45(a).”).

<sup>19</sup> 16 C.F.R. § 436.1(e).

<sup>20</sup> Anya Nowakowski, *Financial Performance Representation: Market Demand Pushing Higher Levels of Transparency*, FRANDATA (Apr. 2017) [https://www.franchise.org/sites/default/files/2017-Financial\\_Performance\\_Representations\\_final.pdf](https://www.franchise.org/sites/default/files/2017-Financial_Performance_Representations_final.pdf).

then the FPR must first be published in the franchisor's FDD (specifically in Item 19 of the FDD).<sup>21</sup> There are requirements concerning the preparation of an FPR, including those imposed by the FTC Franchise Rule<sup>22</sup> and those imposed by franchise examiners in the Registration States, who typically follow policy statements adopted by the North American Securities Administrators Association ("NASAA").<sup>23</sup> Additionally, franchisors need to be mindful of the requirement to provide additional information in order to avoid "half-truths." The FTC Franchise Rule itself requires that the FDD receipt page disclose that "if [the FDD] contains a false or misleading statement, or a material omission, a violation of federal law and state law may have occurred. . . ." <sup>24</sup> In addition, Section 5 of the Federal Trade Commission Act, which as noted in Section III.D below, prohibits "unfair and deceptive acts or practices in or affecting commerce."<sup>25</sup> Courts have upheld the FTC in enforcement cases where the claim is that a party engaged in misleading conduct by omitting material information or giving "half-truths".<sup>26</sup>

### **3. State Franchise Laws**

Under the U.S. system of federalism, the federal and state governments share jurisdiction over certain matters.<sup>27</sup> This system could lead to overlapping regulation, which can be burdensome and costly to businesses that are required to comply with both standards. Fortunately, as noted supra, the FTC and state regulators collaborated during the rulemaking that led to development of the Amended Franchise Rule.

Fourteen states require some form of registration before a franchisor may offer and sell franchises in that state. These states are:

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<sup>21</sup> 16 C.F.R. § 436.5(s).

<sup>22</sup> Specifically, the FTC Franchise Rule requires that if the franchisor makes an FPR, then the franchisor "must have a reasonable basis and written substantiation for the representation at the time the representation is made." 16 C.F.R. § 436.5(s)(3).

<sup>23</sup> See N. AM. SEC. ADM'R ASS'N, DISCLOSING FINANCIAL PERFORMANCE REPRESENTATIONS IN THE TIME OF COVID-19 (2020) <http://www.nasaa.org/wp-content/uploads/2020/06/FPRs-in-the-time-of-COVID-19.pdf> and N. AM. SEC. ADM'R ASS'N, NASAA FRANCHISE COMMENTARY FINANCIAL PERFORMANCE REPRESENTATIONS (2017), <http://www.nasaa.org/wp-content/uploads/2017/05/Financial-Performance-Representation-Commentary.pdf>.

<sup>24</sup> 16 C.F.R. § 436.5(w)(1). States have adopted similar standards. See, e.g., MD. CODE ANN., BUS. REG. § 14-230(a).

<sup>25</sup> 15 U.S.C. § 45(a)(1).

<sup>26</sup> See, e.g., *FTC v AMG Cap. Mgmt. LLC*, 910 F.3d 417, 422 (9th Cir. 2018), *rev'd on other grounds*, 141 S. Ct. 1341 (2021); *FTC v. LendingClub Corp.*, No. 18-CV-02454-JSC, 2020 WL 2838827, at \*6 (N.D. Cal. June 1, 2020).

<sup>27</sup> Intro. 6.2.3 - Federalism and the Constitution, CONSTITUTION ANNOTATED, [https://constitution.congress.gov/browse/essay/intro-2-2-3/ALDE\\_00000032/](https://constitution.congress.gov/browse/essay/intro-2-2-3/ALDE_00000032/) (last visited Aug. 4, 2022).

- California
- Hawaii
- Illinois
- Indiana
- Maryland
- Michigan
- Minnesota
- New York
- North Dakota
- Rhode Island
- South Dakota
- Virginia
- Washington
- Wisconsin

These states (the “Registration States”) require a franchisor to go a step further than just preparing an FDD. The requirements in the fourteen Registration States vary, and generally require franchisors to submit a filing to seek either registration or some form of an exemption from the registration requirements. These states require both “registration” and disclosure using the FDD, absent an exemption.<sup>28</sup>

Six additional states have “business opportunity laws” that typically apply to franchisors:<sup>29</sup>

- Connecticut
- Florida
- Kentucky
- Nebraska
- Texas
- Utah

In these “business opportunity law” states, the filing process is relatively easy, and, in all but Florida<sup>30</sup> and Utah, the filing is a one-time submission (for example, Texas).<sup>31</sup>

#### 4. Exemption Based Franchising

For a franchisor considering entry to the United States for the purpose of “testing the waters,” the possibility of an exemption may make an initial entry into the United States

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<sup>28</sup> CAL. CORP. CODE §§ 31000-31516; HAW. REV. STAT. § 482E et seq.; 815 ILL. COMP. STAT. 705/1 et seq.; IND. CODE § 23-2-2.5-1 et seq.; MD. CODE ANN., BUS. REG §§ 14-201 to 14-233; MICH. COMP. LAWS §§ 445-1501 to 445-1545; MINN. STAT. § 80C et seq.; N.Y. GEN. BUS. LAW §§ 680-695; N.D. CENT. CODE §§ 51-19-01 to 51-19-17; R.I. GEN. LAWS §§ 19-28.1-1 to 19-28.1-34; S.D. CODIFIED LAWS §§ 37-5B-1 to 37-5B-53; VA. CODE §§ 13.1-557 to 13.1-574; WASH. REV. CODE §§ 19.100.10-19.100.940; WIS. STAT. §§ 553.01-553.78.

<sup>29</sup> Several other states have business opportunity laws; however, as noted in this paper, in these states, a franchisor that has a registered trademark at the federal (and sometimes state) level will be exempted from the business opportunity law, without filing, usually predicated on “substantial,” “material” or general compliance with the FTC Franchise Rule. See, e.g., GA. CODE ANN. § 10-1-410(2)(A)(iii) (defining a business opportunity to exclude “the sale of a sales program or a marketing program made in conjunction with the licensing of a registered trademark or service mark”); and OHIO REV. CODE ANN. § 1334.13(A) (exempting from coverage “any transaction that complies in all material respects” with the FTC Franchise Rule).

<sup>30</sup> The Florida business opportunity law has a built-in exclusion, FLA. STAT. § 559.901(1)(a)(4), similar to the Georgia law cited in the note above. However, the Florida law also provides a statutory exemption for franchisors that are covered by the FTC Franchise Rule and that file an annual application with the state. FLA. STAT. § 559.802. Many franchisors file annually for the relatively simple statutory exemption due to the certainty of the statutory exemption, and to avoid having to answer the state’s inquiry as to why the franchisor did not seek that exemption.

<sup>31</sup> For example, the Texas exemption is available to a franchisor that “complies in all material respects in this state with [the FTC Franchise Rule] and each order or other action of the Federal Trade Commission” and that files a simple single-sheet of paper with a filing fee. TEX. BUS. & COM. CODE ANN. § 51.003(b)(8).

considerably more efficient and less burdensome.<sup>32</sup> Thus, the phrase “exemption-based franchising” arises.

In “exemption-based franchising,” the franchisor awards contracts (which are indeed franchise agreements), but it does so only in transactions where an exemption is available from the FTC Franchise Rule and any applicable state franchise or business opportunity laws.<sup>33</sup>

There are various exemptions available from the federal and state franchise laws on a transaction-by-transaction basis. If these exemptions apply, they may eliminate application of the relevant law with respect to registration of the franchisor’s FDD, so they can be especially valuable. However, whenever considering exemption-based franchising, a fundamental concern is to be sure that the requirements needed to claim an exemption are met, because the franchisor bears the burden of proof that it properly relied on the exemption in the first place.<sup>34</sup>

The FTC and many of the Registration States provide limited exemptions on a transaction-by-transaction basis from the requirement to provide disclosure (at both levels) and the requirement to register the FDD (at the state level). And when there are federal and state exemptions, the transaction may be conducted using “exemption-based franchising.” These exemption requirements vary significantly between federal and state, and from state to state.

#### **a. Federal Exemptions**

When the FTC promulgated the Amended FTC Rule in 2007, the federal exemption list grew to include eight exemptions.<sup>35</sup> Of these, for cross-border transactions, the large franchisee

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<sup>32</sup> In other countries with franchise laws that mandate disclosure, exemptions may also be available. For example, in the Province of Ontario, Canada, among the available exemptions are those for franchise arrangements with a term of under one year, for a large franchisee, and for a fractional franchise. Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c.3, s.7. The Australia Franchising Code of Conduct also provides a fractional franchise exemption. Competition and Consumer (Industry Codes—Franchising) Regulation 2014 (comp. 1 Apr. 2022), Part 1, Div. 1, s.3.

<sup>33</sup> Although some parties may refer to an exemption-based franchise as a “license,” if all three of the elements needed to establish that the business relationship is a “franchise” (as noted below), then the name that the parties choose to describe their relationship is of no consequence. Those three elements are: (1) the grant of the right to use the franchisor’s mark; (2) substantial assistance provided to or control of the franchisee; and (3) the payment of a required fee. 16 C.F.R. § 436.1(h). The definition is consistent under the FTC Franchise Rule and all the states with franchise laws, except for New York – under the New York Franchise Law, any combination of elements 1 and 3 above, or 2 and 3 above, will be deemed a “franchise.” N.Y. GEN. BUS. LAW § 681.3.

<sup>34</sup> See *Dollar Sys., Inc. v. Avcar Leasing Sys., Inc.*, 890 F.2d 165 (9th Cir. 1989); *Morris v. Int’l Yogurt Co.*, 107 Wash. 2d 314, 319, 729 P.2d 33, 36 (1986) (“strict compliance with the exemption requirements is necessary” under Washington law); see also OHIO REV. CODE ANN. § 1334.14. *Cf.* *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 409, 412 (D.D.C. 2014) (the franchisor’s misplaced reliance on an exemption, and therefore, its failure to register in New York, did not warrant rescission because even if that was a willful violation, the violation was not material to the franchisee’s investment decision and the franchisee did not prove that it sustained damages because of that violation).

<sup>35</sup> 16 C.F.R. § 436.8.

exemption and large investment exemption are often the most likely to apply and serve a useful purpose in appropriate transactions.

The FTC Franchise Rule exemptions, in general terms, are:

1. Large Franchisee Exemption – Transactions in which the franchisee (including its affiliates) has (a) been in any business for at least five years; and (b) has a net worth of at least \$6,165,500.<sup>36</sup>
2. Large Investment Exemption – Transactions in which there is a “large investment,” meaning that the franchisee – and in particular, one of its principals – will need to spend at least \$1,233,000 on the business opportunity (not counting the cost of buying unimproved land, and also excluding financing provided by the franchisor).<sup>37</sup>
3. Fractional Franchise Exemption – Transactions in which the franchisee has two or more years of experience in the same type of business as the franchise that is being offered by the franchisor and the franchisee and franchisor reasonably believe that in its first year of operation, the new franchised business will not account for more than 20% of the franchisee’s total sales.<sup>38</sup>
4. Minimum Payment Exemption – A franchisee may not make required payments or commitments to make required payments over \$615 to the franchisor or an affiliate of the franchisor during the first six months of operations.<sup>39</sup> (The funds may accrue and be paid to the franchisor after the initial six-month period of operations.)
5. Insiders Exemption – Franchise sales to two categories of insiders are exempt, either to (a) officers, directors, general partners, or managers of a franchisor or (b) owners of a franchisor.<sup>40</sup>
6. Leased Departments Exemption – This exemption applies when “the only payment by the independent retailer-tenant that occupies space within a larger retailer-landlord’s premises is rent. The exemption does not apply if the retailer-tenant

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<sup>36</sup> *Id.* § 436.8(a)(5)(ii). The FTC periodically adjusts the threshold levels for all of these exemptions for inflation, mostly recently in 2016. Federal Trade Commission – 16 C.F.R Part 436 – Disclosure Requirements and Prohibitions Concerning Franchising, 81 Fed. Reg. 31500-01 (May 19, 2016). Additional future adjustments are likely.

<sup>37</sup> 16 C.F.R. § 436.8(a)(5)(i).

<sup>38</sup> *Id.* § 436.8(a)(2).

<sup>39</sup> *Id.* § 436.8(a)(1).

<sup>40</sup> *Id.* § 436.8(a)(6).

must directly or indirectly purchase goods or services from the retailer-landlord or from suppliers required or approved by the retailer-landlord.”<sup>41</sup>

7. Petroleum Marketers and Resellers Exemption – Exempts petroleum marketers and resellers protected by the Petroleum Marketing Practices Act.<sup>42</sup>
8. Oral Contracts Exemption – Purely oral or verbal relationships with no written evidence describing material terms or any aspect of the relationship or arrangement.<sup>43</sup>

#### **b. State Exemptions**

If a transaction might fall within the coverage of the law that applies in a Registration State, then three analyses should be conducted.

First, a careful examination of the scope of the Registration State law should be undertaken. Not all of the Registration State’s laws apply to every transaction even when there is a franchisee domiciled in that state or even a business to be operated in that state. A proper review will reveal whether the state law applies at all.

Second, some state franchise laws have a franchisor-level exemption that might apply to the franchisor. For example, in New York, a franchisor with an audited net worth of at least \$15,000,000 is automatically exempt from the state registration and disclosure requirements (so long as the franchisor provides the name of its agent for service of process New York).<sup>44</sup> Other states also have a “large franchisor exemption,” and require a threshold level of net worth (ranging between \$5,000,000 and \$15,000,000) and some element of “experience,” which is typically measured in the number of franchised or company-owned units that have been operating over the previous five-year period.<sup>45</sup> None of these laws specify that the audited financial statements must be expressed in U.S. dollars or that the units must be operated within the same state or in the United States. Other than in New York, these other states’ “large franchisor” exemptions may

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<sup>41</sup> See *id.* § 436.8(a)(3). See generally Rochelle Spandorf & Leonard Vines, *Exemptions under the FTC Franchise Rule*, in EXEMPTIONS AND EXCLUSIONS UNDER FEDERAL AND STATE FRANCHISE REGISTRATION AND DISCLOSURE LAWS, at 1 (Leslie D. Curran & Beata Krakus, eds. 2017) [hereinafter “ABA Exemption Deskbook”].

<sup>42</sup> 16 C.F.R. § 436.8(a)(4).

<sup>43</sup> *Id.* § 436.8(a)(7).

<sup>44</sup> N.Y. GEN. BUS. LAW § 684(3)(a). A second exemption from the registration requirements is also available for a franchisor with an audited net worth of \$5,000,000, which requires limited disclosure of some details regarding the franchisor. *Id.* § 684(2)(a).

<sup>45</sup> See, e.g., the California Franchise Investment Law, CAL. CORP CODE § 31101 (under the California Franchise Investment Law, a franchisor can claim an exemption from the registration – but not disclosure – requirements if it has a net worth of \$5,000,000 or more and has either operated 25 units or has 25 franchised units of the same type as that being offered by the franchisor over the previous five years; the Illinois Franchise Disclosure Act, 815 ILL. COMP. STAT. 705/8(a)(1) (which provides a self-executing exemption from the registration requirements of the state law for a franchisor with an audited net worth of at least \$15,000,000), and the Maryland Franchise Law, MD. CODE REGS. 02.02.08.10(D) (requires a \$10,000,000 audited net worth and at least 25 franchisees operating the franchised business for the trailing five-year period, as well as an application filed with the state examiner for this registration exemption).

relieve a franchisor from the obligation to register, but they will not eliminate the need to provide disclosure (e.g., an FDD) to prospective franchisees – and, consequently, the large franchisor exemptions outside of New York may not be of substantial utility without a transaction-level exemption, discussed below.

Third, if a Registration States' law applies, then most of the Registration States afford some transaction-level exemptions that, if applicable, may eliminate the requirement to comply with the registration requirements and, usually (but not always) the state-level disclosure requirements (which typically duplicate the FTC Franchise Rule requirements). The criteria for qualifying for an exemption vary by state but typically are somewhat similar to the federal exemptions, with different standards in some cases. For example, some of the Registration States have some form of the Large Franchisee Exemption (as discussed below) and some have adopted a version of the Fractional Franchise Exemption.<sup>46</sup> Some exemptions in the Registration States are unusual, such as an exemption in some states for out-of-state franchise transactions and another exemption, available in some states, for the sale of an additional franchise to an existing franchisee. It is absolutely necessary to review each state law that applies to determine whether to consider the exemption-based model.<sup>47</sup>

Some of the states have exemptions for transactions that are similar to those noted above under the FTC Franchise Rule, but with variations in how the state version applies. For example, the California version of the fractional franchise exemption adds an additional substantive element to the FTC Franchise Rule version of the exemption that limits its availability: the California exemption applies only if the new business will operate from the same business location as the franchisee's existing business.<sup>48</sup>

When state franchise laws apply, there may be other exemptions available that can be especially useful to a franchisor entering the United States (bearing in mind that state-level exemptions do not eliminate application of the FTC Franchise Rule). A few examples of the exemptions likely to be most useful to an international franchisor seeking to offer franchises in the United States include:

- Large Franchisee Exemptions. These exemptions apply where the franchisee meets certain state-specific threshold requirements such as net worth and experience standards. In some states, a filing is needed to claim this exemption.

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<sup>46</sup> See, e.g., MINN. STAT. § 80C.01, subd. 18. See generally ABA Exemption Deskbook, *supra* note 41. See also David B. Ramsey, Adam Siegelheim & Leonard Vines, *Exemption-Based Franchising for Established and Start-Up Franchisors*, INT'L FRANCHISE ASS'N 50TH ANNUAL LEGAL SYMP., at 23, 26-27 (2017).

<sup>47</sup> See Leslie D. Curran & Karen B. Satterlee, *Exemption-Based Franchising: Are You Playing in a Minefield*, 28 FRANCHISE L. J. 191 (2009). See also ABA Exemption Deskbook, *supra* note 41.

<sup>48</sup> Cal. Corp. Code § 31108(c) (a filing is also required) (contrasted with 16 C.F.R. § 436.8(a)(2)). Some version of a fractional franchise exemption is also available under the franchise registration laws in Illinois, Indiana, Michigan, Minnesota, New York, Rhode Island, South Dakota, Virginia, and Wisconsin.

These exemptions can be found in California,<sup>49</sup> Illinois,<sup>50</sup> Rhode Island,<sup>51</sup> South Dakota,<sup>52</sup> and Washington.<sup>53</sup>

- Large Investment Exemptions. These exemptions apply where the franchisee must make a sizable investment in connection with accepting the offer to obtain franchise rights; some states also require filing to perfect these exemptions. These exemptions can be found in Illinois,<sup>54</sup> Maryland,<sup>55</sup> South Dakota,<sup>56</sup> and Wisconsin.<sup>57</sup>
- Isolated Sales Exemptions. These exemptions may be available where the franchisor makes a limited number of franchise offers. For example, the New York isolated sales exemption is available where the franchisor makes an offer to two or fewer parties, does not grant subfranchising rights, does not pay a brokers' commission, and where the franchisor makes a filing with the state (if it is not a

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<sup>49</sup> CAL. CORP. CODE § 31109(a).

<sup>50</sup> 815 ILL. COMP. STAT. 705/8(a).

<sup>51</sup> R.I. GEN. LAWS § 19-28.1-6(3).

<sup>52</sup> S.D. CODIFIED LAWS § 37-5B-13(2).

<sup>53</sup> WASH. REV. CODE § 19.100.030(5); WASH. ADMIN. CODE § 460-80-108.

<sup>54</sup> ILL. ADMIN. CODE tit. 14, § 200.202(c).

<sup>55</sup> MD. CODE REGS. 02.02.08.10(E) (referred to as the "Sophisticated Franchisee" exemption).

<sup>56</sup> S.D. CODIFIED LAWS § 37-5B-13(1).

<sup>57</sup> WIS. STAT. § 553.235.

New York domiciliary).<sup>58</sup> Similar exemptions are also available, applying different state-specific criteria, in Indiana,<sup>59</sup> Minnesota,<sup>60</sup> and Washington.<sup>61</sup>

- Exemptions for Franchisees that Already Operate Substantially Similar Businesses. The California<sup>62</sup> and Maryland<sup>63</sup> statutes provide exemptions for the offer of a franchise that is “substantially similar” to an existing franchise’s business. This especially useful exemption typically would apply when the franchisor of brand “x” offers an additional franchise to a franchisee that already operates one of the franchisor’s “x” brand businesses, but it is interesting to note that the exemption may also apply more broadly. Neither state’s exemption specifies whether the franchisor could claim this exemption might also be available if the operator meets the threshold-level of experience operating a *similar* business but of a different brand and a different franchisor (e.g., an offer or a new franchise for hotel brand X to an operator with experience operating hotel brand Y). Careful attention should

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<sup>58</sup> N.Y. GEN. BUS. LAW § 684(3)(c). The exemption is predicated on the franchisor not making offers to more than two persons – but the statute does not elaborate as to the period of time over which those offers would be measured. It is therefore unclear whether the limited nature of the offerings is measured over a short-term (e.g., at the same time), a medium-range term (over the following 1-2 years), or cumulative (e.g., over a five--to ten-year period), and whether subsequent offerings would be deemed to retroactively vitiate reliance on the isolated sale exemption. Courts have concluded that the New York statute should be liberally construed to achieve the legislative purpose of protecting franchisees from fraud. See *A.J. Temple Marble & Tile, Inc. v. Union Carbide Marble Care, Inc.*, 162 Misc. 2d 941, 951, 618 N.Y.S.2d 155, 161 (N.Y. Sup. Ct. 1994), *aff’d*, 214 A.D.2d 473, 625 N.Y.S.2d 904 (N.Y. App. Div. 1995), *aff’d as modified*, 87 N.Y.2d 574, 663 N.E.2d 890 (1996). *But see* *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 408 (D.D.C. 2014) (considering New York isolated sale exemption, court noted that “[t]his is not to say that a franchisor who has sold an unregistered franchise under the isolated sales exemption can never again offer to sell a franchise in New York; ‘[i]t can, but it must register first.’”).

<sup>59</sup> IND. CODE § 23-2-2.5-3 (the statute does not apply “to the offer or sale of a franchise if the franchisor . . . sells no more than one (1) franchise in Indiana in any twenty-four (24) month period. . .”).

<sup>60</sup> MINN. STAT. ANN. § 80C.03(a).

<sup>61</sup> WASH. REV. CODE § 19.100.030(4)(b)(ii).

<sup>62</sup> CAL. CORP. CODE § 31018. The California regulator issued a release in 1997 to provide details on when the exemption would be available, noting that “[t]he owner or owners have had, within the seven years before the date of the sale or other transaction, at least 24 months experience being responsible for the financial and operational aspects of a business offering products or services substantially similar to those offered by the franchised business. Cal. Dep’t Corps., Release No. 13-F: Notice of Exemption For Use With “Experienced Franchise Purchaser” Exemption Under Corporations Code Section 31106 (Feb. 10, 1997), *reprinted in* *Bus. Franchise Guide (CCH) ¶ 5050.47*. Franchisors must also satisfy a filing requirement in order to claim this exemption. CAL. CODE REGS. tit. 10, § 310.101.

<sup>63</sup> MD. CODE ANN., BUS. REG. § 14-214(b)(2). The Maryland statute does not specify whether the existing business has to be the same as that of the new business, e.g., an additional franchise for the same brand. The Maryland Attorney General’s office issued an advisory opinion in 1998 addressing this exemption but merely noted that the sale of an additional business to an entity that is comprised of the same ownership group as another franchisee would fall within the exemption; the opinion did not address the possibility that the prospective franchisee has experience with a similar but different franchised business). Md. Off. Att’y Gen. Sec. Div., Advisory Op. 98-1 (Apr. 14, 1998), *reprinted in* *Bus. Franchise Guide (CCH) ¶ 5200.21*.

be paid to the underlying facts when assessing whether this useful type of exemption might be applicable in a specific fact setting.

Transactional exemptions, in general, are very useful in terms of helping to facilitate a legal and simpler entry into the U.S. market, for example, to “test the waters” without having to develop a full-scale disclosure document that may be needed in implementing a more substantial expansion plan. Because these exemptions are highly fact-dependent and are available only where the specific requirements of the statute or regulation apply, a thorough factual review is necessary before concluding that an offer can be made without having to comply with the applicable regulatory requirements. For all transactional exemptions, practitioners should conduct a careful review of the details, make certain that they are aware of the requirements to obtain the exemption, assess whether exemptions are available for both the state and federal requirements, determine whether the state exemptions apply to both registration and disclosure requirements, and then advise the client on the basis of that analysis.

### **III. ANTITRUST LAWS THAT MAY IMPACT YOUR BRAND IN THE U.S. MARKET**

The basic antitrust laws in the United States date back to the late 19th century and since their enactment, have undergone substantial review and analysis in the courts. There have been numerous Forum papers and presentations comprehensively addressing antitrust issues in many years,<sup>64</sup> and those wide-ranging and thorough reviews are beyond the scope of this paper. The brief summary that follows is merely to outline the basic laws.

Unlike other countries (and international bodies, such as the E.U.), the administration, enforcement, and interpretation of U.S. antitrust laws have been considerably influenced by the Chicago School of Antitrust Analysis, which:

use[s] rigorous microeconomic analysis to change antitrust enforcers’ focus from economic power to economic incentives. This new focus, combined with a more conservative judiciary, led to a gradual reversal of many previously established antitrust doctrines – from the prosecution of vertical mergers to the per se treatment of several forms of unilateral conduct. Although antitrust scholars may disagree on the appropriateness of the Chicago School ideas, few would question the profound influence those ideas have had on US antitrust policy.<sup>65</sup>

The U.S. Supreme Court’s rulings on vertical price controls imposed by a party such as a franchisor provide an illustration of that concept. In 1997, the Court ruled in a case that concluded

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<sup>64</sup> See, e.g., Filemon Carrillo & Michael K. Lindsey, *Antitrust Issues Today – What Every Franchise Lawyer Needs to Know*, ABA 44TH ANNUAL FORUM ON FRANCHISING W-9 (2021); Steven B. Feirman & Allan P. Hillman, *Antitrust Issues – Back in Vogue*, ABA 33RD ANNUAL FORUM ON FRANCHISING W-8 (2010); Michael K. Lindsey & Paul Walter, *Update of Antitrust Laws Affecting Franchising*, ABA 14TH ANNUAL FORUM ON FRANCHISING W-7 (1991).

<sup>65</sup> Anu Bradford, Adam S. Chilton & Filippo Maria Lancieri, *The Chicago School's Limited Influence on International Antitrust*, 87 U. CHI. L. REV. 297, 298–99 (2020).

that maximum price controls should be analyzed under the “rule of reason” standard.<sup>66</sup> Ten years later, in 2007, the Court reached a similar conclusion with respect to minimum price controls – noting the possibility of pro-competitive effects from those controls.<sup>67</sup>

#### **A. Sherman Antitrust Act**

Congress adopted the Sherman Act in 1890, and Section 1 of the Act enunciates the fundamental principle that “[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>68</sup>

#### **B. Clayton Act**

The Clayton Act<sup>69</sup> was adopted in 1914 to amend the Sherman Act, and specifically addressed anticompetitive mergers, interlocking directorates, and unlawful tying arrangements. One federal district court explained tying arrangements thusly:

A tying arrangement is “an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier.” . . . For a tying arrangement to be actionable, the defendant must enjoy substantial market power in the tying product.<sup>70</sup>

Not all tying arrangements are illegal. In 2006, the U.S. Supreme Court concluded in its *Illinois Tool Works* decision that “[m]any tying arrangements, even those involving patents and requirements ties, are fully consistent with a free, competitive market.”<sup>71</sup> In that case, the Court also held that in tying cases, there should be no presumption of market power without proof,

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<sup>66</sup> *State Oil Co. v. Khan*, 522 U.S. 3, 22 (1997).

<sup>67</sup> *Leegin Creative Leather Prod., Inc. v. PSKS, Inc.*, 551 U.S. 877, 878 (2007) (“Minimum resale price maintenance can stimulate interbrand competition among manufacturers selling different brands of the same type of product by reducing intrabrand competition among retailers selling the same brand. This is important because the antitrust laws’ “primary purpose . . . is to protect interbrand competition.”). Notably, some state-level antitrust laws do not follow the *Leegin* doctrine, and still apply the per se standard to reviewing minimum price restraints under state law. *See, e.g., O’Brien v. Leegin Creative Leather Prod., Inc.*, 294 Kan. 318, 322, 277 P.3d 1062, 1068 (2012). *See also Alan Darush MD APC v. Revision LP*, No. CV 12-10296 GAF AGRX, 2013 WL 1749539, at \*6 (C.D. Cal. Apr. 10, 2013) (“*Leegin* involved an interpretation of a federal statute, not the Cartwright Act [the California antitrust law]. Under current California Supreme Court precedent, vertical price restraints are per se unlawful under the Cartwright Act.”); *but see WorldHomeCenter.com, Inc. v. PLC Lighting, Inc.*, 851 F. Supp. 2d 494, 502 (S.D.N.Y. 2011) (“In light of the *Leegin* decision, the Court finds that the rule of reason and not the per se rule applies to Plaintiff’s Donnelly Act claim [the New York antitrust law].”).

<sup>68</sup> 15 U.S.C. § 1.

<sup>69</sup> *Id.* § 12.

<sup>70</sup> *Westerfield v. Quizno’s Franchise Co.*, 527 F. Supp. 2d 840, 856 (E.D. Wis. 2007), *vacated in part*, No. 06-C-1210, 2008 WL 2512467 (E.D. Wis. Apr. 16, 2008) (citations omitted).

<sup>71</sup> *Illinois Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, 45 (2006).

writing that “in all cases involving a tying arrangement, the plaintiff must prove that the defendant has market power in the tying product.”<sup>72</sup>

The 2006 *Illinois Tool Works* decision abrogated portions of the Court’s 1984 *Jefferson Parish* decision, in which it held that if “the seller does not have either the degree or the kind of market power that enables him to force customers to purchase a second, unwanted product in order to obtain the tying product, an antitrust violation can be established only by evidence of an unreasonable restraint on competition in the relevant market.”<sup>73</sup>

In cases involving franchise systems, courts have largely found the absence of market power, even where the franchisee is contractually obligated to use products that the franchisor has designated or approved.<sup>74</sup>

A court making a relevant market determination looks not to the contractual restraints assumed by a particular plaintiff when determining whether a product is interchangeable, but to the uses to which the product is put by consumers in general. Thus, the relevant inquiry here is not whether a Domino’s franchisee may reasonably use both approved or non-approved products interchangeably without triggering liability for breach of contract, but whether pizza makers in general might use such products interchangeably. Clearly, they could.<sup>75</sup>

### **C. Robinson-Patman Price Discrimination Act**

Also adopted in 1914, the Robinson-Patman Act<sup>76</sup> amended the Clayton Act, and prevents certain forms of price discrimination by wholesalers to their retail customers, which might include franchisees.<sup>77</sup>

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<sup>72</sup> *Id.* at 46. See also *Rick-Mik Enters., Inc. v. Equilon Enters. LLC*, 532 F.3d 963, 972 (9th Cir. 2008) (gasoline franchisee alleged tying between franchise to sell branded gasoline and credit card processing services; court concluded that franchisee neither alleged nor proved market power needed to sustain tying claim).

<sup>73</sup> *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 17-18 (1984), *abrogated by Illinois Tool Works*, 547 U.S. at 42-43.

<sup>74</sup> See, e.g., *Queen City Pizza, Inc. v. Domino’s Pizza, Inc.*, 124 F.3d 430, 438 (3d Cir. 1997); *Westerfield v. Quizno’s Franchise Co.*, 527 F. Supp. 2d 840, 858 (E.D. Wis. 2007), *vacated in part*, No. 06–C–1210, 2008 WL 2512467 (E.D. Wis. Apr. 16, 2008); *Bishop v. GNC Franchising LLC*, 403 F. Supp. 2d 411, 420 (W.D. Pa. 2005), *aff’d*, 248 F. App’x 298 (3d Cir. 2007). See also Alan Silberman, *The Myths of Franchise Market Power*, 65 ANTITRUST L.J. 181, 206 (1996).

<sup>75</sup> *Queen City Pizza*, 124 F.3d at 438.

<sup>76</sup> 15 U.S.C. § 13.

<sup>77</sup> *Nat’l Auto Brokers Corp. v. Gen. Motors Corp.*, 376 F. Supp. 620, 627 (S.D.N.Y. 1974), *aff’d*, 572 F.2d 953 (2d Cir. 1978); see also *Volvo Trucks N. Am. v. Reeder-Simco GMC*, 546 U.S. 164, 175 (2006) (the court posed and answered its own rhetorical question: “[m]ay a manufacturer be held liable for secondary-line price discrimination under the Robinson–Patman Act in the absence of a showing that the manufacturer discriminated

(footnote continued)

#### **D. Federal Trade Commission Act**

The Federal Trade Commission Act<sup>78</sup> was adopted in 1914 and not only established the Commission but also proclaimed that “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.” Congress intended the FTC Act to “supplement and bolster the Sherman Act and the Clayton Act – to stop in their incipiency acts and practices which, when full blown, would violate those Acts...”<sup>79</sup>

The FTC’s authority under this Act was the predicate for its promulgation of the Franchise Rule in 1978.<sup>80</sup> The FTC’s most recent enforcement action involving alleged violations of the Franchise Rule was initiated in 2022 against the franchisor of the “BurgerIm” concept.<sup>81</sup>

#### **E. Horizontal vs. Vertical**

Franchisors entering the U.S. market should consider whether the restraints that they may impose will be seen as “horizontal” or “vertical” in nature because the law treats those different kinds of controls differently.

A horizontal restraint is an agreement between or among competitors at the same market level.<sup>82</sup> This may include joint action taken by franchisees, and in some cases, agreements between franchisors and franchisees. An example of a horizontal agreement might be two food service delivery franchisees reaching an understanding to divide sales activity in an adjacent area where the franchisor has not yet awarded a franchise.

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between dealers competing to resell its product to the same retail customer? Satisfied that the Court of Appeals erred in answering that question in the affirmative, we reverse the Eighth Circuit’s judgment.”).

<sup>78</sup> 15 U.S.C. §§ 41-58.

<sup>79</sup> FTC v. Motion Picture Advert. Serv. Co., 344 U.S. 392, 394 (1953) (citations omitted); see also FTC v. Brown Shoe Co., 384 U.S. 316, 322 (1966) (“[T]he Commission has power under [Section 5] to arrest trade restraints in their incipiency without proof that they amount to an outright violation of [Section 3] of the Clayton Act or other provisions of the antitrust laws.”).

<sup>80</sup> Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, 43 Fed. Reg. 59,614 (Dec. 21, 1978) (to take effect July 21, 1979). See also Michael Moore, Comment, *Franchising: Probable Impact of the New Federal Trade Commission Rule*, 40 OHIO STATE L. J. 387 (1979).

<sup>81</sup> Complaint, U.S. v. BurgerIm Group USA, Inc., No. 2:22-CV-825 (C.D. Cal., filed Feb. 7, 2022). In the past, FTC enforcement cases were brought by either the U.S. Department of Justice or the FTC’s staff, itself, under Section 13(b) of the Federal Trade Commission Act. However, the U.S. Supreme Court unanimously concluded that the FTC lacked authority to bring cases under Section 13(b). *AMG Cap. Mgmt. LLC v. FTC*, --- U.S. ---, 141 S. Ct. 1341 (2021). In June 2021, the U.S. House passed a bill that would restore the Commission’s Section 13(b) authority; however, that bill has not received a vote in the Senate. Consumer Protection and Recovery Act, H.R. 2668, 117th Cong., 1st Sess. (2021).

<sup>82</sup> See, e.g., *Palmer v. BRG of Georgia*, 498 U.S. 46 (1990) (per se violation of Sherman Act found where two bar review competitors agreed to allocate markets). If competitors agree to fix prices, that will also be found to be per se illegal, even if the prices are reasonable. See *U.S. v. Socony-Vacuum Oil Co.*, 340 U.S. 223-26, n.59 (1940).

A *vertical restraint* is a limitation imposed by a party at a different level in the distribution chain. For example, a limit imposed by a franchisor upon its franchisees would typically be seen as vertical in nature. In cases involving dual distribution systems (that is, where the franchisor also operates unit-level businesses at the same level as do franchisees), *nonprice* restraints imposed by the franchisor typically are reviewed under the “Rule of Reason” standard (usually, more lenient) rather than the “per se” illegality standard.<sup>83</sup>

#### **IV. TRADEMARKS AND IP: YOUR FRANCHISE BRAND IN THE UNITED STATES**

Having discussed the kind of structure and agreements to use for your U.S. franchise, as well as the applicable federal and state laws to operate your U.S. franchise (including how to avoid U.S. antitrust violations), the question becomes: what separates your franchise from other competitor businesses in the United States? A higher quality product and/or superior service will help, but how will your franchise be recognized by consumers and the marketplace in the United States? Do you think your non-U.S. trademark will serve as a strong, recognizable brand in the United States, and, if so, are such marks even protectable and enforceable in the United States? Are you prepared to invest to make sure you have valid and protectable trademarks in the United States? Beyond trademarks, have you identified other forms of intellectual property protection available to franchisors in the United States, namely, patents, copyrights, and/or trade secrets? Set forth below are steps for protecting and enforcing your franchise intellectual property in the United States.

##### **A. Trademarks**

##### **1. Selecting A Franchise Brand for the U.S. Market: The Spectrum of Distinctiveness**

Selecting legally protectable trademarks for use and registration is a critical first step for a franchise’s success anywhere, but this is particularly so in the United States. Trademarks, logos, and other source-identifying indicia are crucial to the franchise’s ability to achieve marketplace and consumer recognition, not to mention loyalty and goodwill.

When selecting a trademark, one can determine the protectability or strength of the trademark by applying what is generally known in the United States as the “spectrum of distinctiveness.” On this spectrum, trademarks range from fanciful – the most distinctive and protectable – to descriptive. Descriptive trademarks are the weakest trademarks and often are not protectable until it can be established that the trademark has “acquired distinctiveness” through long and substantially exclusive use. The four categories of distinctiveness from strongest

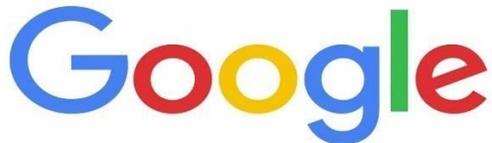
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<sup>83</sup> When a court reviews a claim under the “Rule of Reason,” the court typically considers all the factors relating to the allegedly illegal restraint – including why the restraint was adopted, the history and context in which the restraint arose, the purpose of the limitation, and the effect the restraint has on competition in the relevant market. In general, restraints subject to the Rule of Reason are upheld if they do not substantially impair competition in a relevant geographic and product market. See *California Dental Assoc. v. FTC*, 526 U.S. 756 (1999); *FTC v. Indiana Fed’n. of Dentists*, 476 U.S. 447 (1986); *Continental TV, Inc. v. G.T.E. Sylvania, Inc.*, 433 U.S. 36, 49-51 (1977).

to weakest are as follows: (1) fanciful/coined; (2) arbitrary; (3) suggestive; and (4) descriptive.<sup>84</sup> Marks that lack distinctiveness and serve no trademark function are deemed “generic.”<sup>85</sup>

**a. Fanciful/Coined and Arbitrary Trademarks**

Fanciful or coined trademarks are comprised of words not found in a dictionary. They are made-up terms such as XEROX or KODAK that have no meaning apart from that of a source identifier.<sup>86</sup> Fanciful marks are “inherently distinctive,” which means that they are legally protectable and registrable once used in commerce.<sup>87</sup> Moreover, fanciful marks are also protectable without proof of secondary meaning (*i.e.*, proof that the mark is recognized by the relevant consuming public as a “brand” designating the franchisor as the single source of goods and services).<sup>88</sup>



Arbitrary marks are dictionary words or designs, *e.g.*, APPLE or GOOGLE, that are unrelated or usually have no connection to the product or service marketed.<sup>89</sup> Like fanciful marks, arbitrary marks are inherently distinctive and are also protectable without proof of secondary meaning.<sup>90</sup>

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<sup>84</sup> J. THOMAS MCCARTHY, 2 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 11:1 (5th ed. 2020) [hereinafter “MCCARTHY”].

<sup>85</sup> *Id.* § 12:1.

<sup>86</sup> MCCARTHY, *supra* note 84, at § 11:5.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* § 11:4.

<sup>89</sup> *Id.* § 11:11.

<sup>90</sup> *Id.*

b. Suggestive Trademarks



Suggestive marks are another example of protectable, inherently distinctive marks that do not require proof of secondary meaning. These marks indirectly suggest rather than immediately describe a characteristic of the associated goods or services, and often take imagination or thought on the part of the consumer to associate the mark with particular goods or services.<sup>91</sup> Examples include “Kleenex” and “Coppertone.” Suggestive marks, although slightly weaker than arbitrary marks on the spectrum, are popular and easier to use as a marketing tool to channel information about goods or services.

c. Descriptive Trademarks



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Descriptive marks do not require imagination on the part of consumers to associate the mark with specific goods/services. Descriptive marks can only be protected through evidence of secondary meaning. Secondary meaning is often established by evidence of sales, marketing, advertising, and promotion that result in consumer recognition of the descriptive mark as being associated with specific goods/services emanating from a single source.<sup>92</sup> Descriptive marks are not inherently distinctive and include words that directly identify the characteristic, purpose,

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<sup>91</sup> *Id.* § 11:62.

<sup>92</sup> *Id.* § 11:15.

quality, or function of the goods or services associated with the mark, e.g., “Fresh Milk.”<sup>93</sup> These include (1) trademarks that describe in words or pictures the specified purpose, function, quality, characteristic, effect, or class of consumer for the goods or services marketed; (2) trademarks that principally describe the geographic origin of the goods or services; (3) trademarks that essentially describe a person’s surname; and (4) trademarks that primarily describe admirable qualities or characteristics of goods or services.<sup>94</sup>

d. **Generic Terms**

ESCALATOR



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Generic terms can never become trademarks.<sup>96</sup> Generic terms are ordinary words used to name or describe a general category of goods or services, e.g., “Discount Mufflers.” Generic terms fail to differentiate products from different sources. Although fanciful/coined terms are the most distinctive, they also run the risk of becoming generic, if not used and policed properly.<sup>97</sup> A number of coined terms that used to serve as trademarks have become generic, including, for example, “aspirin” and “escalator.” Without proper policing and enforcement, inherently distinctive trademarks can become generic. For example, “ELEVATOR,” previously a trademark of Otis Elevator Company, is now a generic term that cannot be owned by any one party. Marks like XEROX, and VELCRO have all fought off genericide with clever marketing and consumer education campaigns.<sup>98</sup>

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<sup>93</sup> Trilogy Healthcare of Louisville E., LLC v. Camelot Leasing, LLC, No. 3:18-CV-00307-RGJ, 2019 WL 3991073, at \*5 (W.D. Ky. Mar. 22, 2019).

<sup>94</sup> MCCARTHY, *supra* note 84, at § 11:16.

<sup>95</sup> Escalator Application #78530451, US PATENT AND TRADEMARK OFFICE, <https://uspto.report/TM/78530451> (last visited July 13, 2022); Silvia Marchi, *Spinning, Pilates, and Aspirin: beware of Genericization*, HFG L. & INTELL. PROP. (June 5, 2019), <https://www.hfgip.com/news/beware-genericization>.

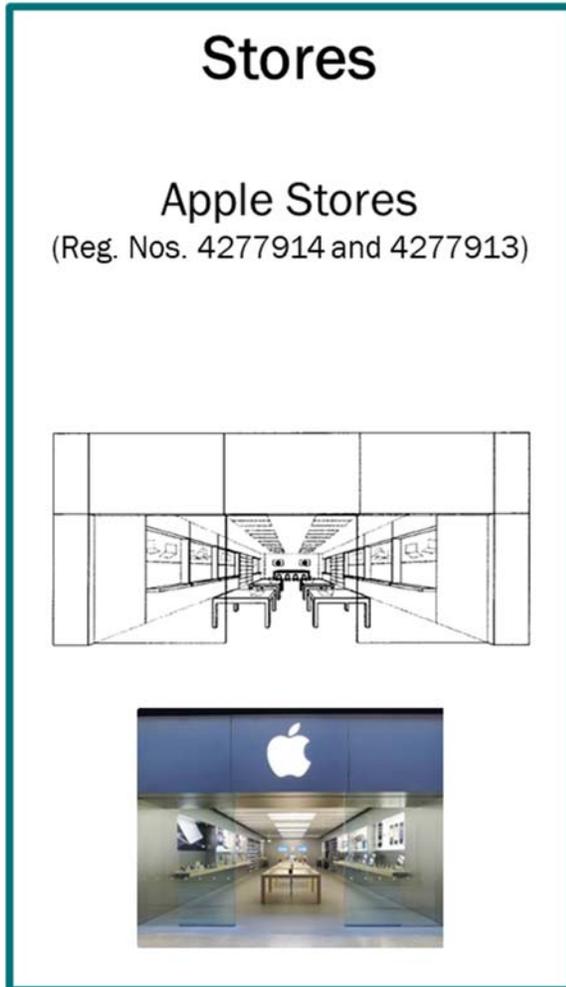
<sup>96</sup> MCCARTHY, *supra* note 84, at § 12:1.

<sup>97</sup> See *id.* at § 11:9.

<sup>98</sup> See Don’t Say Velcro, YOUTUBE (Sept. 25, 2017) <https://www.youtube.com/watch?v=rRi8LptvFZY>; Becky Peterson, *This 1979 letter to The New York Times shows just how much Xerox hates people using its name as a verb*, INSIDER (July 27, 2017, 5:05 P.M.), <https://www.businessinsider.com/old-letter-to-new-york-times-xerox-takes-trademark-very-seriously-2017-7>.

## 2. Trade Dress Marks

Trade dress protection is at the core of brand identity and recognition and is another form of a trademark that non-U.S. franchisors can use to stand out among competitors in the U.S. market. Although there is no federal statute that defines trade dress, U.S. court cases define the term as a combination of a wide range of elements that constitute the appearance, image, or environment of a product or a business to consumers.<sup>99</sup> Trade dress has expanded to include individual attributes/elements, or a combination of thereof, that capture the look and feel of a restaurant or store, e.g., the Apple Store.



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<sup>99</sup> Christopher P. Bussert & Linda K. Stevens, *Trademark Law Fundamentals and Related Franchising Issues*, in *FUNDAMENTALS OF FRANCHISING* 1, 17 (Rupert M. Barkoff et. al. eds., 3<sup>rd</sup> ed. 2008) [hereinafter "Bussert & Stevens"]; see also *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 765 (1992) ("Taco Cabana describes its Mexican trade dress a 'a festive eating atmosphere having interior dining and patio areas decorated with artifacts, bright colors, paintings and murals. The patio includes interior and exterior areas with the interior patio capable of being sealed off from the outside patio by overhead garage doors. The stepped exterior of the building is a festive and vivid color scheme using top border paint and neon stripes.'"); MCCARTHY, *supra* note 84, at § 8:1.

A franchisor's trade dress can include a product's labels, packaging, size, specific shape, color, texture, graphic design, or nonvisual features, including the sounds and smells of a store.<sup>100</sup> The trade dress of a business can also extend to interior and exterior architectural design, layout, décor, employee uniforms, signage, menus, types of cuisine, entertainment, or style of customer service that differentiates the business.<sup>101</sup>

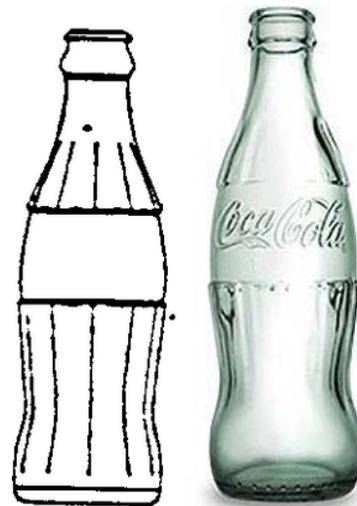
## Product Packaging

Jawbone's  
"Museum" Packaging  
(Ser. No. 85669268)



## Product Shape

Coca-Cola's  
"Contour" Bottle  
(Reg. No. 1057884)



Although franchisors can obtain federal trademark registration protection for trade dress rights, many have sought protection and failed. Without such protection, the upfront investment to develop a memorable brand could be exploited by competing businesses, former franchisees, and infringers.<sup>102</sup>

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<sup>100</sup> See Linda Stevens & Mark S. VanderBroek, *Protecting and Enforcing Trade Dress*, ABA 32ND ANNUAL FORUM ON FRANCHISING W-7 (2009).

<sup>101</sup> Bussert & Stevens, *supra* note 99, at 17.

<sup>102</sup> *Id.*

In *Two Pesos, Inc. v. Taco Cabana, Inc.*, the U.S. Supreme Court held that that a claim of trade dress infringement requires proof of three elements: (1) the trade dress is primarily non-functional; (2) the trade dress is inherently distinctive or has acquired secondary meaning; and (3) the alleged infringement creates a likelihood of confusion.<sup>103</sup>

Franchisors should consider the following recommendations to identify and protect their valuable trade dress:

- Take stock of the distinguishing traits that constitute the franchisor’s trade dress, look to see if you use distinctive recognizable colors, or unique product packaging, or non-functional store configurations.
- Select trade dress elements that qualify for protection at the outset by avoiding elements that are generic or functional.<sup>104</sup> Trade dress elements used by others in “the franchisor’s field, [that] are primarily functional or otherwise have no source designating significance” should be avoided.<sup>105</sup> “Instead, franchisors should strive to adopt combinations of trade dress elements that are distinctive, ornamental, and unique in nature and which serve to distinguish their systems from those of competitors.”<sup>106</sup>
- Promote trade dress use in a consistent and uniform manner in all franchise locations. Using uniform trade dress across franchise locations is significant to enforcing one’s trade dress rights and to prevent likelihood of confusion. If franchisors do not diligently ensure that their trade dress is used in a uniform and consistent manner, they will likely face long odds establishing likelihood of confusion.<sup>107</sup>
- Actively harness a strong connection in the minds of consumers that links the goods and services of the franchise with the trade dress through secondary

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<sup>103</sup> 505 U.S. 763 (1992). See generally Christopher P. Bussert, *A Franchising Conundrum: The Disconnect Between Recognizing, Claiming and Enforcing Trade Dress Rights*, 24 THE FRANCHISE LAW. 4, at 10 (2021).

<sup>104</sup> Bussert & Stevens, *supra* note 99, at 10-11 (citing *Ale House Mgmt., Inc. v. Raleigh Ale House, Inc.*, 205 F.3d 137, 142 (4th Cir. 2000) (“As with generic trade names, the trademark laws do not protect a generic trade dress”); *Happy’s Pizza Franchise LLC v. Papa’s Pizza, Inc.*, 108 U.S.P.Q.2d 1239, 1243 (E.D. Mich. 2013) (pizzeria interior design consisting solely of generic elements not protectable); *Fantastic Sams Franchise Corp. v. Mosley*, No. CV H-16-2318, 2016 WL 7426403 (S.D. Tex. Dec. 23, 2016) (court denied plaintiff’s trade dress claim in part because several of the elements, such as the chairs and the salon layout, served a primarily functional purpose)).

<sup>105</sup> Bussert & Stevens, *supra* note 99, at 10-11 (citing *DP Dough Franchising LLC v. Southworth*, No. 2:15 cv 2635, 2017 WL 4315013, at \*13 (S.D. Ohio Sept. 26, 2017) (plaintiff denied relief on its trade dress claim in part because its red and black color scheme was common in Italian restaurants); *Western Sizzlin Corp. v. Pinnacle Bus. Partners, LLC*, 103 U.S.P.Q. 2d 1148, 1151 (M.D. Fla. 2012) (trade dress protection denied in part because competitors also used red, green, and white color scheme); *Fantastic Sams Franchise Corp. v. Mosley*, No. CV H-16-2318, 2016 WL 7426403, at \* 7 (S.D. Tex. Dec. 23, 2016) (court denied plaintiff’s trade dress claim in part because several of the elements, such as the chairs and the salon layout, served a primarily functional purpose)).

<sup>106</sup> *Id.* at 11.

<sup>107</sup> *Id.* at 12.

meaning. Even if “a franchisor has adopted trade dress elements that [are] capable of protection, this alone will not guarantee a successful enforcement effort. Unless the trade dress is [deemed to be] inherently distinctive, a court will require a franchisor to demonstrate that the trade dress has achieved secondary meaning (*i.e.*, that the relevant consuming public recognizes it as a ‘brand’ designating the franchisor as the single source of goods and services).”<sup>108</sup> Secondary meaning becomes even more important where trade dress consists primarily of a color scheme.<sup>109</sup>

- There are a number of factors courts consider in determining whether a particular trade dress has acquired secondary meaning, including: (1) how long the trade dress has been used, (2) how prominent that usage has been, (3) what efforts have been made by the franchisor to associate the trade dress with the franchisor, (4) marketing expenditures associated with the trade dress, (5) gross sales revenue of the system since adoption of the trade dress, (6) examples of how the trade dress is used by the franchisor and its franchisees, (7) extent of third party use of the trade dress, (8) the existence of independent press, consumer testimonials, or consumer surveys showing a link between that trade dress and the goods and services provided by the franchise system and (9) how franchisees are taught about the importance of the trade dress.<sup>110</sup>
- Explicitly include and identify your trade dress in your franchise documents and agreements. In some instances, trade dress should be discussed in the FDD as one of the elements comprising the franchise system and in the franchise agreement sections that discuss what proprietary marks that are being licensed to the franchisee, as well as the debranding obligations imposed on the franchisee upon expiration or termination of the franchise agreement.<sup>111</sup>

Trade dress protection requires strategic planning and execution and does not happen overnight. By taking steps at the outset to (1) adopt trade dress elements that are capable of protection, (2) ensure that trade dress is used uniformly among a franchise system’s locations, and (3) nurture the trade dress over time to develop a strong connection in the minds of consumers and the goods and services of a particular franchise system, the franchisor is best positioned to be establish very strong intellectual property rights.

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<sup>108</sup> *Id.*

<sup>109</sup> *Id.* (citing *Wal-Mart Stores, Inc. v. Samara Bros., Inc.*, 529 U.S. 205, 216 (2000)).

<sup>110</sup> *Id.* (citing 3 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 15:30 (5th ed. 2020); *CiCi Enter., LP v. Four Word Motion, LLC*, No. 6:16cv1679Orl4KRS, 2016 WL 9244626, at \*3 (M.D. Fla. Oct. 17, 2016)).

<sup>111</sup> *Id.* at 13 (citing *TWTB, Inc. v. Rampick*, 152 F. Supp. 3d 549, 572 (E.D. La. 2016) (franchisor failed to establish that the License Agreement included trade dress or that the parties intended to include it in the License Agreement)).

### **3. Options for Selecting the Right Trademark for Your U.S. Franchise**

When selecting a trademark for the U.S. market, the franchisor's objective should be to select the strongest, most distinctive trademark available. This may or may not be the trademark used for the franchise outside the United States.<sup>112</sup>

Of course, franchisors coming from outside the United States may already have a brand they like, use, and/or are already known for, and hopefully the mark can be cleared for use and registration in the United States. Before adopting trademarks outside the United States, non-U.S. franchisors should give some consideration to whether the trademark they want to use is available and protectable in the United States. If, however, you are looking to start your franchise in the United States and either do not have a trademark, or the trademark you are currently using in your home country is not available for use and/or registration in the United States, you can consider the following options for selecting a new trademark for your franchise:

- (a) Survey or poll a select group of your target consumers to gauge reaction to any marks being considered. Alternatively, consider letting them choose your trademark (assuming you have conducted clearance for the mark(s) being considered); or
- (b) Hire an agency to evaluate and recommend a group of trademarks that they have market-tested and from which you can select a trademark to use with your franchise.

Prices for such agency services usually range between \$10,000-\$50,000 or more.<sup>113</sup> Be advised that these services may not conduct or include the necessary legal clearance (discussed below) for the marks they are suggesting for use in connection with your franchise in the United States. If not, and to avoid risk of infringement in the United States, a franchisor should conduct such clearance before adopting or using the suggested/selected trademark in the United States.

### **4. Clearance for a Franchise Brand Entering the U.S. Market**

After choosing a mark (preferably one that is inherently distinctive), franchisors should prioritize conducting a trademark clearance/availability search prior to adopting and using the mark on packaging or marketing materials, and prior to filing a trademark application with the U.S. Patent and Trademark Office ("USPTO") ([www.uspto.gov](http://www.uspto.gov)). Trademark counsel can help franchisors navigate the different trademark clearance options to determine the availability of a trademark for use and registration in the United States. At a minimum, a trademark search will include a review of confusingly similar trademarks filed/registered with the USPTO. More sophisticated clearance searches (called "full" or "comprehensive" searches) also consider unregistered common law uses of trademarks, as well as use of similar trade names, corporate names, and domain names. The importance of conducting clearance in the U.S. market is primarily because, unlike most countries around the world, trademark rights in the United States

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<sup>112</sup> See Herrine Ro, *15 of your favorite brands are called entirely different things abroad*, INSIDER (July 13, 2016, 11:36 A.M.), <https://www.businessinsider.com/brands-with-different-names-abroad-2016-7>.

<sup>113</sup> The authors could not find a published source for this fee range; but provide this information based on their respective experience with such matters.

are based on use in commerce, not registration. Such trademark rights are often referred to as “common law” rights.

**a. Full Search**

A full or comprehensive trademark clearance search is a cost-effective step that helps franchisors reduce risk when entering the U.S. market. Such searches can take time (turnaround time usually takes five to seven days but, if expedited, can be as short as one to two days), and are more expensive than preliminary/knock-out searches (described below). However, the investment in a full search is nominal compared to the investment a franchisor will likely make in the advertising, promotion, and marketing of a trademark. Moreover, a full trademark search can prevent franchisors from wasting time and money on a trademark that is not available for use or registration in the U.S. market. Perhaps most importantly, a full trademark clearance search can help franchisors avoid costly trademark litigation and/or USPTO proceedings resulting from adoption of a mark that is confusingly similar to another’s mark.<sup>114</sup>

Comprehensive searches are conducted by third-party vendors with significant search resources and capabilities to search not only the USPTO databases, but individual state trademark and corporate databases, directories, social media, internet/domain names, and other common law sources for third-party trademark use. Such searches range in cost averaging from approximately \$1,400 to a high of over \$3,000 per mark,<sup>115</sup> inclusive of search vendor costs and attorney fees associated with reviewing the search results and rendering an opinion.

**b. Preliminary/Knock-out Searches**

Sometimes franchisors do not want or need to spend money on a full search. This could be because they only plan to use the trademark for a short period of time, have already used the mark in commerce, or they are confident in the originality of their selected mark. In such cases, trademark practitioners usually recommend conducting at least a preliminary or knock-out search before adoption, use, and/or filing an application. Preliminary searches usually comprise of a review of registered marks and pending applications at the USPTO, and they are conducted online, allowing the trademark attorney to provide a relatively quick opinion on the risk associated with adoption of the selected mark. Some practitioners will also often conduct a Google search to see if they can spot any existing commercial/marketplace use of confusingly similar marks.

Preliminary/knock-out searches are not as comprehensive as a full search, and they are also subject to significant limitations associated with online resources. Law firms usually charge between \$500-\$1,000 per mark for preliminary/knock-out searches.<sup>116</sup>

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<sup>114</sup> See 15 U.S.C. § 1125.

<sup>115</sup> *2021 Report of the Economic Survey*, AM. INTELL. PROP. L. ASSOC. at I-92 (Sept. 2021) <https://www.aipla.org/detail/journal-issue/2021-report-of-the-economic-survey> [hereinafter “AIPLA Report”].

<sup>116</sup> The authors could not find a published source for this estimated fee range, but provide this information based on their respective experience with such matters.

## **5. Protecting Your Brand in the U.S. Market**

### **a. Federal Trademark Registration**

Registering a trademark is critical for franchisors. And while a franchisor is required to specifically identify the federally registered (and unregistered) trademarks it is licensing to the franchisee in the FDD,<sup>117</sup> trademark registration is not *required* to operate a franchise in the United States, nor to obtain rights in a trademark. But, the owner of a common law (unregistered) trademark in the United States only has exclusive rights to use the trademark in the geographic area of commercial use and any likely zone of expansion.<sup>118</sup> This means that, in the absence of any actual confusion, another business, even the same type of franchise, can arguably use a mark that is the same or confusingly similar without infringing, as long as the use is in a separate geographic area. Commerce on the internet has blurred the definition of what it means to use a trademark in a certain geographic area, potentially making it difficult to determine who has common law rights in a mark and where those rights apply. Issues like this can be avoided by taking early steps to clear and register trademarks before use. Clearing a mark reduces the risk of infringing another party's mark; registering a mark helps prevent infringement of your franchise's trademark.

### **i. Applying for a U.S. Federal Trademark Registration**

Federal trademark registration, which is overseen by the USPTO, entitles a mark owner to numerous benefits, including a presumption of validity and ownership as well as exclusive nationwide use of a mark in connection with the type of goods or services for which it is registered.<sup>119</sup> The owner of a federal registration may also use the Lanham Act to pursue trademark infringement claims in federal court. The Lanham Act provides for statutory remedies that would otherwise be unavailable to trademark owners, including damages for infringement that are separate from what the franchisor may be able to claim against a rogue franchisee for breach of the franchise agreement.<sup>120</sup> Another benefit of federal registration is that it serves as constructive notice of the right holder's claim of ownership.<sup>121</sup> After a mark is registered for at least five years, the owner of the mark can seek incontestable status.<sup>122</sup> Incontestable status reduces the bases upon which a mark can be challenged; once incontestable, a registration can only be challenged on the grounds that the mark is or has become generic, was obtained by fraud, or has been abandoned.<sup>123</sup>

Most importantly, if the non-U.S. franchisor's trademark is not registered in the United States this fact must be disclosed in Item 13 of its FDD along with the risks associated in the

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<sup>117</sup> 16 C.F.R. § 436.5(m).

<sup>118</sup> MCCARTHY, *supra* note 84, at § 26:20.

<sup>119</sup> See 15 U.S.C. § 1057.

<sup>120</sup> See *id.* § 1114.

<sup>121</sup> See *id.* § 1072.

<sup>122</sup> See *id.* § 1065.

<sup>123</sup> See *id.*

absence of such a registration. Such a disclosure is not likely to go over well with a prospective franchisee who is planning to invest in the franchise brand.

Non-U.S. franchisors can and should take advantage of available international trademark filings strategies that include the United States. For example, the United States is a signatory to the Madrid Protocol; accordingly, when a non-U.S. franchisor files for trademark protection in its own country, they could seek to designate the United States, among other signatory countries, as part of an international filing under the Madrid Protocol.<sup>124</sup> On average, the cost to designate the United States and other foreign countries as part of a Madrid Protocol filing is approximately \$700-\$1,000 per one-class application.<sup>125</sup> By contrast, the average cost to prepare and file a U.S. application directly with the USPTO is approximately \$1,200 to over \$1,500 for a one-class application.<sup>126</sup>

After the application is filed, it is examined by a Trademark Examiner at the USPTO. In many cases, the Examiner rejects the application via an “Office Action” on formal grounds (e.g., non-compliant description of goods/services) or substantive grounds (e.g., likelihood of confusion or descriptiveness). Applicants have six months to respond to the Office Action. This back-and-forth correspondence with the USPTO is referred to as “prosecution of the application.” Prosecution costs average approximately \$1,700 to a high of over \$3,000.<sup>127</sup>

If the applicant overcomes the Office Action, the USPTO will then publish the application to give third parties an opportunity to oppose the trademark registration. If there is no opposition, the trademark will be registered, unless filed originally on the basis of “intent-to-use,” in which case the application will be allowed for registration, but subject to satisfactorily proving use of the mark in U.S. interstate commerce, which involves the filing of “specimens” (examples of use of the mark) and dates of first use. Intent-to-use applications may be a critical tool for non-U.S. franchisors looking to come to the United States because such applications, once allowed, can be extended every six (6) months for up to three years (with fees for each extension ranging from \$400 to \$600).<sup>128</sup>

While there are no USPTO fees associated with the issuance of the registration certificate, law firms may charge nominal fees to review the certificate for accuracy and to docket deadlines associated with necessary maintenance and renewal of the registration. Between the fifth and sixth year following registration, the registrant must file a Declaration of Continued Use (Section 8), which can be accompanied by a Declaration of Incontestability (Section 15), as discussed above.<sup>129</sup> Fees for this filing are an approximate average of \$600 ranging up to \$1,000.<sup>130</sup> Finally,

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<sup>124</sup> See *id.* § 1141 et seq.

<sup>125</sup> AIPLA Report, *supra* note 115, at I-92.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> The authors could not find a published source for this estimated fee range, but provide this information based on their respective experience with such matters.

<sup>129</sup> 15 U.S.C. §§ 1058, 1065; MCCARTHY, *supra* note 84, at §§ 19:135, 19:140.

<sup>130</sup> AIPLA Report, *supra* note 115, at I-93.

every ten years following registration, the registrant must file a Section 8 Declaration along with a Renewal request (Section 9).<sup>131</sup> Fees for this filing average \$700 and range up to \$1,100.<sup>132</sup>

## ii. Updated U.S. Trademark Laws Benefit Franchisors

U.S. trademark law was recently modernized with the passing of The Trademark Modernization Act of 2020 (“TMA Act of 2020”).<sup>133</sup> The TMA Act of 2020 went into effect on December 27, 2021. Several of its provisions are important for the U.S. franchise community, with one having a significant impact with respect to trademark infringement matters. Indeed, non-U.S. franchisors seeking to preserve their trademark rights in the United States, perhaps even before they operate here, may also seek to take advantage of the TMA Act of 2020 provisions.

Perhaps most important to non-U.S. franchisors seeking to enforce their trademarks in the United States, the TMA Act of 2020 restores or confirms (depending on the jurisdiction) the presumption of irreparable harm in trademark cases where injunctive relief is sought. The reinstatement of the presumption reverses what had been a refusal by many courts to apply the presumption in trademark cases following the 2006 United States Supreme Court’s decisions in *eBay Inc. v. MercExchange, L.L.C.* and *Winter v. Natural Resources Defense Council, Inc.*, which had eliminated similar presumptions brought under patent and environmental law.<sup>134</sup>

Franchisors and franchisees frequently litigate over trademarks in cases arising from “holdover scenarios” where a franchisee continues to use the franchisor’s trademarks after expiration or termination of the franchise relationship.<sup>135</sup> Such use often is in connection with a competing venture, often from the same location as the former franchised business. The TMA Act of 2020, which is the federal statute governing trademark law in the United States, once again provides franchisors with a significant weapon to secure preliminary and (ultimately) permanent injunctive relief to address these scenarios. To obtain injunctive relief, franchisors typically must demonstrate: (1) a likelihood of success; (2) irreparable injury; (3) the threatened injury to the movant outweighs the harm the relief sought would inflict on the opposing party; and (4) the injunction would not be adverse to the public interest. Prior to 2006, courts routinely held that a movant was entitled to injunctive relief merely by demonstrating a likelihood of success on the merits of a trademark infringement claim. Such decisions highlighted the judicial recognition of a “presumption” of irreparable harm to the movant because of the infringement. The TMA Act of 2020 now confirms that the franchisor trademark owner enjoys a rebuttable presumption of irreparable harm upon establishing infringement at the proof stage; alternatively, this rebuttable

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<sup>131</sup> 15 U.S.C. § 1058; MCCARTHY, *supra* note 84, at § 19:135.

<sup>132</sup> AIPLA Report, *supra* note 115, at I-94.

<sup>133</sup> H.R. Con. Res. 6169, 116th Cong. (2020) (enacted) (amending 15 U.S.C. §§ 1051, 1062(b), 1064, 1066(a)-(b), 1068, 1070, 1071(a)(1), 1071(b)(1), 1116, 1092).

<sup>134</sup> *eBay Inc. v. MercExchange, L.L.C.*, 547 U.S. 388 (2006); *Winter v. Natural Resources Defense Council, Inc.*, 555 U.S. 7 (2008).

<sup>135</sup> See Christopher P. Bussert, *The Trademark Modernization Act of 2020: What Will Its Impact Be on Franchising?*, 24 THE FRANCHISE LAW. 1, at 13 (2021).

presumption can be established upon a showing of a likelihood of success in proving infringement in the context of motions for temporary restraining orders or preliminary injunctions.<sup>136</sup>

For franchisor trademark owners, the availability of a presumption of irreparable harm should make it easier to obtain injunctive relief in trademark infringement litigation. Moreover, with this presumption back in play, franchisees may think twice about using the franchisor's trademarks without permission or in a manner that fails to comply with the franchise agreement's terms. Nevertheless, franchisor trademark owners should be mindful about the importance of showing *evidence of actual irreparable harm* resulting from the alleged trademark infringement, rather than relying solely on the presumption.<sup>137</sup> Without such evidence of actual harm, the opposing party may be able to rebut the presumption. Although loss of revenue certainly qualifies as evidence of irreparable harm, franchise trademark owners can also establish irreparable harm by demonstrating harm to the brand and its reputation, as well as its value in the marketplace.<sup>138</sup> Such evidence may be particularly helpful in jurisdictions that previously refused to apply the presumption following *eBay* and *Winter* and which may, at least initially, balk at its reapplication.

Another significant part of The TMA Act of 2020 for non-U.S. franchisors to take advantage of, perhaps even before they operate in the United States, codifies the existing "letter of protest" procedures, which allow franchisor trademark owners (or any third party) to raise certain challenges to pending applications during examination.<sup>139</sup> This potentially represents a less expensive alternative for franchisor trademark owners to prevent the registration of confusingly similar marks by third parties without having to file opposition proceedings.

The TMA Act of 2020 also provides a more formal approach to submission and consideration of "letters of protest" and evidence relevant to a ground for the refusal of applications.<sup>140</sup> Within two (2) months after the date on which a third party files a submission, the Director will determine whether to include the evidence in the record of the application. Any determination by the Director of whether to forward the evidence to the examiner assigned to an application is final and non-reviewable, but it will not prejudice any party's right to raise any issue and rely on that or any other evidence in any other proceeding.

The new provisions in the TMA Act of 2020 should be beneficial to franchisor trademark owners in the United States and the consuming public in numerous respects. Indeed, taken together, the TMA Act of 2020's reforms may result in greater and more cost-effective protection for trademark owners seeking injunctive relief, as well as a registration system that more accurately reflects the reality of the marketplace.

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<sup>136</sup> See *id.* at 13-14; 15 U.S.C. § 1116(a).

<sup>137</sup> Bussert, *supra* note 135, at 14.

<sup>138</sup> MCCARTHY, *supra* note 84, at § 30:46.

<sup>139</sup> Bussert, *supra* note 135, at 15; 15 U.S.C. § 1051(f).

<sup>140</sup> *Id.*

## **b. Applying for a State Trademark registration**

Franchisors who are unable to obtain federal trademark protection may want to seek state registration(s) instead, or at least on an interim basis until their mark's federal registration status can be resolved. For franchisors considering business only in a specific state, a state trademark registration can be advantageous. For example, owning a state trademark registration enables the franchisor to avoid certain state franchise filing requirements in Connecticut and Georgia.<sup>141</sup> In addition, once registered, the mark will be listed on the state's registration database; this can act as a deterrent and potentially keep others from using the identical mark, or one that is confusingly similar. Moreover, state registration fees are often significantly lower than federal fees (e.g., in New York, the trademark filing fee is \$50 per class of goods/services, whereas a federal filing ranges from \$250-\$500 per class).<sup>142</sup> State unfair competition laws can also offer additional remedies beyond those granted by the Lanham Act.

While state registration for trademarks grants a franchisor limited protection to that state, as opposed to the entire country, the process is simpler and more expedient than the USPTO registration process, and usually results in the issuance of a state registration.<sup>143</sup> Many states have adopted the Model State Trademark Act as the basis for state trademark registration.<sup>144</sup> Because some states deviate from the Model State Trademark Act and Lanham Act, however, franchisors should check specific state requirements related to use and registration for their mark.<sup>145</sup>

State trademark registration typically lasts for five to ten years, after which an application for renewal can be submitted. Each state has its own published application forms to register a trademark. Franchisors can obtain the appropriate state form from the Office of the Secretary or through the individual state trademark office.<sup>146</sup>

## **6. Enforcement and Monitoring Your Brand in the U.S. Market**

Non-enforcement of your trademark rights, *i.e.*, allowing third parties to use the same or similar marks for the same or related products or services to those offered under your franchise trademark, can weaken a trademark so much that the mark can lose its value.<sup>147</sup> Indeed,

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<sup>141</sup> CONN. GEN. STAT. §§ 36b-60 et seq.; GA. CODE ANN. §§ 10-1-410 et seq.

<sup>142</sup> *Application to Register a Trademark*, N.Y. DEP'T OF STATE, <https://dos.ny.gov/application-register-trademark#:~:text=%2450%20filing%20fee%20for%20each,over%20%24500%20must%20be%20certified> (last visited July 15, 2022) [hereinafter "N.Y. DEP'T OF STATE"]; *How much does it cost?*, U.S. PAT. & TRADEMARK OFF., <https://www.uspto.gov/trademarks/basics/how-much-does-it-cost> (last visited July 15, 2022).

<sup>143</sup> See MCCARTHY, *supra* note 84, at § 22:1.

<sup>144</sup> Based on the information available, Maine, North Dakota, and Vermont do not appear to have adopted the Model State Trademark Act or a similar variation of it. See *id.* at § 22:1.50.

<sup>145</sup> N.Y. DEP'T OF STATE. *supra* note 142.

<sup>146</sup> 5 MCCARTHY, *supra* note 84, at § 22:2.; State trademark information links, U.S. PAT. & TRADEMARK OFF., <https://www.uspto.gov/trademarks/basics/state-trademark-information-links> (last visited June 29, 2022).

<sup>147</sup> 2 MCCARTHY, *supra* note 84, at § 11:91.

unauthorized third-party use of your franchise trademark could result in “naked licensing” or abandonment of the trademark as well as render the trademark invalid or unenforceable.<sup>148</sup>

Franchise trademark owners who plan to use their trademarks have an obligation in the United States to protect and monitor their marks to ensure the goodwill of the mark and to maintain the brand’s identity and reputation.<sup>149</sup> As part of any plan to adopt and use a trademark for your franchise business in the United States, pro-active monitoring and enforcement can eliminate confusingly similar marks from the marketplace and further enhance the strength and distinctiveness of a franchisor’s mark.<sup>150</sup>

**a. Watch Services**

To carry out effective monitoring, watch services are available from third party vendors that can scour the internet and market for threats to your franchise trademark, as well as notify you of any pending applications for marks that are identical or similar to your own. These services identify threats including infringers, counterfeiters, and consumer complaints that could tarnish your brand and reputation. Franchisors can set up their own internal procedures or utilize third party vendor services to monitor not only franchisee activity (including corporate registration or LLC formations under the franchisee, proper use of the mark (including logos) on advertisements, and registration and use of unauthorized domain names or social media accounts), but also unauthorized use by unrelated third parties.<sup>151</sup>

Below is a chart that shows the most common watch services available from one such vendor (Clarivate) and the annual costs for such services.

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<sup>148</sup> See *Broeg v. Duchaine*, 319 Mass. 711, 67 N.E.2d 466 (1946) (uncontrolled licensing may result in trademark ceasing to have any meaning and be a fraud on the public); *Dawn Donut Co. v. Hart’s Food Stores, Inc.*, 267 F.2d 358, 367 (2d Cir. 1959) (“The Lanham Act clearly carries forward the view of these latter cases that controlled licensing does not work an abandonment of the licensor’s registration, while a system of naked licensing does . . . [U]nless the licensor exercises supervision and control over the operations of its licensees the risk that the public will be unwittingly deceived will be increased . . . .”); *Heaton Distrib. Co. v. Union Tank Car Co.*, 387 F.2d 477, 485 (8th Cir. 1967) (“The generally accepted meaning of ‘uncontrolled licensing’ is where a trademark owner has licensed someone else to make or manufacture its products and then fails to control the quality of the products made by the licensee, thus permitting a deception of the public.” No such lack of control was found in this case.); *Barcamerica Intern. USA Trust v. Tyfield Imp., Inc.*, 289 F.3d 589, 596 (9th Cir. 2002) (“[W]here the licensor fails to exercise adequate quality control over the licensee, ‘a court may find that the trademark owner has abandoned the trademark, in which case the owner would be estopped from asserting rights to the trademark.’” A lack of adequate control was found.); *FreecycleSunnyvale v. Freecycle Network*, 626 F.3d 509, 515-16 (9th Cir. 2010) (“We have previously declared [In Barcamerica] that naked licensing is ‘inherently deceptive and constitutes abandonment of any rights to the trademark by the licensor.’” Emphasis in original. Summary judgment of abandonment for lack of quality control was affirmed.)

<sup>149</sup> *Id.*

<sup>150</sup> 5 MCCARTHY, *supra* note 84, at § 23:76.50.

<sup>151</sup> Jeff Fabian, *Protect Your Brand: Trademark Monitoring for Franchisors*, FRANCHISE HELP <https://www.franchisehelp.com/franchisee-resource-center/protect-your-brand-trademark-monitoring-for-franchisors/> (last visited July 15, 2022).

<b>Product<sup>152</sup></b>	<b>Price</b>
Common Law Watch (business name, common law, and domain name)	\$870 \$1,160 (with Legacy gTLDs <sup>153</sup> and new gTLDs)
Social Media Username Watch	\$350
Domain Name Watch	\$1,005 (legacy gTLDs, gTLD typo squatting, and ccTLDs) \$1,275 (with legacy and new gTLDs)
Web Watch	\$2,150

In addition to the watches above, Clarivate also provides watches related to U.S. and foreign trademark applications, as follows:

<b>Product<sup>154</sup></b>	<b>Word Mark Price</b>	<b>Design Mark Price</b>
Worldwide Watch	\$555 (one class only)	\$555 (one class only)
US Watch - Pending (newly filed) and Official Gazette (published) Package	\$590	\$1,035
US Watch - Official Gazette (published) Only	\$335	\$590
US Watch - Pending Application (newly filed) Only	\$195 (plus tax)	\$345 (plus tax)

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<sup>152</sup> CLARIVATE, 2022 COMPUMARK PRODUCTS AND SERVICES GUIDE (available offline). See also *Trademark Watching*, CLARIVATE, <https://clarivate.com/products/ip-intelligence/trademark-research-and-protection/trademark-watching> (last visited Sept. 8, 2022); see also *Watching Services FactSheet*, CLARIVATE, <https://clarivate.com/resources/watch-services> (last visited Sept. 8, 2022) (“Common Law Watch” generally includes watching for third-party use of identical or highly-similar marks, as well as business and domain names. “Social Media Username Watch” identifies and provides notification when an identical watched trademark appears as a username on major social media websites. “Domain Name Watch” identifies “copycat” domains that could interfere with trademark rights. “Web Watch” identifies instances of potential brand misuse and abuse, including derogatory remarks and unauthorized use, and provides reports to brand owners.)

<sup>153</sup> See *Registering Domain Names*, ICANN, <https://www.icann.org/resources/pages/register-domain-name-2017-06-20-en> (last visited Sept. 8, 2022) (defining “gTLD” as “generic Top-Level Domain[s]”).

<sup>154</sup> See *Trademark Watching*, CLARIVATE, *supra* note 152 (“Worldwide Watch” entails watching both word and design marks in jurisdictions around the world. “USPTO Pending Application Watch” entails checking the chosen trademark each week against newly-filed USPTO trademark applications, and ensures notification before publication. “USPTO Official Gazette Watch” entails monitoring new U.S. filings recently published in the USPTO Official Gazette that may infringe upon the chosen trademark.)

**b. Cease and Desist Letters**

A cease and desist letter can be a swift and effective, yet inexpensive, alternative to litigation to address trademark infringement.<sup>155</sup> Although the request to stop infringing activities can be rejected or ignored, a cease and desist letter can be presented in litigation as an effort to demonstrate non-litigious means to stop infringing activities. That said, owners of trademarks are not obligated to send cease and desist letters prior to filing a suit.<sup>156</sup>

The letter should (1) include the reason you are writing, (2) present evidence of infringement, (3) establish a deadline to cease infringing activity (with a request for proof of compliance), and (4) list any demands for compensation (if desired).<sup>157</sup> Estimated attorney fees to investigate potential infringement and prepare a cease and desist letter range from \$1,500 to \$3,000.<sup>158</sup>

**c. Litigation**

If the cease and desist letter does not work, and your franchise business is being harmed, franchisors in the United States can assert their trademark rights through various causes of action at both the federal and state court level. The owner of a trademark can file a trademark infringement suit based on a likelihood of confusion between marks.<sup>159</sup> Courts in the United States generally consider eight foundational factors to determine a likelihood of confusion: (1) similarities between the overall look and feel of the marks; (2) similarities between the underlying products or services; (3) the strength or distinctiveness of the owner's mark; (4) proof of actual confusion by consumers; (5) the defendant's intent in adopting or using the mark; (6) whether the goods operate in the same commercial market; (7) the extent to which the goods or services have common consumers; and (8) the likelihood of expanding the product or service lines. Because a likelihood of confusion analysis is fact-based,<sup>160</sup> it can be challenging to anticipate a court's ruling.<sup>161</sup>

In the United States franchise trademark owners can also seek to protect their trademarks even when a likelihood of confusion does not exist, but instead their trademarks have been tarnished or otherwise diluted by an unauthorized third party use.<sup>162</sup> Dilution occurs when a junior

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<sup>155</sup> BARRY KRAMER & ALLEN D. BRUFISKY, 1 TRADEMARK LAW PRACTICE FORMS § 44:1 (6th ed. 2022).

<sup>156</sup> *Id.*

<sup>157</sup> Christopher Kelly & Vincent Frantz, *Basics Track: Franchisor's Intellectual Property and How to Protect It*, INT'L FRANCHISE ASS'N 52ND ANNUAL LEGAL SYMP. (2019).

<sup>158</sup> The authors could not find a published source for this fee range, but provide this information based on their respective experience with such matters.

<sup>159</sup> 5 MCCARTHY, *supra* note 84, at § 23:76.50.

<sup>160</sup> *In re E. I. DuPont DeNemours & Co.*, 476 F.2d 1357, 1361 (C.C.P.A. 1973) (applying a 13-part standard for determining likelihood of confusion for the USPTO to refuse to register a mark under Section 2(d) of the Lanham Act).

<sup>161</sup> *AMF Inc. v. Sleekcraft Boats*, 599 F.2d 341, 348 (9th Cir. 1979).

<sup>162</sup> *See* MCCARTHY, *supra* note 84, at § 24:89.

user's impermissible use of a famous mark on unrelated goods or services causes "a weakening or reduction in the ability of a famous mark to distinguish only one source."<sup>163</sup> Under the federal Lanham Act in order to succeed on a claim for dilution the trademark must be famous, and the trademark owner must show that prospective consumers are likely to make a mental connection between the plaintiff's mark and the junior user's mark so as to cause dilution by blurring or tarnishment.<sup>164</sup> The state dilution statutes all differ in some degree, but in general require a similar showing to that required under the federal Lanham Act, except under most state laws the showing of a "famous" mark is not required.<sup>165</sup>

#### **i. Federal courts**

Owners of a federally registered trademark, under Section 32 and/or Section 43(a) of the Lanham Act,<sup>166</sup> can bring a trademark infringement suit in federal or state court against any person that uses the mark in a way that creates confusion among consumers as to the source of the person's products or services.<sup>167</sup> Causes of action are also available for owners of unregistered trademarks, but only under Section 43(a) of the Lanham Act.<sup>168</sup> Such claims may also be brought in federal or state courts. Although unregistered trademarks do not benefit from the presumption of validity, incontestability, and other benefits given to federally registered trademarks, owners of unregistered marks still have access to remedies under the Lanham Act.<sup>169</sup>

Federal causes of action for dilution of a trademark can also be brought under Section 43(c) of the Lanham Act.<sup>170</sup>

In 2020, according to the AIPLA survey, the cost to take a trademark infringement/dilution case through trial and appeal varied depending on the value of the case, as follows:

- Cases valued at less than \$1 million averaged \$415,000;

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<sup>163</sup> *Id.* at § 24:67.

<sup>164</sup> 15 U.S.C. § 1125(c)(1).

<sup>165</sup> See 5 MCCARTHY, *supra* note 84, at § 24:77; see, e.g., *Firefly Digital Inc. v. Google Inc.*, 817 F. Supp. 2d 846, 866 (W.D. La. 2011) (under Louisiana law, the required strength can be demonstrated by showing a mark to either be distinctive or to have acquired secondary meaning); *ESPN, Inc. v. Quiksilver, Inc.*, 586 F. Supp. 2d 219, 228 (S.D. N.Y. 2008) (under New York statute, mark need not be "famous" or "celebrated," but it must be an extremely strong mark either because of its inherently distinctive qualities or the fact that it has acquired secondary meaning); *Interstellar Starship Services v. Epix, Inc.*, 125 F. Supp. 2d 1269, 1281 (D. Or. 2001), *decision aff'd*, 304 F.3d 936, 64 U.S.P.Q.2d 1514 (9th Cir. 2002) (under Oregon law, plaintiff must prove the mark's "favorable associational value in the minds of consumers").

<sup>166</sup> 15 U.S.C. §§ 1114 (bringing an action based on a registered mark), 1125 (bringing an action based on use of an unregistered mark).

<sup>167</sup> Bussert & Stevens, *supra* note 99, at 30-31.

<sup>168</sup> See 15 U.S.C. § 1125(a); MCCARTHY, *supra* note 84, at § 27:14.

<sup>169</sup> See *id.* See also 5 MCCARTHY, *supra* note 84, at § 27:23.

<sup>170</sup> 15 U.S.C. § 1125(c).

- Cases valued between \$1-\$10 million averaged \$892,000;
- Cases valued between \$10-\$25 million averaged \$1,592,000; and
- Cases valued greater than \$25 million averaged \$3,381,000.<sup>171</sup>

## ii. State courts

Although state trademark registration offers few advantages to rights holders, all states provide a cause of action for common law trademark infringement and/or dilution. Typically, rights holders join applicable state actions asserting unfair competition, misappropriation, false advertising, dilution, etc., with an action under the Lanham Act in federal court.<sup>172</sup> The fees for enforcement actions filed in state court are not likely to be different from those noted above for federal court.

While it is not common to see state court trademark actions, such actions may be more pertinent than federal court if the infringement case and damages are localized to a specific state, or if you could not establish a strong likelihood of confusion case and the state law requirements for proving other forms of unfair competition were less stringent than federal law.<sup>173</sup>

## iii. USPTO Opposition/Cancellation Proceedings

Apart from going to court to stop a third party from using a confusingly similar trademark, there are USPTO-administered proceedings before the Trademark Trial and Appeal Board that franchise trademark owners can utilize to oppose a third-party application, or to cancel a third-party registration for a confusingly similar mark. Such proceedings do not offer injunctive relief or damages, and they only deal with the issue of whether registration of a mark is proper. When taken through trial, legal fees for such proceedings average \$168,000-\$425,000+.<sup>174</sup>

## B. Patents: Another Intellectual Property Asset for Franchisors

Few franchisors include patents in their arsenal for intellectual property enforcement and protection. A patent for an invention is an exclusive yet limited property right under U.S. law.<sup>175</sup> The exclusive right to a patent lasts twenty years from the date on which the patent application

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<sup>171</sup> AIPLA Report, *supra* note 115, at 73.

<sup>172</sup> *Spin Master, Inc. v. Amy & Benton Toys & Gifts Co.*, No. 17-CV-5845 (VSB), 2019 WL 464583, at \*4–5 (S.D.N.Y. Feb. 6, 2019).

<sup>173</sup> *See, e.g., Wolo Mfg. Corp. v. ABC Corp.*, 349 F. Supp. 3d 176, 208 (E.D.N.Y. 2018) (where trademark claims were dismissed, plaintiff succeeded on state claims for unfair competition and deceptive business practices under New York law).

<sup>174</sup> AIPLA Report, *supra* note 115, at 75, I-207.

<sup>175</sup> *General Information concerning patents*, U.S. PAT. & TRADEMARK OFF., <https://www.uspto.gov/patents/basics/general-information-patents> (last visited July 15, 2022).

was filed.<sup>176</sup> To qualify for a patent, an invention must be new, non-obvious (sufficiently distinguishable from prior art), and useful.<sup>177</sup>

Ideas or suggestions are unpatentable; however, a comprehensive description of the machine, method, chemical composition, etc. is required to obtain a patent. In the United States, there are three types of patents: (1) utility patents for new and useful products, methods, processes; (2) design patents for ornamental designs for an article of manufacture; and (3) plant patents for reproductions of new and distinct plant varieties.<sup>178</sup> Most, if not all franchisors, would seek utility or design patent protection. Patents, while considered the most expensive form of intellectual property protection, can serve as an alternative for functional products denied trademark protection.<sup>179</sup>

If a non-U.S. franchisor could obtain patent protection in the United States it could create a significant marketplace advantage over competitors, not to mention potentially additional revenue streams for the franchisor to earn from licensing the patent to franchisees. But be advised, if you have already patented the invention in your home country you will only have one year to file a patent application for such invention in the United States.<sup>180</sup> Be further advised, that on average it is taking about two years to have your patent application examined in the USPTO and issued to patent.<sup>181</sup>

On average, fees to prepare and file a non-provisional utility patent application on an invention of minimal complexity are approximately \$7,500-\$11,000;<sup>182</sup> fees to prepare and file a design patent application average \$1,500-\$3,000.<sup>183</sup>

Prior to operating a non-U.S. franchise in the United States, it is a good idea to assess whether any products, packaging, systems (or other aspect of the franchise) infringe any issued U.S. patents. Patent attorneys can conduct what are known as “freedom to operate” (“FTO”) searches that give franchisors the opportunity to assess and avoid litigation risks by designing around competitor’s patents during the conceptual stage, thereby avoiding an investment of time and money into an already existing invention.<sup>184</sup> While franchisors may develop new product designs or creative solutions, they must also anticipate the prospect or reality that others shared

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<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> Corby Anderson, Naser Baseer, & Paul Jones, *Strategic Intellectual Property Protection In Franchise Systems: Beyond Trademark Registration*, ABA 37TH ANNUAL FORUM ON FRANCHISING W-24 (2014).

<sup>180</sup> 35 U.S.C. §§ 119(a); 102.

<sup>181</sup> See *Patents Pendency Data July 2022*, U.S. PATENT & TRADEMARK OFF., <https://www.uspto.gov/dashboard/patents/pendency.html> (last visited Sept. 8, 2022).

<sup>182</sup> AIPLA Report, *supra* note 115. at I-100.

<sup>183</sup> *Id.* at I-136.

<sup>184</sup> Dominic Frisina, *Patentability Versus Freedom-To-Operate*, JD SUPRA (May 11, 2021), <https://www.jdsupra.com/legalnews/patentability-versus-freedom-to-operate-9262817/>.

the same idea and patented it first in the United States.<sup>185</sup> Counsel can (1) evaluate whether the products or processes require an FTO analysis, (2) identify relevant patents, and (3) assess potential infringement. An FTO analysis provides franchisors with valuable insight to determine patent infringement risks prior to or during the product or system development process, while undergoing due diligence as a part of a potential acquisition or licensing transaction, or when a third party alleges patent infringement or puts forth a patent notice letter. Following an FTO analysis, counsel can determine whether a written opinion is necessary to address patent infringement liability risks, offer defenses against a willful or induced infringement claim or assert that the franchisor's product or process is not infringing, the patent at issue is invalid, or both.

Freedom to operate opinions can cost anywhere from \$10,500 to \$20,000,<sup>186</sup> but considering the cost of patent infringement litigation in the United States, such an investment may be worthwhile in the long term.

### **C. Copyright and Clearance**

Copyrights are another form of intellectual property asset in the United States. While not frequently relied on by franchisors, or described in the FDD, rights in copyrighted material are something that newcomers to the U.S. franchise market might want to identify and use to distinguish their franchise concept.

Copyright protects all forms of original expression that are embodied in a tangible medium of expression. Copyright ownership and protection arise automatically and immediately upon creation of a work. As such, in the United States, there is no need for registration, publication, or notice, although same can be useful if suing for copyright infringement.

To the extent that a franchisor develops the original expression itself or through one of its employees, the copyright in the work automatically vests with the franchisor as a work made for hire. If, however, an independent contractor develops the work, the franchisor must obtain a written copyright assignment from the contractor, unless the agreement with the contractor specifically states that the work being done is a work for hire.<sup>187</sup>

There are all kinds of copyrightable subject matter, including (1) literary works (including computer programs); (2) musical works, including any accompanying words; (3) dramatic works, including any accompanying music; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural (3D) works (including maps and architectural plans); (6) motion pictures and other audiovisual works; (7) sound recordings; and (8) textual works, including advertising, manuals, and instructions. A franchisor's operations manual might be its most important copyrightable work, along with its training materials, recipes, menus, displays, signs, *etc.*

Not all subject matter is copyrightable. Examples of non-copyrightable materials include: raw information (phone numbers/addresses/e-mail addresses/calendars); ideas (consider patents); insignificant subject matter (*de minimis* works, like titles, names, phrases);

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<sup>185</sup> Dominic Frisina, *Dear Patentability: Freedom to Operate*, JD SUPRA (Nov. 8, 2021), <https://www.jdsupra.com/legalnews/dear-patentability-freedom-to-operate-2361815/>.

<sup>186</sup> AIPLA Report, *supra* note 115. at I-105.

<sup>187</sup> *Circulars*, U.S. COPYRIGHT OFF., <https://www.copyright.gov/circs/> (last visited Sept. 8, 2022).

U.S. government works; and public domain works (works that were once protected by copyright but for which copyright protection has expired).

To the extent that a franchise owns/creates copyrightable works that it intends to license to the U.S. franchisee, the franchisor should identify those copyright assets to capitalize on its rights to exclusively permit its franchisees to copy, use, display, sell and use the copyrighted works. The non-U.S. franchisor should then seek to file copyright applications in the United States Copyright Office to obtain formal registration of its copyrightable works.

### **1. Copyright Registration**

In the United States, filing for and obtaining a copyright registration is relatively simple and inexpensive. The entire process can be done online at <https://eservice.eco.loc.gov/>. The cost to file a standard copyright application is \$65 per work.<sup>188</sup> And copyright protection lasts a very long time – for franchise owners the copyright term is ninety-five years from the date of publication, or 120 years from the date of creation, whichever expires first.<sup>189</sup>

### **2. Copyright Clearance**

To the extent a franchisor has important copyrightable works that make up a significant part of the franchise system, e.g., artwork, displays, applied designs to products, etc., it may be advisable to ensure that these works do not infringe the copyrights of U.S. owners. A common form of copyright infringement is found among competitors in the same or related industries. And while it is not easy to conduct copyright clearance and access the actual works submitted with each copyright registration in the U.S. Copyright Office, it is easy to look up whether your competitors have filed for copyright registration in the United States and see what kinds of works they have protected. Copies of “deposits” submitted in connection with copyright applications can be obtained for any registered copyright.<sup>190</sup> Fees associated with a copyright infringement evaluation range from \$1,000-\$5,000, depending on the complexity of the works being examined.

Be advised, that there is no obligation to conduct a copyright clearance prior to creating your own work. If, however, you are working from a primary source or other pre-existing work to create your work, it is advisable to seek copyright clearance before publishing your work to avoid claims for copyright infringement.

### **3. Copyright Enforcement**

Copyright enforcement cases, like patent cases, are exclusively filed in federal courts in the United States. You must own a U.S. copyright registration before you file a complaint for copyright infringement.<sup>191</sup> If you timely file for copyright registration (either before the act of

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<sup>188</sup> *Fees*, U.S. COPYRIGHT OFF., <https://www.copyright.gov/about/fees.html> (last visited Sept. 8, 2022).

<sup>189</sup> 17 U.S.C. § 302(e).

<sup>190</sup> *Circulars*, U.S. COPYRIGHT OFF., *supra* note 187.

<sup>191</sup> *Id.*

infringement, or within 3 months of your first publication), you are entitled to seek statutory damages (up to \$150,000 per infringement for willful infringement) and attorney fees.<sup>192</sup>

Copyright litigation in the United States is less expensive than patent litigation. Fees for court actions through to trial and appeal average \$1.4 million and range up to \$2 million.<sup>193</sup>

#### **D. Trade Secrets**

Another valuable form of intellectual property for franchisors operating in the United States is trade secrets. In the United States, trade secrets are generally defined as information that (a) derives economic value from not being generally known, and (b) is the subject of reasonable efforts to protect secrecy of the information.<sup>194</sup> Trade secrets in the United States are protected by the federal Defend Trade Secrets Act and state laws.<sup>195</sup> And, unlike patent rights which expire after twenty years, trade secret rights exist for as long as the information remains a secret.

Trade secret rights are usually enforced by way of contract/franchise agreement. To ensure the protection of trade secrets, franchisors should make sure that (1) the trade secret is clearly defined; and (2) the franchisor/franchisee, and their respective employees, are mandated to protect against disclosure of the trade secret information. Limitations on the use of trade secrets are crucial for their protection. It should be made clear that trade secrets are the property of the franchisor and may be used only in furtherance of franchised business and only during term of the franchise agreement.

Examples of franchise materials that may fall under the trade secret definition include franchise operations manuals; formulas, recipes, and product information; customer and vendor information; best practices for methods of operation and processes; development plans; marketing and promotional plans; and software and technology systems originally developed by the franchisor.

There are no registration fees or costs for trade secrets, other than those associated with the development and maintenance of the trade secrets.

As for enforcement of your trade secret rights, you should expect that fees and costs associated with any trade secret matter will be similar to those associated with patent litigation.

In 2020, according to the AIPLA survey, the cost to take a trade secret case through trial and appeal varied depending on the value of the case, as follows:

- Cases valued at less than \$1 million averaged between \$800,000 to \$1.8 million;

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<sup>192</sup> 17 U.S.C. § 504(c)(2).

<sup>193</sup> AIPLA Report, *supra* note 115, at I-208-I-214.

<sup>194</sup> RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 39 (Am. Law. Inst. 1995).

<sup>195</sup> 18 U.S.C. § 1836, *et seq.*; see *Panera, LLC v. Nettles*, No. 16-cv-1181, 2016 WL 4124114 (E.D. Mo. Aug. 3, 2016).

- Cases valued between \$1-\$10 million averaged between \$1.7 million to \$3.4 million;
- Cases valued between \$10-\$25 million averaged between \$3.3 million to \$5.4 million; and
- Cases valued over \$25 million averaged between \$4.5 million to \$8.1 million.<sup>196</sup>

## V. CONCLUSION

The U.S. market offers a wealth of possibilities for franchisors, whether they are based in the United States or internationally. The U.S. economy, American consumers' thirst for – and acceptance of – new concepts, the stability of the U.S. franchise sector, and the relatively navigable regulatory environment (especially if exemptions are available) all suggest that franchisors with a proper and well-considered strategy for entering the market, as well as a disciplined implementation plan, are likely to find success in operating in the United States.

The downfalls that some franchisors have encountered when entering the U.S. market are the same as those that would undermine any franchisor expanding in any country. These include factors such as incomplete planning, poor selection of prospective franchisees, reliance on unreliable vendors (such as inexperienced counsel<sup>197</sup> and overreliance on broker networks) and a lack of emphasis on operational excellence. Counsel can play a key role in facilitating the transition to the U.S. market for non-U.S. franchisors by evaluating the legal issues a non-U.S. franchisor may face in the United States market and providing advice and counsel on how to resolve and overcome those issues.

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<sup>196</sup> AIPLA Report, *supra* note 115, at I-218.

<sup>197</sup> Amy Rees Anderson, *Nothing Is More Expensive Than A Cheap Lawyer*, FORBES, (June 4, 2013, 11:23 P.M.), <https://www.forbes.com/sites/amyanderson/2013/06/04/nothing-is-more-expensive-than-a-cheap-lawyer/?sh=471fc6b37d10> (“One of the biggest mistakes I made early on as an entrepreneur was hiring cheap lawyers or not using an expensive lawyer nearly enough, thinking I was saving money for my business. But over the years, the school of hard knocks taught me just how expensive cheap legal help can be.”).

## **Author Biographies**

### **Lee J. Plave**

Lee Plave is a co-founding partner of Plave Koch PLC, an entrepreneurial law firm in Reston, Virginia. He counsels franchisors and distributors, drafts, and negotiates agreements for international and domestic transactions, and advises clients on all aspects of franchise and distribution law.

Lee also advises clients on private equity transactions, the application of emerging technologies to franchise and distribution systems (including data and security policies, social media and networking issues, domain name disputes, and cybersmear sites). He additionally represents clients before the Federal Trade Commission, where he began his career.

Lee serves as Vice-Chair of the Clark University Board of Trustees and as Chair of the Board's Audit and Strategic Risk Committee. He also currently serves as Treasury Officer of the International Bar Association's Committee on International Franchising and served as the Director of the International Division of the American Bar Association's Forum on Franchising (2012-14).

Lee was recognized three times as the global *Franchise Lawyer of the Year* by London-based *Who's Who Legal* (2018, 2019, and 2020), as ranked by his peers. *Who's Who Legal* also designates Lee as one of its "Global Elite Thought Leaders." The London-based *Chambers & Partners*, which publishes an internationally respected client guide, ranks Lee as one of the leading franchise lawyers in both its U.S. and Global editions. In 2019, the ABA Forum on Franchising conferred its "Lewis G. Rudnick Award" upon Lee in recognition of his excellence, professionalism, and leadership in the bar.

### **Marc A. Lieberstein**

Marc A. Lieberstein is the co-chair of the Franchise Group and Retail & Consumer Goods industry team at Kilpatrick Townsend LLP. His practice focuses on intellectual property licensing and franchising in the retail/consumer goods and services areas, fashion/apparel and accessories, food and beverage, and commercial/industrial design, including the drafting, negotiation, and enforcement of license and franchise documents and agreements, as well as implementation of branding and commercialization objectives for clients via licensing and franchising. In conjunction with the services above, Marc counsels clients on creating effective strategies for procuring, protecting, and enforcing their global intellectual property assets. Marc has also participated in and used alternative dispute resolution forums such as arbitration and mediation to enforce intellectual property rights and resolve license and franchise contractual disputes. Marc frequently lectures and writes on intellectual property and franchise issues for a variety of intellectual property and franchise organizations and publications, including International Trademark Association (INTA), New York State Bar Association Intellectual Property Section, the American Bar Association Forum on Franchising, The Franchise Lawyer, Franchise Law Journal, National Law Journal, IP Strategist, The New York Law Journal, Practical Law, and The Licensing Journal.

Marc is listed in the 2022 and the 11 immediately preceding editions of World Trademark Review 1000 – The World's Leading Trademark Professionals. He was recognized as a New York "Super Lawyer" in Intellectual Property by Super Lawyers magazine in 2021 and the 11 years immediately preceding, and he was named a Top 100 New York Metro "Super Lawyer" for Intellectual Property in 2020 and 2021 and also in 2018 and the six years immediately preceding.

Marc was recognized in 2020, 2021, 2022 and 2023 by The Best Lawyers in America® for Franchise Law. He has been recognized as an “IP Star” in 2022 and the nine years immediately preceding by Managing Intellectual Property magazine. In 2017, 2018, 2019 and 2020, Marc was recognized by Who’s Who Legal as a Global Leader for Franchising and Trademarks. He was named a franchise “Legal Eagle” in 2022 and the four years immediately preceding by Franchise Times. Marc was also recommended by Legal 500 US in 2015, 2016, 2017 and 2018 for Copyright and in 2019, 2020 and 2021 for Non-Contentious Trademark Law.