Pitfalls & Protection in Licensing: A Legal Perspective

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LICENSING INDUSTRY SURVEY 2013

The International Licensing Industry Merchandisers' Association
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Dear Licensing Colleague:

LIMA is proud to present this detailed statistical study of the United States licensing industry to you. One of LIMA's main goals is to provide reliable fact-based statistical data to help licensing professionals successfully plan for the future. Accordingly, we feel this study will provide you with an excellent and relevant tool on which to base your future marketing plans.

This finished product is the result of months of preparation, collaboration, planning, surveying, collating and interpreting, done by a research team led by Professor Ravi Dhar of the Yale School of Management. We selected the Yale research team based upon its long-standing expertise in conducting high quality research programs and the unquestioned credibility that the prestigious institution brings to the program. The survey process included mailings of thousands of questionnaires, several hundred phone calls to key licensors and agents within all the different property categories, and the examination of all available public financial documents.

As the authoritative voice of the worldwide licensing industry, LIMA understands that knowledge and accurate information are the keys to success in this complex, diverse and competitive business. This definitive study is one of the many services provided by LIMA to the worldwide licensing community. For more information on LIMA programs and activities, please visit us at *www.licensing.org.*

For those of you who participated, we offer you our sincere thanks.

Best regards,

Charles M. Riotto, President
LIMA

INTRODUCTION

This is the fifteenth annual statistical study of the licensing industry conducted on behalf of the International Licensing Industry Merchandisers' Association ("LIMA"). The first study was commissioned by the LIMA Board of Directors in November, 1998 with the idea of sponsoring a definitive study of the industry. It was decided that the survey should focus on merchandise licensors and their agents, and the statistics were compiled as a function of the royalty income received from the licensing of their properties. This was a marked departure from other studies that focused instead on the retail sales of licensed products. The LIMA Board believed that a study of the actual royalty income received by licensors (and their agents) was a more accurate indication of the size and magnitude of the licensing industry.

This year's survey has the ability to illustrate some of the trends in the industry that have evolved over the last fourteen years. Where appropriate, there has been an attempt to show past years' statistics to give the user of this study a chance to see where the licensing industry has been, and where it is going. It is hoped that such information will be helpful in forecasting future trends.

A team of professors from the Yale School of Management collected, compiled and analyzed the data for this study. All information received from the licensors and agents was transmitted directly to the research team, who retained complete confidentiality of the information.

The previous reports have been widely acclaimed as the most comprehensive studies ever conducted of the licensing industry, and there has been a widespread acceptance of the results in these studies every year. In certain areas, the numbers have been markedly different than other studies. It is the hope of everyone involved in putting together this survey that this year's analysis will prove to be as valuable, if not more so, due to the cumulative information included.

A special note of appreciation is extended to LIMA's General Counsel, Gregory J. Battersby, who has been the driving force both in originating this effort, and in overseeing the work of the research team throughout the years of this study. LIMA Board of Directors member, Charles Schnaid of Miller Kaplan, played a large role in the development of the retail sales portion of this report.

HIGHLIGHTS AND TRENDS IN THE NORTH AMERICAN MARKETS

OVERALL DEMAND

Licensors generated an estimated $5.454 billion in royalty revenue in the U.S. and Canada in 2012, a 2.5% increase from the revenue generated via the licensing of goods and services in 2011. The five largest sectors were entertainment and character, corporate trademarks, sports, fashion, and collegiate. Together, they represented 94% of the overall licensing revenues in 2011.

Those royalties translate into estimated retail sales of $112.1 billion, a 2.5% increase over the $109.3 billion in retail sales generated by licensed goods in 2011.

This is the second consecutive year-over-year increase in the trademark licensing business after four years of declines, as consumer spending continues to rebound in the aftermath of the severe economic slump of the last decade, and the licensing community continues to find new ways to strategically leverage the equity of the brands, characters, imagery and other intellectual property.

As in previous years, Entertainment/Characters was by far the largest revenue generator in 2012, accounting for $2.55 billion in royalty revenues and an estimated $49.3 billion in retail sales, up 2.8% from a year earlier. Because royalty rates are generally higher in this category than in others, that's 46.7% of total industry revenues, but 44% of overall retail sales.

The second largest segment is corporate brands, where total licensing royalty revenues are estimated at $928 million, representing 17% of industrywide royalties. That translates into an estimated $21.6 billion in retail, or 19.3% of overall licensed retail business.

In the next largest sector, fashion licensing, 2012 royalties are estimated at $755 million, accounting for 13.8% of industrywide revenues. That's an increase of 3.4% from the royalties generated in 2011. That translates into estimated retail sale of licensed goods based on fashion properties of $16.5 billion. Those top three business sectors accounted for more than three quarters (77.6%) of licensing royalty revenues generated in 2012.

The next largest sectors in 2012 (in descending order) were sports, collegiate, art, music, publishing-based licensing, and not-for-profits.

While virtually all the major property segments broken out in the LIMA survey showed growth in 2012, the accompanying comments from licensing executives pointed particularly toward industry growth in the home goods categories, and others pointed to licensed giftware as a strong performer.

Even as the business continues to rebound, many of the comments that accompanied the financial responses to the LIMA survey focus on the competitive nature of getting a property and a product onto retail shelves. The key role played by major retailers comes through loud and clear.

"[There are] lots of properties on the market, some outstanding, but [it's] hard to get the proper space at retail to get it to market. [You] need a retail partner on new brands and properties in order to be successful," wrote one respondent. (Due to the confidential nature of the survey, all responses are anonymous.)

"Direct-to-retail licensing is continuing to grow," writes one licensing executive. "Retailers want more exclusivity and are getting more adept at licensing direct."

But even as they recognize the challenges ahead, licensing executives were an optimistic bunch as they exited 2012, and turned their attention toward the future. A separate LIMA email survey at the end of 2012 found that nearly half (44.6%) of those responding expected their companies' licensed business in 2013 to grow at least 7% over their 2012 results. Another 17.4% expected their business to grow 4%- 6% in the year ahead.

Characters (Entertainment/ TV/ Movie)

This is the largest classification, accounting for $2.55 billion in royalty revenues and an estimated $49.3 billion in retail sales, up 2.8% from a year earlier. Because royalty rates are generally higher in this category than in others, that's 46.7% of total industry revenues, but 44% of overall retail sales. This classification is most concentrated of all licensing segments, with a few large players that represent the consumer products division of major entertainment companies dominating the licensing activity. In addition to the major studios and entertainment companies, this segment includes licensing programs based on celebrity brands that have become a prominent licensing segment. The larger entertainment firms continue to pursue a strategy of concentrating on promotional partnerships with larger retailers, who have the financial and marketing capabilities to manage a diverse portfolio. The smaller firms have increased difficulty in gaining shelf space from large retailers especially within an environment of avoiding excess risk-taking. The customer segments for the entertainment properties varies depending upon the property but kids, from pre-school to teens, are a major target segment for all players. However, the window in which traditional toys appeal to kids/teens as well as console games is shrinking due to a migration to digital technologies.

Corporate Brands

The total licensing revenues are estimated at $928 million, representing 17% of total licensing revenues. That translates into an estimated $21.6 billion in retail, or 19.3% of overall licensed retail business. The segment's proportion of total revenues from licensing decreased from the past year, with smaller increases in revenues from the past year, growing by 1.9%. The main challenge for corporate trademark properties is to expand the core brand into new categories by articulating a specific role in the licensee's or retailer's portfolio. In terms of distribution, the importance of certain mass and dollar store channels as well as direct response TV networks, and online marketing channels show continued growth. This sector is expecting strong growth in home improvement and décor as the housing market shows strong improvement.

Sports (Leagues, Individuals)

The major U.S.-based sports leagues account for a majority of the licensing revenue generated ni this segment, in which total revenues increased by 2.2% to $685 million over the previous year. That translated into an estimated $12.6 billion at retail. The licensors in this group report longer strategic partnerships, continued reorganization at the retail level, as well as an opportunity in the growth of retailer's own label products. Direct to consumer sales through the internet is also showing strength; out-of-market fans have traditionally been a major factor in building the online business, but that channel also gives opportunities to niche and specialty products that may have trouble finding brick and mortar retail shelf space. An important long-term opportunity is the extension into growth segments such as healthier food and beverages, travel and women's apparel and accessories.

Fashion

The survey found that royalty revenues from licensing for fashion were $755 million, accounting for *13.8*% of industrywide revenues. That's up 3.4% from the royalties generated in 2011. That translates into estimated retail sale of licensed goods based on fashion properties of $16.5 billion. The changes in the industry are being driven by greater use of exclusive and DTR deals in the mid-tier and mass merchandising segments. Licensing practice in the fashion industry varies significantly across firms and over time – a brand might switch certain categories from inhouse to licensed, and vice versa — making year over year comparisons in licensing revenues difficult. For example, while most firms license their brand in non-core product segments (e.g., eyewear, watches), some firms do so even in their core business (e.g., outerwear) or for a segment of the core business (e.g., sportswear). Key trends include a faster growth in the business linked to beauty (e.g., perfumes) as well as strong performance in the apparel and the accessories segments.

Collegiate

The collegiate licensing sector is the smallest of the top five properties segments, representing 3.8% of total royalty revenues from licensing, estimated at $206 million. That translates into an estimated $3.8 billion at retail – 3.4% of overall licensed product sales. Although this property category still relies in large part on licensing by apparel manufacturers or retailers — still the largest licensed product category by a wide margin — recent years have seen a marked growth of the collegiate trademark business in areas such as tailgating, office products, and fashion accessories. Within apparel, there has also been significant growth in the women's and children's market. Another trend is the rapid growth of the online channel as well as an expansion of the offline channels to include wholesale clubs and home retail chains.

Art

Art licensors are relatively small and very fragmented relative to the size and concentration of key players for Sports and Entertainment. The licensing revenues from art related properties increased by ***1.5%*** over the prior year to $134 million. The small size of licensors in this area means that they continue to be overlooked due to a preference for "safe" options. The preference by large retailers to work with fewer larger players also hurts this sector more as they compete with larger properties. There is a trend in this market to specialize by distribution channels – certain art properties have shifted primarily to the mass retailers whereas others derive their revenues mainly from specialty retailers and follow a differentiation as opposed to a volume strategy. On the positive, new platforms like the tablets and consumer electronics provide opportunities for growth by creating new accessories categories.

Publishing

This year, the licensing of publishing properties decreased by 2.8% to $35 million in royalties. Although consisting of a small base and facing competitive pressures, properties in this space have the potential to increase licensing revenues at faster rates due to a greater exploitation of the faster growth in digital and mobile platform as well as specialty outlets where the publishing trademark provides a strong endorsement. There is also a greater pressure on the smaller properties in this segment to demonstrate distributional support from the retailers before they can garner interest from the large licensees.

Music

Merchandise licensing revenues generated by musical performers and their works increased to $***122*** million or 1.6% over the prior year. As the recorded music industry continues to decline, artists and their management teams look to merchandise revenues that leverage opportunities built on concerts and other events. The major driver of these revenues in recent years appears to be shifting business model of the industry that emphasizes tours organized by the entertainment and companies as well as tie-ups.

Non-Profit

The non-profit licensing properties are relatively small and fragmented. The total revenue generated by licensing was $36 million, translating into approximately $779 million at retail. It witnessed a 2.9% increase from 2011. Since this group finds it difficult to compete with larger properties from other segments, there is a greater downward pressure on royalty rates and reluctance to expand beyond the core group of brands. Although many of the larger licensors now have a broad licensing program in place, many of the smaller not-for-profits lack human resources and network to leverage their brand effectively. On the positive side, a direct-to-consumer strategy through an online presence is very feasible for this group with a focus on creating products that are accessible to their core customers.

DESCRIPTION OF CLASSIFICATIONS

Licensed Properties can be classified in several different ways. Although properties have often been classified based on where they originated (e.g., whether the entertainment character first appeared in comics or films), the present classification system is simpler and takes into account natural categories based on how the customer (i.e., licensee) may see them as interchangeable. Thus, we have classified all characters, whether they are based on television, movie, or TV in the same category. The survey classified several of the product licensee categories in detail. For example, apparel was further divided into adult and kid apparel. However, for the purpose of tabulation of the data, these subcategories have been aggregated where they fit together naturally. Most of these are self explanatory and hence these are simply listed below. The subdivisions within each product category, where applicable, are listed in parentheses for your information.

Property Types

ART

Art licensors are relatively small and very fragmented relative to the size and concentration of key players for other properties. Despite the small size, and due in a large part to the relative uniqueness of properties under this umbrella, this property type tends to command a comparatively high royalty rate. Although the smaller art licensors have focused on niche product segments, the larger players appear to be entering new product segments. The licensing of art properties is likely to continue to grow at a healthy pace.

ENTERTAINMENT/CHARACTERS

This is clearly the largest group of licensors in the current survey. This group is also the most concentrated with a few large players dominating the licensing activity. The key licensees of this property type also tend to be fairly concentrated within their industry segments. The precise revenue from character licensing is difficult to measure accurately due to two recent trends in the industry: a trend towards long-term relationship agreements between the licensor and the licensee, and a trend towards structuring of partial payment in terms of equity in licensee operations. These trends are likely to grow stronger and be adopted by licensors in other areas, particularly sports and fashion. The popularity of interactive online games is also likely to be an important source of licensing revenues in the future.

COLLEGIATE

This property is primarily licensed to the apparel market, and the royalty rates display the least amount of variation across licensors. There is, however, a fair amount of variation in total licensing revenue across the different colleges. While some of these differences are likely a reflection of variations in performance of the sports teams and the size of the university, they also reflect differences in the sophistication of the licensing divisions and the degree to which the licensing programs target alumni with greater variety of merchandise rather than just current college students.

FASHION

Licensing practice in the fashion industry varies significantly across firms. For example, while most firms license their trademarks in product segments that would be considered non-core (e.g., watches), some of the firms have started to license the property even in their core business (e.g., apparel). Alternatively, some firms have purchased non-core businesses and are now manufacturing products in-house that were previously licensed. This is likely to make year to year comparisons in licensing revenues difficult until trends stabilize. Nearly all the major fashion players including accessories designers are positioning themselves as "lifestyle" brands suggesting growth opportunities. However, the actual revenues from licensing activities may depend upon strategic decisions about production.

MUSIC

Product licensing and merchandising based on musical groups, musicians and their works has seen significant growth recently, as performers and their management have sought to replace from declining CD sales. In addition, several major musical performers have continued to try to extend their "brands" into fashion, accessories and fragrances, with varying levels of success.

NON-PROFIT

The non-profit licensing properties are relatively small and fragmented. This in part reflects a lack of well developed brand image for many non-profits. However, like the collegiate properties, a number of the organizations have a reliable customer base with a strong sense of association with the cause. While the current focus appears to be on licensing in traditional areas (e.g., apparel, accessories, publishing), this sector represents a lot of potential for growth if properly managed through licensing agents or in-house.

SPORTS (Leagues, Individuals)

This group is most similar to character licensors in the current survey with several large players accounting for a large proportion of the licensing revenue. Like entertainment, this group also consists of the more sophisticated licensors that are tapping into new sources of revenues for their properties. Also like entertainment, this group is likely to find growth in direct sales through the internet and tremendous opportunities in online licensing as myriad web sites try to differentiate themselves.

CORPORATE/BRAND NAME

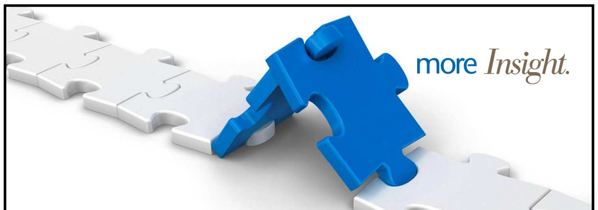
As may be expected for a group that includes vast differences in experience with licensing activities, there is a wide variation in licensing revenue. Interestingly, these firms appear to select the product segments in which to license more selectively than other licensors. Thus, most licensors are active in only few of the segments and these segments vary a lot across the different licensors. This most likely represents strategic concerns about brand extension and dilution of equity or could be in part due to the early phase of their licensing activities. Interestingly, while this group includes some firms with the highest brand equity (barring fashion properties), this is not reflected in the royalty rates charged by these firms.

PUBLISHING

Although small in total licensing revenue, this group of licensors is fairly concentrated and consists of few relatively large and sophisticated players. This group benefits from a relationship with a steady customer base that is leveraged in product categories that are natural extension of readership's interests. The distribution outlets are geared towards mass and direct distribution suggesting that most licensing deals involve products with mass appeal. The credibility associated with publishing properties also makes it a natural partner for e-commerce as the number of sites proliferate.

Product Categories

Apparel: (Adult, Kids)
Accessories: (Head Wear, Jewelry & Watches, Other)
Consumer Electronics: (Headphones, Smartphones and Tablet Accessories, Children's Electronics)
Food/Beverage: (Beverage, Candy, Other)
Footwear: (Adult, Kids)
Home Decor: (Furniture, Home Furnishings)
Gifts/Novelties: (Collectibles, Gift, Other)
Health/Beauty: (Health, Cosmetics, Other)
Housewares: (Kitchenware, other housewares)
Music/Video
Infant Products
Publishing
Sporting Goods
Paper Products / School Supplies: (Art, Greeting Cards, School Supplies, Lunch Boxes, Bags/Totes, Other)
Toys/Games: (Dolls/Action Figures, Games, Pre-School, Other)
Software/Videogames: (Handheld, Software, Accessories, Other)



Pitfalls & Protection in Licensing:

A Legal Perspective

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Licensing Agreements:

Recognizing and Avoiding

PITFALLS

1. Does the Agreement Provide Rights that I Need?
2. Do they Cost What I Expected?
3. How Else Might I Get the Shaft?

There Are No

"Standard Agreements"

Cases 1-3

Am I getting the Rights that I need?

- Must have clear business plan for the License
- Must know how the License will be used in Product Line
- Does the Agreement give me the required Rights?

Case 1

Original Wording

1. Licensed Property:

The "Licensed Property" shall mean the title, artwork, storyline, all characters, vehicles, props, and all other visual and audible elements (except musical compositions) included in the original theatrically released version of the motion picture "Batman Begins."

Preferred Wording

Added to Paragraph 1:

"During the Term hereof, Licensor shall not license or authorize to any third party other than Licensee nor self-exploit the rights for any Licensed Product category licensed herein to Licensee utilizing any embodiment of "Batman" or any related character or the Batman trademark or indicia, whether arising out of the Licensed Property or otherwise, within the Channels of Distribution."

Case 2

Original Wording

The Licensed Property consists of storylines, scripts, designs, artwork, props, characters, names, trademarks, logos and picture entitled "TERMINATOR 2: JUDGMENT DAY," and any sequel, prequel, spinoff, live or animated television or other video program within the industry. The Licensed Property shall also include to the full extent that Licensor shall have such right, the right to use the name and likeness of the principal performers, Arnold Schwarzenegger and Linda Hamilton, and of all other performers of major characters is any of said media productions.

Preferred Wording

Delete:

"…to the full extent Licensor shall have such right…"

Case 3

Actual Wording

2.(a) Proprietary Subject Matter shall mean the following:

All logos, characters, animate and inanimate props, vehicles, environments and any other visual elements, and the names, likenesses and visual representations of any of same (excluding only such talent names and likenesses as may be excluded by cast agreements from Licensor's merchandising rights, but only if such exclusions shall have been brought to Licensee's attention in writing prior to its embodiment of same in Articles); and all copyrights, trademarks, or other intellectual property rights in said logos, names, likenesses and visual representations; and selections of footage, artwork and still photography for use in Licensee's products, commercials, packaging, promotional materials and collectors' cards arising out of any of the following:

(i) The theatrical motion picture Jurassic Park as defined elsewhere herein; and

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Cases 4-7

Will I be paying what I expected—or more?

- How is the Minimum Royalty Guarantee defined?
- How is the Royalty calculated?
- Are there hidden costs?

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Case 4

Original Wording

4.2 Minimum Royalty Guaranty. Licensee agrees that notwithstanding the actual amount of sales of Licensed Products, it shall be obligated to make certain nonrefundable minimum payments to Licensor ("Guaranteed Minimum Royalties") in the amount of Three Hundred Thousand Dollars ($300,000.00) during the Contract Period. The Guaranteed Minimum Royalty is payable as follows: One Hundred Thousand Dollars ($100,000.00) due upon execution of the Agreement, One Hundred Thousand ($100,000.00) due by December 31, 2012 with the balance due on or before December 31, 2012.

17.3 No Cross Collateralization. Any Royalty Payment for a category of Licensed Product sold during a contract year of the Term shall only be applied against the Minimum Guarantee (as defined in Appendix A) for such Licensed Product for the contract year in which such Licensed Product was sold (i.e., any shortfall in, or payment in excess of, the Minimum Guarantee for a contract year may not be offset or credited against the Minimum Guarantees for any other contract year, or against any other Licensed Product.)

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Application of Original Wording

3 YEAR MINIMUM GUARANTY		**$300,000**	
INSTALLMENTS	**$100,000**	**Execution**	
	$100,000	**DEC. 31, 12**	
	$100,000	**DEC. 31, 13**	

	ROYALTIES	PAYMENTS
2011	$250,000	$250,000
2012	$50,000	$100,000
2013	$25,000	$100,000
	$325,000	$450,000

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Preferred Wording

Substitute For 17.3:

Notwithstanding that the Minimum Royalty Guaranty is payable in annual increments, it shall be fully cross-collateralized and shall be recoupable against any Royalty paid at any time during the Term.

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Case 5

Original Wording
"Royalty Calculation"

5. Royalties.

(a) Royalties. Licensee agrees to pay Licensor royalties at the Royalty Rate identified in Section 1(k), determined as follows:

(i) Royalties shall be calculated by applying the Royalty Rate to Licensee's Net Sales (as herein defined);

(ii) "Net Sales" for sales of Licensed Articles shall mean the number of units sold by Licensee, multiplied by the higher of either (i) the gross wholesale list price at the time of sale or (ii) the gross invoice price of the Licensed Articles at the time when initially introduced to the trade (the "Established Price"). No set-offs or deductions of any kind may be taken in the determination of Net Sales or the royalties due Licensor hereunder except only that Licensee may deduct standard trade discounts actually given actual returns for damaged goods in the determination of Net Sales. Notwithstanding the foregoing, the total deduction for trade discounts and actual returns may not exceed seven percent (7%) of Licensee's total gross sales for the Licensed Articles.

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Application of Original

List Price	**$10.00 per unit**
Introductory Invoice Price	**$ 9.50 per unit**
"Established Price"	**$10.00 per unit**

Sales Revenue
100,000 units actually sold at $7.50 per = $750,000

"Net Sales"
100,000 units x $10 = $1,000,000

"Royalty" based on $1,000,000 rather than actual revenue.

At 10%, the Royalty is $100,000 rather than $75,000, or $25,000 more.

Preferred Wording

"Net Sales"

For sales to wholesaler and retailer trade customers, "Net Sales" shall mean all revenue or other consideration received by Licensee for sales of Licensed Products, less reasonable and actual trade discounts, allowances and credits, not to exceed _____(__%) percent of Licensee's gross sales of Licensed Products, and less returns and actual markdown allowances applicable to Licensed Products.

Case 6

Original Word
"Most Favored Terms"

28. Miscellaneous
(d) If, at any time during the Contract Period of the Agreement, Licensee is or becomes party to any agreement permitting Licensee to use the name and/or likeness of any other NASCAR SPRINT Cup team driver and such agreement provides for a higher royalty percentage, higher royalty guaranty, or higher overall consideration than specified herein, Licensee immediately shall provide Licensor with notice of such agreement and higher royalty percentage, higher royalty guaranty or overall consideration. The parties agree that such notice shall automatically amend the Royalty percentage, Minimum Royalty Guaranty and overall consideration of this Agreement to that of the notified agreement and that said revised terms shall be applied to all sales made under this Agreement effective as of the effective date of such other agreement.

Preferred Wording

- Delete, or
- Make as narrow as possible:

Add: "This section applies only to agreements granting rights to Licensee for the same categories of Licensed Products for the same Territory and Channels of Distribution as granted to Licensee by this Agreement and with respect to NASCAR SPRINT Cup teams that have won the same or fewer NASCAR SPRINT cup races during the three (3) seasons preceding the then-current calendar year of the Term."

Case 7

Original Wording

Automatic Renewal

3. Guaranteed Minimum Royalty
Licensee agrees that it shall pay to Licensor not less than $750,000.00 in Royalty in respect of the Initial Term; and not less than $750,000 in Royalty in respect of the Renewal Term, if applicable. In the event that Royalty paid prior to the final day of the Initial Term or the Renewal Term, if applicable, does not equal or exceed the amounts set forth in the preceding sentence, Licensee shall pay any deficiency within five (5) business days after said final day, regardless of the amount of Royalty payable as a result of sales of Licensed Product.

7. Term of Agreement
The Term of the Agreement will comprise an initial term extending from the Effective Date until the third (3rd) anniversary of said date and, if applicable, a Renewal Term extending until the sixth (6th) anniversary of the Effective Date. The Renewal Term shall become effective automatically in the event that Licensee's cumulative gross sales of Licensed Products exceeds $10,000,000 during the Initial Term.

Preferred Wording

7. Term of the Agreement

* * *

In the event that Licensee's cumulative gross sales of Licensed Products exceeds $10,000,000.00 during the Initial Term, it shall have the option to extend the Term to include the Renewal Term exercisable by written notice to Licensor on or before the final day of the Initial Term.

Cases 8-10

Are there other Major Surprises?

- What are my Marketing Obligations?
- If the line takes off, can I renew, or must I win an Auction?
- Who owns my Creations?
- Who is responsible for Claims?

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Case 8

Original Wording

26(c) Continuous Update of Licensed Products:

As a condition to the aforegoing grant of license, it is understood and agreed that Licensee will update, sell and distribute new designs for each and every item set forth under the definition of the Licensed Products at least every six (6) months during the Term, as defined below, or be subject to termination as determined in Licensor's sole discretion. At the time new designs are created, License shall sell off the remaining inventory for the old designs or destroy them, at Licensor's sole discretion. If the Licensee is instructed to sell the remaining inventory, it shall pay Licensor a royalty on such sales based upon either the royalty percentage of actual Net Sales of each of the Licensed Products or the average per unit royalty amount paid to Licensor for each of the Licensed Products in the previous two (2) Quarters, whichever is greater.

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Case 10

Ownership & Use of Related Materials

13.4 Licensee acknowledges that Licensor is the owner of all right, title and interest in and to the Licensed Property, and in all copyrights, trademarks, domain names and other rights associated therewith, and in all artwork, packaging, literary text, advertising and promotional material of any sort which utilize the Licensed Property (including all such materials developed by Licensee), and the goodwill pertaining to all of the foregoing; Licensee hereby assigns to Licensor all right, title and interest including all copyrights, and renewals and extensions of copyright, in and to any and all such materials developed by or under the authority of Licensee, and warrants that Licensor shall have the right to authorize the exploitation of such materials in any manner as Licensor elects without obligation to Licensee or any other entity whatsoever. Licensor may use any such materials developed by or under the authority of Licensee as Licensor may determine in its sole discretion.

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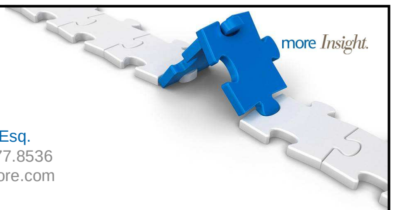
What The Large Print Giveth

The Fine Print Taketh Away.



Questions?

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Pitfalls and Protections in License Agreements

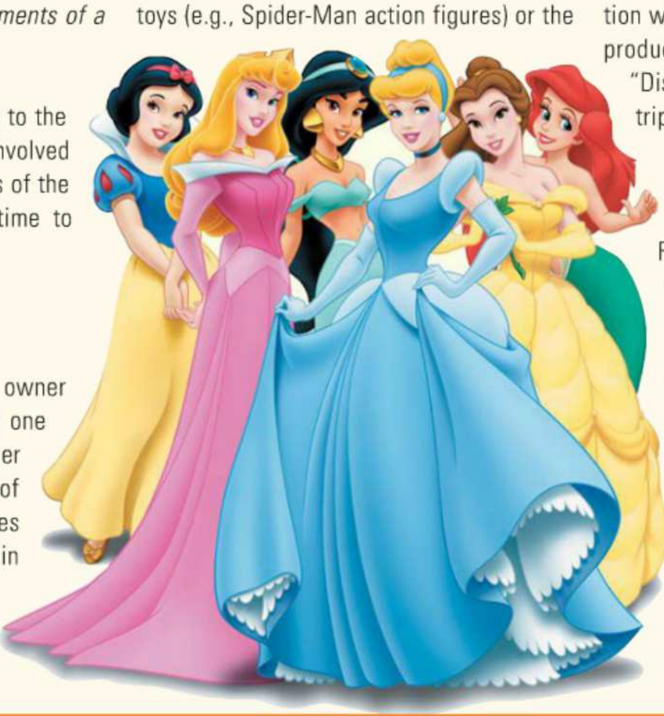
Licensing 101, Part 56

(This is the 56th article in a series devoted to the creation and documentation of the licensing relationship and to elements of a typical license agreement.)

Regardless whether you are new to the licensing industry or have been involved for many years, certain principals of the business deserve review from time to time.

The Licensing Concept

Under a license agreement, the owner of Intellectual Property rights of one kind or another authorizes another party to make use of certain of those rights for specific purposes for a defined period of time in exchange for a payment in one form or another. At the end of the Term of the agreement, the rights revert to the owner. There are many varieties of licensing relationships, but the most common are those under which a manufacturer is permitted to make and sell Licensed Products that embody or otherwise make use of Licensed Properties in various ways. Examples include the licensing of entertainment characters for the creation of toys (e.g., Spider-Man action figures) or the branding of otherwise generic products (e.g., Vicks brand room atomizers).



Other styles of license agreements might convey the use of a celebrity's persona as a spokesperson for the Licensee's products (e.g., Angelina Jolie as a spokesperson for upscale apparel products). Similarly, a Licensed Property might be used in connection with a specific promotion for unrelated products (e.g., cereal boxes bearing a "Disney Princesses" contest for a free trip to Walt Disney World).

"The Standard Agreement"

Regardless of the nature of rights being granted or the purpose for which the license is made, whichever party creates the initial draft of the document may characterize it as "The Standard Agreement." Unlike some other industries, there are no "standard agreements" in the licensing industry. The only thing that is "standard" is that the party who has generated the document will make efforts to favor themselves in the drafting. The characterization "standard agreement" might be used in order to discourage the other party from suggesting revisions, but if you are the recipient of such a document, it is unwise and unnecessary to accept the document as written in stone.

There are no 'standard agreements' in the licensing industry.

If something in the document does not seem consistent with the deal as you understand it, you must ask questions until you are satisfied with the explanation, or until the document is revised to meet your expectations. If the person with whom you are dealing is unable or unwilling to satisfactorily explain or revise the document, you may be talking with the wrong person or dealing with the wrong company.

How to Evaluate?

After having negotiated the deal and received the proposed agreement for review, a Licensee must ask himself or herself three essential questions:

1. *Am I getting the rights that I need?*
2. *Are the rights costing me what I expected?*
3. *How else might I be getting shafted?*

Each of these questions can have a variety of answers, and satisfying yourself that you grasp those answers demands a thorough reading of the entire agreement and a clear understanding of its contents.

An Example: What Are My Rights?

As a simple hypothetical, let's assume that you are seeking a license to use certain elements of an upcoming theatrical release entitled *XYZ*. Having negotiated a tentative deal with the Licensor, you are now reviewing the draft of the Licensor's "standard agreement" that has been submitted to you for signature. The document defines the Licensed Property, as follows:

"The Licensed Property consists of the story lines, scripts, designs, artwork, props, characters, names, trademarks, logos, style guide, and all other elements of the theatrical motion picture entitled *XYZ* to the full extent owned or controlled by Licensor."

The definition appears to be comprehensive as to all of the elements that are to be incorporated within or associated with the upcoming motion picture. The Licensee also takes pleasure in the fact that it will receive these rights without reservation by the Licensor—that is, the rights are being licensed by the Licensor "to the full extent" owned or controlled. Nothing is being held back.

That is certainly one way in which the definition can be read. However, another way to read it is that the Licensor might be putting the Licensee on notice that if, in fact, it does not own or control certain of the elements that Licensee plans to use, and if such use results in third party claims of infringement or any other of a variety of claims, then it's not the Licensor's problem.

In other words, the qualifying language "to the extent owned or controlled by" is not necessarily an assurance that nothing is being held back; rather, it can be a disclaimer of responsibility if the Licensor does not actually own or control what it is granting to the Licensee. Upon releasing its product line, the unsuspecting Licensee might find itself the victim of a variety of claims and potential lawsuits.

Having agreed to the above definition of Licensed Property, it may have no recourse against the Licensor, whose position could very well be "You were warned!"

The Time to Act is Now!

In subsequent articles, we will address a wide variety of "pitfalls" that might await the unwary Licensee as well as how to identify and handle them in negotiations prior to execution of the agreement—and make no mistake, they must be dealt with before the agreement is signed; afterward, it's too late.

If something in the document does not seem consistent with the deal as you understand it, you must ask questions until you are satisfied with the explanation.

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Getting the Rights Without Getting Shafted

Licensing 101, Part 57

(This is the 57th article in a series devoted to the creation and documentation of the licensing relationship and to elements of a typical license agreement.)

Recap

In Part 56 ("Pitfalls and Protection in License Agreements") we saw that the licensee who receives a draft agreement from the licensor must always ask himself or herself three questions:

- "Am I getting the rights that I need?"
- "Will the rights cost what I expect?"
- "How else might I be taken advantage of?"

In order to make a determination regarding the first question, it is essential that the licensee have a clear understanding of what rights are needed.

The Business Plan

Close coordination between the licensee's product design team and the individual or team responsible for negotiating the license agreement is obviously important. If the property is a motion picture and the licensed product is a video game, for example, knowing whether movie clips are to be included in the game play, whether actors' likenesses and/or voices will be used, whether additional voice-over recordings by one or more of the actors will be needed, and other such considerations must be anticipated before the agreement is negotiated.

For example, if branded vehicles will appear in action sequences or other branded products are to appear as props, those must be taken into account.

Whether theme or background music from the movie will be audible during play is another essential pre-negotiation determination.

In short, all visible and audible elements from the motion picture that will be included in the game must be accounted for, and an entirely different issue is raised if and to the extent that the movie action is to be modified when included in the game.

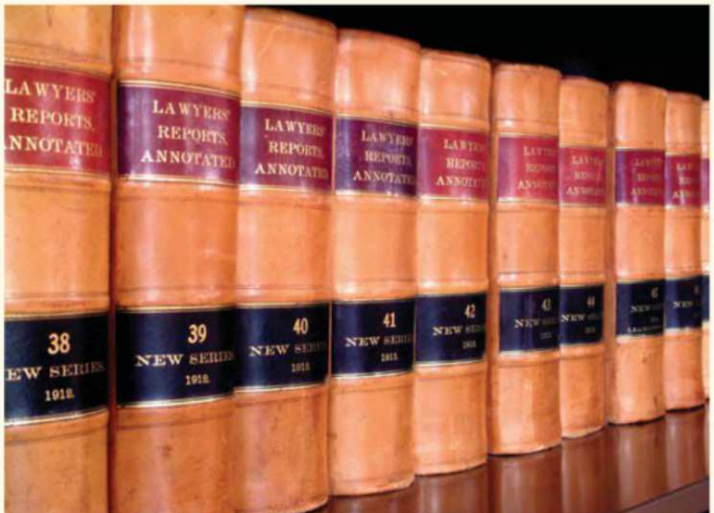
Advertising for the game can present the same questions in a different context, or a different set of questions to the extent that the advertising differs from game content.

Thank You; May I Have Another?

Finalizing such a deal without carefully establishing the necessary elements of the Property to be licensed and how they might be used in the game and related materials would be equivalent to begging the licensor for a thrashing. On the one hand, if essential elements are left out of the definition in the executed agreement, the cost of adding those elements at a later

Finalizing such a deal without carefully establishing the necessary elements of the property to be licensed and how they might be used in the game and related materials would be equivalent to begging the licensor for a thrashing.

point very likely will be much more expensive than including them in the first instance. On the other hand, defining the Property more broadly than necessary for



the content of the game and peripheral material can make the original deal more expensive than necessary.

Making It Count

Assuming that the necessary rights have been determined and coordinated among the licensee's people and negotiated with the licensor, the manner in which the rights are expressed in the agreement can be an additional hurdle in the path to success. For example, in Part 56 we noted that a grant of actor or other rights "owned or controlled by Licensor" begs the question whether the licensor actually has the necessary rights. If not, risk remains that the licensee must acquire those rights after the fact.

It is entirely possible, for example, that the product placement deal for use of a branded vehicle that appears in a motion picture might omit merchandising rights. The lawyers on the production side of the pertinent movie studio who negotiated with the auto manufacturer might be well aware of this. However, the lawyers with whom the licensee negotiates its license agreement might not have been made privy to this critical fact. Such occurrences are not unprecedented.

The manner in which the rights are expressed in the agreement can be an additional hurdle in the path to success.

The careful planning by licensee will not have improved its position unless the contractual language conveys the necessary rights without such qualifications. If the licensee is able to eliminate the qualification and the auto company complains when its vehicle appears in the video game, the circumspect licensee can defer to the licensor the obligation to resolve the situation through its own resources.

What Does That Mean?

In reviewing a draft agreement proposed by the licensor, an understanding of terminology is also a critical requirement. For example, a grant of rights to use an actor's "likeness" may not convey use of his or her "performance" in the above example. The grant of likeness could simply allow the licensee to use a still photograph of the actor on packaging or within the video game but not in action sequences taken from the picture.

Future articles in this sequence will address more considerations of this nature, as well as the other questions that the licensee must ask in reviewing the draft agreement:

- Are the rights costing me what I expected?
- How else might I be getting shafted?

As we will see, the last question can have many possible answers. ●●●●

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Getting the Rights Without Getting Shafted, Part II

Licensing 101, Part 58

(This is the 58th article in a series devoted to the creation and documentation of the licensing relationship and to elements of a typical license agreement.)

Recap

In Part 56, we saw that the licensee who receives a draft agreement from the licensor must always ask himself or herself three questions:

- "Am I getting the rights that I need?"
- "Will the rights cost what I expect?"
- "How else might I be taken advantage of?"

In Part 57, we saw that the threshold requirement to answer the first question is clear of the business plan for application of the licensed property. Only if one understands what rights and elements will be used in the licensed products will he or she be equipped to negotiate effectively for them.

The Situation

Hypothetically, if the licensed property is a motion picture and the licensed product is a video game, the licensee's negotiators must know whether the game will incorporate actors performing action sequences extracted from the picture. If so, it will not be sufficient to acquire use of actor "likenesses" alone; the licensee will also need the right to use actor "performances" and the particular action "clips" from the movie that will be used. If the game will include theme music from the movie, that element will have to be covered as well, and the licensee must differentiate between the musical "score" and the actual "performance" audible in the soundtrack of the picture. Whatever elements are required must be clear in the executed agreement.

Making It Difficult

Refined licensors don't make it easy to know whether you have adequately covered your needs. Extending the hypothetical, assume that you are negotiating with motion picture studio XYZ and that you wish to use elements of the upcoming theatrical release *Death by a Thousand Paper Cuts* for your new video game. After determining the elements of *Paper Cuts* that you intend to use, and after negotiating the basic deal terms, you receive a draft agreement that includes the following definitions:

"'Licensed Property' means the title *Death by a Thousand Paper Cuts*, XYZ-approved characters, names, likenesses, environmental settings, artwork, logos, and other elements appearing in the theatrical motion picture, solely as and to the extent depicted in the Style Guide provided to Licensee by XYZ in connection with said motion picture, and used solely as approved by XYZ in accordance with this Agreement."

Subtraction By Addition

Elsewhere in the agreement, the following appears:

"'Excluded Elements' means all properties and elements that are not explicitly defined as Licensed Property including, without limitation: (a) any motion picture, television production, online production, or other publication that is not defined above as Licensed Property; (b) any other versions of the Licensed Property that are not defined as Licensed Property; (c) film clips, stills, animation clips, voices, sound bites, and other audio clips; (d) elements of or related to the Licensed Property that are not owned or controlled by XYZ; and (e) visual and/or audible representations of talent represented in the Licensed Property, except to the

"Refined licensors don't make it easy to know whether you have adequately covered your needs."

extent specifically permitted pursuant to an XYZ-approved written agreement with third parties having authority to permit such use."

Come Again?!

Even if the licensee has a clear business plan and is certain what elements it requires for inclusion in its video game, navigating these waters will be challenging. First, one must clearly understand what is meant by the terminology used in the definition of the "Licensed Property," but then must also realize that everything defined as "Excluded Elements" must be extracted before a clear understanding is achieved.

Continuing the hypothesis that licensee's business plan contemplates the use of certain actor likenesses and performances, even though the definition of licensed property does include "character likenesses," the likenesses of the actors portraying those characters are specifically excluded. Clause (e) of the definition of "Excluded Elements" puts the burden on the licensee to obtain written agreements with the actors it intends to use, and those agreements must be approved by XYZ.

If the licensee were unaware of this requirement at the time of signing the agreement, it would have to backtrack and negotiate with the desired actors' representatives after having committed itself to the financial obligations that are part of the license agreement. Thus, the licensee will be "over the barrel" in those negotiations and can expect to pay more than it might have if it knew about the requirement. If the licensee must also negotiate with XYZ for "clip licenses" at this late date, it will be over the barrel yet again.

"Time Bomb" Exclusion

While many of the other elements of *Paper Cuts* are clearly omitted from the definition of licensed property or extracted from the definition by virtue of being excluded elements, one of the listed exclusions is particularly elusive. In essence, clause (d) says that even though an element is "...of or related to the Licensed Property..." if it is not "owned or controlled by XYZ," it is an excluded element.

Imagine a situation where (i) an element is included in the style guide that XYZ pro-

vides to licensees for the motion picture, (ii) the licensees reproduce the element in their respective Licensed Products, and (iii) XYZ approves of all of those uses, but when the products are released to the public, (iv) a third party raises claims against each of the licensees for use of that element.

The licensees might look to XYZ for protection, but very well could be left out in the cold. When the license was granted, XYZ actually may have believed that it "owned or controlled" the challenged element. Only when claims have been made might it review its production files and realize that it lacked the right to grant use of that element. Fortunately for XYZ, clause (d) states no conditions and no time limits for its application. As a result, this "Excluded Element" can be used after the fact by XYZ to protect itself—to the detriment of its licensees—from such claims.

Who *should* die of Paper Cuts?

So what is the licensee to do? It had no way of knowing that XYZ's rights were defective. XYZ had all the facts at hand, but negligently failed to address them.

One thing that a licensee might do during the negotiation of its next license agreement is to remember this hypothetical situation and demand that the licensor with whom it is dealing accept the responsibility that it alone should have—to determine at the time of Licensee's initial submission for approval whether or not it has the necessary rights in all the elements submitted to grant the required approval. After giving approval, any flaw in the rights of the licensor should be its own responsibility, not that of its licensee. Once approval is given, any approved element should not be redefined retroactively as "excluded." ●●●●

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Of Counsel/With James Kipling

Getting the Rights Without Getting Shafted, Part III

Licensing 101, Part 59

Recap

In Part 56, we saw that the licensee who receives a draft agreement from the licensor must always ask three questions:

- "Am I getting the rights that I need?"
- "Will the rights cost what I expect?"
- "How else might I be taken advantage of?"

In Parts 57 and 58, we began an analysis of the first question, and continue that analysis with this article.

"We Never Grant Exclusivity"

Many times a request for exclusive rights will receive the above response. In the next breath, the licensor may express the following: ". . . , but we never double-license." This apparent contradiction might mean that the licensor simply wants to keep its options open in case the property that is subject to this agreement takes off and your competitors want to get in on the action. If you have been in this business (or, really, in any business) for any length of time, you already know that you can't rely on expressions of good intentions. Only the written word in your agreement should give you comfort.

If the licensor is sincere about not "double-licensing," their aversion to using the word "exclusivity" might be based on certain legal technicalities that the word carries with it. One example is that a grant of "exclusive rights" can be interpreted as also granting the licensee the right to take action against the third-party infringers of the licensed property. There are other such issues that can give the licensor serious concerns, so they generally try to avoid using the word.

If this is truly the cause for the licensor's refusal to expressly grant exclusive rights and the licensor is sincere about not granting overlapping rights, then you may be able to achieve a measure of protection even though the rights granted to you are characterized as "non-exclusive." To accomplish this you might ask the licensor to add a sentence to the "grant clause" like the following:

"Notwithstanding the foregoing, Licensor shall not license or otherwise authorize any third party to exploit the Licensed Property in connection with products within the defined categories of Licensed Articles during the Term."

This addition adds a level of protection without the peripheral implications of the word "exclusivity." If the licensor refuses such an uncomplicated confirmation of its expression of good intentions, then you can expect the shaft if the opportunity should arise.

Defining the "Licensed Property"

Assuming that the licensor is willing to grant exclusive rights, or at least to incorporate the concept of the sentence quoted above, the licensee's next concern should be the manner in which the "Licensed

Property" is defined. If the property is defined as the 2007 motion picture, *Spider-Man III*, the licensee should ask whether any of the earlier motion pictures in the series, or any other expression of the Spider-Man character group, will be available to your competitors concurrently with your license. Your licensor may respond that you will have to pay substantially more in order to acquire the rights for the earlier motion pictures, the comic books, TV series and other Spider-Man properties for use in your Licensed Articles.

An appropriate response to this would be that you are not seeking to expand your rights to use other Spider-Man embodiments; rather you are only seeking confirmation that your Spider-Man III rights will not be diluted by concurrent licenses for those other properties within your product categories. Based on the licensor's expressions of good intentions, there ought not to be reluctance to include a sentence in your agreement to this effect:

"During the Term, Licensor shall not license or otherwise authorize any third party to exploit the character "Spider-Man" or any trademark that includes the name "Spider-Man" in connection with products within the defined categories of licensed articles."

Defining the "Licensed Articles"

Assuming that the concerns of the preceding paragraphs are addressed appropriately, scrutiny must also be given to the precise manner in which the licensed articles are defined. One common mistake is to define the products granted in terms of the licensee's trademarked product line. For example, since Hasbro owns the Play-Doh brand for modeling compounds, an exclusive grant of rights to Hasbro for "Play-Doh modeling compound and accessories" is not an exclusive grant at all.

Since Hasbro owns the trademark, by definition no one else can market products under the Play-Doh brand. If Hasbro were to accept a grant in such terms, another manufacturer of modeling compounds competitive with Play-Doh branded products could be granted rights for the same licensed property for its own competing products. This would not violate the "exclusive license" to Hasbro because the competing manufacturer would not be marketing "Play-Doh modeling compound and accessories." A more appropriate definition of the licensed articles in the Hasbro agreement would be simply "modeling compounds and accessories," with no reference to branding.

A similar problem would occur if a property were granted exclusivity for "11-inch fashion dolls and accessories." In the toy industry, this phrase articulates a well-recognized category of products, but a literal interpretation of this definition could enable a licensor to grant rights for fashion dolls shorter or taller than 11 inches. One approach the licensee might take would be to negotiate for a range of sizes of dolls in order to deter competitive grants that could cannibalize its sales. Such a range might be "6 inches through 16 inches," or even better, "fashion dolls of all sizes."

Conclusion

Not surprisingly, disputes between licensors and licensees concerning such matters usually occur only when it matters most—after a property has become successful. As pointed out many times in this series, the proverb "An ounce of prevention is worth a pound of cure" must be kept in mind throughout any negotiation. It is particularly apropos in defining the scope of whatever exclusivity might be granted to a licensee. It may seem unlikely that a reputable licensor would engage in such questionable activities as described above, but it certainly would not be unprecedented.

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Images courtesy sxc.hu users "creationc" and "ba1969."

Classic Kipling: Royalty Calculation With Franz Kafka and George Orwell

LICENSING 101: PART 51

(For Toy Fair, we're re-running one of James Kipling's columns at popular request. Originally published in June 2009.)

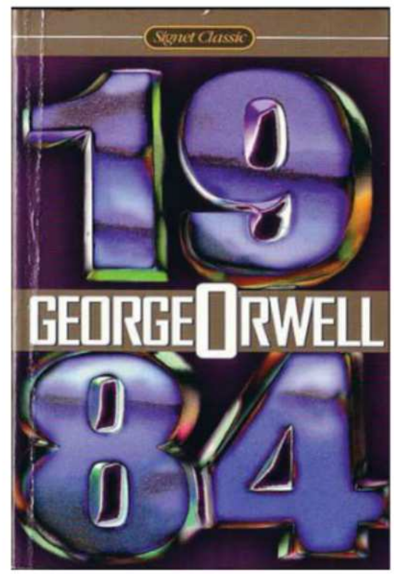
Royalty Calculation

The subject of royalty calculation can be among the most contentious involved in the negotiation of a Licensee Agreement. The objective should be to agree to a formula which reasonably rewards each party on the basis of fair shares of the profitability "pie" resulting from the licensee's product line. If either party cannot turn a reasonable profit under a particular deal, both suffer. The reason is simple: the party having the short end of the deal has little incentive to support the deal or the product line. As a result, the party having highly favorable terms will very likely find itself with a large share of a very small pie. This article and subsequent articles in the series will seek to put forth observations and suggestions that may be useful to both sides when negotiating this crucial element of the License Agreement.

Franz Kafka: Studio Accountant

Deal terms can vary widely from one Licensed Property category to the next: entertainment, sports, corporate brands, artwork, etc. Initially considering the largest category, entertainment characters and brands, it may be surprising to an outsider that there is so little similarity between the manner in which payments made by the studios to contributors to their entertainment productions are calculated, and the manner in which payments made to the same studios by merchandise licensees for the same properties are calculated.

Only the most powerful of Hollywood actors and other talent succeed in being paid on any basis of participation other than as a percentage of the "net profits" of the respective production. The definitions and formulas used by the studios in computing those net profits have become the punch line for numerous jokes because they seldom result in a theatrical release or TV series generating a "net profit." As one example why this can be true, it is not unusual that such a definition will allow the studio to make deductions for artificially calculated "overhead" and then to apply "interest" to that overhead. The total amount of interest is then increased by its own overhead charge. The reverse is also done: interest is charged to the entire production cost, and then overhead is applied to that interest. Moreover, the interest on these various charges (and the respective overheads) can continue to run regardless of recoupment of the costs against which the deductions were initially calculated. This is only one example of the remarkable way in which companies touted to Wall Street as highly profitable can operate ostensibly without having any profitable productions.



Only the most powerful of Hollywood actors and other talent succeed in being paid on any basis of participation other than as a percentage of "net profits."

Orwellian "Double Think"

The same companies that are so protective of the profit "pie" generated by an entertainment production can have a far different vision when the subject turns to calculating their own participation in revenues generated by merchandise licensees. Almost invariably, the merchandise licensee is required to pay its Royalty obligation against something very different from "net profits." The norm seems to be to apply the royalty percentage to strictly defined "Net Sales," which can have no relationship at all to the profitability of the product line. Indeed, before many licensees ever see a penny of true "profit" from a licensed product line, they must undertake significant risks and incur substantial financial obligations and outlays.

Before many licensees ever see a penny of true "profit" from a licensed product line, they must undertake significant risks and incur substantial financial obligations.

Wishin' and Hopin'

For example, if the licensee is a toy manufacturer, before it will turn a profit from a Licensed Product line, it will have to accomplish at least the following:

- Pay the Royalty Advance and commit to the associated Minimum Royalty Guarantee in order to acquire the license;
- Design the aesthetics for its line of products and, for every individual product, make no fewer than three sequential submissions for approval, any of which might result in delayed turnarounds and modification requirements at the "unfettered discretion" of the licensor;
- Engineer the functionality of and prototype each product, subject to additional rounds of submissions for approval;
- Perform trademark and patent clearance searches and evaluations;
- Design and submit all related packaging through its own series of approvals, possible delays and modifications at the licensor's discretion;
- Create a marketing, promotion, and advertising campaign, all subject to approvals, delays, and/or modifications;
- Participate in trade shows and individual presentations to major customers and hope that the licensed product line makes a good impression;
- Design and fabricate production tooling;
- Select a manufacturing vendor that complies with all of legal, ethical, labor, and public relations criteria devised by the licensor, and negotiate terms of production;
- Test all products for compliance with all applicable safety standards of each country in which the products will be sold, including the new lead, phthalates, and independent testing and certification requirements of the 2008 CPSIA;
- Based upon anticipated trade support, estimate and initiate appropriate production; and
- Manufacture, warehouse, and ship to customers just the "right" numbers of its Licensed Products.

Assuming everything to this point has gone well enough, the licensee then will initiate its advertising, hope for sell-through, and pray for re-orders. Only if those re-orders materialize will it have a chance to profit.

But, Wait . . .

Long before any sell-through will have occurred or any payment has been received from its customers—regardless, in fact, whether payment is ever received—the licensee will begin making Royalty payments. Notwithstanding that the licensor/studio will not make a single payment to its "net profits" participants until (if ever) those revenues generated by its entertainment production and actually received by the studio have exceeded all of its liberally defined costs, overheads, interest calculations, etc., etc., the licensee will be required to pay Royalty on every shipment of Licensed Products. Even if no reorders are placed, even if no customer ever makes a single payment to the licensee for those products, even if actual profitability is never achieved, the licensee will pay Royalty for each and every Licensed Product shipped.

Conclusion

Future articles in this series will attempt to address and reconcile these obvious incongruities, but for now we must leave our licensee wishing, hoping, praying, and paying—without receiving dollar one. ●●●●

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Of Counsel/With James Kipling

On the Duration of a License and the Importance of Negotation

Licensing 101, Part 60

Duration of License

One of the central elements of any license agreement is the duration of its term. Since each side to a negotiation seeks to minimize its risk, the greater the uncertainty that is involved in a license, the more difficult the negotiation of its term likely will be. Depending upon whether the property is a new introduction or an established evergreen, the parties may disagree on whether the term should be brief or lengthy, fixed or subject to extension or reduction, and if the latter, on what basis.

Too Short? Too Long?

Unless each party's expectations for success approximate reality, one or the other of them likely will regret the deal it has struck. If the deal requires a minimum royalty guarantee for each year of a license, the licensee will want the opportunity to shorten the term if the property becomes a disappointment in the marketplace. If it's a big winner, however, the licensee doubtless will want to extend its rights. The licensor may have the opposite interest in either scenario. If a property takes off, the licensor may wish an early opportunity to auction the licensee's rights to the highest bidder, but if it is not successful, the licensor will not be interested in shortening the term if that means reducing the guaranty.

Alternative Approaches

As a hypothetical, let's assume that the licensor won't move from \$100,000 per year in minimum royalty guarantee for the desired rights or from three years for the term of license.

The "Success" Scenario:

Both parties know that the licensee is willing to undertake significant initial risk because it has faith in the property. Assuming that the licensor is inclined to be reasonable, it should be willing to give the licensee the opportunity to extend the license if it proves successful.

First / Last?

The licensor might offer a first right of negotiation to extend beyond the initial period, but a circumspect licensee will recognize this would put it into a position of having to negotiate against its own success. That is, if its products have sold well, another potential licensee is likely to offer a premium in order to step into our licensee's shoes and partake of the fruits of its efforts without having taken the risk. Even if the licensor suggests incorporating a matching right into the license, the premium offered by the third party might be beyond our licensee's means and cost our licensee the opportunity to enjoy its own success.

Pre-Set Threshold

Normally, it would be preferable to the licensee to establish conditions at the outset upon which the agreement could be renewed. The parties might agree up front to set a specific minimum guarantee for an extension period, or alternatively to define a formula by which the minimum can be objectively determined, should the licensee elect to extend. (For example, the renewal-period minimum guarantee could be based on an agreed multiple of the actual royalties earned during the initial term.) However defined, if the licensee were willing to pay the minimum for extension, it would have the option to do so.

Multiple of Initial Term Royalty

From the licensor's perspective, these approaches might be palatable in concept but might require safeguards against making renewal too easy for the licensee. For example, if the renewal is based entirely on guaranteeing that the licensee will exceed in the renewal period some multiple of the total royalties earned during the initial term, the licensee could qualify very cheaply if it has been relatively unsuccessful but nevertheless wishes to extend.

Aggravating the licensor's regret in that situation would be greater success of the property in product categories other than those of our hypothetical licensee, implying underachievement by the licensee. Therefore, the wise licensor will seek to condition any such option to extend on some threshold performance achievement—for example, the option could be conditioned upon the licensee's exceeding the minimum guarantee during the initial term by some multiple (rather than simply a multiple of actual royalties generated during the initial term) in order to qualify for the right to exercise the option.

The "Disappointment" Scenario:

If the property fails, everyone will be reading the license agreement hastily. The licensor will want to assure itself that it will receive at least the minimum guarantee for the initial term. The licensee will be searching for an inexpensive opportunity to depart from the relationship. Particularly, if a license involves an unproven property (or an established property, but applied in unproven product categories), some form of exit strategy should be near the top of the licensee's list of objectives during the initial negotiations.

Referring to our example of a three-year term and $100,000 minimum, one exit concept could be a right of the licensee to cancel the third year by giving notice of early termination and paying a buy-out fee in an amount somewhat less than the third-year's minimum guaranty (e.g. $25-$50,000). If the licensor is willing to consider this alternative, it likely will insist upon a substantial lead-time for the exercise of the buy-out, in order to have an opportunity to replace this licensee with one who is more enthusiastic about the property. If the licensee negotiates for and exercises such a buy-out option, it will have reason to congratulate itself for its diligence, if not for its initial evaluation of the property.

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Regardless of the mechanism chosen for extension or early termination, the efforts of each party to risk-adjust the deal during initial negotiation in order to make it mutually palatable is certainly warranted.

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James Kipling

Dealing with, and Accounting for, Deadlines In Licensing Agreements

Licensing 101, Part 62

(This article is the 62nd in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.)

Specified Deadlines for Licensees

Licensors frequently include in their license agreements specific dates by which the licensed articles must be marketed. The objective is to insure that the licensee will actually move forward to exploit the property and cannot merely "sit on its rights" and suppress the property.

A clearly drafted license agreement might include milestone dates by which the licensee is required to do the following:

- Commence showing final prototypes to retailers and/or taking orders for specified delivery,
- Commence commercial production,
- Ship products for retail sale,
- Have commercial quantities on display for sale at retail stores, and/or
- Accomplish such retail availability on a national or international basis.

If a license agreement grants multiple categories of licensed articles, do all categories have the same deadlines, or is a sequential roll-out contemplated? Unless the agreement specifies what activities the stated deadline(s) refer to in this sequence and to which products they pertain, it may be difficult to determine whether the licensee has met its requirement(s).

Window of Opportunity

Particularly in the context of a new theatrical release or television premiere, the licensor may be just as concerned that licensed articles could appear at retail too early as that they arrive too late. If the products are publicly displayed long before the first available for viewing of the associated motion picture or TV series, the production arm of the studio may feel that novel visual characteristics or story line elements of the entertainment could be prejudiced and lose luster. On the other hand, if licensed articles first hit the shelves well after the entertainment premieres, initial excitement may already have waned and sales of the products (and resulting royalties) could suffer as a result.

Hence the quandary that many licensors and licensees feel when licensed articles embody new entertainment properties, and often their interests can be directly at odds. To ensure consistent expectations, the parties should consider clarifying these matters—although the licensee could much prefer to leave the entire subject vague.

"Use It or Lose It"

Another aspect of specifying deadlines is a clear mutual understanding of the impact if deadlines are missed. The most common effect of missing a deadline for introduction is a loss of some of the licensee's rights. If the license agreement includes a grant of rights to several categories of licensed articles, what is the effect of missing a deadline for some but not others? For example, if rights were granted for timepieces, including table clocks and wrist watches, will rights to clocks be lost if only watches are compliant with the deadline?

Similarly, if deadlines are stated by category rather than by individual product, there may be an issue whether an entire category is lost for such failure, or whether shipping a certain category is lost for such failure, or whether shipping a certain number of SKUs protects an entire category. In the above example, if only a single watch meets the deadline, might all clocks and all other types of watches be forfeit by the licensee?

Many standard licensor-issued agreements can go further and make missing such dates a basis for termination of the entire agreement as well as the basis for a claim of monetary damages.

This is yet another one of the fine points that can lead to dispute if not specifically addressed during negotiation. Clarifications prior to execution of a license agreement are resolved more easily (and much more cheaply!) than disagreements which arise after the agreement has been put into effect and each side is expending resources against it.

Penalty Clauses?

Even if termination and a claim for damages is not written into the terms, many agreements involving multiple categories of licensed articles allocate portions of the minimum royalty guarantee to each such category. In the event that the agreement provides for reversion of rights to product categories not used by their respective deadlines, the licensee may be in a position to forfeit that portion of the guarantee associated with the product categories that revert to the licensor. Whether this is a reasonable result depends on one's point of view.

Licensors would argue that they have been deprived of the opportunity to generate revenue from the categories not exploited by the licensee, and that it may be too late to secure a replacement manufacturer. Licensees would argue that reversion of the categories not exploited should be sufficient punishment since the licensee remains responsible for the total minimum royalty guarantee and has fewer products against which to attempt to recoup it.

Specified Criteria for Licensors?

In contrast to the above matters about which licensors often insist upon rigorous detail, a remarkable transformation can occur if the licensee suggests supplementing the licensor's standard form agreement—which may be strangely silent on the subject—with deadlines for national release of the motion picture or the broadcast premiere of the TV series on which the license agreement may be based. Those suddenly can become matters that are entirely beyond the licensor's control—despite the certainty invariably expressed throughout the pitch materials that have been presented to the licensee. "We don't own the network!" "That's in the control of the theater chain!" "Don't you trust us? We have an impeccable record of blah blah blah and blah."

Suggestion: Even though the licensee still would prefer that the licensor actually live up to the glowing representations made in the pitch material, how about revising the agreement to create automatic adjustments to some of the licensee's obligations to the degree that the licensor's actual performance falls short? Of course, for these adjustments to alleviate the licensee's pain effectively, they may require that the licensor be willing to make meaningful concessions.

A potential licensee's creative proposals in this regard during the negotiation can offer at least two salutary results: First, the proposals actually may lead to beneficial concessions; second, if the proposals are met with total intransigence, they may betray the licensor's lack of confidence in what it is selling. Occurring prior to execution of the agreement, this latter may be even more valuable to the potential licensee than the former.

Conclusion

Regardless of one's viewpoint, it is easy to see that this is another area in which opinions of the parties should be aired and resolved on a negotiated basis rather than awaiting a potential disruption of an ongoing business relationship, or worse, litigation.

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Advertising Obligations: An Expensive Proposition

Licensing 101, Part 63
by James Kipling

This article is the 63rd in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.

Many license agreements include a requirement that the licensee must advertise its licensed articles. Frequently, such requirements are coupled with obligatory participation in a Common Marketing Fund (CMF) controlled by the licensor. Each of these obligations can represent substantial incremental spending obligations and must be understood and carefully considered at the time of entering the agreement.

Minimum Advertising Requirement

The first important consideration is whether the advertising obligation is defined as a stated minimum dollar amount, as a percentage of sales (the A/S %), or in some combination. The licensor may require minimum annual spending of "the greater of $500,000 or 5 percent of total sales of licensed articles," for example. The minimum dollar amount assures the licensor that significant spending must occur in any event, while the A/S percentage can cause escalation if the products are a success. Obviously, the minimum dollar figure increases the licensee's risk in the event of "less" success.

How to Measure Spending?

Assuming that agreement is reached upon the amount of spending required, the parties might next focus on how the spending is to be measured. If television or print ads are selected (or required), is the cost of preparing the advertising content (e.g., commercial production) counted, or is only the purchased media in which the advertising runs applied toward the minimum? Obviously, the latter puts a greater burden upon the licensee.

Are specific forms of advertising and specific media required? Are any of the required media affiliated with the licensor? If, for example, a comic book publisher or television network is the licensor and requires advertising in its respective media or on its own website, the licensee must be careful not to undertake the obligation without some contractual assurance that pricing for the media will be fair. Having committed to a spending amount without a predetermined price structure, the licensee may find that it pays top dollar (or more) for media for which it should instead receive preferred pricing as a licensee of the property. One might seek a "most favored nations" provision requiring that it receive the best price available to any advertiser in the licensor's

media. Resistance by the licensor to this concept may signal that the licensor intends to take advantage of the licensee in its position as "captive audience."

Spending Shortfall

What happens if the licensee underspends the agreed upon amount? In many license agreements, licensors require, as a defined remedy, that the licensee must pay to it the spending deficiency on a dollar-for-dollar basis. If the agreement provides a multiyear term, the licensee ought to be given the option to carry forward any spending deficiency, and cover it by increased spending during the following year. If the term of the agreement ends with an unspent obligation, only then should any accumulated deficiency be payable to the licensor. In these instances, the licensee would also be wise to insist that the deficiency payment should be the licensor's exclusive remedy, to prevent an additional claim for "damages" caused by the diminished support provided.

If no such repercussions of spending deficiencies are defined in the agreement, the licensee might feel the provision has no teeth. The licensee must remember, however, that it could be declared in breach of the agreement, and a dispute could ensue regarding the impact of the breach on both parties, potentially resulting in termination of the relationship and/or claims of financial damages.

Exceptional Situations

In the event that the property becomes extremely popular, licensees who have minimum spending requirements may find themselves advertising against empty retail shelves, and wish that they had negotiated for suspension of the advertising obligation in the event that their products sell out or exceed the marketing plan. Any further spending might be wasteful of the licensee's resources, and create friction with retailers who must turn away irritated consumers searching for scarce licensed articles still being advertised. Relief from this situation should be a consideration at the time of negotiating the license agreement, even though it may seem like "pie in the sky" at that point.

Whose Products Are We Advertising?

A secondary benefit to licensors of mandatory spending by certain licensees is that such advertising will create rub-off benefits to other licensees of the same property whose products are not traditionally advertised. In the event that the advertisers' products sell out, fairness would indicate that the suspension of the obligation suggested above would be appropriate even if not stated in the license agreement. Some licensors, however, may insist upon continued spending even in the sold-out situation in order to drive additional sales of peripheral non-advertised licensed articles.

Since such further spending can be harmful to the licensee, both financially and through adverse trade and consumer reactions, addressing the situation during initial negotiation is certainly worth the effort.

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Negotiating the Common Marketing Fund

Licensing 101, Part 64

by James Kipling

(This article is the 64th in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.)

For the Common Good

As was addressed in the preceding article of this series, license agreements frequently include specified minimum advertising requirements that the licensee must expend in promoting its own licensed articles.

The Common Marketing Fund ("CMF") is a separate element of cost of participation required by many licensors that may or may not provide marketing support for the licensee. Ten years ago, it was still a new concept and was strongly resisted by many licensees. Today, it is more of a rule than an exception and has found its way into licensors' standard form agreements.

In essence, the CMF clause requires payment by the licensee to the licensor of additional funds (over and above the costs of royalties on its sales of licensed articles and its own advertising expenditures) that are to be earmarked for use by the licensor in a manner "beneficial to all licensees." At least that's the theory. Such licensor spending might include increased media advertising for the property, financing the creation of in-store boutiques for coordinated display of products embodying the property from various manufacturers, promotional events, or other uses beneficial to licensees.

We use the word "might" advisedly. The devil is in the details—or the lack of detail, depending on which party we're talking about.

Licensees' Payment Obligations Are Clear and Unambiguous

Specificity is never lacking when the licensee's mandatory CMF payments are set out in the agreement. A flat sum, a defined periodic payment, or an incremental percentage of sales must be paid to the licensor for the CMF. Often, separate quarterly statements are required to be sent with a separate check for the CMF payment. In some instances, these are to be sent to a different office of the licensor from that which receives the royalty payments and statements under the same license agreement. It's all very precise and creates the impression of separate and distinct revenue streams being used by the licensor for different purposes.

Licensors' Spending Obligations Are Frequently Less Specific

Many license agreements that include the CMF concept give elaborate examples of the manner in which the funds can be spent, such as those listed above. Licensor spending "might" also include Internet promotion, print ads, and in-store signage. The methods and amounts of licensors' spending, however, are almost invariably qualified as being subject to the "licensor's sole and absolute discretion." In fact, spending of any kind is rarely obligatory.

Some licensees attempt to rectify the uncertainties by negotiating for the definition of what CMF spending will actually be made, the inclusion of the licensee's own licensed articles in specific promotions against which this spending is to occur, and/or detailed reports to be issued by the licensor to confirm that appropriate spending actually has taken place. Such suggestions might be met with varying degrees of licensor shock and disbelief that the licensee might question the licensor's altruistic concern for "what's best for our licensees." Please pass the salt.

Nevertheless, some licensors actually do spend CMF funds and will agree to provide supporting information to licensees who ask the appropriate questions. Those licensors who refuse to provide such information tend to undercut their own indignation at the licensee's brash request.

Just an Incremental Royalty?

Many weary licensees readily take "no" for an answer to their request for an accounting of what's done with the CMF or other relief from what may seem a mere façade for incremental licensor profit. Others don't even bother to ask. They tell themselves, or grumble to others, that the CMF payment is just an "additional royalty" that must be paid in order to obtain the right to use the property.

Actually, it's worse than that.

Licensors who impose CMF payments unanimously require that the payments be rendered separately from royalties and refuse to permit the payments to be recoupable against minimum royalty guarantees. Even though computed as a percentage of sales of licensed articles, CMF payments unspent by the licensor are even less beneficial to licensees than if they were actually incremental royalties. At least then they would count toward the guarantee obligation.

When this aspect is evaluated beyond initial irritation, the weariness of some licensees can be transformed into downright cynicism toward particular licensors. Some licensees have suggested changing the designation from CMF payments to "BLE" payments, for licensors' "bottom line enhancement."

A Revolting Development?

This series of articles is intended to provide reviews of various aspects of license agreements, to explain diverging viewpoints, and to suggest constructive ways to bridge the gaps for the benefit of both sides. However, until more licensors are willing to undertake obligations to spend and report upon the amounts paid into the Common Marketing Fund, it is difficult to find a way to report on this subject impartially. ••••

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Representation and Warranties

Licensing 101, Part 66

by James Kipling

(This article is No. 66 in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.)

An automobile purchaser would exhibit poor judgment if he paid the purchase price without receiving an appropriately formalized transfer of title, and the seller would not be wise to transfer the title without having payment in hand. The representations and warrantees made by each party in a license agreement can be far more significant, financially and otherwise. Nevertheless, they may well be overlooked because they are often written in language that causes eyes to glaze over.

Licensee Obligations

Many licensor-generated agreements require the licensee to warrant that it will not attack the title of the licensor to the property or to any patent, copyright, or trademark pertaining to the property. Similarly, the licensee is usually required to assure that it will not harm, misuse, or bring disrepute to the property in any fashion, nor will it deal with the licensed products other than ethically and in compliance with applicable laws and regulations. Licensees are asked to assure that they will adhere to territorial and distribution channel restrictions, and that their own manufacturing facilities and those of any vendors are operated in compliance with local labor laws supplemented by any additional requirements that may be imposed by the licensor.

The extent of the licensee's burden under these obligations can vary widely from one agreement to the next, and circumspect licensees recognize the need to pay close attention not only to the specific language of their required undertakings, but also to the severity of penalties for failure to conform. In some agreements, seemingly insignificant warranties can carry the "death penalty" of termination of the license and forfeiture of guaranteed royalties in the event of any violation, whether material or otherwise. Licensors' agreements also may include specified liquidated damage provisions, often imposing a hefty fine in the event of any deviation by the licensee.

Licensor Undertakings

Perhaps not surprisingly, licensor-generated agreements seldom make far-reaching assurances on the licensor's own behalf. Those representations that are provided may be limited to statements that the licensor has "the right to enter this agreement" (which is more an assurance of licensors having corporate authority to enter contracts in general, than that it has sufficient rights in the property). The licensor may also include a statement that its entering this particular agreement will not violate its own agreements with third parties, to the extent that this adds any substance. This sparse comfort may be coupled with a statement that the licensor's obligations apply "to the extent that the property is owned or controlled" by the licensor. A licensee might read this as an assurance that they are being granted the license to the fullest extent possible when, in fact, the quoted words operate as a quitclaim.

Would a buyer readily pay a few thousand dollars for an automobile if the transfer of title were qualified by a thought such as, "If I actually own the car, I'm transferring absolutely all of my rights to you"? Very doubtful. Yet these sorts of provisions appear in license agreements worth many times the value of a car and often go unquestioned.

Reasons for Caution

Clearly, the licensee should seek assurance that the licensor does, in fact, own or control all rights in the property that is being licensed and that the licensor's ownership or control is sufficient to support any grant of exclusivity being made. Representations (and indemnifications) should also be included, stating the licensee's use of the property—as authorized under the agreement and as approved by the licensor—will not infringe third-party rights or result in adverse claims. Without these elements, the licensee has no assurance that it can market the licensed products without being at risk of claims originating with the property itself, or that another licensee won't market directly competitive products using the property emanating from a legitimate third-party source.

If the licensee is planning to use the likenesses of actors from a property comprising licensed motion picture or other audio-visual work, it needs assurance that the licensor can convey those rights as well. Otherwise, it may have to defend claims made by the actors or their unions based on the licensee's uses of the likenesses in its products or advertising. Similarly, if an automobile or other prop from the film is to be an element of its product line, the licensee must assure that the licensor has given a warranty that the product placement deal with the automobile manufacturer conveys rights for merchandising uses. Without this, the licensee might face a claim from yet another quarter for which it finds itself on its own.

In a corporate brand license, does the licensor assure that it has taken all of the steps necessary to procure trademark protection for the brand in the licensed product categories? If there is no trademark registration already in place that is applicable to each of the pertinent product categories, has the licensor filed "Intent to Use" applications in the U.S. and applications to register the mark in other countries of the licensed territory? What representations and warranties is it willing to put into the licensing agreement to ensure that it has the necessary rights?

Pinning It Down

Efforts to incorporate such pertinent assurances by licensors into agreements often meet resistance. Licensors may resort to arguments such as: "We are granting you absolutely all the rights that we have; we're not holding anything back." If the licensee is paying for the right to use the property in its product line, should it accept such a weak assurance? Stay tuned.

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Ownership of Derivative Works

Licensing 101, Part 65

by James Kipling

(This article is the 65th in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.)

Who Owns the I.P.? Whether a property to be licensed is a motion picture, corporate brand, professional sports team or sports hero, a celebrity, artwork, or a patented device, it is essential that the agreement defines which of the parties owns further developments of the licensed property that may result from their partnership.

The Licensed Property

License agreements typically grant use of the property for defined purposes for a limited period, and after the expiration of that period, all rights licensed will revert to the licensor. But unless the agreement also addresses the ownership and permitted use by the respective parties of any additional intellectual property included in the licensed products and related materials, there can be disputes both during and after the term of the agreement.

Derivative Works

The term "derivative works" is most commonly used in the context of copyright works, but can conveniently describe any further developments of a property of any nature from the form originally provided by the licensor. For example, a property can be applied to licensed products, either in the original form depicted in the licensor's style guide or in an altered or simplified form better adapted to manufactured products. The latter can be characterized as derivative works, to the extent that they are "derived from" the originals.

For example, that newest hero of heroes, the "Heroman" character, might be licensed to an action figure manufacturer and depicted on packaging and in advertising for the Heroman-licensed products in the exact two-dimensional form that he might have appeared in his recent debut comic book. As applied in licensed action figure products, however, the character would be transformed into a new three-dimensional sculptural form. The new sculpture would be a "derivative work." [*Note:* "Heroman" is used as the centerpiece of this article because of his soon-to-be universal recognition and immense popularity—and also because of his egregiously crafted license agreements.]

Ownership

It is understandable that the Heroman licensor wishes to own and control all such works and all new versions of Heroman, as is also the case with previous superheroes. The standard license agreements of most licensors today already include a provision to the effect that the licensor will own and control all renditions of the property itself that appear in the licensee's products as well any derivative works created by or for the licensee. Even without such a provision, the original versions of the character as well as the licensee's derivative works could not be used by the licensee without permission of the licensor.

In absence of the contractual language, however, there could be an issue regarding use by the licensor of the newly created derivative works without the permission of the licensee. As a result, most licensor-generated agreements include provisions by which any and all modifications, revisions, and renditions of the property will be owned exclusively by the licensor immediately upon their creation and subject to any and all uses by the licensor at its discretion. Thus, 2-D images of Heroman in a licensee's video game will become the property of the licensor upon their creation, as will 3-D embodiments in the licensee's action figures—even though those versions may depart in certain aspects from all prior images of the character—and the licensor will have the right to put them to any use of its choosing.

Peripheral Materials

The question can become a bit dicey when the focus is not upon renditions of the property itself or modified versions of the original, but rather upon the materials in which, or on which, elements of the property appear. For example, if Tonka, Inc. (when it existed as an independent company) was the Heroman licensee for toy trucks and under its license created packaging that included only a single image of the Heroman character and no other licensed artwork on an otherwise standard Tonka Truck package, who should own the rest of the Tonka artwork on the package? (Granted, not a very effective package but please play along.)

If Tonka had created a TV commercial showing kids playing with its Heroman-licensed Tonka Truck, who should own generic music, the kids' dialogue, and any other original elements incorporated in the commercial? Even more basically, if Tonka had affixed a single label depicting Heroman onto the door of an existing Tonka Truck, who should own the truck design itself?

As it happens, in fact, the Heroman form license agreement specifically addresses these questions. Under the pertinent language of the Heroman form license agreement and, in fact, those of many other of today's licensors, the answers to all of the above questions are "the licensor." The mere fact that the image of the licensed character were to appear on these otherwise unrelated works could be enough to transfer ownership of all of them to the licensor.

Most licensees would find such a result intolerable. The Tonka people probably would as well—particularly when they received direction from their licensor at the expiration of the license to ship their Tonka Truck tooling to the new Heroman toy truck licensee.

Reasonable Alternatives

Should not there be some middle ground? Perhaps, for example, pre-existing intellectual property of the licensee ought not to be transferred to the licensor merely because it temporarily included the licensed property. By the same token, should not new but generic creations remain with the licensee despite their having been used with the licensed property? If the licensed property can be removed completely and a viable product will remain, should not the licensee's effort in creating that product have continuing value to the licensee?

The I.P. sections of license agreements can make busy executives' eyes glaze, but circumspect licensees will not simply skim over those provisions. All of the above possibilities deserve attention because the majority of licensor-generated agreements presume that all artwork and other elements of intellectual property used with the licensor's property should be owned by the licensor, no matter the source of those elements or their existence prior to or creation under the license.

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Clearing the Way for Your Trademark

LICENSING 101: PART 54

(This is the 54th article in a series devoted to the creation and documentation of the licensing relationship and to elements of a typical license agreement.)

Fundamental Differences

The two preceding articles in this series discussed essential differences between the trademark laws of the United States (which determine ownership of a mark on the basis of its *actual use in commerce*) vs. those of most other countries (which define ownership by *earliest registration alone*). They also introduced the need for "clearance" of a mark before domestic use.

The second of the preceding articles suggested that there are levels of *inherent protectability* for trademarks depending on the "distinctiveness" of various categories of marks. Distinctiveness of the mark (i.e., the ability of a mark to distinguish products and services of one provider from those of its competitors), and thus its protectability, descends from the highest levels for "fanciful marks" (e.g., Kodak) and "arbitrary marks" (Apple for computers) to "suggestive marks" (Chiquita for bananas), to "descriptive marks" (RealLemon for lemon juice) to generic terms, which are not protectable at all. The article also pointed out that there is natural tension in selecting a new mark between the level of distinctiveness/protectability and the ease of its introductory communication to consumers of the pertinent products and services.

This article will expand upon the previously mentioned need for "clearance" before adoption of a mark in the United States.

Availability is a determination involving whether you are or will be the first to use the chosen mark in connection with your goods or services.

Searching for Freedom

Assuming that you have decided upon a new mark that appears to have the desired level of potential protectability (based upon a balance of your interest in its ease of communication vs. its distinctiveness, as described above), the next steps in the process will necessarily depend upon the "availability" of the mark for use in the manner desired, as well as the potential registrability of the mark with the United States Patent and Trademark Office.

"Availability" is a determination involving whether you are or will be the first to use the chosen mark in connection with your goods or services, or whether another entity was earlier to make such use of the mark and has not "abandoned" its use. The process of making this determination usually starts with a preliminary, or "knockout" search of the U.S. Federal and State registers. Assuming that the mark survives this first test, then it is necessary to decide whether to perform what is known as a "full" or "definitive" search through a competent trademark attorney.

How far to go? How much to spend?

The determination how far to pursue the clearance process beyond the "knockout" stage must be based upon the importance of the new mark to the company in terms of the anticipated long-term investment in

OF COUNSEL WITH JAMES KIPLING

establishing and using it. One way you might assess this is to consider how much it might cost to *change the mark four or five years from now*. For example, if a conflict were to arise, it might be required to destroy or discard inventory of products embossed with a mark that a judge rules can no longer be used and issues an injunction in favor of an adverse party.

Even if the product itself does not bear the enjoined mark, one may be forced—on an urgent basis—to select and clear a new mark, repackage existing inventory for distribution under the new mark, and create and publish new promotional materials in the hope of maintaining viability of the product line despite unavoidable interruption.

Prudent business judgment would suggest that careful evaluation of this sort of downside risk will, in and of itself, define the appropriate pre-introduction clearance effort. For example, if a multi-national company is spending millions of dollars to launch a new product line, spending tens of thousands of dollars protecting its investment with a "definitive" search is appropriate. If a smaller company invests tens of thousands of dollars in launch a new product, then spending several hundred to a couple of thousand dollars searching the mark is more than reasonable.

What Should You Expect from a Search Report?

Unfortunately, only a "no" answer can be rendered with certainty; and that answer almost always costs less than an "almost certainly yes" answer regarding use of a new mark. Before commissioning a search, it is wise to talk with your attorney about (a) the level of risk with which you are comfortable, and (b) the likely cost of searching necessary to reach acceptably diminishing returns at that level of risk.

Once you have commissioned a search, analyzing the search report and making decisions as a result will involve a balancing of those risks. Even though you are looking for an answer such as "Yes, you may use this mark," you are not likely to get an unqualified affirmative answer. Remember, only in countries whose laws are very different from ours can a simple review of registered marks be determinative. Since trademark ownership can be the result of use without registration in the United States, there is always a chance that a prior and continuing use that would preempt the searched mark *will not be identified*. Occasionally, the only potential conflict found in a search will be an expired, cancelled, or abandoned registration or application. In this case, further investigation is almost always warranted. The fact that a registration was not renewed or an application was abandoned should not result in an assumption that a mark is not in use. There may be a variety of reasons, apart from abandoning the mark, why an application was not pursued or a registration not maintained.

Only in countries whose laws are very different from ours can a simple review of registered marks be determinative.

Conclusion

The next article in this group will explain how one evaluates the risks that may be disclosed in a search report, and what the elements are that determine whether the report discloses a significant likelihood that use of the searched mark will result in claims and—worse yet—determinations that the use is infringing on someone else's rights.

In later articles, the subjects will turn to registration of marks with the United States Patent and Trademark Office and the extremely valuable benefits of such registration. We'll delve a bit more into aspects of trademark law at home and abroad, before tackling surveys of patent and copyright laws. ••••

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Clearing Your Trademark: How Close Is Too Close?

LICENSING 101: PART 55

(This is the 55th article in a series devoted to the creation and documentation of the licensing relationship and to elements of a typical license agreement.)

Where is the Line?

The first of the three preceding articles in this series discussed essential differences between the trademark laws of the United States (which determine ownership of a mark on the basis of its actual use in commerce) vs. those of most other countries (which define ownership by earliest registration alone).

The second of those articles suggested that there are levels of strength or inherent protectability for trademarks depending on the "distinctiveness" of various categories of marks. Distinctiveness (i.e., the ability of a mark to distinguish products and services of one provider from those of its competitors), and thus protectability of the mark, descends from the highest levels for "fanciful marks" (e.g., Kodak) and "arbitrary marks" (Apple for computers) to "suggestive marks" (Chiquita for bananas) to "descriptive marks" (RealLemon for lemon juice) to generic terms, which are not protectable at all.

The third article proposed considerations for determining the scope of a trademark search based on the risks associated with failing to identify potential problems before launching a new mark.

This article seeks to bring the "clearance" process into sharper focus.

How to Evaluate the Risk

After the attorney has secured or conducted a database search covering not only registrations of the same or similar marks but

also all available "common law" references (i.e., uses in commerce without regard to registration), the collected mass of references will be evaluated for potential infringement problems. Recalling that the test of trademark infringement in the United States is the reasonable likelihood of consumer confusion, it is evident that a conflicting mark does not have to be identical to the searched mark in order to be a problem, if other factors enhance the likelihood of confusion.

Without getting too heavily into legal analysis, it is worth listing the factors commonly used by courts in making a determination in this regard. These are the "Polaroid Factors" that were enunciated in 1986 by the U.S. Federal Circuit Court of Appeals for the Second Circuit in New York, and they have been used routinely by courts in analyzing infringement claims ever since. Application of these factors does not follow a rigid formula, but must be viewed in context and considered with flexibility as a means of evaluating a particular situation.

"A conflicting mark does not have to be identical to be a problem, if other factors enhance the likelihood of confusion."

The Polaroid Factors are as follows:

• "Strength of the Mark," which is determined by the inherent distinctiveness of the mark itself according to the scale mentioned in the first paragraph of this article, taken together with the longevity, consistency, and notoriety with which a mark has been promoted by the earlier (i.e., the "senior") user.

• "Similarity of the Marks" is applied when the senior and junior marks are not identical, and is determined by comparison of the two marks themselves. If the prior mark is the word "Extreme" and the searched mark is "Xtreme," the difference in spelling could be easily ignored by consumers, if others of the aggravating list of factors were also present.

• "Similarity of the Products" addresses whether the senior and junior users' products are in the same product category, are likely to be marketed near one another at retail, or otherwise are related closely enough by category that consumers would reasonably expect them to be marketed by the same company. Applying this factor to the Extreme/Xtreme marks above, if the two trademarks were used for skateboards, the difference in spelling easily could be ignored by confused consumers. On the other hand, if one mark were used on skateboards and the other on soft drinks, confusion is not as likely to occur.

how carefully consumers are likely to evaluate products in the pertinent category before making purchases. Inexpensive "impulse" purchases of products sold under similar trademarks would be much more likely confused than purchases of more

Licensing as an Additional Factor

Recent applications of the Polaroid Factors in practice have yielded surprising results. In some cases, uses of a similar mark in product categories that would have been considered totally unrelated 20 years ago may be found to suggest a sponsorship or other licensing-related connection—and therefore declared infringing—today. And such a finding can be traced to the increasing prevalence of licensing itself.

Conclusion

In later articles, the subjects to be covered will include the process for, and considerable advantages of, obtaining registration for trademarks in the United States Patent and Trademark Office. We'll also delve into aspects of trademark law at home and abroad before turning to the other major

"Strength of the mark is determined by the inherent distinctiveness of the mark itself...taken together with longevity, consistency, and notoriety."

• "Good Faith" considers the junior user's intentions in adopting its mark. If there is evidence that the latter sought to "trade upon" the good will created by the senior user's products with the target consumers, there's a strong inference that confusion is intentional and therefore likely.

• "Relative Quality of the Product" assesses whether the good reputation associated with the senior user's products would likely be tarnished by the merchandise of the junior user.

• "Sophistication of Consumers" evaluates expensive products, particularly those that involve significant expertise in use or narrowness of target market.

• The presence of "Other Similar Marks" can have the effect of weakening the scope of protection of the senior mark, and can have a significantly negative impact upon the likelihood that "yet another" similar mark would appear likely to create confusion.

• Evidence of "Actual Confusion" in the marketplace can be a determining factor in trademark infringement litigation, but it is not available for consideration at the time of the trademark search.

areas of Intellectual Property Law, copyrights, patents, and trade secrets. ••••

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Gone, but Not Forgotten: Reviving Brands

Licensing 101, Part 67

by James Kipling and Jennifer Miller

(This article is No. 67 in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.)

It has become increasingly common for toy manufacturers seeking to appeal to new generations of children to re-launch previously popular toy brands in order to capitalize on the parent's goodwill and name recognition for those brands. Examples include Care Bears, Strawberry Shortcake, and My Little Pony. A particularly interesting example is Crash Dummies, a popular line of action figures modeled after the well-known car-crash mannequins. This brand has been revived more than once since its original introduction in the 1980s.

James Kipling, Of Counsel

The nostalgia phenomenon is not unique to the toy industry, as evidenced by the popularity of the AMC TV series *Mad Men* and the resulting re-introductions of several dated, but venerable brands. Nevertheless, trademark owners seeking to revive consumer products brands after a period of non-use must carefully consider the impact that non-use may have had on their trademark rights.

Trademarks

Trademark rights are created through use in commerce of a mark, logo, design, or other indicator to signify a particular company's goods or services. Trademarks are legally protected because doing so can be greatly beneficial to consumers as well as to brand owners. After consumers have had satisfactory experiences with branded products, they are likely to seek out the same brands for additional purchases. If there were no mechanism by which a marketer could prevent others from using its brand, consumers, as well as the first user of the brand, could be harmed—consumers would be purchasing inferior products, and first users would be tarnished through the consumer's disappointment with those products.

Unlike other forms of intellectual property, such as patents (which protect qualifying inventions) and copyrights (which protect original works of authorship), trademarks have no expiration dates. Trademarks are protected by law forever, so long as the party that owns the mark continues to use it in commerce. However, when a trademark owner discontinues use of its mark, whether to rest the mark or for other reasons, problems can arise.

Abandonment

Trademark owners seeking to revive a brand that has been on hiatus for a number of years must take care that the trademark has not become "abandoned." Under the Lanham Act, which defines federal trademark rights in the U.S., a trademark can become abandoned when the trademark owner stops using the mark and has no intention to resume its use. If a mark is not used in commerce for at least three years, then there is a statutory presumption of abandonment. If a trademark, no matter how famous, actually becomes abandoned, the former owner has no further rights in the mark. In that event, any other entity can use and become the owner of the mark, even to the exclusion of its creator and former owner.

Avoiding Abandonment

There are strategies that companies and trademark owners can implement to prevent abandonment of their valuable trademarks while keeping their options open for future development of the brand.

Before temporarily halting use of a brand, trademark owners should consider maintaining limited use of the mark during periods of transition or rebranding. By definition, a mark cannot be abandoned if it is still being used in commerce. However, the Lanham Act defines use in commerce as the "bona fide use of a mark in the ordinary course of trade, and not made merely to reserve a right in a mark." That is, mere token or sham use designed simply to keep a trademark registration active would still allow the mark to become abandoned. One way to maintain limited use of a mark, especially during a company transition period, may be to use the old mark as a sub-brand or secondary brand.

Additionally, license agreements may help trademarks stay active even when the trademark owner may not engage in its own use of the mark. If a trademark is licensed to a third party, the original trademark owner has the benefit of the third party's use in commerce. However, it is important to remember that licensed trademarks may be deemed abandoned if trademark owners engage in what is called "naked licensing," which occurs when a licensor fails to exercise appropriate quality control over a third-party licensee's use of the licensed trademark. While there are no bright line definitions for adequate quality controls, some measure of quality control should be present in drafting and administering any trademark license agreement.

In the event of a temporary hiatus where a trademark owner has the bona fide intent to resume use of the brand, it is important to ensure there are no lapses in the trademark registrations both domestically and abroad. Trademark owners should take care to keep their registrations active so that once revival commences, they avoid the potentially complicated process of reviving a dead registration. To ensure a trademark registration does not lapse, trademark owners should closely monitor their trademarks at the U.S. Patent and Trademark Office to ensure all important deadlines for renewal are met. Companies that acquire trademarks from other businesses should take the time to record trademark assignments with the U.S. Patent and Trademark Office.

Intent to Resume Use

Even though a mark has been unused for three or more years and the presumption of abandonment applies, one should not assume the trademark is now up for grabs. The owner may still have rights in the mark and be able to prevent its use by others. Consider a recent litigation involving the Crash Dummies trademark previously mentioned.

The mark was owned by Mattel, Inc., and had been used in commerce for several years for a line of action figures and play sets. During the late 1990s, the company dropped the line and ceased all use of the brand. After several years, an entity called Crash Dummies Movie, LLC (CDM) attempted to register "Crash Dummies," but Mattel objected. CDM argued that Mattel had abandoned its rights in the mark as a result of the extended period of its non-use (by that point having reached eight years). However, in a lawsuit that eventually reached the U.S. Circuit Court of Appeals, Mattel was able to convince the Court that it had never truly "abandoned" the mark and had intended a relaunch throughout the period of non-use.

To support this position, Mattel presented evidence that it was required to re-tool the original Crash Dummies toys


Jennifer Miller, Associate

in order to meet the company's new and stringent safety standards, and that the development project accounted for the entire 8-year period of its non-use of the trademark. The federal circuit court accepted this argument and held that Mattel had not abandoned its rights, even though it had not used the mark for such a long period of time. While there had been a presumption of abandonment because Mattel had not used the mark in commerce for (much longer than) three years, Mattel was able to rebut that presumption by showing it had, at least what the court believed were, reasonable grounds for its suspension of use.

The Crash Dummies case exemplifies that being able to prove the existence of plans to resume use of a trademark after a hiatus may become essential in rebutting adverse claims of abandonment. It also shows the importance of maintaining detailed business records to support arguments to that effect.

Reviving Marks

Reviving a previously used trademark can be complicated. There is the danger that while the mark was unused, another entity may have used or registered the same or a similar mark for the pertinent product category, possibly acquiring ownership and preempting the previous owner's ability to use a mark that it originally made popular. Mattel faced this possibility in the Crash Dummies matter, and led to the company spending large sums of money in the described lawsuit. Had the court's decision been the reverse, Mattel would have lost any right to use the mark. Furthermore, had Mattel commenced use of the mark first and then lost the suit, it would likely have been enjoined from further use, after having spent even more heavily in effecting the relaunch.

Generally, a company seeking to relaunch a mark that has been out of use for an extended period should first perform the same kind of trademark clearance search that it would have done if it never had owned the mark. Such a search could turn up potentially expensive problems that might be addressed before the relaunch, or might make it impossible. Assuming that no preemptive conflicts are identified, the company can safely begin to use the mark or file a new trademark application on an "intent to use" basis in anticipation of actual relaunch.

Trademark owners should also work to ensure there are no lapses in the U.S. trademark registrations. Keeping registrations current allows mark holders to move forward with rebranding or reviving an old product line more smoothly.

Conclusion

Reviving venerable brands for a new generation of consumers allows trademark owners to build upon previous name recognition and goodwill. By taking proper steps before, during, and after a temporary hiatus in trademark use, the rightful owner of a mark can ensure a smooth transition and prevent loss of its valuable trademark rights. ••••

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THE GREY MARKET BLUES

Licensing 101, Part 68

by James Kipling, Of Counsel

(This article is the 68th in a series devoted to the negotiation and documentation of the licensing relationship, and elements of a typical license agreement.)

"Grey market goods" is the designation commonly used for authentic products intended for other markets that find their way into the U.S. (or other territory) even though, by contract, such importation should not occur. The policy of U.S. Customs regarding admittance of grey market goods into the U.S. has been modified several times over the years, and it has been difficult for a licensee to determine whether U.S. Customs will permit or prohibit the importation of licensed products that are, at least in theory, contractually restricted to regions outside the U.S. The situation has become clearer, but more difficult for all concerned, as a result of a decision rendered earlier this year by the U.S. Supreme Court in a case brought by book publisher John Wiley & Sons against an importer of books.

Territorial Restrictions

A license to manufacture and sell licensed articles that are copies or modified versions of a copyright-protected work often grants rights that are not worldwide in scope. Such a license agreement routinely includes language that prohibits the licensees from making sales outside the defined "licensed territory," as well as prohibiting sales to any entity that is likely to export the licensed articles outside the licensed territory. While typically providing that improper exportation by the licensee can constitute a material breach leading to termination of its license (often coupled with financial penalties), an agreement prepared by a licensor rarely includes language protecting the licensee against improperly imported licensed articles.

Since its own rights are limited geographically, the licensee must assume that rights for the same categories of licensed articles will be granted to one or more licensees for sales in other territories. If a question is raised by the licensee about the possibility of grey market goods affecting its market, the licensee can expect to be reassured by the licensor that all of its agreements include the same sorts of restrictive language that the licensee

Grey Market Goods:

The designation commonly used for authentic products intended for other markets that find their way into the U.S. (or other territory) even though, by contract, such importation should not occur.

has in its own agreement. However, a circumspect licensee might ask the licensor to undertake some form of obligation as part of the license agreement: (i) that it will take action to enforce such restrictions against other licensees, should grey market goods appear in our licensee's territory, or (ii) that it will provide some remedy to the licensee if such unauthorized importation occurs.

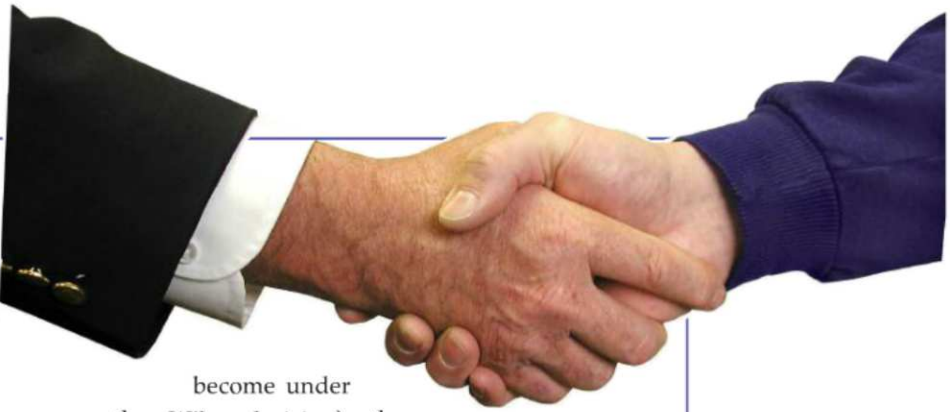
New Complication

In the Wiley case, the defendant-importer had purchased certain English-language books manufactured outside the U.S. by an authorized Wiley licensee, and had imported the books into the U.S. for sale to retailers. The importer made the purchases in Thailand, where the books were available at retail at extremely low prices. In fact, the importer was able to purchase the books in Thailand, ship them to the U.S., and sell them to U.S. retailers more cheaply than Wiley's own domestic prices to retailers for identical books. Because the Wiley licensee's manufacturing license agreement limited distribution to non-U.S. territories, Wiley based its action against the importer upon those contractual restrictions.

Without going into all of the nuances of the case that resulted in a split-decision by the court, the essential factor that resulted in Wiley's losing the case was that, for the first time, the majority of the court held that purchases made outside the U.S. enable the "first sale doctrine" of the U.S. Copyright Act to apply to the purchased products. That doctrine permits the purchaser of a lawfully produced copyrighted product to re-sell or otherwise distribute the purchased product in any way it wishes, and without authorization of the owner of the copyright. Since Wiley's foreign licensee lawfully manufactured the books the importer purchased in Wiley, the fact that the licensee could not legally ship the books to the U.S. has no effect upon their importation by the purchaser. The Wiley decision apparently clarifies long-standing uncertainty about the effectiveness of territorially restrictive language in license agreements for the manufacture of products—at least with respect to disposition of those products by purchasers, whether purchased inside or outside the U.S.

Plan B

Of course, this result will work to the detriment of a U.S.-based licensee in the event of third-party importation of the same licensed product that is subject to its own licensed rights. Since it knows that its licensor now is unable to protect its domestic market from cannibalization by identical products legally produced and purchased outside the country, what are its alternatives? A circumspect licensee will be aware of this likelihood and seek to define anticipatory remedies in its license agreement. For example, a licensee negotiating for rights to a property for exploitation in North America might require of its licensor that all third-party license agreements for the property must prohibit use of the English language. This requirement can be broadened so that all third-party license agreements for products in our



licensee's categories must be limited to use of only those languages pertinent to the respective local markets. However, this will be of limited benefit if language is not particularly significant to marketability.

Plan C

Because of the potentially devastating impact that uncontrolled importation of grey market goods could have, an aggressive licensee might also negotiate for financial relief in the event of such occurrences. One form of such relief might be formulaic cancellation of a substantial portion of the minimum royalty guarantee, in the event that grey market goods become a significant problem.

Another approach might be to provide relief in the form of a reduction in royalty rate for those licensed products most directly affected by the grey market goods. Combined with reduced minimum royalty guarantees, such a provision may go some distance toward bringing relief to the licensee, as well as toward giving the licensor incentive to take preventive action. One avenue to consider would be to cancel the pertinent foreign license agreement immediately upon appearance of grey market goods within U.S. commerce. As a result, the offending products can no longer be "lawfully manufactured" and the first sale doctrine can no longer exempt their importation.

> "When a licensee's business can be severely affected, a bit of aggravation in the negotiating process is certainly worthwhile."

Worth the Effort?

There will be stress between the parties in negotiating the applicable provisions, but if grey market goods are a likely problem (as they certainly may become under the *Wiley* decision), the negotiation of such terms is worth the effort. Because certain industries are more likely affected by grey market goods than others, the decision of whether to force the issue will be made on a case-by-case basis. When a licensee's business can be severely affected, a bit of aggravation in the negotiating process is certainly worthwhile.

The Other Shoe

In most industries, counterfeit products have a much greater financial impact than grey market goods. Because there is less uncertainty regarding enforcement by the Courts and U.S. Customs of intellectual property rights against counterfeits than against gray market goods, there should be less licensor resistance when a licensee requests assurances that action will be taken against counterfeits. This will be the subject of a future article in this series. ••••

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THE GREY MARKET BLUES II

Licensing 101, Part 69
by James Kipling, Of Counsel

This article is the 69th in a series devoted to the documentation of the licensing relationship and elements of a typical license agreement.

In Part 68 of this series, we reviewed the implications of the recent U.S. Supreme Court case involving the book publisher John Wiley & Sons in infringement litigation, brought under the United States Copyright Act, against an importer of books. The books in question had been produced outside the U.S. under a copyright license granted by Wiley, and the license agreement included a territorial restriction having the effect of prohibiting importation of the books into the U.S. The purpose of the territorial restriction was to protect the domestic marketplace, for Wiley's own sales, to retailers in this country.

Copyright Law Implications

A problem arose when a party unrelated to Wiley or to its licensee began to import copies of the books that had been produced by the licensee. The books had been sold by the licensee in various countries that were within its licensed territory. The importer had purchased quantities of the books at retail in Thailand at prices so far below those charged by Wiley in the U.S. that the purchaser was able to ship and import the books into this country and still undercut the prices charged by Wiley to its domestic retailers.

In the past, such territorial restrictions in copyright licenses were routinely enforced against purchasers as well as against the licensed manufacturers of the products in question. However, in the Wiley case, a divided Supreme Court held that the territorial restriction was trumped by the "first sale" provision of the U.S. Copyright Act, at Title 17 of the United States Code. After the Wiley decision, territorial restrictions in copyright licenses will continue to be enforceable against licensed manufacturers, but not against purchasers of the licensed products, whether from the licensee-manufacturer or from the licensee's customers.

Trademark Law Implications

Federal Trademark Law is commonly known as the Lanham Act and is part of Title 15 of the United States Code dealing with commerce and trade. Regulations issued under the Lanham Act specifically address importation of products that are considered "grey market goods," because of trademark considerations. The regulations define situations in which certain categories of such products are permitted to be imported, and others in which shipments of such products are to be refused entry into

U.S. commerce.

"Restricted grey market articles" are those that are subject to exclusion and are defined as products that are made outside the U.S., bear a federally registered trademark or one substantially indistinguishable from a registered mark, and are being imported without the authorization of the U.S. trademark owner.

Even though a trademark may have been applied to goods legitimately, in certain instances importation of the goods will not be permitted unless authorized by the U.S. trademark owner. For example, the goods may bear the trademark legitimately, but the products are excluded if the mark has been applied outside the U.S. by an independent licensee of the U.S. trademark owner for sale outside the U.S. Also, since trademark ownership is determined on a country-by-country basis rather than being international (as is the case with copyrights), a mark may have been applied legitimately under authority of a foreign trademark owner other than the U.S. owner (or a related entity) when the mark is separately owned in the respective countries. The same rules apply if the trademark has been applied to the goods by the U.S. trademark owner or by a related entity for sale outside the U.S., but the goods are "physically and materially different" from articles authorized by the U.S. trademark owner for importation and sale in the U.S. (Note that a special exemption can apply in this instance if the products are labeled clearly as "not authorized by the U.S. trademark owner for importation and is physically and materially different from the authorized product.")

In situations of uncertainty, shipments are to be detained at the port of entry by the U.S. Customs Service. During detention, the potential importer has an opportunity to establish that the shipment falls within a "permissible importation" category. For example, it might be able to establish that the U.S. trademark owner and the foreign trademark owner are really the same entity or one owns or is owned by the other. It also may dispute the determination that the goods are physically and materially different, or it may apply the labeling described above. If it fails to prevail, however, the importer's shipment is to be seized and becomes subject to forfeiture.

The New Reality: Implications for the Licensing Industry

Licensors as well as licensees may feel a bit queasy at this turn of events. Copyright enforcement has been the remedy of relative certainty with respect to grey market goods. Before the decision in the Wiley case, territorial restrictions upon the licensed manufacturer could be imposed and enforced with confidence against the licensee encumbered by the restriction as well as purchasers of the restricted products from the licensee. Trademark licenses incorporating territorial restrictions may offer solace, but, as can be seen above, trademark license restrictions have potential enforcement gaps that had not been the case with copyright protection. After Wiley, the game has changed and neither the Copyright Act nor the Lanham Act provides the comfort of certainty. ••••

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