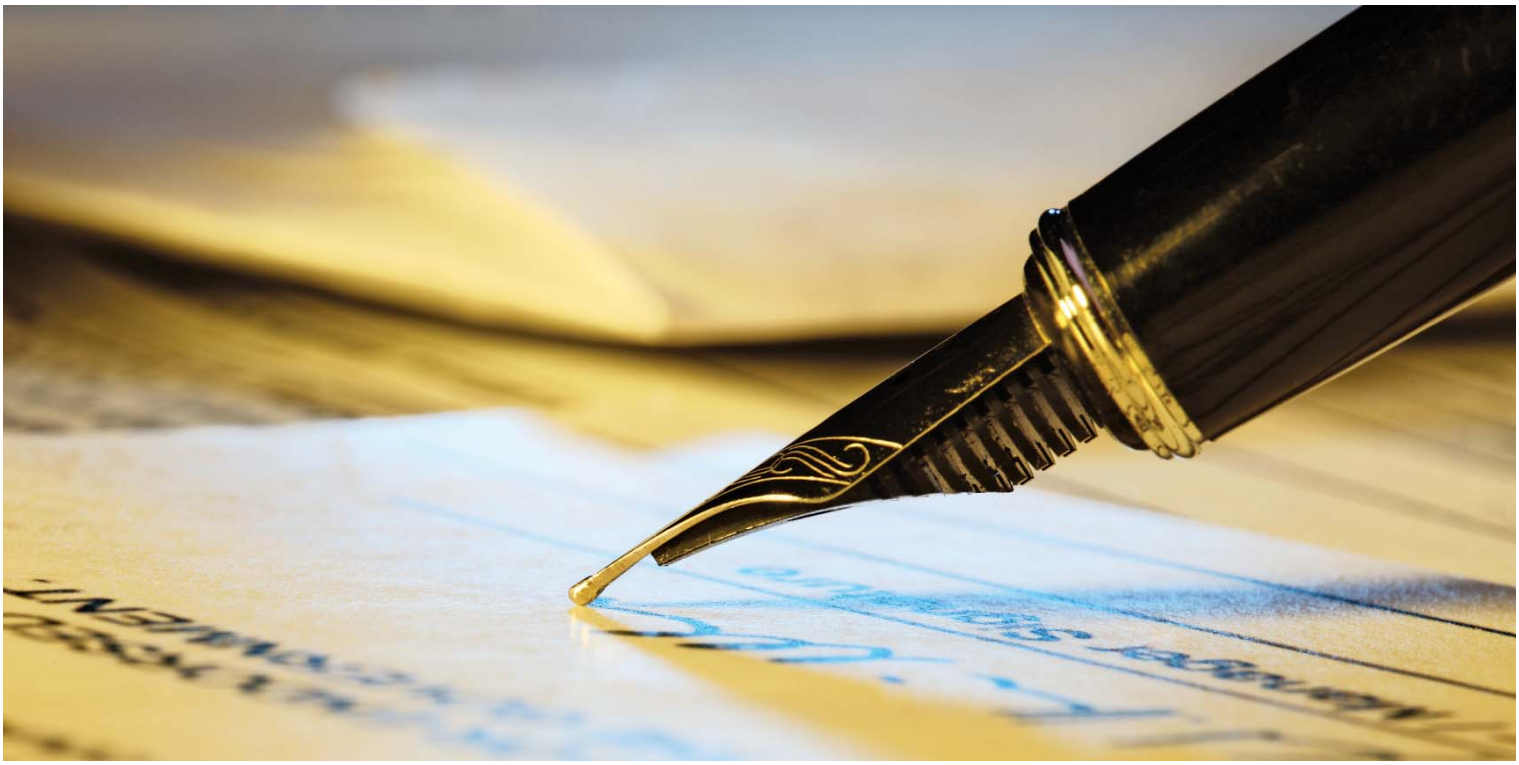

Safeguard your licensing agreement

The need for properly drafted license agreements is being felt like never before and has more or less become a critical need.

EDMUND J. FERDINAND, III

For many years property owners, such as movie studios and major corporate brands, seemed to have all the leverage in their negotiations with licensee-manufacturers. This resulted in a number of licensor-friendly terms becoming more common in license agreements. These terms include transfer fees if the licensee ever seeks to sell or assign the license to a third party; royalty rates touches 20% in some cases, particularly for hot studio properties; licensees providing equity in the company in addition to royalties; licensor's refusing to grant options to renew; licensor ownership of licensee-developed materials; and, extraordinarily high guarantees paid as advances.

There are now far fewer opportunities in the marketplace, particularly for new properties without a proven track record or a successful entertainment component to support the programme.

The global recession has changed the landscape of the licensing industry for the most part. The glory days are unfortunately over for many property owners. There are now far fewer opportunities in the marketplace, particularly for new properties without a proven track record or a successful entertainment component to support the programme. Even when deals can be made, royalty rates are down, and

advances and guaranteed royalty payments are much harder to achieve. Nevertheless, there are ways for property owners to protect themselves in these difficult economic times and particular care must be taken when drafting license agreements.

DILIGENCE UNLIKE BEFORE

Proper due diligence by licensors prior to entering into agreements has never been more important. My partner, Greg Battersby, a prominent licensing industry attorney, has developed his list of 'Rules on Licensing' for property owners. He cautions property owners to take great care when selecting a licensee-manufacturer during these difficult economic times. His advice includes 'better to find a solid licensee partner than a risky one simply because the latter offers the larger advance.' On a positive note, there is now a wealth of public information available to property owners to conduct a proper due diligence search, including Dun & Bradstreet reports and Google searches, among many others.

BANKRUPTCY

These days, even with established licensees, bankruptcy is no longer a remote possibility - it is unfortunately becoming an all too common sign of the times. As a result, licensors must think and act like bankers, asking for the same types of financial information and documents that a lender would ask for prior to making a loan.

In terms of drafting the agreement, the first line of protection is to bolster provisions for the licensor in the event the licensee-manufacturer becomes insolvent or files for bankruptcy protection. Generally speaking, virtually all licenses are executory in bankruptcy proceedings. This means that a property owner will find it extremely difficult, if not impossible, to extricate the contract from the bankruptcy proceeding absent the consent of the licensee. If the license was granted on an exclusive basis, that can have serious consequences for the licensing programme. For this reason, it is now becoming more common for the property owner to seek a security interest in the licensee's inventory of licensed goods. As a secured creditor, the licensor will move to the head of the line in any bankruptcy proceeding. There are also ways for the licensor to make the contract less palatable to the licensee in any bankruptcy proceeding. One commonly used technique is to have an anti-assignment provision barring the licensee from transferring the contract to a third-party.

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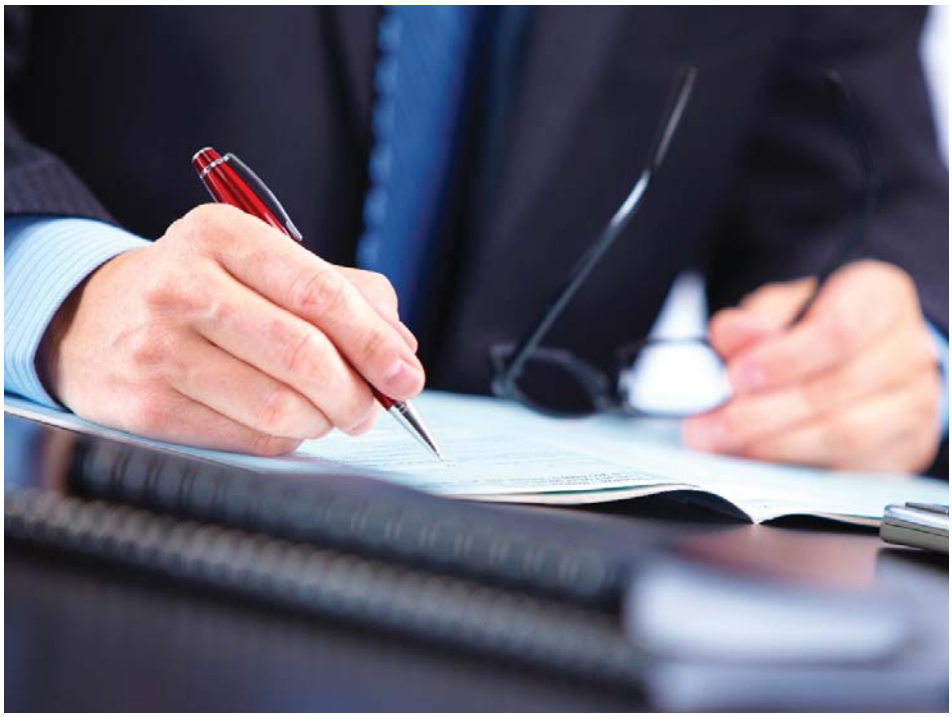
TERMINATION RIGHTS

Aside from bankruptcy, it is also important for the licensor to have strong termination rights in the event the licensee begins to experience financial difficulty. The licensor can look to include the right to terminate the contract immediately if the licensee is deemed insolvent, or cannot meet its debts when they are due and owing, or even if they laid off a certain number of employees. These are all signs of financial difficulty, short of an actual bankruptcy filing, that signal that the licensee may be in serious trouble.

In addition to bankruptcy and insolvency, it is now more common for licensors to demand a letter of credit from a financial institution to stand behind the guaranteed minimum royalties owed during the life of the agreement.

In the fashion industry, it is common for licensee-manufacturers to enter into 'factoring' agreements to provide financing for the transaction. Typically the factor will step into the shoes of the licensee and acquire any remaining inventory in the event of the licensee's insolvency. For this reason, it is critical for the licensor to require the factor to enter into a separate agreement that requires the factor to comply with all of the obligations of the license agreement between the licensor and licensee. This will ensure, for example, that the factor uses the same established channels of distribution to sell the remaining inventory and



cannot merely dump the property in the lowest possible tier upon termination.

A NOVEL APPROACH

We have also encountered one novel approach by a licensor that sought to put itself in the position as a 'lender of last resort' in the event the licensee-manufacturer could not meet its manufacturing obligations due to a lack of financing. The provision reads in full:

"Supplier shall, throughout the term of this Agreement, have immediately available inventory ready for shipment to Retail Customers in an amount not less than five thousand (5,000) Product units (the "Base Inventory Amount"). Should a Retail Customer(s) indicate in writing an intention and or desire (the "Purchase Intent Notification") to purchase an amount of Product that shall exceed the Base Inventory Amount, Supplier shall, within fifteen (15) days of such notice, provide the necessary factory and production financing to begin production of the number of units that are reasonably required to meet the expected current and projected ongoing demand from such Retail Customers based upon its Purchase Intent Notification. In the event that Supplier is unable to provide such production financing, Licensor shall have the option, at its sole discretion, of providing or arranging for such production financing. For the purposes of this section, the Purchase Intent Notification of a Retail Customer(s) shall specifically not require the procurement of a Purchase Order from such Retail Customer(s), but rather shall be an indication of interest by a Retail Customer that reasonably indicates its intent to purchase the number of units detailed in its Purchase Intent Notification in the event that such a number of units were to be in production and capable of delivery with a firm commitment date. In such instances where Licensor elects to provide for such financing, Supplier shall be obligated to accept such financing, so long as the costs of such financing does not result in the Supplier's total variable Product costs for manufacturing and delivering the Product to Retail Customer(s) (including all product production costs, financing and factoring costs, transportation costs, sales commission and costs and Royalty payments due Licensor, and other costs reasonably and typically incurred in the production and delivery of goods to Retail Customers) (the 'Total Product Cost') being greater than the Wholesale Price of the Products to be sold to the Retail Customer(s). For any instance in which Licensor shall provide Production Financing in which the Wholesale Price exceeds the Total Product Cost and any and all costs of Production Financing provided by Licensor, Supplier shall retain the difference between the Total Product Cost and the Wholesale Price."

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This is obviously an aggressive and unusual approach that will not work for most licensors. But it does show the lengths that some property owners are taking in order to ensure that licensed products remain viable in these difficult economic times.

As the economy continues to struggle, licensors and licensees will surely continue to look for new and creative ways to address issues of financial security in drafting license agreements.

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