

MERCHANDISE LICENSE AGREEMENTS - AN OVERVIEW OF KEY PROVISIONS

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Through the merchandise license agreement, the licensor, i.e., the mark owner or its authorized agent, grants limited rights to the licensee to use one or more of the marks. The license agreement is the heart of any merchandising program since it defines and structures the business relationship between the licensor and licensee. It provides the basis for the licensor to exercise the requisite quality control over products and designs covered by the license agreement.

This article will identify and discuss the basic terms of a merchandise license agreement for trademarks, primarily from the perspective of the collegiate trademark licensor.

PRELIMINARY ISSUES

Before entering into a license, the licensor and licensee should determine mutual objectives, create marketing plans, and identify the marks and products that will form the subject matter of the license agreement. The licensee will want to confirm that the licensor owns or has the rights to grant the rights that it purports to grant, and understand the extent of the rights granted. The licensor will want to ensure that the licensee's product is suitable for the program and that the licensee is committed to fully exploiting the rights granted. In short, the parties want to make sure that there is a proper "fit" and establish a positive licensing relationship.

BASIC TERMS OF A LICENSE AGREEMENT

Several provisions fundamental to virtually all merchandise license agreements are set forth below.

Subject Matter

The trademarks that are being licensed should be clearly identified and set forth on a schedule to the license agreement. The schedule should illustrate the style, format and colors of the marks. The agreement should also contain a schedule specifying the goods with which the marks may be used.

Grant

The grant clause is the essence of the license agreement, and should be very specific. Through this provision, the licensor establishes control over the use of the marks. The main issues addressed in the grant clause are degree of exclusivity and the scope of the rights granted.

If the license is exclusive, the licensee is the only entity permitted to use the mark with those goods. In return for exclusivity, the licensor will typically seek a significant minimum financial return and other guarantees of performance. Otherwise, if the licensee fails to sell product, the licensor receives no income. Exclusivity typically will apply to a particular territory, a defined time, specific goods or a combination thereof.

Nonexclusive licenses are granted when it is appropriate to license two or more entities to use marks with the same or similar products. This is a common practice in collegiate and professional sports licensing, where multiple manufacturers are granted rights to use trademarks on apparel, novelties or other goods. The nonexclusive license may be less attractive from the licensee's perspective, as it will face competition from other nonexclusive licensees. The licensor, however, may believe that multiple licensees are required to fulfill demand for licensed products and to create a broad mix of product and designs. This is ultimately a business decision, which should be made as part of an overall licensing strategy, taking into account the market for the relevant product.

The grant section should also refer to the marks licensed and the precise goods authorized to be produced bearing the marks. It is especially important that goods be precisely defined in an exclusive license, as such a license locks up those particular goods. Additionally, the grant clause may refer to the territory in which licensed product may be sold, specify the proper distribution channels, and state that the licensee cannot assign its rights or grant sublicenses without the licensor's prior written consent.

Territory

Often included under the grant section, the territory clause sets forth the geographic area into which licensed product may be sold. The license may cover an entire country or part of a country. In addition, a licensor may grant rights to cover multiple countries. Trademark rights are territorial; protection of a mark may vary from country to country. Accordingly, when licensing a mark for use in countries outside of the United States, the parties should determine the status of the licensor's rights, trademark protection, and licensing restrictions or formalities in the relevant countries. Failure to properly review foreign legal requirements may result in damage to the licensor's trademark rights or expose the licensor and licensee to legal action by a third party which may have acquired rights in the mark at issue.

Term

This section specifies the initial term of the agreement and any means for renewal or extension. While most collegiate license agreements have an initial term of one to three years, this may be the subject of negotiation. One key factor that may affect the length of the initial term is the track record of the licensee. A licensee with a proven track record (e.g., successful performance with other licenses) is more likely to obtain a longer initial term than a start-up company.

Typically, the licensor will reserve the right to offer renewal or extension at its discretion upon expiration of the initial term. However, in some instances, the licensee may negotiate an option to renew or extend the agreement. The licensor may agree, provided that the licensee has met or exceeded certain financial and other performance criteria. The licensor will likely seek to reserve the right to renegotiate certain key terms at the time of renewal or extension. Some agreements provide for renewal or extension for additional periods unless notice is given by either party prior to expiration of the current period.

Payment

The parties should reach agreement on the timing and structure of payments early in the process.

Virtually all license agreements require payment of royalties. The royalty payment is typically based on a percentage of licensed product sales, expressed as “net sales.” Net sales are calculated by starting with gross sales and identifying permissible deductions such as quantity discounts, returns, freight costs and taxes. The licensee should be required to document all allowable deductions to preserve an audit trail. In addition, the licensor will want the agreement to provide that the price used to calculate gross sales be based on an arm’s length transaction, so as to prevent a licensee from making sales to a related party at a minimal markup. Collegiate royalty rates vary per product category, but typically fall within the seven to ten percent range for traditional licensed goods.

The licensor will require that the licensee report and pay royalties on a regular basis, usually either monthly or quarterly, and furnish supporting documentation. Penalties for late payment are typically provided in the form of interest charged on unpaid amounts.

To ensure the licensee’s commitment to the program, licensors will often require an up-front payment by the licensee in the form of an advance against royalties owing. In addition, the parties will negotiate minimum royalty payments, which stipulate that the licensee must guarantee a minimum royalty payment per specified periods, often per year. The agreement should include the mechanism and schedule for calculating and submitting these payments.

The licensor will obtain the right to audit the books and records of the licensee to confirm accurate royalty payments.

Where the licensee is located in a different country, the licensor should specify that payment be made in United States dollars. The parties should consider that withholding tax is usually payable by a licensee out of royalties owed to the licensor.

Quality Control

The trademark licensor must exert adequate control over product and designs produced by licensees to protect trademark rights. In addition, the licensor has a legitimate business interest in ensuring that licensed goods are of acceptable quality. The quality control provision should

spell out the procedure for prior written approval by the licensor of all products and designs, as well as promotional, advertising and packaging materials. The provision should further provide for periodic submission of samples to permit the licensor to confirm that quality is maintained throughout the term. Additionally, the agreement should provide that the licensor can inspect the products and facilities of the licensee for quality control purposes.

The licensor will also typically require that licensees affix certain trademark notices and/or labeling to licensed products, as well as promotional, advertising and packaging.

Representations and Warranties

The licensee may desire assurances that the licensor owns the marks or has the right to license their use, and that the licensee's use of the marks will not infringe upon the rights of third parties. Whether the licensee obtains such assurances in the form of representations and warranties probably depends upon the respective bargaining power of the parties and the circumstances of the license. Since the validity of rights in a mark or its registration may potentially be challenged at any time, the licensor may be unaware of a prior user who decides to assert rights. From the licensor's perspective, any representations and warranties regarding ownership should be approached with care.

Indemnity and Insurance

In the United States, trademarks are viewed by the public as an indication that the owner is the source of the goods bearing the mark or has sponsored or authorized the use of the marks on the goods. The licensor may thus be held responsible for defective products made by licensees. Most license agreements contain at least two types of indemnification. First, the licensee indemnifies the licensor relative to claims by third parties arising out of defective products manufactured by the licensee and/or improper marketing of such products by the licensee (e.g., false advertising, unfair competition, etc.). In addition, the licensee may request that the licensor provide indemnity relative to third party claims challenging the licensee's right to use the marks. The indemnity provision often will require the indemnifying party to pay all judgments and legal fees associated with the defense of the claims.

The indemnity is only useful if the indemnifying party is financially capable of honoring its obligations. The licensor, accordingly, will usually require that licensees obtain and maintain a general liability insurance policy, including product liability insurance, typically in the amount of at least one to two million dollars. The policy should name the licensor as an additional insured party and provide that the licensor must be notified of any changes in the terms of the policy.

Acknowledgment of Validity

The licensor will often require that licensees acknowledge that the marks are valid and have come to symbolize the substantial good will that the licensor has developed in the marks, and that such good will belongs to the licensor. The licensor should include language to the

effect that the licensee's use of the marks shall inure to the benefit of the licensor. Many licensors also require that licensees acknowledge that they will not attack the title or other rights to the marks, or the validity of the license, either during or after the term of the agreement.

Enforcement Responsibilities

The licensor will likely reserve the exclusive right to bring legal action to protect and enforce trademark rights, and the discretion to determine what action, if any, is appropriate under the circumstances. The royalty-paying licensee, however, should rightfully expect protection against unlicensed competition. Most agreements provide that the licensor is responsible for trademark registration and maintenance, and has the right in its discretion to pursue third party infringers in such manner as it deems appropriate. The licensee may attempt to obtain the right to bring infringement actions if the licensor chooses to refrain from doing so. The licensor, however, will likely insist on remaining in control of any legal action concerning the marks and scope of rights, as the licensor's property rights may be at risk in any legal proceeding. The parties should also consider who will bear the expenses and/or recover the proceeds of any enforcement action.

Assignment / Sublicensing

The license agreement is generally considered to be personal to the licensee. The licensor should state in the agreement that the agreement is not assignable without the licensor's prior written consent. The agreement should also state whether or not the licensee can sublicense all or any portion of its rights, and the requirements of any permitted sublicense.

Termination

The termination section is critical. Ideally, the licensing arrangement is going as planned and the provision is never reviewed. However, if problems occur, it is essential for the agreement to contain a mechanism to terminate. The terminating events should be set forth clearly. The licensor should be able to immediately terminate the entire agreement under circumstances such as the following: the licensee uses the marks outside the scope of the license; licensed products become subject to a governmental recall; the licensee permits the required insurance policies to lapse; the licensee takes any action that damages or reflects adversely on the licensor or marks; the licensee repeatedly fails to make timely payments of royalties; the licensee attempts to assign or sublicense rights without consent; the licensee undergoes a change of control or key personnel; and/or the licensee files for bankruptcy or becomes insolvent. The licensor will also want the right to immediately terminate the entire agreement or a portion of the agreement where the licensee fails to begin or maintain the sale of one or more licensed products. For certain terminating events, such as failure to submit a royalty report on time, it may be appropriate to provide a "cure" provision, allowing the defaulting party the opportunity to resolve the breach within a certain time period, thus allowing the agreement to continue.

The ability of the licensee to dispose of inventory will depend on the grounds for termination. For example, the right to dispose inventory will likely be denied where the

agreement is terminated for the licensee's failure to maintain insurance, failure to comply with quality control, or other actions that may adversely affect the licensor. In most other cases, the licensee is given a reasonable period of time in which to dispose inventory of product on hand or in process of being manufactured at the time of termination, provided that said product is distributed pursuant to the terms of the license agreement.

The agreement should also provide that certain provisions survive termination, such as representations and warranties, ownership, indemnities, insurance, royalty payment and interest, and audit.

OTHER PROVISIONS

License agreements typically include several standard provisions. Several of the main provisions are set forth below.

Notices

The agreement should specify the manner in which either party can communicate notice, e.g., registered mail, overnight delivery, facsimile, etc.

Severability

This provision preserves the validity of the remaining agreement where one or more provisions are held invalid or unenforceable.

Relationship of Parties

Most agreements contain a statement that the agreement is a license and not a joint venture or partnership.

Choice of Law and Forum

The licensor will typically identify its home state as the state whose law will govern the interpretation of the agreement and have jurisdiction over disputes arising under the license.

Integration

This clause provides that the license agreement supersedes all previous drafts, representations, discussions, understandings, etc.

CONCLUSION

The license agreement defines the working relationship between the parties. Care should be taken to create an agreement that clearly expresses the agreed-upon legal and business issues.