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Rights Minded

Negotiating Multimedia Program Agreements

By Mark Litwak

Many multimedia program developers do not distribute their own works; they enter into agreements with publishers or distributors. These arrangements vary depending on how the parties want to share the financial risks and rewards of creating and selling the program, and how they divide marketing and distribution responsibilities. An attorney negotiating a publishing deal must detail a number of issues, including grants of rights and compensation.

A developer can license limited rights to a publisher or assign all rights to the program. If the program is custom-made, the company that commissioned it will often insist on copyright ownership. In this case the developer may only be entitled to receive a fee for creating the program. Agreeing to forgo copyright ownership may not be a significant concession if the program is so specialized that it has no outside market.

Developers who use their own resources to create a program often do not want to sell all rights to one publisher. Rights granted can be limited in time, by platform (type of machine used to assess the program) or geography. Some publishers do not have the ability to market the product in all platforms, media and territories. A developer may be willing to grant the right to distribute by CD-ROM and computer disks, but reserve game cartridge and all other rights including the right to distribute over on-line networks. Publishers, however, usually want a broad grant of rights since the marketplace is developing and they want to distribute into new areas.

Merchandising and book publishing rights should also be considered. Spin-off products and sequels can generate substantial revenue. The developer may want to reserve these rights or give the publisher only a right of last refusal, which would grant the right to match the best third-party offer.

Publishers will usually insist on an exclusive agreement for whatever markets

and media are covered; otherwise, there could be a great deal of confusion among retailers and consumers as to the program's identity. Moreover, publishers want developers to agree not to develop directly competing products. Distributors may be willing to accept products on a nonexclusive basis and to distribute similar products by different publishers.

The developer can grant only those rights he possesses. If the multimedia program incorporates a component borrowed from another program, the developer may only have the right to use it on a one-time basis. The developer cannot assign a copyright to those components because he doesn't own the copyright, only a limited license to use the programming.

If the developer wants to use portions of his work in future work, he should reserve that right. For instance, the developer may want to reuse characters, development tools, routines and other underlying technology in a future program. When a developer reserves this right, the publisher will receive nonexclusive rights to those portions.

Compensation is typically in royalties, often with an advance payment made to the developer. The advance counts against the royalties earned. If the advance is non-refundable the developer will not have to repay it even if the royalties earned never cover the amount of the advance.

Sometimes a developer wants an advance payable before completion of the program because the money is needed to create or finish the program. A publisher is unlikely to give such an advance unless it is fairly confident the developer can deliver the final product. When given, the advance will be refundable if the developer fails to deliver the program.

While the royalty's size is important, the manner in which it is calculated is critical. It can be based on gross revenues with no deductions for the publisher's marketing and shipping costs. More likely, the royalty will be based on net revenues (or net receipts), where certain costs are deductible from gross revenues; and what is left, if anything, is the base on which the royalty is paid.

Publishers prefer a royalty based on net revenues because they want to be able to deduct some expenses before sharing revenue with the developer. They will argue that it is not fair to ask them to pay royalties before they recoup their manufacturing and shipping expenses.

Developers are concerned that publishers will deduct so many expenses — similar to "creative accounting" in the movie

business — that no payment will be due. In multimedia publishing, royalties are typically based on "net revenue" or "net receipts," not "net profits." Net revenue is defined so that taxes, freight, discounts, returns and co-op ads are deductible, but not distribution fees or overhead. The definition may, or may not, allow a deduction for manufacturing costs. Since deductions are limited, a multimedia producer sharing net revenues is more likely to receive money than a movie producer sharing net profits.

The revenue from a CD-ROM would typically be divided in the following way: If the product's street price is \$25, the retailer would retain 30 percent (\$7.50). This leaves \$17.50, from which the national distributor retains 10 percent (\$1.75). Thus the publisher nets 15.75 (the wholesale price) from which the cost of goods (\$3 to manufacture and package) is deducted, leaving \$12.75. The distributor holds back 15-20 percent of the invoice amount as a reserve fund to cover product returns. From the remainder the publisher needs to recoup marketing costs, including advertising (\$750,000 or more). The publisher will spend another 5 percent or more of the wholesale price for co-op advertising and market development. Retail promotions might add another \$500,000 in expenses.

The parties might agree to a fixed-sum royalty payable in installments. The developer, for example, could be paid \$40,000 in four \$10,000 installments. In this way he is guaranteed a fixed amount regardless of many units the publisher sells. Publishers who are willing to pay a fixed royalty take the risk of payment despite poor sales, but they may also retain a larger share if the product is a hit, since the royalty doesn't grow as sales increase.

Publishers will want to set fixed royalties low. Developers may be unhappy with a modest fixed royalty because they will not share in its "upside" potential. A better solution, from the developer's point of view, may be a substantial advance payment against royalties.

Royalties are often from 5 to 20 percent of net receipts, with most deals falling in the 10-15 percent range. Royalties can be payable according to a sliding scale, with the percentage changing as sales increase. For example, a 10 percent royalty might be payable on the first 10,000 copies sold, with 15 percent thereafter. A different royalty could apply to direct sales through mail-order catalogs and for foreign sales.

Mark Litwak, an attorney with Berton & Donaldson in Beverly Hills, practices entertainment and multimedia law and teaches torts and entertainment law at the University of West Los Angeles. He is the author of "Dealmaking in the Motion Picture and Television Industry" (Silman-James Press 1994).