Basics of Videogame
Developer-Publisher Deals

Mike Cavaretta

Most Common Deal Structure

- Publisher commissions developer to develop game
- Developer develops and delivers game to publisher according to milestone schedule
- Publisher owns the game
- Publisher markets and sells the game
- Publisher pays developer advances & royalties
Development: Specs and Design

- Design summary
  - Vision statement
  - Describes game’s vision, genre, characters, storyline, features and functions in summary fashion
  - Developed in advance; exhibit to agreement
- Design document
  - Provides greater detail
  - Developed and delivered to publisher according to milestone schedule

Development: Specs and Design

- Technical summary
  - Describes how game will be developed
  - Coding environment, user interface, game engine characteristics, artificial intelligence, other technical characteristics
  - Developed in advance; exhibit to agreement
- Technical document
  - Provides greater detail
  - Developed and delivered to publisher according to milestone schedule
Development: Milestones

- Milestone deliverables
  - Prototype
  - Alpha version
  - Product build
- Developer delivers milestone deliverables by specified milestone dates
- Developer provides basic testing before delivery
  - Feature verification
  - Functionality

Development: Acceptance

- Acceptance testing on each milestone deliverable
  - Criteria in milestone delivery schedule; absence of errors
- Written acceptance
  - Pre-condition to payment
  - Length of acceptance period?
  - What happens if no response by end of acceptance period?
- Rejection
  - Written notice to developer – specify non-conformity
  - Developer corrects non-conformity ASAP
Royalties: Advances

- Payments of fixed amounts
- Paid:
  - (Signing of LOI)
  - Signing of agreement
  - Acceptance of milestones
- Applied against and recouped from earned royalties
- Non-refundable

Royalties: Advances

- Cross-collateralization
  - Advances of multiple games are pooled
  - Pushes actual payment of royalties into future
  - From music industry
    - Recording artists sign long-term contracts
      - multiple releases
    - Label invests $$ in “artist development”
  - What games are cross-collateralized?
    - Different SKUs of same game
    - Completely separate games
Royalties: Earned Royalties

- % of “Net Sales”
  - (“Net Revenues”, “Net Receipts”)
- Often varies based on cumulative sales

<table>
<thead>
<tr>
<th>Net Sales</th>
<th>Earned Royalty Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $5,000,000</td>
<td>10%</td>
</tr>
<tr>
<td>$5,000,001 to $7,500,000</td>
<td>15%</td>
</tr>
<tr>
<td>$7,500,001 to $12,500,000</td>
<td>20%</td>
</tr>
<tr>
<td>$12,500,001 and higher</td>
<td>17.5%</td>
</tr>
</tbody>
</table>

Royalties: “Net Sales”

- “Net Sales” =
  - Gross revenue from distribution of the game
    -- minus --
  - Allowable deductions
- Great impact on royalties earned
- When comparing deals, look at calculation of Net Sales!
  - Lower royalty rate on good Net Sales definition may be > higher royalty rate on bad Net Sales definition
Royalties: “Net Sales”

- Gross revenue from distribution of the game
  - Invoiced vs. received
    - Calculated when publisher ships or invoices (accrual basis)
    - Amounts received (cash basis)
      - Industry standard
      - Received by publisher or its affiliates

Royalties: “Net Sales”

- Deductions – probably OK
  - Returns
  - Rebates
  - Freight
  - Taxes
  - Royalties/license fees to 3rd party system licensors
**Royalties: “Net Sales”**

- **Deductions – beware!**
  - Avoid deductions that are hard to limit/define
    - Cost of goods
    - Price protection
    - Marketing costs; Promotional allowances
  - Could effectively eliminate developer’s opportunity to earn royalties

- **Strategies for allowable deductions**
  - Fewer deductions = less monkey business
  - “Costs” vs. “actual costs”
    - Allocating “costs” to project w/o actually spending the $  
  - Cap deductions
    - Per category
    - Total
Royalties: Other Considerations

- Sublicenses
  - Affiliates
    - “Received by Publisher and its affiliates”
  - Third parties
    - Higher %
    - Calculated “at source”

- Collateral merchandise, rights

- Units distributed for promotional purposes, internal use

- Bundling
  - Allocated based on SRP/prevailing market price

---

Royalties: Other Considerations

- Reserves
  - Publisher withholds portion of royalties
  - “Safety net” against variable costs
    - Returns
      - Big sales in Q1/Q2; big returns in Q4/following Q1
      - Forced price reduction
    - How much?
      - “Reasonable reserve” vs. fixed %
    - Types & extent of costs that may be applied
    - How/when liquidated
Royalties: Payment

- Advances
  - \( n \) days after milestone acceptance
- Earned royalties
  - \( n \) days after end of quarter
  - Statement
    - Detail
    - Copy of publisher’s standard royalty report

Royalties: Audit

- Publisher required to maintain records
- Developer can audit to verify royalties
  - Developer pays unless underpayment of \( n\% \) or more
Ownership

- Game developed on “work for hire” basis
  - Publisher owns
  - Right to prepare derivative works
  - Localizations

Ownership: Defining “the Game”

- What is “the Game”?
  - Opportunities for future royalty streams
  - Opportunities for future work with publisher
Ownership: Defining “the Game”

- Content
  - Aspects of the game that may be perceived by user
    - Artwork, sound, graphics, audio visual elements, displays
- Specifications and design
- Specific release? Sequels?
  - Bug fixes/error corrections
- Specific platforms?
- Name?
- Collateral rights?

Ownership: Tools & Technology

- Preexisting tools & technology
  - Game engine
- “Generic” tools developed?
- Improvements to preexisting engine?
Ownership: Tools & Technology

- Licensed to publisher to use with the Game
- Scope of license
  - Use with sequels
  - Royalty-free vs. royalty
  - Non-compete
    - Developer can’t license to other publishers for competitive products
    - Overly-broad license can kill a studio

Other Opportunities

- Other platforms
- Sequels
- Expansion packs
- Localizations
- Right of first offer
- Right of refusal
Restrictions on Developer

- Non-compete
  - Overly-broad non-compete can kill a studio

Representations and Warranties

- Game doesn’t infringe 3rd parties’ IP or other rights
  - Developer owns or controls all rights to elements incorporated into game
  - Developer has obtained all necessary clearances
    - Names, voices, likenesses, biographical data
    - Photographs, video, sound, music
    - Other third party materials, technology
Representations and Warranties

- No open source
- Developer personnel available to consult with publisher
- Credit lists are accurate and complete
- All hints, cheats, Easter eggs, workarounds, etc. disclosed to publisher
- Developer is financially sound

Indemnification for Infringement

- Developer indemnifies publisher for IP claims
  - If use of Game enjoined, developer will
    - obtain necessary rights
    - modify Game to make it non-infringing
- Publisher indemnifies developer for IP claims
  - Publisher content, materials, etc. incorporated into game
Termination

• Without cause
  – Prior to release of the game
  – Publisher pays advance royalties for accepted milestones
    • Plus next milestone? Pro-rated?
    • Non-refundable
  – Developer has option to purchase game from publisher
    • Fee equal to advance royalties paid by publisher
• For breach
  – Opportunity to cure

Questions?

• Mike Cavaretta
  • mcavaretta@mbbp.com
  • 781-622-5930
  • www.videogame-lawyer.com