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Basics of Videogame Developer-Publisher Deals

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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

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Development: Specs and Design

- Design summary
 - Vision statement
 - Describes game's vision, genre, characters, story line, 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

<u>Net Sales</u>	<u>Earned Royalty Rate</u>
\$0 to \$5,000,000	10%
\$5,000,001 to \$7,500,000	15%
\$7,500,001 to \$12,500,000	20%
\$12,500,001 and higher	17.5%

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

Royalties: "Net Sales"

- 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/prevaling 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, work arounds, 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?

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