Defining the World of Licensing

Definitions and Terminology

Over the years, the licensing industry has developed a set of terms that need to become understood if one is to function effectively in the industry.

Forms of Licensing

The term **"licensing"** typically means any transaction in which the owner of intellectual property grants another party the right to use such intellectual property, typically in exchange for some form of consideration or payment. Absent the grant of such a right or license, the other party's use of the intellectual property would be considered an infringing use. Thus, the license constitutes a defense to infringement. Licensing is, therefore, the monetization of an existing asset.

"Intellectual property" can take many forms including, for example, musical works, literary works, artwork, drawings, inventions, discoveries, designs, patents, trademarks, names, logos, legends, industrial designs, trade dress, celebrity rights, etc. Regardless of the type, the one constant is that it must be protectable under some form of intellectual property protection, e.g., as a patent, trademark, copyright, right of publicity or trade secret. Intellectual property is frequently referred to simply as **"IP."**

There are many types of licensing, virtually all of which will depend, in large measure, on the type of intellectual property involved. For example, when the intellectual property being licensed is technology or is covered by a patent, the licensing of such technology or patent is typically called **"technology licensing"** or **"patent licensing."** Similarly, when the property being licensed is computer software, the licensing of the software is normally called **"software licensing."** When a trademark is being licensed, it is typically referred to as **"trademark licensing."**

When a character from a book or motion picture is the property being licensed, such licensing is commonly called **"character licensing."** Similarly, when a corporate brand is the subject matter, it is typically called **"brand licensing."**

When one licenses a highly recognizable brand or character for goods or services in categories different from the one where the brand or character had originally been popularized, such licensing is frequently called **"brand extension licensing"** or simply **"merchandising."**

This book will focus primarily on merchandising, although at times the terms "merchandising" and "licensing" may be used interchangeably throughout the work. It should be appreciated that the term merchandising may have other meanings, particularly in the retail or marketing fields. In the retailing field, merchandising means something other than licensing, e.g. some form of "a sales promotion as a comprehensive function, including market research, development of new products, coordination of manufacture and marketing, and effective advertising and selling."

Contractual Terms
The grant of a license to a manufacturer is typically done pursuant to a written **"license agreement"** or **"license agreement."** While oral licenses may occur, the clear majority are granted under formal, written license agreements.

In the context of licensing, the owner of the IP that is granting the license is commonly called a **"property owner"** or **"licensor"** while the party receiving the license to use the intellectual property on their product is typically called a **"licensee."**

The intellectual property being licensed is normally called the **"property"** or, more accurately, the **"licensed property,"** while the products for which the license is being granted are typically called the **"licensed products** or **licensed articles."** If the intellectual property is being licensed for use in conjunction with a service, e.g., restaurant services, those services would be called the **"licensed services."**

It is quite common to include **"schedules"** in a license agreement to more accurately and completely define both the licensed property and the licensed products or licensed services.

There are different types of license grants. An **"exclusive license"** is one in which the licensee is the only party receiving the right to use the licensed property for the licensed products to the exclusion of everyone, including the licensor. There may be some instances, however, in an exclusive license where the licensor reserves the right to use the licensed property itself for such products, but that would have to be specifically stated.

A **"non-exclusive license"** is one in which the licensee is granted the right to use the licensed property for the licensed products on a non-exclusive basis so that the licensor may make similar grants to other parties. In merchandising, most licenses are non-exclusive, even where the licensor may have no intention of granting a similar right to anyone else. This is done primarily to protect the licensor should the licensee underperform or even declare bankruptcy. In such event, the licensor might be able to find others to step into the shoes of the bankrupt licensee during the pendency of the bankruptcy proceeding.

Virtually all licenses are granted for fixed periods of time, e.g., three (3) years. Products that require a long development period or a large capital investment are often longer, or, alternatively, for so long as the licensee continues to sell licensed products (called **"Life of Product"** license). The length of a license grant is typically called its **"term."** In many cases, a licensee is given an **"option"** to renew the license for additional terms upon meeting certain conditions. In such cases, the initial period may be called the **"initial term"** and the renewal period may be called the **"renewal term."**

Most licenses will restrict the licensee's use of the property to a geographical area, e.g., North America or the European Union, and this is typically called the **"licensed territory."**

Similarly, a licensor may want to restrict the licensee's sales of the licensed products to a specific market or channel of trade, e.g., "mass market" or "Internet" and possibly even specific retail outlets within that market or channel. Such distribution limitations are commonly referred to as the **"channels of distribution."**

Licensors may want to exclude certain rights from the license grant, either to give it the freedom to exploit those rights itself or to be able to grant such rights to others. Many licensors will exclude the right to use the property as a **"premium"** or in conjunction with a **"promotion."** The exclusion of premium is very common in licensing agreements for movie and television properties. The reason is that premiums and promotional products are not typically sold as merchandise through the normal channels of distribution but, instead, are given away to the public to promote the licensed property and/or the company offering the premium, e.g., McDonald's BAKUGAN Happy Meal Program, in which BAKUGAN toys were given away by McDonald's to help promote BAKUGAN property and drive sales of McDonald's products.

The most common form of compensation for the right to use a licensed property on a licensed product is the payment of a **"royalty"** to the licensor, which is a percentage of the licensee's **"net sales"** of the licensed products. "Net sales" is always a defined term in any license agreement and will vary from license agreement to license agreement. It is often defined as the licensee's gross sales of licensed products, less certain agreed-upon deductions, usually **"discounts and allowances"** and any **"returns"** by the retailer or consumer.

At the time a licensee enters into a license agreement, the licensee is typically required to pay the licensor an **"advance"** against its future earned royalty obligations—think of it as a prepayment of royalties. In most instances, the advance is creditable against the licensee's future earned royalty obligations. Thus, if the licensee paid a $100,000 advance, it would not need to pay any additional earned royalties until such earned royalty obligation exceeded the amount of the advance, i.e., $100,000.

Most licensors require that the licensee pay a **"guaranteed minimum royalty,"** often referred to as simply the **"minimum"** or **"guarantee."** Guarantees are intended to protect the licensor if the licensee's net sales prove to be lower than anticipated. As the name implies, the licensee is guaranteeing that it will pay the licensor a certain minimum amount of royalties over a given period during the term of the license regardless of what the earned royalties may be.

Although there are several ways to apply this guaranteed minimum royalty obligation, in most instances it only applies when the licensee's earned royalties fall below the minimum for that period. In such case, the licensee is obligated to supplement its earned royalty payments to meet the guarantee for that period.

In addition to the payment of a royalty, many licensors require their licensees to also contribute to a **"common marketing fund"** or **"CMF"** which the licensor collects from all its licensees and uses to support and promote the property and the licensing program. These payments are occasionally called a **"marketing royalty"** because they are frequently calculated as a percentage of the licensee's net sales of licensed products in much the same manner that the royalty is calculated.

Many licensees use third parties to manufacture the licensed products for them and/or sell or distribute them. These third parties are called **"manufacturers"** or **"distributors."** This practice is not **"sub-licensing,"** which is almost always prohibited. In sub-licensing, the licensee grants a third party the same rights that it had received from the original property owner or licensor, not simply the right to manufacture or distribute products for it.