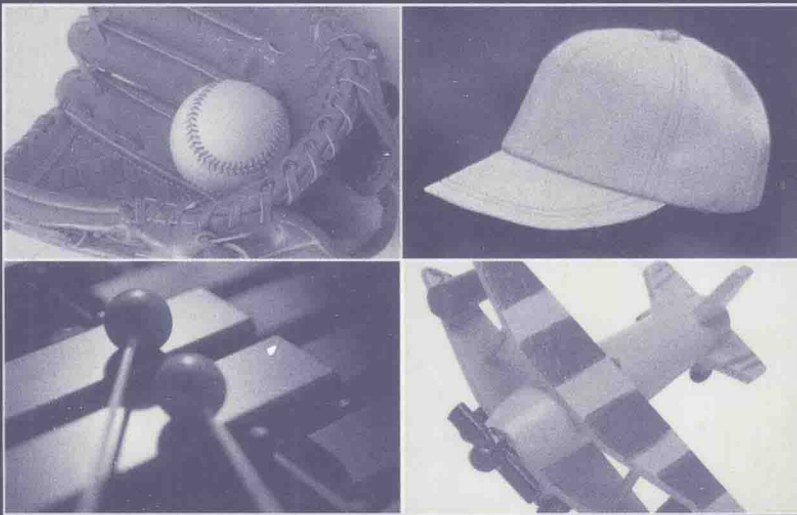


2005 EDITION

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# LICENSING ROYALTY RATES



GREGORY J. BATTERSBY  
CHARLES W. GRIMES

ASPEN  
PUBLISHERS

# LICENSING ROYALTY RATES 2005 Edition

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*To Susan, Gwynne and our families. Their love and support certainly make life worth living.*

# PREFACE

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This study represents the seventh in an annual series of royalty rate studies in the merchandising and trademark licensing area with the first study going back to 1996 as published by Kent Press. Each of these volumes and the material contained therein has been substantially expanded over a simple recitation of standard royalty rate ranges, and the 2005 edition is no exception.

In addition to the tables of royalty rates that we have provided in years past, we have included three additional features that should be of interest to our readers, to wit:

- Reported court decisions that have actually referred to royalty rates in the merchandising area during the previous year;
- References to public documents filed with the U.S. Securities & Exchange Commission; and
- A compendium of the royalty rates typically charged by franchisors as part of their franchise agreements.

We recognize that there is a substantial difference between classic merchandising or trademark licensing and franchising but we feel that an understanding of the royalty rates charged by franchisors, typically couched as trademark license royalties, will be of interest to the licensing community. In addition, we have referenced reported royalty rates from other trade publications as a “check and balance” for our own, more thorough study of the area.

While at first glance it might appear that the results are the same as in previous years, in actual fact we have typically seen approximately a 25% change in the results from year to year. This year the change has been greater, i.e., more than 50%, which we believe is attributable to a weak economy and a corresponding softening of royalty rates. These changes are generally subtle, but should you find yourself in the negotiation of a multiyear license agreement for a hot property, a half-point difference in royalty rates over a five-year period can mean millions of dollars in additional (or decreased) royalty income. As such, we believe that it is quite important to stay current on this information as seemingly minor changes can have substantial consequences.

For perhaps the first time since we started doing our royalty rates study, we began observing a leveling off and, in certain instances, a decline in royalty rates. As noted in earlier editions, royalty rates are market driven and, as such, as the economy weakens one should not be surprised to observe a corresponding weakness in the royalty rates that licensors are charging for use of their properties.

We continue to use the same methodology that we adopted with our first study in 1996, relying on a list of all potential licensed products that was initially compiled from the United States Patent and Trademark Office Bulletin Board. This permitted us to analyze the topic from the perspective of about 1,500 potential licensed products or services.

As in prior years, we continued to identify different types of licensed properties. After some debate, we arrived at the following eight categories: art, celebrity, character, collegiate, corporate, designer, event, and sports. Last, but not least, we went to the experts who are working in these areas on a daily basis to see what the appropriate ranges of royalty rates are for a particular licensed product. Our initial survey in 1996 went to a select group of industry experts with whom we had dealt and believed had their finger on the pulse of royalty rates and, in particular, trends in such rates.

In performing the following analysis, we discovered that royalty rates vary widely from property type to property type, e.g., art versus character versus sports. We also found that while certain licensed products, e.g., T-shirts, can command a “standard” royalty rate, others, e.g., food products, cannot. This is due in large measure to particular margins in certain industries that simply cannot support high royalty rates.

Our field of “advisors” has now substantially broadened since the original 1996 survey, although a number have been on board since the outset. The current group of advisors and contributors include: Linda Balogh of Courtney Davis, Inc. (art licensing); Steve Bobowski of Equity Management (corporate licensing); Woody Browne of Building Q (corporate licensing, character/entertainment licensing, and collegiate licensing); Paul Cohen of Creatif Licensing (art licensing); Allan Feldman of LMCA (corporate licensing); Carole Francesca of Broad Street Licensing (art licensing); Brian Hakan of Hakan Associates (character/entertainment licensing, corporate licensing, and sports licensing); Joshua Kaufman of Veneble, LLP (art licensing); Sal LaRocca of NBA Entertainment (sports licensing); Danny Simon of The Licensing Group (character/entertainment licensing); Rebecca Stroder of Sonnenschein, Nath & Rosenthal, LLP (art licensing); and Maggie Young of Maggie Young & Associates (character/entertainment licensing).

The board is a virtual who’s who of licensing, including former chairmen of the International Licensing Industry Merchandisers’ Association (“LIMA”), the well-known author of *A Primer on Licensing*, and other highly recognized and experienced individuals.



## PREFACE

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What is the purpose of this study? Every licensing executive will tell you that royalty rates drive licensing. From the perspective of every licensing executive, royalty rates are perhaps the most important part of any licensing negotiation as they will dictate the compensation paid for a particular license. A two-point difference on a hot character license can translate into hundreds of thousands of dollars in royalty payments. While lawyers tend to dwell over provisions concerning indemnification and disputes, licensing executives focus on the royalty rate, with the property owner looking to charge the highest possible rate and the licensee seeking the lowest possible rate.

Royalty rates in the merchandising arena are essentially market driven. That means that the hotter the property, the higher the royalty rate. This is, of course, remarkably different from the way that many other intellectual property areas view the establishment of an appropriate royalty rate. Little thought is given to the 25% rule in merchandising or the investment that a studio or publisher puts behind a particular property. Instead, the rule is fairly simple—property owners will typically charge what the traffic will bear . . . within limits, of course.

It must be appreciated that there are always exceptions to every rule. What we have tried to do with royalty rates is to provide a “working range” for such rates. We fully expect that particularly hot properties may justify rates higher than those listed. For example, while we have reported an average royalty rate for entertainment properties in the 8-14% range, we recognize that hot properties such as SPIDER-MAN, WINNIE THE POOH, or LORD OF THE RINGS will justify substantially higher rates. Similarly, we also expect that some emerging properties may not justify some of the rates listed for more established properties. We also expect that certain licensed products may not justify a rate within the range that we provided because of particularly tight margins or competition. The ranges provided are intended to serve as a starting point only for negotiations with the understanding that they might change depending upon market factors.

The user of this book must also take into account the fact that multiple royalty rates situations present special problems. This is particularly true in the multimedia and video game area where a product may carry four or five different licenses. It also is a problem in the events area. Obviously, there has to be some flexibility among all of the property owners or the eventual licensed product will be so highly priced as to be a commercial failure.

Another area of concern relates to F.O.B. rates. There has been a trend in recent years for property owners to recite both domestic and F.O.B. royalty rates in license agreements. This is quite common in the toy industry when much of the product is made offshore, and it is extending into other industries. Generally speaking, the royalty rates recited in this book are for “domestic” royalty rates, not F.O.B. rates that can be anywhere from one to four points higher.

Similarly, with the advent of the Internet and other forms of direct sales, royalty rates need to be adjusted to reflect the elimination of the middleman in the process.

In the merchandising area, royalty rates are virtually always calculated on the manufacturer's wholesale selling price to the retailer who then, in turn, marks up the product by as much as 100% and sells the Licensed Product to the ultimate consumer. When the sale is made directly to the consumer, there needs to be an adjustment in the royalty rate to reflect the significantly higher selling price. Typically, royalty rates are reduced by as much as 50% for sales made on a direct basis. Thus, if the royalty rate for a hot property sold through the normal distribution channels was 10%, the royalty rate for direct sales to the consumer would typically be in the 5% range to reflect the higher retail selling price. This same rationale would also apply to situations between the property owner and retailer.

It must be appreciated that royalty rates are not static. As such, what a property will command in January 2005 may be quite different from what is the "going" rate in December 2005. We will continue to provide periodic updates to this book to reflect such changes.

With this version of the survey, we have substantially expanded the original survey to include an explanation on how royalty rates are established, the different types of royalty rates, and an historical perspective of royalty rates. We have also attempted to explain the interrelationship between royalty rates and advances and guaranteed compensation.

We also recognized that the survey has applications far greater than simply a royalty rate analysis. For example, we saw that the information could be organized in different formats to assist both the licensing administrator in conducting a licensing program as well as the trademark attorney in preparing intent to use trademark applications. Accordingly, we used the information concerning possible licensed products to prepare a checklist of possible licensed products and services (organized by trademark class), which can be used by a licensing administrator when conducting a licensing program. The same information also provided the basis of a comprehensive list of all types of licensed products and services within a particular trademark class. This can be used by trademark attorneys when preparing intent to use trademark applications to insure that they cover most types of licensed products.

We have included a relatively complete list of possible licensing consultants and international licensing agents for use by property owners and manufacturers alike. It should be appreciated that while the authors are familiar with most of these individuals, their inclusion in this work should not, in any way, constitute an endorsement or recommendation of their services. The retention of a licensing agent or consultant is frequently a matter of personal taste and comfort. As such, this list should simply serve as a starting point for individuals in locating the "right" licensing agent or consultant.

No preface would be complete without expressing our appreciation for the contributions of certain special individuals who assisted us in the preparation of this work. In particular, we wish to thank Michelle Virzi at Aspen Publishers, with

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whom we have worked in the past and look forward to working with again in the future. We are most appreciative of the confidence and faith that she has shown and her incredible patience when we fail miserably at meeting projected deadlines.

We would also like to express our appreciation to Peter Maric of our firm for the excellent job he did in compiling and editing the work. Their contributions were critical to the final work product.

*GJB and CWG*

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Messrs. Battersby and Grimes are co-founding partners of the Norwalk, Connecticut law firm of Grimes & Battersby, LLP, 488 Main Avenue, Norwalk, CT 06851 (203) 849-8300, which specializes in patent, trademark, copyrights, unfair competition, antitrust and corporate law, and licensing with a particular emphasis on the merchandising, multimedia, entertainment, edutainment, toy, animation, and publishing industries. They have authored *The Law of Merchandise and Character Licensing*, *Licensing Law Handbook 1985*, *Licensing Law Handbook 1998-99*, *Multimedia and Technology Licensing Agreements: Forms and Commentary*, *Licensing Desk Book*, *Licensing Update (1999-2005 editions)*, *Licensing Royalty Rates (1999-2005 editions)*, *Drafting Internet Agreements*, *License Agreements: Forms and Checklists*, *Patent Disputes: Litigation Forms and Analysis*, *A Primer on Technology Licensing*, *The Toy & Game Inventor's Guide*, and *Trademark & Copyright Disputes: Litigation Forms and Analysis*. They serve as Executive Editors of *The Licensing Journal* and *The IP Litigator* and have also edited *E-Commerce Law*, *The Multimedia and Technology Licensing Law Report*, and *The Y2K Advisor*. They have served as regular columnists to such publications as *Toy & Hobby World*, *The International Licensing Directory*, *The IP Strategist*, and *The Association of Collegiate Licensing Administrator's Bulletin* as well as a score of other business and legal publications. They are frequent speakers on a variety of intellectual property matters and have moderated the legal seminar at the Licensing Show for many years. They are recognized as the leading experts on the subject of merchandising law.

Mr. Battersby is a guest lecturer at the Franklin Pierce Law School Advanced Licensing Institute, is General Counsel to the International Licensing Industry Merchandiser's Association ("LIMA"), and has been an officer and member of the Board of Directors of The New York Intellectual Property Law Association ("NYIPLA"). Mr. Grimes is an Adjunct Professor at Sacred Heart University where he teaches intellectual property law and served on the Editorial Board of *The Trademark Reporter*.

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