

## THE NUTS AND BOLTS OF THIRD PARTY AGREEMENTS

### CRITICAL ISSUES FOR THE DEVELOPER: IP OWNERSHIP TERMS; REPRESENTATIONS AND WARRANTIES; EASTER EGGS; OTHER KEY ISSUES

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#### PRESENTATION BY:

CHRIS BENNETT, ESQ. – DAVIS & COMPANY LLP ~ VANCOUVER, BC CANADA

PATRICK SWEENEY, ESQ. – HAIGHT, BROWN & BONESTEEL, LLP ~ LOS ANGELES, CA

### INTRODUCTION

#### I. What is a Third Party Agreement?

A “Third Party Agreement” is a transaction between a video game “Publisher” (Electronic Arts, THQ, Activision, etc.) and an independent game development company (“Developer”), whereby the Publisher out-sources the actual “creation” of the game. Reasons for contracting in this manner are:

- Publisher “band-width” ~ unable to create the game on its own.
- Developer reputation/expertise ~ Certain Developers are simply better and more marketable than Publisher’s own internal teams.
- Economics/Corporate philosophy ~ Third party development on a project-by-project basis allows Publishers to avoid carrying long-term overhead of all development teams

Third Party Agreements vary in scope and business points depending on the relative leverage of the parties. In most cases, the Publisher ultimately owns all Intellectual Property following completion (title done on a “work-for-hire” basis”). In other circumstances, the Developer retains IP ownership and Publisher simply has broad rights to publish and distribute the game. Other traditional Publisher functions are sometimes split between the two parties (marketing, public relations, territorial splits) in a “co-publishing” arrangement.

#### II. Basic Structure: Advance against future royalties

Regardless of structure and respective leverage of the parties, most Third Party Agreements are structured in the same basic fashion.

Publisher will fund development of the game by paying Developer an “Advance” against future royalties. Upon commercial release of the title, Publisher collects all proceeds from the game’s commercialization and recoups its Advances from royalties otherwise due to Developer. Following recoupment, Publisher will pay Developer a royalty based on various Net Sales calculations (usually on a quarterly basis).

### III. Generally, one-sided in favor of Publisher

These deals are skewed heavily in the favor of the Publisher. Primarily this is due to the financial commitment the Publisher is making (in addition to Developer Advances, Publisher incurs cost with respect to marketing efforts, manufacturing costs and internal overhead). In addition, relative marketplace position is such that most Developers are desperate for a Publisher deal for their continued financial existence (most Developers only work on a small amount of projects at a time). On the other hand, the Publisher may have the financial resources and capacity to be commissioning for multiple titles and is not as reliant on any one transaction for its continued existence.

Accordingly, we are not going to discuss any “critical issues” for the Publisher. They don’t need our help. Instead, we will focus on areas of concern to the Developer and Developer’s counsel when negotiating deals with Publishers. Although the Publisher/Developer Third Party Agreement does favor the Publisher, there are many areas where the Developer can and should exert its leverage and better protect its position.

These areas fall into the general categories of:

### IV. Developer Contractual Obligations/Restrictions during Development

- Well-Defined GDD and TDD and applicable Milestone schedule ~ Often left vague to the Developer’s detriment
- Publisher Approval of Milestones. Publishers prefer sole discretion. Try to tie to reasonable compliance with GDD and TDD. Balance Publisher’s investment against Developer’s ability to perform under the Agreement. Include a deemed acceptance provision so game does not remain in limbo.
- Provide a cushion for unexpected delays
- Contemplate effect of different delays: delays by Developer should be material breach, but delays by Publisher or third parties should not
- Change requests: Publishers want all done for free with no effect on schedule; Developers need protection from feature creep. Definition of “material change” is important.
- Prohibited Content: Easter Eggs, Open Source, third party content

### V. Developer/Publisher Financial Model

- Definition of Net Sales ~ Commonly, gross revenues received less COGS, returns/price protection, freight, certain (but not all) marketing expenditures.
- Ancillary Channels ~ Better revenue split than normal Royalty. 50/50 split of licensing revenue is not uncommon
- Reserve Clauses ~ Certain royalty percentage held back to account for future returns/price protections. Percentage should vary based on platform and should be liquidated frequently.
- Cross-Collateralization ~ At least confine within parameters of THIS deal

- Developer's Unused audit right ~ Rarely negotiated or used. Developer use of audit right can be valuable tool to validate royalty payments.

## VI. Developer Future Positioning

- Ownership of IP in game: Developer will want to own, especially if Developer funded some or all of the development. Publisher may allow this and take protection from sequel rights.
- Ownership of IP in game engine: Developer should always keep this. Can agree to a limited non-competition covenant so that the engine isn't used in competing games within a limited time window. Publisher will need a license.
- Sequel Rights: often granted by whoever owns the IP.
- First Look: Publisher must present to Developer first and negotiate in good faith. If no deal within a certain time, then can shop elsewhere
- Last Refusal: if Publisher strikes deal with 3rd party, must offer same terms to Developer.
- Marketing Input/Responsibilities/Approvals
- Developer Non-Compete: Publishers want this, given large investment in game. However, some Publishers don't like employee non-compete clauses (EA vs. Ubisoft)
- Developer Key Personnel: Allow reasonable changes over time, while protecting core expertise.

## VII. Developer Liabilities/Exposure

- Termination at-will by Publisher. "Kill fee" ~ Meant to cover lag period for new Publisher project. Balance length relative to "burn rate."
- Reps and warranties of the respective parties
- Limitation of Liability ~ Exempt indemnity, confidentiality and IP misuse where possible.
- Employee issues ~ Wage/hour; work-for-hire agreements. Easy to comply, often forgotten.
- Attorneys fees ~ Although mutual, more likely to cut against Developer (party more likely to breach and less able to cover Publisher attorneys fees).

## Conclusion

In many cases, the speed/desperation of a deal from the Developer's perspective ultimately works against that Developer. Managing this process effectively is generally as difficult as negotiating against the Publisher.

However, most Publishers are generally amenable to most of these issues (within reason). It is the role of Developer's counsel to identify and communicate these issues to both the client and the opposition.

**SPEAKER BIOS/CONTACT INFORMATION:**

**PATRICK SWEENEY, ESQ. – HAIGHT, BROWN & BONESTEEL, LLP ~ LOS ANGELES, CA**

Patrick Sweeney is a Partner at Haight, Brown & Bonesteel LLP, where he heads the firm's video game and multimedia practice, which focuses on the representation of game Developers, Publishers, licensors and other industry-specific clients. Prior to Haight, Brown & Bonesteel, Mr. Sweeney was Senior Counsel for Vivendi Universal Games. In addition, Mr. Sweeney is an Adjunct Professor at both Whittier Law School and Southwestern Law School, teaching Video Game Law, the first U.S. law school course solely dedicated to the legal issues of the video game industry. He can be contacted via phone at (310) 215-7547 or via email at [psweeney@hbblaw.com](mailto:psweeney@hbblaw.com).

**CHRIS BENNETT, ESQ. – DAVIS & COMPANY LLP ~ VANCOUVER, BC CANADA**

Chris Bennett is a member of Davis & Company's Video Game, IP and Technology law groups. He advises clients on the creation and protection of IP rights, including development, licensing, and distribution of video games and other technology. He regularly contributes to his group's blog at [www.VideoGameLawBlog.com](http://www.VideoGameLawBlog.com). He can be contacted at 604.643.6308 or [cbennett@davis.ca](mailto:cbennett@davis.ca).

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