



MASTERING THE GAME

**Business and Legal Issues for
Video Game Developers**

Creative industries – No. 8

By David Greenspan

With contributions from

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PREFACE

Today the video game industry is rivaling the size of the motion picture industry and surpassing the music industry in terms of overall revenue. Unlike the film industry, which has a hundred year old history from the late 1880s, the video game industry has perhaps become the fastest growing sector in the entertainment industry and has done so in a relatively short period of time.

Currently, the video game industry employs over 120,000 thousand people only in the United States, with the average employee earning US\$90,000 a year. Its impact is felt world-wide with video game players of all ages able to access games instantly on devices ranging from consoles to smartphones. For many, their image of a video game player is a teenage boy playing alone firing away at bad guys on a television screen at home, but times have changed. Today, the average player has a choice of a wide range of different types of games from action to adventure, role-playing to sports, is in his or her thirties playing on a phone, tablet, console, or PC, possibly connected with players from around the world.¹ Not only have the demographics of players changed dramatically in the last ten years, but so have the games themselves with development and marketing budgets in the tens of millions of dollars or higher for many games, with incredibly realistic graphics, voice-over, faithful depictions of character movements produced through the use of motion-capture, music equal to film scores and original story lines.

Recognition of the need for a publication on the business and legal issues for video game developers takes into consideration the dynamism of the industry and also reflects discussions held with stakeholders in a series of WIPO activities on copyright and the creative industries. The general consensus rests on the need to further link and reinforce intellectual property issues, and in this instance copyright, to the specific needs of a creative industry, i.e., music, film, publishing, and now interactive entertainment software, i.e. video games. This is especially important as small and medium-sized creative industry businesses are rarely exposed to the business and legal implications of a proactive strategy in securing their intellectual property in the creation, distribution and viewing of, and interaction with creative content. A video game developer's knowledge of intellectual property issues is generally incomplete and there is a need for him or her to have a more operational understanding of copyright and the importance of negotiating contracts that determines ownership of copyright.

While it may be true that a handful of distributors dominate the market, there remains the need for game developers to better exploit their video game content through multiple and well established distribution channels, delivery platforms and emerging channel such a mobile. The main objective of this publication is therefore to explain

the significant business and legal issues for the better promotion and protection of game developers' copyright works. The interactive entertainment software industry is where cutting-edge creativity meets the latest technology. As this is one of the fastest-growing content sectors in the world, a WIPO publication for game developers is timely and appropriate.

As a stimulus for economic growth, the video game industry moves beyond the sphere of entertainment to applications in the aerospace and health sectors, which are already applied in the automobile industry. The accelerated speed at which video game technology is evolving allows for such speculation. Beyond the artistic and entertainment value, the video game industry offers opportunities to those countries with vast pools of talented creators and engineers in all sectors.

This publication, the first of its kind, brings to the forefront the key issues identified by experienced attorney, Mr. David Greenspan, along with his colleagues, Mr. Greg Boyd, Mr. Jas Purewal and Mr. Matthew Datum. WIPO hopes that the reader will benefit from the authors' experiences, knowledge and wisdom. Against the background of WIPO's unique range of services across the spectrum of intellectual property this publication seeks to broaden the scope of the debate on the legal status of the video game, bringing to it a very practical business and legal approach.

December 2013



EXECUTIVE SUMMARY

This publication is primarily a guide for developers and legal professionals, to help them understand the many business and legal issues they may encounter in the development and eventual distribution of a video game across numerous platforms: ranging from intellectual property (IP) and regulatory issues associated with game development to forming relationships with publishers, platform manufacturers, distributors, and content owners. In each of these relationships, the developer will need to be familiar with the specific business issues and contractual terms so that they can negotiate effectively and identify risks in order to avoid potentially costly mistakes.

While the publication cannot replace the expertise of lawyers and other key personnel in the video game industry in negotiating deals, it hopefully can offer some guidance and explanations as to why certain decisions are made by various parties during negotiations. Not all topics are covered because of limitations in space; much of the legal commentary primarily reflects practice in the United States, although many of the business and legal principles discussed are applicable in other parts of the world. In addition, the United States is a large market for video games, and with the ease in distributing a game worldwide it is important for developers to have a basic understanding of some of the issues they may come across when dealing with various publishers, distributors, platform manufacturers, and licensors.

Finally, when reading the publication it is important to realize that laws change and every situation is different and negotiations will vary depending on the unique circumstances between the parties as well as bargaining power and perhaps past dealings. Some commentary is reflected a few times in different chapters to underscore the importance of certain business and legal terms.

The introductory chapter provides an overview of the video game industry with a brief discussion on the major players including the platform manufacturers, distributors and publishers, as well as recent economic trends and some of the major challenges for developers, from legal issues to funding.

Chapter 2 examines the relationship between a developer and publisher, with a primary focus on the business and contractual issues between the parties whether the publisher is financing, marketing and distributing a game or is just serving as a distributor. The importance of certain terms, and why parties may negotiate them, are analyzed, including rights, ownership, development and delivery issues, payment considerations and legal responsibilities and obligations. Included at the end of the chapter are a set of questions the developer should consider when evaluating whether to enter into an agreement with a publisher.

Chapters 3 through 5 explore the primary business and legal issues involved in developing a game, from the intellectual property concerns involving copyright, trademarks and patents to licensing content and music for a game. With advances in technology, IP issues have taken on a greater significance in both the tools used to develop games and the content included in a game. Without a basic understanding of intellectual property, a developer could find him or herself with a game that cannot be distributed because proper rights were not obtained correctly.

Chapter 3 discusses the basic IP issues associated with game development. The historical protection and current coverage for patents, trademarks, trade secret, and the right of publicity are discussed. Some current cases, US and world regulatory issues, and cutting edge legal topics are explored. The authors also discuss balancing the game company legal needs to protect intellectual property with the promotion of innovation and community development.

Chapter 4 deals with the major business and legal issues in licensing agreements whereby the developer obtains rights to incorporate intellectual property into their game. In some situations the game may be based on a property such as a film, while in other situations content is incorporated into the game to add realism to the setting of the game. In both situations, certain rights are required and this chapter examines what steps the developer should take and factors to consider before licensing a property, followed by a discussion on the terms in a typical licensing agreement.

Chapter 5 is an introductory discussion on music and what options exist for acquiring music, whether hiring a composer, licensing or using public domain music, and what rights a developer would need for games and marketing materials.

Chapters 6 addresses important business and legal issues dealing with the major console manufacturers and what steps are needed to develop and publish retail packaged goods and digital goods on the respective platforms.

Chapter 7 focuses on the growing importance of PC distribution as a way for developers to reach consumers, as well as the challenges of distinguishing one game from another in what is becoming a very crowded field. The chapter also examines some of the most significant contractual terms between a developer and distributor, including rights granted, delivery of materials, revenue share, obligations and marketing issues.

Chapter 8 talks about the incredible growth of the mobile gaming industry, perhaps the most accessible platform for developers to distribute their games on. Against this backdrop, this chapter discusses the most important legal and business issues that developers will need to be aware of, including those in various agreements that a developer may enter into whether with a distributor (i.e., app store) or publisher. While most agreements with the distributor typically are non-negotiable, it is still important



to understand the obligations and potential risks of these deals, which this chapter will discuss.

Chapter 9 briefly examines some of the key areas of regulation which developers and publishers need to be aware of when making a game, including data privacy, consumer protection and advertising and marketing. In addition, the chapter provides a brief overview of game ratings and the importance of understanding how games are rated and the impact of ratings on development.

Chapter 10 covers confidentiality agreements and deal memos, two significant agreements that many times serve as the foundation to any business relationship. The confidentiality agreement will usually be the first agreement reviewed by a developer when forming any type of relationship with another party, whether it is with a publisher interested in financing a game or working with a platform manufacturer. This chapter will examine the important terms found in a confidentiality agreement. In addition, the chapter also discusses the significance, necessity and problems of a deal memo, as well as points typically raised in the document.

Chapter 11 discusses the meaning behind common clauses that appear in almost all agreements involving any aspect of the video game industry, ranging from publishing agreements to licensing agreements.

CHAPTER 1

THE GLOBAL STRUCTURE OF THE VIDEO GAME INDUSTRY

1.1 The Current Video Game Industry Landscape

The video game industry is a US\$63 billion industry worldwide, rivaling the size of the US\$87 billion film industry.² Many major video game titles have budgets comparable to Hollywood movies, and the success or failure of a major title can make or break a studio. Like the film industry, the structure of the video game industry can be rather complicated, and requires some explanation to be fully understood. This section will give an overview of the industry by outlining the current platforms, distribution channels and major publishers.

Video games can be broken up into three distinct categories: console, personal computer (PC) and mobile. Console games run on dedicated hardware that connects to a television (such as the Microsoft Xbox One), or are handheld (such as the Nintendo 3DS). PC games run on general-purpose personal computers, and while Windows is the most common operating system, Mac and Linux can also run a number of games. Mobile games run on a range of mobile devices including smartphones and tablets. Web-based social or casual games straddle the PC and mobile category, since they are run on PC web browsers, but have game design and target customers similar to mobile games, and therefore are generally regarded as closer to mobile than to PC.

Box 1: Three categories of video games

| Console | Personal computer (PC) | Mobile/Casual |
|--|---|---|
| <ul style="list-style-type: none"> Run on dedicated hardware Expensive to develop Wide variety of genre System controlled by IP owners Box product and digital but dominated by box product sales | <ul style="list-style-type: none"> Run on Windows, Mac, or Linux Wide variety in expense, and genre No single gatekeeper for platform Majority of sales through digital | <ul style="list-style-type: none"> Run on tablets and phones Least expensive to develop Social and casual games Largest number of potential players |

There are a wide variety of video game genres as well. Stories and settings can be just as varied as movies: sci-fi, western, comedy, historic, or romantic. The way a game plays is also a genre that varies title by title. Some examples are: ‘first person shooters’, where shooting is done from a ‘point-of-view’ perspective; ‘roleplaying’ – games based on gaining experience points by defeating monsters; ‘casual’ or ‘social’ –



games where the object of the game is to interact with friends through building; and sports games where the end user controls the athletes. The design of the game is as varied as the imagination of the developer can come up with.

1.1.1 Console Manufacturers

The so-called 'traditional' video game market, console and PC gaming, still dominates the industry, making up around 80% of the industry's revenue.³ Console hardware is currently on its seventh generation. The current console manufacturers dominating the market are Nintendo, Microsoft and Sony, although a host of new challengers include OUYA, Nvidia and Valve.

The Nintendo Wii was the best-selling console of this generation, with over 98 million units sold worldwide and 44 million units sold in the United States.⁴ Released in November of 2006, sales for the Wii peaked in 2008 and then dropped dramatically, selling less than the PS3 and Xbox 360 since mid-2010.⁵

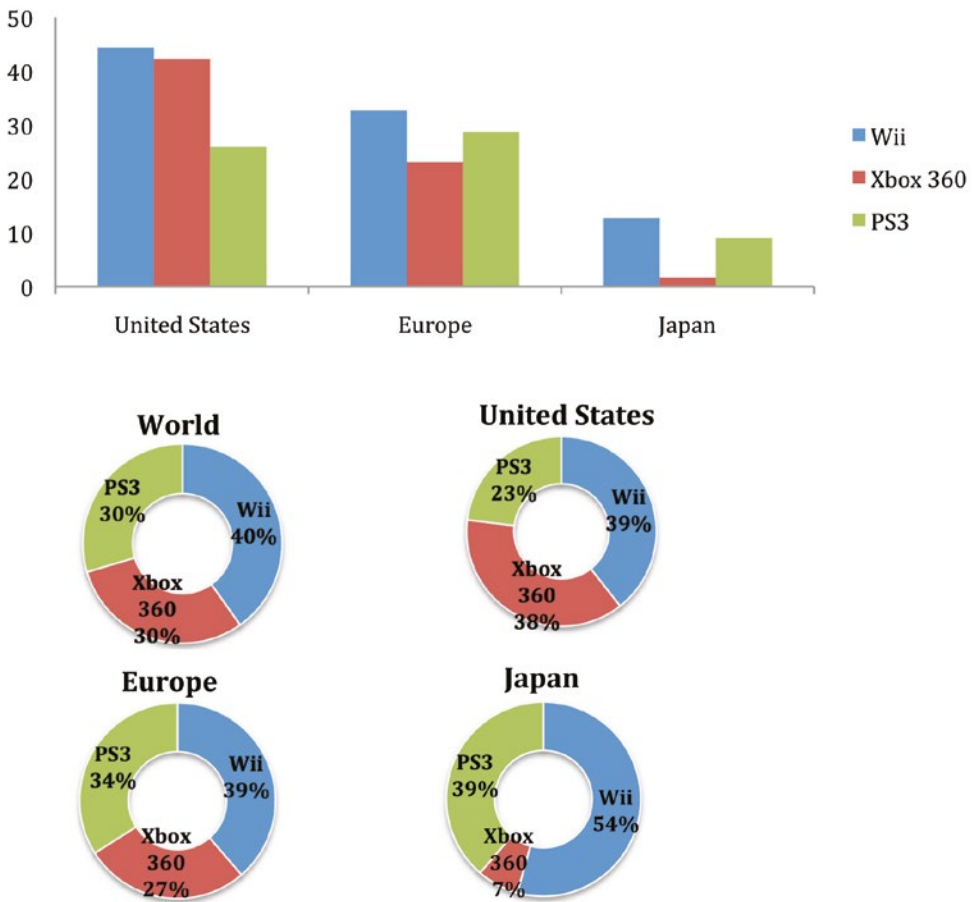
Microsoft started the seventh generation by releasing the Xbox 360 on November 16, 2005. Since then, it has sold over 70 million units worldwide. Sony's PlayStation 3 comes in second with 72 million units sold.

The popularity of each console varies greatly by geographic market. As Figure 1 shows, even though the Wii is the best-selling console, the percentage of total unit sales in the United States, Europe, and Japan for the Xbox 360 and PS3 is wildly different. Sales for the Xbox 360 are almost nonexistent in Japan, and the PlayStation 3 saw better percentage and unit sales in Europe than in the United States.

1.1.2 Digital Distributors

The retail sale of PC games is increasingly becoming outmoded. Online revenue from games across all platforms was up 30% from US\$18 billion in 2011 to US\$24 billion in 2012. Boxed PC games sales are typically a small fraction of a title's console version; however, boxed retail PC games typically sell more units in real numbers in Europe than in North America.

By far the leader in 2012 in PC digital distribution is Valve's Steam. With over 50 million users and around 5 million users logged in at any one time,⁶ Steam has the largest user base of any digital distributor. Steam has over 1800 titles available in its catalog, and is available on Windows, Mac, and Linux. Although Steam does not distribute mobile games, the Steam mobile application gives mobile device users the ability to purchase games and use Steam's community features.

Figure 1: Sales of Consoles (as Percentage of Total Units) 2013

Second to Steam is Electronic Arts' Origin service. Although Origin has only been around since 2010, it has grown quickly, reaching 30 million users (13 million on mobile devices) in only two years.⁷ Part of this rapid growth, however, is the strength of Electronic Arts' games, which require registration with Origin to play. A likely more accurate number of users is the 4.4 million users that have purchased content through Origin.

Two other major players in the digital distribution arena are Amazon and GameStop. Amazon, as the largest online retailer, is a natural choice for many consumers. GameStop's Impulse service, purchased from Stardock, is likely to stay relevant since it has the backing of the largest video game retailer in the United States. There are also a number of smaller distributors that focus on certain niche features, such as GOG.com which releases games without Digital Rights Management (DRM) and Humble Bundle which focuses on games made by independent developers.

On the console side, digital distribution is handled by the first parties. Both Sony and Microsoft offer distribution of titles directly through the console. Nintendo's Wii offers purchase of some titles, but the catalog is quite limited. The Wii-U has a much more robust digital download offering than its predecessor, similar to Sony and Microsoft.



1.1.3 Mobile

With the advent of smartphones, mobile gaming has become a legitimate platform for gaming. Although estimates for the size of the mobile gaming industry vary greatly, mobile gaming generated around US\$8 to 12 billion in revenue for 2012.⁸ Mobile as the future for gaming has been a constant refrain for several years now: with Apple iPhone sales reaching 125 million units in 2012 (up from 40 million two years prior) but only counting for 18% of the smartphone market, it is clear why there is excitement.⁹

The mobile market is split into two large camps. On one side is Apple's iOS, which runs on its iPhone and iPads. On the other side is Google's Android OS, which runs on a plethora of phones and tablets made by a variety of manufacturers, though led by Samsung. Behind these two behemoths are Research In Motion Limited's (RIM) BlackBerry and Microsoft's Windows Phone, both companies trying to be relevant in an industry increasingly dominated by Apple and Google.

1.1.4 Major Companies

1.1.4.1 First Party

'First party' is a term used to denote the makers of video game consoles. First party business activity is not limited merely to hardware: they also develop and publish software. Certain developers are subsidiaries of a first party, known as 'first party developers', and develop solely for the first party's platform.¹⁰

Microsoft

While Windows was always relevant for PC gaming, games were not a major part of the Redmond, Washington-based operating system giant's business until it dove into the video game world with the release of the Xbox in 2001. Microsoft followed up the Xbox with the Xbox 360 and now the Xbox One.

Microsoft's Microsoft Studios business comprises a number of franchise and development studios spread throughout the world, including 343 Industries, responsible for the *Halo* franchise, and Lionhead Studios, primarily developing adventure and role-playing games.

| Microsoft | | |
|-----------|--------------|-------------------------------|
| 2012 | Net Revenue: | US\$9,593 million |
| 2012 | Net Profit: | US\$364 million ¹¹ |

Nintendo

Nintendo has been a mainstay in the video game industry for almost 40 years. Based in Kyoto, Japan, Nintendo first launched the Nintendo Entertainment System (also known as the Family Computer or Famicom) in 1983 and since then has released a number of console and handheld gaming platforms. Nintendo is well-known for a number of iconic game franchises including *Mario*, *Donkey Kong* and *Zelda*.

Nintendo has a very strong first-party development portfolio which develops many of the Nintendo franchise games. Most first-party development is done by the Nintendo Entertainment Analysis and Development division, but Nintendo also has other first party development studios, such as Monolith Soft. Unlike Microsoft, Nintendo's first party development is focused mainly in Japan.

| Nintendo | | |
|----------|--------------|---------------------------------|
| 2013 | Net Revenue: | US\$6,759 million ¹² |
| 2013 | Net Profit: | US\$75 million |

Sony

The Japanese tech giant entered the video game scene in 1994 with the release of its Sony PlayStation, and followed with the PlayStation 2 in 2000. Both systems were huge successes, both selling over 100 million units.

Sony's success is partly due to its ability to have a number of exclusive titles, having a strong first-party development and signing a number of developers to exclusive partnerships.

| Sony | | |
|------|--------------|---------------------------------|
| 2012 | Net Revenue: | 1,558 billion Yen ¹³ |

Valve

Although not necessarily considered a 'first party,' since PC gaming does not have first parties in the same way as console gaming does, Valve can be considered in the same category as the three companies above. It is a major source for PC games, and with the Steam Box, a PC-based game console, announced in March 2013, it is not a stretch to consider calling Valve a first party.

Another Washington based company (Microsoft and Nintendo of America are both based in Washington), Valve started out as a development studio, most known for its *Half-Life* series of games. Steam started in 2002 as a platform for distributing patches and updates to PC games sold at retail. It has since grown to be the largest PC game distribution platform, but also serves as a means for DRM's, servers for online play,



and community features. Valve uses its Steamworks API to allow developers to implement all the features of Steam.

| Valve | | |
|-------|--------------------------|---------------------------------|
| 2010 | Net Revenue (estimated): | US\$1,000 million ¹⁴ |

1.1.4.2 Console and PC publishers

Not all games are made by the first parties; in fact, only a very small percentage of games are. The vast majority of games are made by third party publishers and developers. Currently, there are a number of very large publishers that develop and distribute games for PC, console, and mobile platforms. Often, these large publishers have a number of in-house development studios but will also contract with independent development studios for publishing or distribution. The major difference between a third party developer and a first party is that often games are cross-platform.

1.1.4.3 Mobile publishers

Although all major publishers also develop or publish mobile and social games, a number of companies have formed solely to make games for mobile or social web platforms. While Japan and the United States account for most of the major publishers in console and PC, these mobile publishers are much more diverse. A number of Asian companies based in South Korea, Japan and China have become some of the top mobile gaming companies.

Unlike console and PC publishers, mobile gaming companies tend to be smaller, privately held companies or are based in Asia and do not disclose statistics in the same way as Western companies (or at all). This makes putting together a list of the top worldwide companies in the industry quite difficult because of the frequent changes, the difficulty in obtaining accurate data, and the sheer number of players. Table 2 lists some of the more well-known mobile gaming companies.

Table 1: Major Publishers

| Publisher | Headquarters | Major Titles | Net Revenue (millions) ¹⁵ | Net Income (millions) |
|-----------------|--------------------------|--|--------------------------------------|-----------------------|
| Electronic Arts | Redwood City, California | <i>Battlefield, Mass Effect, The Sims, Madden NFL</i> | US\$4,143 | US\$76 |
| Activision | Santa Monica, California | <i>Call of Duty, World of Warcraft, Diablo</i> | US\$3,620 | US\$1,149 |
| Ubisoft | Montreuil, France | <i>Assassin's Creed, Far Cry, Tom Clancy, Prince of Persia</i> | Euro 1,061 | Euro 37 |
| Sega | Tokyo, Japan | <i>Sonic, Virtual Fighter, Phantasy Star</i> | US\$1,043 | US(\$184) |
| Take-Two | New York City, New York | <i>Grand Theft Auto, BioShock, Civilization</i> | US\$825 | US(\$108) |
| Square-Enix | Tokyo, Japan | <i>Final Fantasy, Dragon Quest, Tomb Raider</i> | US\$1,556 | US\$0 |
| Namco Bandai | Tokyo, Japan | <i>PAC-MAN, Tekken, Soulcalibur</i> | Yen 225,504 | Yen 17,003 |
| Konami | Tokyo, Japan | <i>Silent Hill, Metal Gear</i> | Yen 225,995 | Yen 21,875 |
| Capcom | Osaka, Japan | <i>Street Fighter, Resident Evil, Mega Man</i> | US\$1,000 | US\$150 |

Table 2: A Sample of Mobile Publishers

| Publisher | Headquarters | Major Titles |
|-----------|---------------------------|-------------------------------------|
| Zynga | San Francisco, California | <i>Farmville, Mafia Wars</i> |
| Gree | Tokyo, Japan | <i>Driland</i> |
| Gameloft | Paris, France | <i>N.O.V.A., Let's Golf</i> |
| Gamevil | Seoul, Republic of Korea | <i>Baseball Superstars, Zenonia</i> |
| Nexon | Tokyo, Japan | <i>MapleStory, Dungeon Fighter</i> |
| Rovio | Espoo, Finland | <i>Angry Birds</i> |

1.2 The Changing Landscape of the Video Game Industry

The future of the video game industry is in a state of flux. After a long previous generation, there are many questions about the next generation of consoles. Mobile gaming continues to increase in popularity, but the sustainability of its growth is in question. Digital distribution has completely changed the face of PC gaming. New hardware releases are blurring the line between console, PC, and mobile. Indie developers are on the rise, while ever-increasing development costs for major titles threaten the profitability of major publishers. The uncertainty in the industry not only creates development and business challenges, but also some unique legal issues.



1.2.1 End of Life Economics

With the launch of the Wii-U in November of 2012¹⁶ and the release of the Sony PlayStation 4 and the Microsoft Xbox One in late 2013, the current console generation is finally coming to a close in its eighth year. Compared to the last two generations, which both lasted less than six years, the generation that started in 2005 with the release of the Xbox 360 was very long. Many developers and publishers have cited the long length of this generation as the cause of many of the problems currently facing console developers.¹⁷

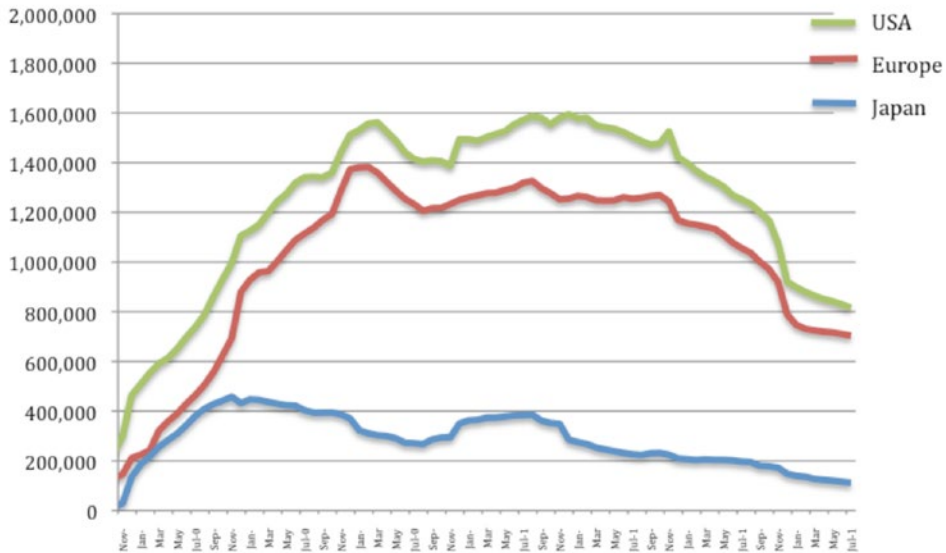
Like any product, video game consoles have their own product life cycles. Due to the proximity of launch date and similar hardware capabilities, consoles within the same generation tend to fall into the same life cycle. The sales of video game software, tied to the hardware, are at the mercy of the current console generation life cycle.

Even though one generation ends, development does not stop right away. Developers have gained familiarity with the console hardware and the market for that console is more predictable than new hardware. It will take time to transition to the new consoles, so for the time being developers will need to decide whether to develop for the old consoles, for the next generation, or for both.

(i) Console Sales

As illustrated in Figure 2 below,¹⁸ the early years of this console generation, 2006 to 2007, saw sharp growth in hardware sales which eventually levelled out in 2009. However, in 2011 a decline in total console sales began, which then increased dramatically in 2012. Of the three consoles, the Xbox 360 showed the least decline, while the Nintendo Wii peaked much earlier. The Wii's quick peak can be explained by its younger target age market and less robust hardware profile. It could also explain why Nintendo was the first to release a next generation console.

Figure 2 also only shows retail unit sales, not revenue. Price drops and hardware improvements were for all devices. Most notably, the Sony PlayStation 3, which had a starting price of US\$499 for a 20GB unit, sold for US\$269 in 2013 for a much slimmer 250GB unit.¹⁹ Even with new hardware and lower prices, hardware sales continue to plummet, with the Xbox 360 and PS3 suffering from a 50% decline in sales year over year for the month of December 2012.²⁰

Figure 2: Total Console Sales (12 Month Moving Average)**(ii) Software Sales**

Sales of video game software follow the same trend as the consoles that support them. This console generation introduced significant digital distribution options for consoles that previously did not exist (discussed below). Unfortunately, granular sales data for digitally distributed software is not readily available, limiting the discussion of software sales to retail distribution. The impact on console sales is unclear, but the impact is likely not significant enough to change the discussion on trends too significantly.

Mirroring hardware sales, 2012 was a disappointing year for retail software sales, registering a 24% decrease in unit sales and revenue from 2011, down 40% from the peak in 2008.²¹ Large AAA titles²² still sell well, but with less total numbers: the risk of a major title not attaining adequate sales numbers is increased.

The trend downward of both hardware and software sales shows a console generation in the later/last stages of the product life cycle.

(iii) Development Cost Risk

Although sales are decreasing, there is increasing demand for bigger and more expensive titles. However, higher development cost and a shrinking market mean a higher risk for large budget AAA titles. The result of this risk is embodied by the collapse of THQ Inc. (formerly a video game developer and publisher). After posting US\$1 billion in revenue and US\$68 million in profit in 2007, THQ Inc. was broken up and sold after five straight years of losses, ending in a US\$243 million loss on US\$831 million in revenue five years later.²³



To lower this risk, similarly to Hollywood, companies focus on known quantities. A sequel to a successful title already has built-in brand recognition and all the marketing behind the first title. It is therefore more likely to succeed than a brand-new project. For some publishers, spending limited funds on a title that is more likely to succeed is a better bet than gambling on the creation of a new series, when the market as a whole is in a state of decline.

Another way to lower development cost risk is to go in the opposite direction and develop a larger number of smaller titles based on new intellectual property (IP) in the hope that one of those titles hits it big and can pay for the development of the rest.

1.2.2 Future Consoles

With the release of the Wii-U,²⁴ PlayStation 4, and Xbox One, the console industry is banking on new hardware to turn the last two years of lagging sales and corporate losses around. New hardware could result in the resurgence of the console industry, but the next generation of consoles will face a different competitive landscape. PC gaming has almost entirely moved away from retail, and the decisions made by the first party console manufacturers (how easy they make self-publishing digital-only games) will set the tone for how console developers may distribute their games.

One positive for new console hardware is that it tends to result in innovation on the software side as well. Titles based on new IP or novel game design may help to breathe new life into the console industry. Sequels are popular among fans of a series, and are lower risk for developers, but a fresh story or design is necessary to move the industry forward. This next generation of consoles should hopefully allow for more risk-taking, since the first party will be supporting early adopters of the consoles through development funding and marketing support.²⁵

The new console announcements furthered the trend of transforming the gaming console into a full home multimedia experience. Both of the new Microsoft and Sony consoles require heavy internet access, and are trying to position themselves as the focal point of the living room. For Microsoft, the announcement could have been better accepted: certain features of the Xbox One (such as requiring a daily internet 'check-in' and some limitations on used-game sales) caused a backlash from video game consumers and caused the software giant to reverse course on some of its proposed features.²⁶

The traditional console manufacturers are not the only companies with new hardware. Valve announced in September 2013 that it will release its own console, the Steam Box, running its own Linux-based SteamOS.²⁷ This will presumably be a bridge between traditional PC and console gaming, allowing consumers to gain access to the PC gaming library through streaming to their TV via the Steam Box.

Other companies are also taking the dive into the console space. Cloud gaming platforms like OnLive, which streams games from the internet instead of requiring a local game or hardware, could be a competitor to consoles, but have yet to take off due to the limitations in bandwidth. Another competitor group is small consoles based on the Android architecture, which would bring mobile style gaming to the living room TV.

Hardware is going through a major upheaval and picking the right platform to develop for is vital for the survival of developers and publishers. However, it is a great opportunity to partner with hardware manufacturers who will be hungry for quality titles to help sell their new hardware.

1.2.3 Rise of Digital Distribution

Another major change in the industry is the growing prevalence of digital distribution. On the PC side, Steam has given developers and publishers access to a worldwide market without the need to fight over limited retail shelf space or carry inventory risk.

On the console side, digital distribution allows publishers to release titles without meeting minimum quantity requirements from first parties and without having to pay first party royalties for those quantities upfront. Digital distribution has opened the door for many small indie developers to reach a much wider audience.

However, not everything is positive; there are downsides to digital distribution as well. An often-cited criticism of Steam and other similar models is the reliance on discounts and sales.²⁸ The low distribution costs for digital allow for drastic cuts in price. Digital distributors often have promotions with well over 70% off titles. This has raised the concern that consumers will begin to expect discounts and will hold off on purchases until the price is lowered. Others, however, state that promotions are good for business as it results in massive spikes in revenue.²⁹ If the race to the bottom were to happen, developers and publishers would have to find alternative ways to monetize their titles.

1.2.4 Rise of Mobile Gaming

The biggest change in gaming in the last several years has been the meteoric rise of mobile gaming. With the advent of smart phones, gaming on mobile devices went from simplified games that resembled console games of the late 1980s to mobile games that have more similarity with modern console and PC games than differences.

A major feature of mobile games is the lower development costs. Mobile games are either free or sold for a very low price. This low price keeps consumer expectations in check, meaning that mobile games are typically more limited in scope than console



or PC games. Development costs for mobile games are typically in the hundreds of thousands, versus the tens of millions required to develop an AAA console game.

This low cost has also allowed for more development outside of the United States and Japan. Mobile development studios can be found all across the globe: South Korea and Eastern Europe have become hotbeds of mobile development.

There are some downsides to mobile development. Since it is so easy to release an application, there is a real danger of an application being lost in the crowd. Most of the revenue in this segment of the industry is focused at the top. The number 10 top grossing application has 10 times the revenue of the number 100.³⁰ Also, the fear that many PC developers hold that prices will be inevitably driven down is a reality in the mobile market. The vast majority of mobile games are either free or sold for only one or two dollars. This has resulted in a variety of monetization schemes, including various so called 'freemium' models and targeted advertising. However, the lower marketing and development costs still allow for mobile game publishers to make a profit in the industry.

1.2.5 Rise of Free-to-Play and other Monetization Schemes

'Free-to-play' or 'freemium' games are games that are distributed for free but have extra or premium content only available with additional purchases. The purchased content could be in-game items, new levels, or extra characters, or the purchase could be a service such as speeding-up activities that normally would take several hours.

The free-to-play model is becoming increasingly popular. While always quite popular on browser-based social applications and mobile games, free-to-play has become the new norm for massively multiplayer online (MMO) games. While some games were free from the start, such as *League of Legends*, recently more and more titles are converting from pay-to-play to the free-to-play model.³¹ One reason why free-to-play is so successful on MMOs is that those games rely on having a large user base to have the correct player experience. Free-to-play allows players to get access to the core content of the game without having to pay, creating the necessary user base, and then giving options for purchases to those players willing to pay.

Free-to-play is going to become a reality for console games as well. This current generation has seen a large amount of downloadable content (DLC) additions to a game that are purchased, but DLC has always been an addition to a purchased game. Now it is expected that console publishers will take the next step and offer some core games for free and rely solely on in-game purchases for the revenue stream. What these free-to-play console titles will look like is an open question, since the free-to-play model may work for small budget mobile or social apps but designing a

free-to-play console game for a different player with larger costs to recoup may mean implementing a different strategy than on mobile.

Box 2: The Simpsons: Tapped Out

The Simpsons: Tapped Out is a freemium mobile game published by Electronic Arts' mobile division EA Mobile released in the UK and US in early 2012. Since then, the application has made over US\$50 million in revenue.³²

The game allows users to build their own version of the Simpsons' city of Springfield. There are a variety of in-game quests, and created buildings generate income for users to use in-game. Users can use real-world currency to purchase 'donuts' to get access to premium features.

The success of the game became a problem for EA Mobile, since the demand tapped out EA's servers and the company pulled it from the Apple App Store while the server and bug issues were fixed.

There are other popular monetization schemes besides free-to-play. Advertising, typically in conjunction with a free-to-play game, is easily the most popular due to its ease of implementation. However, advertising revenue is small compared to the revenue possible through free-to-play. By analyzing activity and collecting user data, advertisers can deliver targeted advertisements to players. For many developers of social free-to-play mobile apps, advertising is an effective way of driving players from one game they might be growing tired of to the newest release by the same developer. Moving players from new title to new title allows for a developer to have a consistent fresh flow of revenue from new in-game purchases.

1.2.6 Legal Challenges Created by Innovation

The changes in the industry (new hardware, new distribution methods, and new monetization methods) bring some legal risks and challenges. Whenever an industry changes, it takes time for laws and regulation to catch up.³³ Sometimes this means that it is unclear how governments will react to certain business practices. Other times it means that regulation written to be applicable to technology thirty years old is applied haphazardly to ground-breaking tech. The result is that companies trying out new things need to be careful and seek advice on how to reduce their exposure.

(i) Patents

One of the largest legal challenges facing the industry today is patent litigation. Whether it is 'patent trolls' or legitimate claims, patent litigation is increasingly becoming a daily matter of concern for video game companies. With the recent release of the PlayStation 4 and Xbox One, there will undoubtedly be some new features embedded in the devices that will make gaming more enjoyable for the consumer. Unfortunately it is likely that the technology behind those new features may fall within a broadly written patent.



By using software development kits (SDKs) provided by device manufacturers and implementing the technology into their games, developers are exposing themselves to patent litigation. Since it is rare for a large hardware manufacturer to offer indemnification for patent infringement in its boilerplate agreements (for a discussion see Chapter 6. 5.1), developers are left to fend for themselves and often forced to settle by paying a license fee to the patent plaintiff. Until governments fix the way the patent system works, patent trolls will continue to be a drain on the industry. Although software patents can be an issue in many countries, patent litigation is primarily an issue in the United States. That is not to say the issue is limited to American companies, as any company distributing games in the United States could potentially face liability under American patent law.

(ii) Digital Distribution

Digital distribution gives developers access to any person anywhere, provided they have an internet connection. This increased access means exposure to the varying laws in the jurisdiction where the consumer resides. Even within the United States, each state has varying privacy, consumer protection, and tax laws. Different countries have different decency standards and some content, while legal in most countries, may be illegal in others.

When delivering a build of a game to a distributor, the developer relies on the expertise of the distributor to follow the laws of the country it is distributing to. Developers should not be lax and should be proactive in protecting themselves by learning from the distributor about the issues that should concern them. Assuming that a title may be sold anywhere and run exactly the same way, especially when there is some sort of networked functionality, is not a safe bet.

(iii) Monetization

Each monetization scheme brings with it a different legal challenge. Advertising requires following privacy laws and online regulations. In-game currency can involve banking law, consumer protection law, tax law, and, in the United States, even the USA Patriot Act. In-game purchases will require adherence to tax and property laws. The way a game sells certain items can bring gambling laws into play, such when Japan outlawed 'gacha' style games, which required players to buy packs of random items to put together collections to gain access to even rarer items. A developer's exposure to these laws can be drastically impacted by the company handling the distribution.

(iv) Privacy

The world is becoming more connected, and gamers are no exception. The ability to play online with friends used to be the only way for players to connect. These days, games are connected to social media sites, and sharing achievements, scores, and

other aspects of games with friends is very popular. How companies manage all the private information that flows from social aspects of games is a concern for consumer groups and governments.

The mobile market is especially vulnerable to these legal changes. New phone devices mean exposure to patent infringement lawsuits, mobile games are only distributed digitally, so the market shares all the same issues as PC and console distribution, and free-to-play and other creative monetization schemes are the norm for social games. Mobile gaming is also a hot industry, so is more likely to catch the eye of regulators.

1.3 Impact of the Changing Landscape and its Effects on Game Development

The changes in the industry discussed above have had a major impact on game development. Developers and publishers need to react or face going out of business. The changes also have created some new opportunities, and the developers and publishers that can take advantage of such opportunities will become the leaders in the years to come.

Since the console industry is shrinking, and the budgets for big budget games are getting bigger, developers and publishers run the risk of one or two major flops severely impacting their entire business. The increase in cost and decrease in sales has caused many publishers to be more risk-averse, focusing on sequels and known properties and decreasing the number of mid-market games.

Although development on the mobile side is much less expensive, the popularity of the industry and the low barriers to the industry create a lot of noise. A well-made and well-supported game runs the risk of never being discovered and since the freemium model requires a large user base, even a mobile developer needs to carefully control costs.

Not everything is dire, however, as the change in the industry creates huge new opportunities. The increase in cost and risk for large games has resulted in publishers doubling down on well-established franchises. This leaves room for smaller indie developers to experiment with new stories and game styles which, if produced for a relatively low cost, can stand out in the crowd of sequels and reboots.

The flood of new hardware, both for console and mobile, can result in partnerships and exclusive deals which can mean access to development funds or free marketing. New hardware also gives developers the opportunity to experiment with new features and perhaps new ways of playing games altogether.

The challenges with these opportunities are obvious. The future is unknown, and not being able to adapt to further changes will spell disaster. Changes in the law and



regulations will also impact development, and often new technology means that the law is not quite settled. Developers will need to determine what risks are worth taking in a legal landscape that might not give a straight answer.

1.4 The Role of the Publisher

This section discusses the different roles a publisher can take and why a developer may be interested in having some, or all, functions handled by an established video game publishing company.

A publisher can offer a wide range of services for developers, typically in return for a percentage of revenue earned from the exploitation of a game. A publisher's role can be as involved as a publishing deal with complete funding of all the development or limited to distribution of physical product in one geographic region, and everything in between. What publishers can bring to the table depends largely on the developer's needs, the type of game in development, the geographic market and the platform. What publishers always can provide, however, is brand recognition. Since there are so few major publishers, most consumers are familiar with each one and having the publisher's logo on the game can help or hurt a small developer, depending on the publisher.

1.4.1 Funding

The major benefit of working with a publisher is access to funding. Like any part of the developer/publisher relationship, the level of funding can vary to fit the parties' exact needs. The testing and submission process costs money, and providing funding for those activities is one option for a publishing deal. Publishers can also fund development of the game itself, or portions thereof, such as ports to different platforms. For cash-strapped developers, getting access to the deep pockets of a major publisher can be vital.

With funding, however, comes greater control, since a publisher will want to make sure its funds are being well spent. Too much of the wrong kind of oversight can turn a great game concept into a horrible game. Conversely, not enough oversight can lead to wasted development funds. Games are creative expression, and tension over the direction of a project can lead to conflict. Having a well-drafted agreement clearly outlining rights and obligations, as well as what to do in case of a conflict, is very important to help facilitate a more stress-free relationship between the parties.

1.4.2 Quality Assurance (QA) and Submission

To release a game that works, quality assurance (QA) testing is required. Once development is complete, the developer will submit to the first party, in the case

of consoles, to a digital distributor like Steam, in the case of PC, or to the mobile marketplace. Both QA and submission are functions that can be handled by publishers.

(i) Console

Historically, to release a game on consoles, one had first to be accepted as a publisher with the first parties. The process to become a publisher varies depending on the first party, and typically involves some review of the potential publisher's business. All first parties require the signing of a publishing agreement (discussed in Chapter 6.2). Once accepted, the publisher can submit game builds for approval to the first party. For developers that do not have the capability, or desire, to go through this process, the publisher plays a major role in the process of getting a game released on the console.

A major service offered by publishers is handling the first party relationship and managing the quality assurance (QA) process. Major publishers have dedicated QA teams, with experience on a variety of titles and close working relationships with the first party, who test games for bugs and glitches. The publisher's experience that comes with developing and publishing a large number of titles can also be a great resource for a developer. Often publishers give advice or feedback during the QA process that can greatly enhance a title.

It is expected with the new consoles that the process of having a game approved for distribution will be liberalized considerably, so in due course there may be far fewer roadblocks to a developer self-publishing its games on console – however, much will depend on how the console manufacturers roll out their plans with the new consoles.

(ii) PC

Releasing a game for PC can be as simple as one wants to make it. Since there are no first party hardware manufactures to submit to, a developer can simply release a game as a download via their website. Self-publishing is made easier by application programming interfaces (APIs) like Valve's Steamworks, available for free, which gives statistics, piracy protection and community options not readily available otherwise.

Publishers can still play a role, since Steam is not an open platform and is available on mobile; it is possible that Valve may switch that model, but currently Valve makes the decision on what games are released on its platform and brand recognition helps with that. However, overall the process to get access to Steam is much less rigorous than the process for console, but a new or small developer could benefit from a publisher relationship for this process.

Submission to Steam is also much simpler. For console, the developer will test the game to make sure that it is relatively bug free.³⁴ For PC, the main concern is that the API is implemented properly. This does not mean that a thorough QA process is not



necessary; however, since a game full of glitches and bugs is less likely to become popular, rather it means that the process is not mandated from the first party. A publisher's expertise with QA is still quite relevant to the PC developer.

(iii) Mobile

Releasing on mobile is by far the easiest. To release on Apple or Google storefronts, all that is required is downloading a software development kit (SDK) and paying a nominal fee. There is no vetting or bug testing beyond the mobile platform's checks to ensure a game follows its terms and conditions (the depth of which varies widely from game to game and platform to platform).

The QA process, like almost everything with mobile gaming, is simpler and less expensive. Since the scope of a mobile game is typically much narrower than a PC or console game, QA can be handled much quicker. The lack of a strict first party approval process puts less pressure on a developer to spend on a thorough QA process. QA is still very important, and as mobile games and technology become more complex and the cost for development increases, access to third-party QA through publishers is becoming more attractive.

1.4.3 Retail Distribution

Digital distribution has made self-publishing a legitimate option for many developers. However, traditional retail distribution is still important for sales of console games. The ability to manufacture and distribute physical product is a process in which many developers have no experience. Publishers, on the other hand, have relationships with the retail chains (GameStop, Wal-Mart, etc.) and the expertise needed to physically manufacture game discs. Getting access to shelf space can make or break a game, so a partner with the right relationships can be key to a game's success.

If a developer self-publishes, the agreement with the publisher can be as simple as a distribution deal and require no input from the publisher except for manufacturing and distribution of games to retail. For this service, a publisher would be acting like any other distributor and would take a percentage of the proceeds.

1.4.4 Marketing

Major publishers will have an entire department dedicated solely to marketing video games. The expertise and ability to get a title in front of consumers in this crowded market is a valuable feature of a publisher. Marketing is also something that can be done by independent agencies, so a developer needs to weigh the costs and benefits of both. In either case, maintaining control over the image and message of one's game is very important, and having a well-structured agreement, as well as keeping tabs on what the marketing team is doing, is vital.

Regardless of platform, traditional marketing is more or less the same. A relationship with the press, creation and distribution of advertising and event marketing are applicable to every platform. In addition, relationships with first parties can be critical for the success of a product especially when dealing with digital and mobile distribution.

All digital distribution platforms are littered with splash pages advertising game titles. Having a title pop up immediately after opening Steam, Google Play, or Xbox Live is invaluable to the developer. Getting a game featured is something that a party with a relationship with the first parties is more likely to accomplish.

One major downside to mobile is the sheer number of applications in the market. Getting lost in the crowd is a reality for mobile developers, no matter how good a title is. Having a relationship with the carriers and phone manufacturers can help a developer get a game featured or preloaded onto a device. Since revenue for mobile games using the freemium model relies heavily on number of downloads, this relationship can make or break a title.

1.4.5 Worldwide Reach

Another option for developers is to contract with a publisher to reach a market it either cannot afford to enter or lacks expertise in. A developer in Canada may not know the proper way to reach gamers in Japan, and a developer in India may not know how to distribute a game in Sweden. The reach could be distribution, marketing, or both. Most major publishers have several subsidiaries across the globe, so can easily reach any target market. Distributing worldwide also means exposure to a large number of laws and regulations, and having another party take on that liability can be a major help.

Digital distribution has made the entire world seem easy to reach with one click of a button, but if the players cannot read the text in the game, they are not going to play it. Localization is something many publishers can either fund or handle in-house. Publishers with expertise in a variety of markets can help developers design games that will have reach across the globe, since the tastes of gamers vary greatly by geographic market.



CHAPTER 2

DEALING WITH VIDEO GAME PUBLISHERS

2.1 The Role of the Publisher

The publisher plays a role similar to a movie studio, whereby the publisher finances, develops, distributes and markets a product to consumers. Not only do publishers finance games of third party developers in return for distribution rights and possibly ownership, but they also distribute finished games, and finance the development of games internally by their own employees.³⁵

Agreements between the publisher and developer will vary depending on the type of role played by the publisher. The most common scenarios involve:

1. The publisher will hire a development team and will own the copyright to the game and will typically pay a royalty to the developer based on revenue earned from the game.
2. The publisher pays for the development of a game based on a concept created by a third party developer and pays royalties based on revenue earned, but does not own the copyright.
3. The publisher acts only as a distributor of a finished game, receiving a fee for its services overseeing the distribution and manufacturing of a game.³⁶
4. The publisher agrees to publish a developer's mobile game, exposing the game to the publisher's network of users in exchange for a percentage fee based on revenue earned from the game.

In each situation, the publisher will also typically front the money for manufacturing, distributing, and marketing the game. In addition, the publisher will: (i) serve as the party that enters into agreements and manages relationships with the first party console manufacturers³⁷ and/mobile app stores, ensuring that a game satisfies the requirements of the hardware owners including delivery, submissions, testing and payment, if applicable; (ii) create and implement a marketing and sales plan; and (iii) secure deals with sub-distributors, if necessary.³⁸

For each scenario many of the terms of any agreement entered into between the publisher and the developer will be the same, but there will also be significant differences involving ownership and rights, costs, and oversight involving the development and exploitation of the game. This chapter will discuss the legal and business issues involving the publisher-developer relationship.

Prior to considering a relationship, both the developer and publisher will discuss, not only a number of business issues to see if the parties can come to an agreement, but also issues affecting whether the parties would be a good fit. The extent in which the issues will be addressed will depend on each party's commitment to the other party. If the publisher is financing production, then it will most likely conduct greater due diligence on the capabilities of the developer.

2.1.1 Developer's Concerns When Considering a Publisher

For the developer, a few of the most significant questions that will need to be asked:

1. What games has the publisher distributed and how well did they do?
2. Does the publisher have the capabilities to distribute and market the type of game (e.g., action, shooter, sports) being discussed between the parties throughout the world and the proper resources and expertise to market, distribute, and exploit a game?
3. Does the publisher use sub-distributors?
4. Were other developers satisfied with the services performed by the publisher for their games and how easy or difficult was the publisher to work with regarding the development of a game?
5. What type of milestone approval process is employed by the publisher?
6. Does the publisher have the financial resources to make payments when owed and to exploit the game?
7. What type of relationship does the publisher have with console hardware manufacturers, retailers and mobile marketplaces such as Apple and Google?

2.1.2 Publisher's Concerns When Considering a Developer

At the same time, the publisher before considering whether to enter into an agreement with a developer should also do its own investigation on whether a deal would be in its interest. Some of the major issues the publisher may address with the developer will include:³⁹

1. How successful were previous games created by the developer?
2. How successful has the developer been in delivering games on time and within budget?
3. Is the developer currently working on other games which might interfere with the game being considered by the publisher? This can involve obligations to fix bugs or provide additional content for previous games.



4. What is the developer's financial situation? Unless it is only acting as a distributor, the publisher will want to consider the possibility of auditing the financial records of the developer.
5. What is the experience of the people that would work on the game for the different platforms?
6. Have the people working on the game successfully worked together on other games?
7. Is the developer licensed to work on first party hardware?

All of the above factors will be important in determining whether the parties will enter into a relationship and also how much the publisher believes in the profitability of the game.⁴⁰ If a publisher does not believe the game will sell, then there will be no interest even if the publisher can acquire distribution rights to the game without paying the developer an advance. To the publisher, costs incurred and time spent to distribute a game would be better spent on other games if the publisher determined it would be more profitable for them.

2.2 The Publishing Agreement

2.2.1 The Long Form Agreement: Introduction

For developers that enter into a publisher agreement ('agreement'),⁴¹ this document will set forth the business and legal relationship between the two parties involved in the exploitation and possibly financing of a game. The agreement will establish the rights, obligations, and responsibilities of each party involving potential financing, royalties, game development, testing, localization, delivery schedules, distribution, approvals, marketing, manufacturing, maintaining relationships with the platform holders and representations and warranties. The agreement will vary depending on the potential role of the publisher and whether the publisher will be a source of financing or just a distributor.

In situations where the developer self-finances the game, the developer may not have the expertise and money needed to distribute and market the game nor the relationships necessary to release a game on the various platforms. As a result, developers will seek a publisher to distribute their game. In addition, although in distribution deals the developer usually does not receive funding for development, the developer may be able to obtain an advance and /or guarantee from the publisher for the rights to distribute the game.

In some situations, developers may even enter into agreements with different publishers to distribute their games in different territories because a publisher may

have greater understanding of a particular market, and the initial financial reward may be greater dealing with more than one publisher.⁴² For example, a developer may enter into a deal with one publisher for European distribution and with another publisher for North American distribution.

2.2.2 Ownership Issues

Other than the financial consideration and the delivery schedule, ownership and the rights granted, which will cover the exploitation of the game, will be the most important section in the agreement.

In a situation where the publisher hires a developer to create a game based on a publisher's original concept or licensed property, the publisher, and not the developer, will own the intellectual property rights to the game in the vast majority of situations. This is almost always achieved through express contractual agreements between the publisher and the developer in a publishing agreement; however, it can also be achieved sometimes through operation of law. For example, in the United States of America such work would fall under the 'work for hire' concept,⁴³ provided the relationship between the two parties falls within the prerequisites of section 101 of the Copyright Act.⁴⁴ That said, not all countries recognize 'work for hire' and in countries such as France and Germany, the 'author' and owner of the work is the natural person or persons who created it.⁴⁵ Nonetheless, either as a result, of contract or of law, the publisher will usually have the perpetual right throughout the world to exploit the game and any elements in the game by any and all means with few restrictions.⁴⁶

In other agreements in which the publisher finances a majority of the game, but the underlying concept to the game originated from the developer, the two parties would need to negotiate the ownership rights and, in the event that the developer maintains ownership rights, then the parties would need to go into specific detail about each party's rights including but not limited to the platforms in which the game will be developed for, term, territory and rights to sequels, prequels, and spin-offs ('derivative works').

Whether the publisher is able to obtain ownership to the game or a grant of rights will depend primarily on the bargaining positions of the parties and the consideration being paid to the developer. If the publisher is funding the entire development, then the publisher will insist on owning the property, but if other publishers are also interested in the game then the developer may be able to maintain ownership. In any event, even if the publisher owns the copyright to the game, the developer will want to at least maintain ownership of the pre-existing source code and any tools used to create the engine since they will most likely use that engine for additional games to help reduce their future costs.⁴⁷ In some situations, the publisher will agree to allow



the developer to maintain ownership of these materials provided the developer agrees to a holdback period whereby the developer consents not to indirectly or directly work on a similar game for another publisher which may incorporate the developer's code for an agreed upon period of time (e.g., one year from release of the game). This prevents a situation whereby the developer may create a similar type of game, which could eventually compete against the publisher's game. Alternatively, although there may be legal limitations, in some jurisdictions, a publisher may allow the developer to maintain ownership of the code subject to a limitation on what other parties the developer may work with utilizing the code.

In deals involving only the distribution of a game, the developer will maintain ownership of all rights associated with the game and the developer will grant a limited right to the publisher to distribute the game on agreed-upon platforms for a specific term in the agreed-upon territory.

2.2.3 Rights Granted

In the event that the publisher owns the copyright to the game, then the publisher will have the exclusive right to exploit the game throughout the world in perpetuity. Otherwise, if the developer controls the copyright to the game, the platforms on which the publisher will be allowed to distribute as well as the rights associated with the exploitation of the distribution, marketing, and sales of the game will be defined in this section. There is no set formula on what rights the developer will grant, and like many other terms in the agreement, they will vary depending on a number of factors, including which party provides the financing⁴⁸ and game concept.

As part of the rights section, the parties will spell out the name of the game or games that will be the subject to the agreement as well as the different platforms on which the publisher will be permitted to exclusively distribute the game.⁴⁹ Furthermore, this section in the agreement will also discuss the form of distribution permitted by the publisher. Generally, the publisher will have the right to distribute games by any and all means and this broad language would include the right to distribute by traditional box games for retail, digital downloads, mobile, and possibly even platforms and distribution means that have yet to be developed.⁵⁰

2.2.4 Additional Rights Issues: Right of First Negotiation and Last Refusal on Future Games

Whether the game will be successful or not is difficult to predict and will depend on a number of factors, but in the event that a game's initial release is successful both parties will want to guarantee their involvement in future releases of a franchise. Publishers that do not own the copyright to the game will try to make sure that they benefit from their contribution and will request that if the developer was to

create a game based on the original distributed game, such as a 'derivative work' then the publisher would have the first opportunity to obtain rights to these future games provided the publisher is not in breach of the agreement. In this situation, the publisher would request a right of first negotiation, which provides the publisher with the first opportunity to negotiate exclusively with the developer on rights for such derivative works during an agreed upon time frame. During this exclusive window, which will vary in each deal but usually will range from 30 to 60 days, the parties would discuss the business terms regarding the rights to exploit a derivative work. If the parties are unable to conclude a deal, then the developer would have the right to negotiate the distribution of the game with any other party. It is very possible that the developer, though initially unsuccessful in securing future rights to their derivative work, might still be able to enter into an agreement with the publisher if unable to find another deal.

In addition to the right of first negotiation, some agreements may even allow for the publisher to have the right of last refusal. In this situation, the publisher will have the opportunity to match any offer that the developer may accept from another publisher. If the publisher matches the offer, then the publisher would then have the right to distribute the derivative works, assuming that the parties come to an agreement.

Neither the right of first negotiation nor the last refusal is automatic and the parties will need to negotiate these points. In the event that the developer agrees to a right of first negotiation and last refusal, then it might be to the benefit of both parties to establish minimum requirements that would trigger either of these rights. Usually, this might include a minimum threshold in which world-wide game sales or revenue must be met in order to trigger a right of first negotiation and last refusal. For example, if the developer receives royalties exceeding US\$1 million, then the publisher will have the right of first negotiation and maybe also last refusal; although the publisher might argue that this threshold can only apply after a certain period from the game's release, since anything earlier would not provide the publisher enough time to earn the royalties that would trigger the right to publish derivative works.

Furthermore, in order for the right of first negotiation to be triggered, there might be other factors that the developer may want to consider including the working relationship between the two parties. If the working relationship is strained, a developer might be willing to take less money knowing that a stronger relationship with another publisher may be more beneficial in the long run than greater initial payments from the original publisher. It is important for the parties to agree on what issues need to be matched in the event of a right of last refusal. For example, will the only concern be about revenues such as advances, guarantees and royalties (many times it is) or will there be other issues that must be matched such as marketing and sales commitments, etc.?



Developers need to be careful when including the right of last refusal, since this could severely handicap the developer in trying to negotiate deals with other publishers.

In most situations, a developer would not want to allow a publisher to match a deal, since other publishers may be reluctant to discuss a deal because they know that any deal they offer could be matched and thereby are unwilling to make a commitment.

In the event that the publisher owns the copyright to a game and elects to create derivative works, then the developer should try to negotiate a right of first negotiation to secure an opportunity to develop a subsequent game. In this situation, the developer would have the initial opportunity to negotiate a development deal with the publisher, provided the developer is still in business and is capable of making the derivative games planned by the publisher.⁵¹

2.2.5 Territory

This section of the agreement will discuss the countries in which the publisher will have the right to distribute the game(s). If the publisher owns the copyright to the game, then the publisher will have the right to exploit the game by any and all means throughout the world. However, if the publisher acquires rights to distribute a game then these issues will need to be negotiated between the parties.

The publisher will want to obtain as broad rights as possible in order to exploit the games in as many countries as possible. A developer may be willing to grant worldwide rights, assuming financial terms are agreed upon and provided the publisher has the capability to distribute in these countries. In countries where the publisher does not sell directly then the publisher will try to sell the game through third party sub-distributors. Most developers will accept this practice, provided the publisher would still ultimately be responsible for any of its obligations and responsibilities under the terms of their agreement. However, the developer needs to be aware if additional deductions are taken from the developer's or publisher's share to pay for the sub-distributor's services, since this might ultimately affect the developer's royalties.

In some situations where the developer is delivering a finished game, or if the parties only entered into a distribution agreement, the developer may limit the territory and elect to have different publishers distribute the game in various countries depending on the capabilities and financial guarantees provided by a publisher. Also, a developer may want to grant different platform rights to different publishers in the same territory. For example, a developer may grant North American rights to one publisher for console games and then grant other rights such as mobile to another publisher.

The developer may also include language in distribution agreements to the effect that if the publisher fails to distribute the game within a certain agreed-upon time period in a country, then the rights would either revert back to the developer or become non-exclusive.

2.2.6 Term

The term of the agreement will spell out the length of time that a publisher has the right to exploit the game, subject to early termination usually caused by the failure of a party to cure a material breach or its entry into bankruptcy (which, as the THQ example mentioned previously shows, is called upon more than one might expect, unfortunately). Unless the game is owned by the publisher, terms will vary depending on platform and the financial considerations of the deal.

For agreements in which the publisher owns the copyright, the term will be perpetual. However, if the publisher is only acquiring distribution rights then the term will be an agreed-upon number of years (with a right to sell-off for physically distributed games⁵²) and will vary from agreement to agreement; although the publisher will seek the longest term possible so that it has enough time to hopefully recoup any costs (e.g., distribution, marketing, QA costs, etc.) and make money on its investment.

Depending on the different platforms negotiated in a distribution deal, the term might only be a few years because the life cycle of a game on a particular platform may be limited, although new forms of distribution such as mobile, tablets, and even new console platforms provide additional opportunities to exploit a game after the initial platform launch and therefore publishers will request longer terms. In addition, as new technology is developed, games originally developed for an older platform may have value on a new platform. For example, while a PC game from 10 years ago would no longer sell at retail, it is very possible that it could still be sold digitally or on a mobile device years later and therefore still retain some value. *Pac-Man*, an arcade game from 30 years ago, is a perfect example of a property that is still popular on new platforms such as mobile.

In addition, the parties may negotiate to allow the publisher an option to extend the term for a certain amount of years. An option to extend the term may serve as a good compromise if the developer is reluctant to grant the number of years requested by the publisher. Provided the publisher is not in breach of the agreement, the publisher would have the opportunity to extend the term by exercising the option. In this scenario, the publisher may pay the developer an additional recoupable advance against future royalties for the right to extend the term.

One point to consider for extending a term may be an automatic extension in the event that the publisher generates an agreed upon amount of royalties for the developer. For example, if the developer receives \$100,000 in royalties then the term extends for an agreed-upon amount of time with or without an additional advance paid to the developer.



2.2.7 Developer's Services; Delivery

This section of the agreement will spell out the specific services, including the time-frames for delivery of milestones that will be required from the developer and will vary depending on whether the game is part of a development deal or just distribution. In both situations, there will be major obligations on the part of the developer under the terms of the agreement, although significantly less if the publisher is only distributing the game.

For games financed by the publisher, during the development process the developer will be required to submit the game design and technical design specifications⁵³ to confirm the direction of the game, followed by deliverables of the game at various stages of development for the publisher's approval or rejection.⁵⁴ The parties will negotiate a detailed milestone schedule listing each deliverable;⁵⁵ the delivery date;⁵⁶ and the compensation to be paid by the developer for the publisher's acceptance of each deliverable.⁵⁷ Milestone schedules will vary depending on the scope of the game and the time allocated for development. Mobile games may only take a few months, while a major console game release can take a few years and cost more than \$30 million. The cost to develop a console or PC game can be enormous and costs for these types of games have increased substantially, whereas games for mobile and tablets average around a few hundred thousand dollars, but one can expect these costs to increase as well as technology and capabilities improve.⁵⁸

Assuming that the deliverable is approved by the publisher then the developer proceeds to the next milestone. The publisher, pursuant to the agreement, will have a certain amount of days to review the submission and provide its comments back to the developer. In the event that the deliverable is rejected, the publisher should provide the basis for such rejection and then the developer will be required to correct the problems and re-submit the deliverable within a certain period of time. Afterwards, the publisher will then again have the opportunity to review the previously rejected deliverable.⁵⁹ Depending on the severity of the problems, this could push back the deliverable schedule. Furthermore, if the problem is material and either cannot be fixed or would take too long to fix to meet the game's street date, then the publisher would have the right to terminate the agreement.

Depending on the complexity of the game and the platform(s), the options for handling rejected deliverables will vary. For mobile, it may be easier in certain circumstances, depending on the complexity of the code, to deliver an unfinished application/game to another developer to complete the game. However, as mobile games become more complex, for certain mobile application/games and for console games the option might not be viable because of possible difficulties in understanding the source code. If the publisher decides not to proceed with development, then in

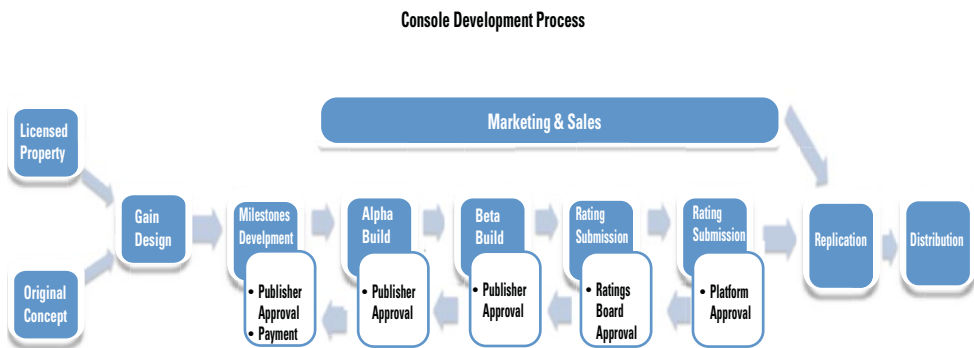
addition to any other rights and remedies it may have it will seek the return of monies paid to the developer.⁶⁰

The developer’s most significant obligation will be to deliver the finished game on the agreed-upon delivery date to the publisher.⁶¹ This is significant, since the publisher will have relied on the delivery date to meet a street date in planning its sales and marketing strategy which may include in-store promotions and advertising. Consequently, any delayed release may result in wasted marketing opportunities and expenses and any marketing may have little or no value if the game’s eventual release is not close to the original planned release.⁶² In the event that the developer does miss the delivery date, and depending on the severity of the delay, then the agreement may include language that any payments to be made to the developer may be reduced, whether it is in the form of an advance, guarantee, or bonus.

In addition to delivering the game on time and on schedule, the developer will also be obligated to make corrections to the game that might be uncovered after the release of the game; and to provide updates⁶³ and assistance that may be needed to help with customer support. The parties may negotiate a finite time period in which the developer would have to provide these services, since the developer may move people from the development team onto other projects. At the same time, it is in the developer’s best interest to support the game since that will help future sales.

If a game is being financed by a publisher then language might also appear in the agreement covering key personnel working on the game. This provision provides the publisher with a level of security that the game hopefully will meet the publisher’s objectives with an assurance that certain people will work on the game whether on a full-time or part time basis.⁶⁴ Any changes to the key personnel must be approved by the publisher.⁶⁵

Figure 3: Console Development Process





2.2.8 Financials

For both the developer and the publisher this section of the agreement will probably be the most important negotiating point in the agreement, since it will spell out the amount of money each party will spend and receive in the development and exploitation of a game. This section will address a number of issues dealing with the amount of money that will be paid by the publisher to the developer, including advances, guarantees, royalties, payment schedule and how royalties will be calculated.

The compensation paid by the publisher will vary depending on whether the publisher is financing the game or is only distributing the game. If the publisher is financing all or most of the development, typically compensation will be broken down into two forms of payment each linked to the other.⁶⁶ First, the initial consideration paid to the developer will typically be in the form of recoupable advances⁶⁷ to cover development costs pursuant to a milestone schedule. Costs will vary but mostly be dependent on the scope of the project. Secondly, the developer may be entitled to royalties based on sales of the game.

The milestone payments paid by the publisher would be considered recoupable advances against future royalties owed to the developer from sales of the game. Only after the publisher has recouped the milestone payments from the developer's portion of net revenue as defined in the contract, as well as any other agreed upon expenses, will the developer be entitled to receive royalties.⁶⁸

If the publisher is financing development, the parties usually would agree to a recoupable advance payment upon signing the agreement as part of the milestone schedule, to allow the developer to begin developing the game, and then additional payments based on the successful delivery of specific materials to the publisher. For example, the second milestone may be paid upon the delivery of a design document followed by additional payments upon the delivery and acceptance of alpha and beta versions of the games.⁶⁹ In most situations when negotiating milestone payments, the publisher will back-end payments since the most important deliverables will be towards the end of the development cycle and it also decreases the risk of their investment if the developer fails to deliver an acceptable game.

If a developer is relying on milestones to fund development, it needs to make sure that it has carefully planned out its costs so the payments will cover the development of the game, including salaries for employees, costs for licensed materials and game assets, and overheads. In addition, the schedule should include a 'cushion' to avoid any unexpected costs during development.⁷⁰

If the publisher is financing development, the second form of payment would generally be in the form of royalties. These payments are usually an agreed-upon percentage of net revenue earned from sales of the game.⁷¹

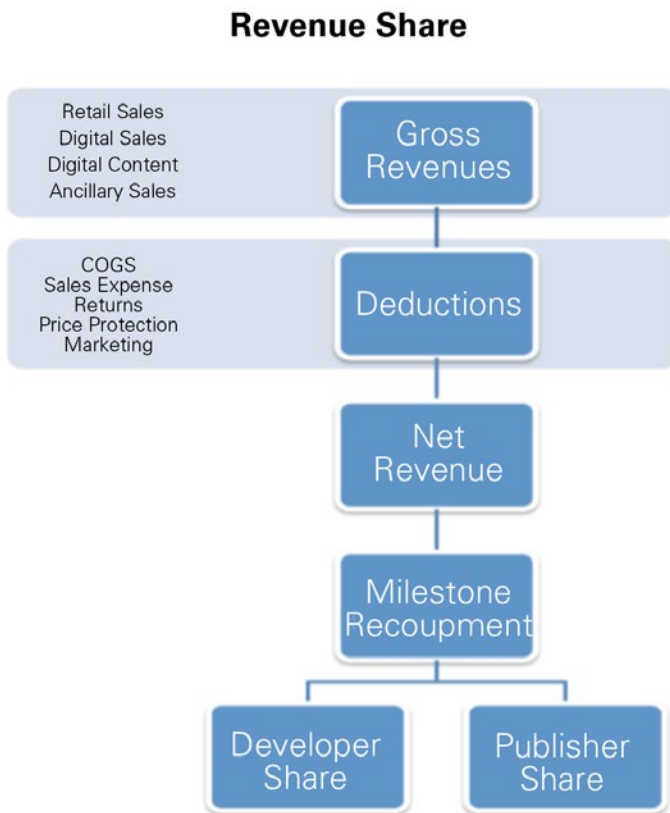
Net revenues are calculated by taking all revenues actually received by the publisher⁷² from the sale of the game (usually referred to as 'gross revenues')⁷³ and then deducting agreed-upon costs incurred by the publisher in distributing and marketing the game.⁷⁴ The parties will need to negotiate the deductions (which in part may depend on the platform and whether the game is being released in physical and/or digital format), but typically the agreed upon deductions may include cost of goods ('COGS'),⁷⁵ discounts,⁷⁶ damaged goods, advertising expenses including 'co-op',⁷⁷ rebates, refunds, credits, returns,⁷⁸ price protection,⁷⁹ service provider costs,⁸⁰ shipping, expenses incurred by publisher in the event that the developer is unable to perform the required services per the agreement⁸¹ and usually taxes.⁸² Afterwards, the developer's royalty rate is applied to the net revenues to determine the amount of money that the developer will receive from the publisher.

The parties will need to negotiate the royalty rate that will be used for determining the developer's share.⁸³ Determining the royalty rate will depend on a number of factors, including but not limited to the bargaining power of the parties, rights granted, development costs, third party licensing fees, advances, marketing commitment, the developer's track record, and platform fees.⁸⁴ Furthermore, as the publisher's financial commitment increases the royalty percentage may be less for the developer.

A developer will only receive a royalty after the publisher has recouped all of the defined costs from the gross revenue, and then any monies paid to the developer for development, which are deducted from the developer's revenue share. Only after the publisher has recouped these costs will the developer actually receive any royalties assuming revenues earned have exceeded costs.

For example, the publisher pays the developer a recoupable fee of US\$1 million according to a milestone schedule for developing a mobile game. Pursuant to the terms of the agreement, the developer is to receive a royalty of 10% of net revenues from all revenue generated by the mobile game. The publisher spends \$100,000 on marketing expenses which are recoupable from gross revenues.

The game is released and generates \$3.1 million in sales. Before determining the amount of royalties for the developer, the publisher is entitled to deduct the \$100,000 marketing expenses from gross revenue, resulting in net revenues of \$3 million dollars. Based on a 10% royalty, the developer would be entitled to \$300,000. However, since the publisher paid a \$1 million recoupable fee to the developer, the publisher before paying any royalties to the developer would be allowed to recoup the \$300,000 from the developer's share and would still be entitled to recoup an additional \$700,000 from future royalties earned by the developer.

**Figure 4:** Revenue Share

In distribution agreements, where there is little or no financing provided by the publisher, the developer will receive a larger share of the revenue than in a publisher-developer development agreement, since the developer financed development and assumed all of the initial risks. The amount of money that the developer will receive from the revenue share and the fee that the publisher will receive will primarily depend on the following factors:

- (i) the amount of money invested by the developer to develop the game;
- (ii) services being performed by the publisher;
- (iii) the amount of money agreed upon by the publisher to pay for various services which may include manufacturing costs, first party licensing fees, marketing and distribution expenses;
- (iv) if the developer has agreed to incur additional costs in the distribution of the game (i.e., marketing costs);
- (v) interest from other parties in distributing the game; and
- (vi) bargaining power of the parties.

As part of the negotiations involving each party's revenue share, the publisher and developer will simultaneously negotiate what expenses will be allowed to be deducted from the revenue earned from the exploitation of the game and the order of the deductions. Typically, the publisher would first be allowed to deduct agreed-upon

expenses (i.e., manufacturing costs, price protection) from the gross revenues and then would be allowed to take its fee from the net revenues. Afterwards, the parties would then be allowed to deduct any other expenses they incurred in the distribution and marketing of the game with any remaining monies going to the developer.

To illustrate one possible scenario, assume that developer and publisher agree that the publisher will take a 10% fee for services provided and will advance all costs for the manufacturing of goods and first party licensing fees, which will be deducted from the gross revenue. Marketing expenses paid for by the publisher will be recouped from net revenues after the publisher has received its fee. The game grosses \$5 million. Manufacturing and licensing fees equal \$2 million and marketing costs are \$1 million. As a result the publisher would first deduct the manufacturing and licensing fees from the \$5 million gross revenue, resulting in net revenue of \$3 million. Based on a 10% fee, the publisher would then be allowed to deduct \$300,000 from the net revenue, leaving \$2,700,000. From the \$2,700,000 the publisher would then be allowed to deduct the \$1 million marketing expenses. The remaining \$1.7 million dollars would then be remitted to the developer. In some distribution deals the developer might cover the marketing expenses.

One of the key points in negotiations will be the order in which costs are recouped if the developer has incurred distribution and sales costs but excluding development costs. Will some of the developer's costs be recouped before some of the publisher's expenses? This is important if a game does not earn enough revenue to cover costs since this will determine the possible gains or losses of the parties.

As part of the compensation paid to a developer, a developer might seek a minimum guarantee from the publisher in exchange for the rights. A guarantee is a payment that the publisher makes to the developer at the end of the term in the event that the developer has not earned the guaranteed amount of revenue from royalties and advances, if applicable.

From the publisher's perspective, a guarantee provided by a publisher will be based on a percentage of the publisher's projected revenue from the exploitation of the game.⁸⁵ The guarantee is important for the developer since it provides some form of assurance that the publisher will maximize the opportunity to exploit the game.⁸⁶ Other factors that will be considered when determining the guarantee and possible advances will include:

- (i) bargaining power of the parties determined by the amount of interest from other publishers;
- (ii) the track record of the developer;
- (iii) rights being granted; and
- (iv) other commitments (i.e., marketing).



For distribution agreements, the developer might also request a recoupable advance which may be a single payment or several payments spread out over the term of the agreement triggered by a particular event such as: the signing of the agreement; acceptance of a gold master by a console manufacturer; or the release of the game. The amount of a potential advance will vary on a number of factors similar to those used in determining the guarantee, including the bargaining power of the parties, interest in the game, royalties and the amount of money the publisher might have to commit to the game.

Because returns and price protection play a significant role in the industry when dealing with retail versions of the game, the publisher will require the right to establish a reserve that it can draw upon in the event that future royalties fail to cover these costs. The reserve is a percentage of the developer's royalties which are withheld by the publisher for an agreed-upon period of time.⁸⁷

For example, the publisher could be in a situation where it has paid the developer royalties based on first quarter sales of the game only to discover later that it overpaid, because of higher than expected returns and/or price protection that the publisher incurs in the second reporting quarter. With a reserve, the publisher would be allowed to access the funds to help pay for the deficit, thereby reducing its risk instead of relying on future royalties to recoup, which may not be enough. Even with a reserve, there still could be situations where the publisher does not necessarily recoup its costs. Some of the additional issues involving a reserve that the parties will need to negotiate include:

- (i) the size of the reserve (usually anywhere from 10% to 25%);⁸⁸
- (ii) what costs will the reserve be applied against (i.e., gross revenue or developer's royalties);
- (iii) how long the reserve can be maintained before the monies need to be liquidated (usually 6-12 months); and
- (iv) what costs can be applied against the reserve (i.e., price protection, returns, damaged goods).⁸⁹

2.2.9 Additional Royalty Issues and Payments

In a few situations, a publisher might structure a deal whereby instead of paying royalties after the publisher has recouped its agreed-upon costs, the publisher only pays a royalty after a fixed number of units of the game have been sold and at a certain price. The publisher would determine its costs and establish a number that would be large enough so that the publisher has recouped its costs in financing and exploiting the game with a profit.

For example, the parties agree that after 200,000 units of a game are sold at a wholesale price no less than \$39, then the developer will be entitled to a royalty for all

units of the game sold thereafter. While this might be easier for accounting purposes, it does lead to some additional issues. Firstly, what price does the game have to be sold at to qualify for the royalty to kick in? Most likely the publisher is looking at the initial wholesale price since the publisher will have calculated the amount of units needed to be sold to cover its costs including development, marketing and sales. Secondly, if the sales threshold is not reached, but just falls short and then the game sells at a lower wholesale price, would the developer be denied royalties? In addition, the publisher would require different royalty rates for units of the game sold over and above the threshold based on the wholesale price of the game.

In many agreements, the royalty rates will change based on the number of units sold of a game and the pricing of a game. If a game does well and hits certain levels of sales then the parties might negotiate a higher royalty rate for games exceeding certain thresholds. For example, the royalty rate for a game may be 10% for sales from 0 to 200,000 and then 12% for sales from 200,001 to 500,000 and then 15% for all sales above 500,000. Again, an issue will arise about the game's wholesale price and how that will affect the sliding scale royalty rates.

In addition to royalty payments, the publisher may also agree to pay bonus payments or increase the royalty percentage to the developer upon the occurrence of certain events. For example, the publisher may agree to pay a bonus to the developer if the developer delivers the game earlier than scheduled or the game meets or exceeds an agreed-upon average game rating based on industry reviews.⁹⁰

2.2.10 Accounting and Statements

In any agreement in which royalties are paid to another party, it is critical that the receiving party receive a statement indicating how the publisher calculated the amount of money paid to the developer. The statement must be clear and easy to understand so that the developer can determine if the statement is in fact accurate. Each deduction in a statement should be spelled out clearly so that the developer can confirm that the deductions were permissible under the terms of the agreement.

At the very least, the statement must include the revenues received by the publisher and the deductions taken by the publisher when determining revenues earned by the developer. Each statement should also break down revenues by territory and platform, if applicable, and how much revenue was earned by the publisher. This is important because certain deductions may only be allowed for certain platforms. In addition, if the publisher agreed to any type of consumer marketing⁹¹ and or channel/trade⁹² commitment, the statement should include how those dollars were spent to confirm that the marketing commitment has or will be satisfied.

In almost every publisher agreement, the publisher will insist that it be allowed to recoup its investment (i.e., development and costs associated with the exploitation



of the game) by co-mingling all revenues earned from all sources involving the exploitation of the game. This provision allows the publisher to recoup its costs faster and lowers its risks. For example, if the publisher paid separate development costs for a console game and a PC game then prior to paying any royalties to the developer, the publisher would be able to combine all revenue earned from the exploitation of both platforms before having to pay any royalties to the developer.⁹³

Statements are generally provided to the developer on a quarterly basis, 30 to 60 days after the close of a quarter, and each statement should be accompanied by any monies due to the developer. In some agreements depending on the length of the term, the publisher's obligation to deliver a statement on a quarterly basis may be reduced since sales numbers most likely will be lowered towards the later part of the term. As a result, instead of issuing quarterly statements the publisher may issue semi-annually or none at all in the event that the game does not earn a minimum amount of revenue during a 6-month period. For example, if revenue is less than \$1,000 for a particular accounting period then the publisher would not be obligated to issue another statement until such time that revenues exceeded \$1,000. A developer may not want to agree to this provision, since it is important for a developer to know how well or how poorly a game is generating revenue, especially if the publisher is recouping costs from the developer's share.

2.2.11 Audit Rights

It is critical whenever an obligation exists to issue a statement that the party receiving a statement also has the right to audit the relevant records associated with the statement. This will be the only means by which a developer can determine if the numbers calculated by the publisher in determining the developer's share of revenue are accurate. While the costs of conducting an audit may preclude a developer from exercising their rights as often as they may like, if at all, it is important that the developer at least has the option to audit the records of the publisher.

2.2.11.1 Parameters for Audits

To avoid potentially time-consuming and costly audits, the parties will need to set out the parameters within which an audit can be conducted. Specifically, the number of audits that can be conducted each year (usually one a year); location of the audit (usually the place of business of publisher); time in which an audit can take place (during normal business hours); length of the audit (an audit cannot go on forever); records that can be reviewed; and who can conduct the audit.⁹⁴

The developer will want to make sure that they know exactly where audits will take place so there are no surprises and potentially added expenses to conducting an audit. Prior to an audit taking place, the developer must provide notice within a

certain period of time so the publisher has enough time to accumulate the records that will need to be reviewed. Sometimes, a publisher may need to go into storage to find certain records and therefore will require anywhere from 10 to 30 days' notice. Furthermore, the parties will have to agree on what documents will need to be provided for the developer's auditors and how long an audit can go on for, since any audit will also involve time and resources from the publisher. This section in the agreement will usually entitle the developer to review records that specifically relate to determining the royalties earned for the game and would include records involving all sales to consumers as well as permitted deductions.⁹⁵ If the publisher cannot support their deductions with proof then the deduction should not be permitted. The limitation is justified to avoid a developer requesting documents that might be associated with the publisher's business, but do not directly relate to the game which is the subject of the audit.

Furthermore, the parties will need to agree on who can conduct an audit. A publisher will at the very least require that the audit can only be conducted by a certified accountant, and may also require that he/she works on a non-contingency basis⁹⁶ and is from a particular accounting firm. The publisher wants to have some degree of approval on who the auditor may be, to ensure that the auditor is competent, has experience in the industry, and perhaps has not audited records for a competitor. This is the publisher's guarantee that the audit will be conducted in an efficient and professional manner, which should help both parties. An auditor not familiar with the industry will waste time for both parties by requesting unnecessary information.

2.2.11.2 Contesting a Statement

A publisher will insist on language limiting the time the developer has the opportunity to challenge a statement. Generally, absent fraud, the developer will only be allowed to challenge a statement within 1 or 2 years from its receipt. Afterwards, the statement is deemed final and accepted by the developer. This restriction provides a level of comfort for the publisher that it will not be required to review records from several years earlier, which may be difficult and extremely time-consuming to retrieve. In the event that it is discovered that the publisher has overpaid the developer, then either the developer will be required to return the overpaid amount or the publisher will be allowed to deduct the amount from future royalty payments, at the publisher's option.

Issues involved in contesting a statement can create further complications. If an error is obvious – perhaps it is as simple as a calculation mistake – then there is no problem about the publisher owing more money to a developer, but in most situations there may be a disagreement about calculations and whether certain deductions were permitted under the agreement. As a result, resolving the issue becomes more of a challenge. At the very least, the developer's auditors will be required to provide the



publisher with a copy of the audit report within a certain period of time, explaining the accounting discrepancies and allow the publisher to respond to the alleged errors. Many times, an explanation on how the developer's revenue share and deductions were calculated quickly leads to a resolution. Other times, the parties might still be in disagreement and will have to discuss a settlement. In the event that the parties need to settle the disagreement, the publisher will require a release from the developer stating that no additional claims will be made against the publisher regarding statements that were covered under the audit, so that future potential litigation is avoided between the parties.

2.2.11.3 Costs of Audits

The responsibility associated with the cost of the audit will be another issue within the audit provision. Generally, the cost of the audit is the responsibility of the developer conducting the audit, but the responsibility shifts to the publisher in the event that the audit shows an underpayment in the amount typically between 5 and 10%.⁹⁷ A publisher may also require that the underpayment meet a certain threshold. For example, the parties might agree that the publisher will pay for the audit in the event that an accounting mistake is 10% or more and at least \$5,000. If either of these two pre-conditions are not met then the publisher would not have to pay for the audit.

2.2.12 Publisher Commitments

In addition to the milestone payments made by the publisher to the developer, the parties may agree on additional obligations to be undertaken by the publisher. Typically, the publisher will handle the relationships and serve as the liaison with the first party console manufacturers, digital distributors and other platforms including mobile. As part of this responsibility, the publisher will test the product (QA) and also submit the game to the hardware manufacturers for certification.⁹⁸ Costs associated with submissions will generally be advanced by the publisher (unless the developer must pay additional fees for extra or accelerated submissions) and then are typically recouped from revenues earned from sales of the game.

In addition, the publisher will generally be responsible for the manufacturing, marketing and sales of the game; and when a developer enters into an agreement with a publisher this should be one of the main issues on which the developer makes its decision to choose one publisher over another, assuming there is multiple interest from various publishers. It will be the publisher's ability to deliver on distributing and marketing the game that will be significant in helping sell the game.⁹⁹

Depending on the negotiations between the parties, the developer should attempt to negotiate a marketing commitment from the publisher, especially if the parties only

enter into a distribution deal. This obligation would require the publisher to spend a certain amount of money and/or engage in certain consumer marketing and/or retail marketing events. This commitment would provide additional assurances that the game would be a high priority for the publisher, although if the publisher is spending a lot of money on development then it would be fair to assume that the publisher will already be committed to putting marketing dollars behind the game.

If the publisher was to agree to this commitment, the parties would also need to agree on when the money would be spent (i.e., within the first 6 months of the game's release) and, depending on the territorial rights granted, the parties must consider how the marketing commitment will be allocated for the different territories. Generally, the publisher will want as much freedom as possible regarding the marketing spend and will argue that based on its experience it needs the right to decide when and how dollars will be spent.

Since the publisher should be in a better position than the developer to understand market conditions, the publisher should be the party responsible for creating a marketing plan and spend for the game. The developer should defer to the publisher, but the developer should try to get approval rights or alternatively consultation rights regarding the game's marketing plans.¹⁰⁰

2.2.13 Representations and Warranties

Although representations and warranties are usually ignored by everyone except the lawyers negotiating the deal, these are significant provisions making up any agreement between parties. It is the statements included as part of the representations and warranties on which the other party relies prior to entering into an agreement. Without these assurances, the other party might not enter into an agreement because there might not be any guarantee that one party possesses the proper rights to enter into an agreement. Without the appropriate guarantees from one party, the other party would then have to assume the risk for certain matters – risks that may not be worth taking and therefore provide justification for not entering into an agreement. In addition to providing assurances to the other party, representations and warranties are significant because they will be tied to the indemnification provision (see below). An inaccuracy in a representation or warranty could lead to a breach of the agreement and eventually a termination of the deal, so it is critical that the representations and warranties provided are accurate. If a party cannot contractually guarantee certain representations and warranties then the risk may be too great for the other party, therefore ending negotiations.

Not only will the developer be required to make a number of representations and warranties, but the developer must require the publisher to make representations and warranties as well. The publisher's representations and warranties many times will



depend on the bargaining power of the parties, since most publishers will try to limit their commitments and exposure by limiting their representations and warranties.

The most important representation and warranty will be that the materials used in the game, whether content for the game or software used to develop the game, are either original, in the public domain, or licensed and do not and will not violate the rights of third parties including copyrights, trademarks, patents, rights of publicity (the right to exploit one's likeness for commercial purposes) and privacy (the right to be left alone).

When a publisher enters into a deal with the developer it needs to have assurances that the materials will not violate the rights of third parties, because a problem with the rights could result not only in legal disputes that could prove to be costly, but also a court order preventing the distribution of a game. In the event of a threatened legal action involving infringing materials, the developer will be responsible, not only for any costs to resolve the problem with the third party claiming infringement, but also for any damages (although they may be limited) incurred by the publisher through the indemnification provision.

In many situations, the publisher may take on the commitment to provide a license for material that the game is based upon or for music. In this particular situation, the developer should require a representation and warranty requesting that: the licensed materials have been properly obtained; the license as used in the game or marketing materials does not infringe the rights of third parties; and to be indemnified against any claims that may arise from the acquired licenses. Furthermore, this representation and warranty should also cover any new materials created by the publisher (excluding any materials as delivered and approved by the developer) whether for the game or for marketing materials.

While the developer will deliver materials to the publisher so the publisher can create marketing materials and perhaps packaging, if applicable, in the event that the publisher alters the materials or places them in a context which might allegedly infringe the rights of third parties, then the publisher should be held accountable. For example, if a publisher uses unlicensed music in a marketing campaign then the publisher should indemnify the developer for any claims associated with the unlicensed music, since a claim regarding the music could result in a breach of the publisher's representations and warranties.

In addition to both parties making a representation and warranty regarding the intellectual property associated with the game, each party usually will also agree to add the following reciprocal guarantees that: (i) it has the authority and is free to enter into the agreement; (ii) it is a validly existing corporation or other legal entity; (iii) it is not involved in any legal dispute that would compromise any of the rights granted or prevent it from carrying out any of its obligations; (iv) it has the capability to perform

its obligations under the terms of the agreement; and (v) it has not entered into any other agreements that would interfere with the rights granted by it.

The developer may also have to further represent and warrant that:

- (i) the game does not contain any computer code, viruses, or Trojan horses that could disrupt, harm, or impede in any manner the game or any 'Easter Eggs'¹⁰¹ which may contain lewd, pornographic or other objectionable content;
- (ii) all people associated with the game will have been paid for their services and publisher will have no obligations to compensate any parties unless otherwise agreed upon by the parties;
- (iii) all people working on the game will have performed services as a 'work for hire' or have contractually assigned all their rights in and to the work they provided for the game;
- (iv) it possesses the technical resources and abilities required to fulfil its obligations under the terms of the agreement;
- (v) it is financially sound and fiscally capable of performing its obligations; and
- (vi) will not use any free or open software that might subject any part of the code used for the game to any license obligations.¹⁰²

Certain representations and warranties can be absolute or they can be limited, depending on the bargaining power of the parties. One way in which the developer can qualify its representations and warranties is by adding the words 'to the best of their knowledge.' For example, the developer may agree to a clause that states the game software does not knowingly contain any virus. In this situation, if there is a virus unknown to the developer it precludes the publisher from claiming breach of the agreement. However, in the event that a publisher accepts limited representations and warranties, it may add a clause that the limitation on a representation and warranty does not limit the developer's obligations under its indemnification provisions.

In addition, the developer should request exclusions from certain representations and warranties including those relating to the delivery of materials provided by the publisher to the developer which would remain the responsibility of the publisher. Also, in the event that the publisher alters the materials provided by developer then those specific alterations to the materials would no longer fall under the developer's representations and warranties.

An additional representation and warranty that may be made by each party involves revenue earned from a game. Since revenue is unpredictable and royalties in some situations may be the only form of payment received by a developer, a publisher may require that language appears in the agreement that it does not guarantee what royalties will be earned, if any at all.



In fact, typically, the agreement will include language that the developer acknowledges that the sales of games are unpredictable and speculative and will need to agree that it will not make any claims against the publisher for lack of sales or more revenue that could have been earned for the game. This is important especially when the developer is relying on earning royalties based on the sales of the game.

2.2.14 Indemnification

Another provision usually only read by the lawyers, unless a problem occurs, but potentially very significant in the event of a dispute involving a third party is the indemnification clause.¹⁰³

Indemnification requires one party (the 'indemnifying party' or 'indemnitor') to defend the other party to the agreement (the 'indemnified party' or 'indemnitee') from claims brought by a third party against the indemnified party. Indemnification will not apply when the parties to an agreement are involved in a dispute but will only involve a situation whereby a third party brings a legal claim and names the indemnified party, and most likely the indemnifying party as well, in the dispute. For example, a developer represents and warrants that all the music in the game is original or properly licensed from a third party. However, a third party sues the developer and also sues the publisher since the publisher is distributing the game. Even though the publisher may not have been directly involved in obtaining the music rights which are the subject of a dispute, since the publisher is distributing the game the publisher could be in violation of the music owner's copyright, because one of a copyright holder's rights is the right to control the distribution of the copyrighted material. In this situation under the indemnification provision, the developer would take responsibility for any damages, legal fees, court costs, and settlement that the publisher might incur as a result of the pending litigation.

The indemnification clause will be tied back to the representations and warranties, since a third party lawsuit will usually be associated with a breach of a representation and warranty that all materials created and used by the developer (other than materials provided by the publisher) do not infringe the rights of third parties. This is why it is critical that the developer be aware of the representations and warranties and must also consider whether the representations and warranties should be limited in certain circumstances. Litigation can be extremely expensive and, for a small developer, the costs involved in defending a lawsuit can be substantial and an award for damages could put a developer out of business. In addition, it is critical that the developer obtain representations and warranties from the publisher as well as an obligation to indemnify the developer against any claims if it is named in a lawsuit involving a potential breach by the publisher of its representations and warranties.

The indemnification provision will not only spell out a party's obligation to indemnify the other party but it will also cover how the process works, which also could have significant ramifications for both parties. Some of the points that are usually raised in this provision include:

1. Proper notice must be provided to the indemnifying party by the indemnified party so the indemnifying party is aware of the legal action; otherwise the indemnifying party, if not named in the lawsuit, might not be aware of any potential litigation.
2. Whether the parties want to include an alleged breach to be covered under the indemnification provision or just a breach. A party may want to exclude this if it feels it may be at greater risk if it is included in the contract, although one party may argue that they should not be responsible for any costs associated with an alleged breach caused by the indemnifying party.
3. The indemnified party may want to have approval rights, not only of any type of settlement, since any settlement could potentially affect the rights of the indemnified party, but also approval of the law firm representing the indemnifying party. The indemnified party may request this additional protection since the indemnified party wants to make sure that the counsel representing the parties is competent; the indemnified party could have a lot at risk especially if there is a potential for losing distribution rights and paying damages.
4. The indemnified party may want to hire its own counsel although the indemnified party would be responsible for the costs unless it took over the defense for both parties.

2.2.15 Insurance¹⁰⁴

Because of the potential costs associated with litigation, and concerns that a developer may not have the resources to cover their indemnification obligations, publishers may require that the developer obtain Errors and Omissions insurance ('E&O').¹⁰⁵ Excluding fraud or deliberate infringement, E&O generally covers the costs involved in litigation and/or settlement associated with claims involving intellectual property issues such as copyright and trademark infringement, as well as rights of publicity and privacy.

Publishers will typically require that the developer:

- (i) maintains insurance with minimum amounts for any cause of action;
- (ii) arranges a deductible that is not higher than a certain amount;¹⁰⁶
- (iii) maintains coverage for an agreed-upon period of time;
- (iv) names the publisher as an additional insured under the policy; and
- (v) notifies the publisher at least 30 days in advance if the policy is cancelled.



In this situation, in the event that the developer has obtained E&O insurance¹⁰⁷ and a claim is made against the publisher, the insurance company would be responsible for a certain amount of the damages or settlements incurred regarding the litigation, subject to the deductible and amounts covered under the policy.

For example, the developer and the publisher are sued for an alleged copyright infringement involving materials created by the developer for the game. Under the indemnification provision, the developer would be responsible for defending the case and paying for any and all damages or settlements including those incurred by the publisher. Assume that the claim is for \$300,000 and the developer's policy covers up to \$500,000 for any single claim and \$1 million for all claims with a \$100,000 deductible. In this case, if the developer settled for \$150,000 then the developer would be responsible for paying \$100,000 which covers the deductible and the insurance company would pay the remaining \$50,000 out of the settlement. As part of the E & O policy, insurance companies will usually direct the insured party regarding the law firm that will represent the developer and may also offer advice on settling the claim, since this could be cheaper for the insurance company

2.2.16 Credits

This section in the agreement covers the attribution credits that will be given to the developer and publisher. For the developer this is a significant issue in the agreement, since credits provide recognition that is seen by other publishers as well as the consumer. The parties therefore need to negotiate where the credits will appear as well as the size of the credit subject to any limitations imposed by console manufacturers or other platform manufacturers. Credit attributions may vary depending on the relationship between the publisher and developer.

If the game is financed or owned by the publisher, the developer will want to make sure that its company logo appears at the beginning of the game on a separate screen prior to the game starting, for an agreed period of time and no less prominently than the publisher's credit. The developer will also want its logo to appear on any packaging as well as marketing materials, either no less prominently than the publisher's logo or if no publisher credit appears then at least larger than any other credit on the packaging and marketing materials. As packaging for console games become smaller to help reduce space on retailers' shelves, the real estate on the back of the packaging has become crowded as more and more companies provide software, licensing content, and even promotional opportunities. As a result, the developer will want to make sure that it receives appropriate and prominent credit for the game on packaging and marketing materials if relevant. In addition to receiving logo credit, a developer will want a guarantee that credits for the personnel and any other third party associated with the game appear in the game's credits.

For games in which the publisher is only distributing the game, the developer's credits should be more prominent than the publisher's, although depending on the publisher's prestige it could be very beneficial for the developer to also have the publisher's logo appear as prominently since it could bring additional credibility to the game.

2.2.17 Termination for Cause and Convenience: Remedies

Another major section in an agreement will involve the consequences of a party failing to cure a material breach of the agreement. This section will spell out the obligations as well as the remedies that may be triggered in the event of a breach of the agreement by either party. In this situation, the breaching party fails to perform one of its contractual obligations under the agreement, thereby allowing the other party the right to end the relationship. Because termination can result in major consequences for both parties, each party will attempt to limit the grounds for termination and request the opportunity to cure any breach.

The most common grounds for material breach by the developer typically include:

1. failure to deliver an approved deliverable;
2. failure to submit a deliverable on time;
3. a breach of a representation and warranty; and
4. bankruptcy.¹⁰⁸

For the publisher, possible grounds for the developer to terminate the agreement could include:

1. failure to pay any advances, guarantees or royalties when owed;
2. failure to issue statements;
3. a breach of a representation or warranty;
4. failure to fulfill any obligations; and
5. bankruptcy.

In order for a party to claim breach, the non-breaching party must first provide notice of the breach and in the event that the accused breaching party fails to cure within a certain period of time then that party will be deemed in breach. Cure periods may vary depending on the type of breach. For example, failure to deliver a milestone or failure by the publisher to pay for a milestone may have a shorter cure period compared to other breaches, such as a breach involving a representations and warranty which may require more time to cure. Furthermore, cure periods may be based on business days or calendar days. In some situations such as bankruptcy, a breach may not allow for a cure period because of the type of breach that has occurred and no matter what the cure period the breach cannot be cured.

In the event of an uncured material breach, the non-breaching party will have the right to terminate the agreement and potentially sue for damages. Depending on the



breaching party and the type of breach, the remedies will vary. The most serious breach that the developer could cause would be its failure to deliver the milestones pursuant to the delivery schedule. In the event that the developer is unable to submit an acceptable deliverable on time, then unless the parties revise the deliverable schedule the publisher will terminate the agreement and seek the return of any advances paid, and, depending on the stage of development, may request access to the underlying source code to provide an opportunity for the publisher to consider hiring a third party developer to attempt to complete the game.

In some situations, the publisher will insist that the code developed during the making of the game be either delivered to the publisher or placed in an escrow account in case the publisher needs to access the code to finish the game if the developer breaches the agreement. On paper this may appear to be a possible solution, but the developer may be reluctant to provide code to either a publisher or third party, since the code could be considered a trade secret. In addition, depending on the type of game and the complexities associated with the source code, it might be unrealistic to assume that the publisher or third party could understand the code to be able to finish the game.

In situations where the publisher has invested in the development of the game, then the publisher will insist on language that prohibits the developer from seeking injunctive relief in the event of a material breach by the publisher. Because a publisher has invested money to create the game, it does not want to be in a situation where its investment is at risk because of a material breach that could result in the game being pulled from distribution. As a result, language may appear in the agreement that states that in the event of a material breach by the publisher, the developer's only remedy will be monetary damages.

A major clause tied to termination and the remedies provision will be a limitation of liability associated with the type of damages that may be awarded to a non-breaching party as well as the amounts that a non-breaching party may claim. Because of the severity of limiting a party's rights, the language will appear in bold and also in capital letters, highlighting its significance.

Language in this section will typically state that damages would not include consequential (i.e., loss profits), specific and punitive (i.e., damages awarded as punishment for the actions of the breaching party to serve as a deterrent for future activities). In addition, the parties may set limits on the total amount of damages. The publisher will generally request a limit on the amount of monies paid to the developer and the developer may seek to limit damages based on monies received.

The limitation of liability is usually not absolute and the parties typically will carve out exceptions to the limits. In most agreements, the limitation will generally not cover breaches of the confidentiality provision, either party's obligations under the

indemnification clause and gross negligence. A breach of confidentiality could reveal trade secrets of a party, which may exceed the value of any damages received by the non-breaching party. In addition, a non-breaching party does not want to be responsible for possible damages for any awards or settlements under the indemnification provision that exceed any cap under the limitation of liability.

Because of the risks and uncertainties of development, the publisher may want to have the right to terminate the agreement at will (typically referred to as termination for convenience). In this situation, the publisher may feel that the game will not turn out the way it was originally envisioned, even though the developer has delivered pursuant to the design document and milestone schedule, and on time. A design concept for a game may satisfy all the parties before work begins, but when executed it may be different from what the publisher had hoped for the game. The publisher may feel that additional monies paid for development and eventually manufacturing, sales, and distribution, as well as lost business opportunities because of a shift in resources, would not justify the continued investment in the game. As a result, termination for convenience allows for the publisher to stop development of the game and will involve a one-time final fee to the developer. This fee represents a 'kill fee' and is a predetermined sum to be paid by the publisher to the developer at the time that the publisher elects to terminate the agreement. Usually, the developer will be allowed to keep any monies it has received for development and would also be entitled to receive the amount of monies owed for the current milestone the developer was working on when the publisher elected to terminate the agreement. In some agreements, the 'kill fee' payment may involve additional payments including possibly additional milestone payments. Furthermore, in this situation, the developer should try to retain the source code, even if the agreement originally stated that the code would be owned by the publisher, and should request that all rights in and to the game revert back to the developer so that the developer can try to find another publisher to publish the game. In the event that the publisher were to agree to a reversion of rights it might insist that if the developer enters into an agreement with another publisher then it would be entitled to some form of compensation to cover its previous costs in the development of the game.

2.2.18 Governing Law and Jurisdiction

One aspect in particular which is often overlooked in a contract, but which is critical to the entire document, is the governing law and jurisdiction clause. This will specify which country's law will govern the interpretation of the contract (such as, for example, Chinese law or French law) and separately which country will have jurisdiction over the contract. It is common for the same country to have the governing law and jurisdiction (e.g. 'French law and jurisdiction') but this is not universal: some businesses may prefer to have the governing law and/or jurisdiction



of the contract as a neutral venue. For example, it is quite common in the business world generally for business contracts to specify English law and/or jurisdiction, since the UK is considered a neutral jurisdiction with a well-regarded legal system. In practice, governing law and jurisdiction is often a matter of bargaining power and the stronger party will specify terms most favorable to it.

When drafting governing law and jurisdiction clauses, it is important to be precise as to which countries or regions are being used in the governing law and jurisdiction clause. For example, 'American law' has no meaning – instead one must use the appropriate US State (California and Washington state law are by far the most frequently used jurisdictions in Western games industry contracts, since the states contain a great many video games companies). Similarly, 'UK law' means little (one must specify English, Scottish or Northern Irish law), nor would 'Cyprus law' (since there are two different Cypriot republics).

2.2.19 Dispute Resolution

Linked closely to the question of which country or countries will govern the interpretation and enforcement of the contract is the question of how any disputes between the parties shall be resolved. The most common approach is for any dispute to be resolved by the courts of the governing country (either on an exclusive or non-exclusive basis).

However, some parties may prefer to specify alternative dispute resolution mechanisms. One partial alternative is to require the parties to have an informal resolution process (for example, the respective CEOs or other officers negotiating for a period of time). Or they may require that the parties engage in a formal mediation process involving a specialist mediator. In both cases though, the final resort is usually to have recourse to the courts.

A complete alternative is arbitration. Very simply, arbitration is a dispute resolution process in which the parties can choose everything about how to resolve the dispute: who will adjudicate it (and there can be multiple arbitrators), where, under which law and rules, when and so forth. Most importantly, arbitration is usually confidential (whereas court proceedings are public). Arbitration can therefore provide a useful alternative to litigation. However, neither arbitration nor litigation is 'better' than the other: which option is chosen depends very much on the deal in question and the attitude of the parties to the issue.

One final note worth bearing in mind is that having a good governing law and jurisdiction clause and dispute resolution process is all well and good, but ultimately if there is a problem between the parties then the victorious party will need to enforce its claims against the defeated party. Sometimes this may be straightforward if the defeated party is able to pay a damages claim, but if it cannot or if it refuses, then

the victorious party can face a distasteful choice between trying to enforce its claim against the assets of the other party (which may even involve having to go overseas to foreign courts with possibly substantial costs of time and money) or writing off some or all of its claim.

Consequently, running through all of the risk allocation, governing law and dispute resolution sections of the contract is the need to be aware of the financial strengths of the parties and the locations of their resources, since it will be a material factor in how the parties approach all of these clauses.

2.2.20 Additional Provisions

The publishing agreement will also include 'boilerplate' language, as outlined in Chapter 11, and a confidentiality section even though the parties may have already signed a separate confidentiality agreement. The confidentiality provision will reiterate the language in the signed document but is included again in the agreement if the parties have not signed a non-disclosure agreement (NDA).

2.2.21 A Changing Role

Since the introduction of next-generation platforms, publishers have played a significant role in the industry by financing and publishing games as well as building relationships with retailers and creating the infrastructure to take a game from concept to retail. But that role is changing with the growing importance of alternative ways in which consumers can play games and increased opportunities that allow for independent developers to deal directly with digital and mobile distributors, thereby reducing their reliance on publishers. How much that role will change will depend on the success independent developers have in financing, marketing, and distributing their products. In the meantime, while the role of publishers may not be as significant for the developer community as in years past, they still will continue to play an important role in the industry financing and publishing projects, especially for higher end titles.



2.3 SCENARIO 1: Questions for the Developer when the Publisher Owns the IP to the Game

| Questions for the Developer when the Publisher Owns the IP to the Game | |
|--|---|
| I. Technology | |
| 1. | Who will own the new technology and code created by the developer? |
| 2. | If the code is owned by the publisher, will the developer have the right to use it for other projects? Will there be any restrictions on the developer's use? |
| 3. | If the publisher is allowed to use code owned by the developer in subsequent products, will the developer be entitled to a royalty? |
| 4. | If the developer owns the new code or technology, will there be any restrictions placed on the developer? |
| II. Delivery of Materials | |
| 1. | Is it clear, based on the milestone schedule, what the publisher is requesting for each milestone deliverable? |
| 2. | If the milestone schedule is revised, will the developer be required to do more work? How will the developer be compensated and how will it affect the delivery schedule? |
| 3. | Is the acceptance/rejection procedure clearly spelled out? |
| 4. | What happens if a deliverable is rejected? |
| 5. | If a deliverable is rejected, will the developer receive any money for the milestone? |
| 6. | How much involvement will the publisher have in overseeing the development of the game? |
| 7. | What happens if there is a disagreement regarding the direction of the development of the game? Will the publisher have the right to terminate? |
| III. Payment | |
| 1. | How will milestone payments be determined? |
| 2. | How will royalties be determined? |
| 3. | What costs will be deducted from gross revenues before the developer is entitled to any royalties? |
| 4. | Will deductions be made from gross revenue or from developer's revenue share? |
| 5. | How and when will the publisher report to the developer on sales of the game? |
| 6. | Will the developer have the right to audit statements? |
| IV. Future Projects, Product Support, and Non-Compete | |
| 1. | Will the developer be allowed the opportunity to work on future projects based on the game? If so, what would be the process to allow the developer to work on the project? |
| 2. | What type of support will the publisher request after the game is finalized? Will the developer need to work on updates, additional content? |
| 3. | Will there be any non-complete clauses limiting the developer's ability to work on similar games for a certain period of time? |

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| V. Representations, Warranties and Indemnification |
| 1. What assurances will each party need to make to the other party under the representations and warranties? |
| 2. Do representations and warranties have to be absolute or can there be exceptions? |
| 3. What responsibilities will the developer have to undertake as part of its indemnification commitment? |
| 4. If the developer is sued because of a breach of a representation or warranty, will the developer be able to control the defense? |
| 5. Will the developer be required to carry E&O insurance? Even if not required, should the developer obtain E&O insurance? |
| 6. Should the developer obtain insurance coverage against possible patent claims? |
| 7. Can the developer's E&O insurance fall under the publisher's policy? |
| VI. Credit |
| 1. What type of credit will the developer receive? Will the developer's logo and name appear on packaging, and if so, where? |
| 2. Will developer's logo appear in the game? Marketing materials? |
| 3. How big will the developer's credit appear on materials? |
| VII. Termination |
| 1. What grounds will either party have in the right to terminate the agreement because of breach? |
| 2. What actions or failure to act will be considered material breaches in the agreement? |
| 3. Will there be a right to cure and how long will the cure period be in the event of a breach of the agreement? |
| 4. What happens if the publisher claims breach and there is a dispute whether a breach has occurred or not? |
| 5. What happens in the event of a breach? What are the remedies? |
| 6. Who owns the IP if the publisher breaches? |
| 7. Will the publisher be permitted to terminate without cause prior to the game being completed? If so, what obligations will the publisher have to the developer? |
| 8. In the event of a dispute that cannot be resolved among the parties, how does the dispute get resolved and where does it get resolved? Will the parties have to go to court or is there an arbitration option? |
| 9. Will the parties be entitled to recover legal fees if there is a dispute? |
| 10. Can either party limit its liability if a claim is made by the other party? If so, how will the number be determined? |



2.4 SCENARIO 2: Questions for a Distribution Agreement Only

| Questions for a Distribution Agreement Only | |
|--|--|
| I. Considering a Publisher | |
| 1. | Why consider working with a publisher? |
| 2. | What services can the publisher provide? |
| 3. | How good are the publisher's relationships with first parties? |
| 4. | What is the publisher's history of working with other developers in distributing products? |
| 5. | Do the developer and publisher have common strategies regarding the release and marketing of the game? |
| II. Grant of Rights | |
| 1. | What rights is the developer granting to the publisher (i.e., platforms, territory and term)? |
| 2. | What happens if the publisher fails to release the game in a particular country/region? |
| 3. | Who will control digital distribution rights? |
| 4. | What approval rights will developer have regarding the distribution and marketing of the game? |
| 5. | What happens if there is a disagreement regarding the publisher's decisions? Whose decision is final? |
| III. Obligations of the Parties; Delivery | |
| 1. | What will the developer be required to deliver to the publisher, and when? |
| 2. | What languages will the game be localized in and what elements will be localized? |
| 3. | What happens if there is a problem with the delivery of the game? |
| 4. | What happens if the delivery is late? Will a delayed delivery affect the publisher's payment obligations? |
| 5. | What are the publisher's obligations? |
| 6. | Who will be responsible for marketing? Will there be a certain amount of money required to be spent on marketing? |
| 7. | Which party will be responsible for ratings and testing? |
| 8. | Who controls the inventory? |
| 9. | What information will be required to be provided by the publisher when submitting a sales and marketing plan? When would the plans need to be delivered? |
| 10. | What happens if the publisher fails to release a game in a territory? |
| IV. Consideration | |
| 1. | Is the publisher paying an advance or guarantee for the rights? If so, when are these payment made? |
| 2. | Will a certain metacritic score for a game trigger a bonus for the developer or decrease the guarantee for the developer? |
| 3. | What is the fee that the publisher will receive for providing its services? |

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|--|
| 4. What costs will be fronted by the publisher? |
| 5. What costs will the publisher be allowed to deduct before remitting monies to the developer? Will there be caps on deductions? |
| 6. What will be the order of deductions taken? |
| 7. What happens if the publisher is unable to recoup its costs? |
| 8. When will statements along with payment need to be made to the developer? |
| 9. What information will be included in each statement? |
| 10. What rights will the developer have regarding audits? |
| V. Representations, Warranties and Indemnification |
| 1. What assurances will each party need to make to the other party under the representations and warranties? |
| 2. What responsibilities will each party have to undertake as part of their indemnification commitment? |
| 3. Do representations and warranties have to be absolute or can there be exceptions? |
| VI. Credit |
| 1. Will the developer receive a credit and where will it appear? |
| VII. Termination |
| 1. What grounds will either party have in the right to terminate the agreement because of breach? |
| 2. Will there be a right to cure and how long will the cure period be? Will cure periods vary depending on the breach? |
| 3. What happens in the event of a breach? What are the remedies? |
| 4. In the event of a dispute that cannot be resolved among the parties, how does the dispute get resolved? Where does it get resolved? Will the parties have to go to court or is there an arbitration option? |
| 5. Will the parties be entitled to recover legal fees if there is a dispute? |
| 6. Can either party limit liability if a claim is made? If so, what limits will be allowed? |



2.5 SCENARIO 3: Publisher Helps Finance a Game Based on Developer's Concept

| Publisher Helps Finance a Game Based on Developer's Concept | |
|---|---|
| I. Grant of Rights | |
| 1. | Who owns the rights to the game? And to the underlying code and technology used to create the game? |
| 2. | If the developer owns the IP, what rights will be granted regarding platforms, term and territory? |
| 3. | Will the publisher sub-license rights? In the event, the publisher sub-licenses, how will this affect the economics of the deal? |
| II. Derivative Works | |
| 1. | What business terms will be considered if the rights of first negotiation and last refusal are included are in the agreement? |
| 2. | Are there certain requirements that trigger a right of first negotiation and last refusal? |
| III. Other Issues | |
| 1. | Publisher considerations, delivery, milestone schedules, obligations, representations and warranties, payment, credit, payment, credits and termination: See above scenarios. |

CHAPTER 3

INTELLECTUAL PROPERTY IN THE VIDEOGAME INDUSTRY¹⁰⁹

3.1 The Importance of Intellectual Property

Intellectual property (IP) is the most important branch of law for videogame developers and publishers to understand. IP is a vital element of videogame development contracts, employment agreements, distribution, advertising and every license in the game industry. As houses are made from wood and stone, videogames are made almost exclusively from IP.

Intellectual property laws are about protecting developers and their creative work. These laws protect the developer from pirates and competitors that want to take a game work and use it without any compensation.

What does someone buy when they buy a game? In the old days before digital distribution, there were retail computer and video game stores. People would actually drive or walk down to a physical building called a video game store. They bought a box with a manual and a CD made from less than five dollars' worth of material. How, then, could people be persuaded to pay sixty or seventy dollars for a product we call a 'game?' People are persuaded, even eager, because they are really buying a larger entertainment experience beyond the physical goods. This experience is legally enjoyed by consumers through a limited license to the IP. The game code, manual text, box art, title, game art, music, story, game world, middleware and graphics are all IP.

As we venture into the next generation of game consoles with an increasing number of major platforms including social, tablet, and mobile, more money than ever will be put into game development. This has been the trend since the start of the game industry and will likely continue into later generations. Game development budgets for many large titles already meet or exceed film budgets in terms of years in production and total expenditure.¹¹⁰ As a result of this trend, protecting that ever growing capital investment from competitors and pirates is becoming increasingly important. Of equal importance is harnessing the IP in a game for maximum value in order to recoup costs and generate profits. As simplistic as these statements are, the questions and strategies generated by them are immediately more complex.

IP is an emotionally charged issue in the software community generally and the game development community in particular. Many people are in favor of open source initiatives and are against software patents, patents in general, or even intellectual property in general. These points of view are clearly influential and hotly debated at the highest public policy and legislative levels throughout the world. Still, as an



educational and reference tool, this chapter serves as a guide to what the legal issues currently *are*, not how they might eventually evolve or how they *should* be.

Putting all disputes aside, everyone agrees that there is room for improvement in the IP system and that the system is evolving. In addition, the current system is complex. Competitors are sophisticated and will try to use the IP system against your company. For this reason alone, it is important to understand the current IP legal framework, at the domestic, regional and international levels.¹¹¹

Given the complexity of IP laws at the international level, this chapter focuses on US law by way of example and insight into the regulation of the video game industry. Where possible, European and other country perspectives are provided. It is herein stressed that, due the cross-cutting nature of video games, a number of questions and challenges exist, especially in terms of IP. In relation to copyright, although Article 2 of the Berne Convention provides a solid basis for eligibility for protection of video games by copyright, they are in fact ‘complex works of authorship, potentially composed of multiple copyrighted works.’¹¹²

In an effort to get started summarizing these concepts and as a preview for the remainder of the chapter, Table 3 (below) lists examples from a game project and the type of IP law used to protect each component.

Table 3: Game Project and IP Law

| Copyright | Trade Secret | Trademark | Patent |
|---|--|--|--|
| <ul style="list-style-type: none">• Music• Code• Story• Characters• Art• Box design• Website design | <ul style="list-style-type: none">• Customer mailing lists• Pricing information• Publisher’s contacts• Middleware contacts• Developer’s contacts• In-house development tools• Deal terms | <ul style="list-style-type: none">• Company Name• Company Logo• Game Title• Game Subtitle• Identifiable ‘catch phrases’ associated with the game or company. | <ul style="list-style-type: none">• Inventive game play or game design elements• Technical innovations such as elements in software, networking or database design• Hardware technical innovations |

3.1.1 Copyright

Copyright is arguably the most important IP protection for most game companies. Generally speaking, copyright protects the fixed expression of ideas, and easily qualifies as the best tool for protecting game property because of its ease of use, power, and versatility.

Similar to patents, copyright is an area of law that has its roots in the US through the Constitution, although copyright legislation goes back even further to 1709 and England's Statute of Queen Anne. In the US Constitution, copyright law derives from the same section as patent rights. Article I, Section 8, Clause 8 provides that Congress shall have the power: 'To promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.' The 'writings' language is the focus to derive the power of Congress to make laws for copyright. Another critical element of the sentence above is the phrase that copyright is meant to protect these writings for 'limited times'. In the EU, Member States have similar protections for expressions fixed in a medium for a limited time, primarily under their domestic legal regimes, though it has also been provided for at the EU level (which is very roughly analogous to the 'federal' level in the US) by a range of EU legislation including the Treaty on European Union (one of the EU constitutional documents) as well as primary legislation including the Copyright Directive and the Copyright Duration Directive. As a result, while it is possible to talk about copyright law across in the EU in general terms, there are often differences between countries (especially the common law and civil law countries, such as the United Kingdom or Ireland on one side and France or Germany on the other) so this chapter provides only a general overview of EU copyright law and its comparison with US law.¹¹³

3.1.1.1 What Can Be Protected By Copyright?

In the US, eight categories of works are eligible for copyright protection. These are listed in the statute 17 USC 102(a). They are: literary works; musical works including any accompanying words; dramatic works including any accompanying music; pantomimes and choreographic works; pictorial, graphic and sculptural works; motion pictures and other audiovisual works; sound recordings; and architectural works.¹¹⁴

Interactive entertainment is protected as either an 'other audiovisual work' or, perhaps surprisingly to some, as a 'literary work.' Practicing attorneys often discuss which is more appropriate, but filings using either designation are common. Games are not unusual in this way, as other creative endeavours also fall into more than one category. The only time this is important is for the registration of copyright. Registration under the literary work category may seem strange for a computer program, but literary works are defined in Section 101 of that statute to include works expressed in 'words, numbers or other verbal or numerical symbols or indicia, regardless of the nature of the material objects such as books, periodicals, manuscripts, phonorecords, film, tapes, disks, or cards, in which they are embodied.' Clearly the source code is a collection of words, numbers, and symbols, stored on some media.¹¹⁵



As far as video games are concerned, copyright covers stories, characters, music, graphics, in certain instances imagined environments and geographic locations,¹¹⁶ and even the software source code itself. Moreover, it also protects the entire game as registered under the category of audiovisual or literary work. A critical, but often misunderstood aspect is that copyright protects the *expression* of ideas, not the *ideas* themselves. This leads to two consequences. First, no game ideas are protected by copyright until they are fixed into some expressive medium (like code or print or a saved art file). Secondly, similar ideas expressed in different ways are allowable with copyright. Determining infringement in copyright requires comparing the fixed expression in the copyrighted game to the fixed expression of the accused infringer. With the rise of short development cycles in social and mobile, this comparison is more of a problem than ever, but game industry copyright cases have been with us since the beginning. There were copyright cases involving arcade machines and Atari before Facebook and Apple.¹¹⁷

The position in the EU is essentially the same, in terms of the split of copyright into categories of work, the need for works to be fixed in a medium and the classification of interactive entertainment primarily as a literary work.

3.1.1.2 What Rights Are Conferred by Copyright?

Another counter-intuitive element of copyright is that it is not the right to do anything; instead, copyright is a negative right. It does not grant the holder the right to reproduce a work, but rather it grants the holder the right to authorize others to reproduce a work or prevent them from doing so. The rights specifically stated in the US statute (and in EU law) are the rights to: make copies, make derivative works, distribute, public performance and public display.¹¹⁸

Copyright is also easy to invoke. Copyright comes into being as soon as an original work is fixed in a tangible medium. As soon as plans are drawn or code is written, copyright is present. In contrast, patents and trademarks have important and complex application processes with registration fees and trade secrets require that certain steps be followed within the company, and constant vigilance to protect the secrets. Even though registration is not necessary to invoke copyright, it is still a good idea for most works because it changes damage calculations and is necessary to bring a litigation.

In the EU, generally speaking there is no registration requirement for copyright works: copyright in a work exists as soon as the work has been fixed in a medium and there is no legal or practical requirement to register with a national regulator (this is also the practice in most other countries which have signed the Berne Convention). Some countries, such as France or Spain, offer a voluntary registration system¹¹⁹ (which then provides a rebuttable presumption of ownership of the copyright work).

3.1.1.3 Some Examples of Copyrights

One key element of copyright is that the definition of art is surprisingly broad beyond the most minimal standards of original expression. From Botticelli paintings to *Breakout*, all fixed original creations can be protected by copyright. Early game industry litigations did fight over whether or not games were protectable with copyright, but eventually as games grew in complexity those issues were resolved in favor of copyright protection.

The game *Breakout* is an interesting example, because that game was the subject of a series of cases surrounding the minimal level of creativity necessary for copyright. Atari tried at least twice to register the game for copyright, but registration was initially rejected because of the simplicity of the artistic display in the game. *Breakout* was merely a rectangular object moving in one plane that reflected a small ball into a multicolored wall of rectangles. The ball eliminated a portion of the wall of rectangles and rebounded toward the bottom of the screen, where the player attempted to move the lower rectangle to redirect the ball back toward the wall of rectangles. Atari had to fight a series of cases over the application rejection from 1989 to 1992, eventually winning the fight.¹²⁰ This series of cases is important, not only to game IP, but to copyright in general. Those cases stand for the proposition that courts or the Register of Copyright will not judge the creativity or artistic quality in copyright. Any original fixed work in a tangible medium is protected.

Copyright is also the main claim for games accused of cloning. In recent years, many cases of cloning have been filed. One example from 2012 was *Spry Fox vs. 6Waves* over cloning *Triple Town* with *Yeti Town*. This resulted in settlement where *Yeti Town* was handed over to Spry Fox.¹²¹ Zynga has been involved in multiple cloning cases since the start of its company. As sophistication grows and development costs for social and mobile remain relatively low, cloning is occurring more frequently. Still, this is not a new phenomenon in the game industry. In the early 1980s Atari was involved in litigation over its *Pac-Man* IP against a Phillips game entitled *K.C. Munchkin*.¹²²

3.1.1.4 US Copyright Filing Information

Although any work is copyrighted as soon as it comes into existence, you can also register the copyright for additional rights in the US.¹²³ Copyright registration is absolutely necessary to litigate over copyright infringement and an early registration usually yields a better damage calculation. As a consequence, it is also prudent to register copyright before even writing a 'cease and desist' letter to potential infringers. Balancing all the factors, the registration is so inexpensive, easy, and necessary for real legal teeth that the cost and effort necessary for the federal registration are easily worth it.



3.1.1.4.1 Process and Cost

The form required to register a copyright is only a few pages long and the cost is approximately US\$45. The Copyright Office has detailed instructions and information on completing the forms as well as contact information for questions. Of the forms of IP that benefit from registration, this is the easiest and cheapest process.

3.1.1.4.2 Length of Copyright Protection

The length of copyright is another element that makes it attractive for game developers. Copyright is long, not immortal like trademark, but long enough to outlive creators. At different times, copyright has varied in length, and the history of copyright contains enough different lengths for such protection to warrant further consideration. Luckily for computer games, in the US, the length of copyright for works created after 1978 can easily be remembered as 95 years after publication or 120 years after creation for corporate creations. For personal creations, it is the life of the author plus 70 years.¹²⁴ In the EU, generally it is 70 years after publication or corporate creation or, for personal creations, the life of the author plus 70 years. This means that no one can copy the original *Pac-Man* until about 2100. This also means that derivative works require a license until that time expires as well. For *Pac-Man* this means that cartoons, board games, clothing, or re-creating that yummy *Pac-Man* cereal are not allowed without the appropriate legal permissions. Around the year 2100, people can go wild and cover the planet with copies and derivative works after the original game falls into the public domain.

Consider how length affects what is possible for copyright. The length of protection is intimately tied to potential revenue generation. Game developers can use copyright to protect their ideas, build new games, and sell related products for a century. Copyright in a property can literally be developed and exploited over generations. Mickey Mouse, *Star Wars*, and Superman are excellent examples of this. These IP examples have existed for decades and have been exploited across multiple media, including games.

For a period, the game industry believed that ever-increasing technological sophistication and graphical presentation were key to high-revenue-generating games. Successful social and mobile games like *Farmville* and *Angry Birds* now confirm that simple, even 2D, games can achieve eight and nine figure revenues.¹²⁵ These games will likely remain popular to some degree over a much longer lifecycle than originally anticipated.

3.1.1.4.3 Protecting Copyright

The most basic step in dealing with copyright infringement is to send out a 'cease and desist' letter. This letter simply explains that you own the copyrighted material, the

material is registered, and that the other party is using the material without a license. The letter usually goes on to explain the penalties for infringement and demands the other party 'cease and desist' from using the material. If the infringement is online, a similar letter or DMCA (in the USA) or E-Commerce Directive (in the EU) take-down notice can be sent to the other party's ISP. Most ISPs do not want the potential liability for hosting copyright infringing material. This letter to the infringer and/or his ISP is often enough to stop an infringer. In any event, this process should be managed by, and the letters should come from, an attorney.

3.1.1.4.4 *Penalties for Infringement*

Heavy potential punishment is a necessary part of any substantial IP protection and copyright has it. Punishment for copyright infringement allows game developers to prevent infringing parties from selling works that include the developer's copyrighted work. In those legal jurisdictions that permit it, developers can also sue for damages and profits equal to the profits the infringing parties made from selling the illegal works. Furthermore, willful copyright infringement carries a statutory penalty of up to US\$150,000 per work infringed in the US.

In a typical copyright law suit filed in June 2004, Midway brought a case against Sony Ericsson for violating its copyright on the game *Defender* from 1980.¹²⁶ Midway claimed that Ericsson was using the game on its mobile phones without permission. Midway requested that the court award damages and reimbursement of its legal fees and require Sony Ericsson to turn over all mobile phones, software, and other materials in its possession related to the alleged copyright violation. The case was settled out of court and dismissed a few months later, but still serves as an excellent example of what remedies can be requested in copyright cases.

There are also potential criminal penalties that can result in prison time, when people are caught violating copyright by selling or distributing games over the internet, under 17 USC. § 506(a) and 18 USC. § 2319. An instance of this came to light in February of 2004 when Sean Michael Breen, leader of the Razor1911 Warez group, received a four-year prison sentence and was ordered to pay nearly \$700,000 in damages for copyright infringement. He was one of 40 people arrested in a sting operation by the US Customs Service 'Operation Buccaneer.'¹²⁷ An example of appropriate punishment surfaced in early 2006 when Yonatan Cohen was convicted of criminal copyright infringement in Minnesota for making a game console that included unlicensed Nintendo games. He was sentenced to five years in prison, lost hundreds of thousands of dollars in cash and property, and was deported to Israel. His punishment included using his own resources to pay for advertisements in game magazines warning about the penalties for copyright violation. The advertisements had his picture in the center, a picture of his copyright violating device, a description of his punishment, and a caption that read: 'This ad was paid for by Yonatan Cohen as



part of his restitution to warn other about the dangers and penalties associated with violating the copyrights laws.'

In the EU, copyright infringement can carry both civil and – in serious cases – criminal penalties. For example, Nintendo has also taken legal action across the EU against unauthorized software and hardware.¹²⁸ However, generally there is no principle of statutory or punitive damages in civil copyright infringement lawsuits, so typically damages can be substantially less in the EU than in the US.

3.1.1.5 Derivative Works

The idea of a 'derivative work' is critically important in the way copyright is used in the game industry. A derivative work is a new work derived from an existing copyrighted work. The language of the US statute defines a derivative work as a work that 'is based upon one or more pre-existing works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgement, condensation, or any other form in which a work may be recast, transformed, or adapted.'

What does it mean when you read that a company has acquired 'the rights' to make a game based on a film? In the copyright sense, this means that game company has acquired the right to make a derivative work of the film. This is how films are made from games as well. *Doom* the movie was a derivative work created from *Doom* the game. The same concept works in reverse as well. *Shrek* was first a film and then a derivative work was created, turning the copyrighted material in the film into a game. It is easy to imagine that this process gets complex quickly. Consider the world described in *The Lord of the Rings*, a series of books by J. R. R. Tolkien. The entity that controls the copyright to this world has granted a copyright license to make derivative works for board games, computer games, films, and replica weapons; all of those products are derivative works that also have their own copyright. Any material in a derivative work that is not contained in the underlying work is copyrightable as a new work. Furthermore, this new material may even be licensable itself!

Continuing with *The Lord of the Rings* example, this property offers a fascinating derivative works case study in the game industry. Starting in 2001, Electronic Arts (EA) had developed games including the first *Battle for Middle Earth* game based on a license from the Peter Jackson films. This meant that the games from EA could only produce game content, or a derivative work, that came from the Jackson films. In 2005, while creating the *Battle for Middle Earth* sequel and other *Rings* games, EA acquired a license to produce a game based on the entire world of fiction as described in the Tolkien books. This license to make derivative works based on the books opened up a great deal of new territory for creativity. Here EA was licensing a

subset of material from one derivative work and later went on to acquire a license in the entire base of material.

3.1.1.6 The Public Domain

What happens to copyrighted works after the protection expires, and how does that affect game copyrights specifically? The short answer is that formerly protected work that loses its IP protection passes into the public domain. This is a particularly exciting idea because anyone, even game developers, can use material in the public domain to create new works. As a rule of thumb, the older a work is the more likely it is to safely be in the public domain. Law professor Laura Gasaway has produced a chart which is one of the most cited tables for determining the expiration of copyright. The Gasaway chart and another one from Cornell are referenced in Table 4 (below), which shows a greatly simplified set of rules for determining when a work passes into the public domain.

Table 4: The Gasaway Chart

| **Is the Work in the Public Domain? | |
|--|---|
| Before 1923 | Public Domain |
| 1923-March 1989 | Depends if the work was published with a notice of copyright registration and if the registration was renewed. |
| After March 1989 | Under copyright for 70 years after death of author, or if work of corporate authorship, the shorter of 95 years from publication, or 120 years from creation. |

**For US works only. More thorough charts can be found through UNC-Chapel Hill or Cornell.
<http://copyright.cornell.edu/resources/publicdomain.cfm>
www.unc.edu/~uncclng/public-d.htm

Before making any final decision, it is prudent to check with IP counsel before using works assumed to be in the public domain. Particular caution should be used for works created outside of the US or works created in the US between 1923 and 1989. There may also be special circumstances surrounding a particular work that limit its use in a game. A common example of these special circumstances is when public domain works have been previously used to create new works. As discussed above, these new works are derivative works. They have their own new IP protection for the new elements contained within them, but the underlying public domain works remain in the public domain.

The story of Robin Hood is an excellent example of a special public domain situation, because the story is so old it is practically a fairy tale; there may have been someone that performed similar feats in medieval England, but the myriad stories do appear somewhat exaggerated. It is also true that there have been countless books and movies using the Robin Hood story. There have also been several videogames based



on Robin Hood, his merry men, the Sheriff of Nottingham and Maid Marian. The main point here is that the underlying story and characters are part of the public domain, but when creating new stories using this inspiration, developers should be careful not to infringe on modern works that still have copyright protection. The license-hungry game developer should be encouraged by a secondary point implicit here: there are many popular stories and characters now available for free game development, including much of the great art and literature from the 19th century and earlier.

Another important example of the public domain comes in the form of myths, history, and cultural lore. Anyone can use these as familiar settings to build games because they are so old and their authorship is collective and forgotten.

Before the trademark dispute and subsequent cancellation of the Microsoft project *Mythica*, the game was going to use the place named Muspellheim. *Dark Age of Camelot* also uses the name Muspellheim. They can both do this because Muspellheim is a place from Norse mythology which both used as a setting for their games. That story is not under copyright protection because the author or authors of those myths have been dead for centuries. This is similar to using 'Mount Olympus' or 'Hell' as a setting in a game. On the other hand, using 'The Death Star' or 'Tatooine' for game development names would be an entirely different case because these places (imagined environments and geographic locations), as story elements, are the intellectual property of the *Star Wars* universe. These names were created recently by an author and are protected by copyright as story elements. Even though they are such a pervasive part of our cultural consciousness and even more well-known than Muspellheim, they cannot be used in games without permission because the stories they are part of are still protected by copyright. Any use of these names in new and similar stories would contribute to a finding of copyright infringement.

Historical events are also not subject to copyright, but the stories created out of them are. An example is World War II, a fertile area for game development in the last five years. No one can copyright the specific events of that or any time period. *Battlefield 1942*, *Call of Duty*, and *Medal of Honor* can both use tanks, weapons and uniforms that are historically accurate. Furthermore, they are not infringing each other's copyright because the games are merely representing historical facts.¹²⁹

It is important to remember that copying a story inspired by historical facts is still copyright infringement, but merely copying the historical facts is not. For instance, a developer cannot make a game based on the movie *Saving Private Ryan* without the appropriate license. A developer can however, make a game about Pearl Harbor or other WWII events as long as she or he is creating the game around the historical event and not the movie of the same name.

3.1.1.7 Scènes à faire Doctrine

The *Scènes à faire* doctrine is similar to public domain property. This doctrine recognizes that some expressions of ideas are so often used that they cannot be copyrighted by themselves. An example of this is the fairy tale beginning, 'Once upon a time...'. So many fairy tales begin that way that a fairy tale-based game could certainly begin that way, too.¹³⁰ Other *Scènes à faire* doctrine examples would be the generic elements of a fantasy story such as wizards or dragons. These races and their general stereotypes are not copyrighted, but specific instances of these races that are established characters such as Gandalf or Drizzt would be.

Despite *Scènes à faire* being a French term originally, the same doctrine is not formally recognized in EU copyright law, although the requirements of originality for copyright works arguably would help arrive at a similar result if necessary.

3.1.1.8 Fair Use

The concept of 'fair use' is commonly discussed and misunderstood in copyright law. As a general notion, fair use is the idea that one party may use a portion of a copyrighted work for a limited purpose without paying the copyright holder for a license. This concept is derived in US law from a US statute which states that four conditions must be met as per Table 5 (below).

As one might imagine, fair use can be a muddy issue at times. It is commonly brought up by parties opposing copyright infringement, but it is not a perfect defense.

There are two common pitfalls relating to fair use to keep in mind. First, fair use is a US concept. Most other countries, especially in Europe, do not contain provisions allowing copyrighted material to be used without a license,¹³¹ except in some limited situations (such as for news reporting or legitimate educational purposes). This means that a game company hoping to incorporate some copyrighted material into a game as a 'parody' or other traditionally shielded type of fair use may run into problems selling their game in other countries.¹³² A small clip intended as a humorous interlude may lead to the company in litigation or forgoing sales outside the US.

The second issue to remember about fair use is that fair use is a *defense* to a claim of copyright infringement. This means that a copyright holder in the US can certainly sue the company that included the clip for using a copyrighted work or a derivative of that work without a license. After the case is brought, the law now grants the offending company the opportunity to argue the merits of fair use. This means that a company plainly operating in the traditional boundaries of fair use is still open to litigation and therefore open to the associated costs and bad publicity associated with a copyright litigation. In short, the decision to use copyrighted material in a game under the protection of fair use poses a risk and should be weighed heavily.

**Table 5:** Four Conditions to meet for Fair Use

| | |
|--|--|
| 1. The purpose and character of your use. | Educational uses and uses in parody are more often protected than strict commercial copying. |
| 2. The nature of the copyrighted work. | Using sections of a commercial work is more likely to result in a finding of infringement. Copying creative fictional works is more likely to result in a finding of infringement than copying factual compilations. |
| 3. The amount and substantiality of the portion taken. | Taking a large portion from a work is more likely to result in a finding of infringement than taking a small portion. |
| 4. The effect of the use upon the potential market. | Demonstrably weakening the market for the copyrighted work is more likely to result in a finding of infringement. |

3.1.1.9 Common Questions about Copyright

Is mailing a sealed envelope proof of copyright?

Mailing a sealed envelope to a person with a copy of the company's newest game is not remotely the same as registering the copyright for the game. Sometimes called 'the poor man's copyright' this procedure has no legal effect. At best, it may prove that the material was in a certain form on a certain date, but that evidence is open to challenge since an individual can mail an unsealed envelope to themselves. Actual copyright registration is easy and inexpensive, so there is little reason to resort to this when mailing a form and payment to the Copyright Office is nearly as easy, or (outside of the US) there is an alternative national registration system available.

In the US, is a copyright holder entitled to US\$150,000 in damages per instance of infringement?

The statutory damages clause for copyright infringement is often misinterpreted. A copyright holder is entitled *up to* US\$150,000 in damages per instance of copyright infringement in the US. This is for *willful* infringement of a registered copyrighted work. Furthermore, it is not per copy of the registered work, it is per instance of infringement. Making 10,000 copies of a particular game or film does not multiply the damages by 10,000. The game or film is one copyrighted work and that counts as one instance of infringement. The damage calculation may end up becoming more than \$150,000 through other damage calculation mechanisms such as calculating ill-gotten profits or lost sales, but it is not the result of multiplying the number of copied units by \$150,000. The damages may also add up as well because most games actually contain many copyright works. The number of copies does not directly multiply the damages under the willful damages statutory section. The number of works, not the number of copies, is most significant. That said, as noted previously, statutory damages for copyright infringement are not typically available for countries outside the US.

3.1.2 Trade Secret

Trade secret can be thought of as the oldest form of intellectual property. Even 2 million years ago, *Homo habilis* could keep his competitive advantage for a new stone tool through IP protection. He could keep the use and construction of that tool as a 'trade secret.' The mechanism then, as now, was merely to keep the idea a secret. The processes have grown more complex, but at root the idea is same.

In modern times, a trade secret is loosely defined as some information that may be used for business advantage that a company keeps secret. This is the only form of IP that is not disclosed publicly; patents, copyrights, and trademarks all rely on some form of public disclosure. Trade secrets are company business secrets. A pretty good legal definition comes from the US Uniform Trade Secrets Act, which defines a Trade Secret thus:

'Trade secret' means information, including a formula, pattern, compilation, program device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

3.1.2.1 What Can Be a Trade Secret?

Any idea can be a trade secret as long as it is an idea that confers some business advantage and can be kept secret. Trade secret rights can extend to virtually any concrete information that grants a business advantage, such as formulae, data compilations, devices, process, and customer lists. The most well-known example of a trade secret is the formula for Coca-Cola. The formula is known by some people at the company, but it is not known for certain anywhere else. The secret has been held by the company for more than one hundred years. Though many public descriptions exist, none have been verified.¹³³ Furthermore, great steps are taken to prevent anyone from discovering the secret. Other examples of trade secrets include customer lists, notes on game development, business contacts, license terms, and other internal business items that are valuable to game development but not protected by the other IP tools.

Two advantages of trade secrets are that they have no registration cost and can be protected quickly. Trademarks require using the mark and patents require an application and a lengthy approval process; both also require registration fees. While there is no registration fee for trade secrets, it would not be entirely fair to say that their protection is free. A company must make structured efforts to keep valuable business information a secret if that company wants to claim that information as a trade secret, as described later.



In the EU, trade secrets are also referred to as 'confidential business information.' Analogous to the US, there is no EU level or federal law relating to their protection. For now, they are protected on a Member State level under regimes that vary from country to country but are all broadly similar to the US position. The key is always to ensure that that information you wish to protect is valuable, confidential and *kept* confidential. Further afield, there is a general obligation on most countries under an international treaty called the Trade-Related Aspects of Intellectual Property agreement (TRIPS)¹³⁴ to provide protection for '*undisclosed information*' (though the means of implementing this treaty vary widely).

3.1.2.2 What Rights Are Conferred by Trade Secrets?

The rights given to a trade secret holder include the right to prevent others from using the trade secret unless the other party discovers the secret through legitimate research. Speaking in terms of the Uniform Trade Secrets Act, a company has the right to prevent others from 'misappropriating' a trade secret. The Act describes misappropriation in this way:

'Misappropriation' means: (i) acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means; or (ii) disclosure or use of a trade secret of another without express or implied consent by a person who (A) used improper means to acquire knowledge of the trade secret; or (B) at the time of disclosure or use knew or had reason to know that his knowledge of the trade secret was (I) derived from or through a person who has utilized improper means to acquire it; (II) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or (III) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or (C) before a material change of his position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.

3.1.2.3 Examples of Trade Secrets

As an example, consider mailing list data for subscribers of an MMO as a type of trade secret. These people have subscribed to Company A's MMO for years and have each paid literally hundreds of dollars to the publisher. If an employee steals the MMO contact list, this employee can now have easy access to people interested in playing an MMO and willing to pay for it in the long term. This information could be enormously valuable for a competitor.

Development tools could also be trade secrets. Consider a development tool that may populate a 3D level intelligently with environmental objects by pulling these objects from a specified directory. This software was written in-house for one development

project, but could easily be modified to work with other projects, saving programmers and level designers many hours of work by placing a 'skeleton'¹³⁵ level down according to certain conditions. Now this tool is certainly also covered by copyright, but if it is never sold, published, or patented, it could also be a trade secret. To be clear, like Coca-Cola, some elements of the tool could remain trade secrets even if the tool itself were sold. An employee leaving with the code for this design tool and taking it to a competitor is stealing a trade secret.

Details about licensing and publishing agreements can also be a trade secret. In fact, license agreement and other contract secrets are one of the most common trade secrets in the game industry. Often both parties do not want deal details leaked to the public. This class of secrets covers obvious clauses such as how much is paid and when. It also covers less obvious, but equally important information such as which employees are 'key employees' for fulfilling a development agreement.

3.1.2.4 Trade Secret Information

3.1.2.4.1 *Length of Protection*

Trade secrets last as long as the owner of the information prevents it from becoming common knowledge. This, like trademark, is potentially immortal. The only limitation is the time the information can be kept 'secret.'

3.1.2.4.2 *Process and Cost*

Unlike patents and trademarks, and similar to copyright, there are no formalities such as registration required to obtain trade secret rights.

It is often said that having a trade secret is 'free.' This is true to some extent. There are no registration or maintenance fees required. Yet trade secrets do require a process. They must be handled carefully and have some efforts made by the company to keep them secret, as described later in this chapter.

3.1.2.4.3 *Protecting Trade Secrets*

Common protections include recording trade secrets and having employees sign documents stating that they understand that certain information is a trade secret and has special restrictions on dissemination. Controlled access is an important part of a trade secret. If the trade secrets are electronic files, allow only certain people to access those files, consider encryption for those files, and place special protections on modifying or copying the files.

Protection of trade secrets also includes not telling anyone unless that person needs to know the information, but it also can include other internal security measures to protect the information. Measures such as restricted access to the information



internally, passwords, encryption, locked cabinets, and non-disclosure documents all help protect the company's trade secrets.

If you find that someone has leaked trade secrets, you should take specific actions. First, your company should do whatever is necessary to stop the leaked information. This may include further restricting access, changing passwords, and perhaps moving databases. This may also include sending ISP and/or webmaster notices if the trade secret information is being hosted online. The company usually also places the offender on notice that the offender is distributing a trade secret. This notice, similar to other such webmaster/ISP notices, will demand that the offender 'cease and desist' from distributing the secret. Finally, if this fails to remedy the harm caused by the leak of the trade secret, litigation may be in order. Similar to copyright and other types of IP enforcement, each of these steps should be done in concert with your attorney.

3.1.2.4.4 *Penalties for Infringement*

Virtually every country has a sanctions system for misuse of trade secrets or confidential information. For example, in the US the Uniform Trade Secret Act allows damages for misappropriating trade secrets. These damages can be measured in three ways. First, the damages may be measured as the loss of profits by the party that originally held the secret. Second, the damages may be measured by the profit of party that used or disclosed the misappropriated trade secret. Finally, if appropriate, the measurement could be as a reasonable royalty payment for the trade secret. In addition to, or as an alternative to, damages a party may be able to enjoin (or stop) the misappropriating party from using the trade secret. Legally, this is referred to as seeking an injunction against the misappropriating party.

3.1.2.5 Trade Secret is State Law in the US

In the US, copyright, federally registered trademarks, and patents are all controlled almost exclusively by federal law. Trade secret, on the other hand, is controlled by the law of the individual states. Therefore, it can be more variable than other IP laws because it can differ from state to state. Throughout this chapter, information has come from general principles contained in state law or from the Uniform Trade Secrets Act. The Uniform Trade Secrets Act is a model that approximately 40 states have adopted or have used as a guide in creating their own law. There is no substitute for a qualified attorney familiar with state laws when it comes to trade secret matters. As a rule, most attorneys will be comfortable working with trade secret law in their home state, New York, and California.

3.1.2.6 Common Questions about Trade Secrets

Can trade secret help me protect my IP from reverse engineering?

Unfortunately, trade secret cannot provide full protection from one of the biggest assaults against game IP: reverse engineering. A truly legal reverse engineering job is performed when hardware or software is inspected and ultimately re-created without misappropriating a blueprint, source code, or other related information. This process, while in no way easy, has been accomplished for some relatively secure gaming systems and software. However, trade secret can protect game developers from reverse engineering since the difficulty of reverse engineering is sometimes well beyond the realm of human capability, and is only possible if some inside information (i.e., trade secret) is leaked to the public. Trade secret can help protect against this leak, and potentially cut off reverse engineering attempts before they become feasible.

At what stage should a game company use trade secret?

The best advice for a gaming company embarking on any new project is to maintain some planned secrecy at every stage. Try to keep key in-game calculations, customer lists, community information, and key business contacts a secret. As long as proper non-disclosure measures are followed along the way, it is possible to amass quite a bit of trade secret knowledge that should prevent your game ideas from being stolen or reproduced. The major reason that game companies lose trade secrets is the cost and trust issues associated with maintaining such secrets. Quite often, a small game company may be started with a group of friends who feel that such measures would be unnecessary because of a high level of trust between the founders. Although this may be the case, it is always better to ensure the protection of valuable resources with the proper measures before there are any problems.

3.1.3 Trademark

Where trade secret focuses on keeping information about a company behind closed doors, trademark focuses on pushing information out into the public. In fact, a successful trademark is one that allows consumers to instantly recognize the company and its products when they see the mark. The Xbox, PlayStation, Apple, and Facebook logos are immediately recognizable and consumers have certain thoughts and feelings associated with those marks. That brand recognition and association with a particular company is the purpose of trademark.

Trademarks are arguably the second most important IP protection for game companies after copyright, since a good trademark can set a company and its games apart from others in the minds of consumers. The Lanham Act is the primary trademark statute in the United States and also governs false advertising and



trademark dilution, as well as trademark infringement. It sets out the basic rules governing registration, infringement standards and the penalties for infringement.

3.1.3.1 What Can Be Trademarked?

The most common trademarks are a word, name, symbol, graphic, or short phrase used in business to identify a specific company's products. More exotic trademarks can be smells, sounds, or colors, but these are rarely used.¹³⁶ Trademarks come into being when they are used in business by a company to identify products or services. To identify a trademark for a game company, the company only has to use a superscript TM after the mark, like this: TM. Of all the types of IP, only copyright is easier to invoke because it only requires the fixation of a creative work. Simply placing the TM designation after a word puts the world on notice of 'common law' trademark rights. Common law trademark rights are derived from use of the mark in commerce. Through business use, trademarks become associated with a company and perhaps also with a particular product or service within the company. Common law rights are also controlled by state law and the mark is not protected throughout the United States. The mark is only protected in the area where it is in use. The position is the same in other common law countries, such as Canada, the United Kingdom, India or Australia and in practice in many other countries too (in Germany, for example, a business can gain unregistered trademark rights simply by use of the mark in the course of their business).

3.1.3.2 Examples of Trademarks

The strongest trademarks are words that have only the meaning that a company has given to them, like Xbox, Sony, Facebook, or Nintendo. The words do not mean anything alone. In other words, the more imaginative the trademark, the stronger it is.

Microsoft has learned some lessons twice the hard way in the game context. The first time was just before the launch of the first Xbox. The Xbox trademark was in use by another software company when Microsoft started marketing the Xbox. Worse, the competing company was a publicly traded company that should have been easy to find in a standard trademark search.¹³⁷ Clearly this is something that should have been found and negotiated much earlier in the launch cycle or perhaps even another name should have been chosen. This case was eventually settled out of court and probably cost Microsoft a substantial amount of money.

The second and more recent trademark lesson for Microsoft came in 2003 with the planned MMORPG *Mythica*. One of the most popular games in that market, *Dark Age of Camelot*, is made by Mythic Entertainment. This potential trademark conflict was so obvious it did not really require a search, and could have been uncovered simply by asking just about anyone familiar with the genre. In response to the clear *Mythica*/Mythic conflict, Mythic initiated a case against Microsoft for trademark

infringement.¹³⁸ Around the time of the case, Mark Jacobs is famously quoted as telling a Microsoft lead designer at E3 that Mythic was going to call its next game 'Microsofta.' Whether causally related or not, Microsoft canceled the whole *Mythica* project after the dispute arose. Microsoft settled the suit with Mythic, agreeing not to use the term 'Mythica' and to drop its US applications to register 'Mythica' as a trademark. As part of the settlement, Microsoft also assigned Mythic the rights to international trademark applications and registrations for 'Mythica' as well as the associated domain names. The lesson here is that trademark searches should not be considered an additional frivolous cost for a game company. Instead these searches are an essential part of the registration process and mistakes have in the past and will in the future cost game companies literally millions of dollars and potentially be involved in the failure of entire projects.

3.1.3.3 Trademark Information

3.1.3.3.1 *Length of Protection*

Trademarks can be immortal. If the mark is used continuously in commerce and the relevant fees are paid, the mark can exist forever. There are some marks in the United States, for example, that have been used for more than one hundred years.

3.1.3.3.2 *Process and Cost in the US*

In the US, a trademark may also be registered with the federal government for wider and stronger protection. The registration is more complex than the copyright registration process, but not as complex as the patent registration process. For this reason, it is usually done through a law firm with paralegals and attorneys that specialize in trademark registration. The process should begin with a trademark search that examines US and perhaps international sources to try to discover if other companies have been using the mark. If other companies have been using the mark then the search can try to determine if the mark is being used in a related field. After the company has the results of this search, the company can either decide to move forward with the federal registration process or reconsider the mark. As routine as this initial search process is, sometimes the process fails in spectacular ways – even for very established companies.

After the trademark search, the federal registration process with the USPTO begins. This process usually takes less than year and costs approximately \$3,000, including the earlier trademark search. After the mark has been federally registered, this registration and the litigations surrounding it are controlled by federal law. The registration is at this point, good throughout the entire United States.

The fees for renewing a trademark are currently lower than patent maintenance fees. The fees can vary based on how many trademark 'classes' are covered by



the trademark. A class can be thought of as a class of products. At the time of this writing, the cost for renewing a trademark in one class and filing the appropriate declaration of use is approximately \$600.

3.1.3.3.3 *Protecting Trademarks*

All trademarks should be noted with the appropriate symbols. Use the symbol TM to indicate if the mark is being used in business. If the trademark registration is successful, the applicant can use the ® symbol following the mark, as an indication that the mark has been registered with the USPTO or another national trademark office.

Policing trademark is similar to policing other types of IP. One important difference is that a trademark used by unauthorized companies can actually damage the value of the trademark. If this unauthorized use becomes rampant, the mark runs the risk of 'genericide,' where the mark loses all value. This has happened in the United States to trademarks that were so often misused that they became household words, such as aspirin and thermos. Both of these were trademarks at one time, but have died a death from misuse and over-popularity.¹³⁹

3.1.3.3.4 *Penalties for Infringement*

The penalties for trademark infringement can be harsh and are similar to copyright infringement. These penalties can include the destruction of the infringing items if the items are considered counterfeit. An injunction stopping the use of the infringing trademark, is also an option. Money damages based on loss of profits or ill-gotten gains are also possible. Similar to copyright, personal liability through the corporate shield is also possible. The specific damage calculation for each case is dependent upon the circumstances surrounding the infringement.

3.1.3.4 Picking a Good Trademark

Trademarks are divided into five categories. The categories are broken down to reflect the relative strength of the mark. Mark strength is an indicator of strength of protection. That strength of protection should also contribute to IP value. The five categories of trademark strength are fanciful, arbitrary, suggestive, descriptive, and generic. See Table 6 (below).

Fanciful marks are the strongest marks. They have no meaning other than the meaning a company associates with them. Examples of fanciful marks include: Xbox, Bioware, NVIDIA, *Tetris*, and Eidos.

Arbitrary marks are also strong, but less so than fanciful marks. They are words, but are not associated with the particular product until the company associates them.

An example of an arbitrary mark is 'Apple' for computers, Android for an operating system, or 'id' for a development studio.

Suggestive marks can be a natural word that suggests the product it represents, but does not directly describe it. These are the weakest marks that companies can normally obtain protection for. Examples of suggestive marks are Electronic Arts for a maker of video games, PlayStation for a console game platform, Sonic the Hedgehog for a fast moving hedgehog, *Space Invaders* for a game starring invaders from space, or *Centipede* for a game featuring a centipede.

Descriptive marks are extremely weak marks. They are essentially useless unless a company has used them so much that they have acquired something called 'secondary meaning.' Secondary meaning can only be acquired through extensive marketing and public exposure. Examples of descriptive marks include Vision Center for a store that specializes in glasses, or Computerland for a computer store. *Generic* terms are things like video card, controller, or video game. The term generic is the polar opposite of trademark and a generic term can never be converted to a trademark in the US or virtually anywhere else.

Table 6: Trademark Strength and Categories

| Judging Trademark Strength | | |
|----------------------------|--|-----------------------|
| Mark Category | Description | Example |
| Fanciful | Words that have no meaning beyond that given by the company. | Xbox |
| Arbitrary | Words previously unassociated with a type source. | Apple (for computers) |
| Suggestive | Words that suggest something about the source. | Electronic Arts |
| Descriptive | Words that merely describe the source. | Computerland |
| Generic | Generic descriptor; cannot be a trademark. | Video game |

It should be obvious that you should not name your next game and development company, *Game* by 'Game Development Company.' Those terms are too generic to become trademarks at all. Examples outside the game industry such as Exxon, Intervolve, and Kodak are great trademarks because they do not have any other meaning besides the meaning the company generates in them. When naming a new company or product, it is worth trying to create a fanciful or arbitrary mark. The increased strength legally afforded to creative marks is a fascinating example of how IP law respects and promotes creativity.



3.1.3.5 Notable International Variation

Although trademark law is respected in most countries, the realities of enforcing a trademark on foreign soil will be different than enforcing a trademark inside the United States. For example, some countries in Europe require use of the mark in commerce, whereas others give a grace period but still require use within several years. Also, the registration of a mark in the United States does not mean that the mark is enforceable in another country; it merely means that should the foreign business with a similar trademark attempt to bring its product into the United States, you could then enforce your rights.

An interesting phenomenon to take note of in the foreign market is the Community Trade Mark (CTM) that one can apply for in the EU.¹⁴⁰ This mark, if granted, can be used across all of the 27 Member States of the EU, and can be a cost effective way of establishing trademark rights over a broad array of countries. However, there are complexities and alternatives to this type of trademark that are beyond the scope of this chapter. The most important alternative to discuss with your IP attorney is using the WIPO Madrid Protocol¹⁴¹ to obtain international protection. In short, this is an area that becomes complicated very quickly and if your company has the products and resources to consider international protection, the company should make sure it has appropriate counsel to arrange for such protection.¹⁴²

3.1.3.6 Common Questions about Trademarks

Do I have to use a trademark in commerce?

Actual use is always better for bolstering trademark rights, but in the United States it is possible to establish such rights for a short time merely by establishing an 'intent-to-use'. In 1988, trademark law changed when this intent-to-use provision was added. Prior to this addition, a mark needed to be used in commerce; since 1988, it has been possible to merely apply for a federal registration with the stipulation that there is a bona fide intent-to-use the mark in commerce.

As discussed above, using a trademark in commerce without registration grants common law protection for the trademark. In this way, actually using offers additional protections beyond a filing of intent to use. Trademark law offers some protections here including protections against the infringement called 'passing off.'

Can I let fans use my trademark without a formal license?

This is commonly done in the game industry for both copyrighted material and trademarks. Game companies often create fan site packages that include material and conditions for using that material. The allowed uses are case specific and it is often not economically feasible to attack every website 'infringer' that pops up. Game

companies also recognize the advertising value in game-related communities. In short, make sure the fan sites know what uses your game company is comfortable with. Be as clear as possible about the rules and try to stress that appropriate attribution is important. For example, a fan website kit may include appropriate legal attribution for a trademark. The notice may say something similar to '*Title* is a trademark of GameCompany' or '*Title* is a registered trademark of GameCompany.' This situation becomes more complicated if there is a substantial commercial component for the website or if the website is spreading misinformation that is harmful for your game sales. In the case of a commercial component, the website may be making money using your game company's trademarks and perhaps copyrighted material. As mentioned above, the appropriate action, if any, is dependent on the individual circumstances. A negotiated license and/or a 'cease and desist' letter may be in order to stop unwarranted uses.

Can I trademark my game title?

Here the answer is 'Yes.' Normally, trademarks are not meant to cover a title that will be used for only one property only. Recall that trademarks are a sign of the source of a product. Films, books, and other creative products usually need some type of product extension such as merchandising or a sequel. However, despite the normal rule that applies to most other goods and services in the US, there is a special exception for video games in the United States Trademark Office stating that game titles may seek trademark protection.¹⁴³

3.1.4 Patents

The patent system in the United States is descended from the 1623 Statute of Monopolies in England, which sought to overturn earlier royal monopoly grants but preserved inventor's rights for 14 years with grants of 'letters patents' for 'new manufactures.'¹⁴⁴ More recently, in the United States, patents go all the way back to the Constitution. In Article I, § 8 clause 8 grants Congress the power to 'promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.' Since that time, patent law has undergone and continues to undergo revision, sometimes significant.¹⁴⁵

Traditionally, in the EU, patents were currently handled by each member country individually. Now, the EU is moving toward a unified patent system that is set to go into effect in 2014 (though the details of exactly how that will work are still being worked out at the date of writing).¹⁴⁶ In the meantime, an applicant can obtain a bundle of patents in each of several European countries at the same time under the European Patent Convention.



Although extremely important for some hardware, software, development tools and other middleware companies, patents are not used as often in the game context. This may change as the industry matures, but for the time being patents are not often utilized throughout the majority of the game industry. By way of example, in the United States there are approximately the same number of game industry patents each year as patents on toothbrushes. Still, each year there are large patent litigations in games. This increase has caused a substantial burden for developers, which must often take on the cost of defending these cases if the publisher and developer are named in a patent infringement complaint.

3.1.4.1 What Can be Patented?

In the US, the Patent Act defines potentially patentable subject matter as any 'new and useful process, machine, manufacture, or composition of matter...'.¹⁴⁷ Examples include machines, pharmaceuticals, medical equipment, video cards, or a better mousetrap. Patents do not usually protect games themselves because they do not usually meet the statutory criteria. Yet, there are a growing number of game-related patents, usually in the areas of hardware, digital distribution, networking, and inventive gameplay.

The position is similar in Europe and internationally, with one vital caveat for games: it is often much harder outside of the US to patent software inventions. For example, in the EU there is a complex prohibition on software patents under the European Patent Convention.¹⁴⁸ Another point to be aware of is that some countries allow applications for lesser patents known as either 'utility patents', 'lesser patents' or 'innovation patents' which do not exist in the US. These are essentially similar to 'regular' patents but protect lesser innovations for less time (but are easier to obtain).¹⁴⁹

3.1.4.2 What Rights are Conferred by Patents?

A common misconception is that a patent grants the right to make an invention, but this is not true. Similar to copyright, patents grant a negative right, meaning they grant a right that prevents others from doing something. In other words, a patent confers the right to prevent other people from making, using, selling, or importing an invention. The patent owner is under no obligation to ever actually construct the patented invention, but can prevent others from practicing the invention.

3.1.4.3 Patent Information

Patents are perhaps the most complex form of IP protection. It is important to understand the details about this form of IP if you plan to use it in your business.

3.1.4.3.1 *Length of Protection*

Patents have a limited lifespan and that lifespan is relatively short compared to other forms of IP. A lay person might think a patent expiration date would be printed right on the front of a patent. Unfortunately, nothing could be further from the truth. Currently, patents that pay the required maintenance fees are valid for twenty years from the time they are filed. Before June 1995, this calculation was not so simple. For these older patents, the patents are valid for either seventeen years from the patent issue date or twenty years from filing – whichever is longer.¹⁵⁰ Just to make the calculation more complicated, it is not unusual for patents to be shortened or extended for some time through a variety of mechanisms. It is possible to *estimate* a patent term by looking at basic date on the face of a patent, but a full review of the patent history and related documents is necessary to find an exact expiration date.

3.1.4.3.2 *Process and Cost in the US*

Of all the types of IP registration, this is the longest and most complicated. The process takes 2-4 years and includes creating all of the written material for the patent application including all relevant figures. The process also includes regularly corresponding with the Patent Office, complying with, or writing rebuttals to Patent Office arguments. Although it is possible to go through this process without a patent attorney, that direction is strongly not recommended.

There are two main sections that make up a patent. The first section is called the specification and is the narrative description that makes up most of the written material in a patent. This section includes a background of the invention that goes through the state of the technology leading up to the invention. There is also a detailed description of the invention with figures and examples. In theory, a person reading this section can learn everything there is to know about how to make and use this invention. Remember that a patent is a deal with the government: in exchange for sharing complete knowledge of the invention with the world, the patent holder is granted a limited monopoly on that invention.

The second main section is the patent claims. These claims are numbered sentences found at the end of a patent. There has to be at least one claim, but there is no absolute upper limit on the number of claims; however, in the US every patent claim over 20 costs an additional amount of money so high numbers of claims are economically discouraged. The average patent has about 3-15 claims. The patent claims are the most important section of the patent because this is the portion of the patent that describes exactly what the patent protects. In fact, material in the specification that is not included in the claims is given away to the public. Be very careful that patent claims adequately and completely describe your invention.



The cost of filing a patent application varies based on several factors. These factors include the complexity of the technology, the number of other patents in the field, and the amount of material that your company can provide to the patent attorney. If technology is complicated, there are many patents in the field, and every time you call your patent attorney with an idea written down on an index card, the cost is going to increase. A general price range for total cost of application can be between \$15,000 and \$30,000. This includes the costs to file an application and shepherd it through the patent office. The range also depends on the number of mailings called 'Office Actions' from the Patent Office and the time spent preparing answers to those Office Actions.

Beware of companies that offer to 'file' a patent application for \$2,000 or some other very small amount. There are at least two areas where these companies are hiding costs. The first is that the USPTO fees are usually not included in these costs. Secondly, the low estimate is usually only for 'filing' the patent application. The cost of answering Office Actions and doing the other work necessary to get the patent is not included in that estimate. This is similar to stating that skydiving costs \$200, but the parachute is extra.

The good news is that patent costs tend to be spread out over the whole period of the application. There will be costs to prepare and file the application, but paying for the Office Action work is not necessary until many months later when the patent application has been acted on by the Patent Office. It is also possible, but unlikely, that an application can go straight through to become an issued patent.

There are also ongoing costs for patents in addition to filing costs. In order to keep a patent enforceable during its term, maintenance fees must be paid to the US Patent and Trademark Office. These maintenance fees are due at 3.5, 7.5, and 11.5 years after issuance. The fee amounts change often and the best source of information regarding these fees is your IP attorney. If the fees are not paid, the patents will expire and it takes substantial effort to revive them, if it is possible at all. The difficulty reviving the patent is dependent on the length of time since the fees were due and the circumstances surrounding the failure to pay fees.¹⁵¹ Make certain your company plans for this and has someone designated to monitor that these payments are made.

Outside of the US, you can expect a similarly long, complex and expensive process compared to other forms of IP protection. You should also be aware that the process itself can have very important differences compared to the US. For example, traditionally, Europe uses a 'first to file' approach to patents (the first applicant for the patent is the person who gets it by default, not the person who invented the patentable invention first). The United States has only recently adopted a type of 'first to file' in March 2013 as its standard under the America Invents Act, so the

differences are hopefully becoming smaller, but we will likely never achieve complete harmonization.¹⁵²

3.1.4.3.3 Protecting Patents

If another company is violating your patent rights, the first step in policing this type of IP is to put the other company on notice by sending them the patent and a letter about the potential infringement. Hopefully, the parties can work out some suitable licensing settlement, but this is sometimes not the case. If the parties cannot come to an agreement, litigation may be in order.

3.1.4.3.4 Patent Litigation and Penalties for Infringing Patents

Generally speaking, patent litigation itself is punishment for both parties. Even the winner of the litigation often does so at substantial cost in time, money, and other resources. Patent litigation is complicated, ultra-niche litigation. It is not surprising that it is expensive and costs often run well past two million dollars in legal fees. There is also no doubt that this will become substantially more expensive in the future.

Winning a patent litigation normally results in two remedies. First, the patent holder can win an injunction that stops the losing party from practicing the invention. Second, the infringing company may be forced to pay damages for past infringement and potentially a royalty on units sold going forward.

3.1.4.4 US Patent Pending and Provisional Patent Applications

The use of 'patent pending' is only appropriate when an application or provisional application has been filed with the USPTO or another national patent office. The marking is not mandatory, but can be important when proving notice and calculating potential damage for patent infringement. Some people also argue that the notice adds value to the product in the eyes of investors and consumers and expresses a certain level of business sophistication.

In the US, provisional patent applications are often an attractive option for small or mid-sized game companies with a patentable invention. These applications cost less than pursuing a standard patent application and preserve the priority date for the invention. These provisional applications resemble complete patent applications, except that they will not be examined at the USPTO without further action on behalf of the inventor. The inventor has one year from filing a provisional application to file a standard patent application based on the provisional. If successful, the applicant will be able to use the date of the provisional application as the date of invention. Finally, the expiration date of the patent is still counted from the date the full application is filed so the company does not pay any time-related penalty for filing the provisional application.



It is common for an early stage game company to be cash-poor, but perhaps they have an invention or several patentable inventions that are potentially worth a great deal. This is particularly true with middleware companies. The company may fear its competition stealing the invention, but still wants to market the product and raise money. This is potentially a great position for a provisional patent application. After the company files the application it now has three issues covered. First, the invention is on file with the USPTO and the invention priority date is set. The company can market the invention without fear of losing it due to a statutory bar or competitor copying. Second, the company has spent a fraction of the full cost of a patent application. Finally, the company can point to the pending application for both product sales and as a valuable addition to the company for capital acquisition.

3.1.4.5 Patent Invalidity

There are two circumstances when patent invalidity is particularly important in the game industry. The first instance is when a game company is trying to get a patent issued through the USPTO. The second instance is when a game company is being sued by a patent holder for infringement. In the first instance, the company will want to show that its patent application represents a valid invention. In the second instance, the company will try to prove that the patent holder's patent does not represent a valid invention. This area of patent law is enormously complex and the ideas contained in the sections below should be considered as minimal summaries.

3.1.4.5.1 *Anticipation and Obviousness*

There are many mechanisms that lead to patents being declared invalid. Two of the most often discussed mechanisms are called 'anticipation' and 'obviousness'. Anticipation is found when something in the prior art meets every element of a patent claim. Patent claims are the numbered paragraphs at the end of a patent document that explain what the patent 'claims' it protects. Each one of the claims has subsections that are indented as individual steps and those steps are called 'elements.' An easy way to think about anticipation is using this idea – that which infringes if after would anticipate if before. In other words, patent cannot be valid if there is something found in the prior art that would have infringed the patent. This means there must be something in the prior art that met each and every portion of the claim being invalidated.

The second common way patents are declared invalid is through obviousness. With obviousness, every patent claim portion does not have to be met by just one invention or publication. Instead, inventions and publications can be blended together with other knowledge that was present before the patent. The standard here is: what would a person of ordinary skill in the relevant scientific discipline know and do with the information available to him? A simplified way to look at it involves three steps.

First, were all of the pieces of an invention present? Second, was there is a reason to put those pieces together? Third, could a person of ordinary skill put those pieces together to make the patented invention? If these steps are all met, the patent is invalid for obviousness.

3.1.4.5.2 Timing a Patent Filing

Before a recent revision of the US patent laws, people were allowed a year to use or sell their inventions before they had to file a patent application. This grace period was very much out of synch with international patent laws. As of 2013, this grace period no longer exists in the United States. Game developers that wish to file for a patent must do it before the invention is publicly used, sold, or advertised.

As mentioned above, there are other ways for patents to be found invalid beyond those discussed in this chapter. These include keeping information from the Patent Office, affirmatively lying to the Patent Office, and a variety of technical issues. As always, the best advice beyond understanding this simple summary is to consult your patent attorney and the more specialized sections of this text.

3.1.4.5.3 Reasons to File a Patent Application

People usually only consider enforcement, litigation, and licensing as the reason to file a patent application, but there are many others. First, patents and patent applications are a symbol of sophistication for your company. Companies often demand some concrete proof of intellectual property before agreeing to protect it in contract negotiations and licensing. Patents grant your game company that concrete proof and gravitas. Second, patents and patent applications change the valuation of your company. Investors consider these as substantial assets, especially when they are referenced in license agreements. On average, a company with patents will be valued higher than a company without patents, all other things being equal. Third, patents and patent applications can increase pricing on your products. Software and hardware that is patented or patent pending has a higher value in the marketplace because, by definition, it is not available elsewhere. Fourth, a patent application creates an intellectual moat and prior art 'bomb' for people that file later. Even if your application publishes and is never approved, that publication by the USPTO alone ensures that no one can come after you and patent the same invention. Fifth, patents provide potential patent counter-claims if a patent case is every brought against your game company. When two companies with substantial patent portfolios are involved in a litigation, the defendant often has grounds for counter-claims based on its portfolio. These counter-claims raise the stakes of litigating with a game company that has patents. Lastly, patents can be used for direct enforcement and licensing, but this is a very long, complex, and expensive proposition. In fact, it is usually a last resort, resulting in about 1-2% of all patents ever being involved in a litigation.¹⁵³ The items at the start of this paragraph are far more common uses for patents.



3.1.4.5.4 Common Questions about Patents

What can our company put 'patent pending' on?

Writing 'patent pending' can only be done if an actual patent application or provisional patent application has been filed with the national patent office. Putting this marking on a product that does not meet these criteria could result in liability.

While the mark of 'patent pending' does not directly grant patent rights to the user, it serves to put potential future infringers on notice. Some companies hold the common misconception that they should always put 'patent pending' on any invention. Yet, patent pending is not like trademark. This notice does not grant the common-law rights that the symbol TM does. Also, if the patent is not granted, it is not proper to keep this marking on the unpatented item. As a final consideration, in the US placing patent pending on a product when there is no patent application is a violation of 35 USC § 292. There are financial penalties for marking products incorrectly.

Patent agents and patent attorneys in the US – what is the difference?

As you can see by all the information presented in this chapter, patent law is a complex legal specialty. It may not be surprising to learn that most attorneys practicing patent law have additional qualifications and specialized study. In the United Kingdom, becoming a patent attorney is a very different legal educational process from other attorneys. In the US, law school is the same for all attorneys and all practicing attorneys are required to take a state bar to practice law, but only patent law has an additional examination necessary to be a 'registered patent attorney.' This exam covers patent law and particularly the rules dealing with patent applications. The test is administered by the USPTO and may be taken by either attorneys or non-attorneys. One requirement for this exam is a college level scientific or technical education. The exam is difficult and in some years only about fifty percent of people pass it. An attorney that passes this exam is considered a 'patent attorney.' A non-attorney that passes the exam is a 'patent agent.' Patent agents can aid in writing patent applications and other matters before the USPTO, but their abilities are more limited than registered patent attorneys.

3.1.5 Rights of Publicity and Moral Rights

(i) Publicity Rights

Publicity rights, also known as rights of publicity, are sometimes considered an intellectual property right because they are intangible property rights. Furthermore, these rights are considered in any creative endeavor that may use someone's image. Generally speaking, publicity rights are a set of rights that allow a person to control the commercial distribution of their own name, image, likeness, voice, or other identifiable representation of personality. This is the right that allows a celebrity to be

paid to endorse a certain product and simultaneously allows that celebrity to prevent a business from misappropriating an endorsement by that celebrity.

The rights of publicity are similar to trade secret rights in that in the US they are governed by state law. The state that matters is where the person currently lives. There is no federal registration process or federal law for publicity rights. These rights come about through state law statutes or some have come about merely through court cases with no statute behind them.¹⁵⁴ Importantly, there are state law statutes in many states responsible for the bulk of game development in the US, including California, New York, Texas, and Massachusetts. Also, keep in mind that some states allow publicity rights to pass through a person's estate so they may still be protected for a period even after death.¹⁵⁵ While some states have no post-mortem right of publicity, and most others are limited to a certain number of years, one state, Tennessee, the home of Elvis Presley, has a perpetual right of publicity.

Publicity rights exist for several policy reasons. These include the idea that the right to one's identity is among the most fundamental human rights. It is also closely tied to the right of privacy, protecting a person from unwanted commercial exposure. There is an additional line of argument that rights of publicity prevent fraud and unfair business practices that could derive from a fake endorsement.

Publicity rights are important in the game context in a few instances. First, using a person in a game or to advertise a game usually requires that person's permission. The same is true for using a person's voice or other recognizable characteristic.¹⁵⁶ Failing to obtain the person's permission could result in a court granting an injunction to halting sales of the game and/or ordering damages to the person whose image was used without consent. These damages will likely have a punitive characteristic on top of the court derived fair market value for licensing the person's right of publicity.

When negotiating for a right of publicity, the most critical license terms are the territory, the term of the license, the way the likeness will be used, costs and whether or not the likeness will be used in advertising.¹⁵⁷ For game industry uses in the 21st century, worldwide rights and a perpetual license are going to be preferable, but the cost to obtain these rights will reflect their broad nature. Another consideration is whether or not the game developer will require the person to create voice-over recordings or perform motion capture services. These fees will often be charged in addition to the mere likeness license.

Potential licensees should also be aware that in the United States most celebrities and actors are members of a guild for performing artists called SAG-AFTRA.¹⁵⁸ This Guild has additional requirements above and beyond contracted payments to the celebrity. Most critically, the Guild requires recurring payment for uses of the celebrity and payments into the pension and health funds of the Guild.



Publicity rights of the kinds described above are unique to the US. Other countries around the world have developed publicity rights which on the whole arise from the same fundamental policy reasons, i.e. the human right to protect one's name and image coupled with the economic right to control their commercial exploitation, though the implementation of those policy reasons in law varies around the world.

For example, in Commonwealth common law countries including the United Kingdom, Canada and Australia, publicity rights have been created by case law¹⁵⁹ drawing on the common law rights of privacy and of passing off (or, in other words, by fusing together an individual's right not to have their person broadcast in public together with their right to avoid having their person associated with a product without authorization). However, these rights are not nearly as robust or as detailed as the US system (reflecting perhaps these countries' reluctance to enshrine a formal or detailed publicity rights system). In other countries, including France,¹⁶⁰ Germany¹⁶¹ and the People's Republic of China,¹⁶² publicity rights are part of statutory law, although again the degree of protection varies considerably. The moral rights doctrine (discussed further below) developed in many Francophone and European Union countries also has an impact on publicity rights to the extent that it permits a person to assert their right to be recognized as the true author of a work.

Consequently, when looking to license the likenesses or other brand usage of persons outside of the US, it is worth bearing in mind that broadly similar legal considerations will apply – above all the need to obtain a license from the relevant person(s). However, the exact manner of ensuring legal compliance, the costs of doing so and the penalties for non-compliance will vary considerably from country to country.

(ii) Moral rights

Moral rights are a concept which originated in the civil law systems of France and Germany and spread out from there, assisted in part by international treaties such as the Berne Convention.¹⁶³ Moral rights are rights granted to the authors of creative works (i) to be identified as the author of the work in certain circumstances, e.g. when copies are issued to the public; and (ii) to object to derogatory treatment of the work or film which amounts to a distortion or mutilation or is otherwise prejudicial to the honor or reputation of the author. Moral rights are therefore rights concerned with protecting the reputation of an author. They are similar in a sense to publicity rights but not as wide-reaching since they apply to author's work, not the author generally.

There are some important caveats regarding moral rights. The first is that they are personal to the author and cannot be assigned, transferred or sold (although frequently in contracts the owner of the moral rights will try to give them as much force as possible). Secondly, a moral right has to be publicly asserted to be useable (which is why you will see in many non-US books some wording at the very start of a book explaining that the moral rights of the author are asserted). Thirdly, the author

can waive his or her moral rights: consequently, whenever there is an assignment, sale or transfer of a copyright work a well drafted contract will include the author waiving any corresponding moral rights. Lastly, moral rights do not apply to computer programs (meaning in practice computer code, but not related works such as game artwork). For all that, it is very rare for moral rights to cause issues in games development.

3.1.6 IP Strategy 101

When looking at your bottom line, your IP is the lifeblood of your company. Here are some tips for how to best protect your IP in your day-to-day business.

3.1.6.1 Have a Relationship with Experienced IP Counsel

At the risk of sounding repetitive, this cannot be said enough. And you should ideally find an attorney with game industry experience if you can. This relationship is the beginning of educating the development team about IP rights surrounding the game project and building protections for those rights. This person can help developers of any size to protect IP, by drafting and reviewing documents and offering advice. Having this relationship ensures the developer has taken the appropriate steps in advance of pitching the game. This relationship also ensures the best possible case-by-case advice while interacting with publishers or investors.

3.1.6.2 Protect IP in Advance

Use trademarks properly, including using the appropriate symbol (™ or ®) when they are used in documents. Keep trade secrets, especially when pitching a game, and understand that sharing those secrets can jeopardize their protection. Publishers and other parties understand that developers cannot give away the farm: answering that some delicate information is proprietary is expected. Developers can always describe processes in general without going into detail. For copyright protection and date confirmation, developers should always write critical game design ideas out in detail and save concept art and early screen shots. Before pitching ideas to publishers and investors, discuss patent registration possibilities with your attorney. Finally, and most importantly, keep good records to document the earliest possible ownership, development, and use of the idea for all types of IP.

3.1.6.3 Protecting IP when Pitching a Game to Publishers and Investors

Understand that publishers and investors want to limit their legal exposure and many 'standard' NDAs are essentially one-sided documents to protect the other party and not you or your business. The development team should have its own NDA or a mutual NDA and ask if the publisher or investor would consider signing it. This negotiation can take some time and should be done before the pitch day. It is impolite



and unprofessional to wait until the last minute to produce this document. Advice of IP counsel in this area is critical in drafting an NDA to protect the developer's interests and in deciphering the other party's NDA.

3.1.6.4 The Process is Complex, but Results are Achievable

Since the process of protecting IP is often so complex and attorneys are a necessary part of it, why should a game developer even bother? First, a knowledgeable game developer can ask good questions when dealing with IP advisors, saving everyone time and money. Secondly, a game developer familiar with IP may recognize the warning signs of IP infringement in game development early, before money is wasted on creating an infringing character, storyline, or feature. In addition, much of IP protection requires planning and structure within the development company. An educated consumer of IP advice is best situated to understand that advice and implement structure within the company that protects IP. Most importantly, all the contracts and licenses surrounding games deal with IP, from the work-for-hire contracts for employees to publishing deals, royalty structures, and movie rights. Even though the developer is working with attorneys, the developer makes the final decisions and should know that the ultimate responsibility for protecting and selling the game rests on him. Given everything discussed in this chapter, that burden requires an understanding of this extremely important topic.

3.1.6.5 Strategies for Small Companies and Individual developers

Small companies and individual developers should concentrate on low cost options to protect their IP. These companies do not usually have the staff or the resources necessary for elaborate IP strategy. Most of these companies will not even have a single employee tasked solely with developing and implementing an IP strategy.

The low-cost options for IP protection include simple copyright registration for commercially available products. The plan may also include federally registering the company's one or two most important marks to receive the ® designation or using ™ to achieve common law protection at the very least. The company's most important mark is usually the name or name/logo combination of the company. Trade secret processes are also relatively inexpensive and easy to put in place for a small company.

Small companies and individuals will probably not be as interested in international protection, but this option should be considered carefully for a company distributing their games over the internet. These companies will also be less interested in patent protection unless patent protection is involved in the core business model, such as hardware development.

3.1.6.6 Strategies for Large Developers and Publishers

Larger developers and publishers should implement everything in the lower cost plan for small companies above, but should also expand IP protection to include more resource-intensive protection. This includes federally registering the trademark for all major titles put out by the company. This may also include international registration and monitoring of the company's most important trademarks. Large publishers and developers should also consider filing separate copyright applications for music and other protectable components associated with game titles.¹⁶⁴

An upgraded IP program may include building a patent portfolio. Some game companies pay bonuses to employees in the company that submit patentable ideas and help complete the patent process. After a company has developed and/or purchased a patent portfolio, larger companies should consider monetizing this portfolio by seeking out licensing partners. These patents can be used as friendly negotiating tools with partners to add value to negotiated transactions or they can be used offensively to force competitors into paying licensing fees or designing their product around the patented invention.

Patents, even though they are legally a purely offensive instrument, also have a certain perceived defensive value. This value comes from the fact that litigants often find companies with large patent portfolios to be 'menacing.' A large patent portfolio is usually indicative of the company having significant legal resources and sophistication. Of course, there is also the idea that a company with a large patent portfolio may file a counter-claim for patent infringement in any litigation against the company.

3.1.7 Three Important Points

Even the largest game development and publishing companies can make trivial errors in IP protection that cost significant money or, worse, the rights to a whole game. These errors can sometimes be avoided with an introductory understanding of IP and a relationship with a competent, experienced attorney. Failing to take these steps is the metaphorical equivalent of leaving the city gates open and letting the Visigoths rush in.

Game developers can take three steps to avoid these potentially disastrous IP pitfalls. First, developers should have a basic understanding of IP protection and what it means to them, especially the areas that are most important to the creation of games. Sources of information include this chapter as well as the International Game developers Association (IGDA) IP Rights White Paper.¹⁶⁵ The IGDA White Paper was written by an international collection of attorneys and game developers with the goal of spreading IP information to the game development community.



As a second step, developers should have an attorney with broad experience in IP, especially trademark and copyright. This attorney, who may or may not be the same attorney used for other business issues, can help set up the most efficient and protective internal structures to protect IP. As discussed throughout this chapter, they can also aid in negotiating the myriad game contracts that are literally filled with IP-related language.

Third, developers should ensure that their employees and contractors sign appropriate agreements assigning all the IP they produce to the company. These three steps are necessary to build solid legal defenses around valuable game property. It is not an understatement to say the life and future of your game depends on it.

Table 7 (below) looks at all the different forms of IP with some of the important details to know when implementing an IP Strategy.

Table 7: IP Rights in the Video Game Industry

| IP in the Game Industry | Patents | Trademark | Trade Secret | Copyright |
|--------------------------|----------|-------------|--------------|-----------------------------|
| Length | 20 Years | Immortal | Immortal | 70-120 Years |
| Cost | High | Medium | Medium | Low |
| Ease of obtaining | Tough | Medium | Medium | Easy |
| Use | Rare | Often | Often | Often |
| Registration? | Yes | Recommended | No | Recommended where available |
| Coverage | Medium | Narrow | Large | Large |

CHAPTER 4

LICENSING IP FOR GAMES

4.1 Introduction

Throughout the evolution of the gaming industry, developers have incorporated licenses in their games to help distinguish their games and hopefully attract a wider audience with recognizable brands and more realistic game play. Typically, developers will either develop games based on wholly owned, original intellectual property created by the developer or obtain content owned by other parties such as movie studios, sports leagues,¹⁶⁶ authors, comic books, and toy manufacturers through license agreements. Usually, a developer or publisher¹⁶⁷ (for purposes of this chapter both will be classified as 'licensee') may want to incorporate licensed property into their game under a number of different scenarios including: (1) basing their game on another party's intellectual property (i.e., a game based on a movie¹⁶⁸ or book or a toy¹⁶⁹); and/or (2) incorporating into their game intellectual property owned or controlled by another party to provide more realism for the game player.¹⁷⁰

Licensed intellectual property will usually consist of copyrighted material and trademarks associated with a particular brand. The licensee may have interest in a licensed property to base the game on the property with the belief that the value associated with the property will result in greater consumer recognition upon the release of the video game. For example, a game is based on a story for an upcoming motion picture¹⁷¹ or a successful television show.

In other situations, a licensee may want to incorporate various licenses that are part of the game, but not necessary the focus of the game, but which help provide realism to the game. For example, a licensee may want to use cars, planes, or other identifiable marks in a game, and while they may be desired for the game, they may only be one aspect of the game. In this scenario, the licensee would pay considerably less than if the game was based on an underlying property although many of the contractual issues will be the same.

For a licensor, an association with a video game also brings with it possible benefits. In addition to receiving potential money from licensees, inclusion into a game for a licensor also has many other benefits, including publicity and retail promotion for brands targeted at the video game consumer.¹⁷²

Traditionally, licensing in games has been focused on the traditional platforms of the console and PC. However, even with new platforms such as mobile licensing, opportunities can arise rapidly. For example, Rovio's *Angry Birds* was relatively quickly followed by *Angry Birds: Star Wars*; Imangi Studios' hit game *Temple Run* now



features the likeness of athletes such as Olympian Usain Bolt; and one of the most successful mobile games of 2012, car racing game *CSR Racing* by Natural Motion, featured a series of sports cars licensed from car manufacturers. In mobile and online, as in PC and console, licensees may look to licensed properties to distinguish their games from other games in increasingly crowded markets.

Box 3: Movie Licenses

Movie licenses associated with video games have been a major part of the industry for over 30 years but with mixed results. Some licensed games have been hugely successful while others have been major disappointments, although a number of reasons may contribute to a game's success or failure including poorly reviewed games and/or movies.

As the cost of development increases combined with licensing fees, possible marketing commitments, short development cycles to meet a film's release date, limitations on creativity for licensees and the growing importance of creating original intellectual property, licensees today appear to be less interested in tying games to movie licenses for console and PC games. In addition, since the development cycle can be 18-24 months to create a game, a licensee may only have the opportunity to look at a first draft of a script to determine whether they wish to enter into an agreement to obtain video game rights to a film, which puts them into a risky position as to whether to commit or not. However, even a poorly reviewed video game based on a film license can do well because of the strength of the brand. As publishers rely more on their own brands, and because of other issues dealing with licensors, there may be less reliance on licensed properties to drive traffic on the console platforms. Nonetheless, lower licensing fees might appeal to licensees for other platforms such as mobile and tablets. Movie licenses tend to go in cycles, although fewer licenses are associated with recent major video game releases.

In one famous licensing mishap, although it was due to a poorly developed game, the 1982 version of the film *ET*, developed in 5 weeks instead of the normal development cycle of about 6 to 8 months to meet the Christmas season, was released for the Atari 2600 to such disastrous results that it led shortly thereafter to Atari's bankruptcy and a profound downturn for the video game industry.¹⁷³

Before deciding on whether a license would be desirable, a licensee must consider a number of factors including:

1. Which party owns or controls the rights to the license?
2. Does the licensor have a licensing programming and does it handle inquiries internally or through a licensing agent?
3. What is the licensee's budget and has it factored in licensing costs which may include advances, guarantees, royalties and a marketing commitment?
4. Will potential licensing costs justify the license's inclusion into the game, generating additional sales?
5. What rights does the licensee want to obtain? Will the licensor allow it to alter the licensed property for a game?
6. Does the license have world-wide recognition?

7. Is there enough time to contact the licensor(s), negotiate a deal or deals (a deal memo may be required) and put the licenses in the game prior to the anticipated video game release date?
8. What restrictions, if any, will the licensor impose that may affect game development and marketing of the game?
9. What will be the major business terms, including rights granted, platforms, territory, term, exclusivity vs. non-exclusivity, consideration, and approvals?
10. Additional business and marketing considerations: (i) what will the market conditions look like for the type of game planned by the licensee when released? (ii) does the market already have similar games on the market and how will the licensee distinguish its game? and (iii) will the price point for the game change because of licenses?

Not all uses of marks or materials need to be licensed, because the IP may fall into some of the exceptions requiring a license in the United States, such as First Amendment protections,¹⁷⁴ fair use, parody, incidental use, and materials in the public domain, to name a few (of course, the available exemptions depend on which country's legal system applies to the licensee's usage of the IP in question). However, in deciding whether IP must be licensed or not, the licensee must be extremely careful since an incorrect decision may result in huge costs defending against any claims. Litigation, whether valid or not, can be costly.

Depending on the outcome of the litigation or settlement, a licensee may: (i) be forced to pay damages (including profits made from any actual use of the unlicensed IP); and/or (ii) stop selling the disputed game; and/or (iii) redesign the game to avoid any infringements which could cause delays in the game's release and increase expenses; and/or (iv) enter into a license agreement, which if available, might be on unfavorable terms.¹⁷⁵ Furthermore, there will be additional problems if a game is subject to any infringement claims and has been published on a console system or digital distribution platform, since a potential infringement claim could result in a breach of the console manufacturer's licensing agreement or distribution agreement. As a result, before proceeding with using any third-party intellectual property, the licensee must discuss these issues with a legal expert in IP rights and clearances. In addition, laws will vary among countries and what may be legally acceptable in one country may not be acceptable in another country.¹⁷⁶

4.2 The Licensing Agreement: The Long Form Agreement

In the event that the licensee decides it wants to include a licensed property in a game and it is determined that a license is required, then it will need to enter into an agreement which will spell out at the very least the rights granted, the length of



the time to exploit the rights, the way in which the rights can be exploited, the costs involved in securing a license including possible advances, guarantees, and royalties; approvals, representations and warranties, and indemnification.¹⁷⁷

Depending on the use that the licensee wants to make of the licensed intellectual property, the terms and conditions of the agreement will vary. For example, if the game is based on a license such as a movie, then the movie owner will demand a lot more control over the exploitation of the game and seek higher advances and royalties as compared to the use of a trademark that appears in a game, but does not play a major factor in the game.

In most situations, the licensor will draft the agreement and will include terms favorable to the licensor, which should be expected. The drafter of an agreement always has an advantage initially, since that party will include all of the provisions it requires and with favorable terms. It will be the responsibility of the licensee to therefore request additions and deletions from the agreement. Furthermore, unless the licensor has experience in the video game and mobile gaming industry it may not include specific provisions required from a licensee. Therefore it is important that the licensee's counsel review the agreement and include language relevant to the licensee, including ownership of intellectual property such as source code, returns, factors in royalty calculations unique to the video game industry and issues dealing with the exploitation of a game after the term.

The next section of this chapter focuses on the major issues of a licensing agreement incorporating a license, which is the subject of the game. Most of the sections will be relevant in any type of licensing agreement but there will be a few differences, which will be pointed out throughout the chapter.

4.3 The Major Issues in Licensing Agreements

4.3.1 The Licensed Property

In this section the parties will define the nature of the licensed property that will be used in the game as well as any materials associated with the exploitation of the game (i.e., marketing). It is very important that the parties clearly define the property since the licensor may want to limit the definition as much as possible while the licensee will want it to be as broad as possible. Any rights not spelled out in the agreement will be reserved by the licensor (usually in express language to that effect) and if later sought by the licensee will most likely cost the licensee additional fees.

In licensing rights to a book or a comic book, the licensee, at the very least, will want the rights to the title, logos, story, images, characters and the ability to use the author's name in publicizing the video game. When dealing with items such as toys,

planes or cars, the licensee must also obtain the rights to use the 'look' of the item in the game including the designs and marks associated specifically with the item.¹⁷⁸

Licensing opportunities for movies are usually more complicated to negotiate because of the possibility of a number of parties associated with the property.¹⁷⁹ A licensee interested in a movie property at a minimum would want to make a game based on the story while incorporating the title and logo, characters (including voice and likeness of the actors if possible), themes, images, settings as well as the right to use the music from the movie.¹⁸⁰ Unfortunately, the rights to actors, music, and actual film footage, perhaps from a previous movie, may result in additional costs for the licensee because video game rights may not have been secured by the licensor. Usually, a licensor will ask for these rights when negotiating deals with the talent but it's possible, because of additional costs, that the licensor may not have secured these rights.

Sometimes, these additional costs may not be worth the licensee's investment and therefore a game may not have an actor's likeness or recorded voice although consumers expect that elements in a movie will become part of a video game. In addition, in most situations, the licensee may require specific voice-over for the game and therefore would probably have to enter into a separate agreement with the actor to obtain those services and accompanying rights. Furthermore, in the event that the actor is a member of a guild, the licensee must be careful about how to proceed, since entering into a deal with a union actor in the United States may result in consequences for the licensee involving not only the game being developed but also for future projects.¹⁸¹

Sports leagues are somewhat unique because while the licensee could develop a team sports game without a license, the success factor would probably be extremely low since most fans want licenses attached to a sports game so a consumer can play their favorite team and control their favorite players. To do so, a licensee would need to obtain a license from both the sports league which controls the rights to team names, logos, uniforms, and league logos, and the players associations which represents the players and licenses the use of their names and likeness. As a result, the licensee would need to negotiate two separate agreements; each with different guarantees and royalty rates. However, the potential returns can be extremely lucrative: games such as EA's *FIFA* series of soccer games or the *Madden* series of American football games (both of which feature extensive licensing from their respective sports) are amongst the most profitable in the entire video game industry.



Box 4: Licensing hypothetical

| LICENSING HYPOTHETICAL | |
|---|---|
| SkyVision Productions ('SVP') wants to create a racing game, but the company is not sure which direction to take the game; however, it has been considering incorporating a number of licensed properties including car manufacturers. Before making a decision, SVP will need to consider : | |
| 1. | Which party owns or controls the rights to license the cars? |
| 2. | For each car manufacturer, does the car manufacturer have a licensing programming to license the cars? If so, does the car manufacturer handle licensing opportunities, or is it done by an agent representing the car manufacturer? |
| 3. | What is SVP's budget for potentially paying licensing fees? |
| 4. | Will potential licensing costs which may include advances, guarantees and royalties justify the licenses inclusion into the game generating additional sales? |
| 5. | What cars are they considering for the game? Does SVP just want current cars or older models? |
| 6. | If the game is sold worldwide, what car manufacturers would SVP want to include to appeal to a world-wide audience? Are there specific brands in Europe or Asia that may add extra appeal for the game in these markets? |
| 7. | In addition to obtaining rights to cars, what other rights does SVP want to obtain? (i.e., logos, drivers). If additional rights are required, who controls those rights? |
| 8. | Is there enough time to contact car manufacturers, negotiate deals (a deal memo may be required) and put the licenses in the game prior to the anticipated release date? Alternatively, can new cars be added to the game after the game's release as downloadable content? Also, how long is the approval process? |
| 9. | What restrictions, if any, will the car manufacturers impose on SVP that may affect game development and marketing of the game? For example, will crashes be permitted? Can cars be re-modeled? |
| 10. | What will be the major business terms including rights granted, platforms, territory, term, exclusivity vs. non-exclusivity, consideration, and approvals? |
| Additional business and marketing considerations: | |
| 1. | What will the market conditions look like for the type of game planned by SVP when released? How successful have recent racing games been in the last few years? Have games on certain platforms performed better than others? |
| 2. | Are there already competitive racing games on the market which would make it difficult for SVP to sell their game? If so, what will distinguish SVP's game from other games? and |
| 3. | Will the price point for the game change because of licenses? |

4.3.2 Rights Granted

Under this section, the licensor will specify the rights granted to the licensee and whether the rights are exclusive or non-exclusive. In almost all situations, the rights granted are conditional upon the licensee fulfilling its obligations under the terms of the agreement. At the very least, the licensee must have the right to develop,

manufacture, sell, distribute (either directly or indirectly through distribution partners such as console manufacturers, digital distributors, mobile carriers), market, promote, and publicize the game throughout the licensed territory (which can be limited to certain countries or be worldwide depending on the deal) during the term and sell-off period, if applicable. As part of the grant of rights, the licensee will need the ability to alter the property subject to the licensor's approval.

The above rights will be conditional upon licensor's approval and the extent to which the licensor enforces its approval rights will vary depending on the specific function carried out by the licensee. For example, game development and marketing will be closely overseen by the licensor pursuant to the approval process to ensure that the game's development and marketing is consistent with the direction of the licensed property.¹⁸²

In contrast, the licensor should have less oversight in sales and manufacturing. Regarding sales, although the licensor cannot dictate the price of a game, the licensor will be concerned that the price of the game does not drop to a price point that may lead to consumer perception that the property's value is diluted if the game is sold at below the prices of similar titles. While prices of games will drop over time and earlier than expected if the game does not sell as projected, one way in which the licensor may protect itself is by requesting a minimum royalty for each unit sold, though this approach may be difficult or impossible in mobile or free-to-play games where revenue can be structured rather differently to traditional games and therefore the licensee may not be able to give per unit price guarantees even though overall revenues may prove substantial nonetheless.

It is important, however, that the licensee maintains control of the development and exploitation of the property since the licensee will be in the better position to understand the market since this is their expertise. While licensors need to have approval rights regarding game development, licensors must give licensees the freedom to create a game, which may mean giving licensees more leeway in using the licensed property than is customarily done by the licensor with other third parties.

The rights section will also spell out whether the rights granted are exclusive or not. In most licensing situations where the property is the basis for the underlying game, the licensee will want to have exclusive rights to the property for the video game category which should include all platforms.¹⁸³ This decision will mostly depend on the type of license requested; how the licensed property will be incorporated into the game; and the licensee's budget, since an exclusive license will cost more for the licensee although in some situations it is counter-productive if a licensor were to license the same property to different licensees. For example, it probably would not be a good idea to have several games based on a new Spiderman movie developed by different licensees unless the original licensee was unable to develop for certain



platforms; and even then one would normally expect that other licensees would be involved to port the licensed game to other platforms, rather than creating entirely new and rival games based on the Spiderman IP.

Non-exclusive licenses are common but are usually tied to situations whereby the licensed property is only one element of a game and not the basis for the game (i.e., cars, some sports properties). Car manufacturers will usually license vehicles for a number of games although they may grant exclusives for certain car models to a licensee.

In the event that a licensee obtains a licensed property that will serve as the basis for a game, such as a movie, the licensee should request the right to make games based on sequels, prequels or television shows. If the licensee is going to invest millions of dollars in a game in addition to providing financial benefits to the licensor then the licensee should also benefit from its success in making a game by obtaining the right to option future games. Otherwise, a licensee may feel that its time and investment for a game based on just one film may not be worth it. Instead, a licensee may consider that the same investment may be better spent on creating its own intellectual property. If the parties do agree to an option on future films, it is just as important that the parties negotiate the business terms for those rights when they enter into the original agreement or else the licensee may find itself in a vulnerable bargaining position.

4.3.3 Platforms

Once the parties agree on the property to be licensed, the next issue will be what platforms the licensee will be allowed to develop and distribute a game on.¹⁸⁴ The more platforms are licensed, then the more likely the higher licensing fee, since the game should sell more units generating more revenue, which will ultimately affect the guarantee.

The licensee should also be aware that platforms not licensed to one licensee may be licensed to another party. From the licensor's standpoint, it will want to have the property exploited on as many platforms as possible to help generate additional royalties.

If a licensee does not have the capability to develop games for a certain platform then it is possible that a licensor may want to license those platforms to another licensee. This can be a delicate situation depending on the platforms granted to a licensee, since a poorly received game developed by one licensee may adversely affect the other licensee since a consumer may not distinguish different licensees and different platforms. On the other hand, a very well received game could help future releases. As a result, the primary licensee (i.e., the party paying the higher licensing fee) will need to coordinate with the licensor on the release schedule for the game on the

different platforms to insure that they have the opportunity to release their game first. Although this is rare, a primary licensee therefore may request that the other party be prohibited from releasing their game until an agreed-upon date ('holdback period').¹⁸⁵

One point of contention between licensor and licensee may involve future platforms and technologies, depending on the length of the term. Most licensors may feel uncomfortable granting rights without an understanding of the business model associated with future platforms, fearing that a license without knowing all of the economic factors could result in undervaluing the property for a particular platform. As a result, most licensors will want to restrict the license from applying to future platforms that are not specifically mentioned in the agreement with the hope that they can earn more revenue later by selling rights for those future technologies, although any future iteration of a current platform usually would be included in the grant of rights. In addition, typically language will appear in an agreement that rights not specifically mentioned in an agreement will be reserved by the licensor.

If future technologies are not covered in the agreement then the licensee should ask for a right of first negotiation and maybe even a right of last refusal to try to secure these rights during the term. A right of first negotiation requires the licensor to first negotiate in good faith with the licensee for a certain period of time a license for the rights under consideration. In the event that the parties are unable to come to terms, then the licensor would be free to discuss and enter into a deal with other parties for the rights. The right of last refusal, which may also be referred to as last negotiation, allows the licensee an additional opportunity to acquire the rights since the licensee has the right to match and improve the terms of any genuine deal that the licensor may have discussed with a third party. Licensors may be reluctant to grant rights of last negotiation, feeling that it will handicap their negotiations with other parties since those parties will know that they may not get the rights if another party has the right to match their offer.

4.3.4 Territory and Term

A licensee should request worldwide rights with the right to sub-license distribution in certain territories, and will also need the right to distribute the game in any language. The countries listed in each territory should be clearly defined, since that will eliminate potential issues with rights and possibly allocation of royalties as this may vary by territory.

Regarding the term, a licensee will need to have a term long enough to exploit the game and any ancillary rights (i.e., strategy guides) to hopefully make a profit. The longer the term, the higher the minimum guarantee because of anticipated additional sales although sales clearly will decrease in future years.¹⁸⁶ Terms should commence upon execution of the agreement or a binding deal memo so that development can



begin immediately, since time will be critical if the parties want to release the game within a certain time period such as a movie's release or the start of a sports season. Some deals allow for terms to start upon execution of the agreement and continue for a fixed number of years from the release of the game. This language would be favorable for the licensee, but may pose a problem for the licensor unless an outside date is agreed upon by the parties for the release of the game to avoid a term extending indefinitely. For example, a term may start on execution of the agreement and continue for a period of three years from the release of a game, but in no event will the term extend past an agreed-upon date.

Licensees should also consider the possibility of an option to extend the term, which will allow the licensee at a pre-determined time to notify the licensor that the licensee wishes to extend its rights to exploit the game. However, in many situations the licensor may not be willing to allow for such an option. For example, a movie studio will most likely not want to extend a license for a movie-based game if the studio is planning to release a sequel, since this might interfere with future video game deals involving sequels. A previous game might reduce the value of a subsequent video game license. In order to avoid a disadvantaged bargaining position, the licensee would need to negotiate the guarantees, advances, and royalty rates for the extension while negotiating the original agreement or otherwise the licensor could be in a lot stronger position to dictate the terms if the original licensed property exceeded expectations.

4.3.5 Licensing Fee

Other than the rights being granted, the costs associated with obtaining a license will be the most significant issue negotiated between the parties. For some licenses, the competition is intense in acquiring the rights to a particular property resulting in higher costs for the licensee. The more rights requested by the licensee, the higher the fees that the licensor will require in the deal. The cost to obtain a license will vary but will largely be dependent on the factors below:

1. The type of property. If the property is based on a famous book or sequel to a blockbuster movie then the minimum guarantee and royalties will be higher since there will be less of a perceived risk of a game's commercial failure;¹⁸⁷
2. Is the property the underlying property for the basis of the game or one of many elements in the game?
3. What is included as part of the property? If it is a movie, will it include music, talent?
4. Interest in the property from other potential licensees;
5. Length of term;

6. Territory;
7. Platforms requested;
8. Projected sales of the game based on wholesale price and projected royalties;
9. Exclusive or non-exclusive;
10. Royalty percentage, which depending on the amount could affect the advance and/or guarantee; and
11. Is a marketing commitment being requested that may impact a guarantee, advances and the royalty percentage?

Licensors, unless in the case of a cross-promotional deal, will request a minimum guarantee, which is a fixed payment that the licensee will have to pay at the end of the contractual term. The guarantee is an assurance that, no matter how well or poorly a game does, the licensor will receive a fixed amount of money for the rights granted to the licensee.¹⁸⁸ In the event that the licensee fails to reach the minimum guarantee payments through a combination of advance payments (which will most likely also be required by the licensor) and royalties, then the licensee must pay the shortfall at the end of the term.

In some situations when the licensed property is not the basis for a game, the parties could agree to a one-time payment to the licensor. This possibility is preferable from an administrative standpoint for a licensee, since it eliminates the need to issue statements. However, it also adds to uncertainty for both the licensor and licensee in determining the value for the license and therefore the fee paid for the rights. A licensee may be concerned that it has overpaid if the game does poorly and a licensor may feel that it was underpaid if the game exceeds expectations.

The minimum guarantee number will vary depending on a number of factors, including agreed-upon royalty, projected sales, popularity of the license and current market conditions; but in many situations, the bargaining power of the companies will be the most significant factor. The benchmark for guarantees is typically between 30% and 50% of projected sales, but can be higher or lower depending on the property. The licensee may have great arguments on why the guarantee and other payments should be at a certain rate, but if other parties are interested in the same property then the licensor will have more leverage to negotiate more favorable terms.

If a licensee is obtaining a license, especially if it is based on an upcoming movie, then the licensee should try to build in some protections, although, depending on the parties involved and the licensed property, this might be a difficult request. For example, if the license is based on an upcoming movie then the licensee will want to get assurances that the movie will be released on a certain date since the game



development schedule will be timed to the release. In addition, a licensee may try to request a guarantee involving a marketing and theatrical distribution commitment for the movie. If the licensor fails to satisfy potential guarantees, then there should be a reduction of any guarantees or royalties, or even possibly a termination of the agreement.

As part of the minimum guarantee, a licensor will usually require fully recoupable, but non-refundable, advance payments based on future royalties, to be paid at various stages to the licensor during the term triggered by either a date(s) and/or event(s). The amount of the advance payments will vary, but generally, a licensor will require a certain payment upon signing and then another payment during development and/or upon the game's release, with an outside date in the event that the game misses its scheduled release date. The advances will be non-refundable and as a result unless the licensor has breached the agreement the licensor keeps any advances even if the licensee is unable to recoup all of its advances.

In addition to a minimum guarantee and probably advance payments, a licensee will need to pay a royalty (i.e., a fixed fee which can either be a royalty percentage or a specific dollar amount) for each unit of a game sold or manufactured (or each in-game item sold) based on net sales.¹⁸⁹ Net sales typically will be defined as the gross revenues received by the licensee from all revenues received from the exploitation of the game (i.e., sales of the game, downloadable content, in-game advertising, if permitted) less allowable deductions.¹⁹⁰

Royalty rates will vary depending on the rights requested, popularity of the licensed property and other financial commitments from the licensee. Royalty rates may also vary depending on: (i) the platform, with royalties higher for platforms in which first party fees are not applicable (i.e., PC games), and (ii) the means of distribution where there may be fewer costs to distribute such as digital distribution. For example, the royalty rate may be higher for the licensee for games distributed on digital or mobile as compared to retail, because there are no costs for manufacturing.¹⁹¹ Furthermore, royalties can vary during the term depending on the success of the game: the parties may agree to a sliding scale royalty rate with the royalty percentage increasing with corresponding sale increases. For instance, the parties may agree to a 10% royalty for all units of the game sold on a particular platform from 1 to 300,000. The royalty rate might increase to 11% for all units of the game sold over 300,000.¹⁹²

A major part of negotiations will involve how the royalty rate is calculated. The licensee will usually be permitted to deduct the following from gross revenues when calculating net sales: (i) actual out of pocket third party service charges incurred in the distribution of the game (i.e., a mobile carrier or first party console manufacturer retains a certain fee for distributing the game on their platforms); (ii) sales taxes, shipping costs; and (iii) allowances such as price protection and returns, quantity

discounts, refunds, rebates, chargebacks and governmental taxes. Licensees will typically allow these allowances, but may also insist that they are capped, and anything over the cap would therefore not qualify as a deduction. Depending on the platform, certain deductions may not be permitted since they may not be applicable when calculating royalties. For example, price protection would not be relevant for mobile distribution.

In addition, licensors generally will not allow for the licensee to deduct costs incurred in manufacturing, selling, distributing, advertising, uncollectible accounts or currency conversions. As the costs for console games increase, this is an area that the licensee may want to consider pushing back on and may consider trying to recoup some of the costs although to date it has been very rare for a licensee to deduct these expenses.¹⁹³

4.3.6 Ownership Issues

While the licensor will own the intellectual property provided to the licensee to make the game the licensor will also typically require that any materials derived from the original property will also be owned by the licensor. For example, even if the licensee has created new characters and/or stories for the game, the licensor will claim ownership of those creations. The agreement will often include language that the work created by the licensee will be 'works for hire' which is an American copyright concept whereby the licensor would own the work and not the licensee pursuant to a license agreement¹⁹⁴ (though as discussed in Chapter 2.2.2 this does not always apply and alternative language may be needed depending on the jurisdiction in question).

In the event that courts do not acknowledge that work was done under a work for hire arrangement, then the licensee would be required to assign (i.e., transfer) all of their rights, perpetually and throughout the world, to the materials they created to the licensor. Furthermore, if a work for hire and assignment are not upheld then the agreement may also have language that provides for a perpetual royalty-free world-wide license to the licensor. In all of these situations, the licensor usually will be free to use the materials created by the licensee by any and all means without further compensation to the licensee even after the term.

While the licensor will own all of the derivative materials created from the underlying property, the licensee will still own any of the source code and tools used to make the game that they created or licensed.¹⁹⁵ It is critical that the licensee maintain ownership or control of these materials so they can possibly be used for future projects. Since the licensor in most situations is not in the business of making games, this should not be an issue.



4.3.7 Statements and Audits

In all licensing situations involving royalty payments to the licensor, the licensee will be required to provide financial statements to the licensor outlining the revenue generated from the sales of the game and deductions permitted in order to determine the royalty payments owed to the licensor. The licensee will generally issue statements at an agreed-upon time concurrently with any royalties that may be owed as per the statement. What information will be required in the statements will vary depending on the negotiations, but generally the licensee will need to indicate the number of units sold during an agreed period of time (e.g., quarterly) usually separated by country or territory (i.e., North America, Latin America, Europe, Asia) although it should be made clear between the parties what countries are actually included in each territory. In addition, the statement will show: (i) revenues received by licensee during the accounting period (i.e., gross receipts); (ii) net receipts that will show allowable deductions from gross receipts including any advances paid to licensor, price protection, returns, etc.; and (iii) the distribution partner that may have distributed the game via a particular platform (i.e., mobile carriers and digital distributors).¹⁹⁶

Licensors will require that they have the right to audit the books and records of the licensee to verify the accuracy of any statement provided to them. While the licensor should have the right to audit, it is important that the licensee limit the licensor's right to audit since if parameters are not set for an audit it can quickly become a very time-consuming and costly process for the licensee even if the licensee properly reported to the licensor. As a result, the parties need to negotiate specific conditions and time limits regarding the audit. Specifically, the licensee will want to limit the number of audits that can be conducted by the licensor (usually one a year); location of the audit (usually the place of business of the licensee); time in which an audit can take place (during normal business hours); length of the audit; and who can conduct the audit subject to the auditor also signing a confidentiality agreement.

It is important that the auditor understands the video game business so that time and money is not wasted during the audit. Generally, a licensee may require that the auditor is a CPA, works for a major accounting firm, and is not conducting an audit on a contingency basis.

An auditor will require that they have access to all books and records that may determine the royalty amount owed to the licensor. This can result in a huge amount of documentation and therefore the licensee should insist on narrowing the scope of the records requested by the auditor. At the very least, the auditor, prior to conducting an audit, should be required to provide a specific list of documents that may be requested for the audit to allow for the licensee to compile the records and also contest a requirement if they feel certain records are not relevant.

Furthermore, a licensee should try to restrict the time period in which statements can be contested. For example, a licensee might try to limit the right of a licensor to contest a statement to one or two years. Anything longer than two years usually imposes an administrative burden on the licensee not only in keeping the records but finance people and business people may leave a company making it more difficult to explain some of the old statements. While the licensee will need to agree to a time period in which statements can be contested, the licensee must add language that in the event that a licensor does not contest a statement within a certain period of time then the statement should be deemed final and cannot be contested unless fraud was involved, in which case a statement can be questioned at any time.

Issues involved in contesting a statement can create further complications. If a mistake is obvious, perhaps it as simple as a calculation mistake then there should be no problem with the licensee paying the licensor the difference in the mistake.¹⁹⁷ However, in most situations when a statement is contested usually involve a discrepancy on the allowable deductions. As a result, resolving the issue becomes more of a challenge. At the very least, the licensor's auditors must provide the licensee with a copy of the audit report within a certain period of time explaining the accounting discrepancies and allow the licensee to respond to the alleged errors. Many times, an explanation on how the net receipts were determined quickly leads to a resolution. It is very important that any deductions taken by the licensee must be supported by proper documentation or else they will be challenged by the licensor's auditor and difficult to contest.

Other times, the parties might still be in disagreement and will have to discuss a settlement. If there is a disagreement about a royalty statement and if it is a large amount it could result in creating problems with the relationship and therefore any questions need to be settled in a timely fashion. In the event that the parties need to settle a disagreement, it is important that the licensee also obtains a release from the licensor stating that no additional claims will be made against the licensee regarding statements that were covered under the audit, so that the threat of potential litigation is avoided between the parties.

The responsibility associated with the cost of the audit will be another issue within the audit provision. Generally, the cost of the audit is the responsibility of the party conducting the audit, but the responsibility shifts if the audit shows that a mistake had been made with previous statements and if the mistake exceeds a certain percentage of the amounts paid. The range will vary but is usually between 5% and 10%.

In the event that the audited party (i.e., the licensee) has made a mistake, then the licensee will be responsible for paying for the licensor's costs associated with the audit. While the licensee will be responsible for the audit, it is important that limitations are imposed on the licensee's liability. First, the licensee will want the



rate to be as high as possible that would trigger licensee's obligation to pay for the audit and should also insist that the mistake must meet a certain minimum dollar amount. For example, the parties could agree that the licensee will pay for the audit in the event that an accounting mistake is 10% or more on what was reported in the contested statement provided the mistake must be at least \$5,000. If the mistake only amounts to \$3,000 then the costs would still be incurred by the licensor. Second, the parties need to determine what costs will be covered under the reimbursement. Costs should be actual and reasonable expenses that may be incurred by the auditor. In addition, consider whether costs include not only the costs to conduct the audit, but the auditor's traveling and possible lodging expenses.

4.3.8 Representations and Warranties

For the licensee, the representations and warranties are critical because without these guarantees associated with the licensed property the licensee will be taking on unknown risks in its attempt to exploit the property in a game. At the same time, the licensor will also require reciprocal representations and warranties from the licensee involving the distribution and marketing of the game and any new materials created by the licensee.

For the licensee, the representations and warranties are assurances that the licensee is relying on in obtaining the license. Without these guarantees, the licensee would be at risk of possible lawsuits involving ownership of the licensed materials. Generally, the licensor will try to limit its exposure by limiting its representations and warranties and therefore the licensee must insist that the licensor provides the necessary protections to allow the licensee the guarantees to move forward with development and distribution of the game without any concerns about possible litigation involving IP infringement with the materials delivered by the licensor.

Because the licensor is in the best position regarding knowledge about ownership issues and since the licensee is paying minimum guarantees and royalties based on these assurances, the licensor must provide for the necessary representations and warranties to the licensee. While licensors will try to limit their exposure, at the very least the licensee must obtain the following representations and warranties:

- (i) the licensor either owns or controls the rights being licensed to the licensee to allow the licensee to exploit the licensed property pursuant to the agreement;¹⁹⁸
- (ii) the licensed property does not and will not violate the rights of any third party including the rights to copyright, trademarks, rights of publicity, privacy or patents;¹⁹⁹ and
- (iii) there is no pending or threatened litigation involving the licensed property and the entering of the agreement by the licensor will not violate any other agreements.²⁰⁰

The licensor will also request representations and warranties from the licensee, including that the game and any elements contained therein such as software used in the development of the game, as well as any marketing materials except for the licensed property does not infringe on the rights of any third party. This provision will include infringements involving copyrights, trademarks, patents, privacy and publicity. This provision is the most significant for the licensor since in many situations the licensor will have greater resources and will definitely be named as a party in any intellectual property lawsuit involving the game even if the licensed property is not the subject to the litigation. The fact that the licensor is associated with the game will be enough for a third party to also initially make a claim against the licensor. Fearing that the licensee may not have the resources to defend against an infringement case, the licensor usually will also require the licensee to obtain insurance to protect against and cover the costs associated with possible infringement claims.²⁰¹ The licensor may also require the following additional representations and warranties from the licensee:

- (i) there is no pending or threatened litigation against the licensee;
- (ii) the licensee is a validly existing legal entity, whether a corporation or limited partnership;
- (iii) the games will be of high quality (although this is highly subjective);
- (iv) it will not harm, misuse or bring into disrepute the licensed property;
- (v) it will not incur any costs chargeable to licensor;
- (vi) it will comply with all laws and regulations involving the sale, marketing and any other form of exploitation of the game;
- (vii) it will maintain adequate arrangements for the distribution of the game throughout the territory;
- (viii) an agreed-upon rating; and
- (ix) there are no material defects, viruses, worms, Trojan horses, time bombs or hidden content that may negatively affect the game. This provision is unique for video games since a licensor does not want to be the subject of bad publicity in the event unknown and/or damaging elements are hidden within the game.

Furthermore, the licensor will probably require that the licensee uses commercially reasonable efforts to release the game on a minimum of one platform on an agreed-upon launch date and may even insist on a marketing commitment.²⁰² If the licensee must agree to these requests then it is important that the licensee add language that the licensee would not be responsible for any delays in the game's release caused by the licensor's delays in performing its services including delivery of materials and timely approvals under the agreement.



4.3.9 Indemnification

While each party will be required to make representations and warranties, the parties will also need to guarantee that, in the event of a breach of the agreement including a representation and warranty, then the party making the representation and warranty ('indemnifying party' or 'indemnitor') will need to indemnify the other party ('indemnified party' or 'indemnitee') against damages suffered by the indemnifying party's conduct or product.

Basically, the indemnification provision protects the non-breaching party against 3rd party claims that may be made against the indemnified party for an alleged breach of the agreement. The same concerns that arise with the developer and publisher relationship also need to be addressed in any licensing agreement such as:

- (i) what claims will be covered under the indemnification;
- (ii) what will be paid by the indemnifying party, including but not limited to third party damages, legal fees and court costs;
- (iii) when will payment be owed (e.g., after final judgment of a claim, after appeals have been exhausted);
- (iv) the extent of the indemnified party's involvement with a claim including when notice must be provided to the indemnifying party of a claim; and
- (v) how settlements would be handled.²⁰³ Parties will attempt to limit their indemnification obligations by limiting the claims that may be covered under the clause, type of damages, and the amount of damages.²⁰⁴

Because of the increased threat of litigation involving video games, and concern by licensors that licensees may not have the funds necessary to defend against a potentially costly litigation, licensors have required that licensees obtain Errors and Omissions insurance ('E&O') to protect against these risks.²⁰⁵

E&O primarily insures against claims associated with unauthorized use of copyrights and, trademarks, invasions of publicity and privacy and defamation. If the licensee has obtained E&O, and a claim is made against the licensor, the insurance company would be responsible for a certain amount of the damages or settlements incurred regarding the litigation subject to the deductible and amounts covered under the policy²⁰⁶ as well as the right for the insurance company to help determine the licensee's legal representation.²⁰⁷ For example, the licensee as well as the licensor is sued for an alleged copyright infringement involving the game separate from any materials provided by the licensor. Under the indemnification provision, the licensee would be responsible for defending the case and paying for any and all damages or settlements. Assume that the claim is for \$300,000 and the licensee's policy covers up to \$500,000 for any single claim and \$1 million for all claims with a \$100,000 deductible. In this case, if we further assume that the licensee settled for \$150,000 then the

licensee would be responsible for paying \$100,000 which covers the deductible and the insurance company would pay the remaining \$50,000 out of the settlement.

4.3.10 Approvals

Another critical provision of the agreement will be the right of the licensor to approve all materials involving the licensed property which will include the game, marketing, packaging, and publicity materials and possibly the distribution and sales strategy of the licensee. This is language that will appear in every licensing agreement, but depending on the license granted the amount of approval will vary from agreement to agreement. This is a critical provision, since many games based on an underlying property will be released in conjunction with a particular event such as a movie's release or the start of the sport season and therefore the licensee must be careful to build in enough time for the licensor to approve the various submitted elements involving the game to avoid potential delays.

In most relationships, the licensor will require prior written approval over all materials involving the game. The licensor needs to protect the integrity and value of their copyrights and trademarks and wants to make sure the game is consistent with the direction of their property. Although they should understand the risks, and most do since many have already been associated with some type of video game, licensors do not want to be in a position where if a game is a poor product it could still undermine the goodwill and value built up over the years by the licensor. While the possibility will always exist because of challenges in development, the licensor will want to reduce its risks and therefore will want broad approval rights. The licensee must be aware of the approvals required by a licensor and factor into its development, sales, and marketing schedules the amount of time a licensor will have to approve materials and the possibility that the licensor may reject materials. The risks can be high that development plans and other opportunities can be jeopardized because of slow response times regarding approvals.

Typically, a licensor will require a fixed amount of days to approve any materials submitted. The amount of time will vary depending on the bargaining position of the parties and can be anywhere from 5 to 30 days depending on the item being submitted for approval. For example, reviewing the game towards the end of the development cycle will involve more time to review as compared to reviewing a press release. In addition, parties could even agree to reduce time periods under certain circumstances that may involve immediate responses to prevent a loss opportunity, perhaps in a sales or marketing situation.

Depending on the licensor, the licensor might require additional time because of the number of parties that might be involved in the approval process. A movie, for example, may need approval from the people working on the video game that might be very different than the people associated with the movie, which is the subject of



the license. Unfortunately, this puts an extra burden on the licensee, and because it could have a negative impact on the licensee, it is critical to try to lock in very specific time frames for approval.

Although it might be difficult to obtain, a licensee should try to get a concession from the licensor that in the event that the licensor fails to respond to an approval inquiry within a certain period of time then the materials would be deemed approved. Otherwise, the licensee could be waiting for an excessive period of time, which would create uncertainty in moving forward with game development and the release of the video game. Furthermore, the licensor will require that once an item has been approved that the licensee does not depart from the approved item without first obtaining an additional approval from licensor.

In a perfect scenario, materials are submitted to the licensor for approval and the licensor approves the materials within the allocated time period. In the event the materials are rejected then the licensor must provide clear and precise written explanations for the reason behind the rejection so approvals can later be obtained based on the licensor's feedback. It is important for both parties that the licensor be involved early in the development process so they understand the direction of the game and how the license will be incorporated into the game, to avoid any surprises which can result in increased delays and costs.

One way in which the licensee can avoid potential problems with approval is to include language in the agreement stating that approval of materials cannot later be disapproved during a subsequent submission. This is significant since the licensee will be relying on the previous approved milestones and an unexpected rejection of a milestone involving previously approved materials whether in the game or as part of marketing materials will result in potential delays and increased costs for the licensee. A licensee must receive in writing all approvals from the licensor so there can be no disagreements in the future. Also, materials approved for one territory should be deemed accepted for other territories unless material changes have been made.

The licensor might add language to the agreement that states that their approval of a submission does not include approval of any third-party rights and even though the licensor may approve materials other than the materials created by the licensor, in the event of any legal action the licensee will be required to indemnify the licensor.

Subject to approval rights regarding the game and marketing materials, the licensee should have the right in its sole, reasonable, discretion to determine the logistical aspects associated with the distribution, marketing and sales of the game including the channels of distribution and pricing of the games on the various platforms.

How can a licensee reduce its risks regarding approvals?

1. If materials are not approved within a certain time period then they are deemed approved.
2. Different approval time periods depending on the materials submitted and the possibility to reduce time periods subject to mutual agreement in the event an opportunity requires a faster turnaround.
3. Materials previously accepted cannot be rejected at a later date.
4. Materials accepted for one territory do not need to be approved again for another territory unless material revisions have been made to the previous submitted items.
5. Materials should be provided throughout the development process to confirm the licensor's acceptance of the direction of game development.

4.3.11 Termination Rights

In certain situations, a party will have the right to terminate the agreement because of the failure of one party to fulfill and/or perform its obligations. Typically, the non-breaching party will be allowed to terminate the agreement in the event of a material breach of the agreement subject to the failure of the breaching party to cure the alleged breach within a certain period of time upon receipt of notice ('cure period'). A material breach for the licensee generally would include among other things: (i) licensee's breach of representations or warranties; (ii) failure to pay any monies owed to licensor when due, whether royalties or advances; and (iii) failure to complete the game within a certain period of time. However, a licensee should try to avoid committing to a release of a game, because problems could happen in development and that is the main reason behind the guarantee paid to a licensor to help reduce licensor's risks. On the other hand, it is also possible that the licensor could be in breach of the agreement and that could include a breach of licensor's representations or warranties or failure to perform any of its obligations.

In order for a party to claim breach, the non-breaching party must first provide notice of the material breach and in the event that the accused breaching party fails to cure within the cure period then that party will be deemed in breach. Cure periods may vary depending on the type of breach. Failure to pay an advance may have a 10 day cure period while a breach involving a representation and warranty may have a 30 day cure period. Furthermore, cure periods may be based on business days or calendar days. In some situations, because of the type of breach there may be no possibility of a cure period. For example, if the licensee becomes insolvent, or is unable to pay its debts when due, or makes an assignment for the benefit of creditors, or files a petition in bankruptcy, then the agreement would typically terminate immediately.



The termination language in the agreement will spell out the conditions in which an agreement can be terminated and will also discuss the remedies that may be sought by the non-breaching party. Clearly, termination for breach can have significant ramifications for the breaching party. For the licensee, depending on the type and when the material breach occurs, the licensee may have to:

- (i) stop development or stop the distribution and exploitation of the game;
- (ii) accelerate payments upon termination if any advances or guarantees are owed;
- (iii) provide a final royalty report for sales of the game;
- (iv) return all materials delivered by licensor and created by the licensee except for source code and development tools; and
- (v) either return any remaining inventory or destroy the game and provide proof of destruction.

Furthermore, the licensor may seek additional damages such as loss profits unless the parties agreed to limit their liability if the agreement is terminated because of a material breach.

In the event that the licensor materially breaches the agreement and depending on when the breach occurs, licensee should seek, although it may be difficult, a return of any advances and royalties and may also attempt to recoup development costs if the game would not have been developed if not for the underlying licensed property.

Under certain conditions such as an infringement involving a copyright or trademark, the licensor could seek in the United States a preliminary injunction against the licensee, which could result in the immediate termination of any exploitation associated with the game subject to a court order.²⁰⁸ In this situation, the licensee perhaps released the game without final approval of the licensor, or the licensee sold the game beyond the term or in an unauthorized territory. If an injunction is granted, the licensee might be required to immediately remove all games from the market in the territory in which the injunction was granted: a difficult and costly requirement that the licensee will have to comply with in order to avoid further damages.

Because injunctive relief is an extreme remedy and requires a number of pre-conditions in order for it to be possibly granted by a court, contracts typically will include language whereby the parties acknowledge certain facts, making it easier for a party to obtain injunctive relief. The agreement will usually include language that: (i) a licensor has the right to seek injunctive relief; and (ii) the licensee is required to acknowledge that in certain situations in which injunctive relief is sought that a material breach would result in irreparable harm and that monetary damages would not remedy the licensor's damage. By including this language in the agreement, the licensor will find it easier to prove to the court one of the main conditions for granting an injunction since the licensor will have acknowledged that the material breach has

caused irreparable harm.²⁰⁹ In addition to showing irreparable harm, the licensor will also have to prove to the court that there is a likelihood of success on the merits.

A major clause tied to termination and the remedies provision of a licensing agreement will be a limitation of liability associated with the type of damages that may be awarded to a non-breaching party as well as the monetary amount that a non-breaching party may claim. Language in this section will typically state that damages do not include consequential (i.e., loss profits), special, incidental, indirect, punitive (i.e., damages awarded as punishment for the actions of the breaching party to serve as a deterrent for future activities).

The parties may also set limits on the total amount of damages. The licensor most likely will require that the amount of damages it would be liable for in the event of a breach would be capped by the amount of money it has received during the term, which may be less than the minimum guarantee depending on when the breach occurred. To illustrate, the licensor may have breached prior to the term expiring and may have received royalties and advances less than the guarantee and therefore the licensor will want to limit its damage liability to money actually received at the time of the breach. As a result, the amount needs to be carefully considered depending on the type of damages that a party may be exposed to or could be awarded. For example, a licensee may suffer a lot more monetary damage than the amount of money that it paid to the licensor prior to licensor's breach especially if development costs are factored in the damages. Although it may be difficult to obtain, the licensee should ask for a reciprocal limitation on damages and also should tie it to the amount of money it has paid the licensor.

The limitation of liability is not absolute and the parties will typically carve out exceptions to the limits and in certain jurisdictions claims such as fraud and gross negligence would not be limited.²¹⁰ In most agreements, the limitation will not cover breaches of the confidentiality provision or either party's obligations under the indemnification clause. A breach of confidentiality could reveal trade secrets of a party, which may exceed the value of any compensation received by a party. In addition, a non-breaching party does not want to be responsible for possible damages for any awards or settlements under the indemnification provision that exceed any cap under the limitation of liability.

Finally, the parties could agree to a set damage award in the event of a breach by one the parties. This liquidated damage clause would set a fixed amount of money for any damages incurred by the non-breaching party for a particular type of breach. The amount, however, must be a fair amount and cannot serve as a penalty against the breaching party²¹¹ (since under the law of many countries penalties are liable to be challenged and can be held as unenforceable).



4.3.12 Expiration of the Agreement

Language will appear in the agreement covering each party's obligations upon the expiration of the term. In this situation, unlike termination of the agreement, the term of the agreement has expired and neither party has breached the agreement. Since retail games may still be on the market, the licensee will want to include language in the agreement which allows for the licensee on a non-exclusive basis, to sell off remaining inventory in any of the distribution channels permitted under the terms of the agreement. This right will generally be granted by the licensor provided the licensee: (i) is not in breach of the agreement; (ii) accounts to and pays any royalties owed to licensor from sales during the sell-off period; and (iii) does not manufacture any new games during the sell-off period. The sell-off period may vary depending on the platform. Typically, sell-off periods will range from 60-90 days, although it most likely would be less for other forms of distribution (i.e., digital) since removal of games can be done in a shorter period of time.

4.3.13 Miscellaneous Provisions

Finally, the agreement will also contain common terms (see Chapter 11) that appear in all agreements (referred to as a 'boilerplate' agreement) covering confidentiality, law to apply, where a legal proceeding between the parties can be heard, *force majeure*, notices, etc. Although the language looks similar in many agreements it is very important to carefully review the language so nothing unexpected is included in the section.

4.4 Licensing Properties: Back to the Future

Licensing has played a significant part in the video game industry as companies have sought licenses to brand games hoping that the association with a named brand would result in greater consumer recognition as well as more realism in games that eventually would lead to additional sales. Despite the risks associated with licensing such as costs, uncertainties on whether a property will be successful, and possible content restrictions, for many licensees the benefits in securing sports, film, television, comic book and children's properties outweighed the risks. However, a different picture may be emerging in the near future with growing development budgets, a desire to create original IP, possible broader first amendment protection in the US, higher licensing fees and an unknown marketplace there could be fewer higher end titles associated with licensed properties. In contrast, the growing mobile and digital markets may lend themselves to more licensing as a way for games to distinguish themselves from others in these increasingly competitive and crowded marketplaces.

CHAPTER 5

MUSIC

5.1 Introduction

Music²¹² has now become a major part of any console and PC game and eventually the same will be true with mobile as technology and capabilities improve in the next few years.²¹³ Music for games primarily involves either original scored music (whereby a composer is hired to provide work for hire services or licenses such scored music) or pre-existing music that is licensed, or a combination of both. The type of music that will be used in a game will be similar for what is done in films and television shows and will depend on the budget, the developer's vision, and the intended use of each piece of music.²¹⁴ Today, many games are scored in a similar way to motion pictures and famous film composers have also ventured into video games.²¹⁵

5.1.1 Hiring a Composer

A composer typically would be hired by a developer to either write or modify a score alone (e.g., compose, orchestrate, and arrange the composition) or to write the score and deliver a finished master of the score.²¹⁶ Under the work for hire concept in the United States, the developer and not the composer would own all of the music created by the composer (which may include the composition and/or the master recording).²¹⁷ This will allow the developer to own the copyright in and to the music and provide the maximum rights regarding exploiting the music. The music could then be used for any purposes including marketing materials, on-line and even in future games without having to obtain any additional rights. In contrast, a hired composer who retains ownership will issue a license that will impose limitations on how the developer can use the music.

Main issues involved in negotiating composer agreements, which will primarily depend on whether the composition/master sound recording is produced as a work for hire or licensed:

1. Services to be provided;
2. Ownership of the music;
3. The rights granted by the composer if he/she retains ownership of the composition/master sound recording and if the music is not owned by the developer (including the term of use, the territory, and the media in which the composition/master sound recording can be used):



4. Compensation: usually a fixed fee, although composers might also try to negotiate for royalties;
5. Payment schedule and if royalties are part of the agreement then the parties will need to determine how royalties are calculated and the developer would then need to send statements;
6. Delivery schedule and approval process involving submissions;
7. Representations and warranties;
8. Indemnification;
9. Grounds for termination;
10. Credit;
11. Developer's right to use the composer's name and likeness in marketing, publicity, and packaging materials;
12. Confidentiality;
13. The right to assign; and
14. Limitations on remedies for composer (i.e., only direct damages rather than injunctive relief).

5.1.2 Licensing Music: Master and Synchronization Rights

Developers may also elect to license pre-existing compositions and master sound recordings, which might include a popular song or 'library' music.²¹⁸ In most situations when licensing music, the developer will need to obtain both synchronization and master use rights to the music (e.g, the composition and the master sound recordings). Synchronization rights²¹⁹ allow for the composition to be synched to the game or any marketing materials and master use rights allow for the original master recording of a particular artist to be synched to the game or any marketing materials. In some situations, it is possible to acquire just the synchronization rights to the composition and the developer would create its own master recording of the music by hiring artists to perform the composition. This may or may not be cheaper than acquiring the master use rights, although the original recording will bring additional value since it will be better recognized.

The major factor for any developer involving licensed music will be the costs associated with the license which will vary depending on the intended use of the music and the forms of exploitation by the developer. The developer will want to obtain as broad as rights as possible but with the request for more rights comes a higher price tag.

Some of the factors that might determine the costs of a licensed song will include: (i) the popularity of the artist and song; (ii) the total amount of the song used in a game (e.g., 30 seconds, the entire song); (iii) how many times the song will be used in the game; and (iv) if the song will be used in marketing materials and if so, what type of materials. A song used in an advertisement (whether on television, the radio, or online) will increase costs substantially.

Additionally, a developer's desire to use music for marketing opportunities including the internet, demos, and maybe even television will also increase the costs for the developer. The dilemma for the developer is what rights they should pay for when signing the agreement because failing to secure rights at such time may increase their costs at a later date. Pre-negotiating optional uses is a useful tactic, but the developer will need to consider whether paying more money for rights up front (or specifying an allocated cost) will be better even though there may be uncertainty as to whether certain rights will eventually be needed.

Typically, the owners of licensed music will provide their template agreements for synchronization and/or master use licenses. The main issues in the agreement will involve:

1. Rights granted including the duration of the composition/master sound recording permitted to be used²²⁰, the territory (which needs to be world-wide if the developer seeks worldwide distribution) and the media in which the composition/master sound recording can be used;
2. Consideration and payment schedule;
3. The term of use;
4. Representations and warranties which are usually extremely limited;²²¹
5. Indemnity;
6. Royalties, if applicable;²²²
7. Approvals;
8. Developer's representations and warranties and indemnification;²²³
9. Ownership issues;
10. Grounds for breach and termination;
11. Delivery;
12. Rights to use the name of the artist or songwriter in packaging, marketing and any other materials;



13. Limitations on use of the music including making any changes to the music or using the name of the song as a title to a game;
14. Limitations on liability whereby the music rights holders will usually limit it to the amount of money received for a license; and
15. Credit and copyright notices.²²⁴

In most situations, the owner of the synchronization rights (which could be multiple parties) and master use rights will be different companies (i.e., the publisher(s) and the record label) and therefore two or more negotiations will need to occur in order to obtain the music. Furthermore, both rights holders will generally seek the same compensation for the rights being granted for the game via the 'most favored nations' clause.

5.1.3 Licensing Music from Music Libraries

A third alternative regarding music is licensing the use of music from stock music libraries, which provides music at reduced rates while usually maintaining very high quality.²²⁵ In this situation, the stock music house will provide both the master use and synchronization rights for music and tend to grant very broad rights for the music. Many developers will include 'stock music' in their games in combination with licensed songs if music has not been composed for a game.

5.1.4 Public Domain Music

A fourth alternative is using public domain compositions, which allows a developer to record its own version of the public domain composition.²²⁶ Public domain songs can be used by anyone to record since the copyright to the song has either expired or never was copyrighted. However, there are many risks and limitations with the use of public domain songs. For example, simply because a composition is in the public domain does not allow a developer to use a third party recording of a public domain arrangement of the public domain composition unless the developer obtains a master recording license from the owner of such sound recording. In addition, what might be in the public domain in the United States may still be protected under copyright in other countries and therefore the developer must do the appropriate research to ensure that it is not infringing the rights of the copyright owner.²²⁷

5.1.5 Anticipating Costs

Because certain licensed and composed music can be expensive it is very important the developer determine anticipated costs for music in their game budget. In many situations to balance the music budget, games may include licensed music from lesser known or new songwriters or recording artists with little following since the

rights to their music will be at significantly reduced rates or even free in exchange for exposure for the group. In most situations, the songwriters or recording artists themselves might be video game players and to be part of a game as well as the exposure is worth the trade-off in asking for minimum compensation.



CHAPTER 6

ISSUES DEALING WITH THE CONSOLE PLATFORM MANUFACTURERS

6.1 Introduction

One of the most important relationships that a publisher or developer will typically form will be with all, or some, of the three major platform owners that manufacture game consoles and portable hand-held devices²²⁸ and provide the tools and hardware necessary for publishers and developers to develop and publish their games²²⁹ on each respective platform.

Although console retail game sales have decreased in recent years,²³⁰ and more consumers are playing games using alternative platforms, with 51% of US households estimated to own at least one of the three major consoles manufactured by either Sony, Nintendo or Microsoft (console manufacturers, (CMs)),²³¹ and with the recent releases of the Wii U,²³² PlayStation 4, and Xbox One, publishers will continue to derive a significant amount of their revenues from products made for video game platforms by the three major CMs.²³³

In addition, an increasing number of independent developers²³⁴ will likely distribute their products digitally²³⁵ through the CM's online distribution channel as well. As a result, understanding what a party is required to do in order to publish and develop games for a console platform, as well as the legal and business issues involved in any relationship with the CMs, is essential for a publisher and developer.²³⁶

This chapter will briefly examine some of the major business and legal issues²³⁷ involving the CMs as well as general game submission processes, so that publishers and developers are aware of some of their basic obligations and liabilities.²³⁸

6.2 Approving Publishers and Developers; Agreements

As the gatekeepers to their proprietary systems, the CMs²³⁹ have each established their own procedures, although similar in many respects, in permitting parties to publish and develop games for their platforms.²⁴⁰ Some of the rights, procedures and agreements will vary depending on whether the party is a publisher or developer. In addition, a publisher and developer will need to sign different agreements, not only with each CM, but also for each platform controlled by a CM (i.e., for Sony, the PlayStation, PSP and Vita) and for certain CMs, possibly separate agreements for different regions (i.e., North America, Europe, Japan).²⁴¹

Subject to a developer satisfying the pre-requisites established by the CMs, and in the event that the developer is not also a licensed publisher or does not have a

relationship with a licensed publisher, a developer will only be permitted to develop, but not publish, a retail game for a specific console and only have the opportunity to publish the game digitally.²⁴² On the other hand, a licensed publisher will have the opportunity to develop and publish games for both retail and digitally. While the bar to becoming a publisher will be higher than the requirement for a developer, the publisher will have additional benefits as well as more obligations.

Prior to either a publisher or developer entering into any licensing agreements with a CM,²⁴³ the CM may conduct a review of the parties to make sure that the party has the technical and financial capabilities to fulfill the requirements as per the various agreements that are needed in order to become a licensed publisher or developer. As part of the review, the CM will often examine the technical expertise of a developer and a publisher (assuming that they will also undertake development)²⁴⁴ to determine whether the party has the capabilities and skill to develop games for a particular system. For example, part of the inquiry may possibly involve: (i) the experience of the developer and whether the developer has worked on previous games; and (ii) what platforms has the developer worked on.²⁴⁵

A CM may also want to examine whether the publisher or developer is financially secure enough to fulfill its obligations, although this factor will be more significant for the publisher because of the additional costs associated with publishing games at retail. For example, how strong is a publisher's credit so they can meet any minimum order requirements? Furthermore, a CM may want to determine how strong the publisher's relationships are with retailers,²⁴⁶ since this could be important in placing product at retail.

Upon approval, the publisher and developer will then need to enter into a set of agreements with the CM, which establishes the guidelines, rights, obligations, and submission procedures between the CM and the publisher or developer. Because the CM has significant bargaining power, and deservedly so because of their huge investments in research and development in the various platforms, there may be few opportunities to negotiate terms with the CM although it will depend ultimately on the leverage of the parties.²⁴⁷ Of course, if the CM is attempting to enter into an exclusive deal with a developer or publisher,²⁴⁸ or either party provides product that is important for the success of a particular platform, then there might be room to negotiate various business points.

For developers and publishers that will also develop games, they will first need to enter into an agreement with the CM that provides them with the materials to develop for that particular platform under specified conditions. This agreement will typically grant a non-exclusive license for a certain period of time in a designated territory for the developer to utilize the CM's proprietary hardware equipment and tools such as



development kits, programming tools, emulators and any other materials provided by the CM needed to develop a game for a platform.²⁴⁹

The agreement will most likely cover a number of areas, including but probably not limited to the conditions of use, access to the materials, costs, ownership, representations and warranties, indemnification, the CM's limitations of liability including that materials provided are 'as is,' termination, injunctive relief if materials are being used improperly, limitations on rights to assign, the law that would apply in the event of a contractual dispute, what jurisdiction the dispute would be heard, and other 'boilerplate' provisions.²⁵⁰

In the event that the developer elects to have its game distributed digitally through the CM's online distribution channel²⁵¹ without a publisher, then the developer would also need to sign a separate agreement covering these rights with the CM. The digital agreement most likely will address various business terms similar to those raised in PC digital distribution agreements,²⁵² including but not limited to:

- (i) the submission and approval process²⁵³ for a game and accompanying marketing and publicity materials;
- (ii) rights granted by each party;
- (iii) term of the agreement;
- (iv) territory in which a game may be distributed;
- (v) the revenue share between the parties from the exploitation of the game and any content;
- (vi) when payment is made by the CM and what information will be provided to the developer or publisher regarding the payment; and
- (vii) what materials will need to be delivered.

In addition, the digital distribution agreement will also cover legal terms, and it could be assumed that some of the issues might include ownership rights, the CM's limitation of liability, termination, representations, warranties and indemnification that will require at the very least that the materials in the game do not infringe the rights of third parties, and 'boilerplate' language.

Both a publisher and developer can enter into agreements with the console manufacturers to create games for a particular platform, but traditionally only publishers have had the right to distribute their games at retail subject to a platform license agreement. As a result, if a developer wants to distribute its product at retail, the developer would either need to become a publisher by entering into a separate agreement with the CMs, although this is very rare, or enter into a relationship with a publisher.²⁵⁴ Many developers, in exchange for granting distribution and possibly other rights, will enter into relationships with publishers, since publishers typically will provide the financing and services associated with the distribution, manufacturing, marketing, submissions and testing (QA) for a game. In addition, a publisher most

likely will have relationships with retailers, and with perhaps more product and franchised properties may be able to use this leverage with retailers and CMs to obtain more favorable terms and commitments including additional marketing opportunities for a game.

For a company to become a licensed publisher it will need to enter into the CM's publishing agreement, which allows the publisher to publish games for a particular platform. Under this agreement, the publisher typically would have the non-exclusive, non-transferable right to publish, develop, and distribute games on the console platform;²⁵⁵ manufacture through approved CM vendors; and market games for a specific console platform.²⁵⁶

The publisher will also need to follow specific procedures for submission of games as well as committing to a number of other important obligations which may include, among other things, licensing/royalty payments to the CM, approvals, representations and warranties, indemnification, manufacturing procedures, product warranties, minimum orders, specific procedures involving the delivery of publisher's content to the CM, restrictions and obligations regarding online gameplay purchases of downloadable content, and collection of end-user information.²⁵⁷

6.3 Development and Manufacturing Issues

6.3.1 The Submission and Approval Process

Each CM requires that games, together with a game's packaging (retail only) and marketing materials must be submitted for approval.²⁵⁸ Each CM will have its own submission policies and guidelines covering technical and content requirements involving game development.

While a developer or publisher may begin development on a game at any time once they receive the necessary tools and sign the appropriate agreements, at some time before a game can be released on a console platform, certain information about the game including the game's concept will need to be approved by the CM.²⁵⁹ However, it is probably best practice to submit a game's concept as early as possible to avoid unnecessary costs and time developing a game concept that is not approved by the CM. A publisher or developer may be required to submit game and technical design documents, which may include among other things the proposed game concept including online content, descriptions of the different level designs, characters, art design, and explanations about the game play and how the controls will work with the game.

During development, a publisher or developer may also need to submit the game at various stages, including those that are most likely close to alpha or beta,²⁶⁰ for a CM's acceptance to confirm that the game will be technically acceptable and



mirrors the concept proposed to the CM. For example, if the concept proposed was a simulation racing game and the submitted game is a combat racing game, then it most likely will be rejected. Because policies are changing with the recent introduction of the new consoles, developers should contact the appropriate CMs to confirm each CM's requirements for developing a game on their platform.

Prior to submission for final approval by the CM, the publisher must first test the game to ensure that the game is compatible with the appropriate hardware and configurations;²⁶¹ works with any approved peripherals; and that there are no bugs in the game which would prevent it from playing on a platform.²⁶² Once the publisher has tested the code²⁶³ it would submit a 'gold master candidate' for CM approval²⁶⁴ to ensure that the game meets the CM's technical and quality requirements, and is functional so it is ready to be released for distribution.²⁶⁵ Upon approval by the CM, the gold master candidate becomes the 'gold master' and is ready for duplication or digital distribution.²⁶⁶

The publisher will also need to submit all retail packaging materials which will include related artwork, user instructions, warranty information, brochures, and packaging designs.²⁶⁷ Furthermore, all marketing and promotional materials must be approved by the CM. These requirements are quite broad and cover practically anything associated with these activities which would involve the use of any of the CM's trademarks, brand names, and any other intellectual property. For example, this could include any materials associated with any form of advertising such as online, television radio, print, promotions, posters, public relations, press releases, contests, and retail displays. Failure to do so could result in a breach of the agreement.

Depending on the CM, some other possible restrictions and requirements may include:

1. Each game whether sold at retail or digitally distributed must receive a rating and include the assigned content descriptors by the region or country's rating board. In addition, the rating can be no more restrictive than a mature rating in the US and its equivalent in any other territory with a rating system;²⁶⁸
2. Unless approved by the CM, restrictions may apply on bundling of games and use of peripherals;²⁶⁹
3. Once the game is in distribution, the publisher will be required to provide customer support for the game which will need to include technical support and issues dealing with game play;²⁷⁰ and
4. The publisher must provide a standard defective product warranty on all products sold.²⁷¹

6.4 Business Issues

The major business issues for a publisher in a publishing license agreement typically will involve: (i) the licensing/royalty percentages paid to the CM for packaged goods and the revenue share split involving digitally downloaded content; (ii) minimum order requirements for packaged goods; and (iii) possibly marketing support from the CM. For the independent developer not dealing with a publisher, and interested in digitally distributing its product through a CM's online network, the most important business issues more often than not may involve the revenue share split for its digital download content and confirming a release window for the digitally downloaded game.²⁷²

Console manufacturers primarily make money from:

- (i) sales of each unit of a game manufactured by the publisher whether the product is ultimately sold or not in the form of a royalty/licensing fee;
- (ii) sales of their hardware, although this is usually done at an initial loss²⁷³ as the CMs subsidize the costs to help drive software sales;
- (iii) a share of all sales from digital content sold through their online network;
- (iv) sales of games developed by the CMs whether by internal teams or third parties hired pursuant to a developer agreement; and
- (v) sales of licensing fees from any peripherals compatible with the hardware.²⁷⁴

The licensing/royalty rate is one of the most important business issues between the parties, since some CMs have required minimum orders for packaged goods for each defined region or territory and therefore a publisher must commit to a certain minimum payment. These minimum order requirements for packaged goods typically include a licensing fee for use of the CM's name, proprietary information and technology as well as a manufacturing, printing and packaging fee and must be paid prior to shipment.²⁷⁵ Even if the publisher is unable to place the units ordered into retail, whether that is from the minimum order requirements or incorrectly ordering more units than needed based on sales forecasts, the publisher will still be responsible for the entire payment of an order and will not be entitled to a refund.²⁷⁶ Therefore, the publisher must determine even before developing a game that the anticipated packaged good sales numbers combined with digital sales make it economically viable.

Licensing/royalty fees, which can unilaterally be revised by the CMs,²⁷⁷ will vary based on a number of factors that may include but not be limited to the CM, the region in which product is sold, the amount of units ordered by the publisher²⁷⁸ and the pricing of a game.²⁷⁹ In some situations, publishers receive manufacturing discounts for packaged goods in the event that a game qualifies as part of a CM's greatest hits or similar program.²⁸⁰ In this scenario, the game has achieved certain sales numbers set by the CM and certain shelf life,²⁸¹ and is re-released and re-packaged later at a reduced price but under the CM's special sales program. The greatest hits program



extends a game's brand recognition and helps distinguish the game for the end user as a previously top-tier selling game, providing an additional incentive for the end-user to purchase the product at a reduced price. Furthermore, for the publisher, it provides an opportunity to sell product later in the game's distribution cycle at a reduced price with lower royalty commitments, while for the CM it might help sell consoles and maybe even attract new consumers tempted by lower prices to try games they may have previously ignored.

For digitally distributed content, the issues in determining the revenue split between the two parties are much simpler, since manufacturing, shipping, and minimum orders are not relevant. Revenue generated from the publisher's or developer's content is received directly by the CM and then the CM, based on an agreed-upon time schedule, will remit any monies owed.

For a video game the marketing budget is one of the most significant expenses incurred by a publisher outside of development and manufacturing. In a highly competitive video game market, a game may have a very short window of time to attract consumers and therefore a marketing 'spend' can provide greater recognition to a consumer.²⁸² As a result, a developer should try to negotiate a marketing commitment from a CM, although this can be difficult. One way in which this could be a possibility is that the publisher enters into an exclusive distribution opportunity for a certain period with the CM.

6.5 Legal Issues

All the CM agreements will contain quite a bit of legal language clearly beneficial to the CM and only on very rare occasions depending on the publisher or developer; typically there is little room, if any, to negotiate any of these terms. While agreements will differ among the CMs, and vary depending on the type of deal entered into with the CM, each one will at the very least address issues such as representations and warranties, indemnification, confidentiality, limitations on collection of end-user data, termination, and limitations on liability.²⁸³ This section will discuss some of the legal terms that may appear in publisher licensing agreements with the CM, although they most likely will also appear in other agreements involving a developer.

6.5.1 Representations and Warranties; Indemnification, Limitation on Liability

In the various CM deals, the CMs, not unexpectedly, have traditionally limited their representations and warranties thereby limiting their liability. Typically, the only representations and warranties they have made, although it might vary slightly among the CMs, is that they have the right to enter into the agreement and they will fully perform their obligations which are extremely limited.²⁸⁴ Like other manufacturers of

hardware, not only will CMs limit their representations and warranties, but they will affirmatively disclaim any guarantees that their platform and materials provided to the publisher or developer infringe the rights of third parties as well as any implied warranties of merchantability.²⁸⁵ As a result, materials provided to the publisher or developer are typically on an 'as is basis' to the maximum extent permitted by law.²⁸⁶

CMs will also restrict their liability by limiting the amount of potential monetary damages in the event of a breach on their part, and the type of damages such as consequential and indirect damages which may include loss profits, opportunity costs, loss of good will, and damage to reputation that could be claimed by a publisher or developer.²⁸⁷ For example, a CM's online network going down results in a loss of potential sales for a publisher or developer.

On the other hand, the publisher or developer will probably be required to make a number of representations and warranties reducing the CM's risks and liabilities as much as possible as well as indemnifying the CM against any loss, liability and expenses resulting from any claims against the CM regarding the publisher or developer's goods and services²⁸⁸ involving the development, marketing, sale, or use of the publisher's games.²⁸⁹ Furthermore, depending on the extent of a claim under the indemnification clause, a CM may insist that not only does it have the right to approve counsel selected by the publisher or developer and any settlement, but possibly also that it has the right to take control of the litigation. It is conceivable that, in some situations, the interests of the parties may be different, further complicating how indemnification will be handled.

The most significant representation and warranty made by the publisher will most likely involve the content incorporated and tools used for the game or any other materials created associated with the game such as downloadable content (DLC) or marketing materials. Under this situation, the publisher would need to represent and warrant that the materials and content (excluding the development tools provided by the CM), are owned or licensed by the publisher and do not infringe upon the rights of any other party. These rights would typically include names, trademarks, copyrights, patents, trade dress, trade secrets, rights of publicity and privacy, moral rights and any other intellectual property rights throughout the world.²⁹⁰ This is a critical representation and warranty and it is to be expected since the CM could be named in a lawsuit involving a publisher's game that might be infringing the rights of a third party whether justified or not.

Other representations and warranties have included: (i) the game will be free of major bugs, or viruses; (ii) the distributed game will be rated and will not be altered which would invalidate the rating;²⁹¹ and (iii) the CM will not incur any financial liability for content used in the game (i.e., talent, music).²⁹² In the event any of these



representations and warranties are breached and the publisher or developer fails to cure the breach then the CM would have the right to terminate the agreement.

6.5.2 Confidentiality

Even though the publisher or developer may have signed a separate confidentiality agreement, a confidentiality clause will usually exist in subsequent agreements and generally supersede the previous confidentiality agreement, given that the relationship between the parties will have expanded since their initial communications. Since the publisher and the CM would both be exchanging extremely sensitive information, whether orally, written, or in machine readable form, that goes to the core of each other's business, each party would be required to maintain the confidentiality of the disclosing party's information.

For the publisher, the CM will typically receive information that might include: (i) the publisher's finances to confirm that it will be financially capable of paying for retail units manufactured and royalties owed; (ii) product proposals; and (iii) game designs and other information about the game planned for development. Later, the parties may exchange business and marketing plans eventually followed by game software and marketing materials not yet made public. At the same time, the CM will be providing confidential information about the hardware and software including development tools, as well as marketing and business strategies.

Because of the important nature of the confidential information exchanged, each party will be required to maintain confidentiality for a fixed period of time and take the necessary steps to maintain the confidentiality. Furthermore, both parties will generally be permitted only to share confidential information with employees, developers and subcontractors on a need-to-know basis and subject to signature of a separate confidentiality and non-disclosure agreement. However, in certain circumstances, confidential information may be disclosed publicly, such as by a court, government, or administrative order.²⁹³

6.5.3 Assignment

Similarly to a licensor-licensee relationship, since the CM is specifically entering into an agreement with the publisher and typically is doing so based on a number of factors including the expertise and financial security of the company, the publisher will be prohibited from assigning the agreement to another party unless approved by the CM. As a result, the publisher cannot transfer its rights and obligations to another party without the prior approval of the CM.

6.5.4 Term and Termination

The length of the agreements are set by the CM and can either expire upon the end of the term or be terminated under certain circumstances in the event of an uncured material breach by the publisher.²⁹⁴ The material breach language will usually be very broad and can affect any agreements between a publisher and CM. As a result, an uncured breach for one agreement can possibly result in the termination of other agreements.²⁹⁵ Therefore, the repercussions can be great.

Although the breaches may be slightly different depending on the agreement and depending on the CM, it should be expected that typical material breaches would most likely include among other things:

1. Failure to pay monies owed to the CM;
2. Failure to cure a breach of a representation and warranty or any other material term in the agreement;
3. Failure to follow the guidelines for submission and approval of games and any other materials;
4. Failure to safely secure materials provided to the developer or publisher such as development tools;
5. Improper use of a CM's trademarks;
6. Use of materials that have not been approved by a CM;
7. Failure to comply with ratings rules and regulations; and
8. Bankruptcy or insolvency.²⁹⁶

If a publisher or developer were to breach, it usually would be given a fixed amount of time to cure the breach depending on the type of breach and assuming the breach is curable. For example, a bankruptcy filing or an assignment for creditors may not entitle the publisher or developer to a cure period. Furthermore, in certain circumstances the CM may have the right to seek injunctive relief in the event of a breach.²⁹⁷

In the event that an agreement expires, in certain circumstances the publisher would be allowed to sell off remaining inventory, within a period which may vary from 90-180 days depending on the CM agreement.²⁹⁸ Any inventory remaining after the sell-off period would then need to be destroyed within a certain period of time.²⁹⁹ In addition, publishers might still be required to provide customer support for online features, and any CM materials in the possession of the publisher, whether it be developer kits or confidential information, would need to be returned or destroyed subject to the CM's decision.



6.5.5 Choice of Law; Venue

What law the court or arbitrator, if applicable, will apply, and where any dispute between the parties will be resolved between the parties will be discussed in this section of the agreement. Because of the bargaining position of the CMs, the publisher or developer will need to agree to the choice of law and venue determined by the CM. For publishers and developers, especially smaller companies, this is a significant issue in the event of a dispute between the parties, since travel expenses, the possibility of needing local counsel, and other expenses can be a huge burden on any company. For example, a company in Florida may have to travel to Washington State to litigate an issue applying Washington State law.

6.6 Moving Forward

The role of the CMs will change in the next few years with the shift in the way consumers can play games. Many consumers who have played hand-held devices and games on a console may now spend most of their gaming experience using alternative platforms on mobile and tablet devices. Although some consumers may switch their gaming habits, many will still continue to play games on consoles and others (introduced to gaming by mobile devices itself) will start playing games (whether purchasing retail games or playing online) using a console platform. While more economic and procedural barriers exist at this time to develop and publish games on console platforms compared to other platforms and distribution methods, the rewards can be great, especially for successful AAA titles, and it is therefore an option that developers will need to consider when planning to develop games. However, before undertaking any development, a developer and publisher must know how each CM operates; what they require; what guidelines they will need to follow; and what obligations, including financial, will be required from them.

CHAPTER 7

DIGITAL DISTRIBUTION

7.1 PC Digital Distribution Introduction

Within the last few years, with improvements in technology, shrinking retail space for PC games, growth in bandwidth capabilities and rising internet use, digital distribution has become the leading form of distribution for PC games and a growing form of distribution for console games.³⁰⁰ This significant change will impact the industry in the years ahead, and has helped fuel an unprecedented number of games released digitally by independent developers³⁰¹ and publishers.

Digital distribution is another form of distribution in which content is delivered via the internet or game console without the use of physical media and allows end-users to purchase³⁰² and/or license games, additional downloadable content ('DLC'),³⁰³ upgrades and enhancements instantly.³⁰⁴ This transition from retail to digital has helped expand publishing opportunities for developers,³⁰⁵ providing them with greater and direct access to end-users throughout the world while at the same time allowing them to bypass the more expensive costs associated with retail. Furthermore, as shelf space continues to shrink in many retail outlets,³⁰⁶ digital distribution provides a significant and potentially cheaper alternative for releasing new products while also providing a new source of revenue for older products.³⁰⁷ However, these same benefits have resulted in an abundance of games and distinguishing one game from another is becoming more challenging for many developers.³⁰⁸ Furthermore, developers also need to be aware that not all games may be accepted for distribution on a particular PC distribution platform.³⁰⁹

This chapter will examine some of the challenges facing developers and the relationship between the distributor and developer and the significant legal and business issues between the parties including the main terms of an agreement whereby the developer licenses its game(s) for distribution on the distributor's distribution platform.

7.2 The Long Form Agreement: Introduction

In most situations, the digital distribution agreement (referred to as 'the agreement' in this chapter) will be drafted by the distributor as the owner of the platform and will tend to include terms favorable to the distributor. However, while each deal will vary, a developer should be able to negotiate many of the terms in the agreement based on each party's respective bargaining power, market alternatives to the developer, and the demand for and quality of the game(s).³¹⁰



7.2.1 Rights Granted

This section in the agreement describes the rights granted to the distributor by the developer and will usually cover three areas: (i) the properties licensed to the distributor including any applicable games, DLC, updates, demos, etc., ('products') (ii) territory in which the properties can be exploited; and (iii) the rights the distributor has to exploit the products including selling and marketing. Typically, the developer will grant a non-exclusive, non-transferable license during the term and within the territory allowing the distributor to sell, license, advertise, promote, market, modify³¹¹ and otherwise distribute the products through the distributor's system. Terms and territories might vary among products if there are restrictions on underlying rights. The non-exclusive grant of rights is important since this allows the developer to grant rights to other distributors during the term and in the territory. If the developer is not receiving any consideration other than a royalty, then any deal should always be structured on a non-exclusive basis. Furthermore, the licensing grant will also include the non-exclusive license for the distributor to use the developer's trademarks in collaboration with the selling and marketing of the developer's products, which should be subject to the developer's prior approval.

7.2.2 Delivery of Materials

This section outlines in what materials and formats a game or any other content needs to be delivered to the distributor, as well as when delivery must occur. These are issues that must be addressed for both parties since the developer must deliver the products and other content, based on the specifications required by the distributor, to meet a recommended launch date.

The developer will be required to submit a game in object code form (i.e., gold master) to the distributor. A developer can decide whether or not to include DRM and either the developer or distributor can add it to the gold master although some distributors require that the game be left unprotected without any DRM. Furthermore, in some instances, the developer may also elect to implement a specific SDK³¹² for a distributor. In addition, the developer will also be required to deliver certain marketing assets, such as game descriptions, logo icons, screen shots and videos, that the distributor will use to promote the game via its platform. Upon receipt of the applicable gold master, the distributor will then determine whether the game is technically acceptable for distribution.

Although many PC games are released only digitally, if a retail and digital version of a game exists a distributor will request release date parity with retail, in other words, the opportunity to release the digital version of the game, day and date with the retail version to avoid a competitive disadvantage with retail. Accordingly, the distributor will want the gold master³¹³ along with the applicable assets and documentation

associated with the game to be delivered in enough time so it can launch the game to ensure a simultaneous release with the retail version.³¹⁴ Furthermore, the distributor will want to release any licensed games no later than any other distributor.³¹⁵ If the game has already been released, then delivery is not such a big concern since there is no issue releasing a game day and date with the retail version, but all distributors will want to have the opportunity to release the game at the same time.

What happens when the developer is unable to deliver the materials to a distributor? The answer will vary depending on the type of deal structured between the parties and whether any monies were paid to the developer for the distribution rights. If the problem is caused by the distributor's technical requirements and the developer is unable to meet those requirements then the developer should be able to remove the game from the agreement without any repercussions. However, if an advance was allocated to that game, then the situation becomes more complicated and resolutions will vary. Examples can include the developer either returning any advances or the replacement of the game with an alternative game to be mutually agreed upon by the parties.

7.2.3 Continuing Obligations

Throughout the term of the agreement, the developer will be required to provide any upgrades, enhancements, localized versions if created, add-ons, changes or fixes and improvements for any games that are created and made available to end-users ('upgrades'). It is important that the developer negotiate with the distributor to clarify what each request specifically requires, including fixing of bugs, and whether those requests require any unforeseen additional work on the part of the developer that might impose an unexpected financial burden. Clearly, if the game has significant bugs then it would appear that it would be in the best interest of the developer to correct them to avoid an erosion of sales and damage to the company's reputation. However, the developer does not want to be in a situation where it is contractually obligated to fix costly bugs if the economics do not justify the corrections for the game. In addition, if a developer elects to release any upgrades to any third parties or to the public then the distributor will want to receive those materials at the same time, to assure itself that it is being treated equally with other distributors and retailers, unless a promotion is undertaken by the distributor.³¹⁶

Each party, as part of their continuing obligations, may be required to supply customer support.³¹⁷ Generally, the distributor will be responsible for providing technical and other customer support to its end users with respect to issues associated with downloading the game from the distributor's site as well as any billing issues. At the same time, the developer will be responsible for technical support to the distributor regarding specific issues involving the actual game, which may include problems with operating or playing the game. For both parties, they will each want to ensure that the



assistance provided will be of a high standard that will be no less than the support offered for other games of comparable quality and that responses will be made in a timely manner.

7.2.4 Term

The parties will agree to a set number of years in which the distributor will have the right to distribute a game, usually on a non-exclusive basis. The term for each game (assuming the parties enter into a deal for multiple titles) will usually commence on signing of the agreement and continue for an agreed period of time beginning with the distributor's receipt and acceptance of the required materials or release of the applicable game on the platform.³¹⁸ In addition, for agreements that include multiple games, the terms may vary because of the different delivery dates for each game.

In some agreements, provided neither party is in breach of the agreement, the contract will permit automatic term renewals³¹⁹ usually for successive one-year periods. In the event that a party wants to terminate the agreement then it would need to provide notice no later than an agreed period of time (e.g., 30 days) before the expiration of the renewal term. It is important that a party be aware of this requirement or else it will miss its opportunity to terminate the agreement unless it has the right to terminate for convenience. Furthermore, a term may also be extended for an additional period of time as a result of a *force majeure* event.³²⁰

A term may also be shortened as a result of an uncured breach of the agreement or for termination for convenience.³²¹ The parties must also decide whether a breach of the agreement involving one game would also allow for termination of the entire agreement or just for the affected game.³²²

7.2.5 Marketing Issues

As the quantity of games on digital platforms continues to rise, the ability to differentiate games to the consumer becomes more challenging. Even if the developer has created a hit game, consumer awareness will pose a challenge for most developers. To address this crowded marketplace, developers should try to negotiate some form of a minimum marketing commitment from the distributor and/or favorable positioning of a game for an agreed-upon period of time. In some situations, a developer may choose to work with a publisher since a publisher may have greater leverage than a developer in dealing with distributors and therefore may be able to obtain some or better marketing and promotional commitments from a distributor.³²³

Some games, such as the major releases, will get prominent positioning on the distributor's website because the game will help drive sales for the distributor. For other games that do not have the same draw, the exposure, even if short lived,

is critical to help sales for a game and marketing commitments will need to be negotiated. A game featured on the front page of a distributor's store could drive an immense amount of traffic to the game's page, resulting in a tremendous increase in sales.

A distributor typically will be permitted to market the game, at its own sole cost and expense, and generally this will be subject to the developer's prior approval. At the same time, while a developer will want approval it also does not want to be in a situation whereby a lengthy approval process may prevent the game from being highlighted, since opportunities may be limited, so the developer needs to resolve the approval process carefully and at times, quickly. In order to reduce concerns about approvals, many agreements provide for either extremely quick approval turnaround times and/or delivery of pre-approved materials that can be used by the distributor without approval (provided the materials are unaltered). The only concern the developer might have is the context in which the pre-approved materials are used. In the event that the marketing is carried out and the developer is unhappy, then it can notify the distributor to correct the marketing or remove it.

One significant way in which a developer may attract consumers is by allowing the distributor to run a special limited time promotion in which the developer's game(s) receives prominent placement on the distributor's home page while agreeing to reduce the suggested retail price ('SRP') of their game(s). For example, a distributor may elect to reduce the price of a game for a limited period, such as during a holiday or other special event, subject to the prior approval of the developer. In this situation, the distributor would not be required to pay a minimum payment for each sale of a game based on the SRP, but instead would pay the contractually agreed-upon royalty rate based on the approved discounted price during the promotion. If the developer is to engage in this type of limited time promotion, it must make sure that it is not required to provide the same deal to other distributors unless they offer a similar benefit in return (e.g., prominent placement). While in some situations revenue earned for a game may be less for both parties, a promotion can be very beneficial for both parties in that it may help drive traffic to a site and also provide perhaps needed exposure for a title to gain awareness. On the other hand, in many situations, the spike in sales is so great that the reduced revenue from the sale of each game is outweighed by the increased sales volume.

7.2.6 Revenue Share and Pricing

The biggest business issues for a developer will be the percentage of revenue it will earn from the sale of its products and what the percentage will be based upon (i.e., net revenue and/or the SRP). Both the developer and distributor receive a revenue share based on an agreed-upon percentage of the net revenue earned by the distributor. For some PC digital distribution deals, it has been reported that the



developer receives a revenue share of 70% with the remaining amount retained by the distributor.³²⁴

Distributors then apply the revenue share split to the revenue earned from the exploitation of the product. How much the developer earns will depend on the success of the products and the amount charged by the distributor unless the revenue share is based on a published SRP by the developer. Pricing for games on a distributor's platform may be determined by either party, depending on the agreement.

If the price is determined by the distributor, how does a developer then protect itself against the distributor reducing the price of a game, which could potentially undermine the value of the game and projected sales? In this situation, the developer should require a minimum payment based on the SRP for each sale of a game or other content associated with the game irrespective of the price charged to the consumer, although this may be difficult to negotiate in the agreement. In this scenario, the distributor sets the price but is required to pay the developer the *higher* of: (i) a fixed percentage based on the actual selling price of the game and any other content, or (ii) a minimum payment which may be based on a percentage of the SRP. The minimum payment for each sold product affords some protection for the developer since it is guaranteed at the very least a fixed sum for the sale of each downloaded product although if the developer does have a problem with the pricing it can always elect to terminate the agreement for convenience.³²⁵

Unlike the 'traditional' retail publisher-developer distribution relationship, there are fewer deductions taken by the distributor as there is no inventory to consider (i.e., price protection and manufacturing are not relevant to digital distribution). Before remitting revenues to the developer, the distributor will first take its fee from all revenues received and then deduct approved costs. Typical deductions in most agreements will include actual costs resulting from returns, discounts, refunds, fraud, taxes and chargebacks from the credit card companies.³²⁶

Box 5: Traditional Retail Channel

The traditional retail channel continues to provide a major source of revenue for publishers who have built up the relationships and infrastructure to support distribution of physical content at retail. Generally, unless a developer has signed an agreement with a publisher to distribute the developer's PC game the traditional retailers most likely will not represent a viable option for independent developers because of the costs and logistics of supporting retail distribution.

There are major costs associated with distributing physical games in the traditional retail channel, including manufacturing shipping storage and risk of inventory co-op advertising returns and price protection.

Some advantages of games sold at retail include that it offers an alternative for consumers who do not have access to high speed internet or credit cards and in most situations provides additional consumer recognition of a game for a certain length of time.³²⁷

In the event that the developer has entered into a number of non-exclusive deals, distributors will expect to be treated equally when it comes to pricing so they are not economically handicapped against any other distributors. As a result, the published SRP will be the same for all distributors but the revenue share they receive may differ between distributors.

In addition, the developer may also distribute a free-to-play game whereby virtual goods and advertising appear in the game to generate revenue instead of actually selling the game for a particular price. The parties will need to also negotiate the revenue splits, which may vary depending on the source of revenue (i.e., in-game purchases) as well as any allowable deductions.

7.2.7 Statements and Audits

In any contract involving the payment of royalties, the party receiving payment should receive statements and have the right to audit. The developer should insist on either quarterly or monthly statements, although some distributors can provide sales information to the developer on a daily basis but will only commit to a quarterly statement and issue payment with the delivery of each statement. When dealing with different territories and possibly different games, the developer should request the following:

- (i) statements broken down by each product and by territory indicating gross revenues received from all forms of exploitation involving the game;
- (ii) allowable deductions;
- (iii) developer's net revenue;
- (iv) prices per product; and
- (v) number of units sold.

Furthermore, all net sales amounts should be stated in the currency of such sale followed by the equivalent amount of such net sales in the currency in which final payment is made.³²⁸

7.2.8 Termination

As with all of the other types of agreements that have been covered to this point, the termination provision will allow each party the right, but not the obligation, to terminate the agreement if a party materially breaches the agreement and fails to cure within the agreed upon cure period. Termination rights might be triggered by either party in the event of a material breach of the agreement.³²⁹



For the distributor, a material breach could involve:

1. Failure to pay monies owed to developer;
2. Failure to issue a statement;
3. Distribution of a game prior to the agreed-upon launch date;
4. Distribution of a game outside the agreed-upon territory or beyond the term;
5. A breach of a representation or warranty;
6. Failure to obtain approval; or
7. Failure to provide appropriate customer support.

For the developer, a material breach could involve:

1. A breach of a representation and warranty;
2. Failure to deliver materials for a game while delivering materials to other distributors including any updates; or
3. Failure to provide customer support.

In addition, either party generally will have the right to immediately terminate the agreement without the right to cure if a material breach is incurable or if a party becomes insolvent or is unable to pay its debts when due or makes an assignment for the benefit of creditors.

Either party may also have the right to terminate the agreement for convenience provided that no advances were paid to extend the term.³³⁰ In this scenario, a party can terminate without cause provided it sends notice to the other party within an agreed-upon time period (usually 30 to 60 days). The reason for termination does not matter provided the reason is not to avoid any obligations (i.e., payment) although certain clauses will survive termination, such as any payments that may become due, representations and warranties, and indemnification to name a few.

Upon the expiration or termination of the agreement, all rights granted to the distributor will cease and the distributor will be required to stop all selling, distribution, and marketing of the licensed game(s,) which can be done almost immediately. Any materials in the possession of the distributor will either be returned to the developer or destroyed by the distributor, at the developer's option. However, the distributor should still have the right to process any current orders and continue to provide customer support for end-users as well as any updates to correct any errors in the game. Other obligations should include:

- (i) the distributor making final payment regarding royalties and issuing a final statement;
- (ii) the developer's right to audit;

- (iii) warranties, representations and indemnification;
- (iv) limitations of liability;
- (v) confidentiality;
- (vi) governing law and venue; and
- (vii) cumulative remedies.³³¹

7.2.9 Limitation of Liability

In many agreements, the parties will usually agree to limit their liability and this is done primarily in three ways. One, the parties may limit the amount of damages that either party can claim as a result of a termination of the agreement caused by a breach. If agreed upon, the two parties will need to determine a formula for capping damages. In many situations, the distributor will insist that the cap is tied to the amount of monies paid to the developer including any royalties and advances. However, this formula may not serve the best interests for a developer, especially since the severity of the breach may not match the amount of damages that the developer may have incurred (it can also be a problem for the distributor but distributors tend to want to cap at this amount). As a result, it may be more beneficial for the developer to request a cap that may be a certain percentage of the royalties earned, such as 200% or greater, or the developer may request that the cap be tied to the distributor's E&O insurance liability cap. For example, the distributor may have a \$1,000,000 cap on its insurance coverage. It is important to note that the cap on damages typically excludes any claims involving indemnification, breaches of confidentiality and usually gross negligence.

Secondly, the parties may generally agree to cap the type of damages that will be excluded from any claims between the parties, such as punitive, consequential, special and speculative.

Thirdly, both parties may want to further limit their liability with regard to their products by disclaiming any and all statutory, express or implied warranties except as specifically expressed in the agreement (e.g., infringement involving the intellectual property of third parties) including but not limited to warranties of merchantability, fitness for a particular purpose and any warranties arising from a course of dealing, usage or trade practice covering the product and the software used to distribute the products.³³²

7.2.10 Assignment

An additional concern that the parties will need to negotiate is whether either party would have the right to assign its rights under the terms of the agreement. In this situation, the party transfers its rights and obligations to another party. In some agreements, a party would have the right to assign subject to the other party's approval, not to be unreasonably withheld. A valid justification for refusing an



assignment could be to avoid requiring the developer to possibly now work with a company that may be a competitor or a company that may have had a previously poor relationship with the developer.

In other agreements, the developer might insist that it has the right at its discretion and without limitations to determine whether to approve an assignment unless the rights are assigned to a parent or affiliate. In many situations, a developer may enter into an agreement with a distributor based largely on a particular relationship and therefore any change could possibly undermine the relationship between the parties.

In the event that an assignment is permitted, the non-assigning party should require that the assignee assume and agree to all of the obligations and responsibilities of the original distributor and in the event that the assignee breaches the agreement then the original distributor would be responsible for any damages.

7.2.11 Other Terms

Other important terms that will appear in the agreement will include:

1. Language that any new materials created or contributions made by the distributor based on the game will be considered a work made for hire and therefore owned by the developer and not the distributor.
2. Representations, warranties and indemnification which will include among other things that:
 - (i) the distributor will seek guarantees that the developer owns or controls all the rights in and to the game and updates;
 - (ii) that the exploitation of the game and Updates permitted under the agreement will not result in a violation of any rights of third parties; and
 - (iii) that the game and updates do not contain any computer viruses, time bombs, worms, or other contaminants intended to modify, damage, or disable distributor's or any other party's computer systems.

For the developer, it is important that it also receives representations and warranties and indemnification covering the actions of the distributor. For example, (i) the distributor should warrant that the distribution platform and any marketing materials created that are not based upon and approved by developer will not violate the rights of third parties including any copyrights, trademarks and patents; and (ii) it will comply with all applicable international, national, state and local laws and regulations in the performance of its obligations.

Finally, the agreement will also typically cover:

- (i) confidentiality;
- (ii) approvals regarding materials created by the distributor and the context in which the game and materials will be sold and marketed to the end-user;
- (iii) credits, use of developer's logos, and legal notices and where they will appear;
- (iv) press releases;
- (v) end-user license agreements (EULAs);³³³
- (vi) procedures and precautions taken when dealing with infringers; and
- (vii) ratings.³³⁴



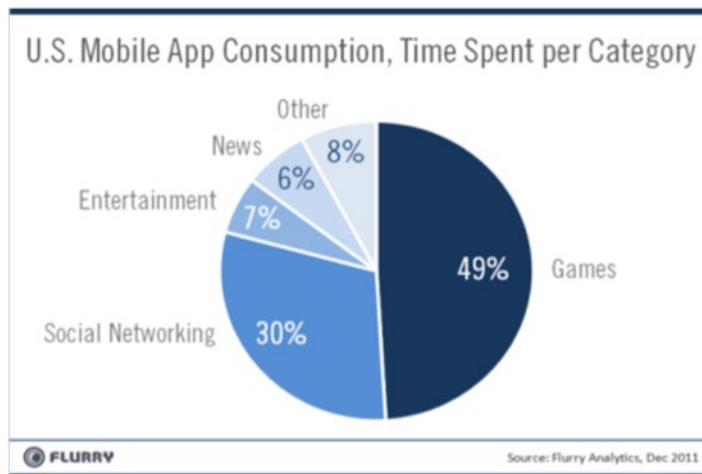
CHAPTER 8

THE MOBILE GAMING MARKET

8.1 Introduction

Mobile gaming, which includes games on mobile devices such as smartphones, feature phones³³⁵ and tablets,³³⁶ has become the fastest-growing sector in the video gaming industry.³³⁷ Moreover, games have become the single largest use of mobile smartphones. For example, in December 2011 mobile analytics firm Flurry estimated that mobile games occupy 49% of all US mobile app consumption:

Figure 5: Mobile App Consumption



Furthermore, this is a truly global market. For example, while at present the largest mobile markets are relatively affluent countries such as the US, the UK, Japan and South Korea, the greatest rate of growth in smartphone adoption is being seen in countries such as China, Vietnam, Columbia and Turkey.³³⁸

For developers, the mobile market offers benefits that might be unattainable in other areas of the video game market, with relatively low barriers of entry including lower development costs compared to other platforms,³³⁹ ease of publishing worldwide, immediate availability over mobile networks and, with increasing availability of mobile devices throughout the world, unprecedented ease of access to game applications ('apps') for consumers.³⁴⁰

At the same time, the mobile gaming industry can be a challenge for some developers to make money, as it is a marketplace characterized by an abundance of product³⁴¹ varying in quality, constant introduction of new devices and technologies,³⁴² different operating systems,³⁴³ new and evolving revenue business models³⁴⁴ and regulation.³⁴⁵ Yet, for many developers and publishers the mobile market has become

extremely profitable. All of these elements help contribute to make it also the most rapidly changing sector in the video game industry as well as extremely competitive in trying to distinguish one app from another.

This chapter will discuss some of the business and legal issues associated with mobile gaming, including those that appear in the different contracts a developer may enter into in order to get its app distributed. In many respects, several of the issues discussed throughout this publication will be applicable for the developer dealing in the mobile market, including development, IP clearances, licensing considerations, publisher-developer relationships, ratings, regulatory restrictions and common legal language that appears in many other video game-related publishing, distribution and licensing agreements.

8.2 Dealing with Distributors (the 'App Store')

Apps become available for consumers by accessing 'app stores' via the internet from a mobile device or tablet connected to a mobile network or wireless network. Developers therefore would need to first enter into agreements with the various distributors, such as Apple App Store, Google Play, or Samsung Apps,³⁴⁶ that serve as distribution platforms. In some situations, a developer may also enter into an agreement with a device manufacturer to create or license a game exclusively for use on a specific device through that device's storefront (although this is relatively rare unless the developer or the IP is particularly in demand and the platform is seeking actively to grow through direct incentives).

For most developers, entering into a deal with a distributor is an easy process in which the developer signs a distribution agreement by accepting a click-through agreement with the distributor. The agreement is a form contract that is not-negotiable (unless, possibly, the developer has extreme bargaining power and even then it is little known what it may be able to negotiate with the platform) and will set forth the rights and obligations for the developer and distributor. Although agreements will vary among distributors, typically the agreements usually cover the submission process, approvals,³⁴⁷ the non-exclusive licensing of the platform technology,³⁴⁸ the fee charged by the distributor for distributing the app,³⁴⁹ when payment would be made to the developer, term, territory, developer's grant of rights, ownership rights, pricing, removal notices,³⁵⁰ restrictions on data collection,³⁵¹ ratings requirements,³⁵² testing, insurance obligations,³⁵³ restrictions on the use of open source software, and certification of the app by the distributor.

The agreement will also require that the developer represent and warrant that all intellectual property associated with the app is either owned or properly licensed from a third party, and indemnify and defend the distributor against any liability, loss, and any costs resulting from any infringement claims for copyright, trademark, and



patents that might be brought against the distributor. Furthermore, the agreement, like all other agreements discussed throughout this publication, will cover a number of legal issues as well, which will include but not be limited to how and where disputes would be resolved, termination, confidentiality,³⁵⁴ limitations of liability, distributor's right to revise terms of the agreement, disclaimer of warranties, and 'boilerplate' provisions.³⁵⁵

In some cases, a distributor which may also manufacture a mobile device may be interested in a particular app for an exclusive period if it has been developed by the developer but not yet released. For example, this might be done as a way for the distributor to promote an upcoming or newly released device. In this situation, although rare, the parties would enter into a separate agreement³⁵⁶ which typically amends the distribution agreement and will specify the services required which may (depending on the deal terms) include terms regarding the development of the app, delivery dates, localization obligations, the delivery process (including the acceptance procedures), term, territory, financial³⁵⁷ and marketing terms. In practice, the most important of all deal terms here usually will be the marketing commitment: the developer will be keen to leverage the platform's promotional abilities as much as possible, since this can lead to a significant boost in sales.³⁵⁸

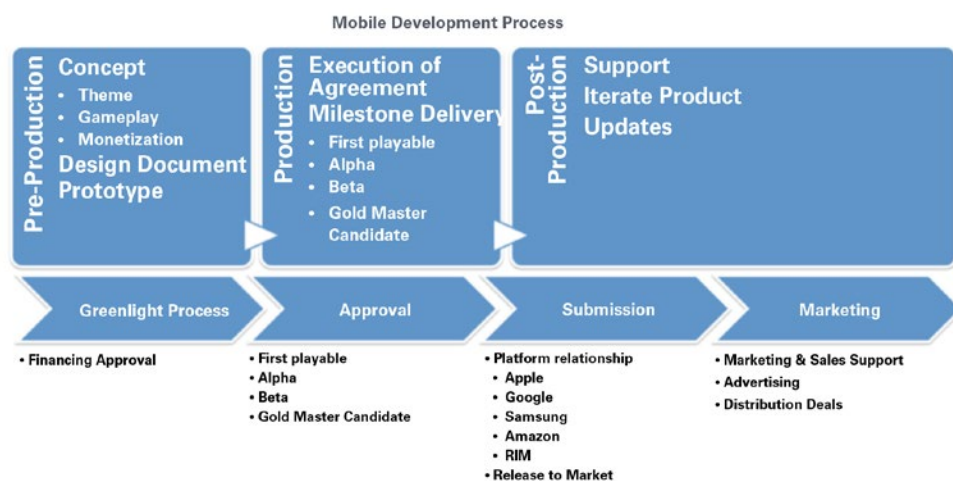
8.3 The Publisher – Developer Relationship

Because of the relatively low costs to develop an app and the ease with which a developer can get its game distributed through an app store, many developers elect to self-publish their apps, especially if the costs of development are relatively small. The biggest benefit for a developer is that the developer does not have to share any of the revenue earned or seek approvals other than with the distributor and any licensors that may have provided content for use in an app. On the other hand, the developer assumes all the risk in developing a game as well as sole responsibility in publishing the app.

In some situations, however, a developer may elect to work with a publisher in various scenarios. Why would a mobile developer want to work with a publisher when it can arrange for the distribution of the app on a mobile platform itself? There are two main reasons. The first is that publishers tend to be well capitalized and therefore can provide development funding. The second is that publishers can leverage their greater market presence to provide marketing support which is otherwise unattainable (or unaffordable) for the developer. Equally, publishers may need to do deals with developers: many publishers have considerable experience (and in-house studio talent) in the console and PC worlds, but not in mobile – therefore, it may make sense to seek an independent studio to help make a mobile game (often, but not always, using existing publisher IP).

Consequently, one may see development/publisher agreements in the mobile world in the following scenarios: (i) the publisher provides financing to help pay for all or parts of development and for other costs associated with the promotion and marketing of the app and in return acquires certain rights to the app including distribution rights; (ii) the publisher hires a developer to create a game that will be owned by the publisher; (iii) the publisher is simply involved in the marketing of the app but is not otherwise involved in funding or distributing the app;³⁵⁹ or (iv) the publisher distributes the developer's app and enters into agreements with distributors (particularly distributors outside the developer's zone of operation, such as launching a European game for distribution on Chinese mobile platforms). In scenarios (i) and (ii) the deal will involve the elements set out in Figure 6 (below):

Figure 6: The Mobile Development Process



The obligations between the developer and publisher will vary widely depending on the kind of deal agreed between them. For example, if the publisher is funding the developer to create one of the developer's own apps, or if the developer is creating an app as a work for hire for the publishers, then key considerations will include:

- (i) delivery of an app and milestone schedule;
- (ii) formats that will be delivered (i.e., iOS, Android);
- (iii) issues dealing with late delivery or failure to deliver an App which may include termination, or a reduction in payments or royalties;
- (iv) update obligations;³⁶⁰
- (v) testing of the various submissions for the different devices;
- (vi) localization of the app;
- (vii) porting of the app to additional devices;
- (viii) customer support responsibilities;
- (ix) ownership issues;³⁶¹
- (x) revenue sharing (see further below);



- (xi) distribution and marketing obligations;
- (xii) statements and audit rights; and
- (xiii) possible approvals.

Of these different requirements, the most hotly negotiated will often be revenue terms. As with most publishing agreements in the game world, for mobile publishing the publisher and the developer are typically remunerated through some form of percentage revenue share. As with the other revenue share deals described elsewhere in this publication, the exact amount payable to the developer and publisher (plus how and when it will be paid) will be a matter of negotiation affected by a wide number of factors including the parties' respective bargaining positions and whether the publisher has provided development funding which it wishes to recoup. However, in mobile publishing agreements both parties will take their revenue share after the distribution platform (e.g. Apple iOS or Google Play) has taken its standard fee deduction.³⁶² Moreover, depending on the business model of the app, there may need to be negotiations regarding what qualifies as revenue and how: for example, if the game has virtual items then the publisher and developer will need to agree how to recognize and share revenue from virtual items within the game as well as any revenue from the sale price of the app itself, if any.

More generally, regardless of the precise kind of publisher-development agreement, all of them will also include a number of legal issues similar to those addressed in standard distribution agreements elsewhere in the game industry, such as representations and warranties, indemnification, how and where disputes would be resolved, termination, confidentiality, limitations of liability, insurance and 'boilerplate' provisions.

8.4 The End-User Monetization Models

With an abundance of apps distributed in the mobile marketplace, increasing app costs, and many apps given away for free, making revenue for many developers and publishers has become the biggest challenge for developers and publishers. Consequently, several different business models have evolved or been adapted from other parts of the game industry (notably browser and online games), ranging from a fixed fee for purchasing an entire app (e.g., Premium), to free games which are supported by advertising or in-game purchases.³⁶³

In some instances, business models for an app change, depending on the initial end-user reaction; and in other situations, the pricing model for an app may vary depending on the app store, territory, and the brand. A strong brand, for example, may be able to command various fees because the app has been well received and is popular with consumers. For some developers, certain models have worked while for other developers those same models have failed although many factors contribute

to a game's success or failure. As a result, developers must carefully consider what model works best for them, since once a particular model is picked it may be difficult to change because of consumer expectations and distributor or technical restrictions.

While business models may continue to evolve, the most popular monetization models will all involve either some form of payment and/or fee to play elements or a combination of both.³⁶⁴ Table 9 (below) illustrates the possible ways a developer or publisher may earn money at different stages of gameplay under various business models.

In the Start Game phase, the end user would either pay money to start playing the app or have access to the app for free. In the During Game stage, the end-user would either continue playing the game without any additional cost or could elect to pay a fee to enhance their gameplay, perhaps with new characters or costumes or improving their playing skills with additional or enhanced functionality. Finally, in the Finishing Game phase the end-user does not have to pay any additional fees to complete the game under most of the business models, except for the Unlockable Demo whereby the end-user plays a certain amount of the game for free but must pay additional money to 'unlock' the entire game.

Table 8: Possible ways to earn money at different stages of gameplay

| Business Model | Start Game | During Game | Finishing Game | Example |
|--------------------------------|------------|-------------|----------------|--------------------------|
| Premium | Pay | Free | Free | <i>Angry Birds</i> |
| Ad Supported | Free | Free | Free | <i>Pool Pro Online 3</i> |
| Free-to-play ³⁶⁵ | Free | Pay or Free | Free | <i>Candy Crush</i> |
| Paymium | Pay | Pay or Free | Free | <i>Infinity Blade</i> |
| Unlockable Demo ³⁶⁶ | Free | Pay/Free | Free/Pay | |

8.5 Regulatory Considerations

Like any game, mobile games must comply with a wide range of regulation, from consumer protection to child protection and privacy issues. We discuss the key areas of regulation for games in Chapter 9.

However, it is important to bear in mind that these regulatory issues are particularly applicable but at the same time particularly opaque in the mobile game space, because mobile games have the largest actual and potential consumer reach of all game platforms but at the same time mobile smart devices are still very recent technology and therefore regulators are only beginning to understand how existing regulation should apply to mobile games and what new regulation will be required in the future.



For example, in the USA the Federal Trade Commission has been publishing since 2012 a series of reports regarding mobile privacy and children's access to mobile devices,³⁶⁷ while in 2013 the influential Article 29 Working Party of the European Union published a report recommending widespread changes to the entire mobile ecosystem, from platforms to developers, to comply with EU data privacy law.³⁶⁸ Other countries, including for example Australia³⁶⁹ and Canada,³⁷⁰ have published similar reports. All these reports focus on the importance of ensuring that the mobile devices and the apps which operate on them (including games) comply with applicable privacy and other laws, given the importance of mobile devices to many consumers' lives (plus their portability, meaning they are with consumers all the time). However, as yet there has been little enforcement action or other developments giving developers or publishers' guidance as to how such (often widely differing) rules should be implemented in practice.

Another important regulatory consideration for developers and publishers of mobile games is the global regulatory dimension: if an app can be distributed worldwide by default then, in principle, the laws of every country will apply to that app. Clearly, this would impose an intolerable burden on any business (even the largest publishers in the game space) and therefore the job of a lawyer in this space is to advise his or her client on which regulation is particularly important and how to chart a path through them.

8.6 Tax

One international legal consideration which cannot be avoided is the application of national tax rules to apps. Under the laws of man, if not most, countries in the world, the sale of an app – or of content within an app – will be subject to sales tax. Furthermore, the publisher or developer will be subject to corporation tax on its revenue from such sales. This can present complicated questions of law and accountancy in terms of defining and recognizing revenue.

These considerations present difficulties, not only for developers and publishers but for the platforms themselves. How should a mobile platform go about permitting VAT or other sales tax to be added to an app? Is this the responsibility of the platform, since it is the source of the download of the app by the consumer, or should this be the responsibility of the developer or publisher which created the app and/or made it available for distribution in the first place? What should the consumer make of all this? Given the global dimension to these questions, answering them rapidly involves issues of international taxation far beyond the scope of this publication and which in any event are changing all the time.

However, as of the writing of this publication, the following can be said of the two major platforms, Apple iOS and Google Play. In general, iOS Apple provides a measure

of help in relation to tax. For example, it provides assistance in relation to US States which charge an online sales tax. In the European Union, Apple structures all app sales through its Luxembourg subsidiary, which attracts a very low rate of VAT compared to other EU states (although this is expected to change due to EU tax law changes in 2015 which will prevent a company from choosing a single VAT rate across the EU and instead require VAT to be charged where the consumer and not the company is based). By contrast, with Google Play, Google appears to have left taxation largely in the hands of the developer or publisher, which are responsible for ensuring that the proper tax is collected and accounted for to the appropriate tax authorities. It is important to stress again, however, that the application of tax law to mobile games is still unsettled and there may well be significant additional change in the future.

8.7 IP Considerations

Mobile games, like all other games, will of course be subject to the basic principles of intellectual property law for games described in Chapter 3. However, three considerations in particular are important to know for mobile games.

The first is that game copying is still endemic on the mobile platforms and legal solutions to it can be difficult. Game copying, or 'cloning', is seen so commonly in mobile games because it is so easy: as discussed above, development costs are relatively low and distribution costs are tied to sales, making it easy for one developer to copy entire elements of a game (such as its name, gameplay, look and feel or characters) or even copy the entire game (hence 'cloning') and pass it off as its own in order to make cheap revenue at the expense of the original inventor.³⁷¹ Since there are so many apps in circulation, the mobile platforms usually claim it is impractical for them to review each one to ensure they are appropriate to be added to the platform and therefore it falls to the developer or publisher itself to protect its apps against copying/cloning. This is usually achieved through a combination of monitoring the relevant app stores for similar products, keeping in touch with the game playing community for warnings and, once identified, issuing takedown requests through the mobile platform.

The second key IP issue to be aware of in relation to mobile games is that piracy is an increasingly serious problem, especially on Android due to its relatively relaxed controls on what the software will permit. Such piracy usually works by a user circumventing the security software on his or smartphone (so-called 'jailbreaking') which then permits him or her to download apps for free rather than paying for them. There is no authoritative research as yet, however, on the impact of these developments on the app community or mobile games in particular. Anecdotal evidence suggests it is increasingly a problem for mobile developers,³⁷² to which the best solution so far seems to be business model innovation – above all the use of the free-to-play model (in which of course there is no upfront pricing and therefore it makes no difference whether the user is using a legitimate or 'jailbroken' phone).



However, this itself may not be a sufficient solution (particularly if pirates are able to circumvent the free-to-play aspects of the game as well) and it remains to be seen, therefore, what impact piracy will have on mobile games in the future.

A third and final IP consideration worth noting in relation to mobile games is that mobile games have become popular against a background of rising patent battles between the major players in the mobile world, involving smartphone manufacturers, mobile platforms, major software companies, non-practicing entities (so-called 'patent trolls') and even, on occasion, small developers.³⁷³ As yet, these wide-ranging patent battles appear not to have significantly affected mobile games developers or publishers, apart from in a few isolated instances,³⁷⁴ but it remains to be seen what impact (if any) these battles will have on the landscape on the mobile industry and therefore indirectly on mobile games.

8.8 Compliance with Mobile Platform Rules

One critical, but often little remembered, requirement of publishing an app is to ensure that it complies with the terms and conditions of the mobile platform, lest it otherwise either be rejected from admission altogether or – possibly worse still – be taken down after it has already been launched. Above all, understanding Apple's admission requirements is essential, since it is not only one of the pre-eminent mobile platform for games but it has also been stringent in the application of its rules to apps. It has been known to remove, or refuse admission to, apps based on their deemed inappropriate content³⁷⁵ or for breaching its rule on promotion of other apps.³⁷⁶ Anecdotal evidence suggests that other developers have faced queries about issues as diverse as IP rights ownership to gambling law compliance when attempting to have their game admitted to the Apple App Store. In light of the above, therefore, best practice is to review the relevant app store terms and conditions during the design process and to ensure that during the development process all major issues are being complied with, rather than have to redesign the app after it has already been developed (with all the costs and time involved) but then rejected.

8.9 Moving Forward: The Constantly Changing Landscape

The possibilities involving mobile gaming are immense because of the relatively low development costs, easier and faster accessibility of games for consumers around the world, growing popularity of mobile devices with a wide variety of apps, and low costs to play. But at the same time, these advantages have also resulted in a market filled with the highest number of available games for any platform by a wide margin, with varying business models to attract consumers and challenges in distinguishing one product from another making it difficult to make money. Yet for some developers, it has become an incredibly profitable business and has also allowed developers an opportunity to create and sell their games that would be unattainable on other

platforms. This will only continue as the amount of people in the world using smartphones rises (particularly in the developing world) and new technologies and ways to use mobile phones (and therefore mobile games), from location-based apps to apps integrating with television and other technologies, arrive and mature.

At the same time, the rise of mobile presents unique legal and business challenges and therefore a developer or publisher involved in mobile games will find it pays ample dividends to give some consideration to these issues before devoting substantial investment to such a profitable but increasingly complex and fast-changing part of the worldwide game industry.



CHAPTER 9

THE REGULATION OF THE GAME INDUSTRY

9.1 Introduction

As any industry develops, it becomes over time subject to increasing amounts of regulation, derived not only from legislation but also from case-law, regulatory guidance and self-regulation standards. The video game industry is no exception to this, but its unusual status of being both a creative and a technological industry means that the application of existing regulation to video games is often less than clear. Moreover, we are beginning to see the creation of regulation that applies specifically to the video games industry. This chapter gives a very brief overview of the key areas of regulation which developers and publishers need to be aware of when making a game: data privacy; consumer protection; advertising and marketing; and other regulation.

9.2 Data Privacy

Many modern games – particularly in the online, social and mobile sectors – are built on the collection and exploitation of data.³⁷⁷ The rapidly increasing use of data in the modern games industry is due to a number of linked factors. New platforms have arisen, including smartphones and modern web browsers, which make it relatively easy to collect data of all kinds, from an email address to how many times a user has clicked on a particular button during a particular period of time. Users (at least arguably) have become accustomed to providing data about themselves in a way they were not used to historically. Game studios have developed game development models which not only permit, but actively encourage, the regular collection of data in order to permit redesign of the game to fit what customers want. All of this encourages the collection, storage and exploitation of data on an ongoing and growing basis.

At the same time, across the board data privacy is becoming a more regulated space and one from which the game industry is not exempt. Although data privacy regulation has existed in the USA for many years,³⁷⁸ at present the European Union has arguably the most comprehensive and stringent data privacy regulation system, though the USA is fast developing and evolving its own data privacy rules (discussed below). To put it simply, developers need data to make most if not all games these days, but to get that data without attracting legal difficulties, they need to have a basic understanding of data privacy laws.

The EU system derives primarily from the Data Protection Directive (DPD)³⁷⁹ passed in the 1990s, though it has been supplemented by other legislation including the

E-Privacy Directive³⁸⁰ among many others. The DPD revolves around the concept of 'personal data' which essentially is data that, taken on its own or in combination with other data, may be used to identify an individual. It imposes eight central requirements on any individual or business which is responsible for the collection and control of personal data (known as a 'data controller'). Personal data must: be processed lawfully and fairly; be obtained only for one or more specified and lawful purposes; be adequate, relevant and not excessive in relation to the purpose or purposes for which they are processed; be accurate and, where necessary, kept up to date; not be kept for longer than is necessary for that purpose or those purposes; be processed in accordance with the rights of data subjects; have appropriate technical and organizational measures taken against unauthorized or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data; and finally not be transferred outside the European Economic Area except under certain circumstances. Exactly what those requirements mean and how they are enforced varies from Member State to Member State, unfortunately, and therefore EU data privacy law is (in)famous for its inability to provide a simple compliance guide across all 28 Member States. However, data privacy remains a serious compliance issue, as for instance Sony found out following a series of security breaches of its PlayStation Network resulting in significant EU data breaches.³⁸¹

In the United States, by comparison, one sees a comparatively less prescriptive system, which is over time becoming more comprehensive but also developing unevenly. US data privacy law is derived partly from federal statute, but also significantly from state law, partly from case law and increasingly from the decisions and guidance of the Federal Trade Commission. Consequently, it might be said that while the US has fewer data privacy laws than the European Union on the whole, what the US *does* have is rather spread around – which presents its own complexities. However, data privacy laws are to be taken seriously: in 2011, for instance, the Federal Trade Commission and the games company Playdom agreed to a \$3 million settlement over Playdom's alleged breaches of the Children's Online Privacy Act³⁸² (a statute which since then has been further developed and now presents an even more significant compliance challenge for games companies).

The starting point in the US is whether the data in question constitutes 'personally identifiable information' (PII) the meaning of which in principle is similar to 'personal data' in the European Union but in practice is defined to mean more limited categories of data than those regulated in the EU.

The position outside the US and the EU is as varied as you can imagine, from countries which have no meaningful data privacy system at all through to countries which have relatively well-established data privacy systems. Consequently, unless a developer has particular ties to a particular country (for example, it is incorporated there or the country is one of its major markets) it is common for a developer to focus



its data privacy compliance on the US and the EU first (the priority typically being the US unless the developer has a particular European focus).

Given the wide variations in data privacy law between the US, the EU and the rest of the world, plus the bespoke data usage and needs of each games business, data privacy compliance is one of the areas where legal advice is particularly recommended. Legal counsel well-versed in this area will be able to advise what a developer should and should not do while balancing up the cost of practical compliance with the risk that non-compliance involves. Nevertheless, some suggested pointers are offered below to try to give developers a starting point for data privacy compliance:

1. Only collect data which you need to collect.
2. Consider how best to collect the data.
3. Only store the data for as long as you need it.
4. Think about where and how to store it.
5. Take reasonable precautions to protect the data.
6. Have mechanisms in place to deal with user queries regarding the data.
7. Obtain consent for the collection, storage and exploitation of data.
8. If in doubt as to whether particular data is regulated or not, err on the side of caution.
9. Embody all this in a privacy policy.
10. Be aware there can be additional legal steps you need to comply with in particular jurisdictions (such as the potential need for a cookie policy in the European Union).

9.3 Consumer Protection

Consumers have long had certain legal rights and remedies regarding consumer products they buy or use, most of which apply in legal theory to games just like they apply to films, books or to a newly bought kitchen appliance. Often the practical application of these rules to games is unclear, not least because of the evolving nature of games themselves. To make things more complicated, as with data privacy laws, there is no consistency across different legal systems and therefore consumer laws vary widely from country to country.

In the United States, consumer protection laws are a mixture of state and federal laws, combined with case law and regulatory guidance. Similarly, in the European

Union the laws derive from Member State law as well as EU-wide legislation, case law and regulatory guidance. Most if not all countries have their own consumer protection systems (though many are still geared toward physical rather than digital goods and services). Again therefore, the average games developer has a challenging job when it comes to attempting to protect itself in an area where full worldwide compliance is effectively impossible and even substantial compliance is a challenge. A combination of expert legal advice, coupled with focusing initially on the developer's country of incorporation and later to its main operations and revenue bases, is essential. However, the following high-level pointers can be offered:

1. Think consumer: How would you as a consumer respond to a particular feature, development or issue with the game? Thinking consumer first can help resolve many problems before they become legal issues.
2. Most countries will have certain minimum requirements in the performance of the developer's obligations to consumers. For example, across much of the EU there is a requirement that goods or services sold to consumers must effectively be of 'satisfactory quality' – for example, a software product has to actually work. (This can cause and has caused controversy when a game is released with bugs, errors or otherwise lacking in features which previously had been associated with the game).
3. The majority of consumer complaints can be settled directly with consumers provided that a sensitive approach is taken.
4. However, in some situations you may find that consumers group together to take action against the developer (for example, via the class action system in the USA) or that a consumer regulator takes on a claim against the developer or the industry more widely.

A good way to deal with consumer protection issues is to have an End User license agreement (EULA) and/or Terms of Service which set out exactly what a consumer can and cannot do with a game and what happens if they go beyond those terms. Note that this means that those documents are bilateral – they set out what consumers can and cannot do as well as what you can and cannot. Moreover, because these are consumer documents they should be capable of being understood by consumers: which means keeping legalese and technical jargon to a minimum. Indeed, in many countries a developer has to localize terms entirely if it wishes them to be enforceable. For example, a developer seeking to enforce an EULA in France or China may well find it very difficult if the document is not in French or Chinese respectively. Getting such documents right legally and in a cost-effective way can often therefore be much more complex than the ubiquity of these documents in the video games industry may suggest.



1. Again, different countries have different approaches to different consumer issues. For example, in the EU consumers have a right to return unused physical games within a certain period of time after purchase. Further, the EU is moving towards permitting consumers to sell their used physical and digital games. By contrast, there are no such rules in the USA and it is arguable the US is moving further away from the EU in this regard. On the other hand, many fast-developing game markets such as China or Brazil have no similar rules at all at present.

9.4 Advertising and Marketing

Marketing a game usually still costs a very significant proportion of the overall game budget (even in the modern mobile game industry, which for a period had much lower proportional marketing costs relative to the console and PC games industries). From a legal perspective, the advertising and marketing of a game must comply with local legal rules – again on a country-by-country basis, the focus being on country of incorporation first and then other operational and revenue-generating territories. However, it is important to bear in mind that local laws regarding marketing a game, as well as the content of the game itself, are as much a product of culture as they are of law and therefore there is even further variation from country to country. For example, Germany is well known for its stringent requirements on game content and marketing, while countries in East Asia and the Middle East have strong, often morally-influenced rules on what can be advertised generally (including for games).

It is worth making a special note regarding children. The marketing of products to children is particularly heavily policed, from food products to toys, and these legal requirements affect games as well. For example, there is a broad legal and regulatory consensus around the world that children under the ages of 13 should not be marketed to at all (or sometimes only with prior parental consent). The marketing of games to children is an evolving legal issue that is still being explored. For example, during the course of writing this book two separate authorities in the EU (the Office of Fair Trading in the UK and the German Federal Court in Germany) were carrying out investigations regarding the marketing of free-to-play games to children.³⁸³ Similarly, in the US the Federal Trade Commission continues to monitor closely the marketing and use of digital products in relation to children.³⁸⁴

The basic rule running through these requirements is that the marketing of a game should be truthful and able to be factually evidenced, should not be misleading to consumers and should be targeted to the appropriate consumers. Failure in these requirements can result in both consumers and local marketing law authorities taking action against game developers.

9.5 Other Regulation

The regulation of the game industry continues apace in many other directions which are beyond the scope of this book. For instance, laws designed for the gambling industry increasingly affect the game industry (particularly with the convergence beginning in some quarters between those two industries), though there are very stark differences between the US, European countries and the rest of the world regarding the legality of gambling (the operation of which is a criminal offence in many countries). Physical products (both games as well as merchandise) are subject to product liability laws. Antitrust (also known outside the USA as 'competition') law issues are sometimes raised in relation to the largest players in the game industry. The growth of exports may introduce sports regulation into some parts of games. The interaction between games and broadcasting on platforms such as YouTube may over time result in broadcasting regulation impacting on games. The rise of the cloud as a distribution mechanism as well as a factor in game production will raise issues as the cloud becomes subject to greater regulation over time. Fundamentally, this is taking place due to the increasing success and prominence of the game industry as well as its convergence with other creative and digital media.

We do not yet know how regulated the game industry will become over time, though there is certainly a trend of increasing regulation. All that can safely be said as a result is the time is fast coming (if it is not here already) when game developers and publishers will need to tread carefully in their business endeavors and seek greater amounts of legal advice as the game industry becomes a more complex space in which to operate.

Box 6: How does the European Union legal system work?

The European Union (EU) is an economic and political association of 28 sovereign European countries. Each country (a 'Member State') has its own legal system creating domestic laws for that country. In addition however, the European Union itself passes legislation. This legislation in some cases becomes part of each Member State's legal system automatically but, much more often, the EU legislation sets out the principles which Member States are meant to implement in their own ways. As a result, while in many legal fields there is at least a degree of similarity between the 28 EU Member States, very often there are considerable differences (which are sometimes clarified and sometimes exacerbated by the Member State and EU court systems). Therefore, it is often hard to state what the EU legal position actually is on any particular topic.

9.6 Ratings

9.6.1 Age Ratings and Content Descriptors

In all the major video game markets, a developer or publisher ('submitter')³⁸⁵ will typically need to obtain a rating for its game prior to a game's release, whether the game is sold at retail or digitally downloaded or released on a mobile device. With






several different parties possibly involved in the rating process, especially if a game is released worldwide, navigating the various steps can be a challenge for a first time submitter. However, it is essential to get age ratings correct – not only because in many countries it is a legal requirement, but also in order to ensure that children are protected and that consumers are not misled (either of which can cause very considerable reputational harm to a games business). This section will briefly discuss in general terms the various issues associated with obtaining a rating for a game.



A game's rating indicates the suitability of the game for various age groups³⁸⁶ and, depending on the different ratings boards, also provides guidance to consumers (usually parents) on whether a game is suitable for a consumer over a certain age.³⁸⁷ In addition, the game's rating will typically be accompanied by content descriptors indicating the reasons why a game received a particular rating. For instance, a content descriptor may indicate that the game contains intense violence thereby triggering a particular rating.

In European countries, for example, that have adopted the Pan European Game Information (PEGI) rating system (30 countries currently use it),³⁸⁸ there are five age categories. These are depicted in Table 9 (below).

Based on the PEGI system, a PEGI 7 game rating is only suitable for those aged 7 and above and a PEGI 18 game rating is only suitable for adults 18 and older.

Table 9: The Pan European Game Information (PEGI) Ratings







| | |
|--|--|
|  PEGI 3 | The content of games given this rating is considered suitable for all age groups. Some violence in a comical context (typically Bugs Bunny or Tom & Jerry cartoon-like forms of violence) is acceptable. The child should not be able to associate the character on the screen with real-life characters, they should be totally fantasy. The game should not contain any sounds or pictures that are likely to scare or frighten young children. No bad language should be heard. |
|  PEGI 7 | Any game that would normally be rated at 3 but contains some possibly frightening scenes or sounds may be considered suitable in this category. |
|  PEGI 12 | Videogames that show violence of a slightly more graphic nature towards fantasy characters and/or non-graphic violence towards human-looking characters or recognizable animals, as well as videogames that show nudity of a slightly more graphic nature, would fall in this age category. Any bad language in this category must be mild and fall short of sexual expletives. |

| | |
|--|---|
|  <p>PEGI 16</p> | <p>This rating is applied once the depiction of violence (or sexual activity) reaches a stage that looks the same as would be expected in real life. More extreme bad language, the concept of the use of tobacco and drugs and the depiction of criminal activities can be content of games that are rated 16.</p> |
|  <p>PEGI 18</p> | <p>The adult classification is applied when the level of violence reaches a stage where it becomes a depiction of gross violence and/or includes elements of specific types of violence. Gross violence is the most difficult to define since it can be very subjective in many cases, but in general terms it can be classed as the depictions of violence that would make the viewer feel a sense of revulsion.³⁸⁹</p> |

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In addition, ratings are typically accompanied by content descriptors which may also be accompanied by icons.³⁹⁰ Under the PEGI system, the content descriptors, Table 10 (below), cover the following areas as illustrated below: (i) Bad language; (ii) Discrimination; (iii) Drugs; (iv) Fear; (v) Gambling; (vi) Sex; and (vii) Violence: Game contains depictions of violence.³⁹¹

Table 10: PEGI Content Descriptors

| | |
|--|---|
|  <p>BAD LANGUAGE</p> | <p>BAD LANGUAGE – Game contains bad language</p> |
|  <p>DISCRIMINATION</p> | <p>DISCRIMINATION – Game contains depictions of, or material which may encourage, discrimination</p> |
|  <p>DRUGS</p> | <p>DRUGS – Game refers to or depicts the use of drugs</p> |
|  <p>FEAR</p> | <p>FEAR – Game may be frightening or scary for young children</p> |
|  <p>GAMBLING</p> | <p>GAMBLING – Games that encourage or teach gambling</p> |
|  <p>SEX</p> | <p>SEX – Game depicts nudity and/or sexual behavior or sexual references</p> |



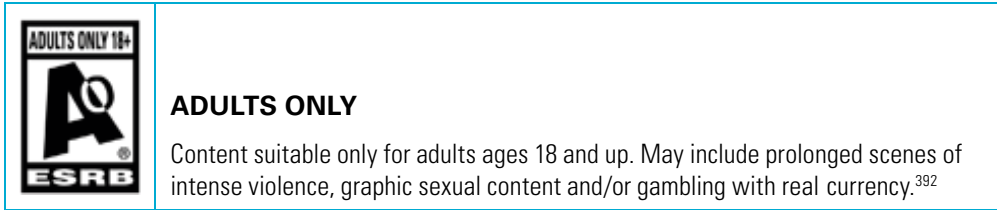
| | |
|--|---|
| | <p>VIOLENCE – Game contains depictions of violence</p> |
| | <p>ONLINE GAMEPLAY – Game can be played online</p> |

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In the United States and Canada, the ratings board known as the Entertainment Software Rating Board (ESRB) has two parts: (i) rating symbols suggesting what the appropriate age should be for an end-user and (ii) content descriptors. The ESRB uses six rating categories, which are depicted in Table 11 (below).

Table 11: The Entertainment Software Rating Board (ESRB) Rating Categories and Content Descriptors

| | |
|--|--|
| | <p>EARLY CHILDHOOD Content is intended for young children.</p> |
| | <p>EVERYONE Content is generally suitable for all ages. May contain minimal cartoon, fantasy or mild violence and/or infrequent use of mild language.</p> |
| | <p>EVERYONE 10+ Content is generally suitable for ages 10 and up. May contain more cartoon, fantasy or mild violence, mild language and/or minimally suggestive themes.</p> |
| | <p>TEEN Content is generally suitable for ages 13 and up. May contain violence, suggestive themes, crude humor, minimal blood, simulated gambling and/or infrequent use of strong language.</p> |
| | <p>MATURE Content is generally suitable for ages 17 and up. May contain intense violence, blood and gore, sexual content and/or strong language.</p> |



The ESRB ratings icons and other marks are trademarks or registered trademarks of the Entertainment Software Association.

Under the ESRB system, there are more than 30 descriptors covering different levels of violence, sex, nudity, gambling and uses of drugs, alcohol and tobacco. For example, a game could contain descriptors for violence ranging from cartoon violence to intense violence.³⁹³

In most situations, depending on the platform, a rating will be required either by a governmental body, the manufacturer of the hardware,³⁹⁴ or an app store.³⁹⁵ Some rating systems are overseen by a governmental ratings body and others by voluntary self-regulatory rating organizations³⁹⁶ or app stores each with slightly different criteria in determining a rating for a game.³⁹⁷

One of the challenges for a submitter³⁹⁸ is dealing with the various rating boards because of the different procedures and criteria they employ when rating a game. Rating boards may have different: (i) standards for achieving particular ratings; (ii) submission policies including what elements need to be submitted for different platforms; (iii) classifications and content descriptors; (iv) time frames for reviewing materials; (v) procedures for challenging a rating; and (vi) submission fees.

9.6.2 Factors in Rating a Game

Most ratings boards, in determining a rating for a game will primarily focus on potential contentious scenes in a game that may include: (i) violence, (ii) language, (iii) sex and nudity, (iv) drug use, (v) a game's theme, (vi) criminal acts including hate crimes, and (vii) content which is deemed culturally or otherwise inappropriate. In addition, many ratings boards will also factor in gambling or possible discrimination and whether the end-user is rewarded for certain acts such as violence, drug use or sex.³⁹⁹

While the various rating boards list the factors that a ratings board uses in determining a rating, the way in which some of the broad limitations may be applied can make it sometimes difficult for a submitter to determine what may or may not be acceptable within a certain age category or even in a game. For example, the South Korean ratings board (GRB) may factor in their rating decision whether a game includes anti-societal or anti-governmental messages.⁴⁰⁰ Similarly, the Entertainment Software Rating Association in the Islamic Republic of Iran is responsible for classifying games according to (among other things) the existence of 'religious values violation' or 'social



norms violation'.⁴⁰¹ Furthermore, various countries may treat a particular subject matter such as violence differently and as a result certain violence that may be acceptable in one country may not be accepted in another country.⁴⁰²

9.6.3 Submissions and Review

While packaged game submissions vary depending on country or region, typically, the submitter must provide: (i) a completed application which will require a description of the game as well as scenes involving the most contentious issues such as violence and sex, (ii) a DVD that captures an overview of the game as well as all the pertinent content including gameplay, cut scenes, hidden content along with the most extreme instances of how any of the above content appears in a game, (iii) appropriate submission fees, and (iv) a signed terms and conditions agreement. In addition, some rating boards require the submission of a beta or near final version of the game for the board's review. Upon receipt of the submitted information, the materials will be reviewed and then a rating for the game as well as the appropriate content descriptors will be determined by the ratings organization.

For games which are only accessed via download, such as digital and mobile platforms, some ratings boards such as the ESRB provide immediate ratings and content descriptors determined by answers to a questionnaire (referred to as a 'short form'),⁴⁰³ and no member of the rating's board initially reviews the games. However, some games are reviewed at a later stage to confirm the accuracy of the game's rating and that the information provided in the questionnaire by the Submitter was accurate.⁴⁰⁴ In contrast, PEGI reviews online/digital games the same way in which they review packaged/retail games.

In the event that content submitted, whether sold at retail or digitally downloaded, was not accurately or fully disclosed, then significant repercussions could be imposed upon the submitter including: (i) fines; (ii) removal of games for sale; (iii) revoking of a rating; or (iv) request that the game be re-labeled or stickered to reflect the new rating.⁴⁰⁵ As a result, it is critical that the submitter understands and follows the various procedures and regulations imposed by the various ratings boards.

When a game receives a rating, a submitter can generally either: (i) accept the rating; (ii) revise the game or delete scenes which are contentious in order to receive a less restrictive rating; or (iii) appeal the rating. It is important that the submitter gives itself enough time, not only for the submission process, but also to make any revisions that might be required for a particular country or region to achieve a desired rating.

A submitter should have an understanding of the different rules and regulations when planning games so that it has a general idea of what rating it wants to achieve and what materials may pose a problem. Submitters should also consider whether a particular scene that may contain some contentious content, whether it is one scene

of someone getting shot or a character using profanity, is worth jeopardizing a desired rating for a more restrictive rating which could result in a delay in the game's release or minimize the potential audience for a game.

Once a game receives a rating, the submitter must ensure that the rating, along with any applicable content descriptors, is displayed in the appropriate places such as in the game, packaging and marketing materials, if applicable, pursuant to the various guidelines established by the rating's board. In addition, submitters may need to abide by rules which restrict where advertisements for certain categories may appear and what type of content can be shown.⁴⁰⁶ Depending on the circumstances, there can therefore be a powerful incentive to attempt to achieve a particular rating, for example if a higher than expected rating may limit the game from reaching significant audiences (though games have yet to reach the significant efforts often made by major films to reach the widest possible demographics).

For DLC, generally the content does not need to be reviewed provided it is consistent with the game's rating and content descriptors. In this situation the rating that the game received will be applicable to the DLC. The ESRB and PEGI only require the material be submitted if the content exceeds that which is in the existing game.⁴⁰⁷ For example, there may be more violence or the violence may be more intense in the DLC than in the game, resulting in a different rating for the DLC content than the game.

9.6.4 Ratings for Online Games

The ratings bodies traditionally have focused primarily on ensuring that offline PC and console games obtain ratings (partly because such games historically formed the largest part of the games industry). However, recent years have seen the significant rise of online gaming, usually with players being able to interact with each other through multiplayer functionality.

Generally speaking, it has become fairly common for 'traditional' core games on PC and console, for example Massively Multiplayer Online games such as Activision-Blizzard's *World of Warcraft*, to be given ratings under ESRB, PEGI and other standards. This is relatively straightforward in one sense, since such games have many similarities to the traditional games rated by the authorities. However, the methodology is often a little different: whereas a traditional game such as *Super Mario* can be played solo by an examiner if necessary multiple times in pretty much the same way in order to explore its content, a purely online game such as *World of Tanks* by Wargaming depends on the existence of many people playing the game simultaneously and therefore the audiovisual content displayed in any one session can vary significantly.

There is also another category of online game altogether: browser-based games. These are games, such as Zynga's *Farmville*, which are usually not subject to the



above game rating authorities. Usually, if they are hosted on a third party platform (as the browser version of Farmville is hosted on Facebook) then they are subject to the age rating rules of those platforms, but otherwise at the moment they are essentially unregulated apart from any system they set up for themselves. Nonetheless, it is still important for developers or publishers making browser-based or other online games to give consideration to the underlying requirements of age ratings, i.e. the protection of children and the explanation of game content to consumers.

9.6.5 Ratings for Mobile Devices

Ratings for mobile devices are treated differently than console and PC games, since they are first and foremost governed by age rating requirements set by the platforms themselves. Storefronts for Apple, Google Play, Barnes & Noble, and Samsung, by way of examples, each utilize their own alternative rating systems although all rate games based on the suitability for different age categories. The rating is typically determined instantly, based on a submitter applying content guidelines for each storefront.

Games, for example in the Apple storefront, are rated based on 4 different categories which include the following:

4+ Applications in this category contain no objectionable material.

9+ Applications in this category may contain mild or infrequent occurrences of cartoon, fantasy or realistic violence, and infrequent or mild mature, suggestive, or horror-theme content which may not be suitable for children under the age of 9.

12+ Applications in this category may also contain infrequent mild language, frequent or intense cartoon, fantasy or realistic violence, and mild or infrequent mature or suggestive themes, and simulated gambling which may not be suitable for children under the age of 12.

17+ The end-consumer must be over 17 to purchase the application. Applications in this category may contain frequent and intense offensive language; frequent and intense cartoon, fantasy or realistic violence; and frequent and intense mature, horror, and suggestive themes; plus sexual content, nudity, alcohol, tobacco, and drugs which may not be suitable for children under 17.^{40B}

Google Play's rating system consists of four categories:

| |
|-----------------|
| Everyone |
| Low Maturity |
| Medium Maturity |
| High Maturity |

All content included as part of the application including gameplay, in-app products, or advertisements, must be factored when determining the rating. The different levels of particular content will determine the application's rating. To illustrate, applications

that contain mild cartoon or fantasy violence must be rated low maturity or above. However, applications that contain realistic or intense fantasy violence must be rated medium maturity or high maturity, and those that contain graphic violence must be rated high maturity. Google Play does not permit gratuitous real violence. In addition, other factors besides actual game play may determine a rating. For example, an application that publishes or shares a user's location with others must be rated medium maturity or high maturity. A submitter can revise a rating but if Google Play believes a rating was rated incorrectly then they will have the right to re-rate it based on their guidelines. A submitter that is found to have incorrectly assigned the proper rating may be subject to disciplinary action including account termination.⁴⁰⁹

In practice, all of this can impose burdens on developers and publishers, since they are effectively required to comply with a series of different age ratings for the same app if they wish to distribute it on multiple platforms. Attempts have been made to consolidate the mobile game rating process⁴¹⁰ though in practice little progress has been made as yet, not least because the major smartphone operating system players (Apple and Google) retain their own systems. To make things more complicated yet, in some countries, games/applications that appear on a mobile device must also be rated by the country's rating board and therefore a mobile platform rating from, say, Google Play or Apple iOS alone will not be sufficient.

Ratings have become an important part in the development and publishing of games, but determining what a submitter needs to do to comply with the various rules and regulations can be a challenging undertaking. As a result, it is critical that the submitter of a game understand when a game must be rated, how a game is rated, and what factors are considered in the rating process in each country or region, as well as for each device, to help reduce costs and potential delays in a game's release.



CHAPTER 10

CONFIDENTIALITY AGREEMENTS

Non-disclosure agreements (NDAs) and deal memos

10.1 The Purpose of Confidentiality Agreements

The confidentiality agreement, also referred to as a non-disclosure agreement (NDA), in most situations will be the first agreement that the developer will be exposed to when considering entering into a business relationship with a third party whether it is: (i) a publisher interested in distributing or financing the developer's game, or (ii) a licensor which controls a property, or software that the developer may be interested in for a game, or (iii) a new console or mobile manufacturer that is interested in distributing a game in development. In this situation, one party or both will be providing information to the other party that is not known publicly and the disclosing party wants to maintain confidentiality since the information may provide a competitive advantage to the party providing it. As a result, the disclosing party will provide confidential information to a receiving party only upon the condition that the information remains confidential except under specific, limited circumstances.

Which party is providing the confidential information will determine some of the negotiating points in the NDA. In most situations between a developer and publisher, the developer might be providing the most sensitive information such as a game design, but the publisher could also be providing confidential information that it does not want to release publicly including information about its business and future sales and marketing plans.

In order for the publisher to determine if it is interested in publishing the developer's game, the publisher will need to learn information about the game including the type of game which the developer is hoping to discuss with the publisher, as well as the game's story, game play, projected release schedule, and budget. At the same time, the developer will want to know certain information about the publisher in order to be comfortable with the financial strength of the publisher as well as learn about previous publishing commitments that might be relevant. For example, a developer might want to know certain financial information about a publisher that may not be publicly disclosed, depending on whether the company is publicly traded or not. If the parties negotiate a deal in which the publisher is financing the game, then the developer needs to be comfortable that the publisher will have the financial resources to finance, market, exploit, and sell the game.

In a licensing situation, generally the licensor (the owner of the intellectual property that is the subject of a license) will want to obtain information about the licensee (the

party interested in licensing a property for a product (i.e., video game) to confirm that the licensee has the resources and capability to distribute a product using the license.

Another example of when confidentiality agreements will need to be signed is with the introduction of new platforms and devices between the console manufacturer and a publisher creating a game. Because of the time it may take to develop a game, a publisher will want to start development as soon as possible so that the release of the game can meet the console's street date or shortly thereafter. As a result, the console manufacturer or a mobile device manufacturer will need to share design specs and other information about the device prior to its public release, to allow the publisher to develop the game. Simultaneously, the publisher will need to share non-public information about the game, including its design and projected release, with the platform owner. Typically, whenever a platform manufacturer is releasing information about a new platform or device, the NDA will be very favorable for the platform manufacturer since it is critical that none of the features be disclosed prior to any public announcement about the device.

NDAs are usually temporary, since they are in time replaced by confidentiality clauses in a subsequent agreement between the parties. Sometimes, the NDA will be referenced and incorporated into the agreement.

10.2 The Major Issues in a Confidentiality Agreement

The major issues discussed in a confidentiality agreement will include the names of the parties, what the parties consider confidential for purposes of the agreement, what the confidential information can be used for, what information will not be considered confidential, level of care in treating confidential information, circumstances in which confidential information might need to be disclosed, what happens in the event that information is disclosed in breach of the agreement, and an acknowledgement that discussions between the parties does not mean that the parties have entered into any other deal other than the confidentiality agreement.

Perhaps the most contentious issue involving a confidentiality agreement between a publisher and a developer or a console manufacturer and a developer will be the publisher's request that the developer acknowledge that the publisher receives other submissions for games and may also be working on projects that may seem similar to the game being revealed to the publisher. Because publishers may be working on multiple games and communicating with third parties about potential games, the publisher wants to ensure that the developer providing confidential information will not sue for misappropriation of developer's concept in the event that the two sides decide not to form a relationship and a game later is released that the developer may feel resembles the game it pitched. Language in the agreement may state that the developer acknowledges that the publisher receives numerous submissions of similar



concepts from other parties and may also be working on a similar project and that no consideration will be owed in the event publisher releases a similar game.

This is a difficult area, because the developer needs to see if there are parties interested in distributing and/or financing their game and yet will also have to acknowledge that the publisher may release a game with similar elements. As a result, the developer must make sure however if they accept this language – and in most situations they might have to – that the publisher must show that they independently created materials or designs for a game prior to entering into the confidential relationship with the developer.

Another potential controversial issue involves a request by the receiving party that the disclosing party acknowledges that some people receiving confidential information may retain that information because it stays in their memory (the residue of a negotiation).⁴¹¹ While the receiving party will agree not to use the information prohibited by an NDA there is always the possibility that a person may use that residual information in another unrelated project. Often, it is difficult to determine what information may fall into this residual exception. For developers this language is problematic and should be avoided, although depending on the bargaining power of the parties it may be difficult to remove from an NDA.

10.3 The Major Terms in the Confidentiality Agreement

10.3.1 Preamble

The first section typically will include a preamble introducing the parties to the agreement and should also include the address of the company's principal place of business as well as the date on which the agreement is signed by both parties. Generally, this will be filled in by the second party signing the agreement. In addition, it is advisable to include, if applicable, the company's state of incorporation or where the business entity was formed. This will be helpful in the event that there is a dispute with the agreement.

In addition to the preamble, some parties will also include information about the agreement and why the parties are entering into the relationship. For example, language may be included that states that the parties are interested in possibly entering into a business relationship and therefore have decided to enter into a confidentiality agreement whereby either one or both parties will exchange confidential information. The preamble will also probably include language about what each company does. In a publisher-developer relationship the agreement might say that the developer is in the business of publishing, distributing, marketing, and selling of video games and that the developer has developed or is developing a game.

The preamble can be helpful in determining the intent of the parties in discussing a confidentiality agreement. However, US courts have been split on whether the information in a preamble that discusses the reasons for a party entering into an agreement has any effect on establishing the intent of the parties, but at the very least each party should make sure that the language in the preamble is accurate to avoid any potential problems later in the event of a dispute between the parties.

10.3.2 What is Confidential? Exclusions; Permitted Uses of Confidential Information

What the parties deem confidential is another section that the parties will need to negotiate, and this will vary depending on the type of deal entered into between the parties. Confidential information will most often include information provided by the disclosing party, whether disclosed orally or in writing, that is labeled as confidential or that the receiving party under the circumstances should know is confidential. In developer-publisher NDAs, the terms of the confidentiality agreement and discussions between the parties, as well as the developer's game designs, story, budget, programming and technical information, will be considered confidential. A publisher will want to include as part of the confidential information potential marketing and sales information, business forecasts, and company business information which the developer may want to know to ensure the publisher's financial viability. In addition, the developer should consider that any information created by the receiving party based on the confidential information should also be deemed confidential and owned by the disclosing party. For example, a publisher suggests game design features based on the confidential information provided by the developer.

Certain information that may be deemed confidential can still be disclosed if it falls within one of the exceptions usually carved out between the parties. These exceptions usually include:

- (i) information that can be shown by documentation to have been independently developed prior to the parties entering into discussions;
- (ii) confidential information that had already been disclosed publicly through no fault of the receiving party;
- (iii) confidential information that was disclosed by a third party to the receiving party with no obligation to maintain confidentiality of the disclosed information; and
- (iv) confidential information that was disclosed by the party delivering the confidentiality information.

Although each party may want to include information as confidential and therefore kept from public disclosure, there are situations whereby the parties agree that in certain circumstances the confidential information may be released. Such a situation



might be a legal proceeding involving the parties entering into a deal; or a third party involved in a legal dispute and a party involved in the litigation might seek the disclosure of confidential information as part of the legal or regulatory proceeding. This is permitted subject to the party obligated to disclose the information providing reasonable advance notice to the disclosing party to provide the disclosing party with the opportunity to seek a court order to prevent or limit disclosure of the confidential information.

The NDA will also discuss what the receiving parties will be permitted to do with the confidential information. Language will typically state that the information can only be used to help determine whether the parties desire to pursue a business relationship. Consequently, the NDA will impose limitations on who can receive and review confidential information and will usually limit it to people on a 'need-to-know' basis. These people will be the personnel involved in making the decision on whether to establish a business relationship.

10.3.3 Level of Care and Length of Term

In this situation, the parties agree to commit to a certain minimum level of care in handling confidential information. This provides a guarantee that the level of care at the very least will be equivalent to the level of care the receiving party would use to protect its own confidential information. If this is language that the parties agree to, then each party must make sure that it knows exactly what that level of care would include.

Depending on the significance of the confidential information, the disclosing party may also request that certain measures are taken regarding the confidential information including:

- (i) limiting access to employees of the receiving party so that only those who may be involved in making a decision based on a potential deal would be entitled to access the information;
- (ii) requiring employees who have access to the confidential information to sign a separate confidentiality agreement; and
- (iii) the information must be placed in a secure place with limited accessibility (i.e., locked cabinets).

The parties will also need to agree to the amount of time for which the information needs to remain confidential. This varies quite a bit and usually will depend on the type of information being exchanged and the potential deal between the parties. In some instances, the term may be a few years, while some other agreements may require a perpetual term although the term should be reasonable in relation to the type of information exchanged. The developer needs to consider the type of information being provided. If it is a game design and development schedule that a

developer wants to pitch to a publisher or platform manufacturer developer, then the period may be a few years with the thinking that a potential deal, whether with the party entering into the confidentiality agreement or another party, may occur, and therefore once the game is publicized and eventually launched, information that was once confidential is now public.

Upon the expiration or termination of an NDA, the parties will establish the procedures by which the confidential information is either returned or destroyed, at the disclosing party's option. In the event that there are a lot of documents or other materials then it may be easier and more cost-effective for the receiving party to destroy the material and provide proof of destruction, usually through a certificate of destruction signed by an officer of the receiving party verifying the destruction.

10.3.4 Breach; Injunctive Relief

What happens when a party discloses confidential information? In this situation, the non-breaching party will first seek to prevent the continued distribution of the confidential information. In some situations, the disclosing party might need to seek a court order to prevent the further distribution of the confidential information. For example, the disclosing party may seek injunctive relief, where the court might issue an order to prevent the further distribution of any confidential information. In order to obtain injunctive relief in the United States, the moving party must show that the damage is irreparable and that monetary damages could not be determined. Since the value of confidential information is based on its secrecy, it may be difficult to ascertain its value if it is disclosed thereby qualifying for equitable relief. As a result, the parties will generally agree that a party disclosing confidential information in violation of the agreement acknowledges that the above requirements will have been met without any need for a court to decide the issue, thereby making it easier to obtain injunctive relief; nor will the non-breaching party be required to post a bond.

In addition to having the right to seek injunctive relief under the terms of the agreement, the non-breaching party will also have the right to pursue any other remedy that may be available at law or equity.

10.3.5 No License Agreement

Language will often appear in confidentiality agreements stating that the execution of an NDA does not mean that the parties will subsequently enter into any other type of agreement, whether it be a distribution, licensing or publishing agreement and that the parties have no expectations that they will enter into a subsequent agreement. In addition, while either one or both parties will own or control the confidential information it is sharing with the receiving party, the disclosing party will note that it is making no representations or warranties as to the accuracy of the information and



that it is being provided 'as is' so as to avoid any later claims by the receiving party that it relied on the representations and warranties made by the disclosing party to move forward with signing the confidentiality agreement.

10.3.6 Additional Terms

The confidentiality agreement will also include language generally referred to as 'boilerplate' language and will include some of the terms discussed in Chapter 11. While the term boilerplate is used to describe provisions which are typically standard in agreements, it is very important that the developer review the provisions and make sure they are acceptable. In most instances, very few revisions may need to be made except when dealing with issues about what law will be applied in the event of a dispute (i.e., the law of a particular country or the law of a particular state); where disputes would be resolved (i.e., what country or state or county) and how will disputes be resolved (i.e., arbitration or court proceedings).

For a developer, these are important issues because where a matter is litigated may greatly affect the costs of the litigation. Costs will have a big impact on whether a party decides to even proceed with litigation. No doubt, major companies realize that the burden of costs may be greater for small companies, including developers, and know that developers may be reluctant to bring a claim. One significant clause that must be added by the developer is that, in the event that there is a dispute, the side prevailing in any dispute will be entitled to any legal fees and other costs incurred in pursuing a claim. Usually, this is limited to 'reasonable' costs and expenses but provides for court costs and expert witness fees.

10.4 Deal Memos: Purpose and Potential Problems

'It took longer to make one of Mary Pickford's contracts than it did one of Mary's films.'⁴¹² Sam Goldwyn, one of the big studio bosses in the 1930s and 1940s, said this about negotiating a deal with the famous actress Mary Pickford, who later became one of the founders of United Artists.

Although Sam Goldwyn's quote dealt with negotiating a deal involving talent in the film industry, in some situations it is just as true in other areas within the entertainment industry, including video games, music and licensing. In many situations because of the urgency in starting game development, or commencing distribution, or acquiring a license for a game, the parties may not necessarily have enough time to negotiate a long form agreement which would include the complete agreement and all the terms and conditions between the parties. This could be particularly true if a developer is trying to release a game to coincide with a film's release, an event (e.g., the start of a sports season) or the Christmas holiday season. As a result, the parties will negotiate what is typically referred to as a deal memo. The deal memo will usually be a binding

agreement between the parties covering the major business terms of a deal, which allows the parties to proceed with the understanding that a long form agreement will eventually be executed between the parties.

For example, a publisher is interested in releasing a game in November and December which by a large margin are the biggest sales months for video games.⁴¹³ With development time taking an average of 18 months to 2 years for console and PC games (annual sports games take less than a year), a publisher will most likely want to sign a deal quickly if it hopes to release the game during the holiday season; and by entering into a deal memo, development can begin once the deal memo is signed.

For publisher-developer deal memos, the agreement should include:

1. A description of the game to be developed;
2. A milestone schedule, which would include the amount of money paid to the developer and when payments would be made, based on delivery of materials subject to agreed-upon dates;
3. Rights granted including rights involving potential sequels;
4. Ownership issues dealing with the game, development tools, and source code;
5. Royalty amounts and how they are calculated;
6. When statements will be issued;
7. Representations and warranties at least covering the rights in the game; and
8. Specific legal issues such as: (a) where a dispute would be resolved; (b) what law would be applied in the event of a dispute; and (c) confirmation that the deal memo will remain in effect until a long form agreement is entered into between the parties.

While deal memos serve many useful purposes, there are also some significant potential risks. Since deal memos usually only cover the major business points, there will be some terms that may not be covered and ambiguities in the deal memo may result in problems later between the parties. For example, during development it is possible that issues may arise that were not addressed in the deal memo, and if the long form agreement has not been signed, then issues may go unsolved possibly resulting in disputes between the parties.

Because long form agreements may take time to negotiate, draft, and execute, deal memos are now incorporating more terms, including representations and warranties and accounting provisions to name a few, but as more terms become part of the negotiations, there is greater risk that negotiations will take longer, defeating the



purpose of a deal memo. What eventually gets incorporated into a deal memo may depend on the relationship between the parties as well as the money involved in the deal. If it is a new business relationship and little is known about the parties then most likely additional terms will be added to the deal memo to provide further protections and assurances for the parties. If the parties have done business in the past and established a relationship, then fewer provisions may be needed in the deal memo because of the previous trust built up between the parties. Whatever the case, developers should be cautious when only relying on a deal memo; they need to insure that their rights are protected and obligations clearly spelled out to avoid unnecessary costs and risks.

CHAPTER 11

COMMON CLAUSES IN AGREEMENTS

11.1 Common Clauses in agreements

In all agreements there will be common clauses, which are usually referred to as 'boilerplate provisions' that will typically appear at the end of an agreement under the miscellaneous section. However, you should not let the name fool you: even though the lawyers will probably be the only people reading this section, there are important provisions that will have an impact on both parties in the event of a problem with a contract. Agreements will vary on the scope in which the clauses are defined and some may not include all of the clauses.

11.1.1 Jurisdictional Issues

In this section, the parties will agree to how disputes will be settled; what law will be applied in the event of a dispute; and where the dispute will be resolved. The parties first must agree on whether a court proceeding or arbitration⁴¹⁴ will be the forum for resolution of a possible dispute. Each has their advantages and disadvantages, with the primary difference, many believe, being that arbitration may result in a faster resolution and may have lower costs⁴¹⁵ although it will depend on the complexities of the dispute.⁴¹⁶ The fact that arbitration may cost less is a reason why some parties may not want to arbitrate, with the thinking that higher costs will serve as a deterrent against lawsuits. Because of the high costs of litigation, it is important to determine which party will pay for legal fees including attorney fees, court costs, and expenses for witnesses. In some agreements, the losing party would pay the costs of legal fees and costs would be restricted to reasonable fees, although that can also create a problem because determining what might be reasonable can be difficult.

In addition to deciding how a dispute will be resolved, the parties will also need to agree where the dispute will be resolved and the law that will be applied in the event of a dispute. Different states within the United States may interpret laws differently and state law will vary from State to State, and laws between countries will also vary. Depending on where the parties are located and where they conduct business, the parties will agree to use the law of one of the States where they are located, but in many situations, the parties may operate out of different States or countries, thereby creating a problem. In most situations, the party with the greater leverage typically will be able to dictate the law that will apply as well as the venue in which any dispute will be resolved. This is significant because of the costs that will be incurred by one of the parties to travel and/or hire local counsel to help in any litigation.



Assuming that the parties have equal bargaining position and different choices on where a case may be heard, there are some possible options that the parties may agree to on this issue. One possibility is that the parties select a neutral site provided there is some form of business conducted in that jurisdiction. For example, a California publisher and a developer based out of Michigan may elect to hear any litigation in New York. Because the entertainment industry has played a dominant role in both California and New York there is an advantage to having cases heard in those jurisdictions because of the familiarity of entertainment-related issues. A similar scenario may exist between two companies located in different countries, which is becoming more and more common as developers now occupy all parts of the globe. A game developer from Europe and a publisher from the United States may agree to settle the matter in England. The fact that both companies would need to spend a lot of money to litigate a matter may serve as a deterrent against proceeding with litigation.

Another option for the parties would be to agree that the party bringing the claims would need to bring it in the jurisdiction where the other party is located. For example, a company located in New York suing a California publisher would need to bring the action in California.

11.1.2 Waiver

In this section, a party's decision not to enforce the other party's strict performance of any provision of the agreement does not constitute a waiver of its rights to later enforce such provision or any other provision in the agreement. For example, a publisher does not lose its right to pursue an action against the developer at a later time if it believes a problem can be resolved without litigation.

11.1.3 No Joint Ventures

This section confirms that an agreement does not create a joint venture, partnership or any other type of business relationship that would allow one party to bind or commit the other party to any deals.

11.1.4 Severability

In this section, in the event that a particular provision is held to be unenforceable or invalid under the law, and provided the provision is not material that would change the intent of the parties, then the parties will agree that the agreement will continue in full force and effect as if the provision was not part of the agreement.

11.1.5 Assignment

Assignment provides the right for a signatory to the agreement to either transfer all of its rights and obligations or parts thereof to another party. This is a significant provision because a party that enters into a deal may only want to deal with the other party that signed the agreement. For instance, a party when deciding whether to enter into a business relationship will typically consider factors such as the quality of the work of the other party and their reputation. As a result, parties may restrict the rights or impose additional obligations on the other party with regard to assignments. For example, in the event that one party wants to assign its right, it might be: (i) subject to the prior written approval of the non-assigning party;⁴¹⁷ (ii) a party assigning its rights must guarantee that the assignee assumes all responsibilities under the terms of the agreement; and (iii) if the assignee fails to perform, then the party originally assigning the rights must be held accountable for the failures of the assignee.

Whether a party can assign or not will also depend on the bargaining position of the companies and the type of agreement. In a publisher-developer agreement, the developer will typically not be allowed to assign since the publisher has specifically entered into the agreement because of the developer's talents in creating a game. On the other hand, a publisher may be allowed to assign its rights under the possible restrictions listed above.

In licensing agreements, the licensor will generally have the unlimited right to assign its rights while the licensee's rights will only permit an assignment subject to the licensor's approval. In addition, in certain circumstances, the licensor may require an additional payment or other obligations to permit the assignment, based on the feeling that the licensed property may bring additional value to the parties engaged in the assignment and therefore the licensor should be further compensated as a result of the assignment.

One exception to the assignment usually agreed upon by the parties is that a party will be allowed to assign its rights to an affiliate. An affiliate will usually be defined as an entity that directly or indirectly controls, is controlled by, or is under common control with, the party seeking to assign its rights.

It is important that the agreement contains language that the parties have the right to assign since some jurisdictions in the United States may prohibit an assignment if it is not specified in the agreement.

11.1.6 Survival

This section notifies the signatories to the agreement that certain sections in the agreement will remain in effect even after the expiration or termination of the



agreement. Generally, this obligation will include some of the representations and warranties, indemnification, possibly payment if monies are owed after the term, issuing of statements, sell-off period, audit rights, and issues dealing with lawsuits. In addition, for deals where games are embedded onto a mobile device or part of subscription service, the right for the distributor to continue honoring previous agreements will usually survive termination or expiration of the agreement.

11.1.7 Notices

This provision will detail the procedures and the personnel who will need to be notified in the event that a notice needs to be sent to the other party as required under the terms of the agreement. For example, a notice will be required to be sent by a publisher to a developer in the event of a breach of the agreement. The language in the section will specify under which situations notice must be provided, which will typically include breach, a change of address, and an assignment of rights. In addition, the agreement will specify the person or parties that must receive notice in order for it to be effective. Generally, notice will be provided to the signatory of the agreement with a copy to the legal department for the company. It is sometimes better to have more than one person listed to ensure that notice does get to the proper people; also, people leave companies and therefore you want to make sure that when notice is sent the other party receives it.

The notice provision will also specify where notice needs to be sent, usually the address listed in the preamble of the agreement, and how notice will be sent. Notice should be sent in a way that receipt of the notice or when notice was sent can be verified. Most companies therefore will agree that overnight courier, hand delivery or registered return receipt requested will suffice as proof that notice has either been delivered or received. This is important, because the agreement will state when notice becomes effective and if a party needs to respond within a fixed time then there needs to be some acknowledgement that notice has been sent. Finally, an agreement may state when notice shall be deemed effective which will usually be a few days from sending of the notice or the date in which notice is received. This becomes important when a party needs to cure a potential breach within a fixed period of time.

11.1.8 Entire Agreement; Revisions

This section notes that the expressed language in the agreement is what will dictate the relationship between the parties and any previous or post discussions regarding the deal will have no relevance to the agreement. Consequently, any revisions to the agreement must be in writing and signed by either both parties or the party affected by the revision. This is important, because if one party promises the other party they

will take on certain obligations and it is not included in the agreement then it is not part of the deal.

11.1.9 Reserved Rights

In agreements in which property is licensed or is granted to a licensee, the owner of the intellectual property should add language to the agreement that states that all rights not expressly granted to the licensee by the licensor are reserved by the licensor. This is an important provision, since the licensee will want to obtain the broadest grant possible while the licensor will try to limit the rights granted because additional rights would result in additional consideration. In addition, as new forms of distribution and new platforms emerge, the licensor may not want to give rights away without understanding the potential business models for these emerging platforms and distribution channels.

11.1.10 Force Majeure

This is a clause that protects one or both parties from a breach of an agreement caused by an occurrence that is beyond the breaching party's control and may force the suspension of the agreement.⁴¹⁸ For example, a *force majeure* event occurs, materially affecting a party's ability to either perform its obligations or cure a breach.

Acts that typically fall under a *force majeure* clause include acts of God, natural disasters such as earthquakes and floods, war, epidemics, acts of terrorism, explosions and riots, provided it is not caused by the party claiming *force majeure*, as well as government acts which could include enactment of new laws. In addition, some agreements will also include labor disputes, shortage of materials and any other cause reasonably beyond the control of the parties.

If a *force majeure* event occurs, the contract will be suspended for the equivalent length of time of the event. During this time the affected party will usually be required to at least use good faith efforts to either perform its obligations or cure its breach. However, the suspension cannot continue indefinitely and therefore there will be a limitation, usually between 30 to 90 days. If the affected party is unable to perform or cure its breach prior to the suspension period expiring, then the other party will have the right to terminate the agreement.



APPENDIX

Sample Milestone Schedule for a Console Game

The list below highlights only some of the most important milestones and will vary depending on the project undertaken, the length of time for development and the platform the game will be released on. The parties should agree to more detailed delivery descriptions for each milestone and each should be fully defined before the next milestone. Not all milestones are listed when the agreement is signed and therefore the parties will label those milestones as 'to be decided' (TBD). It is critical that the parties determine what will eventually be delivered under a TBD milestone to avoid confusion among the parties when the milestone is actually delivered and whether payment might be owed. Furthermore, milestones may change and therefore the parties in the agreement will note that milestones can be altered subject to agreement between the parties.

Sample Milestone Schedule

1. Full execution of deal memo, if applicable
2. Full execution of the agreement
3. Delivery of design documents*
4. Technical design review*
5. Working prototype
6. Vertical slice*
7. Pre-alpha version
8. Code and content complete ('alpha')*
9. Final release candidate ('beta')*
10. Localization complete
11. QA candidate. All bugs resolved. QA begins
12. Delivery of a Gold Master Candidate
13. Final Master (NTSC version)
14. Final Master (PAL version)
15. Archive/return of loaned materials, (e.g., development kits), delivery of documents (e.g., work for hire documents and agreed-upon printed pages of the code for US copyright registration), and delivery of developer's assets (i.e., source code and game data, if applicable) to publisher.

*Typically represents particular milestones when a publisher decides whether to move forward to the next stage of development.

ACKNOWLEDGEMENTS

I would first like to thank the other authors who worked on this project and whose significant contributions were instrumental in making this publication possible.

I would also especially like to acknowledge the assistance, dedication, and endless support of Ms. Donna M.A. Hill of WIPO. Her incredible support and patience made this publication possible. The seeds for this project were planted a few years ago and it was her continuing support and vision that resulted in the project becoming reality.

I am extremely grateful to a number of people who provided their generous assistance, time, knowledge, and valuable contributions, including:

Adrienne Lauer, a sales executive with over 22 years video game experience including six years dedicated to global digital distribution and business development strategies. Adrienne is currently a sales consultant developing and executing sales and business development plans for several clients in the gaming space. Prior to her current role, she spent 14 years at THQ Inc. managing retail sales, establishing and leading THQ's global digital business.

Gary Rosenfeld, who has over 20 years' experience managing business development, product acquisition, licensing, business affairs and legal affairs for interactive game publishing, general entertainment and consumer products companies. Gary previously served in senior executive capacities at 20th Century Fox, THQ, The Endeavor Agency and Playmates Toys.

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Rob Aft, a film finance and distribution expert, for his encouragement and support. His WIPO publication, *From Script to Screen*, served as a model for this book and is available on the WIPO web site.

Ron Goldberg, Vice President of Manhattan Production Music, who has 22 years of experience licensing library and label music for videogames, films, TV, trailers, promos, news and sports. Ron is also involved in the hiring of artists and composers as well as overseeing all music production at Manhattan's growing libraries.

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Finally, additional thanks to Martin Nguyen, David Wang, Tad Hirabayashi, Kelly Flock, Michael Herz, Lloyd Kaufman, Professor Ted Hagelin, David Localio, Jim Kennedy, Dan Mueller, Ivar Posthumus, Maurice Molyneaux, James Shelton, Jerome Markota, Mark Litwak, Brian Pyne, Randy Walker, Eliot Mizrachi, Seth Steinberg, Donald Polden, and Mom and Dad.

David Greenspan

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Online Resources

There are hundreds of websites dedicated to gaming. Listed below are a few excellent sites involving business, marketing, and legal issues as well as stories and reviews about games.

- Bluesnews.com
- Eurogamer.net
- G4TV.com
- Gamasutra.com
- Game Industry International
- Gamesindustry.biz
- Gameinformer.com
- Gamepolitics.com
- Gamespot.com
- igda.com
- ign.com
- kotaku.com
- metacritic.com
- vgchartz.com

Sources of Further Information on Chapter 3

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- [2] Social Science Research Network (SSRN) *Paper, Copyright Law and Video Games: A Brief History of an Interactive Medium*, by Greg Lastowaka, Draft October, 2013, at <http://ssrn.com/abstract=2321424>
- [3] United States Patent and Trademark Office (USPTO): www.uspto.gov/
- [4] US Copyright Office: www.copyright.gov/
- [5] World Intellectual Property Organization (WIPO): www.wipo.int/portal/en/



ENDNOTES

- ¹ Based on the 2012 Essential Facts About the Computer and Video Game Industry published by the Entertainment Software Association.
- ² www.venturebeat.com/2013/06/06/global-games-market-to-hit-86-1b-by-2016-as-mobile-charges-ahead/; and <http://in.reuters.com/article/2013/06/10/gameshow-e-idINDEE9590DW20130610>
- ³ Accurately defining the size of the industry is difficult due to the varying definition of platforms, especially with the mobile category. Revenue numbers, especially for digital distribution and mobile gaming, tend to be estimates and those estimates can vary wildly. Although mobile gaming is the fastest growing sector of the industry, traditional gaming still makes up the bulk of industry revenue. See *Reuters, Factbox – A look at the \$66 billion video-games industry*; and Takahashi, *Mobile growth will fuel global game market that hits \$86.1B by 2016*.
- ⁴ VGChartz, www.vgchartz.com
- ⁵ *Id.*
- ⁶ www.gamesindustry.biz/articles/2012-11-22-steam-still-at-50-million-users-500-000-use-big-picture
- ⁷ www.gamasutra.com/view/news/180646/Origin_continues_to_creep_up_on_Steam_with_30M_registered_users.php
- ⁸ See *Reuters, Factbox – A look at the \$66 billion video-games industry*
- ⁹ <http://bgr.com/2012/12/04/mobile-market-share-2012-android/>
- ¹⁰ http://en.wikipedia.org/wiki/Category:First-party_video_game_developers
- ¹¹ Microsoft Annual Report 2012.
- ¹² Nintendo Annual Report 2013.
- ¹³ Sony Annual Report 2012.
- ¹⁴ www.forbes.com/sites/oliverchiang/2011/02/15/valve-and-steam-worth-billions/
- ¹⁵ Electronic Arts Inc. Annual Report 2012; Activision Blizzard Inc. Annual Report 2012; Ubisoft Entertainment U.A. Annual Report 2012; Sega Sammy Holdings Inc. Annual Report 2011; Take-Two Interactive Software, Inc. Annual Report 2012; Square-Enix Holdings Co. Ltd. Annual Report 2012; Namco Bandai Holdings Inc. Annual Report 2012; Konami Corporation Annual Report 2012; Capcom Co. Ltd. Annual Report 2012.
- ¹⁶ Nintendo's launch of the Wii U has been a major disappointment with a lack of compelling titles. See www.gamespot.com/news/wii-u-struggling-mightily-says-analyst-6409358; www.nbcnews.com/technology/nintendo-ceo-we-are-blame-poor-wii-u-sales-6C10378098
- ¹⁷ www.gamesindustry.biz/articles/2012-07-09-square-enix-on-next-gen-and-why-the-uncanny-valley-will-always-exist
- ¹⁸ Vgchartz, *supra* at 4.
- ¹⁹ [http://en.wikipedia.org/wiki/History_of_video_game_consoles_\(seventh_generation\)](http://en.wikipedia.org/wiki/History_of_video_game_consoles_(seventh_generation)); www.engadget.com/2012/09/19/sony-announces-a-new-ps3-the-latest-redesign-of-its-gaming/

- ²⁰ <http://business.time.com/2013/02/11/game-over-why-video-game-console-sales-are-plummeting/>; www.cbc.ca/news/technology/story/2013/05/17/f-video-game-console-analysis-nowak.html
- ²¹ http://gamasutra.com/view/news/184899/US_retail_software_in_2012_What_you_need_to_know.php
- ²² 'Triple A' titles are usually defined as big budgeted, high quality games.
- ²³ Wiki invest.
- ²⁴ The Nintendo Wii U has had a disappointing initial release, blamed primarily on a lack of compelling software. www.nbcnews.com/technology/nintendo-ceo-we-are-blame-poor-wii-u-sales-6C10378098 ; Invest, www.theverge.com/2013/2/15/3990934/npd-january-2013-sales-figures-wii-u
- ²⁵ See www.vg247.com/2013/07/11/sony-boss-the-steven-spielbergs-of-our-industry-are-indies/;
- ²⁶ www.theverge.com/2013/6/19/4445984/xbox-one-policy-reversal-changes
- ²⁷ www.techradar.com/us/news/gaming/valve-steam-box-release-date-news-and-features-1127072
- ²⁸ See: www.pcgamer.com/2012/06/06/ea-senior-vp-comments-on-steam-sales-%E2%80%9Ci-just-think-it-cheapens-your-intellectual-property-%E2%80%9D/, http://business.financialpost.com/2012/04/18/are-steep-discounts-for-online-game-sales-bad-for-business/?__lsa=06aa-4bd7
- ²⁹ See: www.gamasutra.com/blogs/DanielMacedo/20121219/183701/Why_Steam_sales_are_good.php, www.eurogamer.net/articles/2012-07-11-valve-counters-eas-steam-sales-cheapen-intellectual-property-accusation
- ³⁰ <http://venturebeat.com/2013/02/15/the-deanbeat-the-state-of-free-to-play-mobile-gaming-by-the-numbers/>
- ³¹ SWTOR, www.forbes.com/sites/erikkain/2012/11/21/star-wars-the-old-republic-goes-free-to-play-but-not-too-free/; Tera, www.eurogamer.net/articles/2013-02-05-fantasy-mmo-tera-goes-free-to-play-with-rousing-new-trailer; Star Trek Online, www.theverge.com/gaming/2012/1/18/2715087/star-trek-online-free-to-play. Never winter, www.ign.com/articles/2011/10/05/big-changes-to-cryptics-neverwinter
- ³² www.gamasutra.com/view/news/191079/At_EA_packaged_games_are_sliding_as_digital_nudges_upward.php
- ³³ See *The Legal Status of Video Games: Comparative Analysis in National Approaches*, World Intellectual Property Organization (WIPO), July 2013, a Study involving a survey of national legislation on copyright protection of video games covering the following jurisdictions: Argentina, Belgium, Brazil, Canada, China, Denmark, Egypt, Germany, India, Italy, Japan, Kenya, The Republic of Korea, Rwanda, Russia, Senegal, South Africa, Spain, Sweden, the United States of America and Uruguay. Andy Ramos, Laura Lopez, Anxo Rodriguez, Tim Meng and Stan Abrams. www.wipo.int/export/sites/www/copyright/en/activities/pdf/comparative_analysis_on_video_games.pdf
- ³⁴ Bugs are errors in the software causing in unexpected results in the gameplay as well as preventing the player from performing certain functions. Bugs usually will be categorized by their severity (A, B, C, etc., with A being the most serious) and depending on the severity would prevent a game from being released until fixed. An 'A' bug could prevent the player from playing the game, such as when the game freezes. A 'B' bug may allow the player to play the game, but a major feature may not work and, depending on the type of bug may or may not prevent the game from being released.



A 'C' bug is usually a negligible problem (i.e., a graphics issue, a misspelling) and would not prevent the game from being released. See Heather Maxwell Chandler, *The Game Production Handbook*, 241 (Jones & Bartlett Learning 3rd edition 2013).

- 35 In some situations, the publisher forms its own internal development team to develop a game and in other situations, publishers have acquired third-party development studios along with their employees and intellectual property. All rights to the games are owned by the publisher unless the game includes licensed property.
- 36 Even if the publisher acts only as the distributor, the publisher may assist in some of the financing for a game to help finish the product. In return, the publisher might receive a higher distribution fee and/or additional rights. Developers may self-finance games but it can be extremely challenging depending on costs and platforms. It is a lot easier to self-finance when developing for a mobile game as compared to a console because of the lower development costs. Some developers have obtained financing from venture capitalist and through donation websites like Kickstarter. Chandler, *supra* endnote 34, at 70-71. In situations like Kickstarter, the public makes contributions and generally receives something in return (i.e., copy of the game). See www.kickstarter.com/discover/categories/games?ref=sidebar. See also http://gamasutra.com/view/feature/182962/what_do_investors_look_for_in_a_.php regarding venture capitalist.
- 37 Unless a developer is also a publisher then the developer must enter into an agreement with a publisher that has a license agreement with a console manufacturer in order to have their games distributed at retail. See www.warioworld.com/apply/ and Chapter 6.2.
- 38 Other services a publisher may provide include: (1) overseeing game development; (2) debugging and testing the game; (3) working with retail to get product in stores; and (4) securing third party licenses such as trademarks, talent, and music. There are also advantages for the publisher in working with third party developers including: (i) expertise in certain categories of games as well as technology; (ii) possible reduction in costs for development and sharing of risks; and (iii) new intellectual property to distribute. Activision Blizzard Inc. Annual Report 2012.
- 39 The publisher may also want to: (i) interview other publishers that are working with and/or worked with the developer; (ii) conduct an on-site inspection to review the developer's facilities.
- 40 A publisher often will create a document outlining the potential profitability of a game, referred to as the 'Profit and Loss Analysis' (P&L). The P&L details how much money the publisher expects to receive based on different sales scenarios and how much they anticipate spending exploiting the game to determine whether they believe the game will be profitable.
- 41 For purposes of this chapter, the use of a publishing agreement will cover two situations: (i) the publisher is involved in the development and distribution of a game; or (ii) the publisher acts only as a distributor. In many situations, because of time restrictions and the length of time it make take to execute a long form agreement, the parties may agree to sign a deal memo to commence the project as quickly as possible. The deal memo will usually include the major business points and possibly some representations and warranties. See Chapter 10.4 for a discussion about deal memos.
- 42 In this situation, the publisher pays the developer an agreed-upon recoupable advance. Advances will vary depending on the type of game and platforms but some advances can easily reach into the millions of dollars.
- 43 If the game is based on a licensed property then ownership rights will be subject to the limitations imposed on the publisher pursuant to any licensing agreements. See Chapter 4.

- ⁴⁴ A work can qualify as a work for hire in two situations. One way is that the work was done within the employee's scope of employment. For example, an engineer creates code during his employment and therefore the code would then be owned by the employer. The second situation is when a work is created by an independent contractor and three conditions are met: (i) the work is specially ordered or commissioned (i.e., the independent contractor is paid to create something new); (ii) the work must fall within one of the nine categories outlined in the Copyright Act which include: a contribution to a collective work, contribution to a motion picture or other audiovisual work, a translation, a test, answer material for a test, an atlas, an instructional text, a compilation or supplementary material; and (iii) prior to the start of any work, the parties expressly agree in writing signed by both parties that the work shall be considered a work made for hire. Gary Myers, *Concise Hornbooks: Principles of Intellectual Property Law* 42-47 (Thomson West 2008); www.copylaw.com/new_articles/wfh.html. In the event that an employer fails to enter into an agreement prior to work commencing, then the employer must include language in the agreement that the work will be assigned, or at the very least, licensed to the employer.
- ⁴⁵ Julie E. Cohen, Lydia Pallas Loren, Ruth L. Okediji & Maureen A. O'Rourke, *Copyright In A Global Information Economy* 126 (Aspen Publishers 2nd ed. 2006). The principle of 'moral rights' is also relevant in relation to games which are originated or have links with European individuals. See Chapter 3 on intellectual property rights.
- ⁴⁶ By owning all rights to the game, the publisher, usually without any limitations, would also have the right to exploit any of the elements contained in the game (i.e., characters, story lines) by any and all means including Derivative Works, merchandising, films, etc. See www.toynews-online.biz/news/38372/Video-game-toy-sales-rise-28. For an article on some interesting video game related merchandise. See www.toptenz.net/top-10-most-baffling-pieces-of-video-game-merchandise.php. See also *Encyclopedia of Video Games: The Culture, Technology, and Art of Gaming* 392 (Mark J.P. Wolf ed., Greenwood 2012).
- ⁴⁷ The parties should list in the agreement the developer's specific pre-existing tools and technology. In the event that there are pre-existing tools and technology then the publisher will need to license those rights from the developer to use in the game.
- ⁴⁸ The rights granted for a game will often also be affected by the amount of money that may be paid to the developer, which could include advances, a guarantee, royalties and possibly even a marketing commitment. Typically, the more money paid to the developer, the more rights the publisher would obtain. Publishers will seek the broadest rights possible so they can recoup their investment, especially if they are providing any type of advance and/or guarantee. For certain games such as AAA titles, the bargaining power lies mostly with the publisher, since there are few parties that can provide the financing and other resources needed to support these types of titles. In addition, with fewer publishers, there are fewer alternatives for developers to work with on these games.
- ⁴⁹ Depending on the length of the agreement, a game may do well on one platform and as a result the developer or publisher may decide that the game should then be developed for or ported to other platforms that were not originally contemplated with the initial launch of the game. Furthermore, a publisher may also want to obtain rights for all platforms no matter what platforms the developer has delivered the game for since the publisher may want to restrict other companies from distributing the same game on different platforms. If a game is successful, the publisher may argue that their investment helped sales of the game and therefore other publishers should not be allowed to benefit from the original success of the publisher's actions. From the developer's perspective, the developer may not want to give up rights for other platforms since the publisher may not have the expertise in distributing on certain platforms. For example, a publisher that specializes in console and PC distribution may



not have sufficient capabilities or the relationships to distribute games via the mobile market.

- 50 In some situations, units of a game may be sold with other games, which are known as a bundle. In this situation, the royalty paid to the developer is usually a proportional percentage based on the number of titles included in the bundle. For example, if two different titles are sold together for one price, then a royalty of 50% of the revenue received would be allocated to each title. Usually, a developer in a distribution arrangement with a publisher will request that any potential bundling deal must first be approved by the developer, especially if one game has greater value (i.e., greater previous sales) than other games included in the bundle.
- 51 If the concept for a game originated from the developer, but the publisher owns the copyright or the publisher wants to use the developer's source code and the developer does not participate in the development of any derivative works, then the developer might request a passive royalty from any revenues earned from the exploitation of the derivative works. In this situation, even though the developer does not work on the derivative work, it would still be entitled to an agreed upon royalty. For example, the developer may receive a passive 2% royalty.
- 52 Provided the publisher continues to comply with the terms and conditions of the Agreement, and does not manufacture any new inventory, the publisher may have a limited non-exclusive period to sell-off any remaining inventory after the term. The sell-off period typically ranges from 3 to 6 months.
- 53 Design specifications usually cover how the game will look and may change during the course of development as agreed upon by the parties or as requested by a licensor if applicable (i.e. the game is based on a licensed property). If the milestone schedule changes as a result of the direction of the game then payments may need to be revised if the developer is to incur any additional costs. The technical specifications deal with programming development systems and software used in the development of the game as well as the technical risks and possible alternatives.
- 54 For games financed by a publisher the publisher will typically want to approve game designs and technical design specifications and will usually play an active role in overseeing development. In most situations the publisher will play a role similar to a studio financing the production of a film providing recommendations and feedback and in other situations they may have less oversight depending on the history of the developer; in some cases the publisher feels more comfortable allowing the developer to make certain decisions in the game's development. However in most situations where the publisher finances development and owns the intellectual property the publisher generally will have full creative and quality control. Also the size of the budget might determine the level of the publisher's involvement overseeing the project. A triple A title with a big budget will frequently result in a lot of oversight by the publisher but a mobile game for \$50,000 might have much less publisher involvement after the design concept and milestone schedule has been agreed upon by the parties.

In many distribution deals the developer is delivering a completed game and therefore the publisher's approval process may not be relevant although owners of the various platforms such as Sony or Valve will need to approve the final deliverables to ensure that the game conforms to their platform. Also if the publisher is paying a minimum guarantee or advance then the publisher, to protect itself against an unacceptable game should have rights to review the game during various stages of development.

- 55 Unless the publisher is providing IP assets typically the developer will be responsible for providing all the services and materials to develop all versions of the game and possible demos of the game agreed upon by the parties for all agreed upon formats (i.e. NTSC/PAL). Services will primarily include programming artwork software graphics animation/cinematics/video text sound dialogue music and some QA testing. The

developer may also be responsible for delivering localized versions of the game for various countries which involves language translations and revisions if necessary for rating purposes and perhaps local customs. (See Chapter 9 on ratings). Traditionally games have been localized into English French Italian German and Spanish (referred to as EFIGS) but as new markets evolve then more games may need to be localized assuming the costs to localize the game are justified by additional sales. Localization can be very expensive and time consuming especially if voice text and screens are localized and therefore the parties must budget the cost and time carefully so it does not delay the release of the game. Localization costs are typically covered by the publisher. Agreements will typically allow the developer to hire subcontractors to perform some aspect of development subject to the publisher's approval.

- ⁵⁶ The delivery dates for each milestone are critical to ensure that the game is released on time. The developer's payment often will be tied to its delivery of the agreed upon assets for each milestone. If a milestone is delayed because of the failure of the publisher (i.e., failure to deliver music, localization assets) or a third party licensor's failure to provide timely approvals, then the developer should not be liable for missed milestones. The parties need to draft the agreement to cover what happens if delivery is delayed as a result of the failure and may need to revise the milestone schedule to reflect the delays.
- ⁵⁷ One possibility when dealing with milestone payments although very rare is to divide the milestone payment into two payments. One payment would be made upon acceptance of a milestone deliverable and another payment may be a monthly fee. In this situation if the developer is late delivering an acceptable deliverable the developer would still be entitled to receive some money to allow them to continue development. Otherwise there could be situations where the developer may have a problem working on the game if its funding is delayed even though it may have caused the delay. This is perhaps one of the most difficult issues to deal with since the publisher must weigh the consequences of delaying or stopping funding for a game based on unacceptable deliverables.
- ⁵⁸ See <http://www.technewsdaily.com/17477-development-costs-crash-industry.html>. See also: www.vg247.com/2013/03/27/analyst-tomb-raider-cost-100-million-needs-10-million-sales-to-succeed/; www.gameranx.com/updates/id/13977/article/the-cost-of-making-games-examined/; www.gamespot.com/news/star-wars-the-old-republic-cost-200-million-to-develop-6348959; <http://1985fm.com/blog/2013/1/30/high-cost-of-video-game-development>; <http://leviathyn.com/games/opinion/2013/04/12/the-costs-of-aaa-games-development/>. See also articles below regarding costs for mobile game development: <http://online.wsj.com/article/SB10001424127887324345804578425252956831668.html>; www.forbes.com/sites/terokuittinen/2012/02/14/mobile-game-revenue-math/; www.nytimes.com/2012/03/19/technology/game-makers-give-away-freemium-products.html?pagewanted=all&_r=0
- ⁵⁹ All agreements should clearly spell out the delivery and acceptance procedures for each deliverable. One of the main issues is whether, if no response is received from the publisher within the review period, the deliverable is then deemed accepted. Also, what standards are used to determine acceptance or rejection of a deliverable? In most agreements, the criteria are somewhat vague, providing a lot of latitude for the publisher.
- ⁶⁰ Although an agreement generally includes language that in the event the developer breaches the agreement during development then the developer must return any monies received from the publisher, the publisher's rights might be difficult to enforce. In many situations the developer might not have the financial capability to return the money since the money received for development would have been used for the development of the game. To verify that money paid for development is actually used for that purpose, publishers may request the right to audit the developer's financial records. This can be a very contentious issue, since the developer may argue that how



they spend their money and what their costs are is confidential or a trade secret and therefore they should not be required to reveal the information to the publisher.

- 61 Depending on what the parties negotiate, the developer may also be responsible for localizing the game, obtaining a rating, and advancing certain costs such as marketing. See Chapter 2.2.12.
- 62 Like film studios, a publisher may need to purchase consumer and trade marketing placement months in advance. In some situations it might not be possible to pull the advertising or promotions and therefore the publisher would still be responsible for the costs.
- 63 Depending on the platform, the developer may also be required to provide additional updates and content after the game's initial release, although the publisher would provide additional compensation for these deliverables.
- 64 A development studio may be working on a number of projects at one time and therefore personnel that the publisher had hoped to work on a game may be assigned to another project. This provision will address this issue.
- 65 While a publisher often will want key personnel to work on a specified game, an employer cannot prevent an employee from leaving. Of course, the employee cannot misappropriate any trade secrets or other confidential information. See Chapter 3.1.2.2.
- 66 There are situations where the publisher pays a developer only a fee for developing the game and no additional payments are made to the developer. These types of deals are usually associated with lower costing products such as mobile games. However, in some situations if the game includes developer's pre-existing software then the developer may ask for some form of royalty for the licensing rights although payment would not be made until the publisher has recouped its development costs out of the developer's share.
- 67 In this situation, a recoupable advance is a payment or payments made by the publisher to the developer that the publisher regains from the royalties due to the developer.
- 68 The agreed-upon deductions would be deducted from gross revenues and not from the developer's share, although it may affect the developer's share since less money would be available to allocate for royalties.
- 69 See Appendix for sample of a console game milestone schedule.
- 70 Prior to the parties agreeing on a milestone schedule, the publisher will often request that the developer demonstrate to the publisher the developer's costs so the publisher can confirm that costs are consistent with the type of development being undertaken by the developer.
- 71 Depending on the negotiations and ownership of the IP, the developer might also share in other forms of revenue derived from the exploitation of the property such as licensed products based on the game (e.g., hint books, toys).
- 72 The revenues actually received by the publisher will determine the royalties earned by the developer since distributors whether it be for a mobile device or digital distributor often will be entitled to deduct an agreed-upon percentage as their fee before remitting any monies to the publisher. In addition, if the publisher is using sub-distributors then it will usually only account for the money it actually receives since the sub-distributor will deduct its fee and possibly expenses prior to remitting money to the publisher.
- 73 Gross revenue would include sales of games, DLC, in-game purchases, subscriptions, rentals, in-game advertising, ancillary sales, and any other revenue generated from the exploitation of the game.

- ⁷⁴ A developer will want the publisher to spend money on marketing and distributing the game since it is assumed that money spent wisely will help sales. At the same time, the developer will want to have some approval rights on how much money will be spent since this will ultimately affect the developer's revenue if the marketing spend is deducted from gross revenues. As a result, the developer would want to have the right to either approve or consult on the game's marketing plan, which would outline the amount of money anticipated to be spent and how it will be spent by the publisher.
- ⁷⁵ Cost of goods would include the cost of manufacturing, assembling and packaging units of a game (this would not be applicable to digital games) as well as any royalties owed to console manufacturers or licensors. Generally, no royalties would be paid on (i) units sold for less than the cost of goods since the publisher would not be earning any money on the sales; (ii) replacement copies; and (iii) free goods although this may be capped unless they are being provided to the press.
- ⁷⁶ Often large retailers will require an additional discount because of the large quantity of purchases made of a game. This is a cost that would apply towards physical game sales.
- ⁷⁷ In some agreements, depending on the negotiations, the parties may agree that all costs associated with the marketing of the game would be recoupable by the publisher. The costs would be recouped from gross revenues and not from the developer's share. In the event the costs are recoupable (if the game does poorly then it's very possible that the publisher does not recoup the costs) the developer should have the right to approve how money will be spent although the final decision will most likely rest with the publisher. The parties may want to consider a cap on marketing expenses and any amounts above the cap would need to be agreed upon by the parties. 'Co-op' advertising in this situation involves the practice by which the publisher pays a portion of advertising created by retailers involving the publisher's game(s). Costs are usually associated with in-store, point-of-sale, circulars, and similar promotions paid by the publisher to a retailer or discounted from monies owed by the retailer to the publisher.
- ⁷⁸ A publisher will often be allowed to deduct returns and refunds from gross revenues since they are not earning any money on those games. This can be particularly important in countries with strong trade laws regarding returns. For example, in Germany the great majority of retailers have a strong right to return unsold goods to their suppliers for full value. Consequently, European distribution agreements will usually need to apportion this risk between the parties (usually to the publisher's benefit).
- ⁷⁹ In general, in this situation price protection is money paid or credited to a retailer by the publisher when the publisher elects to drop the wholesale price by a certain amount and pays the difference between the original wholesale price paid by the retailer and the new wholesale price. Price protection would only apply to inventory still in the retailer's possession. For example, the publisher sells a game initially at a wholesale price of \$30. Later, the publisher decides to drop the wholesale price to \$20 to help sell games; then the publisher would owe the retailer a credit of \$10 for each unit still in the retailer's inventory. Typically, in order for the retailer to qualify for price protection it must satisfy certain conditions such as compliance with applicable payment terms and sales information (i.e., confirmation of inventory levels). Activision Blizzard Inc. Annual Report 2012; Take-Two Interactive Software, Inc. Annual Report 2012.
- ⁸⁰ In this situation, the publisher is paying a third party to provide services involving the distribution of a game such as internet hosting charges, carriage fees for mobile games, and in-game advertising.
- ⁸¹ If the developer is contractually required to provide certain services (i.e., bug fixing, localization, music) and is unable to do so then the costs incurred by the publisher in



using a third party typically will be recouped from developer's royalties or from gross revenues.

- ⁸² Different sales or consumption taxes may apply around the world. For example, US states have different levels and rules for sales tax and similarly the European Union has a Valued Added Tax system with different rates across different countries. Therefore, the same game could sell with approximately 10% sales tax in California but 20% sales tax in the United Kingdom. There are also different rules across the world regarding corporate taxation and revenue recognition. It is useful therefore to have a working understanding of the applicable financial and tax rules when negotiating a development agreement.
- ⁸³ The royalty rate may also fluctuate if the developer is late with delivery of the game. For example, depending on how late the developer is with the game, the royalty may be reduced.
- ⁸⁴ Royalty rates may vary depending on the platforms in which the game is sold. For example, a PC retail game may earn a slightly higher royalty because no royalties need to be paid to a first party console manufacturer. In addition, royalty rates may vary depending on the item sold. A royalty rate for ancillary products may result in a higher royalty rate for the developer than a game or downloadable content.
- ⁸⁵ The publisher needs to be careful when providing projected numbers so they do not over-promise, but at the same time, should not project sales too low since the developer might not have confidence in the publisher's capabilities if the number is lower than developer's expectations.
- ⁸⁶ Gregory J. Battersby & Danny Simon, *Basics of Licensing: How to Extend Brand and Entertainment Properties for Profit* 84 (Kent Press 2012).
- ⁸⁷ Don Thornburgh, 'The Reserve', in *IGDA Contract WalkThrough* 34 (International Game Developers Association 2003), available at http://legacy.igda.org/sites/default/files/IGDA_Contract_Walk-Through_v1.pdf Publishers need to be careful when ordering retail product so they can reduce their risks with returns, price protections and COGS.
- ⁸⁸ The percentage of the reserve can vary, with a higher reserve for the period covering the first 6 months after launch and then dropping thereafter. Also, publishers instead of establishing a reserve based on a percentage may ask for more flexibility by establishing a reasonable reserve based on the publisher's expectations.
- ⁸⁹ Thornburgh, *supra* endnote at 87, at 35.
- ⁹⁰ Most agreements will often use 'metacritic' scores as the basis for determining reviewer scores; these are named after a company which accumulates review scores of games. The company accumulates the reviews from what they believe to be the most respected game reviewers and assign weighted scores to their reviews (some reviewers receive more importance because of their track record and the publication they work for) resulting in an average score. See <http://www.metacritic.com/about-metascores>. However, this can create problems. What happens if the developer scores 1 point below the agreed-upon rating?
- ⁹¹ Consumer marketing usually covers advertising (on-line, off-line, television), public relations, game trailers, trade shows and all consumer creative.
- ⁹² Channel/Trade marketing would usually cover materials that appear in retail stores and in-store placement. Retailers promote video games through their store and store brand, referred to in the business as the 'channel'. The consensus in the industry is that such in-store promotion (either in a video game dedicated store such as GameStop, or a general store with a dedicated video game section, such as a Wal-Mart or Target) has value because the persons receiving the advertising in the stores have self-identified

themselves as interested in video games simply by their presence in the store, and are therefore more likely to purchase a game.

- ⁹³ This concept is also referred to as cross-collateralization. The publisher would be permitted to recoup any advances or development costs against any and all royalties regardless of the platform. Cross-collateralization may also be allowed if the publisher is financing multiple games, and this would allow for the publisher to recoup all advances paid to the developer from the combined revenue of all the games distributed by the publisher. As a result, if one game does poorly and is in a negative recoupment position, the difference can be made-up from revenue from the other games. Cross-collateralization allows the publisher to recoup its costs faster. Without cross-collateralization, the publisher would be allowed only to recoup its costs for that specific game against the revenue earned from that game.
- ⁹⁴ The auditor would be required to first sign a confidentiality agreement.
- ⁹⁵ Some of the records that an auditor might request could involve costs of goods, marketing expenses including those incurred by third party vendors and price-protection allowances. In addition, if a game is sub-distributed then the auditor may want to look at the statements provided by the sub-distributor to the publisher. However, a publisher may only be able to provide a statement and not necessary back-up information since it may not be provided by the sub-distributor.
- ⁹⁶ A publisher usually will make this request since an auditor working on a contingency basis tends to spend more time on the audit and raising issues since he/she will be paid on what he/she finds.
- ⁹⁷ The parties must also agree as to what costs would be reimbursed. Costs should be actual and reasonable expenses that may be incurred by the auditor. In addition, consider whether costs include not only the costs to conduct the audit, but the auditor's traveling and possible lodging expenses.
- ⁹⁸ In some distribution deals involving retail product, the developer may elect to deal with the first parties regarding the approval process but will look to the publishers to help finance the manufacturing costs.
- ⁹⁹ Other than a situation whereby the publisher owns the IP to the game or hires a developer to create a game based on a third party IP, the developer may request that the publisher provide the agreed-upon services comparable to other similar games that were distributed by the publisher.
- ¹⁰⁰ For distribution deals, the developer typically will have a much greater say in the marketing plans and creative issues for the game because of their greater monetary investment in the game.
- ¹⁰¹ An 'Easter Egg' is an item or gameplay hidden in a program which is accessed by performing certain commands outside normal gameplay.
- ¹⁰² The only obligation that usually would be acceptable is a credit acknowledgement. For a discussion on open source software see Raymond T. Nimmer, *Licensing of Intellectual Property and Other Information Assets* 808-825 (LexisNexis 2nd edition 2007).
- ¹⁰³ See also Chapter 4.3.9 regarding indemnification involving the licensing of properties.
- ¹⁰⁴ See also Chapter 4.3.9.
- ¹⁰⁵ The E&O Application will seek information to help the underwriter determine the risks involved with insuring a game. Some of those questions will include: (i) Is the game original and have any rights been obtained from a third party? (ii) Have agreements been signed with 3rd parties providing the rights necessary for the developer to exploit



the game? (iii) Have all clearances been obtained? (iv) Is the music original or have licenses been obtained? (iv) Has the developer been sued in the past for any claims? (v) What is the anticipated revenue from exploitation of the game? and (vi) What steps did the developer take to insure there are no possible infringements?

- ¹⁰⁶ While a higher deductible will result in a lower premium there is a possibility if the deductible is too high that the developer may not be able to cover the amount in the event of a claim.
- ¹⁰⁷ Few developers think about insurance and depending on the budget may not have allocated resources for a policy. It is very common especially for smaller developers not to have a policy because either they are not aware of it or do not have the money to purchase a policy.
- ¹⁰⁸ See Cynthia Cannady, *Technology Licensing and Development Agreements* 208-213 (Oxford University Press 2013) for an excellent discussion on dealing with bankruptcy issues.
- ¹⁰⁹ By S. Gregory Boyd and Jas Purewal. Gregory Boyd – Partner and Chairman of Interactive Entertainment Department at Frankfurt Kurnit Klein & Selz; Jas Purewal is an attorney with Osborne Clarke and author of the Gamer Law Blog – <http://www.gamerlaw.co.uk/>
- ¹¹⁰ Are Big Budgets Killing the Video Game Industry? October 25, 2012, Nachiket Mhatre, <http://tech2.in.com/opinions/gaming/are-big-budgets-killing-the-video-game-industry/536622>
- ¹¹¹ For a broader discussion and information on specific Intellectual Property Laws, please refer to the World Intellectual Property Organization's (WIPO) website at www.wipo.org
- ¹¹² For an introduction to WIPO's work on video games, see http://www.wipo.int/copyright/en/activities/video_games.html
- ¹¹³ See *The Legal Status of Video Games: Comparative Analysis in National Approaches* World Intellectual Property Organization, WIPO, July 2013: www.wipo.int/copyright/en/activities/video_games.html
- ¹¹⁴ Architectural works that are publicly viewable, when used as a general part of the scenery in games, do not normally require a license to be represented in a video game because of statutory exceptions. However, be wary of prominently featuring buildings (such as making them the focus of a game level), destroying buildings, using the interior of a building, or distinctive sculptural elements on the exterior of buildings, all of which may cause an issue. For example Sony had an issue when it used the interior of the Manchester Cathedral for in-game combat. http://en.wikipedia.org/wiki/Controversy_over_the_use_of_Manchester_Cathedral_in_Resistance:_Fall_of_Man
- ¹¹⁵ In the US, the Copyright Office maintains a useful website at www.copyright.gov to help people through the process of copyright registration and has informational documents called Circulars. These Circulars, written in non-technical English, explain copyright registration and other topics for creative works. At the time of this writing, the Copyright Office Circular 61, freely available on the website, gives detailed information about the copyright registration of computer and video games.
- ¹¹⁶ Examples of this include Middle Earth, Pandora from *Borderlands*, Mos Eisley from the *Star Wars* universe, Azeroth from *Warcraft*, and the post-apocalyptic world and cities in *Fallout*.
- ¹¹⁷ Pac-Man was the source of an early copyright infringement case against K.C. Munchkin. *Atari, Inc. v. North American*, 672 F.2d 607 (7th Cir. 1982).

- ¹¹⁸ For additional information, please see www.wipo.int/copyright/en/
- ¹¹⁹ For information on Copyright Registration and Documentation, see www.wipo.int/copyright/en/activities/copyright_registration/
- ¹²⁰ Atari Games Corp. v. Oman, 979 F.2d 242 (D.C. Cir. 1992).
- ¹²¹ <http://www.gamesindustry.biz/articles/2012-10-15-spry-fox-wins-ownership-of-yeti-town-as-part-of-triple-town-settlement>
- ¹²² www.gamespot.com/special_feature/attack-clones/image-feature/?image=3
- ¹²³ www.copyright.gov/help/faq/
- ¹²⁴ For information on what is publication, among other questions, see www.copyright.gov/help/faq/faq-definitions.html
- ¹²⁵ The annual revenue for *Angry Birds* in 2012 was approximately US\$200 million. <http://mashable.com/2013/04/03/angry-birds-2012-earnings-report/>
- ¹²⁶ www.gamasutra.com/view/news/94949/Midway_Sue_Sony_Ericsson.php
- ¹²⁷ http://en.wikipedia.org/wiki/Operation_Buccaneer and www.gamespot.com/news/game-pirate-gets-four-years-jail-time-6089247
- ¹²⁸ See for example the UK case of Nintendo Company Ltd & Anor v Playables Ltd & Anor [2010] EWHC 1932 (Ch) (28 July 2010) available at www.bailii.org/ew/cases/EWHC/Ch/2010/1932.html
- ¹²⁹ Having said that no infringement exists, this question has come into some dispute as of 2012. Electronic Arts has sued Textron (makers of Bell Helicopters) seeking a declaratory judgment on this issue. www.patentarcade.com/2012/07/new-cases-electronic-arts-inc-v-textron.html. The case was settled out of court. In May of 2013, EA publicly announced that it would no longer license any weaponry for use in its games. <http://www.reuters.com/article/2013/05/07/videogames-guns-idUSL2N0CS2A220130507>
- ¹³⁰ See the Fort Apache case discussing a Paul Newman film. *Walker v. Time Life Films, Inc.*, 784 F.2d 44 (2d Cir. 1986).
- ¹³¹ P. B. Hugenholtz, Martin Senftleben, Fair Use in Europe: In Search of Flexibilities, November 14, 2011 available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1959554
- ¹³² Although some countries, such as the United Kingdom, are enacting or proposing to enact specific copyright infringement defences for parody works.
- ¹³³ With modern chemical analytic methods, discovering the composition of any food product borders on trivial, but this is a well-known example in the legal field.
- ¹³⁴ See www.wto.org/english/tratop_e/trips_e/t_agm0_e.htm
- ¹³⁵ By 'skeleton' level, we mean a basic outline structure that can be added to and changed by the developers as they polish the level.
- ¹³⁶ For a list of more exotic trademarks see this Wiki article: http://en.wikipedia.org/wiki/Sound_trademark and http://en.wikipedia.org/wiki/Tiffany_Blue
- ¹³⁷ www.theregister.co.uk/2001/06/18/microsoft_buys_xbox_name_off/
- ¹³⁸ www.seattlepi.com/business/article/Microsoft-ends-development-of-Mythica-game-1137016.php



- ¹³⁹ There are companies that specialize in searching for infringing uses of trademarks. These companies can perform searches on a regular schedule and send your game development company reports on potential infringers. As with most types of IP, one of the early steps in policing the IP is sending a 'cease and desist' letter. Later steps can include litigation over the trademark.
- ¹⁴⁰ This is done by application to the Office for Harmonization for the Internal Market (OHIM): <http://oami.europa.eu/ows/rw/pages/index.en.do>
- ¹⁴¹ See <http://www.wipo.int/madrid/en/>
- ¹⁴² www.inta.org/TrademarkBasics/FactSheets/Pages/CTMMadridComparisonFactSheet.aspx
- ¹⁴³ Trademark Manual of Examining Procedure (TMEP) section 1202.08(b) 'What Does Not Constitute a Single Creative Work'. Interestingly, coloring books allow a user to trademark titles for a single version as well.
- ¹⁴⁴ http://en.wikipedia.org/wiki/History_of_United_States_patent_law
- ¹⁴⁵ The America Invents Act in 2011 was the first change to the patent system since 1952. http://en.wikipedia.org/wiki/Leahy-Smith_America_Invents_Act
- ¹⁴⁶ http://en.wikipedia.org/wiki/Community_patent
- ¹⁴⁷ 35 § USC. 101.
- ¹⁴⁸ The prohibition derives from a provision in the Convention that 'programs for computers' are excluded from patentability to the extent that a patent application relates to a computer program 'as such'. This rather ambiguous phrase has been interpreted in different ways over time, though as of the time of writing the trend seems to be towards loosening up the European hostility to software patents. For example, software patents have been permitted on the basis that they had a technical effect on hardware or even that the software permitted other software to work significantly better.
- ¹⁴⁹ Utility patents derive from the German concept of *Gebrauchsmuster*, or the utility model for patents: <http://en.wikipedia.org/wiki/Gebrauchsmuster>
- ¹⁵⁰ http://www.gamasutra.com/view/feature/2457/nintendo_entertainment_system__.php
- ¹⁵¹ <http://www.uspto.gov/web/offices/pac/mpep/s2590.html>
- ¹⁵² http://en.wikipedia.org/wiki/Leahy-Smith_America_Invents_Act
- ¹⁵³ <http://www.patentlyo.com/patent/2011/12/patents-litigation-and-reexaminations.html> and <http://www.ipwatchdog.com/2011/08/02/patent-litigation-statistics-1980-2010/id=17995/>
- ¹⁵⁴ Also in the United States, various aspects of rights of publicity may also be protected under federal trademark and unfair competition law. David Welkowitz & Tyler Ochoa, *Celebrity Rights: The Rights of Publicity and Related Rights in the United States and Abroad* xix, (Carolina Academic Press 2010).
- ¹⁵⁵ One of the biggest hurdles in obtaining the rights for a deceased person is trying to find out who actually controls the rights.
- ¹⁵⁶ See *Hart v. Electronic Arts, Inc.*, No. 11-3750 (3d Cir. May 21, 2013) and *Keller v. Electronic Arts, Inc.* No. 10-15387 (9th Cir. July 31, 2013) covering some recent cases whereby former college athletes sued a number of parties associated with the development of certain college sports video games published by EA for, among other things, a violation of their right of publicity. Even though their names were never

used in any game, the plaintiffs successfully argued that the developer used other characteristics of the athletes including various attributes such as skin color, hair, facial features, jersey number, statistics, athletic skills and biographical information (i.e., player's home state, team, class year, weight, height) which taken together would identify that avatar as a specific athlete therefore violating their rights of publicity which outweighed EA's First Amendment rights. See also *Kirby v. Sega of America Inc.*, 144 Cal. App. 4th 47 (2006) and *No Doubt v. Activision Publishing, Inc.*, 192 Cal. App. 4th 1018 (2011) involving rights of publicity cases using the likeness of musicians in video games.

- ¹⁵⁷ Depending on the extent of the person's services for a game, other factors in the negotiations may include exclusivity and approvals.
- ¹⁵⁸ SAG and AFTRA were two independent guilds for more than 60 years. They merged in 2012 to create the combined guild, which essentially represents every American actor or celebrity of prominence. <http://www.sagaftra.org/>
- ¹⁵⁹ See for example *Re Pacific Dunlop Limited v Paul Hogan and Ors* [1989] FCA 185 in Australia (the 'Crocodile Dundee' case) or *Robyn Rihanna Fenty v Arcadia* [2013] EWHC 2310 (Ch) (the 'Rihanna tshirts' case) in the United Kingdom.
- ¹⁶⁰ See Article 9 of the French Civil Code and Article 226-1 of the French Criminal Code, which together enshrine the right to "respect of private life" and impose penalties on persons infringing it.
- ¹⁶¹ In Germany the doctrine of publicity rights is known as the *Allgemeines Persönlichkeitsrecht* and is derived from the German constitution, the German Civil Code and court decisions.
- ¹⁶² See Article 99 of the General Principles of Civil Law of the People's Republic of China.
- ¹⁶³ The Berne Convention: <http://www.wipo.int/treaties/en/ip/berne/>
- ¹⁶⁴ Larger projects often have more protectable IP and large developers have the resources to spread the protection around. More registrations often result in more potential claims if there is a theft down the road. So, a large developer with multiple filings can litigate several registrations and several different types of IP in one case and has more granular coverage if just one element is taken (such as just taking the music from a game).
- ¹⁶⁵ The White Paper is available for download free from the IGDA web site, www.igda.org/
- ¹⁶⁶ In order to compete in today's sports video game market, certain games must acquire licenses from the appropriate sports leagues and player associations so the game can include the players and teams and accompanying indicia such as logos, jersey designs and statistics from that sport. In addition, licensees will also want to include stadium names and designs, and any signs, statues, and pictures that may appear in the various venues to allow the end-user to feel as if he or she is playing as the actual sport athlete or as a team in the game or event. Supposedly EA's deal in 1984 with Larry Bird and Julius Erving ('Dr. J'), two of the top basketball players at the time, was the first sports license agreement in the video game industry. Their names and likeness (although difficult to ascertain because of technology limitations) were used in the game *Dr. J and Larry Bird Go One-On-One*, which was released on the Apple II and Commodore 64. The licensing Game, Next Generation, July 1998.
- ¹⁶⁷ Because of the costs associated with most licenses, licensors typically only dealt with publishers that were able to afford the guarantees and other commitments required by the licensor. However, with more opportunities for developers to release their games directly to the consumer without a publisher, licensors are licensing properties directly to independent developers especially for mobile and tablet games.



- ¹⁶⁸ A few articles are listed below that have covered movie licensing over the years. See Chris Kohler, *Why Games Based on Movies Disappeared (And Why They're Coming Back)* *Wired* www.wired.com/gamelifelife/2013/02/movie-games/, Robert Levine, *Story Line Is Changing for Game Makers and Their Movie Deals*, *The New York Times*, February 21, 2005, Pages 1B, 5, www.nytimes.com/2005/02/21/technology/21game.html?_r=0. For Game Makers, <http://tvtropes.org/pmwiki/pmwiki.php/Main/TheProblemWithLicensedGames>.
- ¹⁶⁹ Games based on toys such as Lego or the Teenage Mutant Ninja Turtles, for example, have proven very successful over the last three decades.
- ¹⁷⁰ For example, logos from sports teams (i.e., EA's *Madden* football game based on licenses from the National Football League and NFL Players Association, FIFA, car manufacturers). In addition, licensees may license software to help in the development of a game such as middleware.
- ¹⁷¹ Typically, a licensee will want to release a game upon a motion picture's release and take advantage of the press, advertising, and promotion accompanying the motion picture's world-wide release as well as consumer built in recognition with stories and characters associated with a particular motion picture franchise. In addition, there might be opportunities to cross-promote the video game with the motion picture (i.e., tagging film posters with a mention of the video game, placing ads in the video game materials promoting the film).
- ¹⁷² There may be situations where the license, while providing additional benefits to the licensee, may also equally provide advantages to the licensor to be part of a game. As a result, other possible licensing scenarios, although smaller in scale, could include cross-promotional and/or product placement opportunities and/or free licenses. In the cross-promotional opportunity, the licensee incorporates the licensor's brand into the game and in return, the licensor promotes the game with their brand. For example, a soccer ball company grants a licensee the right to use the name of the manufacturer on the balls in the game and in return the ball manufacturer attaches a tag about the game with the soccer balls at retail. In a product placement situation, the licensor would actually pay money or another form of consideration to the licensee to have the licensor's brand placed in the game. This scenario is similar in motion pictures and the licensor may believe that the value of placing their product in a game justifies paying the licensee. For example, characters in a game may wear a particular clothing line. Under the free license possibility, the licensee receives permission from the licensor to place a brand in a game without the exchange of any monetary or marketing consideration. This is done to provide realism in the game in exchange for providing branding opportunities for the licensor. For example, a stadium's name and design are provided to developers creating a sports game. The benefit for the licensor is that the game may provide additional recognition for the stadium name to licensee's demographics especially if the stadium is named after a brand (i.e., AT & T Park, home of the San Francisco Giants US baseball team).
- ¹⁷³ See www.canada.com/topics/technology/games/story.html?id=2285e0f0-a77a-4536-bec8-6aca99027d7c&k=10775
- ¹⁷⁴ The US Supreme Court in *Brown v. Entertainment Merchants Association*, 131 S. Ct. 2729 (2011) in a challenge to California Civ. Code 1746-1746.5 ('Act') which prohibited the sale or rental of 'violent video games' to minors and required their packaging to be labeled '18', ruled that video games like protected books, plays, and movies qualify for first amendment protection in the USA subject to a few limited exceptions such as obscenity, incitement and fighting words.

The Act covered games 'in which the range of options available to a player included killing, maiming, dismembering, or sexually assaulting an image of a human being, if those acts are depicted' in a manner that '[a] reasonable person, considering the

game as a whole, would find appeals to a deviant or morbid interest of minors,' that is 'patently offensive to prevailing standards in the community as to what is suitable for minors,' and that 'causes the game, as a whole, to lack serious literary, artistic, political, or scientific value for minors.' 1746(d)(1)(A). Violation of the Act would be punishable by a civil fine of up to \$1,000. The court rejected California's claim that 'interactive' video games present special problems in that the player participates in the violent action on screen and determines its outcome, noting that California's law was too broad as written and couldn't satisfy the 'strict scrutiny' legal test. The Court further went on to say that video games 'communicate ideas through familiar literary devices and features distinctive to the medium and 'the basic principles of freedom of speech ...do not vary with a new and different communication medium.' *Joseph Burstyn, Inc. v. Wilson*, 343 US 495, 503. With recent first amendment protection provided to video games, it is possible that licensees may be more willing to challenge that licenses are needed in certain situations since they might not be required in other forms of entertainment. See <http://www.gamesindustry.biz/articles/2013-05-08-ea-drops-gun-licenses-will-use-them-anyway>; See also http://lslegal.com/index.php?option=com_content&view=article&id=162&Itemid=60 involving a legal dispute over Electronic Arts' use of Bell Helicopters. The case was settled out of court.

¹⁷⁵ THQ Annual Report 2011

¹⁷⁶ See Chapter 3.

¹⁷⁷ A licensor will either have people within the organization dedicated to licensing or be represented by agents that will negotiate the deal with potential licensees. The licensor may not have the resources or capabilities to engage in a licensing program and therefore hires an agent in return for a fee based on sales, to negotiate deals; review statements; approve materials; and deal with day-to-day issues with the licensee.

¹⁷⁸ This can often lead to protracted debate between the parties: the licensee usually will want to be able to create as faithful as possible a re-creation of the licensed IP in its game. The licensor will usually want to have creative input, it not creative control, over how that re-creation is created and finalized. Moreover, the licensor will often want input, or even veto rights, over how the licensed IP is used in the game (extending the car example, it is very common for licensors to insist that any damage done to licensed cars is realistic, not disproportionate and in keeping with its overall brand and marketing guidelines).

¹⁷⁹ Movie licenses may require the input from the producer, director, and talent involved with a film along with people working in the video game division. Coordinating approval rights can sometimes be difficult, time consuming, and result in contradictory responses.

¹⁸⁰ There can be situations whereby a property may have two licensors and therefore if a licensee is unable to obtain a license from one licensor it might try to obtain a license from the other licensor although the rights will slightly vary. For example, a comic book made into a movie could potentially have two licensors. One licensor would be the original creator of the comic book and the other licensor would be the copyright owner of the motion picture. Subject to their agreement with the movie studio, the comic book company may be able to license rights to the story and characters in the comic book, but would be unable to license any of the actual actors (i.e., name and likeness) and any revisions made to the comic book story created by the movie studio. Consequently, the movie studio could have the right to license the film based on the comic book, which would include all the elements in the movie. For the video game *Walking Dead*, Telltale Games had the rights from the author of the comic book series and Activision had the rights to the AMC television show.

¹⁸¹ When utilizing union talent, licensees will need to pay union wages as well as health benefits and will need to comply with minimum working requirements and work



restrictions. Furthermore, the game will be subject to re-use fees. See the Interactive Collective Bargaining agreement at <http://www.sagaftra.org/production-center/interactive/documents>. In the event, a licensee becomes a signatory to the SAG-AFTRA (Screen Actors Guild and the American Federation of Television and Radio Artists) agreement then the licensee would be required to utilize union talent for all future games developed by the licensee. As a result, many licensees will hire union talent through a third party.

¹⁸² See Chapter 4.3.10.

¹⁸³ In some agreements (usually in exclusive deals), if the licensee fails to exploit certain rights within a certain period of time or perhaps even in a particular territory, those rights either become non-exclusive or revert back to the licensor without any reduction in the guarantee. A sports league like other licensees such as the holders of very successful IPs (i.e., *Star Wars* or *Harry Potter*) may want to grant non-exclusive licenses because: (i) more competition may result in better products; and/or (ii) more companies providing guarantees in exchange for the license might result in receiving more revenue than one exclusive license; and/or (iii) it reduces its risks in the event a licensee has problems with development and is either unable to release a game or the game is delayed then a game created by other licensees may still be released on time. On the other hand, a licensor may decide to grant an exclusive license believing the guarantees and royalties paid will exceed those of a number of licensees and less oversight will be needed since the licensor will only need to work with one licensee.

¹⁸⁴ When determining which platforms to license to a licensee, the amount of money paid for the rights will probably be the most important consideration, but the licensor will also want to consider the licensee's ability to develop, sell, distribute and market the game on different platforms. For example, the licensor should investigate the track record of the licensee to determine how successful previously released games performed and how successful the licensee was in distributing and marketing a game in the territory and on different platforms where rights are requested.

¹⁸⁵ In addition, if there is a hold back provision, the licensor will request that there be an outside release date for the primary licensee in the event there is a delay with the licensee's release.

¹⁸⁶ Although sales of games decrease over time, a successful game can still do very well several months after its initial release with price drops and qualifying for participation in 'Greatest Hits' type programs offered by console manufacturers which can result in additional revenue.

¹⁸⁷ For example, a licensee interested in a new movie cannot predict the success of a movie, although it will hope to maximize its investment and minimize its risks by attaching a game to a movie with well-known talent, an appropriate movie budget, workable release date, and a world-wide marketing and theatrical release commitment. In addition, consideration paid to the licensor might be contingent on the eventual box office results of the movie.

¹⁸⁸ Battersby & Simon, *supra* endnote 86.

¹⁸⁹ Royalty rates will vary on a number of factors but there is no limit on how high costs can go other than those imposed by market conditions. See Theodore M. Hagelin, *Technology Innovation Law and Practice: Case and Materials* 396 (LexisNexis 2011).

¹⁹⁰ In some agreements, licensors may insist that the royalty rates are calculated, not based on revenue received but on all products sold, shipped or distributed by the licensee even if revenue is not received, thereby putting the risk on the licensee in the event that a third party fails to pay. Other issues that will need to be factored in when determining royalties will include units sold at discount and copies, subject to a possible cap, distributed for free to third parties.

- ¹⁹¹ While there may be fewer costs in some aspects regarding the release of a game, there may be other costs unique to that platform that the licensee must still incur to justify why royalty rates should not increase. For example, the costs associated with updating games.
- ¹⁹² If a sliding scale royalty is used it is important to determine how those sales numbers will be calculated. Does it include any sale of a game at any price or must the game be sold at a minimum price?
- ¹⁹³ One possible scenario to consider is that the parties agree to split marketing costs and allow for a certain percentage of the costs to be deducted from revenue with the possibility of increasing the cap subject to approval from both parties.
- ¹⁹⁴ Section 101 of the Copyright Act. Myers, *supra* endnote 44, at 42-47.
- ¹⁹⁵ The licensee cannot assign source code and tools licensed from the console manufacturers and third parties.
- ¹⁹⁶ It is often good practice to attach a sample of a statement that both parties can agree on so there is no disagreement on what the licensee reports in a statement.
- ¹⁹⁷ Unless there is a legitimate or bona fide dispute regarding an amount owed to the licensee then the failure by the licensee to pay royalties on time will require licensee to pay interest on the amount owed. There can be situations in which the auditor uncovers a mistake favorable for the licensee. In that situation, the licensor should re-pay any monies overpaid by the licensee or provide a credit against future revenues that might be earned by the licensor, if applicable.
- ¹⁹⁸ The licensee does not want to be in a situation in which another party claims rights to the licensed property since this could result in litigation and a demand to stop distribution of a game.
- ¹⁹⁹ Licensors will seek limitations on this absolute representation and warranty conditioned upon licensor's approval rights and exclusions to any alterations to the licensed property whether approved or not by the licensor.
- ²⁰⁰ If there is litigation and it could potentially affect the game's development then the risks may not justify the potential benefits.
- ²⁰¹ See Chapter 4.3.9.
- ²⁰² In many licensing agreements, the licensor will also require that the licensee agree to a marketing commitment to be mutually agreed upon by the parties which provides a guarantee that the licensee will spend an agreed upon amount of money on marketing initiatives. The amount might either be a fixed sum or a percentage based on projected sales of the game (i.e., 5% of projected net revenues). Projected sales can pose a problem for the licensee if the projected sales far exceed actual sales and there is not enough revenue to recoup marketing costs.

Marketing initiatives could cover marketing involving television, print, internet, events, etc. If the licensee agrees to this then the licensee should tie this into the overall consideration paid to the licensor although the marketing dollars will eventually help both parties by increasing awareness of the game which should result in greater sales. For example, a higher marketing commitment might result in reduced royalty rates or a minimum guarantee. The parties will need to negotiate what marketing opportunities the money will be spent on, when the money will be spent (usually in the first few months of a game's release), and what countries the money will be spent in. In some situations, the licensor will want some money allocated to marketing programs initiated by the licensor. For example, sponsoring a licensor event. This should only be agreed to if it will help drive sales.



²⁰³ Cannady, *supra* endnote 108, at 171.

²⁰⁴ See Chapter 4.3.11.

²⁰⁵ Licensors in most situations will also require that the licensee maintain products liability, comprehensive general liability and possibly advertising liability insurance throughout the term. Within a certain period of time (usually 30 days), the licensee will need to provide proof of insurance coverage to the licensor by submitting a certificate of insurance outlining the insurance coverage and naming the licensor as an additional insured party. Licensees should also require that licensor's have E&O coverage as well.

²⁰⁶ There are typically two types of limits related to E&O policies. One is for each claim and the other is for all claims combined. Standard policies will have limits of \$1 million/\$3 million. The first number is the limit per claim and the second number covers the limit on all claims under the policy. Therefore, the insurance company will not pay out any amounts exceeding \$1 million dollars for any one claim under a \$1 million/\$3 million policy. In addition, an insured party must understand how the policy is written and whether it is a claims or occurrence made policy since this will also impose an additional restriction. Under a claim's policy, the policy will only cover claims made during the policy period. For example, if the claim policy runs from January 1, 2012 to January 1, 2013 and a claim is made against the insured on February 1, 2013 even though the alleged copyright infringement occurred in December of 2012 then the policy will not cover the claim. As a result, it does not matter when the infringement occurred. In contrast, under the occurrence policy, the policy does not go into effect when the claim is made but when the event occurred giving rise to the claim. In the above example, if the insured had an occurrence policy then the alleged copyright infringement claim would have been covered under the policy. See Ted Gerges, *Providers in the Digital Age*, in *Counseling Content Providers In The Digital Age* 281-291 (Kathleen Conkey, Elissa D. Hecker & Pamela C. Jones eds., New York State Bar Association 2010).

²⁰⁷ As part of the E&O policy, insurance companies will usually want to direct the insured party regarding the law firm that will represent the licensees since the insurance company wants to assure that the law firm is knowledgeable and capable of defending a claim in the jurisdiction in which the claim is brought and their fees are within the insurance company's range. However, this issue should be discussed with the insurance company since a policy holder may feel more comfortable working with its own firm.

²⁰⁸ In the United States, the party seeking injunctive relief must show they will suffer irreparable harm if equitable relief is denied. Where money damages are adequate to remedy the problem then injunctive relief will not be granted. *Delphine Software International v. Electronic Arts, Inc.* United States District Court, Southern District of New York, August 18, 1999 No. Civ. 4454 AG AS, 1999 WL 627413. The Delphine case deals with injunctive relief involving confidential information.

²⁰⁹ See Russell Weaver, Elaine Shoben & Michael Kelly, *Concise Hornbooks: Principles of Remedies Law* (Thomson West pages 46-50).

²¹⁰ See footnote 286.

²¹¹ Weaver, Shoben & Kelly, *supra* endnote 209, at 224-7.

²¹² Music or rather each 'song' consists of two separate copyrightable interests: (i) the composition (which includes the lyrics, notes, orchestrations, and arrangements) and; (ii) the master sound recording (which is the actual recorded version of a particular composition). Unless otherwise noted herein, the use of 'music' in this Chapter will denote both the composition and the master sound recording.

- ²¹³ There could be memory and disc space limitations depending on the amount of music planned for the game.
- ²¹⁴ Once the script for the game is finalized, the Developers will go through what is called a spotting session to analyze the script to determine what scenes require music, what kind of music works where, and whether the scenes should be scored or 'sourced' using licensed music.
- ²¹⁵ Danny Elfman the composer for many of Tim Burton films and former member of the musical group Oingo Boingo has also composed music for games. www.giantbomb.com/danny-elfman/3040-45016/. Hans Zimmer who has composed over 50 film scores including *Rain Man*, *The Lion King*, *Gladiator*, and *The Dark Knight Rises* has scored multiple games including *Modern Warfare 2*. Ramim Djawadi composed the film score for *Iron Man* and the video game *Medal of Honor: Warfighter*. <http://herocomplex.latimes.com/games/for-composers-video-games-are-the-surreal-land-of-opportunity/>
- ²¹⁶ Pamela C. Jones & Melinda L. Lee, *Rights and Clearances*, in *Counseling Content Providers in the Digital Age* (Kathleen Conkey, Elissa D. Hecker & Pamela C. Jones eds., New York State Bar Association 2010).
- ²¹⁷ A developer could consider hiring a composer to create just an original song for a game.
- ²¹⁸ Music libraries will provide the synchronization and master rights to their music which can be licensed usually for any use.
- ²¹⁹ Synchronization rights are usually acquired from the composition's writer or publisher. The master use rights are generally obtained from the recording label that owns or controls the master sound recordings.
- ²²⁰ Usually the licensing rights will be non-exclusive.
- ²²¹ Music labels generally will limit their representations and warranties and may only grant rights on a quitclaim or 'as is' basis especially for older music thereby shifting the risk to the licensee of the music. Gary Morris & Richard Beyman, *Licensing Intellectual Property, in Business & Legal Primer for Game Development*, 200 (S. Gregory Boyd & Brian J. Green eds., Charles River Media 2007). As a result, Developers need to investigate whether there has been any litigation or issues regarding a particular song.
- ²²² Developers should generally avoid paying royalties and instead insist on a flat fee for the rights unless paying out royalties will reduce the upfront costs to obtain the rights and be economically advantageous. If royalties are to be paid then the developer should consider capping payments at a certain amount. If the developer agrees to pay royalties then they will need to issue statements and also might be subject to an audit. Alternatively, the parties might consider a flat fee and pay additional fees in the event the game reaches certain sales numbers. For example, if the game sells 500,000 units at the original suggested retail price then an additional payment of \$5,000 will be paid to the music rights holder. If the parties elect to incorporate a bonus payment it is important the parties decide the pricing for games that will qualify as part of the bonus numbers. Selling games at 50% off the initial suggested wholesale price might not trigger a bonus payment. The developer will also need to be aware of any possible music fees other than fees associated with obtaining the master and synchronization fees. For example, are there any union fees that might be owed to musicians or re-use or residual fees? This might be the case when an original score is being produced using a live orchestra in the United States or in some cases using an existing orchestral song from a record label that utilized a live orchestra.
- ²²³ The developer will often need to represent and warrant that the game and any marketing materials incorporating the music does not infringe on the rights of thirs



parties and will also need to indemnify the music licensor for the breach of such representation and warranty.

- ²²⁴ See Jeffrey Brabec & Todd Brabec, *Music Money and Success: The Insider's Guide to Making Money in the Music Business*, 481-484 (Schirmer Trade Books 5th ed. 2006). An outstanding book on the music industry and the various issues associated with all types of deals involving music. The 6th edition of the book was released in 2009.
- ²²⁵ Some of the music library companies in the United States include Associated Production Music ('APM'), Manhattan Production Music, Megatrax, killerTracks and Opus 1.
- ²²⁶ See Dianne Brinson & Mark Radcliffe, *Multimedia Law and Business Handbook* (Ladera Press 1997).
- ²²⁷ Stephen Fishman, *The Public Domain: How to Find and Use Copyright-free Writings, Music, Art and More*, 87-126, 297-314 (nolo 6th ed. 2012). See also www.copyrightfree.blogspot.com
- ²²⁸ Both Sony and Nintendo manufacture consoles as well as portable hand-held devices such as Nintendo's 3DS and Sony's PSP and Vita. For purposes of this chapter, the focus will be on the gaming consoles, although many of the policies enacted by the platform holders for consoles will also be applicable for the hand-held systems.
- ²²⁹ Retail games for consoles can take anywhere from 12 months to 3 years to develop with the average cost for frontline titles generally ranging from \$10 million to \$60 million US dollars. Take-Two Interactive Software Inc. Annual Report 2012. A few titles have exceeded the \$100 million mark. See <http://tech2.in.com/opinions/gaming/are-big-budgets-killing-the-video-game-industry/536622>. Few frontline titles games are done under 1 year except for major sports games usually associated with a professional sports league that tend to be released yearly for each new season.
- ²³⁰ There were many reasons for the decrease in sales of retail console games during the last few years including: (i) the growth of mobile gaming which grabbed a majority of the 'casual' gaming market; (ii) growth of PC digital distribution; (iii) the world economic slump; and (iv) the end of the console's life cycle with the PlayStation 3, Microsoft X-Box 360 and the Nintendo Wii. Overall, sales of retail games tend to decrease during the end of a platform's life cycle. Typically, when new console platforms are announced and introduced, consumers tend to reduce their purchases of games in anticipation of the release of the new console platforms. Majesco Entertainment Company Annual Report 2012; Electronic Arts Inc. Annual Report 2012.
- ²³¹ http://www.theesa.com/facts/pdfs/ESA_EF_2013.pdf
- ²³² Nintendo introduced their new console, the Wii U, in December of 2012 but it has had an extremely difficult start especially since many believed it did not have enough quality games that would help drive sales. Matt Martin, Nintendo Misses Profits Forecasts by 50% Due to weak Wii U, 3DS Sales (April 24, 2013) <http://www.gamesindustry.biz/articles/2013-04-24-nintendo-misses-profitsforecasts-by-50-percent-due-to-weak-wii-u-3ds-sales>. Without third party support for game development, the Wii U may face difficulties although Nintendo has consistently developed exclusive first party games that have helped drive sales for their systems. Traditionally, if a platform is performing poorly then publishers and developers have been reluctant to commit to developing for the system since resources (i.e., money and personal) can be used for other games on different platforms. Publishers must commit resources well in advance of new hardware releases and usually costs to develop games for new platforms will cost more than current platforms because of the expanded capabilities and new technology. A new platform, whether a console or hand-held device, may or may not succeed and as a result deciding on what platforms to develop for can be a challenge for any publisher or developer.

- ²³³ For example, in 2012, 79.5% of Take-Two's net revenue was derived from sales for consoles. Take-Two Interactive Software, Inc. Annual Report 2012. Sales of products for consoles accounted for 45% of Activision/Blizzard's revenue in 2012. Activision Blizzard Inc. Annual Report 2012. 60% of EA's revenue was derived from sales of products and services on the PlayStation 3 and Microsoft Xbox 360. Electronic Arts Inc. Annual Report 2012. There have been two significant trends regarding retail sales: (i) the growing importance of 'blockbuster' titles that tend to be part of a franchise and have the most expensive development budgets. According to the *New York Times*, the top 20 games in 2012 accounted for 41% of total American game sales in stores, nearly double what was achieved a decade earlier. www.nytimes.com/2013/09/30/technology/a-shrinking-list-of-blockbusters-dominates-video-games.html; and (ii) a high percentage of sales occur during the year-end holiday buying season in the fourth quarter of the year. Activision Blizzard Inc. Annual Report 2012.
- ²³⁴ With the introduction of the most recent next generation of platforms, some CMs have announced that publishing for independent developers would be easier than in the past. See www.gamasutra.com/view/news/189271/Sony_kills_concept_approval_makes_moves_to_get_indies_onto_PS4.php; www.gamasutra.com/view/news/189180/; <http://wiiudaily.com/2013/04/wii-u-developers-free-dev-kits/>; www.xbox.com/en-US/developers/faq
- ²³⁵ www.gamesindustry.biz/articles/2013-10-03-digital-console-revenue-to-surpass-pc-this-year.
- ²³⁶ With the recent introduction of the PlayStation 4 and Xbox One with their new features; the growing importance of downloadable games through the CM's digital distribution platform; and the recognition of the growing importance of independent developers, it is expected that procedures, barriers to entry, legal issues and guidelines established by the CMs will continue to evolve to deal with the changing video game landscape.
- ²³⁷ Privacy rights, intellectual property, rights of publicity, end-user created content, content regulation, and monetization policies including those involving virtual currency are some of the potential areas that might take on greater legal relevance in the future.
- ²³⁸ Many of the comments in this chapter are based on various 10Q reports filed with the US Securities and Exchange Commission. Most of the documents are a few years old, but are the only public documents available establishing the contractual relationship between the major console platform manufacturers and various video game publishers. For this chapter, the author analyzed language in the public documents and provided assumptions on what may be incorporated into new agreements. It is assumed that while revisions have been made to these documents there are many terms that will probably remain very similar to those in previous agreements.
- ²³⁹ Since the introduction of Microsoft's X-Box in 2001, the main CMs have been Nintendo, Sony and Microsoft usually referred to as first parties. Nintendo, the only company of the three whose only business is video games, has manufactured video game consoles since the 1970s. Nintendo introduced what many consider the first modern video game platform called the Nintendo Entertainment System (NES) in 1983 in Japan and two years later in the United States. Nintendo's hand-held video game device, the DS, is the most successful dedicated video game device in terms of sales and their Wii console introduced in 2006 helped expand the video game audience with its motion-sensing technology. www.xbitlabs.com/news/mobile/display/20121219125234_Nintendo_DS_Becomes_World_s_Best_Selling_Video_Game_Console_Ever.html. Nintendo was also the first to introduce the newest generation of consoles with the launch of the Wii U in 2012. Sony entered into the video game console market in 1995 with the introduction of the PlayStation and revolutionized the industry with its gaming technology. At one time, Sony was in discussions to partner with Nintendo on building a CD-ROM drive for Nintendo's SNES. http://reviews.cnet.com/2300-9020_7-10015764.



html. The PlayStation sold over 100 million units and Sony would soon become the leading console manufacturer in the world. Sony has since released the PS2, which became the best-selling console in history selling over 140 million units, and the PS3 which was released in 2006. http://en.wikipedia.org/wiki/Video_game_console. Microsoft entered the console business in 2001 with the Xbox later adding Xbox Live, an online gaming service that allowed subscribing end-users to download content. Four years later Microsoft released the Xbox 360. In November 2013, both Sony, with the PlayStation 4 and Microsoft with the Xbox One released their latest next generation consoles in several territories. See also Chapters 1.1.1, 1.2.1, and 1.2.2.

- ²⁴⁰ See the following platform manufacturer sites regarding information for developers and publishers: <http://us.playstation.com/develop>; <http://www.warioworld.com/apply/>; www.xbox.com/en-US/developers?xr=footnav; <http://www.xbox.com/en-us/developers/id>; and <http://msdn.microsoft.com/en-us/aa937791.aspx>
- ²⁴¹ Historically, publishers would have to submit materials separately for different regions (i.e., US, Europe, Japan) for certain CMs with each possibly having different acceptance criteria. As a result, a game accepted in Europe may not have been accepted in Japan. CMs are now moving towards single submissions and a single gold master candidate may contain a number of different versions of the game to satisfy various rating boards and regional customs although consumers would only be allowed to play the version of their designated country.
- ²⁴² A developer can't sell their game at retail unless they either become a publisher or enter into a deal with a publisher to distribute their game. See www.xbox.com/en-US/developers/faq and www.warioworld.com/apply/. See also Chapter 2 about relationships between a developer and publisher.
- ²⁴³ The publisher or developer will need to enter into a confidentiality agreement with the CMs before any business relationship is established between the parties. Because the parties may exchange information that is non-public and potentially represents trade secrets the parties will enter into an agreement prohibiting the receiving party from publicly disclosing confidential information unless under pre-approved circumstances. See www.xbox.com/en-US/developers/faq. See also Chapter 10 for a discussion on confidentiality agreements.
- ²⁴⁴ CMs have required some level of approval and/or impose confidentiality restrictions in the event a subcontractor is hired to work on a game. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009).
- ²⁴⁵ www.xbox.com/en-US/developers/faq; <http://warioworld.com/apply/> Prior to entering into a relationship with either a publisher or developer, some CMs may also want to confirm that any materials provided by the CMs (e.g., development kits) will be kept in a secure place. <http://warioworld.com/apply/>
- ²⁴⁶ www.xbox.com/en-US/developers/faq
- ²⁴⁷ For example, according to EA's 2013 Annual Report, EA does not have minimum purchase requirements. Electronic Arts Inc. Annual Report 2012.
- ²⁴⁸ See www.gamesradar.com/paying-exclusivity-why-its-here-stay/
- ²⁴⁹ THQ Annual Report 2011. The hardware development systems needed by developers and publishers can be costly especially depending on the number required by the developer. As a result, the publisher and developer need to factor these costs into their development budgets especially if they are developing for multiple platforms. In some situations, CMs are reducing some of the costs associated with obtaining development kits in an effort to promote development for their various systems. See <http://us.playstation.com/develop> and <http://www.xbox.com/en-us/developers/id>

- ²⁵⁰ See Chapter 11 for a discussion on common clauses that appear in many agreements and would likewise probably appear in the various CM tool agreements.
- ²⁵¹ Sony's PlayStation Network, Microsoft's X-Box Marketplace and the Nintendo Shop.
- ²⁵² See Chapter 7.
- ²⁵³ There are different technical requirements for digital and retail.
- ²⁵⁴ See Chapter 2 regarding the publisher-developer relationship.
- ²⁵⁵ THQ Annual Report. 2011. With the new publisher licensing agreements, digital rights would most likely be included as part of the agreement.
- ²⁵⁶ In addition, the publisher would have the right to use the CM's trademarks subject to CM's approval but only in connection with the publishing (i.e., manufacturing, sale, and marketing) of the game. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ²⁵⁷ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ²⁵⁸ Activision Blizzard Inc. Annual Report 2012.
- ²⁵⁹ But see Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007) regarding different submission policies under limited circumstances for games released in specific territories. Certain CMs may want developers to integrate features that highlight capabilities of their platforms (i.e., consoles, portable devices). Supporting specific hardware features of a platform may provide a better chance that the game concept will be approved by a CM. Sony requires that for the Vita, the developer incorporates at least camera support, near support, back touch or front touch in the game. www.gamasutra.com/view/news/189271/
- ²⁶⁰ See Appendix: Milestone Schedule.
- ²⁶¹ THQ Annual Report 2011.
- ²⁶² Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ²⁶³ Code can either be submitted digitally or on a disc.
- ²⁶⁴ The CM will conduct what is usually referred to as first party checks and this is to verify that the software works on the platform and does not violate any technical requirements or guidelines established by the CMs. It is important that a publisher or developer does not submit a game to the CM expecting it to do the initial testing since this will only delay the approval process and increase costs.
- ²⁶⁵ If the submission is approved then the CM will release the gold master to manufacture (i.e., duplication, packaging) and it usually takes anywhere from 2 to 3 weeks for games to be shipped. Take-Two Interactive Software, Inc. Annual Report 2012. If the gold master is rejected then the publisher will need to re-submit, and the CM will again need to review it. A publisher might be allowed to request an expedited review perhaps needed to make a projected release date, but that will most often result in an additional charge.



²⁶⁶ To date, CMs have required that all manufacturing for game discs, cartridges, and demos be done either by the CMs or their certified vendors. Take-Two Interactive Software, Inc. Annual Report 2012. This insures that the quality and security measures required by the CM are carried out pursuant to the CM requirements. All the CMs have a number of approved certified manufacturers to duplicate product throughout the world. However, Nintendo requires that their own manufacturers duplicate product that involves cartridges for their game systems (i.e., hand-held systems such as the 3DS). As a result, publishers may need to give themselves more time when ordering cartridges used with Nintendo devices because of limitations with production capacity and time to ship product from facilities in Japan. In contrast, for PC, the publisher can contact and enter into a deal with any DVD replicator.

Even after materials have been approved by a CM, the CM will have the right to require a publisher or developer to correct any defects in a game or mistakes with materials such as an incorrect use of a CM trademark. This could include but not be limited to a recall of product, or publication of an update for a game to correct the problem. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).

²⁶⁷ Take-Two Interactive Software Inc. Annual Report 2012. As part of the packaging submissions, the publisher will need to submit inserts, front and back covers of retail versions of the game.

²⁶⁸ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007). See also Chapter 9.6 regarding ratings.

²⁶⁹ Id.

²⁷⁰ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009).

²⁷¹ THQ Annual Report 2011. In addition, some CMs have previously prohibited the use of some 3rd party advertising or product placement in games. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009).

²⁷² In some situations there may be a limited amount of slots for independent games and as a result, games may not be released digitally immediately upon CM approval.

²⁷³ See <http://www.forbes.com/sites/erikkain/2013/09/20/sony-to-take-a-loss-on-playstation-4-sales/> and Home Videogame Platforms, by Robin Lee (March 2011), pages 6 and 7.

²⁷⁴ *Secrets of The Game Business* 103 (Francois Dominic Laramée ed., Charles River Media 2nd edition 2005).

²⁷⁵ THQ Annual Report 2011.

²⁷⁶ Activision Blizzard Inc. Annual Report 2012.

²⁷⁷ Id.

²⁷⁸ Similar to the purchase of any type of goods, royalty rates may decrease as the amount of orders increases for a particular region. Electronic Arts Inc., Quarterly Report (Form 10-Q), Ex 10.2 (Nov. 10 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).

Unlike the CMs that require a royalty payment for each unit of a game manufactured, there are no royalty payments paid to PC hardware manufacturers.

- ²⁷⁹ Royalties may vary depending on the SRP or wholesale price of a game. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.2 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007). For example, a lower wholesale price might result in lower royalty percentages for the CM. Historically, publishers paid their licensing/royalty fee based on either the initial wholesale price or suggested retail price (SRP) even if the price subsequently was lowered. Furthermore, unless the game was part of a greatest hits program, re-orders would also require a royalty/licensing fee based on the original wholesale or SRP price. In contrast, if the wholesale price or SRP increased at any time, the publisher would have to pay a higher licensing/royalty for those units. *Id.*
- ²⁸⁰ Take-Two Interactive Software, Inc. Annual Report 2012.
- ²⁸¹ *Id.*
- ²⁸² Typically the marketing spend for a retail console game will be a percentage of projected sales. Publishers in determining what percentage to allocate for marketing a game will usually consider the following factors: (i) units forecasted; (ii) budget of the game; (iii) current market conditions; (iv) marketing spends for similar games; and (v) past sales of a franchised game, if applicable. Marketing plans might encompass television, print, and online advertising, event sponsorships, outdoor advertising, direct mail and cross-promotions. In addition to marketing, publishers will spend money on retail or channel marketing which may include pre-sell give-aways, point-of-purchase displays, and co-op retail advertising campaigns. Actual marketing numbers for games are difficult to obtain since they are sometimes combined with development costs. For AAA titles, marketing dollars can easily be in the tens of millions of dollars especially if there is a television campaign. See: million http://en.wikipedia.org/wiki/Marketing_of_Halo_3_Left_4_Dead_2 – \$10 million www.edge-online.com/features/left-4-deads-10m-ad-campaign/; GTA5 cost \$265 in marketing and dev www.ibtimes.com/gta-5-costs-265-million-develop-market-making-it-most-expensive-video-game-ever-produced-report
- ²⁸³ Electronic Arts Inc. Annual Report 2012. See also Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ²⁸⁴ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ²⁸⁵ *Id.* In the United States, an implied warranty of merchantability basically means that the goods meet certain criteria such as they are fit for the purposes in which the goods would be used and are adequately packaged and labeled and conform to any statements made on the container or label. U.C.C. #2-315; 314(2)(c).
- ²⁸⁶ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007). In the United States, state law may limit the enforceability of limitations of liability, and courts will not limit liability in the event a party has engaged in gross negligence, fraud, unlawful acts or intentional torts. Cannady, *supra* endnote 108, at 275. See Cal. Civil Code #1668.
- ²⁸⁷ *Id.*
- ²⁸⁸ Electronic Arts Inc. Annual Report 2012. In addition, in many agreements, the CM will likely require that the publisher or developer carry various forms of insurance to cover any claims made against the publisher or developer or the CM (claims in which the CM is indemnified). Some forms of insurance may include coverage for personal injury, product liability and E & O which covers claims involving infringements associated with



intellectual property. See Chapters 2.2.15 and 4.3.9. Furthermore, similar to licensors, the CMs will most likely require the following: (i) coverage amounts and deductibles at certain levels depending on the territory or region; (ii) proof of insurance indicating the coverage obtained and naming the CM as an additional insured party under the policy; and (iii) provide notice to the CM within an agreed period of time in the event the policy is terminated or modified. Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).

²⁸⁹ THQ Annual Report 2011.

²⁹⁰ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).

²⁹¹ Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010).

²⁹² Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009).

²⁹³ See Chapter 10.3.2 on the common exceptions in confidentiality agreements.

²⁹⁴ Electronic Arts Inc., Annual Report 2012. Some breaches may not be curable and therefore an agreement can be terminated immediately. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009); Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).

²⁹⁵ *Id.*

²⁹⁶ See various 10Q filings for other acts that might result in a material breach. Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.1 (Apr. 30 2010); Electronic Arts Inc., Quarterly Report (Form 10-Q/a), Ex 10.5 (Nov. 10, 2009).

²⁹⁷ See also Chapter 10.3.4 regarding a discussion on injunctive relief.

²⁹⁸ THQ Annual Report 2011.

²⁹⁹ *Id.*

³⁰⁰ See Chapter 1 on revenue numbers for digital distribution and Chapter 6 on console digital distribution. Various distributors have created their own platforms to deliver digital content. The market is dominated by Steam on the PC side, which controls an estimated 70% of the market for downloadable PC games and has a user base of over 50 million active accounts. www.giantbomb.com/steam/3015-718/ http://store.steampowered.com/news/?feed=steam_press. Other PC distributors include but are not limited to EA's Origin, Amazon Digital Services, GamersGate, Good Old Games, GameTap, and Impulse controlled by Gamestop (the world's largest retailer of video game hardware and software). In addition, each of the major consoles have their own digital platforms exclusively selling product related to their respective hardware platform. See also http://indiegamebundle.wikia.com/wiki/Humble_Bundle; http://en.wikipedia.org/wiki/Humble_Bundle.for information about an alternative 'pay-what-you-want' business model created by Humble Bundle involving digital distribution of games from either one or multiple companies that are sold as a bundle (multiple games are sold together for one price) for a short period of time usually for 1 or 2 weeks with the purchaser setting the price. In addition, under the Humble Bundle model, the purchaser determines how their payment should be divided among selected charities, the game developers, or Humble Bundle or a combination of any of the above. www.humblebundle.com

- ³⁰¹ Independent developers generally develop games without financing from publishers or first parties such as Sony and Microsoft.
- ³⁰² In addition to selling games, developers and publishers may make games available as 'free-to-play.' In this model, an end user can play the game for free and then can elect to pay for in-game items to enhance their gaming and/or to purchase a service that might speed up game play that may normally take hours to complete.
- ³⁰³ DLC content generally refers to online content and features unique to a specific game that can be purchased, downloaded, or accessed separately from the game or through in-game store purchases. Online content and features may include virtual items, new game scenarios or levels and additional functionality to enhance the user's experience. Typically, the full game must first be purchased to be able to access DLC.
- ³⁰⁴ Games and other content can either be downloaded or streamed. Downloading involves transferring a file from a remote server which is then saved onto an end-users local hard drive (i.e., computer) unlike with streaming which is the transmission of data (i.e., game) to a device as required instead of saving and downloading an entire game. An advantage of streaming is that the game can be picked up on another device and continued at the place the gamer stopped. www.pcmag.com/encyclopedia/term/64601/streaming-video-games. Unlike downloading files, which remain on the computer until the user deletes them, streaming content is automatically deleted from the computer by the operating system after it is played or watched. www.pcmag.com/encyclopedia/term/52131/streaming. For some games, the game will contain elements that are both downloaded and streamed.
- ³⁰⁵ For the purposes of this chapter, 'developers' will also include 'publishers' unless otherwise noted. However, it should be noted that publishers and developers may have different relationships and varying levels of success dealing with distributors because of the difference in each party's bargaining power. Established publishers may have greater leverage dealing with distributors because they may have stronger intellectual property and a deeper catalog that distributors want access to. As a result, publishers may be able to negotiate more favorable terms including marketing and placement commitments from distributors.
- ³⁰⁶ The amount of space allocated to PC games at retail has shrunk considerably or has been completely eliminated in some retail outlets in certain regions over the years and represents an extremely small fraction of overall video games sold at retail. With retail space limited, retail stores typically focus on selling the top 10 to 20 boxed games while digital distributors offer a much deeper selection of games. Depending on the distributor, hundreds to thousands of games may be offered at one time.
- ³⁰⁷ Digital distribution allows for a longer product life cycle through virtual shelf space and ultimately can generate incremental revenue for older games (i.e., catalog titles), but the developer needs to make sure that any licensed content including music is still under a valid license. Otherwise, the developer will need to enter into a new license for the content, which may be time consuming to obtain and expensive, assuming it is available.
- ³⁰⁸ A different type of space issue referred to as 'discoverability' has become one of the major problems for some developers on certain PC digital platforms. Distributors can only promote a limited amount of games on their banners and the front pages of their stores, which provide the first and probably the most important impression to consumers. This space has become the equivalent of prominent positioning within a retail store (i.e. end caps and store windows). As a result, it is critical that the developer try to negotiate some type of commitment from the distributor to highlight their game(s).



- ³⁰⁹ Different distributors have adopted different policies in reviewing and placing independent games on their distribution platform although the more games submitted the more challenges for the distributor. Valve introduced Steam Greenlight for the submission of games by independent developers and for some of the smaller publishers. This process allows for consumers to vote for games they believe Valve should distribute via Steam. Because of the increase in the submission of games, the Steam Greenlight process is Valve's way of funneling content through a submission process while engaging consumers to vote on which games they would like to see on Steam although Valve has the ultimate approval authority. See <http://steamcommunity.com/workshop/about/?appid=765§ion=faq>; [http://en.wikipedia.org/wiki/Steam_\(software\)](http://en.wikipedia.org/wiki/Steam_(software)). There are also a number of alternative distributors that may have a lower hurdle for approval; allow for better featuring; and may offer better financial and contractual terms although they will likely have a smaller consumer base. www.forbes.com/sites/danielnyegriffiths/2013/08/28/greenlight-go-steams-greenlight-green-lights-100-games/
- ³¹⁰ Because additional games may be added to an agreement throughout the term, typically, the distributor and publisher and perhaps even an individual developer depending on how many games it may release during a term, will often enter into a template agreement whereby the standard terms to the relationship will be spelled out in an agreement and supplemented at later dates with an attachment that may be referred to as an Appendix, Schedule, or Exhibit ('attachment') outlining the specific business points for each subsequent game(s) added to the agreement. The attachment primarily will list the name of the game(s) added to the agreement, revenue percentage splits, specific territories, delivery and release dates, marketing obligations, suggested retail pricing by currency and recoupable advances, if any. By adding an attachment, the parties do not have to draft a new agreement every time additional games are licensed to the distributor.
- ³¹¹ Distributors may request the right to modify the games to enable them to be downloaded via the distributor's service. For example, a distributor may need to wrap a game with their download manager and/or their DRM solution.
- ³¹² SDK is the abbreviation for software development kit which is typically a set of software development tools that allows for the creation of applications for a certain software package, hardware platform, software framework, computer system, video game console, operating system or similar development platform. http://en.wikipedia.org/wiki/Software_development_kit. For example, Steam's SDK, known as Steamworks, can include DRM, matchmaking services and auto patching. See <https://partner.steamgames.com/documentation/>
- ³¹³ Typically, the gold master will be a final build of the game and it may include DRM (Digital Rights Management), which encrypts the game to help minimize the risk of unlawful copying. There are no requirements to deliver different masters for different countries unless localized versions are required because of ratings and language (e.g., French versions for Quebec).
- ³¹⁴ Generally, a distributor will want to receive the game in object code format 2-4 weeks prior to the release date of the retail version to provide enough time to onboard the game for distribution via its service. 'Onboarding' the game is when the distributor prepares the game to be digitally downloaded from its site.
- ³¹⁵ The developer will determine the date of the release for the game, which may vary for different countries. Furthermore, the distributor is usually prohibited from releasing a game prior to its retail launch, if applicable.
- ³¹⁶ See Chapter 7.2.5.
- ³¹⁷ Typically, companies will provide at least 12 months' worth of support for end-users.

- ³¹⁸ The term of the agreement should start on the execution of the agreement to allow the distributor to prepare materials such as marketing materials and press releases.
- ³¹⁹ Some agreements may require one party to provide notice to the other party within a certain time period to permit additional term extensions. Failure to provide notice will result in termination.
- ³²⁰ See Chapter 11.1.10.
- ³²¹ See Chapter 7.2.8.
- ³²² The developer will also want to have the right to terminate the agreement specifically for a game in question if an underlying license for a game terminates or if, in the developer's judgment, a game potentially may become the subject of litigation and therefore removing the game may minimize possible damages from any pending, threatened, or possible suit or proceeding involving a potential infringement of a game.
- ³²³ A publisher may have a more extensive catalog including franchised properties that a distributor will want to license for its platform.
- ³²⁴ It was disclosed in a claim filed against THQ in Bankruptcy Court that Sega received a 70-30% revenue share from Valve. www.escapistmagazine.com/news/view/125846-Sega-Sues-Bankrupt-THQ-Claiming-941-000. The GameStop-Impulse site notes that the revenue split is 70-30% <https://developer.impulsedriven.com/>. See also www.pcgamer.com/2013/05/02/steam-and-gog-take-30-revenue-cut-suggests-fez-creator-phil-fish/
- ³²⁵ In some situations, although more rare these days, a distributor may elect to pay a developer an advance for distribution rights for a game(s). The advance paid by the distributor would typically be applied against future royalties earned by the developer and only after the distributor has earned back the agreed upon amount of the advance would the developer then be entitled to additional royalties. At one time, distributors were paying recoupable advances under certain conditions as a way of competing against other distributors for content and to help grow their platform in the market. As new distributors enter the market there is a possibility that some of them may offer some form of an advance. Also, if a distributor pays an advance or provides for a minimum guarantee then this could affect other financial terms of the agreement such as the revenue split and term. For example, the term may be longer and the distributor may seek a greater revenue share.
- ³²⁶ Regarding tax obligations based on the revenue generated from sales, the parties generally agree that all amounts payable are exclusive of all sales, use, value-added, and other taxes and duties. The distributor generally will also be responsible for paying all taxes and duties assessed involving the agreement except for taxes payable on developer's net income received from the deal. This should also be added to the representations and warranties so the distributor and not the developer is responsible for paying the applicable taxes in the various countries within the territory. However, the distributor similar to a film distribution deal will typically insist that language also includes the right of the distributor to withhold monies that may be owed that is required by any law or governmental order provided: (i) the distributor tries to minimize the amount that needs to be withheld; (ii) pursues any tax credits for the developer; and (iii) provides the necessary documents so the developer can claim any tax credits that may be applicable.
- ³²⁷ See Sean Kane, 'Technology Remains the Driver of Evolution of Interactive Entertainment: Gaming Beyond the Consoles and Applications That Are Much More Than Games', *Technology And Entertainment Convergence* 2010: Hot Business And Legal Issues In 'Technotainment,' Nov. 20, 2010, at 873-891. See also Chapter 2.2.8.
- ³²⁸ The parties will need to agree to: (i) what currency the developer will be paid in; (ii) what exchange rate will apply; (iii) when the currency will be calculated; and (iv) who



pays for the currency conversion. Generally, the distributor would be responsible for the costs in converting the currency and for any decline in value of the currency after the date in which the distributor was obligated to pay the developer.

- ³²⁹ Termination rights, which can have significant consequences, should only be triggered by a material breach of the agreement as compared to just any type of breach. In addition, the developer will also want to add language that for certain material breaches, the developer can seek to obtain an injunction to prevent a continuation of a breach such as the selling of a game beyond the term or outside the territory.
- ³³⁰ In the event advances were paid then this would be a problem since the distributor may not have received the value of its bargain if a game can be removed prior to the expiration of the term.
- ³³¹ This section confirms for both parties that the rights and remedies under the agreement are cumulative and are not exclusive of any rights or remedies available at law or equity or by and other agreement the parties may have entered into.
- ³³² A developer will want to include language that its products are provided 'as is' thereby disclaiming any representations and warranties except for those expressly provided for in the agreement including that any products or any other materials will be error-free or operate without interruption or be compatible with distributor's system. At the same time, the distributor will insist on disclaiming that the distribution system will operate as intended and that the system will be free or errors and that its use with the products will not result in uninterrupted errors.
- ³³³ Both the distributor and developer may have their own End-User License Agreements. The EULA establishes the conditions and restrictions for the end-user (i.e., consumer) when playing the game. In addition, the EULA will include language regarding: (i) ownership and other rights' issues; (ii) acceptable conduct for end-users including on-line play and chat sessions; (iii) grounds for termination; (iv) limitations on damages; (v) privacy; (vi) the process in which EULAs can be updated by the developer; (vii) indemnification; and (viii) ways in which disputes are settled. If the end-user does not accept the terms of the EULA then they cannot play the game and must return the game for a refund. In addition, the distributor will also establish its own guidelines that end-users must comply with before using the system.
- ³³⁴ See Chapter 9.6.
- ³³⁵ At one time, feature phones were the main source of revenue for the mobile industry, and while revenue generated from feature phones has decreased they continue to be popular in certain parts of the world including India, Latin America, Africa and the Middle East. Feature phones, which primarily use the Java and Brew operating systems, are typically characterized as having smaller screens, less color variation, and processing power limiting the complexity of games. Smartphones continue to grow in popularity since they were introduced by Apple with the iPhone in 2007 and according to a report by Gartner research, smartphones accounted for 51.8 percent of mobile phone sales in the second quarter of 2013 resulting in smartphones sales surpassing feature phone sales for the first time. www.gartner.com/newsroom/id/2573415
- ³³⁶ A study conducted by the research firm Magid Associates reported that 69% of tablet owners regularly play games and a tablet owner downloaded an average of 25 games in the past year (2012). <http://www.gamesindustry.biz/articles/2013-07-10-in-game-purchases-on-tablets-nearly-tripling-sales-on-smartphones>
- ³³⁷ Numbers vary on revenue generated from mobile gaming, but according to the App Annie Index, the games category as of Q2 2013, dominated the share of revenue for the iOS and Google Play app stores. Games in Google Play and iOS app store accounted for over 80% and 75% of revenue respectively. http://blog.appannie.com/app-annie-index-market-q2-2013/?utm_campaign=weekly-digest&utm_source=hs_

email&utm_medium=email&utm_content=9829145&_hsenc=p2ANqtz-9evugPNhAao1tSB7UnMNsTMa2XP7QxT6mtCOimCLlIVRa1yCt8t7oanqDdeTidvhzDRgP6LdFLutA0DSbn0ppVvNNop6yPoO00cLn-HyBuySqvAM&_hsmi=9829145. Capcom's 2012 Annual Report noted that mobile revenue increased to 12.3 billion dollars from 8.6 billion dollars the previous year (an increase of 43%). In addition, the report noted that the smartphone market is predicted to grow to 950 million units (up 32.7% from the previous year and revenues from tablets would exceed those in the home video game market. Capcom Annual Report 2012. What makes these numbers even more extraordinary is the fact that apps sold on these devices cost a fraction of what games cost on other platforms. See www.nytimes.com/2013/10/22/business/international/asia-where-mobile-games-flowered-extends-its-reach.html?_r=1&

- ³³⁸ See <http://blog.flurry.com/bid/91911/Electric-Technology-Apps-and-The-New-Global-Village>
- ³³⁹ Development costs for apps can vary considerably based on resources and time allocated for development as well as complexities of an app. Generally, development costs for apps average around a few hundred thousand dollars although that number is skewed lower because there are so many games developed around \$30,000 or less. However, higher end games are averaging over a million dollars. It is expected that costs will increase with improvements in technology which will allow developers to expand on features and create more elaborate artwork, together with the rapidly increasing costs of marketing as mobile games becomes a more crowded ecosystem.
- ³⁴⁰ Consumers who would not necessarily want to spend hundreds of dollars on a console system and for games can now play very elaborate apps on a phone. Today's smartphones have more computing power than the original PlayStation console. 'All the World's Game', *The Economist*, December 10, 2011, at 4.
- ³⁴¹ There are currently more than 160,000 active game apps in the US Apple App Store alone, based on a report by 148Apps. Biz. See <http://148apps.biz/app-store-metrics/?mpage=appcount>. It has been estimated that on the iOS App Store alone apps have been downloaded more than 60 billion times:
- <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0CCwQFjAA&url=http%3A%2F%2Fwww.engadget.com%2F2013%2F10%2F22%2Fapple-ios-7-downloaded-over-200-million-times-in-5-days%2F&ei=Cw98UoPKDcmsiQLcuYQBw&usq=AFQjCNGFU0817MnC2BDSwt2DTjiYh4TY9Q&sig2=w8lCUFN77T3LENDtq2qJ-Q&bvm=bv.56146854,d.cGE>
- ³⁴² Just a few of the new features in mobile gaming are expected to include connecting mobile devices to smart televisions, the introduction of wearable computing (e.g. Google Glass) and integration with other technologies from video game consoles to home appliances. In addition, social media will likely take on greater prominence in how consumers play games.
- ³⁴³ An App developed for one mobile device manufacturer does not mean that the App can play on other mobile devices. Apple uses an iOS operating system and other mobile device manufacturers such as Samsung, Google, Nokia, Amazon and Barnes & Noble use the Android operating system. The next most popular operating systems, although the percentage that use these systems is less than 5% as of the writing of this publication, include Microsoft's Windows Phone and Blackberry (formerly Research in Motion), the developer of Blackberry phones. Blackberry and Windows Phone market shares presently are about 2 or 3 percent apiece. www.gamesindustry.biz/articles/2013-08-09-mobile-game-market-growth-opportunity<http://www.gameindustry>

Each operating system has its own advantages and disadvantages, although these may change in the future. For the iOS, the advantages include: (i) uniform encoding language making it faster to develop for; (ii) tremendous exposure if the app is featured on the Apple storefront; and (iii) fewer devices to develop for since a developer may



need to only focus on less than 10 devices while on Android there are nearly 1200 devices with a wide range of screen sizes, processors and different versions of the Android software making it a challenge to select which devices to develop for. <http://www.theguardian.com/technology/appsblog/2013/aug/15/android-v-ios-apps-apple-google>. The disadvantages include: (i) too many apps making it difficult to distinguish from other apps unless it is featured; and (ii) can only develop apps if the developer is using a Mac. The advantages for developing for the Android operating system include: (i) perhaps more visibility because of fewer apps (though this is fast changing as Android becomes as popular a platform as Apple iOS); and (ii) no testing (QA) of the submitted application for Google Play and therefore any app can be launched quickly on the storefront. The disadvantages include: (i) no support for the operating system; and (ii) piracy. Many games are hacked easily and there is little enforcement assistance provided by the platforms in practice.

³⁴⁴ Electronic Arts Inc. Annual Report 2012.

³⁴⁵ See Chapter 9.

³⁴⁶ For the purposes of this chapter, app stores/marketplaces will also be considered distributors. For some sample distribution agreements with app stores, see: <http://play.google.com/about/developer-distribution-agreement.html> and <https://developer.amazon.com/help/da.html>

³⁴⁷ Prior to the release of an app, developers must satisfy certain guidelines established by the distributor. Typically these guidelines will involve a review of the quality of the app, and confirmation of the content rating and processes (i.e., certain processes are needed for customer payments). Currently, if the developer has signed a distribution agreement involving Google Play then there is no approval process required for a submitted application and the app can go 'live' almost immediately. However, the developer still needs to test the app, since a poorly received app with many problems will generally result in a lack of sales and negative publicity for the developer. Furthermore, all app stores employ a removal process if an app violates the storefronts guideline, which typically include such restrictions as incorrect use of a rating, offensive content (i.e., pornography), promotion of gambling, or there is an IP problem (i.e., illegal use of content). See the following links for different guidelines required by various storefronts for Apps: <http://developer.android.com/distribute/googleplay/publish/preparing.html>; <http://developer.samsung.com/distribute/certification-guide/certification-policy;jsessionid=YpvLRp3GWIKfFyBKg1gV1XvNgfwQ5GK9MvPp8Ng6YY7gXZGtwdkC!-1018311749>; <https://nookdeveloper.zendesk.com/entries/22345027-nook-app-submission-guide>; <https://developer.amazon.com/help/faq.html#AppDetails>

³⁴⁸ Distributors will license software on a non-exclusive, non-transferable basis to developers which will allow developers to incorporate various features into their app.

³⁴⁹ The typical revenue arrangement is that the distributor takes 30% of gross revenue and the balance is paid to the developer. It is important to bear in mind that this deduction is only charged if the game actually makes revenue: this has been seen by developers as one of the major benefits of mobile games, since they incur zero distribution costs unless they actually make sales of the game. See <https://developer.amazon.com/help/da.html>

³⁵⁰ Removal or take-down rights allow for the developer to remove the app from the store, provided it satisfies certain requirements such as refunding obligations to consumers, customer support, and honoring delivery of previously purchased products to name a few of the requirements. <http://play.google.com/about/developer-distribution-agreement.html>. Distributors also have the right to takedown Apps that violate the distributor's guidelines.

- ³⁵¹ Distributors impose a number of restrictions on the collection of user or device data by a developer. Developers must comply with all applicable privacy and data collection laws and regulations in the territories in which an app is distributed and at the minimum must obtain the consent of a user with regards to the collection, use, and storage of any personal data. See <https://developer.amazon.com/help/da.html>; http://seattleclouds.com/ticketfiles/8665/ios_program_standard_agreement_20120912.pdf
- ³⁵² See Chapter 9.6.5.
- ³⁵³ Some distributors may require that a developer carry certain types of insurance and name the distributor as an additional insured party. See Chapter 2.2.15 which discusses insurance between the developer and publisher; similar issues would exist between a distributor and developer.
- ³⁵⁴ Some distribution agreements expressly note that information submitted to them by a developer is not deemed confidential including information about a submitted app. See http://seattleclouds.com/ticketfiles/8665/ios_program_standard_agreement_20120912.pdf
- ³⁵⁵ See Chapter 11.
- ³⁵⁶ If a distributor and developer and/or publisher enter into a subsequent development agreement, then the parties need to confirm which agreement, whether the distribution agreement or the development agreement, would prevail in the event of an inconsistency between the two documents.
- ³⁵⁷ In exceptional cases, it may be that the distribution platform is involved in funding the app or pays an advance amount to secure exclusive distribution rights. In the event that this does occur, the developer must make sure that a cancellation of a device results in some form of compensation not only for work done but also an agreed-upon amount for scheduled future work similar to a termination for convenience as mentioned in Chapter 2. Also, the parties need to factor in delays in the device's release and how that affects the milestone schedule (i.e., payments, delivery dates). Although funding for apps by the distribution platform has been extremely rare at present, it may become a trend seen more in the future if/when competition for content becomes more intense. For example, at the time of writing this publication, the Finnish mobile games company Supercell had achieved very considerable success with its mobile games *Clash of Clans* and *Hay Day* (widely said to have generated it millions of revenue per day) – both of which were only available on iOS and were therefore de facto Apple exclusives. See <http://online.wsj.com/news/articles/SB10001424052702303376904579136873973130670>. That said, the mobile industry has not (yet) seen the common practice in the console industry of securing permanent exclusive distribution rights from leading games developers.
- ³⁵⁸ The distributor's storefronts provide critical marketing visibility to the app they select to profile by providing strategic placement for the selected apps. With so many apps, it can be difficult to distinguish an app that is not necessarily a recognized brand.
- ³⁵⁹ This is a relatively new innovation in the developer-publisher relationship but which appears at present to be gaining some traction. The rationale essentially is that mobile developers are not only able, but actively want, to have control over the development and publishing of their app games. However, few developers have true expertise in marketing even while, in the increasingly crowded app ecosystem, differentiation becomes more important for financial success. In this way, developers can gain from effectively outsourcing the marketing of their already prepared app to publishers (although in practice the businesses providing such marketing services are 'publishers' only by convention and may share little in common with traditional games publishers).
- ³⁶⁰ One of the main features regarding an app is that it can be continuously updated thereby expanding the game play possibilities and prolonging the app's shelf life. For



example, new cars and racetracks can be added to a racing game. Updates will also be important if the developer needs to correct any errors in the app.

- ³⁶¹ In deals only involving distribution, the developer will own the copyright in the game; but in situations where one of the parties is either paying all or partial development expenses, which party owns the copyright will need to be negotiated. Typically, the outcome will most likely depend on which party created the intellectual property including the underlying code, and the amount of money invested by the publisher. Generally, the more money invested by the publisher the greater likelihood that the publisher will want to own the IP of the app. In the event that a developer is hired by the publisher to create an app, typically the IP will be owned by the publisher except for any content that may have been licensed or any underlying code created by the developer. Ownership of the IP is critical since it will allow the party that eventually owns it to create derivative works including sequels and the right to exploit the apps and source code on other platforms. If the publisher does not own the IP then it is likely it will want to have the opportunity to distribute future products created by the developer based on the original app.
- ³⁶² For game businesses which have operated in the PC and console world this is really no different to what they have experienced: a retailer would in effect deduct its share of the proceeds before it passes the balance to the publisher to be shared between the publisher and developer.
- ³⁶³ Perhaps the biggest concern with the monetization models is whether enough people are actually paying to play games? According to the market research firm Interpret, the average gamer on smartphones and tablets spends US\$.92 per month on full game apps, and only US\$.79 per month on mobile in-game items. www.gamesindustry.biz/articles/2013-04-18-mobile-tablet-players-spend-just-92-cents-a-month-on-average. But see, www.gamesindustry.biz/articles/2013-07-10-in-game-purchases-on-tablets-nearly-tripling-sales-on-smartphones, according to Magid Associates, in-game purchases of virtual goods on tablets reached US\$914 million dollars while smartphones generated US\$341 million dollars.
- ³⁶⁴ Analytics has become a growing field in the mobile space, involving the collection and interpretation of consumer conduct and buying habits in order to help developers to better target their audience and learn what practices achieve the most success. Some of the areas in studies may include: (i) how many consumers are paying and how many are playing for free; (ii) what are consumers purchasing; (iii) how long do consumers play the game; (iv) how many consumers are converted to paying customers; and (v) what is the average spend by a consumer. See Will Luton, *Free-to-Play: Making Money from Games You Give Away* 107-132 (New Riders 2013). In addition, it is important to keep in mind that the buying habits of consumers can vary from one territory to another and as a result what may work in one territory may not work in another.
- ³⁶⁵ Free-to-Play games generally refers to Apps that allows the end user to play the entire app for free with an option to pay money to either buy additional content such as new characters or different backdrops to improve the gaming experience, or accelerate their game play by perhaps purchasing a hint or power ups. According to a report by Newzoo, free-to-play was the most profitable business model in 2012 representing over 70% of Apple's mobile game revenues in the United States and about 68% in Europe. http://www.newzoo.com/wp-content/uploads/Newzoo_Mobile_Games_Trend_Report_Free.pdf
- ³⁶⁶ An unlockable demo generally refers to an app that provides limited gameplay unless the consumer pays for the 'unlockable' content. A consumer can finish the demo for free but would have to pay to play the entire game which is usually referred to as an up-sale.

- ³⁶⁷ See for example www.ftc.gov/os/2012/12/121210mobilekidsappreport.pdf and www.ftc.gov/os/2013/02/130201mobileprivacyreport.pdf
- ³⁶⁸ See http://ec.europa.eu/justice/data-protection/article-29/documentation/opinion-recommendation/files/2013/wp202_en.pdf
- ³⁶⁹ See www.oaic.gov.au/privacy/privacy-engaging-with-you/previous-privacy-consultations/mobile-privacy-may-2013/mobile-privacy-a-better-practice-guide-for-mobile-app-developers-consultation-draft-april-2013
- ³⁷⁰ See www.priv.gc.ca/information/pub/gd_app_201210_e.asp
- ³⁷¹ See the following articles on the problem of cloning and ways developers may be able to protect themselves against cloning See www.gamasutra.com/view/feature/187385/; <http://www.gamesindustry.biz/articles/2012-05-31-how-to-protect-your-game-from-clones> on cloning issues; <http://articles.latimes.com/2011/apr/17/entertainment/la-ca-cloner-20110417>
- ³⁷² See the following articles covering piracy: www.gamezebo.com/news/2013/09/23/new-survey-shows-piracy-and-discoverability-are-still-pressing-issues-game-developers-today; www.gamesindustry.biz/articles/2013-09-23-app-devs-facing-major-problems-with-piracy-profitability; www.joystiq.com/2013/08/24/indie-game-gentlemen-was-bought-144-times-pirated-over-50-000/
- ³⁷³ See further www.economist.com/node/17309237 and http://en.wikipedia.org/wiki/Smartphone_wars
- ³⁷⁴ For example, in 2012 patent licensing company Uniloc sued a series of companies including game publishers Electronic Arts and Square Enix as well as developers including Halfbrick Studios and Mojang for patent infringement: www.pcworld.idg.com.au/article/431396/electronic_arts_other_game_developers_sued_patent_infringement
- ³⁷⁵ One mobile game app ‘based on theme of running a sweatshop’ was removed by Apple: www.theguardian.com/commentisfree/2013/mar/22/sweatshop-game-apple-app-store
- ³⁷⁶ In 2013, for example, Apple forced the takedown of app promotion app AppGratis: <http://appgratis.com/blog/2013/04/09/appgratis-pulled-from-the-app-store-heres-the-full-story/>
- ³⁷⁷ See for example this article on how Riot Games, creator of hit sports game League of Legends, leverages data from consumers: <http://slashdot.org/topic/bi/for-riot-games-big-data-is-serious-business/>. Data mining is such a hot topic that Rovio, creator of Angry Birds, has even created a policy for analytics and data usage in Rovio games in addition to its privacy policy: www.rovio.com/en/news/blog/235/analytics-and-data-usage-in-rovio-games and www.rovio.com/Privacy
- ³⁷⁸ See for example the Right to Financial Privacy Act 1978: www.ots.treas.gov/_files/422240.pdf
- ³⁷⁹ The Data Protection Directive is known officially as Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31995L0046:en:HTML>
- ³⁸⁰ The E-Privacy Directive is known officially as Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications): <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002L0058:en:NOT>



- ³⁸¹ Sony was fined a total of £500,000 (approximately \$750,000) by the UK data privacy regulator over this incident: www.bbc.co.uk/news/technology-23313535
- ³⁸² See <http://ftc.gov/opa/2011/05/playdom.shtm>
- ³⁸³ See www.ofc.gov.uk/news-and-updates/press/2013/3313 and www.osborneclarke.co.uk/publications/sectors/digital-business/update/2013/federal-court-of-justice-bans-ads-for-purchase-of-virtual-items-in-free-to-play-online-game.aspx#, UicNRUvlyzA.twitter
- ³⁸⁴ See for example the Federal Trade Commission's October 2012 report on mobile apps and children: www.ftc.gov/os/2012/12/121210mobilekidsappreport.pdf
- ³⁸⁵ For the purposes of this chapter, 'a submitting party' will cover both publisher and developer.
- ³⁸⁶ Rating boards do not determine whether a game is good or bad in making their decision on rating a game, nor does the rating indicate the level of difficulty or skill.
- ³⁸⁷ See http://en.wikipedia.org/wiki/Video_game_content_rating_system for a chart on the various age classifications for a number of countries. Many of the video game rating boards are government bodies and may also rate other entertainment content such as films, television, and publications.
- ³⁸⁸ PEGI was formed in 2003 and replaced a number of national rating systems with a single system. It is used by the following countries: Austria Denmark, Hungary, Latvia, Norway, Slovenia, Belgium, Estonia, Iceland, Lithuania, Poland, Spain, Bulgaria, Finland, Ireland, Luxembourg, Portugal, Sweden, Cyprus, France, Israel, Malta, Romania, Switzerland, Czech Republic, Greece, Italy, the Netherlands, Slovak Republic and the United Kingdom. www.pegi.info/en/index/id/28/. Germany is not a member of the PEGI and instead has its own rating's board called the Unterhaltungssoftware Selbstkontrolle (USK). Because of Germany's past political climate, the ratings board is extremely restrictive especially involving hate crimes, symbols, and extreme blood, and advertises on their site that they have 'the strictest age classification rules in the world.' See www.usk.de/en/classification/classification-procedure/. Given the strictness of the USK rules, it is fairly common for games to be released later in Germany than elsewhere in the major games markets and/or with significant graphical or other changes.
- ³⁸⁹ www.pegi.info/en/index/id/33/
- ³⁹⁰ For example, in Japan, a content icon appears on the back of the packaging which indicates why a game received a certain rating by the Japanese rating board ('CERO'). The icons are grouped into 9 categories which include: (i) love; (ii) sexual content; (iii) violence; (iv) horror; (v) drinking/smoking; (vi) gambling; (vii) crime; (viii) controlled substances (drugs); and (ix) language. www.cero.gr.jp
- ³⁹¹ www.pegi.info/en/index/id/33/
- ³⁹² www.esrb.org/ratings/ratings_guide.jsp. While a game (whether physical or digital in its eventual final version) is undergoing the rating process, it
- ³⁹³ Id.
- ³⁹⁴ Console manufacturers require games to be rated prior to their release. www.nytimes.com/2011/04/18/arts/video-games/video-games-rating-board-questionnaire.html?_r=0 Furthermore, in the event a country does not have a rating's system, some console manufacturers will have the right to reject a game if in its opinion it may contain elements that contain excessive violence or sexual content, inappropriate language or other elements deemed unsuitable by the CM. Majesco Entertainment Company, Quarterly Report (Form 10-Q/A), Ex. 10.1 (Jan. 17, 2007).
- ³⁹⁵ See Chapter 9.6.5 regarding app stores' own ratings system.

- ³⁹⁶ For example, the ESRBs ratings work on an industry self-regulation model whereas PEGI is enforced in some parts of Europe as a legal requirement (e.g. the UK) and in other countries on a voluntary basis (e.g. Russia). See further www.esrb.org/about/news/downloads/ESRB_Fact_Sheet.pdf
- ³⁹⁷ In some countries, where there is no requirement to submit a game to be rated, the business realities and other licensing contractual obligations require the game be submitted to recognized industry voluntary organizations. Otherwise, submitters face the possibility that retail outlets won't sell their game without a rating. Chandler, *supra* endnote 34, at 275. See also www.pegi.info/en/index/id/26/. In addition, owners of intellectual property that license rights to submitters for their games will typically require that the game be rated and in most situations receive a particular rating. A licensor of a children's property will not want to be associated with a rating that may state that content in the game is not suitable for children in a particular age category. According to the PEGI 2012 Annual Report, a group comprising the rating boards from Europe, US, Australia, Brazil and other countries (currently called the International Alliance for Rating Content) are working on creating one questionnaire combining the different criteria of the different ratings boards for mobile and online games. www.isfe.eu/sites/isfe.eu/files/attachments/annual_report12_web.pdf
- ³⁹⁸ If a developer has entered into an agreement with a publisher to have its game distributed then the parties would need to determine which party would submit the game to the various ratings boards. Depending on how many submissions may be required to the various ratings boards, the parties will also need to negotiate which party would be responsible for the costs and are the costs recoupable from revenues earned from the distribution of the game.
- ³⁹⁹ For example, the Australian Classification Board ('ACB') factors in rewarding players engaged in certain acts such as violence when determining a rating for a game. www.classification.gov.au
- ⁴⁰⁰ See www.grb.or.kr; Heather Maxwell Chandler, *The Game Production Handbook* 281 (Jones & Bartlett Learning 3rd ed. 2013).
- ⁴⁰¹ See <http://www.irvgame.com/Esra.aspx>
- ⁴⁰² In the United States, the video game *Saints Row IV* received a Mature rating. However, in Australia, the ACB banned the sale of the game based on the initial game rating submission, citing sexual violence and the awarding of incentives or rewards end users for illicit or proscribed drug use. It was the first game to receive an RC (Refused Classification) in Australia. www.theguardian.com/commentisfree/2013/jun/26/saints-row-4-censorship-australia. Mortal Kombat, an extremely popular and violent game, was banned in Germany when it was first released throughout the world. <http://mogi-translations.com/games-age-rating/video-game-age-rating-germany/>
- ⁴⁰³ The short form ESRB questionnaire requires the submitter to answer a number of multiple choice questions dealing with the game's content as well as the game's interactive components. The interactive components involves information dealing with the interactive aspects of the game such as an end user's interactions with others, the sharing of a user's physical location with others, or whether personal information is shared with third parties. In the event any of these features are part of a game then the submitter must include specific ESRB icons advising end-users of the use of these interactive elements. www.esrb.org/ratings/enforcement.jsp.
- ⁴⁰⁴ Because of the proliferation of games submitted on the various platforms, many ratings boards are unable to review every game in person and therefore some have adopted different submission processes depending on the game's platforms to help bring about faster turnaround times. See Pan European Game Information Annual Report 2012. www.isfe.eu/sites/isfe.eu/files/attachments/annual_report12_web.pdf



- ⁴⁰⁵ Id. In addition, retailers in some situations have previously removed games from shelves and requested that the publisher of the game accept product returns. Activision Blizzard Inc. Annual Report 2012.
- ⁴⁰⁶ www.esrb.org/ratings/ratings-guide.jsp
- ⁴⁰⁷ www.esrb.org/ratings/enforcement.jsp; <http://www.pegi.info/en/index/id/952>
- ⁴⁰⁸ <https://itunes.apple.com/WebObjects/MZStore.woa/wa/appRatings>
- ⁴⁰⁹ <https://support.google.com/googleplay/android-developer/answer/188189?hl=en>. For other examples of different rating systems established by various store fronts, See: <http://msdn.microsoft.com/en-us/library/windows/apps/hh452763.aspx>
- ⁴¹⁰ For example, in 2011 the ESRB announced a partnership with the US CTIA and six telecommunications companies to have a single mobile app rating process: www.ctia.org/consumer_info/service/index.cfm/aid/12076
- ⁴¹¹ Cannady, *supra* endnote 108, at 101.
- ⁴¹² <http://biography.yourdictionary.com/mary-pickford>
- ⁴¹³ Sales in November and December represent around 40% percent of yearly video game sales. See <http://content.usatoday.com/communities/gamehunters/post/2012/01/video-game-sales-have-disappointing-december-and-annual-drop>
- ⁴¹⁴ In binding arbitration, a third party (this can be made up of one or several arbitrators depending on what the parties decide) resolves the disputes and their decisions are typically binding on the parties, and most arbitration judgments have very limited appeal rights. See 9 USC #10. However, certain matters such as a preliminary injunction can't be decided by arbitration. Cannady, *supra* endnote 108, at 194-197.
- ⁴¹⁵ One of the reasons why arbitration may be a less costly alternative is that the parties agree to limit discovery and interrogatories, thereby limiting legal fees, which will often be the parties' biggest expense.
- ⁴¹⁶ The parties could decide that an arbitration is confidential subject to certain terms and conditions.
- ⁴¹⁷ Usually this limitation may include language that the approval will not be unreasonably withheld. However, this can cause problems since there could be a dispute on what is deemed reasonable. As a result, the parties may elect to list parties that an agreement may not be assigned to (i.e., competitors of one the signatories to the agreement).
- ⁴¹⁸ Melvin Simensky, Thomas D. Selz, Robert C. Lind, Barbara Burnett, Charles A. Palmer & F. Jay Dougherty, *Entertainment Law* 1529 (Lexis Nexis 3rd ed. 2004).

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