Licensing and Trade in the Cosmetic Industry

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This paper provides a brief overview of licensing and trace in the cosmetic industry to provide insight as to why large multi-nationals such as Unilever are involved in licensing in this area. As well as providing reasons and examples, the paper also addresses some important practical considerations and key terms that should not be overlooked when concluding licenses of this nature. Formalities and pitfalls to watch out for are also covered.

WHY LICENCE?

Why is this such an important and attractive business proposition? The answer is quite simply a four part equation: That is, cosmetics and perfumery mean glamour to most people, glamour is closely associated with fashion, fashion nowadays is inevitably linked to designer labels and with designer labels come high margins and therefore high profits.

WHO LICENCES WHOM?

Again the answer to this is quite simple. Because most top designers do not have the infrastructure or resources to support a global marketing operation in this area, they join forces with top manufacturers. In this way, a designer exploits large multi-national marketing manufacturing and distribution infrastructure, while the manufacturer exploits the famous designer label. In many ways this is a text-book licensing arrangement and one in which both sides stand to gain.

UNILEVER EXAMPLES

The most famous examples within Unilever are divided among what we refer to internally as our prestige businesses, namely Elizabeth Arden and Calvin Klein. The Parfums International division of Elizabeth Arden, through a series of independent and different licensing arrangements, is responsible for the six design "houses" of Chloe, Lagerfeld, Valentino, Cerruti 1881, Jean Louis Scherrer and Elizabeth Taylor.

The Calvin Klein Cosmetics Corporation is a Unilever subsidiary. It is important to stress that this is entirely separate from the rest of the Calvin Klein organization, including the clothing business, all of which is unrelated to Unilever. The famous brands of Calvin Klein in the perfumery area are Obsession, Eternity, Escape, CK One, CK Be and the latest entrant Contradiction.

Obsession was originally launched in 1984 as a female fragrance, followed two years later by the male equivalent. Eternity and Escape followed suit. CK One was the first so-called shared fragrance launched originally in 1994 and this was followed subsequently by CK Be. There are now numerous other examples of shared fragrances on the market from our competitors who subsequently followed this lead. Contradiction was a return to the more traditional male and female fragrance lines.

The various fragrance houses managed by Parfums International are all successful in their own right and have numerous main and sub-brands that have been launched under these designer labels.

NON-UNILEVER EXAMPLES

Unilever is, of course, not the only company that licenses designer labels in the cosmetic and perfumery industry. Procter & Gamble has Hugo Boss; L'Oreal has Ralph Lauren; Lancaster, which is a division of the German/Dutch company Benckiser, has Davidoff; Estee Lauder has Tommy Hilfiger; and Sanofi has Yves St. Laurent.

KEY TERMS

What then do you need to consider when entering into a licensing arrangement of this type?

Firstly, and most contentiously, is the royalty rate. This is arguably the most negotiable point of the whole license. This will usually include both an actual and minimum royalty rate, the latter designed to protect the licensor in case sales targets are not met. In my experience, the actual royalty rate is usually in the range of 4 to 8 percent of net profit on sales (NPS), but it can be higher than this in exceptional cases.

The second key important point is who should own the sub-brands that often are equally important to the main designer brand. An example of this in our own area would be Elizabeth Taylor's White Diamonds. While there is no question as to who owns the designer name, it is often negotiable whether the secondary or sub-brand is owned by the licensor or the licensee.

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The third key point is geographical extent. This is particularly important if the license is not intended to be worldwide. If the license is restricted to particular regions or countries, there are some potential pitfalls that should not be overlooked. I will touch on these pitfalls later.

The fourth point is who has control over the conception of the new secondary or sub-brand names. In my experience, most designers insist on having control over the creative aspects of the new name because it will always be used in close association with their own names. If the sub-brand is successful, the designers also may wish to use the secondary name in other areas. If the secondary name is not in their ownership this would require a license back, covering other classes of goods or services that they were interested in licensing.

The fifth point, which needs to be addressed from a purely practical perspective, is who should file and prosecute the trademark actions. This includes not only the initial prosecution o f the application through to registration, but also infringement actions and maintenance and renewal actions. It needs to be clear and unambiguous whether this is the responsibility of the licensor or the licensee, and it needs to be clearer still as to who pays for what in these circumstances. In my experience, it is better from a practical point of view if the licensee initiates all the actions in this area and manages them on behalf of the licensor. The question of who pays, however, is highly negotiable and links very strongly with the royalty rate that has been negotiated.

Something else that should be considered right from the very outset is the effect of termination. This includes residual rights to use not only the main designer name (which will almost certainly cease on termination), but also (and perhaps more importantly) rights to use the secondary names or sub-brands that may have been conceived throughout the life of the license.

The next point is perhaps obvious, but it is nonetheless one that should never be overlooked, and that is that it should be abundantly clear in the license exactly what is and is not being licensed in respect to the goods and services. It is a good idea that this list is exhaustive and it is also helpful from a records standpoint, if the terms used follow the Nice International Classification of Goods and Services. For the cosmetics and perfumery industry, this means Class 3 with all that that entails and related services in the beauty industry in Class 42.

The next point also is obvious, but extremely important, in that the license must be defined as exclusive, non-exclusive or sole, bearing in mind that exclusive also excludes the licensor, whereas a sole does not.

The next two points are again second nature to someone preparing a license, but should not be overlooked; restrictions on use of course need to be defined. This includes selective distribution, if appropriate, and quality control.

Finally, there must be clauses regarding whether or not assignment of the license is possible; whether or not sub-licensing is permitted (assuming local laws provide for this); and any warranties or liabilities that the licensor is prepared to provide.

FORMALITIES TO WATCH FOR

There are several formalities you should look out for that are not just applicable to the cosmetics and perfumery industry, but are applicable across the board.

First, the license must comply with any prevailing competition law that may be relevant. Secondly, the license should comply with any free movement of goods laws that apply within trading blocs such as the European Union, the Gulf Cooperation Council (GCC) in the Middle East; the ASEAN and APEC countries in the Far East, MERCOSUR and the ANDEAN Pact in Latin American and NAFTA in North America. In view of the recent Silhouette, Sebago and Davidoff cases in the European Union/European Economic Area, the is point is even more important than it used to be.

The tax implications of the proposed royalty flow need careful consideration and detailed advice from a professional in this area to ensure that you do not fall foul of any tax laws or, worse still, leave your client or company open to a large tax bill.

It goes without saying that the license needs to comply with any local law requirements where it is intended to be enforced.

Finally, but no less importantly, it is essential that the license is registered or recorded in all countries where such registration is posisble. This ensures that the trademark can be adequately enforced against infringers and counterfeiters, and is protected from cancellation challenges on grounds of non-use.