

# Negotiating Complex Licensing Agreements

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## INTRODUCTION

In this overview of licensing negotiations we will address three areas: In Part One of the article, our focus is on the art and artistry, the issues and interests, the options and opportunities, and the alternatives and end-games that occur in a complex licensing negotiation. In Part Two, we briefly review opportunities to extend a licensing program during the renegotiation process. Part Three is a case history of a complex negotiation.

## PART I—THE PROCESS AND ART OF NEGOTIATION

**P**art One is applicable to all licensing negotiations (and most other negotiations, in fact). The second part is aimed at existing licensors and licensees—those with both mature and growing programs in renegotiation—and is meant to stimulate some creative thinking on the part of program managers as they face a new negotiation with a key licensee. We also deal with the single most important concept for any negotiation: the BATNA—best alternative to a negotiated agreement. Finally, we conclude with a brief case history of two large companies negotiating a new license in the food industry.

### The Process and Art of Negotiation

There are a variety of viewpoints written on negotiating a license, but the most important element may be sensitivity towards the other side and its positions. In this section we look at some considerations and techniques for managing the negotiating process and bringing it to a successful conclusion. Much of this is based on our own experience over the last two and one-half

decades, as we have engaged in license renegotiations for trademarks, technologies, brands, copyrights and software; and have engaged in those negotiations in North America, Asia, Europe and Latin America.

We in the licensing business often think that the problems of negotiating are unique, particularly the problems of coming to a fair and successful agreement. Licensing people all agree that the licensing business is very interesting and very different, and in some ways is unique in the service that it sells. However, we are certain that the negotiation process that one goes through in licensing, while complex, is not unique.

Whether the issue is a successful negotiation of a merger or acquisition deal, a reorganization under Chapter 11, a personal appearance contract, or a major licensing agreement, there are great similarities in the process. The essence of the negotiating process is basically the same, the core motivations of the parties are the same, the types of self-interest can be categorized into a few groups, and common negotiating techniques can be made effective across all types of negotiations.

### What is a Successful Negotiation?

In an ideal world, a successful negotiation is one where both parties get everything they want. This, however, never happens. Each license agreement that is negotiated calls for givebacks and takeaways on the part of each party. A successful negotiation then is one in which each party feels that on balance their goals and interests have at least been advanced through joint decision and joint action on the negotiations. Even if those goals have not been fully

met, each party must feel that they have attained a meaningful portion of their goals.

Perhaps the best way to define a successful negotiation is as a means to advance the full set of your own interests through joint decisions and actions of the two parties in the negotiation. The key is to understand your own interests and those of the other party, and then to identify alternatives that will address both sets of concerns. In addition, it is important to understand what is happening away from the negotiating table. While the facts and issues being negotiated face to face at the table appear to be of paramount importance, oftentimes the behind-the-scenes plans, processes, positions and postures can be equally important as internal in-fighting and/or jockeying for position may be taking place behind closed doors, on one side of the table.

### Identify, Assess and Prioritize Interests of Both Parties

Success in negotiating an agreement is to understand completely the interests of your own team and those of the other negotiating team. We not only need to understand what those interests are, we have to assess them and then prioritize them as a reality check. However, understanding the key interests of the other side is, if anything, more important to a successful negotiation.

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There are both tangible and intangible interests on the table, some visible and some invisible. The tangible interests are obvious and include such things as a longer term, more frequent renewals, broader product definition, a higher royalty rate or greater guarantee of royalties. Perhaps better advertising allowances or other marketing considerations come into play. On the other hand, the intangible interests, while less obvious, may be equally important. They can include reducing tensions between the two parties, building a relationship of mutual trust with an established licensee, ensuring that the licensor's reputation is maintained at the highest level, and helping to see that there is a friendly, if not cordial relationship between the two parties as they move through the negotiations into implementation. Each of these intangibles can have as much bearing on the negotiating process as the tangible and specific financial interests and goals.

It is important to understand that when negotiating, the interests of your side are both objective and subjective. There are objective standards such as an absolute royalty percentage below which you will not go. On the other hand, a subjective interest might be a requirement for a creative commitment to the licensing program by the licensee that is more difficult to measure and negotiate. It is also important not to allow the hard or tangible issues to drive out these critical soft issues. For example, objective negotiating goals in terms of dollars or time cannot totally push out considerations such as reputation, quality, creativity and emotional commitment.

Interests drive specific issues and positions. Each party in a negotiation has specific interests and these form the bases that drive the negotiating process. If one can distinguish core interests from specific issues or positions then one has taken the first step toward ensuring that an effective negotiation can follow. Too often, one of the negotiating parties will focus solely on a specific issue such as maximizing percentage royalty rates. In fact, what the overall inter-

## “Managing the Negotiation Process”

<b>Issues:</b>	<b>Your Problem</b>	<b>VS. Their Problem</b>
<b>Goals:</b>	<ul style="list-style-type: none"> <li>• To optimally advance your interests</li> </ul>	<ul style="list-style-type: none"> <li>• To optimally advance their interests</li> </ul>
<b>Interests and Issues:</b>	<ul style="list-style-type: none"> <li>• Prioritize your interests</li> <li>• Assess your BATNA</li> <li>• Identify their needs, pressures</li> <li>• Make your need their opportunity</li> <li>• Optimize concession management</li> </ul>	<ul style="list-style-type: none"> <li>• Term Extension</li> <li>• Dollars/ Advances</li> <li>• Royalty Rate Decreases</li> <li>• Guarantees</li> </ul>
<b>Results:</b>	<b>Agreement</b>	<b>Agreement</b>

est may represent is a need to maximize early cash flow as opposed to the specific issue of high-end royalty rates. Recognizing this key interest can then lead to many different solutions to address it.

It is important that the parties at the table be able to identify the important differences in their interests. In other words, if one party has a key interest to keep early cash flow to a minimum and the other party can recognize this, then they are well on their way to addressing the underlying issue of royalties, advances and guarantees to satisfy that interest. The key concept is interests versus issues: Identifying the underlying interests and reconciling the various issues that flow from them.

### Negotiation is a Means to an End—The Concept of BATNA

Often, the process of negotiating appears to become the end in and of itself. In fact, we believe that in the licensing industry parties often allow the negotiations themselves to become the object. Too often people lose sight of the fact that negotiating is a means to solve problems for both licensor and licensee. When in negotiations, ask yourself a question: What is my BATNA? BATNA means The Best Alternative To A Negotiated Agreement. Ask yourself: If we can't negotiate an agreement here, what are my alternatives? Do I have alternative licensees? Are there product

lines I can add to existing contracts? Can I wait a year to introduce this product line? Can I contract and manufacture it myself, or perhaps import it?

The BATNA becomes the minimum threshold that the negotiated deal must exceed in order for it to be acceptable. With the concept of BATNA in mind while negotiating, you realize that there are a range of possible agreements. BATNA allows you to focus on the key alternatives, and when necessary, actually change the game; instead of negotiating a license agreement, for example, consider bringing in more partners on your side. Or, away from the table, find a way to diffuse or spread the risk, or enlist others in a joint venture. Considering any of these alternatives gives a new view of the negotiating process. Remember that moves and changes away from the negotiating table can improve your BATNA.

Assuming that you understand your alternatives, and have identified the best of those, then it becomes time to look at the other side's alternatives. The more one can identify feasible and viable alternatives for the licensee or other party facing you across from the negotiating table, the better one can understand the maximum advantage to be gained at the table. In other words, if the party on the other

side of the table has relatively few alternatives then your negotiating position becomes much stronger. If on the other hand their BATNA has a high degree of attractiveness, it will mean that the relative inclination to negotiate more favorable terms will decline, as the other side looks at the possibility of moving to that best alternative.

### Their Problem is Part of Your Problem: The Art of Concession Management

One of the most important concepts to bring to the table when negotiating a license agreement is to understand that the opposing side's problem really becomes yours if you are going to have a successful negotiation. You must put yourself in their shoes. Far too often I have heard the statement made in a negotiation, "Well, that's their problem. I am not going to worry about it." In fact, that problem becomes both your problem and theirs, because if you can't help them solve their problem, they cannot solve yours. Consequently, it is important to the greatest extent possible, to understand the other side's egos, needs, pressures, marketing strategy, and internal organization. The classic error we most often see in negotiations is for one side to focus on its own position without understanding the position or problems of the other side.

The best illustration of an effective way to handle the issue of "their problem is your problem" is found often in Japanese negotiations and contracts. Oftentimes when the Japanese negotiate a complex agreement that spans multiple years with multiple permutations, they put in a paragraph known as the Otawara clause (there are other descriptive terms for this clause). The so-called Otawara clause addresses the following issue: Should relative conditions between the two parties that are negotiating the agreement change substantially, then that party which has accrued greater power than the other has a commitment to renegotiate and make things fair. While this is a common

approach and philosophy in Japan, it is a virtually unknown concept in American negotiating.

Someone once described negotiation to me as: "The art of letting them have their own way. To our advantage." We agree. It fully implies that making their problems part of your problem brings you to successful conclusion. The essential task becomes to get them to see their problem in your terms. In other words, get them to focus on their problem and encourage them to do so, but within the context of your terms, conditions, mobility, and alternatives. Each side tries to optimally advance their own interests, which (hopefully) then leads to agreement. However, in order to reach that agreement, the art of concession management comes into play. Make the licensee see that your need or problem is their opportunity to advance their own economic and other business interests.

The art of concession management is straightforward. It is the ability, while negotiating, to play key elements against each other: Time versus dollars, now versus later, lower royalty rates versus higher minimums, and exposure versus obscurity. Sometimes, however, concession management becomes the end play in a negotiation and, unfortunately, too many people see it as the process of negotiation itself. Concession management is simply the means that one uses during the negotiation to get to an agreement that best addresses the most important issues. Concession management is an art form in many negotiations.

### Summarizing The Art of Negotiation

Let's return to our original question: What is a successful negotiation? It is that negotiation that best advances the interests of both parties through joint decisions and actions. The key first step is for each party to identify, assess, and prioritize their full set of tangible and intangible interests. Once the parties understand their real interests, they can then move on to the specific issues and positions that each needs to ad-

dress. It is important not to let the hard issues drive out the critical soft issues that can be equally important over time. Remember too, that negotiations are a means to an end, not an end in and of themselves. In negotiating, both parties' BATNA must always be kept firmly in mind. If there is no BATNA for one party, the rules of the game change.

Most importantly, remember that their problem is part of your problem. Understand what their needs and pressures are, and do not make the classic error of thinking that "It's their problem, they have to solve it." Part of the process is the art of concession management, and effectively using some of the techniques we have described here.

## PART II—OPPORTUNITIES TO EXTEND A LICENSING PROGRAM IN THE RENEGOTIATING PROCESS

In this brief article we take a moment to identify ways to best extend the life of a successful licensing program. In today's constantly changing society, and in a licensing industry faced with increasing compression and competition, the ability to hold licensees and renegotiate successful agreements with them becomes increasingly important. In the face of the pressures within the licensing industry (and within consumer goods in general), the rising importance of successful renegotiation cannot be overestimated.

Time is the enemy of most licensing programs. With more rapid technology change, shorter and quicker product introductions, shorter retail lead times, smaller retail orders, shorter attention spans among consumers, the faster pace of societal change, and greater licensing competition, one must continuously adapt—and adapt more rapidly: As a general rule, the life span of a licensing program is continually going to shrink, with few exceptions. The average licensing program cycle time is substantially shorter today than it was 10 or 20 years ago.

When a corporation is trying to revitalize and extend its licensing program it is important to brain-

storm, identifying and discussing alternative ideas and concepts prior to entering a critical negotiation. Conceptually, the management team starts with a broad scope so that many ideas will be considered and discussed. From this point, it is important to narrow the scope so the strategy will be focused.

### Alternative Negotiating Strategies and Techniques

There have been many books written on the negotiating process. This brief article is intended to be a helpful guide when negotiating license agreements, whether for trademarks, technology, character licenses, celebrities, patents or music rights. Some of the negotiating techniques to be aware of include the following:

- **Bulwarism** – Bulware, the infamous GE Labor Relations Manager, is the father of this technique, based on the principle that the first offer given is the best and only offer that will be given. However, a more realistic way to look at it is the refusal to bargain in good faith. Clearly, it is a bankrupt technique, and one that is rarely successful although it is still seen occasionally in negotiations.

- The unbundled approach to negotiating a license agreement is one that we often use. In this approach we break the agreement into two or three sections; each is treated as a separate piece. When the separate piece is fully negotiated, then the next piece of the agreement is brought to the table. While the advantages of the technique are that it breaks down the negotiations into more manageable pieces, it can artificially separate integral parts of a single negotiation.

- The components of value approach to negotiating a license agreement is a technique that we helped pioneer in licensing. The underlying principle states that in any negotiation there are three, five, or ten primary items that have to be negotiated. These items can include the term, royalty rates, guarantees, separate fees for product design, advertising, etc. This approach is useful when there is a hybrid agreement

to be negotiated; one that involves perhaps a trademark, a technical process, copyright and/or patent. (See Part III)

- The final technique we always use is: Nothing is agreed upon until everything is agreed upon. In other words, as one goes through the negotiation process, addressing specific issues, the two parties may agree (for example) on minimum annual financial guarantees. However, later in the negotiating process that agreement on minimum guarantees may have to be readjusted in order to get agreement on other issues such as length of the contract or number of product categories involved.

There are, of course, other negotiating techniques or postures that we often see. Among those is “the unique market syndrome,” and “the sky is falling” doomsday technique. In the first case, “the unique market syndrome,” the position is basically the following: You can’t work this market without us. The one party takes the position that they are the only alternative in the negotiation and that the other side should recognize this immediately. This is a form of brinkmanship (although it is also often a form of hubris). The second, “the sky is falling technique,” is seen quite often. In this scenario, typically put forward by the licensee, the blackest possible picture is painted—this technique is based on the hope that by painting such a black picture, the other party at the negotiating table will immediately lower its sights and become more flexible in its negotiations. There are permutations and combinations of all these techniques and combinations that can be used in any negotiation.

In sum, the licensing industry has become more complex over the last decade, and has gone through a period of consolidation, retrenchment and decline. As a consequence, the negotiating process is more important today than it ever has been. As one sits down to renegotiate with existing licensees or to bring a new licensee together in a negotiation, each party must be far more critical and concise in assessing their interests,

issues and realistic solutions—the process of negotiating a license agreement is not becoming simpler, it is becoming more complex.

### Creative Re-negotiation

In the face of these facts, then, the most critical issue facing a licensing manager is how to extend a successful but mature program. However, a mature program doesn’t mean a stagnant or static program. The following outlines some suggestions on how to renegotiate and extend a mature, successful program so that it remains viable—and profitable.

- Add new licensing elements (sub-brands, new technology, etc).

- Try co-branding or co-licensing.

- Extend licensee product lines with new designs, logos, etc.

- Modify existing terms and restrictions. In other words, if you need to be flexible, do so.

- Add parallel licensees. If you have a retail licensee, add a direct-mail licensee. If you have a mass-market licensee, find a specialty market licensee.

- Modify the definition of your licensee’s product lines.

- Extend retail distribution up, down or sideways, go up the chain, down the chain or expand sideways with direct marketing.

- Modify pricing strategies and price points.

- Begin working with the licensee’s distribution channel and retailers. Involve them in timing, product selection and off-peak promotions.

- Expand geographically. Go to China. Go to Europe. Export.

- Reduce dependence of the program on its core vehicle. If the core vehicle is a patent or single logo element, find ways to make the program live beyond its lifespan.

- Encourage sub-licensing. At the beginning of the program, you may not want much sub-licensing, but when you are in the fourth, fifth or tenth year, you may want a lot of sub-licensing.

- Help your licensees when they get into trouble. If they have poor products, help them dispose of them.

- Finally, a new look: New graphics, new characters, new colors, new logo treatments.

Maturity does not have to mean stagnation. Remember, in licensing and in the consumer marketplace, the only constant is change. The final thought is to remember that the licensee always has a BATNA (Best alternative to a negotiated agreement). Therefore, an analysis of their alternatives, their interests, their issues, their needs and their positions is of paramount importance prior to beginning the renegotiating process. If this analysis is undertaken by a licensor in advance, then the chance of renegotiating and extending a mature program increases dramatically.

### PART III—HYBRID LICENSING: A CASE HISTORY

We were involved as consultant and advisor in a complex licensing deal between two multinational food companies. The deal would affect both companies' basic business for perhaps the next 50 years.

Company A, our client, is a publicly traded manufacturer and marketer of consumer and commercial food products. Well known for its corporate name and brand, along with other trademarks and brands it controls, it is also respected for its consumer marketing abilities in a highly competitive environment.

Company B is a very strong publicly traded multinational focused on consumer foods. The parent company has several strong divisions and this deal involved its snack foods operations. The division is well known and thoroughly respected for its ability to deliver, to distribute and to merchandise in tens of thousands of outlets.

This complex deal had five key elements: use of the trademark and brand name, production and technology know-how, manufacturing capabilities, physical distribution and delivery, and finally, merchandising and marketing of product. These five core elements were then divided into two distinct agreements and two sets of negotiations. The first agreement covered the

**Table 1: Bundle of Rights**

Marketing Bundle of Rights	Technical Bundle of Rights
Umbrella Brand Name	Packaging Technology
Sub-Brand Names	Baking Technology
Product Names	Formulae and Blending
Trademark Registrations	Product Shapes / Designs
Copyrights	Process Technology
Graphics	Key Patents
Corporate Name and Logo	Equipment Design
Labeling and Package Design	

manufacturing elements including plant construction, testing, product development, etc. It also covered the basic elements of marketing, merchandising and distribution. The second agreement, the licensing agreement, covered the use of the brand name and of packaging and other production technology, all provided by Company A.

There was substantially more than simply a trademark and patent involved: First, the marketing bundle of rights along with the brand name and trademark. Second, the technical intangibles licensed in the technology section of the agreement.

(See Table 1)

#### General Background

The two companies had mutually identified a product category that was ripe for a new competitor. The category had been in existence for several decades and was dominated by a handful of competitors who were strapped by high production and distribution costs combined with low efficiencies. Consequently, Company B saw an opportunity to build a market quickly that offered annual sales volume between \$300 million and \$1.5 billion. However, they lacked the product know-how and suitable brand franchise which Company A had.

There was a good marketing match. Company A does an effective job of consumer advertising and promotion and is superb at pulling product through the distribution channel via consumer advertising and promotion. Company B, on the

other hand, is superb at pushing product through multiple channels via merchandising and pricing. Jointly, therefore, they would decide on and control effective trade and consumer marketing programs. Finally, there was good use of Company A's general product technology. However, it meant that in addition to negotiating the manufacturing and distribution deal, it was necessary to put together a license agreement to cover the trademark and brand name, along with the technology.

We were hired to help our client review some of its alternatives, including the possibility of having a joint venture with Company B, a pure licensing agreement, simply private labeling and packaging for them, or a combination of the above. In the final analysis, we believed that a combination deal of manufacturing agreement and licensing agreement was best. Company A agreed. We used the set of key factors that helps predict success in a licensing environment like this. As shown in Table 2 there are 10 key factors we considered in this licensing deal. The match appeared to be exceptionally good in this case.

Company A had broad goals or primary issues they needed fulfilled from this licensing agreement. The first was to generate incremental income from all of the assets employed in the license agreement, both trademark assets and technology assets. The second key interest was to broaden their consumer and trade franchise, increasing distribution and production while, third,

ensuring that their image was not cheapened or damaged.

Company B had four interests that were clear to us. First, and most important, was to better utilize its distribution capabilities. The second was to spread distribution costs over product lines. Third, was to launch a new product line that it could not make. The fourth and final interest was maximum cash flow and income.

The issues, which are secondary to the key interests, also differed for the two companies. The key issues for Company A were:

- Potential damage to the name.
- The danger of a short-term arrangement.
- The loss of proprietary technology.
- The need for market-based royalty rates.
- Annual royalty guarantees.
- Effective escape clauses.

For Company B, the issues included:

- Use of unique technology.
- That new products were continuously developed.
- That the costs of promotion and royalties remained manageable.
- That this not be a short-term affair.
- That the total cash paid to its partner not be excessive in any given year.
- Effective escape clauses.

Finally, there was a key difference in overall corporate philosophy, operating style and management. Company A is a production and marketing-driven company. Company B is distribution driven and has a distribution mentality. Those two diverse points of view and corporate strategies had to be reconciled in the license agreement, at the juncture where sales and distribution intercept manufacturing and marketing. With these key thoughts in mind we moved to establish a framework for negotiating the deal.

### Negotiating a Framework for the Deal

We identified as many comparable licensing transactions as were appropriate, and determined that a royalty rate for use of the brand name and other marketing intangibles would

**Table 2: Key Factors in Consumer Goods Licensing**

Licensors Contribution or Support for Licensee	Company A Rating
1. Consumer awareness of licensor	+++
2. Retailer acceptance of licensor	++
3. Strength of licensor's core products	+++
4. Advertising / promotion by licensor	++
5. Piggyback on licensor's distribution	-
6. Volume potential for licensed product	+++
7. Filling a void for the licensee	+++
8. Manufacturing / product fit	-
9. Higher attainable margins for licensee	++
10. Potential for efficiencies, profits, licensee	++

### Comparable Transactions

<b>Trademark Royalty Rates</b>	2.0%	6.0%	3.5%
<b>Technology Royalty Rates</b>	0.5%	5.0%	2.0%

be between 2.0% and 6.0%. We then undertook a similar exercise for food technology licensing and determined the royalty rates were somewhere between 0.5% and 5.0%.

After further research, we provided Company A guidance as to trademark royalty rates and technology royalty rates. We suggested royalty step-ups with price increases and royalty rates with volume discounts. We helped establish minimum sales levels and minimum royalties. We recommended proportionate pricing formulas, and addressed the issue of branded product sales versus unbranded product sales. We also created a framework of approvals over marketing, packaging, labeling, etc. And, finally, we provided to each company a number of unique escape mechanisms or exit clauses that could be exercised in five-year intervals—with a substantial fiscal penalty should the escape-clause mechanism be exercised.

By reducing the key terms and

conditions of the proposed license agreement to a common deal memo, we were able to help Company A and Company B reach an agreement on the following:

- Term and renewals
- Royalty rate scales
- Options
- Minimum sales clauses
- Minimum royalty clauses
- Test market details
- Channels of distribution
- Product definition

In essence, by reducing the negotiating process to address the key interests and issues, we were able to condense the wanted result into a one-page deal memo, from which a full-fledged license agreement was structured.

### Conclusions

What conclusions do we draw from this long but ultimately successful process? First, that complex issues can be resolved and unified

via a licensing agreement. Second, that trademarks and technology can be married in one deal. Third, this combination or hybrid deal will play an ever-larger role in the future of corporate licensing and corporate transactions in general. Finally, when negotiating, get the parties to separate their key interests from the more minor issues. And, make sure that each party understands its BATNA.