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Celebrity Branding Opportunities

Strategies for Allocating Long-Term Value In Fashion and Apparel License Agreements

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Fashion and apparel goods are an important source of branding opportunities for artists and celebrities. One of the most vexing economic issues in fashion and apparel licensing deals is the task of allocating the long-term value of a branded product launch. If a branded product line is not generating significant sales volume in the early years of a license, the celebrity licensor may prefer to terminate the existing license agreement in order to enter into potentially more lucrative arrangements. Conversely, the fashion/apparel licensee may have invested significant financial resources to develop and promote the brand and wants to reap the long-term economic benefits of the brand's eventual success.

Contractual Remedies

There are a variety of contractual arrangements that can address these apparently conflicting interests, but these agreements require that the parties address the issue at the time they initially structure their business and legal relationship. Certainly, the most comprehensive way to address this issue is by creating a partnership or joint venture that shares equity ownership of the brand and binds the parties together on a long-term and formal basis. However, the economic issues also can be addressed within the framework of a fashion/apparel license agreement through well-drafted renewal rights, rights of first refusal or first negotiation, and put/call rights.

Iconix Brand Group Inc. recently announced the formation of a new joint venture, MG Icon LLC, with a mission to leverage Madonna's name and personality in the development of brands throughout the world. MG Icon is structured as a 50-50 joint venture between Iconix and an entity controlled by Madonna and Guy Oseary, Madonna's manager. One of MG Icon's first transactions was to enter into a direct-to-retail agreement with Macy's for a newly created Material Girl collection of junior apparel, footwear and accessories that will be launched exclusively in Macy's stores and online. This is a compelling approach to launching branded product lines because it gives both parties an ongoing equity interest in the success of the products. Joint ventures such as MG Icon, however, require a significant commitment to the partnership by all parties and necessitate agreement on, among other matters, the mechanics of governance, operations, future equity contributions and debt financing, ownership transfer and dissolution. Parties unwilling to enter into this type of complex joint venture can still allocate long-term economic benefits of a branded product launch within the context of a more traditional licensing agreement.

Licensing agreements in the fashion and apparel industry can be used for a variety of purposes: to create a "second line" of products under a new trademark to be sold at a different price point and into a different market from the primary line; to develop brand extensions under an existing trademark in product categories that complement primary product lines; or to help expand an existing trademark into new geographic markets.

In each of these situations, the parties enter into the license agreement with the goal of promoting a brand for economic benefit. The licensee typically retains the proceeds of all sales of the licensed products, but pays the licensor a royalty, usually ranging from 3%-15% of net sales (subject to certain negotiated deductions). The licensor typically has approval rights over the design and production of the product, all advertising and the channels of distribution in order to maintain the quality and image of the brand. Since license agreements typically have relatively short initial terms (frequently three to five years), the parties need to address what happens when the initial term is over.

License Agreement Renewal

Fashion and apparel license agreements generally specify the conditions upon which the license can be renewed after the initial term. One or both parties may have the option to renew one or more times, provided certain conditions are satisfied. At a minimum, the party seeking to renew ought not to be in breach of the license agreement with regard to such ma-

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terial items as royalty payments, deadlines and quality control.

The licensor may wish to also condition the licensee's right to renew on the achievement of certain milestones or of minimum royalties or sales volume over a specified period of time (which could range from the entire duration of the license to some lesser period). In this way, the licensor can be assured that it won't be obligated to renew the license if the licensee is not successful. The licensee, on the other hand, may want the option to pay to the licensor the amount of royalties that would have been due if the milestones or minimums had been achieved. The licensee may not have achieved the required milestones or minimums, but may have invested so much time and money in the brand that it wants the opportunity to harvest its investment over a longer term. Query whether under such circumstances the licensee should pay a premium for the right to renew, in light of the fact that it did not achieve the anticipated results in the timeframe set out in the license agreement.

Right of First Refusal

Similarly, a licensor will want to license only specified trademarks, products and geographic areas in a new licensing deal, so that it can assess whether the licensee is the best strategic partner for its brand. If a licensee gets only a limited license agreement, it may want to at least have the opportunity to be considered for additional business lines or geographic areas, to the extent that they are within the licensee's areas of expertise. The licensee would prefer to have a right of first refusal, or a right to match, with respect to any new deals. A right of first refusal obligates the licensor to offer the new business to the licensee before it offers it to anyone else on the terms first offered. A right to match, which is a variation of a right of first refusal, grants the licensee a right to match the best offer obtained from a third party.

These rights may inhibit third parties from engaging in negotiations with the licensor, because they give the original licensee too great an advantage. Licensors would prefer to grant a right of first offer or first negotiation, if they have to grant any rights at all. This type of provision requires the licensor and licensee to negotiate in good faith for a specified period of time, and if they do not reach agreement on the terms of a new or expanded license within that time period, the licensor is free to negotiate with third parties and to reach a deal on whatever terms it can. The licensor should understand, however, that it is required to actually negotiate in good faith and not have another potential licensee already lined up for the new business.

Put/Call Feature

Both the fashion/apparel licensor and licensee may desire to have a mechanism in the license agreement to allow the licensor to eventually cash in on a successful brand and to allow the licensee to take complete ownership of the brand. In theory, such a mechanism would incentivize the licensee to more fully fund the product launch and to hire additional staff to service the design, manufacture and distribution of the products. One of the most useful mechanisms to achieve this goal is a put/call feature. The parties agree that, after a specified period of time (perhaps after the initial term and one renewal), or after the achievement of specified sales volume or royalty payments, the licensor can "put" the licensed products to the licensee or the licensee can "call" the licensed products from the licensor.

The put/call feature may be exercisable only once, for a specified period, or may be exercisable periodically after the initial milestone has been achieved. In each case, full ownership of the trademarks and associated rights and goodwill relating to the licensed products are transferred to the licensee. These provisions typically provide either a formula or a mechanism for determining the put/call price. A formula might be based on a multiple of either net sales or royalties over a specified time period prior to the exercise of the put or call. Alternatively, a mechanism might provide for an independent third-party expert to determine the fair market value of the put/call in a manner that binds the parties (absent manifest error). This alternative may be problematical because it commits the parties to a price that they can't predict with certainty in advance and may be materially different than their expectations. The put/call feature clearly has risks — at the time of exercise, one party may find that it is economically disadvantaged either because of the timing or pricing. However, it can be a useful tool to incentivize the licensee and to provide a final allocation of long-term value for the parties.

Conclusion

Strategic license agreements can be profitable for both parties, by potentially increasing market exposure and revenue streams. In drafting license agreements, however, it can be difficult to anticipate every possible future issue or outcome. The one outcome that clearly should be considered is the licensed product's eventual success. The parties can, and should, negotiate at the outset how they will allocate the long-term benefits if the licensed fashion and apparel products are eventually financially successful. If the parties fail to consider these issues and address them appropriately, both the licensor and licensee may have expended significant effort and expense for a result they neither expected nor desired.

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