Exercise #1 // Important Deal Terms
By Eric Goldman
September 19, 2005

An Overview of the Relationship

This is an endorsement contract. Some endorsement relationships merely involve the celebrity saying nice things about the product, but this relationship is more complex because Cheetah's name and likeness will incorporated into the product.

The integration of Cheetah's brand into the product creates some risks for both parties. From Acme's perspective, Acme will incur some start-up expenses to manufacture and market the product. If the relationship sours, Cheetah's brand becomes worthless or Acme loses its rights, then (a) Acme's stream of cash flows may be prematurely interrupted, undercutting its investment decisions, and (b) Acme may be stuck with a warehouse of goods (and perhaps some manufacturing equipment) that it can't use.

From Cheetah's perspective, he "owns" his brand, which is basically a set of consumer psychological perceptions. By letting Acme use his brand, he is giving up some control about how consumers perceive him. If Acme denigrates these perceptions, Cheetah's brand becomes less valuable in all respects.

In theory, the shared interest in Cheetah's brand and the associated revenue share should align the parties' interests. Because both parties will make more money as the product succeeds, both parties have incentives to make that happen. For reasons that I'd be happy to explain offline, revenue shares do not align the parties' interests 100%. For now, consider that Acme might find the product line unprofitable even if it makes significant sales, so Acme might want to kill the product line even though Cheetah is earning substantial royalties. Alternatively, Cheetah may have non-monetary considerations that trump his interest in this relationship. For example, imagine that Acme wants to distribute the product through low-end retail chains—BigLots or the dollar stores. Cheetah might be concerned about the impact on his reputation even if this distribution channel might maximize profits.

With that high-level overview, I'll now address more specific considerations for each party.

From Cheetah's Perspective

Cheetah is the vendor in this transaction. Typically, vendors care most about getting paid and defining what they are selling (so that they don't unintentionally sell more than they are getting paid for).

What Cheetah is Selling

- What products can Acme attach his name to? [Cheetah generally will want these products to be as limited as possible, so that he can sell his naming rights to other products for more money. Cheetah will also probably like to restrict Acme's ability to "sublicense" its rights (i.e., designate third parties who can use Cheetah's brand as well.]

- Is Cheetah providing anything other than permission to use his brand? (such as time)

Getting Paid

From Cheetah's perspective, this relationship should produce a stream of cash flows. He cares about the size of those cash flows, but he also cares about riskiness of the cash flow (i.e., he would like to be able to plan and rely on the cash actually coming in). Therefore, he will want to control both size and risk of the cash flow.

- Size of the cash flow. Cheetah will want to tightly define what "5% of sales" means. For a terrific example of a battle over revenue share accounting, see Buchwald v. Paramount. Also, Cheetah cares about what efforts Acme undertakes to expand sales (the more Acme does to increase sales, the more valuable his 5% is). Cheetah may want to see a business plan from Acme with guarantees about how much marketing they will do to promote the products.
- Duration of cash flows: how long does the contract last?
- Timing/risk of cash flows. Cheetah may want minimum monthly/quarterly payments (regardless of actual sales) so that he can plan on cash flow. He may also want upfront payments (an advance payment or a signing bonus) to minimize the risk that Acme stiffs him.

Managing His Brand

Cheetah will also care about managing his brand so that it has value for other/future endorsements (and because of his ego).

- He may want to ensure that the goods conform to a minimum quality. He can do this by specifying minimum quality parameters in the contract, or he can retain approval rights over the product.
- To increase his brand generally, he may want Acme to promote his personality to the public (and coattail riding on Acme's marketing budget may be an integral part of the value to Cheetah). Alternatively, he may not want extra publicity to avoid overexposure.
- He may want a termination right if Acme turns into a disreputable company (think Enron or other companies embroiled in corporate scandals).

Other Issues

- He may want to get some free products for himself and his entourage.
- He will want to restrict his liability for any personal injury or property damage caused by the products. Note that Cheetah might procure insurance to cover this risk in addition to shifting the risk to Acme.

Some of you mentioned that Cheetah should restrict Acme's ability to obtain endorsements from other celebrities. Why would Cheetah care about this? One reason is that if Acme keeps signing up the flavor of the month, they might reduce their efforts to promote the Cheetah-branded products, which would reduce the value of Cheetah's 5% stake. However, there are plenty of other reasons why Acme might reduce their efforts in the Cheetah line, including a change in management, a decision to focus on other aspects of the business, or if the line isn't profitable. I think the better approach from Cheetah's standpoint is either to (a) get minimum levels of marketing commitment from Acme (coupled with meaningful remedies if they shirk), or (b) get minimum payments regardless of actual sales, which forces Acme to generate enough sales to cover the minimum payment.

From Acme's Perspective

Acme is the buyer in this transaction. In this case, they are procuring an asset (Cheetah's brand) as part of assembling the assets required to launch a new business line (the Cheetah branded products). Cheetah's brand is only one component of a complex undertaking—while it's a key component, Acme wants a good return on all of the assets it deploys in the business line.

Procuring the Asset

- Acme needs Cheetah's permission to use his name and likeness sufficient to run the business line they are launching
    - They may also want the right to use his name on additional business lines
- Acme wants to keep the rights so long as they are valuable
    - They do not want the permission terminated by Cheetah under any circumstance. Termination by Cheetah may eliminate a good profit source, prevent them from getting a return on their investment, and leave Acme with worthless inventory/assets
- Acme wants exclusivity (i.e., Cheetah can't endorse other products)
    - They may only want exclusivity for the specific products, or they may want it for the entire category of sports goods, or they may want to be the only product Cheetah endorses at all. [Normally, the broader the exclusivity, the more the buyer has to pay to get and keep it. They can't just deny him the ability to license out his personality to others without compensating him accordingly (but see Wood v. Lucy)]
- They may want marketing support from him in the form of time, such as in-person appearances, media interviews/press tours, appearances in the product advertising, etc. Note that Acme may have to compensate Cheetah for this additional time and may have to cover his expenses; whether this is included in the 5% or a separate expense, Acme mostly will want assurances that Cheetah will, in fact, make himself available.

Preserving the Asset's Value

Unlike a sale of UCC goods, in this case the seller (Cheetah) can, by his actions, unilaterally reduce the value of the asset that Acme is buying. Thus, Acme will want to restrict Cheetah's ability to do so. There are also some other ways that Acme will want to preserve the value of the endorsement.

- Morals clause (no behavior that undermines consumers' positive feelings towards buying Cheetah-branded products)

- No disparagement of Acme's products [no one is going to buy his paddles if he says they are crummy]
- He must exclusively use the Cheetah-branded products in public [hard to convince the public to buy his goods if he chooses a different brand for his own use]
- Need to spell out consequences if Cheetah gets injured, suffers a career slump, retires or dies. [Acme might choose to buy insurance to protect its financial interests in these circumstances.]
- Right to sue anyone who creates knock-off versions (i.e., Acme wants to be able to eliminate illegal competitors)
- Extra bonus if Cheetah can get engaged to Katie Holmes and do his paddle-twirling trick on Oprah

Termination

Acme will want to preserve a termination option if the business turns out to be unprofitable.