

SPECIAL SECTION: **HOSPITALITY & GAMING**

**MCC INTERVIEW: Lewis Stark / EisnerAmper LLP**

# Increase the Odds of Licensing Success

*Leveraging a brand in the gaming industry can be a lucrative bet with proper controls in place*

*The value of intellectual property in the marketplace is ever expanding, and when you consider licensing, that value could have a very precise dollar figure attached. Licensing arrangements can provide corporations with a handsome additional revenue stream, one outside of their core business, and Lewis Stark of EisnerAmper encourages trademark holders to consider pursuing agreements in the gambling industry if it is in line with your brand strategy. Here, he suggests tactics for establishing a successful partnership with a gaming licensee. His remarks have been edited for length and style.*

**MCC:** Tell us about your background, particularly in relation to licensing and audit work in the gambling and lottery sectors.

**Stark:** My specialty is conducting royalty and contract compliance audits and related services. I represent a variety of licensors in many industries. Some of my clients license into the gambling industry, but the opportunities to work in that sector aren't as large as in other sectors. I have over 20 years of royalty and contract compliance auditing experience.

**MCC:** As head of Eisner's Royalty Audit and Contract Compliance group, you must see many contractual agreements and confront a wide range of issues. How do you translate that broad experience into value for your clients?

**Stark:** We utilize the experience we have gained auditing different types of companies and apply a variety auditing techniques in our process. We approach our engagements by looking at more than just the numbers



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surrounding a licensing program. Usually, monetary results are the main concern of the client, and we definitely focus on that concern, but we further help the client in many ways, including enhancing the contractual terms of their license agreement. We provide suggestions on improving agreements, primarily in the royalty and audit provisions, as well as whether it makes sense to add penalties for breaches, nonconformity or other things that we find.

We also observe the licensees, what they're doing and sometimes not doing, which may be nonmonetary in nature, and provide that business intelligence back to our clients. An example would be rights or territories granted to a licensee that are not being exploited. That intelligence might give the client the opportunity to claw back those rights and license them to somebody else for additional compensation and revenue.

Since we've been exposed to a number of licensees, and have audited a variety of companies in many industries and territories, we are very effective in identifying issues that might not be just black or white. Thinking out of the box helps us identify and quantify esoteric claims.

**MCC:** What is a particular challenge in licensing in the gaming sector? Are there issues that are highly specific to this area?

**Stark:** One of the prevalent issues is being associated with gambling, even the lottery. There can be a negative connotation with gambling that causes many licensors to forego licensing into this industry.

With respect to auditing licensees, there are also challenges with getting information pertaining to the deals that the manufacturers of slot machines have with the casinos, which can be significant. If the royalty is based on the revenue generated from gambling activity, gaming revenue has to be reported back to the licensee, who then has to report that to the licensor as part of the royalty payment. Getting access to that information and understanding how the casinos, say, are identifying and reporting that revenue is almost akin to a sub-licensing arrangement, where you have a third party reporting to the licensee, and the licensee is reporting based on that third party. There are definitely some unique concerns in making sure that the third party's reporting is complete and accurate and that licensees are checking the figures.

**MCC:** Online gaming has become a massive industry despite facing many regulatory hurdles. What impact does that have on licensing and royalties?

**Stark:** In my business I haven't seen the effect because I've been focusing more on traditional gambling. Also, we work in the past, as our audits go back three to five years, and thus we have yet to see the current trends of online gambling.

**Lewis Stark**

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I would assume, though, that as gambling expands, there's the need for gaming companies to separate themselves from others, and one way to do that is through exclusive properties and superior experiences. Why do you choose one site versus another? It's based on the experience. If that experience is enhanced through a familiarity with brands, the opportunity for a successful program is enhanced, which could lead to increased opportunities to license.

Conversely, as noted above, many licensors are hesitant to license into the gambling industry. Many doors may be shut simply due to the nature of the product that the licensee is providing.

**MCC:** *Tell us about a typical audit engagement. What is your usual entry point, and does it arise from a lack of clarity in contractual arrangements?*

**Stark:** Some licensors are reactive – they may react to information from the marketplace or to royalty statements coming in late or not looking proper, and that will trigger an audit. But most of my clients are proactive. They have a systematic program in place to select licensees to audit annually, and they look at certain parameters to determine who to audit and when. Some licensors might think that the gaming industry, just because it's gaming, may be more prone to issues, but there are other characteristics to look at when determining which licensees to audit. Consider whether the licensee is in financial distress, is expanding rapidly, is producing a lot of products or was just acquired. Where are they with the minimum guarantee – are they unrecouped or fully recouped and/or do reported

royalties always approximate the minimum guarantee? Are the licensee responses to your inquiries transparent? Do they provide complete and timely information?

**MCC:** *A good part of your work is in protecting intellectual assets and helping companies actively manage what can be highly lucrative, if intangible, property. Tell us about that aspect of your practice. Has the digitization of so much of entertainment and sports changed the way you go about your business of protecting a client's IP?*

**Stark:** Intellectual properties possess great value. Brands and trademarks reflect the identity of your company and can generate significant amounts of royalties. There is also the added benefit of obtaining free promotion through your licensing program. However, you have to be careful when licensing your properties to a third party as you don't want them to tarnish or devalue the brand. Whenever a celebrity is associated with a brand, you take the risk that the celebrity might do or say something that reflects poorly on the company.

In the gaming world, especially with electronic commerce, the lines of delineation can be blurred, such as territorial or sales channels or other items that you're trying to restrict the licensee from doing. When licensees have access to distribute products or services over the internet, it is more difficult to control, especially if via third parties. Part of our process is understanding the controls in place to make sure that the licensee is adhering to the requirements in the license agreement. We'll perform certain tests to verify whether such processes are working and identify areas that may be problematic for our clients.

**MCC:** *What can an IP owner do to maximize the short-term value of assets without endangering their long-term worth?*

**Stark:** Licensing is a fantastic opportunity to generate revenue outside of the core business. There are always going to be risks, but you can mitigate them by having a robust agreement that protects you as well as fulfills your goals. It's important to use an experienced licensing attorney, not necessarily an in-house attorney or someone who doesn't specialize in licensing.

Second, vet your potential licensees by conducting thorough due diligence. You want someone with experience in licensing, a strong reputation and the ability to fulfill the obligations of the license. Then go into the relationship with a "partnership" mentality. If your licensee wins, you win. You want to give your licensees the opportunity to make money under terms that work for both parties. If you have terms that are onerous to them and solely for your benefit, then the licensee may act in a manner that makes them money and that might be adverse to the agreement. You want your licensees incentivized to promote your properties and increase revenue and royalties.

The final thing is to maintain a proactive royalty compliance program and utilize an experienced royalty auditor to make sure that a licensee is actually living up to its monetary and certain nonmonetary obligations.

Licensing into the world of gambling can be lucrative. To win in this world, licensors must hedge their bets by doing their homework and their due diligence, and by actively monitoring their licensees.