"The Big Picture 2009:
Managing Your Game Dev Deal
and Operating your Game Dev Studio"
Tuesday, March 24, 2009, San Francisco, CA
10:00am to 6:00pm

OUTLINE FOR GDC BUSINESS & MANAGEMENT TUTORIAL 2009

Important disclaimer – This material is provided for educational purposes only and is not to be taken as legal advice for your own situation. Each transaction is different and it is important to have knowledgeable counsel working on these complicated issues every step of the way.

Further disclaimer – the documents attached to this outline are provided for use as examples in this program and may not by suitable for other purposes.

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A. OVERVIEW OF THE DAY AND INTRODUCTION OF THE PANEL

1. Intro and opening comments of each panel member – Overview of these issues:
   (a) How has the business changed for developers since GDC 2008?
   (b) Discuss the factors that led to your decision to start-up as an independent studio.
   (c) What unexpected issues confronted each panelist at start-up? Along the way?
   (d) What lessons can be learned from your experience?
   (e) What steps can be taken to adjust for the current business climate?
   (f) How are publishers adjusting in their approach to game dev deals?

B. FORMATION & OPERATIONAL ISSUES FROM PRE-START-UP TO CASH OUT

1. Pre-formation
   Relationship of principals;
   Ownership of collaboratively prepared materials, ideas, tech, designs, trademarks;

2. Formation
   Work with local lawyer;
   Entity selection; state of formation; potential for limiting liability;

risk of piercing veil if formalities not observed; bylaws, operating agreement, shareholder agreements; annual meetings; resolutions; capitalizing the company; issuing stock; legal issues relating to treatment of stock as a security;

3. Financing the start-up; writing a business plan; bootstrap start-up; attracting financing from angels; v.c.'s; what does each expect; restricted or vesting founders' stock; who controls the board?; can you live with that?;

4. Cashing out; structure of acquisition deals; who will buy you?; what can founders and key employees expect?

5. Employee Agreement
Ownership of work product; confidential treatment of information, technology, and assets; moonlighting; restrictive covenant/non-compete; employment at will; enforcement of the foregoing;

6. Employee Ownership; equity
stock options; phantom stock; when is it a good idea; when is it not; vesting schedules; sell-back

7. Policy Manual
Why it is desirable; contents: restatement of at will status of employment; non-discrimination/equal opportunity policies; annual review policies; employee discipline; holiday and leave policies; insurance; other;

8. Management
When is it time to give job titles; create an organizational chart; set up formal reporting structure?

9. Employee Evals and raises
Formalizing the process; annual evals; documenting the process; practices to help avoid claims of discrimination;

10. Insurance:

(a) Why do developer's need insurance?

(i) Risk management considerations: the cost of litigating in the US has risen substantially. Insurance can provide developers and publisher with financial reserves to defend against these claims.

(ii) Contractual requirements: Video Game publishers mitigate the legal costs associated with claims that their games infringe another party's intellectual property by contractually requiring developers to obtain insurance to cover such risks. Insurance provisions are

additional covenants that the developer makes to publisher and failure to obtain coverage can be deemed a breach of contract allowing the publisher to terminate. Insurance provisions require certain types of insurance coverage that cover claims arising out of a breach of the developer's representations and warranties.

(b) How much insurance coverage is required? Insurance coverage typically covers claims up to certain amounts, both "per occurrence" and "in the aggregate." Publishers may require coverage from $1,000,000 to $3,000,000 per occurrence and from $2,000,000 to $5,000,000 aggregate depending on the type of risk. This is the maximum amount the insurance company will reimburse for all claims covered by the policy.

(c) How long should the policy last?

(i) Term of development: Publishers may require coverage from the beginning of development until delivery of the product. Most policies are offered on a yearly basis and require that premiums be paid on an annual basis.

(ii) Post launch obligations: Some publishers may require that the insurance policy cover claims initiated after the launch of the game. Many policies are "Claims Made" policies which only cover claims initiated during the policy term. Developers required to extend the original policy coverage maybe able to obtain "Tail Coverage" which covers claims that accrued during the policy period but were initiated after the policy term ended.

(d) What types of insurance are available?

(i) Property/Casualty: pays for damages to property as a result of various types of common "perils" such as fire or theft. These policies commonly cover the cost of repairing damaged buildings, replacing office furniture and equipment, recovering lost data and may provide operating expenses incurred to continue doing business.

(ii) Commercial General Liability (CGL): pays legal fees and damages resulting from injuries to third parties caused by defective products, errors in performance, damage to personal property or Advertising Injury. Advertising Injury policies cover only a limited range of copyright, trademark and defamation claims related to the developer's advertising. The policies commonly exclude coverage for claims related to intellectual property infringement.

(iii) Workers Compensation: pays for medical costs and lost wages to injured workers. Most US states mandate minimum coverage requirements for employers of certain size.

(iv) Professional Errors & Omissions (E&O): pays legal costs and damages to third parties for liability resulting from negligence in providing services to third parties. This is commonly referred to as "malpractice" insurance.

(v) Intellectual Property E&O: a specialized version of E&O that covers claims made by third parties during the term of the policy for unintentional or negligent errors and omissions that result in a claim for infringement of intellectual property rights. A typical Intellectual Property E&O policy may cover the following:

(1) unintentional breach of contract;

(2) negligent transmission of a virus, Trojan horses etc. ("Malware");

(3) infringement of copyright, trademark, trade dress, trademark dilution, publicity rights, misappropriation;

(4) unfair competition and deceptive business practices;

(5) breach of duty of confidentiality, invasion of privacy, or disclosure of personal information in violation of law; and

(6) Defamation including libel and slander.

(vi) What types of risk do E&O policies not cover? Claims for patent infringement, trade secret infringement intentional or reckless acts, crimes, regulatory penalties, gambling, punitive damages, and claims made prior to the policy term. E&O policies do not cover lost profits or punitive damages

(e) Will getting insurance relieve the developer of all liability? Common representations and warranties in developer contracts require developers to warrant more risk than the E&O policy covers. Developer's risks include patent infringement, regulatory fines for including obscene materials, recalls due to defects or reprogramming related to middleware tools that require free redistribution under an open source license.

(i) Common representations include:

(1) The Game will work on the target platform as designed without defect;

(2) The Game will be wholly original to Developer and will not infringe any third party patent rights, trade secrets, trademarks, copyrights or other propriety rights;

(3) The Game does not contain any defamatory material, viruses and will not violate the publicity or privacy rights of any individuals;

(4) Developer has not previously granted or reserved and will not grant or reserve to any third party any rights in the Game;

(5) Developer has full right to grant the rights granted and nothing contained in this Agreement or in the performance of this Agreement will place Developer in breach of any other contract or obligation;

(6) Developer will comply with all applicable laws and regulations in performing its obligations hereunder;

(7) Developer will obtain any and all approvals, authorizations, consents, licenses necessary to publish the Game.

(ii) Developer indemnification obligations, unless specifically capped in the developer agreement, may not be limited to the insurance policy maximum. Developer's indemnification obligations also survive the term of the developer agreement.

(f) Is insurance available in my country? Common law v. Civil Law jurisdiction.

11. Developer as Publisher's Banker

Getting additional payments, not just day for day extension for publisher delays; how to get paid when publisher refuses to approve or delays approval of milestones; what is the role of the publisher-producer; qualifications and training of producer; who makes publisher decisions; does producer have skill set to manage development; how many producers want to be designers; identifying publisher decision maker; process to approval of payments; what are ramifications if developer stops work because it has not been paid;

12. Use of Open Source: Developer must make reps to publisher for open source utilities or code base that is licensed by author with no reps; how can/should developer take this risk? Who in the audience is using open source? Many dev agreements prohibit it. Many open source tools are licensed under open source licenses that could place a developer in breach of its obligations to a publisher.

    (a) Not all open source will pass muster for use either by the publisher or even by a developer for its own purposes. There are many types of open source licenses, but the principal licenses are the GPL, BDS-type licenses and the Mozilla license and progeny. The General Public License (GPL) is viewed by many as the most radical of these licenses. It requires that software be licensed ***free of charge*** (except for copying costs, consulting fees, etc) ***and that the source code of the software be made available free of charge and be freely modifiable as well***. The GPL further requires that ***any user/licensee must make its program which uses software licensed under the GPL available free of charge in both source code and object code forms, i.e., not only the specific tool licensed under the GPL, but the entire program which used that tool in development***. So choosing the wrong open source could inadvertently require the mandatory redistribution of a game to millions of end users, or require a developer to re-program the code, at its sole expense, to remove the GPL software.

    (b) However, the analysis doesn't end there. The trade-off in using a free-of-charge open source tool (that isn't covered by the GPL) is that the software is licensed without any warranties and disclaims liability. However, a developer gets no free pass from a publisher on this score; a developer assumes the liability to the publisher if there is a claim which relates to the open source tool, e.g. a claim of infringement or a warranty claim relating to the performance of the game (e.g., no bugs, first class work, and that the game works the way the developer told the publisher it would work). So care must be taken in using open source software to use only that which the industry accepts as reliable.

13. Developer compensation tied to game review scores where developer does not control game content.
    Why 80%; what is nature of the game review sites?; who controls decisions that relate to score?; do game ratings impact sales?; is 80% a realistic number given the budget and schedule constraints of the deal?

LUNCH

C. IP PRIMER

1. Formulating an IP business plan is essential regardless of whether you develop casual games, wireless games, ringtones, MMOGs or next gen console games. Should you license middleware or develop proprietary technology? How much time and effort should be invested into pure R&D? How important are original game concepts? Can you grow the value of a company through original IP while feeding at the "work-for-hire" trough?

(a) What intellectual property rights must be considered and who will own or control such rights? What is realistic in today's market? Does retaining IP rights increase the value of your company? If so, which rights?

(i) "Intellectual Property Rights" Defined: Typical contract definition: *"all now known and hereafter known or acquired tangible or intangible (i) rights associated with works of authorship including, without limitation, copyrights (including, but not limited to, ownership rights in all titles, computer code, themes, objects, characters, character names, stories, dialog, catch phrases, locations, concepts, artwork, animation, sounds, musical compositions, audio-visual effects and methods of operation, moral rights and any related documentation) and (where said registrations, renewals and/or extensions exist) copyright registrations, applications, renewals and extensions therefore, moral rights, data base rights, and mask-works, (ii) rights associated with trademarks, service marks, trade names and similar rights, including, without limitation, design rights, and rights in trade dress and packaging, (iii) trade secret rights, (iv) patents, designs, algorithms and patent registrations, applications, renewals and extensions therefore, (v) all other intellectual and industrial property rights of every kind and nature and however designated, whether arising by operation of law, contract, license or otherwise recognized by U.S. law and other applicable foreign and international laws, treaties and conventions, (vi) all registrations, applications, renewals, extensions, continuations, divisions or reissues thereof now or hereafter existing, made, or in force (including any rights in any of the foregoing), and (vii) any and all causes of action arising from or related to any of the foregoing.*

(b) Copyright:

(i) Original works of authorship fixed in a tangible form of expression are protected by copyright. Computer games and video games and other software applications qualify for copyright protection. Copyright vests upon creation and in the U.S., runs for life of the author plus 70 years in the case of individuals, and if such copyrightable work was created as a work for hire (defined below), and is accordingly owned by a company, copyright protection in the U.S. continues for 95 years from 1st publication or 120 years from creation, whichever expires first.

(ii) Work For Hire: Where employees of a company create copyrightable works in the course of their employment, or where independent contractors are commissioned to create or contribute to audio-visual works such as computer or video games, the employer or the party commissioning the

independent contractor is, by law, deemed the author and owner of the copyright interest from the creation of the copyrightable work.

(1) Independent contractor agreements must be in writing specifying that the work they are doing is on a "work-for-hire" basis and the agreement must be signed by the contractor before work commences; otherwise the contractor retains the copyright in his/her work product, and the commissioning party's use of such work product is deemed to be under a license and is terminable by the contractor!

(2) Likewise, development agreements need to recite that the game is considered a work-for-hire; otherwise the publisher won't be deemed the author for copyright purposes.

(iii) Copyright interests are divisible so that in a computer or video game, there can be numerous copyrightable interests.

(1) The most common divisible interests in our industry are tools and technology (retained by developer), game code (transferred by contract from developer to publisher or sometimes to property licensor) and trademarks and characters (transferred by publisher to property licensor, if any). To the extent the parties desire to maintain separate copyright interests, the agreement governing such copyrightable work must expressly provide for such separate interests:

(A) "Owning The Game": this can cover everything from the audio-visual display to the underlying technology if the contract doesn't address ownership of the constituent elements with specificity. For our purposes, the "game" covers the audio-visual display, the story and the characters.

(I) Depending on the kind of game, often there are third parties that license a property to a publisher to create a game and the licensor retains the interest in that property.

(II) Examples: movies, books, and sports games. These types of games are typically referred to as "Licensed Titles".

(III) Sports games based on professional sports or entertainment sports such as wrestling. In the case of professional leagues, publishers get licenses to use team names, logos and other artwork, and player names and likenesses may be licensed from player unions. Using the

example of John Madden Football, there are at least three separate licenses necessary to produce this game: rights must be granted by John Madden to use his name, likeness, and voice; from the National Football League to use the team names, uniforms, stadiums, etc.; and the players union to use the names, likenesses and moves of the players. In addition, any outside music licensed to be in the game must be separately licensed from both the record company and the music publisher. As with movies or books, the publisher will own the "game" but not the licensed properties incorporated in the game.

(IV) Publishers typically own these types of games from the outset and developers who are hired to develop these games do so on a "work-for-hire" basis whereby the publisher is the owner of the copyright in the game. This is distinguished from a game that originates with a development group, and where copyright ownership is the subject of negotiation between the publisher and developer.

(B) Development Technology: this covers the game engine and development tools and utilities used in the development of the game, but which are not "game-specific" and are used in development of multiple titles. Development technology is separately copyrightable.

(I) Commercial Tools: this is a subset covering commercially available third-party tools that are typically licensed for use in game development, e.g., Maya, Studio 3D Max, Unreal, Gamebryo. Publishers and developers enter into limited licenses with the owners of these tools to use these tools in specific games; the licensors of these tools retain the IP ownership.

(II) Proprietary Tools: Ownership or use of a developer's proprietary technology is reserved by Developers, but is always a subject of intense negotiation in development contracts, most notably in two areas: (i) whether new development technology, and/or extensions and improvements of existing development technology developed in the course of development of the game, are reserved by Developer or owned by Publisher; and (ii) the extent of some negotiated form of "non-compete" on using the development technology in games which the parties

agree are "competing games". The length and scope of such non-competes are heavily negotiated and should be carefully scrutinized at the outset.

(c) Ownership of "Original" Titles: where the story and characters and other principal elements of the game originate with the development group.

(i) The developer as the originator/creator/designer of the original title is the copyright owner of the game and I.P. Ownership of the copyright gives the developer the right to produce "derivative works" which includes conversions, sequels, add-ons to the game as well as all ancillary rights (strategy guides, hint books, merchandise, movies and television productions) which also raise questions regarding trademark ownership. But in order to secure the financing necessary to complete development, the issue of ownership of the intellectual property rights will certainly come into play.

(ii) Will the publisher or developer own the "Original Title"? Most publishers will want to own all IP rights in an original IP. They are spending the funds to develop the title and turn it into a franchise/brand; they want to control the right to exploit derivative works. The farther along a game is developed, the more of a developer's own funds are invested in the game before the publishing agreement is signed, the more likely it is that the publisher will get a license to the game rather than outright ownership of the copyright. If the publisher takes over the project when there is only a game design, it is more likely that the publisher will own the copyright.

(iii) Contractual Alternatives to IP Ownership of "Original Titles":

(1) Where developer retains copyright, publisher will insist on options on derivative works and ancillary rights. Such options range from automatic options to rights of negotiation and matching rights.

(2) Where the publisher secures the IP rights to developer's original game as an element of the deal, developers will insist on rights to produce derivative works ranging from automatic options to rights of negotiation and matching rights, and royalties from the exploitation of derivative works, sequels, add-ons, etc. and income generated from exploitation of ancillary rights.

(d) Ownership of IP: Costs and Responsibilities

(i) Representations and Warranties: with ownership of IP come representations that the IP does not infringe on the intellectual property rights of third parties. Parties who retain the IP in a game will be required to make these

representations and stand behind them by indemnifying the publisher from any infringement claims that may arise relating to such property.

(ii) Responsibilities/Self-Protection:

(1) Trademark Searches: for the title of a game and, at a minimum, the names of key characters in the game. Searches cover categories which include video and computer games as well as categories or classes of goods that cover the ancillary rights in a game, i.e., hint books, posters, caps, apparel, other toys and games. Searches must cover these names in these classes of goods and services in the US, Canada, and, at a minimum, major territories around the world (for commercial exploitation and anti-piracy protection.

(2) Game Script clearance: reduces the risk of infringement claims over unlicensed use of logos, signage, actual names, license numbers, works of art.

(3) Music Clearance: reduces the risk of infringement claims over unlicensed use of music, even of samples.

(4) Patent Searches: is it worth it? Knowing infringement can result in triple damages!

(5) Budget for legal and clearance fees associated with these activities.

(6) Insurance: Errors and Omissions policies, professional indemnity policies.

D. PROCESS AND CONTRACTING ISSUES

1. The Development Agreement: Can you ever earn royalties **on next gen deals**? Traditional advance & royalty model? Only if the game is a true "blockbuster". **Profit Share model?** Is it available? Can it emerge as an alternative to advance and recoup deals? Can games recoup? What is the developer left with? Are we moving towards movie-type deals? Is "net profits" participation realistic?

(a) Process – pre-contract

(i) Purpose and role of the Letter of Intent or Term Sheet - What should it cover? Should it be binding or non-binding?

(ii) Prototype and Proof of Technology Contracts – As deals get bigger and bigger, step deals to get to a "green light" make more sense to a publisher

(iii) First payment issues – Will money be paid at "letter of intent stage"? Must contract be signed? Should a developer start work with no contract? Are there any assurances of payment without paper?

(iv) Length of Time to Negotiate the Agreement; how long should it take? Maintaining open lines of communication. What to do during the Negotiation Process. To work or not to work.

(b) Contract Negotiation Issues

(i) Contractual assurances of timely delivery

(1) Key people – how deep into your team should you go?

(2) Exclusivity of key people. Is it necessary for the duration of the project?

(3) On site visits

(4) "Time is of the Essence" – what does it mean; is this ever enforced?

(5) Consequences of late delivery of materials by publisher; or late delivery of code by developer

(ii) Milestone schedules

(1) Payments tied to milestones

(2) Approvals by publisher and manufacturer and the effect of late approval – maintain an internal "tickler" system to keep track of your milestones at the publisher. Understand the process at the publisher. Who has the power to accept/approve the milestone and who does not? Someone in the developer organization must be assigned the responsibility of following milestones through the publisher review and approval process.

(3) Assets to be delivered by publisher (e.g., FMV, cut scenes, music, voice-overs, translations and other localization materials) and the effect of late delivery

(4) Marketing demos. You know they will be requested. These take time and can cause late delivery of game milestones. If they are part of the milestone schedule, they can also be paid for by the publisher.

(5) Special Features – Who provides them? Is it part of the development budget and schedule? Is it a recoupable advance or paid and absorbed by publisher?

(iii) Change order procedure when changes affect delivery dates and cost of development contract – how to document

(iv) Termination

(1) For cause

(2) For convenience – commercial reasons

(A) Payments – kill fees?

(B) Turnaround rights – How long it really takes to set up a project somewhere else and how to hold out for cash for 3 – 4 months.

(3) Effects of Termination – contract rights

(A) Damages

(B) Refund to Publisher

(vi) Payment Issues

(1) Advance vs. royalties vs. flat fee vs. time and materials

(2) Understanding "recoupment" and how it affects when and if you receive royalties.

(3) How to calculate milestone initial payments to avoid back ending fees. It's important to *really* understand your cash flow needs.

(4) Performance Bonuses – recoupable v. non-recoupable – can be based on meeting delivery date or some rating system (metacritic.com, other game sites)

(5) Penalties/liquidated damages for late delivery – are they enforced? enforceable?

(6) Royalties:

(A) Definition of "net sales" – What is being deducted to get from gross to net? What is "standard"? When can this be negotiated? What is included in "cost of goods?" Why are console royalty rates lower than computer software rates? What are Platform Fees? Does the "traditional" model of advance vs. royalty work anymore? Are there alternatives?

(B) escalations and reductions

(C) sublicensing and how it affects royalties

(D) Derivative works: sequels, conversions and add-ons

(I) Done by the original developer

(II) Done by a different developer

(E) Passive royalties for use of content and developer technology in future works

(F) Derivative works outside of software – licensing for television, motion pictures, graphic novels, toys, clothing lines, etc. How does the developer share in this revenue stream? How can you get a better deal from your publisher?

(G) Digital Distribution – How does this affect royalty rates?

(H) Cross-collateralization.

(I) Accounting issues; reserves; liquidation of reserves; audit rights; how and when to audit; who should do your audit.

(vii) Credit

(viii) Non-compete clauses – Are they enforceable? California rules. Can non-solicitation serve as a "stand-in" for non-compete?

(ix) Future Work – Sequels, conversions, add-ons and other projects

(1) Rights of 1st negotiation; last refusal; options based on sales performance. Contrast requiring developer to do sequels and conversions – how to break away from a publisher – developer relationship; Does fighting for these rights add value; or just cash flow?

(2) Options on Next Project – Does this add value?

(x) Reps & Warranties; Indemnification; Limitations on Liability –

(1) Publisher to developer (to cover pub supplied assets, & other)

(2) Developer to publisher (i.p. and others: ratings, hidden content, no viruses, etc.)

(3) Indemnity – "hold harmless" clauses

(4) Limitations on liability – special, consequential, punitive damages

(xi) Insurance requirements – e&o and liability; for how long must coverage be maintained?

(xii) Bugs and Quality Assurance – how long/should a developer warranty for no bugs? For how long should developer fix code for free? Who is ultimately responsible for quality control?

(xiii) "No Raiding"

2. Publisher – Developer Disputes

(a) Causes

(i) Late delivery by both parties

(ii) Technology problems

(iii) Turnover in a publisher PD dept.

(iv) Late or Slow Payments

(v) Business Direction Change at Publisher

(vi) Publisher Acquired / Developer acquired

(vii) "The game isn't fun . . ." and other misadventures in subjective (as opposed to objective) analysis.

(1) How documenting performance during development benefits both parties.

(2) Publisher misrepresentation – "the check's in the mail"; "You'll have your development systems tomorrow," "I know we're late but we still want it WHEN!!??"

(3) Developer misrepresentation – "all features are in"; "we have two teams that can start on this right away"; "we have all rights to use this technology"; "we achieved 40 frames a second in that other product"

(b) Dispute resolution – the four "shuns" -- negotiation, mediation, arbitration, and litigation. Does alternative dispute resolution (ADR) have a future in the games business?

(c) Impact of "choice of law" and "choice of venue" clauses on dispute resolution.

Question and Answer (time permitting).

Hypo for GDC 2009

GameDevCo is a large successful game developer located in Austin, TX.

PubCo is one of the world's largest game publishers, with offices and studios around the world, and headquarters in Paris.

PubCo recently licensed console and computer game rights from LicenseCo, the licensing arm of StudioCo, to a new action/disaster movie, "Elemental Carnage," starring top action star SuperTuff Biff Charles. "Elemental Carnage is in script development, scheduled to begin shooting in October, 2009, and planned for release in theaters in Summer, 2011. Budget for the movie is $110 million. It will be shot in New York, Monte Carlo, Moscow, London, Bermuda, and Rio. The special effects budget alone is $30 million.

PubCo is mindful of the importance of simultaneous release of the game with the movie. It is very aware of the huge hit Electronic Arts took when it was forced to cancel its Dark Knight games in 2008.

Because of its track record developing big action games on time and on-budget, GameDevCo has been identified as a strong candidate for the Xbox360 and PlayStation 3 games based on the movie.

PubCo wants to propose a deal with heavy incentives for GameDevCo to complete work on time, and additional incentives based on the quality of the game, as evidenced by ratings that appear on gamerankings.com.

GameDevCo is generally willing to accept this deal – but has concerns about schedules, timing of, and access to material from the movie that could help in development, approvals process and rights, and GameDevCo's own cash flow needs.

GameDevCo also has another possible deal on the table. PubCo needs to get started pretty quickly if it is to make its deadlines – but can not let itself make a deal it may regret later.

LicenseCo will need to be consulted all along the way – starting with its right to approve the game developer. LicenseCo's management is available by phone as needed.

Can PubCo and GameDevCo make a deal here?