

THE LEGAL DEPARTMENT

How To Be A Rock Star

GUITAR HERO. MY KIDS LOVE IT and your kids probably do too. It's one of the hottest video game franchises around—and one of the loudest. And because of its integration of “classic” rock songs, it's even fun for parents to play. But that enticing aspect of the game led one rock band to court recently to try to stop sales of the game. Its experience is a good opportunity for a litigation lesson.

Activision released *Guitar Hero Encore: Rocks the 80s*, a 1980s version of *Guitar Hero*, in 2007's third quarter. It included the Romantics' song “What I Like About You.” Soon after, the group's current members asked a Michigan court to issue a preliminary injunction to immediately stop sales of the game. The band argued that consumers would be wrongly confused into believing that the current Romantics somehow sponsored or endorsed this particular entry of the *Guitar Hero* franchise, when the truth was the band did not. This, according to their attorneys, entitled the current Romantics to demand monetary damages, despite Activision having obtained a valid “synch” license to reproduce and use “What I Like About You”—a license the band did not dispute. In fact, because the band members had changed since the song was released, they did not claim they owned the song's rights.

Not surprisingly, the court immediately pointed to the synch license and found that the license provided Activision with a valid right to make the recording in the game. Also, there was no evidence of consumer confusion over whether the Romantics endorsed the game. The facts showed no likely deception, and no “likelihood of success” in the band's ability to prove its case—a key factor when asking for a preliminary injunction.

Avoiding harm

The timing of the motion—in the midst of the holiday shopping season—also played into the ruling. The court noted that an injunction that time of year may be especially harmful, since seasonal sales, if not made, can be lost forever. Also, due to the public nature of the case, the court concluded that an injunction could irreparably harm Activision's substantial goodwill and tarnish its reputation. And so, the court denied the injunction.

It may come as a surprise, but usually the law makes sense. If your instinct tells you not to press your case, think hard before hiring a lawyer who tells you differently. It seems difficult to imagine what the Romantics hoped to accomplish, other than grabbing a piece of the *Guitar Hero* pie.

Don't make the same mistake. Knowing when to go after the bad guys, and when not to, will make you the rock star.

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An Historic Shift

Making sense of the toy industry's near future.

By Richard Gottlieb

While in Hong Kong and since returning I have had the opportunity to speak with numerous citizens of the toy industry. I have met with toy company CEOs, presidents and sales managers. I have spoken with Chinese manufacturers. I have talked with buyers, reps, inventors, designers, entrepreneurs, financial analysts and more. In consulting with this cross section of the industry, it becomes apparent that they sense we are in the midst of a fundamental change in how the industry operates. What that change will be, how long it will take to occur and how it will unfold is still unclear. Yet, there is a clear consensus on some things.

Prices are going up

We have, for the last couple of decades, been blessed with low inflation. That is, at least in part, due to America's largest retailers forcing costs downwards. Aiding this has been a Chinese labor force that was so large and so cheap, and a Chinese infrastructure that seemed so unlimited in its capacity, that there seemed to be no bottom to a “lowest price.”

“[Winners] will be the ones who see beyond current means of production, the common wisdom...and the common consensus of what makes up a successful business model.”

The consensus is that this period of history may well be coming to a close. China is experiencing inflation that is now into monthly double digits. Complicating this is an American dollar that is weak and weakening. China is being forced to allow its Yuan to float against the dollar and this makes things cost more.

Complicating all of this is the Chinese government's efforts at closing factories. Concern over safety violations has caused the Chinese to shut down hundreds of toy manufacturers. This will reduce the number of plants available to bid on projects. The fewer the number of bidders, the less leverage buyers have in finding someone to give them yet a lower price.

Most seem to agree that this year's price increases are going to stick and that there may be more coming before the year is over; all despite recessionary or near recessionary economies in the West. In short, consumers are going to have to pay more.

Experienced buyers know they will have to take some price increases. The question will be how high a price increase to accept, whether to walk away from products they deem too high priced, and what to do if faced with additional increases later.

Large retailers who direct import are going to have a leg up in determining what makes sense in a price increase. They know first hand what kind of labor and material cost increases are taking place. That knowledge allows them to determine what is legitimate. Other retailers who use sharp sourcing agents should also be able to gauge what is legitimate.

Who will be at a disadvantage are smaller retailers trying to go it alone. They will need to do their homework by seeking reliable sources of information on Chinese labor and material costs. They will also need

to monitor Chinese inflation and currency exchange rates. In this coming period, failure to accurately assess costs could lead to a retailer having prices that are out of line with the marketplace.

Prices are going to stay up

So far, we have talked about economic forces as they affect price increases. Let's now consider political forces. Due to numerous product recalls, the Chinese government was this year forced to take a hard look at its toy sector and it did not like what it saw.

It perceived Chinese factories as doing anything for an order and when that was not enough, cutting corners. The government sees the root of the problem as Chinese factories caving in to demands from the West, particularly large Western retailers like Wal-Mart.

As a result, the days of China being the bargain basement for the world are coming to a close. The Chinese government is putting pressure on the Chinese toy industry to just say no. They are intent on getting pricing up. They realize that, as of right now, there is nowhere else for toy companies and retailers to go. There is no other single country ready to produce on a volume

level comparable to China.

The consensus is, therefore, that we are now coming into a period of higher retail prices for toys. Whatever is common wisdom about perceived value is going to shift upwards. And retailers and manufacturers will make changes in quality, quantity, size and content in an attempt to mitigate some of the increases. I believe that this will be short-lived and short sighted.

Examples to model

Successful companies will adjust to the new paradigm by creating greater value with less labor and fewer components. They will take advantage of automation and the public's acceptance of virtual value. To get a hint of what is to come, keep your eyes on the success of the video gaming industry and virtual value products like *World of Warcraft* and *Second Life*. Toy manufacturers will need to adapt their offerings to these successful business models and technologies.

As we move through this major paradigm shift, we are going to see winners and losers. Those who win will be the ones who can see beyond current means of production, the common wisdom of what constitutes value, and the common consensus of what makes up a successful business model. Futures will be decided by how smart, how fast, how agile and how forward-looking we all are.

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