LOWENSTEIN SANDLER PC CLIENT ALERT
TECH GROUP

ATTORNEY ADVERTISING

# BARBIE DISCIPLINES A BRAT: PLAYING WITH THE WRONG DOLLS CAN COST $100 MILLION

By David Leit, Esq. and Kathi A Rawnsley, Esq.

September 2008

**In April 2004, Mattel, the well-known toy company with household brands such as Barbie, Hot Wheels, Matchbox and Fisher-Price in its stable, sued a former employee for stealing its designs and helping a competitor. The complaint alleged breach of contract, breach of fiduciary duty, breach of duty of loyalty, as well as unjust enrichment and conversion. By the time the case reached the jury, claims for copyright infringement were also at issue.**

All of these allegations stemmed from the former employee's work for MGA Entertainment, a competing toy company, in the development of the wildly popular "Bratz" line of dolls. Although the initial complaint only named the former employee, MGA got involved soon after the complaint was filed. On August 26, 2008, a jury awarded Mattel a total of $100 million in damages from MGA (the former employee entered into a confidential settlement just before trial began). The appeals will begin shortly, but in the meantime, this "toy story" has important lessons for grown-ups.

The modern American economy is no longer driven primarily by traditional hard assets, manufacturing capabilities, or inventories of material goods. Companies in industries ranging from toys to technology to trucks derive their primary value from the ideas, inventions, and designs of employees and consultants who are hired to come up with the next great thing, whether it is a new doll, a new drug, or a new device. The problem is that ideas and inventions cannot be secured in the way tangible assets can. In the age of the Internet, a disloyal employee can send his or her employer's "secret sauce" to its main competitor with the click of a mouse.

## What can a company do to protect its valuable intangible assets?

Let's first look at this from the perspective of a company in Mattel's position: the company has certain employees and wants to make sure that those employees are creating and designing new ideas and products only for them.

Employers should consider requiring their employees and consultants to enter into an agreement governing confidentiality obligations and invention assignment obligations. These agreements go by different names depending on who is doing the drafting: Non-Disclosure Agreement ("NDA"), Confidentiality Agreement ("CDA"), and Proprietary Inventions and Assignment Agreement ("PIIA") are all common jargon. What matters is not the title but the contents of that agreement. At a minimum, such a document should have provisions covering these issues:

- The employee's employment does not and will not conflict with any other agreement or obligation.
- Anything the employee creates will not infringe on the proprietary rights of any third party.
- The employee will keep the company's confidential information confidential.
- Anything the employee creates will be owned by the company.

Each of the foregoing points contains numerous nuances. To what extent can an employee use ideas he or she has created elsewhere, or on their own? Will an employee be willing to give a broad guarantee that what they create won't violate anybody else's

Lowenstein Sandler
ATTORNEYS AT LAW

rights? How does the company define what information is confidential? How does title pass from the employee to the company? (The answer is different for different types of intellectual property, and varies for employees and consultants.) Which employees should sign these agreements—only key developers of intellectual property, or is there just as much risk that someone in the mail room will take off with the crown jewels?

In specific situations, additional issues may arise:

- If the employee or consultant is working for more than one company, how do you divvy up who owns what?
- Are the employee's "personality rights" important? For example, in certain industries, such as fashion design or video game design, a "rock star" designer who can lend their name to the product is important intellectual property.
- Is the company in a regulated area, such as finance or health care, in which specific protections need to be built in to protect the confidentiality of customer or patient information?
- Are there specific state laws that impact the enforceability of the agreement? (For example, California's Labor Code imposes limits on the types of inventions that can be assigned to an employer.)
- What happens if open source materials are used in an employee's inventions?

Another important tool in the employer's arsenal is a non-competition agreement. These agreements are designed to prevent valuable employees from taking their expertise to another competitor. Non-competition agreements are sometimes built into the nondisclosure and invention assignments agreement, and are sometimes standalone agreements. Non-competition agreements need to be carefully drafted in order to be enforceable. State law varies widely on the enforceability of non-competes. Existing case law guides courts to enforce non-competes that are "reasonable" in their restrictions in terms of the time a non-compete remains in effect, the geographic area in which an employee is forbidden from competing, and the fields of endeavor that are forbidden. Courts generally disfavor enforcing any non-compete that will prevent a person from earning a living in their field. Existing case law is of limited utility in the context of many modern situations. For example, traditional case law calls for non-competes to be limited in geographic scope, but in the Internet economy, an employee can compete from anywhere in the world if he or she has a computer.
This may make larger geographic restrictions more enforceable. On the other hand, given the pace at which the economy now moves, courts may take a stricter view on the amount of time a non-compete can be in effect and still be "reasonable." Non-competes have the greatest chance of being enforced if the former employer is willing to pay the former employee during the non-compete period.

Contracts such as the two suggested here help a company to ensure it holds the rights it needs, and makes it easier to enforce those rights in litigation. The third leg of this stool supporting a company's rights in its intangible assets is a program that reduces the risks of its intellectual property leaving the company. Such a program should be designed to cover the following points:

- A security policy must be implemented that ensures that only employees with a need to know and have access to sensitive information have that access. For example, the formula for Coca-Cola is purportedly known in whole only to a handful of senior Coca-Cola executives.
- Physical measures should be put in place to be sure that inventions don't "walk out the door." Important intellectual property should stay on the company's premises, and not go home at night on employees' laptops.
- IT measures need to be put in place to ensure limited access to key intellectual property.

In the Bratz case, Mattel's principal claims rested on the fact that it had the employee in question sign both a confidentiality and invention assignment agreement and a conflict of interest questionnaire that required him to update his answers if future events required (and thus was somewhat akin to a non-compete agreement). Mattel was able to point to the signed agreements as evidence of the duties owed by the employee to Mattel. Unfortunately, the employee also signed what appeared to be a conflicting agreement with MGA while still employed by and obligated under his agreements with Mattel.
MGA was held liable for aiding and abetting the former Mattel employee in his breach of duties, for intentionally interfering with the contracts Mattel had with the employee, and for copyright infringement.

Now let's look at this from the perspective of the company in MGA's position. How can a company hiring a new employee with a great idea be sure it is not unknowingly "stealing" something that belongs to that employee's former employer? In today's job-hopping, multiple start-up company resume world, almost every company or investor backing a company can envision the nightmare of discovering that an employee or founder developed the key "crown jewel" intellectual property while still employed by a previous employer.

**Indeed, in start-up situations, the founders of the new company often came upon their "eureka" moment while toiling away at some other job, and one of the first challenges of the new company is to ensure that the company has good title to the key intellectual property.**

A common problem we also see in our practice is a start-up company that is moving to the "next stage" in which founders may not play as active a role; as the company outgrows the founders, venture capitalists will often find that there is nothing to document the transfer of intellectual property from the individual founders to the company. This gives the founders a chance to hold up the company for a greater piece of the pie as a financing is taking place.

Some of the things this company can do relate to the same documents we've already discussed: (1) get a guarantee from the key employee that they are not, by working for the new company, violating obligations to another company, (2) get a guarantee that they have title to the intellectual property they create, and (3) get a guarantee that the intellectual property they create will not infringe on anyone else's rights. But these guarantees only go so far. An individual may not understand what obligations he or she still owes to a former employer, or know that their intellectual property is infringing someone else's rights. Moreover, if these guarantees are breached, only the wealthiest individuals will have the financial wherewithal to compensate a company for such breaches.

**The fundamental answer has to lie with good fundamental due diligence. A good venture capitalist, investor, or potential employer must look beyond the statements of a potential new employee and determine when and how the idea or invention came about, and get competent advice regarding the ownership implications.**

A potential new employee should be asked to produce all agreements and policies he or she signed with a former employer, and these must be examined to make an independent determination as to the individual's obligations. A highly talented engineer or designer from a direct competitor brings a risk profile that may require some extra care in the hiring process and some extra work following the hire to ensure that the company avoids allegations of wrong-doing.

In the Bratz case, while the jury is in, the final resolution of the matter is still a ways off. Both sides have declared victory: Mattel has pointed to the unanimous jury verdict finding infringement, breach, and the $100 million award, while MGA has highlighted the fact that Mattel originally sought $1.8 billion in damages, but was only awarded a fraction of the requested amount. Both sides have vowed to appeal the award. In the meantime, observers would be wise to regard this case as an object lesson in the major consequences that can result from a failure to exercise proper care in hiring decisions, in putting proper agreements and procedures in place, and doing thorough due diligence when bringing key employees on board.

*Gina Perez Flynn assisted with the research for this article.*

**David Leit and Kathi Rawnsley are partners in the Tech Group working in the firm's Roseland and Palo Alto offices, respectively. Gina Perez Flynn is counsel to the Tech Group in the firm's Boston office.**

*For more information, please contact:*

**David Leit**
973 597 2340
dleit@lowenstein.com

**Kathi Rawnsley**
650 433 5596
krawnsley@lowenstein.com

**www.lowenstein.com**

**Boston**
One Bowdoin Square
Boston, MA 02114
617 399 5950

**New York**
1251 Avenue of the Americas
New York, NY 10020
212 262 6700

**Palo Alto**
590 Forest Avenue
Palo Alto, CA 94301
650 433 5800

**Roseland**
65 Livingston Avenue
Roseland, NJ 07068
973 597 2500

Lowenstein Sandler
ATTORNEYS AT LAW

© 2008 Lowenstein Sandler PC. In California, Lowenstein Sandler LLP