INDIRECT PROFITS, CAUSALITY, AND PUNITIVE DAMAGES

Michael A. Einhorn, Ph.D.[1]

Imagine that you are a young songwriter and you've just signed a hot music publisher to plug your new work to a number of leading recording artists. Unfortunately, a major car company picks up your song, strips the lyrics, and sets your melody with new words on a new mission -- the promotion of a new sports coupe. They expand the use from website into a national advertising campaign on major broadcast channels, beginning with a well-placed television ad during the Super Bowl. They also register the copyright of the derivative work in their names, thus giving them complete control over your melody in all future uses.

As the commercial reaches international attention, you find that your interesting song is now a ditty hummed by shoppers in every auto mart, but lost irretrievably to you. When you hire an attorney to recover copyright damages, your infringing auto company offers you the sum of $3,000, which their expert presents as a reasonable royalty that covers the licensing revenues (i.e., actual damages) lost by a non-distinguished writer (i.e., you) of an unproven tune. If you had been able first to put the song on a multi-platinum album, life might have been kinder in the cash register, but you still would have earned no more than actual damages. Unless you can get an injunction (now itself an uncertainty[2]) , you are now the proud grantor of a compulsory license for use of you work in an infringement that you may thoroughly detest.

As you had not yet had a chance to register the copyright, you cannot recover statutory damages of $30,000 (or more) that would have otherwise been payable for a willful infringement.[3] This pre-registration requirement for statutory damages is a modern American oddity that was not present in American law before 1975, and now appears in no other major country[4] And without preregistration, you cannot recover attorneys' fees, which can run you about $300,000 for a small case.[5] If you lose your case for any number of reasons (by the way, how good is your musicologist?), you can also expect to pay as the losing party for the defendant's legal costs.[6]

When you finally suggest to your attorney an expert to recover additional defendant profits, you learn the ultimate harsh reality of the present copyright law. While your song was a huge smash and generated considerable interest in the company's advertisements for its new product. it is difficult to prove that the song itself actually generated any discernible level of profits. We have a problem of proving causality in indirect profits. *It is unlikely that you will recover any defendant profits because you cannot prove causality.*

The distinction between direct and indirect profits is critical in copyright law. Direct profits in copyright arise from the sale of any media product that directly bears a reproduction or synchronization of the original work (e.g., record albums or movie soundtracks bearing infringed musical compositions). Indirect profits arise in non-infringing products or performance venues where sales might nonetheless have increased due to copyright infringement in an advertisement, promotion, or related item. For example, when a musical work was infringed in a live Las Vegas review, ticket sales at the event were recoverable as direct profits, while additional earnings earned at the restaurant and hotel were indirect.[7]

Under 17 U.S.C. §504, a court with direct or indirect infringement may award to copyright plaintiffs actual damages (arising from lost sales or licensing opportunities) plus any additional defendant profit not previously take into account.[8] The purpose of defendant disgorgement is clear; "by preventing infringers from obtaining any net profit, [the law] makes any would-be infringer negotiate directly with the owner of a copyright that he wants to use, rather than bypass the market."[9] As additional consideration, a copyright plaintiff may alternatively choose to recover statutory damages ranging from $200 to $150,000, depending on the degree of defendant egregiousness (most importantly, willfulness).

While a plaintiff may collect both actual damages and defendant profits when indirect profits are at issue, the aggrieved must first prove a *causal connection* between the use of the original work and final sales of product –an often arduous task.[10] The standards here have been tightened considerably since the 1980s.[11] Practically speaking, causality is most effectively demonstrated -- through *circumstantial evidence* -- of an infringing use with a nexus to sales that is so secure that is reasonable to infer that the use of the infringed work actually promoted sales.[12]

Once a plaintiff proves causality in any indirect matter, it must then prove – as in a direct profit case – the level of resulting defendant revenues. Defendant in direct and indirect matters must then prove offsetting costs and reasonable procedures for apportioning the relative worth of infringing and noninfringing components.[13] Once causality is proven, the defendant evidently carries a considerably heavier burden.

The demonstration of causality is no small order. In the Fifth Circuit decision of Estate of Vane v. The Fair, Inc.,[14] a distinguished marketing professor[15] showed through a complex linear regression that defendant's television advertising campaign (which made infringing use of a copyrighted visual work) influenced defendant sales. As a component in the advertisement, the infringed work may indeed have helped generate interest in the defendant's product, However, the expert could not prove that the use of the work within the advertisement actually increased defendant revenues. The Court ruled here that "a lump sum figure for profits attributable to the television commercials that contained infringed material as a whole without accounting for the fact that the infringed material constituted only a fraction of the given commercial"[16] presented too speculative a connection to compel disgorgement of defendant profits. That is, sales may have been no less had the infringement not occurred.

The Court in Estate of Vane then allowed plaintiff to recover only the actual damages that it suffered from lost licensing fees. When based on lost licensing fees, this is the amount that the defendant would expectedly have paid anyhow. Thus the defendant lost nothing in the venture, and had the actual possibility of suffering no loss at all if the plaintiff backed off.

Within the present strictures of the common law, many would-be indirect infringers may be counseled then to learn the ropes of an interesting business strategy. Why not **STEAL?**, because the plaintiff will often be able to prove only as actual damages the reasonable royalty amount that would have been paid anyhow. Or perhaps **the injured plaintiff will just GO AWAY.** And if the matter does go to court, settlement will be easy because there may be little real cash on the line.

The proper legal resolution of this copyright quandary might implicate some of the structure in patent law, where courts may set punitive damages up to a triple multiple of actual damages.[17] The critical consideration in enhancing patent awards is the egregiousness of the defendant's conduct.[18] As many as nine considerable factors have been itemized, including defendant willfulness.[19] Considerable discretion is then left to the trier of fact.

The Copyright Act now makes no explicit provision for punitive damages whatsoever. And while some courts have come in recent years to rule that punitive damages are admissible,[20] there is no general concensus that this is allowable.[21]

The legislative course that most easily meets the Constitutional requirement to compensate and thus provide incentives to stimulation the creation of original works (and simultaneously reduce incentives for bad actors) would indeed extend the wording or application of the Copyright Act to allow a copyright plaintiff to recover punitive damages as some multiple of actual damages, at least in those instances where direct defendant profits (i.e., causality) cannot otherwise be proven and disgorged. The statute should also keep in place the plaintiff's current option to recover statutory damages and attorney's fees if the original work is properly registered in the Copyright Office.

While the suggested structure here appears at first blush to be redundant, the envisioned statutory and punitive instruments are designed to achieve two different objectives that are enactive of the Constitutional imprimatur behind copyright. Statutory damages (with attorney's fees) allow plaintiffs the right to seek their imposition at any point in the litigation, and provide in their wider scope for recovery *a general incentive for authors to register their works* to provide to others listings that can facilitate search and proper acquisition. A creator who registers a work then follows a useful incentive that helps rationalize the Copyright system.

But the same statutory structure now provides to infringers loopholes to avoid paying damages and verifiable attorney's fees, and possible incentive to infringe in the gaps. As a legal backstop, punitive domains can be activated to cover a multiple of demonstrated actual damages. This would be left presumably at court discretion, but would reasonably be called into play if direct defendant profits cannot be proven. Courts here may consider matter related to willfulness, failure to prove causality, and general defendant conduct. Punitive damages then are *primarily designed to increase the potential loss than infringers may face, and thus encourage negotiation per the Constitutional objective to stimulate the creation of the arts and sciences.* [22]

With judicial discretion, punitive damages might be most useful in those instances where the infringing work is part of an *advertisement or promotion* that is designed specifically to promote sales of a final product – *conceivably in national or international campaigns* – to the apparent preemption or other despoliation of the market of another copyrighted work. Here, it is quite clear that a musical background in an well-placed advertisement can generate audience interest that advertisers may value highly. For example, after R.E.M. declined from Microsoft the sum of $10 million for use of their composition *It's the End of the World as We Know It (And I Feel Fine)* in a SuperBowl commercial for Windows 95, Microsoft licensed *Start Me Up* from the Rolling Stones for $15 million in the same spot.[23] For its part, U2 contracted in a very lucrative profit-sharing arrangement for the use the song *Vertigo in a commercial for Apple iPod.* [24]

But proving sales causality is another matter. In Cream Records v. Schlitz,[25] owners of movie hit "Theme from Shaft" sued Schlitz after the song was modified and used in a beer commercial on national television. The court in this early case awarded to plaintiffs a percent share of beer sales, which now seems questionable since causality could not be proven. As mentioned, the court in Estate of Vane[26] later declined to disgorge defendant profits in a similar advertising matter after finding lack of causality between the infringing component and product sales. The latter outcome would provide no incentive for infringers to come to negotiation ahead of time.

From an evidentiary standpoint, it is admittedly questionable whether the infringements in Cream Records or Estate of Vane actually increased defendant sales or profits. However, it is also true that both infringements were part of advertisements and thus actually enhanced audience interest. Consequently, a punitive damage award based on a multiple of lost licensing fees would seem to have been a more reasonable outcome in both of these instances, which involve the use of infringing material in a manner that can benefit the infringer and harm the original owner.

By contrast, the need for discretionary punitive enhancement might be more speculative in matters where an infringement purportedly led indirectly to promotion of brand value and goodwill (a more diffuse effect),[27] and to instances where the sale of one infringing product purportedly promoted sales of a non-infringing second sold in the same physical location.[28]

ENDNOTES

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[2]eBay Inc. v. MercExchange L.L.C. 547 U.S. 388, 392-93 (2006). ("this Court has consistently rejected invitations to replace traditional equitable considerations with a rule that an injunction automatically follows a determination that a copyright has been infringed.")

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[3] 17 U.S.C. §412. See also Derek Andrew, Inc. v. Poof Apparel Corp. 528 F. 3d 696 (9th Cir. 2008)

[4]MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT §7.16[C][2], §17.01

[5]AM. INTELL. PROP. LAW ASS'N, 2007 REPORT OF THE ECONOMIC SURVEY 1-100 (2007).

[6] 17 U.S.C. §505.

7Frank Music, infra note 11

8A Circuit Court has also upheld the value of infringer's use as a permissible basis for estimating actual damages, while distinguishing this value from total infringer profits and the list price of the infringer's product. Deltak, Inc., v. Advanced Systems, Inc., 767 F. 2d 357, 361 (7th Cir. 1985).   .

9Taylor v. Meirick, 712 F. 2d 1112, 1120 (7th Cir. 1983).

10Polar Bear Productions Inc. v. Timex Corporation, 384 F. 3d 700, ¶47. (9th Cir. 2004) ("Polar Bear failed to satisfy its antecedent obligation of demonstrating causation.") See also Mackie v. Reiser, 296 F. 3d 909, 915. (9th Cir. 2002) ("There must first be a demonstration that the infringing acts had an effect on profits before the parties can wrangle about apportionment."); Bouchat v. Baltimore Ravens Football Club, Inc., 346 F. 3d 514, 522 (4th Cir. 2003) ("Defendant could properly be awarded summary judgment … if … there exists no conceivable connection between the infringement and [defendant] revenues"); On Davis v. The Gap 246 F. 3d 152, 160 (2d Cir. 2001) (The term 'gross revenue' under the statute means gross revenue reasonably related to the infringement, not unrelated revenues.")

11Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc., 886 F. 2d 1545, 1548 (9th Cir. 1989); Cream Records v. Jos. Schlitz Brewing Co., 754 F. 2d 826, 829 (9th Cir. 1985).

12Andreas v. Volkswagen of America Inc., 336 F. 3d 789, 796 (8th Cir. 2003) ("The [infringing picture] was the centerpiece of a commercial that essentially showed nothing but the IT coupe … We conclude that the jury had enough circumstantial evidence to find that the commercial contributed to profitable introduction of the IT coupe, which shifted the burden to [the defendant] of showing what effect other factors had on its profits.") Lucky Break Wishbone Corp. v. Sears Roebuck and Co., D.C. No. 2:06-cv-00312-TSZ (9th Cir. 2010) ("Lucky Break introduced evidence sufficient to establish causation, specifically that the [infringing] wishbone coupon was redeemed at a rate 42.7% higher than the average rate of bounce-back coupons distributed in December.")

13Id., Andreas. See also Konor Enterprise et al. v. Eagle Publications, 878 F. 2d 138, ¶9. "Once there is a finding of copyright infringement and a demonstration by the plaintiff of the defendant's revenues, the burden shifts to the defendant to prove what portion of its revenue did not result from the infringement."

14849 F. 2d 186; see also Straus v. DVC Worldwide, 484 F. Supp. 2d, 620, 647 (S.D. Tex. 2007).

15Dr. Herbert Lyon of the University of Houston's College of Business.

16Estate of Vane v. The Fair, 849 F. 2d 186, 190

1735 U.S.C. S 284

[18]Rite-Hite Corp. v. Kelley Co., 819 F.2d 1120, 1125-24, 2 USPQ2d 1915, 1919 (Fed.Cir.1987).

[19]Read Corp. v. Portec, Inc., 970 F. 2d 816 (Fed. Circ. 1992)   provides a comprehensive list of factors: (1) whether the infringer deliberately copied the ideas or design of another; (2) whether the infringer, when he knew of the other's patent, investigated the patent and formed a good faith belief that it was invalid or that it was not infringed; (3) the infringer's behavior in the litigation; (4) the infringer's size and financial condition; (5) the closeness of the case; (6) the duration of the misconduct; (7) the remedial action by the infringer; (8) the infringer's motivation for harm; and (9) whether the infringer attempted to conceal its misconduct. Defendant willfulness then is considerable but not determinative.

20TVT Records v. Island Def Jam Music Group 262 F. Supp. 2d 185 (S.D.N.Y. 2003); see also Blanch v. Koons 329 F. Supp. 2d 568 (S.D.N.Y. 2004); Stehrenberger v. R.J. Reynolds Tobacco Holdings, Inc. 335 F. Supp. 2d 466 (S.D.N.Y. 2004).

[21]Richard Posner would write in 2003, "there is no basis in the law for requiring the infringer to give up more than his gain when it exceeds the copyright owners' loss … The statute contains no provision for punitive damages." Bucklew v. Hawkins, Ash, Baptie, & Co. 329 F. 3d 923, 931-32 (7th Cir. 2003).

[22]Supra note 9 and surrounding text.

[23] Barnet D. Wolf, Selling Out, COLUMBUS DISPATCH, Sept. 29, 2002, at 01E.

[24] Chris Ayres, U2 Online Deal Hastens Last Spin for the CD, THE TIMES (U.K.) , Oct. 20, 2004.

25Supra note 6 and surrounding text.

26Supra note 14 and surrounding text.

[27]Polar Bear, supra note 10. There is a distinction here between promoting general goodwill and promoting sales of a product through advertising. See also Business Trends Analysts, Inc. v. Freedonia Group, Inc. 887 F. 2d 399, 404 (2d. Cir. 1989); Rainey v. Wayne State Univ., 26 F. Supp. 2d 963, 971 (E.D. Mich. 1998).

[28]Baltimore Ravens, supra note 10. Court rejected plaintiff recovery of ticket revenues at Baltimore Ravens home games where team sold sweatshirts and hats bearing an infringing drawing as a team logo. Plaintiff attorney did not pursue an independent claim for actual damages.