

## Indirect Profits From Copyright Infringement: Establishing the Connection

By Ryan Bell, JD, and John Pilkinton, MBA, MS

A client calls about a copyright infringement case for which he wants to hire you as a damages expert. He represents the plaintiff in a case involving copyrighted mortgage analysis software that was used without license by the sales staff of a large, regional homebuilder. Because the Copyright Act provides that the “copyright owner is entitled to recover . . . any profits of the infringer that are attributable to the infringement and are not taken into account in computing actual damages,”<sup>1</sup> your client would like you to make this calculation. Of course, when a party seeks to recover an award of the infringer’s profits, the Copyright Act outlines a burden-shifting rule, wherein “the copyright owner is required to present proof only of the infringer’s gross revenue and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.”<sup>2</sup> At first blush, the plaintiff’s calculation of the homebuilder’s unjust enrichment is straightforward.

However, copyright in-fringement cases present some unique challenges for those interested in monetary remedies. When presenting proof of the infringer’s gross revenue, the plaintiff must show a connection between the infringement and the revenue claimed in order to recover an

award of the infringer’s profits. In cases where the infringer has actually sold the copyrighted work, these profits typically have an obvious connection to the alleged infringement. For example, in the case your client outlined, if the defendant had actually sold the mortgage analysis software, the revenue from those sales would be directly connected to the infringement. In cases where the defendant earns profits from using the copyrighted work in conjunction with other products and services—say, for example, using the mortgage analysis software to help sell homes—the link between the infringement and these profits (often called “indirect” profits by the courts) must typically be established, and this is where the damages expert comes in.

When the alleged infringer has used the copyright as some form of advertising, such as a song used in a TV commercial selling cars, establishing the indirect profits is fairly obvious. However, in situations such as where engineering software is used to offer technical advice or financial analysis reports are used to sell economic consulting, profits attributable to the infringement can be more difficult to quantify. The damages expert can assist the finder of fact by providing economic reasoning that establishes a nexus between the infringing conduct and the infringer’s gross revenues.

**Show a connection.** Some defendants have suggested that the only way to show a connection between indirect profits and the infringement is to offer customer testimony that the sale was made *because* of the copyright, or to obtain an admission from the defendants that the copyright was important to its business. Such a stringent hurdle is analogous to the entire

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Article footnotes begin on page 6.

1 17 U.S.C § 504(b). An award of the infringer’s profit is also known as unjust enrichment or disgorgement, under the theory that the alleged infringer has been unjustly enriched by its infringement and that the financial benefits gained from its infringement should be disgorged or removed.

2 17 U.S.C § 504(b).

market value rule that arises in patent litigation, where “the patentee can recover damages based on the value of an entire apparatus containing other features when the patented feature constitutes ‘the basis for customer demand.’”<sup>3</sup> In a number of copyright cases, however, expert testimony has established this connection between indirect profits and the infringement by focusing the scope of the revenue claimed to the revenue that has a demonstrable relationship with the copyrighted work. For example:

- In *Brian Andreas v. Volkswagen of America, Inc.* (336 F.3d 789) (8th Cir. July 21, 2003), an indirect profits case that involved an infringing advertisement for the Audi TT coupe, the court concluded that the copyright owner’s initial burden under §504(b) was met simply by showing Audi’s gross revenue from sales of the TT coupe without including revenue earned from the sale of other Audi automobiles. The court “reject[ed] the notion that [the copyright owner] was required to put a TT buyer on

the stand to testify that she bought the car because of the commercial in order to meet his burden of a causal connection.”

- In *Polar Bear Productions Inc. v. Timex Corp.* (384 F.3d 700) (9th Cir. 2004), Polar Bear claimed a number of different damage elements arising from Timex’s use of a kayaking video as advertising for its “Expedition” line of watches. The court determined that testimony from the plaintiff’s expert witness calculating the approximate profits Timex gained from trade-show sales where the infringing video was prominently shown was sufficient to establish a causal connection. The plaintiff was not required to “put Timex customers on the witness stand to testify that they purchased watches because of Timex’s use of [the copyrighted kayaking] images.”
- The court followed a similar analysis in *Bonner v. Dawson* (404 F.3d 290) (4th Cir. 2005). In that case, an architect sued a builder for infringement of his copyright of a building design. The court held that the copyright owner met his initial burden under §504(b) merely by proving that the builder had made a profit from leasing out space in the infringing building and limiting

3 LaSpaluto, David M., “Reasonable Royalty Damages in the Wake of *Lucent v. Gateway*: Better Guidance or More Confusion?” *Intellectual Property Today*, September 2010.

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the profits sought to those generated from leases in that particular building. The architect did not have to show that the tenants leased space because of the specific design of the structure.

- In *William A. Graham Co. v. Thomas P. Haughey, et al.*, 68 F.3d 425, 442 (3d Cir. 2009) Graham limited its request for damages to the commissions obtained by defendants as a result of the purchase of insurance by clients who had received proposals containing infringing language. According to the court, “In order to satisfy its initial burden of proof, Graham was required to prove only that the profits it sought to recover were ‘reasonably related to the infringement.’”

Some courts have accepted economic analyses as satisfying this initial burden where the expert made an effort to focus the scope of the indirect revenue claimed based on the facts of the case. Indeed, when claiming indirect profits, plaintiffs must often do more than simply point to a defendant’s undifferentiated financial statements. For example, in *Lowry’s Reports, Inc. v. Legg Mason, Inc.* (271 F. Supp. 2d 737) (D. Md., July 10, 2003), although the defendant had used the plaintiff’s stock reports to give advice to its own customers, the plaintiff claimed all of the defendant’s profits from multiple sources, and the court denied the plaintiff’s claim for profits as too speculative. A damages expert can assist the finder of fact by undertaking the accounting and financial investigations sufficient to show that the claimed revenue is reasonably related to the infringement.

**Establish a relationship.** In the present case, a variety of analyses might help the court understand the link between the homebuilder’s revenues and its unauthorized use of the plaintiff’s software. Intellectual property typically affects profits in at least one of three ways: a) it increases or maintains price; b) it increases or maintains volume; or c) it decreases costs. Accordingly, it might be established that the homebuilder was able to up-sell potential home buyers by indicating they could afford more upgrades (i.e.,

increase or maintain pricing). Alternatively, the home-builder might have been able to increase or maintain sales volume if the sales staff used the software to help close sales. If so, a number of questions are raised: Which salespeople used it? How often was it used or how many hours were spent using it? Was the software implemented companywide in the normal course of business or used sporadically by a limited few? Nevertheless, in calculating the homebuilder’s unjust enrichment, focus the scope of revenue claimed to those home sales on which the software was used.

With respect to decreased costs, the magnitude of the defendant’s unjust enrichment might be measured by the costs it avoided by misappropriating the software—subject, of course, to the caveat that cost does not necessarily equate to value. Did the software increase efficiency of current employees, negating the need for more sales staff or more expensive computer programs? There’s always the possibility that, like a hammer used in building a home, the software at issue is a rather fungible tool and the cost of other available and acceptable alternatives indicates the home builder’s unjust enrichment. The cost of acquiring the copyright (or a license thereto) on the open market may also be informative. In the present hypothetical, the plaintiff had not independently sold the software in question, but if it had been sold, the damages analysis would benefit by considering the “observed practice where improvements that lead to cost savings are captured (if at all) in the purchase price of the equipment that yields the savings”<sup>4</sup>

For a plaintiff’s expert, access to the defendant’s sales process may be limited to evidence produced through the discovery process, such as interrogatory responses and deposition testimony. If the circumstances of the case permit, retaining counsel may find it helpful to understand early in the case what kinds of documents and testimony would assist in performing an unjust-enrichment calculation and in establishing

4 Kidder, Douglas, et al., “Reasonable Royalty by the New Rules,” *Dunn on Damages*, Summer 2011, pp. 8-12.

that the claimed revenue is reasonably related to the infringement. These documents could include sales by agent, time records, and commissions paid, as well as deposition testimony regarding the software's actual use by the sales team.

**Profit attributable to infringement .** Thus, upon further reflection, the case presented by your client isn't as straightforward as it might first appear. Indeed, without fair warning, your client may be surprised at the amount of time and effort required to establish a credible claim on the defendant's profits.

Conceptually, quantifying indirect profits is more difficult because the revenue stream is often earned as a result of multiple factors. Even in the most straightforward cases, revenue may be the result of brands, distribution networks, technical features, and other business elements. When profit is earned indirectly from infringement, additional steps exist between the revenue-generating transaction (e.g., the sale of a home) and the copyrighted work. Given that "the infringer is required to prove . . . the elements of profit attributable to factors other than the

copyrighted work,"<sup>5</sup> the plaintiff's expert may be tempted to push the difficult task of allocating value to the infringed work to the defendant. In some contexts, this is also known as apportionment. However, the plaintiff must be mindful of the need to show that the defendant profited from the infringement at all. When profits result from indirect use of a copyright, there is a fine line between the defendant's burden for apportionment and the plaintiff's burden to establish a nexus. The plaintiff must show that there is revenue (or profit) attributable to the infringement; the defendant must then show what profit is attributable to other factors, if any. Keeping this distinction in mind will help set client expectations and assist in offering damages testimony that is helpful to the finder of fact.

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<sup>5</sup> 17 U.S.C § 504(b).