Concern for Causation: Calculating Fair Damages for Indirect Copyright Infringement

BY JOSHUA M. DALTON AND LAWRENCE T. STANLEY JR. OF BINGHAM MCCUTCHEN LLP

Joshua M. Dalton is a partner in the Intellectual Property Litigation and Patent Prosecution group at Bingham McCutchen LLP, resident in the firm's Boston office. He may be reached at josh.dalton@bingham.com.

Lawrence T. Stanley Jr. is an associate in the Intellectual Property Litigation and Patent Prosecution group at Bingham McCutchen LLP, resident in the firm's Boston office. He may be reached at lawrence.stanley@bingham.com.

When the Copyright Act was passed in 1976, the majority of copyrighted works were more traditional literary and artistic works, such as books, musical recordings, and the like. Computer programs were not nearly as common as they are now. Today, computer programs are commonplace, as is their registration as a copyrighted work, including programs which perform important but very utilitarian functions. As with other works, calculating actual damages concerning the direct infringement of software under the Copyright Act, such as copying and redistributing software without authorization, is relatively straightforward.

On the other hand, courts have been challenged in assessing damages where a computer program is only indirectly infringed by use in connection with a larger enterprise (*i.e.*, to facilitate generating a good or offering a service not consisting in whole or part of the copyrighted work itself) in a manner that fairly compensates the copyright holder without generating an unfair windfall. In order to more fairly address such instances of indirect infringement, courts should not take an overly-literal view of the Copyright Act, but rather should focus on the causal connection between the specific work and the success of the enterprise, in part by borrowing the concept of non-infringing alternatives from patent law.

The Copyright Act provides that the copyright holder is entitled to either actual damages or statutory damages for the infringement of a copyrighted work, and where actual damages are sought, also "any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages."[1] Under the classic example, a defendant selling a copyrighted work (such as a photograph or a musical recording) without authorization, this clause of the Copyright Act is easily applied: if the plaintiff foregoes statutory damages, the plaintiff is entitled to its actual damages (*i.e.*, the diminished value of the copyrighted work or what a willing buyer would pay a willing seller) plus any profits of the defendant from the sale that are not taken into account in computing the actual damages.

The damages calculus becomes much more difficult where the defendant generates only "indirect" profits from the infringement. This occurs where a defendant does not sell the copyrighted work itself, but rather uses the work in conjunction with its efforts to generate revenues, such as using a copyrighted painting in a print advertisement, using a copyrighted song in a commercial, or using a copyrighted market research report in rendering financial advice. Importantly, Section 504(b) only permits recovery of those "profits of the infringer that are *attributable to the infringement* . . ."[2] Courts have struggled with determining what standard should apply in indirect profit cases, and as such, have set forth varying levels of proof necessary to show a connection between the infringement and defendant's profits.

Some courts set a low threshold, requiring little more than a showing that the defendant in fact used the copyrighted work in any way in connection with its business activities. For example, in a case before the United States District Court for the Eastern District of Pennsylvania,[3] plaintiff, an insurance brokerage firm, accused defendant of infringing two books containing plaintiff's copyrighted insurance forms and coverage descriptions. Plaintiff sought as defendant's indirect profits all commissions that the defendant was paid when its clients purchased insurance after receiving proposals containing language from the copyrighted forms. The court relied upon the express language of the Copyright Act, which places the burden of apportionment on the infringer, and held that the plaintiff has only a "minimal" burden in establishing a causal connection and that in cases where the profits are attributable to a mix of infringing and non-infringing material, "[e]quity places the burden on the defendant to unravel the threads."[4]

Other courts have required that the plaintiff show as a threshold matter a more robust connection between use of the particular work and defendant's profits. For example, in a case before the United States District Court for the District of Maryland,[5] plaintiff, the publisher of a financial newsletter, accused defendant of making available to its employees copies of plaintiff's newsletter without plaintiff's authorization. On the parties' cross-motions for partial summary judgment, the Court held that although the defendant was liable for copyright infringement, the plaintiff could not pursue claims for indirect profits. The court reasoned:

> Although it seems that some of [the defendant's] profits 'should' relate to its infringing use of [the plaintiff's] Reports, the appearance defies reason . . . . [The plaintiff] has articulated no more than a speculative correlation. It is utterly implausible that all of [the defendant's] profits resulted from its infringing use of the Reports.[6]

Whether profits are "attributable to the infringement" may become murkier when the work at issue is a fungible computer program used to operate a larger enterprise, provide a service, or manufacture a product, but where the end product does not contain the copyrighted work itself in whole or part. Consider, for example, the scenario in which an attorney uses without authorization a copyrighted word processor program in offering legal services. Under the Copyright Act, the plaintiff-copyright holder is entitled to its actual damages, which would likely equate to the lost sale or license fee for the software. But under Section 504(b), the plaintiff is also entitled to defendant's profits "attributable to the infringement." Arguably, all of defendant's profits are "attributable" to the infringement because, strictly speaking, the attorney could not have practiced law without the software. The Copyright Act, however, clearly was not intended to give a copyright holder *all* of the law firm's profits in connection with the infringement of a software program that likely sells for a few hundred dollars.

This problem arises because, under a strict reading of the Copyright Act, once basic causation is shown, the burden shifts to the defendant to apportion what, if any, of its revenue is not attributable to the infringement. A review of caselaw suggests that courts can vary wildly in doing the apportionment analysis, commonly giv-

ing the plaintiff a windfall recovery of more than 20% of defendant's profits, even where the court acknowledges that the copyrighted work had little to do with the profits generated.[7]

In the context of using a software program in a larger enterprise, a literal interpretation of Section 504(b) thus creates an exposure that is vastly out of proportion to the actual value of the software to the larger enterprise, particularly in instances where multiple alternative programs exist that could perform the same function and obtain the same results in the enterprise for little or no additional cost. To avoid unjustified windfalls, there is a need to acknowledge that the value of copyrighted works used in creating a product or service should be tied to the cost of replacing or licensing that work. However, that understanding must be balanced with public policy concerns, namely that the statute cannot make the cost of infringement the same as the cost of compliance, because then there would be no incentive to play by the rules. A more thorough analysis is therefore necessary.

To start, there should be a focus on whether the infringement was innocent/merely negligent or willful. For example, for the infringer who thinks it had a license or went beyond the scope of a license by accident or mere negligence, no amount of punitive damages would have deterred the infringement because the infringer never had an intent to cheat. Furthermore, while increasing damages against a willful infringer will more likely provide a deterrent, it should be recognized that even with willful infringement, the Copyright Act was not meant to create huge windfalls.[8]

Nonetheless, cases acknowledge that, while a windfall is not the intent of the statute, some amount of windfall is likely inevitable once profits are awarded, especially on indirect infringement. As such, whether plaintiff's recovery should stretch to defendant's profits created from using a copyrighted work in a larger enterprise is best addressed at the causation prong. The court's approach in *DaimlerChrysler Services v. National Summit*[9] provides a model for using causation to avoid a disproportionate award. There, the plaintiff alleged that the defendant used its ALAS source code without authorization in connection with financing automobiles and sought defendant's profits. The court rejected plaintiff's broad reading of Section 504(b) and stated that it was persuaded by cases placing a "heightened initial burden" on the copyright holder where profits are indirect:

> To recover [defendant's] profits as provided by Section 504(b), [plaintiff] must do more than merely point to [defendant's] balance sheet. To meet its initial burden, [plaintiff] must 'establish[] a causal nexus between the infringing conduct and the infringer's gross revenue.' ... Clearly, [defendant's] entire gross revenue is not attributable to ALAS source code. It is therefore incumbent upon [plaintiff] to make a threshold showing of the nexus between [defendant] and those profits generated by the infringement of ALAS.[10]

In determining whether a causal nexus has been established, the most striking analogy -- an analogy that courts do not yet appear to rely on -- is the comparison to the non-infringing alternatives analysis in patent law.

One type of damages awarded under the Patent Act is lost profits, which are intended to award the patent owner the profits it would have received "but for" defendant's infringement. It is well-established that one of the threshold inquiries in analyzing lost profits is whether non-infringing alternatives exist.[11] Courts reason that, if a defendant could have accomplished the same thing without infringing the patent, then the value plainly derives from something other than the patented invention. Therefore the existence of non-infringing alternatives lowers, if not defeats outright, the claim to lost profits.[12]

A similar analysis is appropriate in the copyright context. Indeed, although not discussing non-infringing alternatives, the Supreme Court has even acknowledged that "[i]n passing the Copyright Act, the apparent intention of Congress was to assimilate the remedy with respect to the recovery of profits to that already recognized in patent cases."[13] Similar to the patent law analysis, where a copyrighted software program is used to perform a very utilitarian function and is fungible with programs that do not violate the plaintiff's copyright, the defendant's profits are plainly attributable to something besides the protectable elements of the copyrighted work and therefore causation is lacking. Courts should give significant weight to that fact, just as courts give to non-infringing alternatives in the patent law context. In other words, the existence of alternative programs should lower, if not defeat, plaintiff's claim to indirect profits.

Developing a proper framework for analyzing indirect profit claims is all the more important in view of Congress' recently renewed interest in the damages recoverable under the Copyright Act. This past December, representatives in the U.S. House of Representatives introduced a bipartisan bill called the Prioritizing Resources and Organization for Intellectual Property Act, or PRO IP Act.[14] Aims of this now-pending bill include to increase the civil penalties for copyright infringement, boost criminal enforcement, and even create a new federal agency charged with coordinating national and international enforcement efforts to protect intellectual property rights.

In view of these efforts to crackdown on copyright infringement and increase the penalties stemming from copyright infringement, it becomes all the more imperative to ensure that the damages recovered by a copyright holder, particularly actual damages and infringer's profits, actually relate to the copyrighted work itself. The approach advocated here is intended to do just that. While still providing for significant compensation for infringement, by placing a heightened initial burden on the copyright holder to justify reaching a defendant's indirect profits, the approach advocated here will help prevent unjustified windfall recoveries that are not at all related to the value of the copyrighted work itself. IPT

ENDNOTES

1. *See* 17 U.S.C. § 504(b).
2. 17 U.S.C. § 504(b) (emphasis added).
3. *William A. Graham Company v. Haughey*, 2006 U.S. Dist. LEXIS 84736 (E.D. Pa. Nov. 21, 2006)
4. *Id.* at *18.
5. *Lowry's Reports, Inc. v. Legg Mason, Inc.*, 271 F. Supp. 2d 737 (D. Md. 2003)
6. *Id.* at 752.
7. *See, e.g., Bruce v. Weekly World News, Inc.*, 310 F.3d 25 (1st Cir. 2002) (affirming 50% apportionment of defendant's profits where publisher exceeded licensed use of copyrighted photo of President Clinton within magazine and on t-shirts, even though court recognized the significant contribution other non-infringing factors have on profits); *Caffey v. Cook*, 409 F. Supp. 2d 484 (S.D.N.Y. 2006) (where theater production company infringed copyrighted materials by including those materials in the production, court awarded plaintiff 33% of defendant's profits, even though court noted that other substantial factors aside from copyrighted material contributed to success and profits generated and that it would be "unjust" to award all profits from the shows to the copyright holder). *But see Cream Records, Inc. v. Joseph Schlitz Brewing Co.*, 754 F.2d 826 (9th Cir. 1985) (affirming award of 1/10 of 1% of defendant's profits where brewing company used portion of copyrighted song in a commercial created by an advertiser, but commissioned by the brewer, because profits of defendant allocable to the infringement were "miniscule").
8. *See Sheldon v. Metro-Goldwyn Pictures Corp.*, 309 U.S. 390, 399 (1940) ("The purpose [of awarding infringer's profits] is … to provide just compensation for the wrong, not to impose a penalty by giving to the copyright proprietor profits which are not attributable to the infringement.").
9. 2006 U.S. Dist. LEXIS 4282 (E.D. Mich. Jan. 26, 2006)
10. *Id.* 11.
11. *See Panduit Corp. v. Stahlin Bros. Fibre Works, Inc.*, 575 F.2d 1152 (6th Cir. 1978) (non-infringing substitutes considered in lost profits analysis).
12. *Grain Processing v. American Maize-Products*, 185 F.3d 1341, 1351-52 (Fed. Cir. 1999) (holding that "only by comparing the patented invention to its next-best available alternative(s) … can the court discern the market value of the patent owner's exclusive right" and noting cases illustrating that "market sales of an acceptable noninfringing substitute often suffice alone to defeat a case for lost profits").
13. *Sheldon*, 309 U.S. at 400.
14. H.R. 4279.