More Blurred Lines: On Downstream Infringement And The Disgorgement Of Profits

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In copyright, as well as trademark litigation, litigants and finders of fact face the often bewildering task of determining the extent to which downstream infringers—those companies one or more steps removed from the creative work at issue—may have benefited when someone upstream has usurped another's work. Often, the results at trial are contradictory. We first review the history and purpose of the disgorgement remedy, identifying tension in the case law and statutes when the subject turns from competitors to downstream infringers. We look at three well-known cases from the world of recorded music—including the recent Blurred Lines decision—highlighting unexplained differences in the treatment of record companies when songwriters are accused of infringement. We then review our understanding of how firms capture value, and illustrate how that understanding can lend guidance to juries in assessing the profits to be disgorged. Our intent is to help reconcile observed differences in the treatment of downstream infringers.

Premise

Copyright law of the United States grants to rights-holders a number of exclusive rights, including the right to reproduce a protected work, the right to prepare derivative works, the right to distribute copies, and the right to perform, display or broadcast the work, as applicable.[1]

A violation of any of these rights is an act of infringement. Thus, a composer, a performer, and a record company may each be liable for the infringement of a composition; an author, publisher and bookseller for the infringement of a book; a screenwriter, production company and distributor for the infringement of a screenplay; and so on.

The remedies available to a successful plaintiff include a recovery of its own losses (as from an unpaid royalty or fee), as well as a disgorgement of that portion of each defendant's profits that are attributable to the infringement, to the extent such amounts are not duplicative.

The oft-cited purpose of the disgorgement remedy is to guard against efficient infringement. If the infringer is capable of producing or distributing a higher volume of products than the rights-holder, an award of plaintiff's losses may be inadequate to ensure deterrence.[2] Thus the purpose of disgorgement is, at least in part, to ensure that an infringer cannot benefit unfairly from his wrongful act.[3]

Yet the disgorgement remedy is not intended to be punitive. To ensure an equitable, rather than punitive, outcome, the law provides for an apportionment of defendant's profits between those profits derived from the infringement and those derived from other, presumably legitimate, sources. As a matter of form, plaintiff's burden is to establish only the infringer's gross revenue; the infringer must identify deductible expenses as well as any "elements of profit attributable to factors other than the copyrighted work."[4]

A long line of opinions sets forth the logic of apportionment. In copyright applications, the logic derives largely from an opinion written by Judge Learned Hand in *Sheldon v. Metro-Goldwyn Pictures Corp.* in 1939. Defendants had been found liable for infringement of Mr. Sheldon's play Dishonored Lady in connection with their production of the film Letty Lynton. Until that time, it had been the tendency of the courts in copyright cases to avoid difficult disentanglements. Unless

1. 17 U.S.C. § 106.

2. Note that, in some areas of copyright at least, the notion of efficient infringement may be increasingly irrelevant. In the digital age, reproduction and distribution in many media are essentially costless; if demand warrants, a virtually unlimited number of copies of a given recording can be produced without significant capital investment and at zero marginal cost. In such cases, it should be apparent that a difference in the volume of sales between two recordings is logically attributable to factors other than the composition (*i.e.*, fame of the recording artists, marketing, etc.). This, in fact, suggests a useful thought experiment: If the underlying composition was alone responsible for the greater part of the sales and profitability of a given recording, with costless distribution (and assuming otherwise comparable marketing efforts), all recordings of a given song would lead to comparable levels of sales. Of course, such a conclusion is preposterous.

3. See H.R. Rep. No. 1476, 94th Congress, 2d Session 161 (1976).

4. 17 U.S.C. § 106.

the non-infringing elements could be wholly and unambiguously separated from the infringing elements, the courts determined to grant plaintiffs 100 percent of infringers' profits.[5]

In Sheldon, however, Judge Hand could not bring himself to award plaintiff all of the defendant's profits, given that the success of the film clearly derived from factors other than the script. Ruling for the Second Circuit, Judge Hand opined that it would be "nearly as unfair to cast the infringer for all the profits, as it would be to deny the patentee or author any recovery whatever, because he could not separate his contribution."[6]

The Supreme Court affirmed:

> [W]e perceive no ground for saying that in awarding profits to the copyright proprietor as a means of compensation, the court may make an award of profits which have been shown not to be due to the infringement. That would be not to do equity but to inflict an unauthorized penalty. [7]

"Equity," the Court continued, "is concerned with making a fair apportionment so that neither party will have what justly belongs to the other."[8]

Thus we arrive at the two sometimes competing principles that define a disgorgement analysis: to provide a remedy that is sufficient to ensure that the infringer does not benefit from a wrongful act, but not so far as to impose a penalty.

While simple in concept, the task of apportioning profits often proves difficult in practice:

> The simplicity [of § 504(b)] masks fiendish difficulties concerning the calculation of those two amounts, however; and given the remarkable breadth of works eligible for copyright protection, and the numerosity of variables involved in determining loss and gain under each scenario, the experience of copyright damages has been one of case-by-case assessment of the factors involved, rather than application of hard and fast rules.[9]

Such is the difficulty of apportioning profits that courts and juries have sometimes reached widely divergent opinions even in cases with largely similar claims—acutely so when attention turns from a direct competitor of plaintiff to a downstream infringer.

A review of the awards granted in copyright cases suggests a tendency on the part of juries, courts and litigants to overlook systematic differences in how contributors to a finished product—*e.g.*, a recording of a song or a completed motion picture—capture profit associated with an underlying work.

In this article, we begin with a discussion of three well-known cases in which defendants were found liable for infringement of a musical composition, focusing on the treatment by the court or jury not of the composer defendants, but of the companies that manufactured and distributed a recording of a performance of the resulting composition—*i.e.*, the record companies.

Three Cases

In the recent Blurred Lines case, styled *Williams v. Bridgeport Music, Inc.*, defendants Pharrell Williams and Robin Thicke were accused of plagiarizing musical elements of the Marvin Gaye tune *Got to Give It Up*. (In fact, Williams and Thicke initiated the suit, seeking declaratory judgment of non-infringement; the Gaye parties countersued.) The jury sided with the Gaye family, awarding amounts that included both a recovery of their losses and a disgorgement of a portion of defendants' profits. Specifically, the jury awarded the Gaye parties (1) $4,000,000 in actual losses (later remitted to $3.19 million), ostensibly representing 50 percent of the publishing royalties—*i.e.*, the royalties earned on the composition, as opposed to the performance—earned by Williams and Thicke; and (2) disgorgement of $1.61 million in profits earned by Williams (later remitted to $358,000) and $1.77 million in profits earned by Thicke, ostensibly representing 40 percent of their producer and artist royalties—*i.e.*, from the performance and recording of the song.[10]

5. See *e.g.*, *Callaghan v. Myers*, 128 U.S. 617, 666 (1888); *Belford v. Scribner*, 144 U.S. 488, 508 (1892).

6. *Sheldon v. Metro-Goldwyn Pictures Corp.*, 106 F.2d 45, 49 (2d Cir. N.Y. 1939), aff'd, 309 U.S. 390 (1940).

7. Sheldon, 309 U.S. at 405.

8. Sheldon, 309 U.S. at 408–409 (1940). See also *Bucklew v. Hawkins, Ash, Baptie & Co.*, LLP, 329 F.3d 923, 931 (7th Cir. 2003) ("But 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. Such a requirement would add a punitive as distinct from a restitutionary element to copyright damages . . . ."); Nimmer on Copyright, § 14.03[D], pp. 14-58–14-59 ("It is to be noted that the Supreme Court approved such apportionment, even where the infringement was deliberate, given that the purpose of awarding profits is to provide just compensation for the wrong, and not to impose a penalty.").

9. *Walker v. Forbes, Inc.*, 28 F.3d 409, 412 (4th Cir. S.C. 1994). Although no longer relevant since patent law no longer provides for disgorgement of defendant's profits, courts in patent cases have also found apportionment a challenge. See,*e.g., Bush & Lane Piano Co. v. Becker Bros.*, 234 F.79, 82 (2d Cir. 1916): "Impediments to recovery of both damages and profits have arisen, not so much from difficulty in ascertaining in what the infringing thing or article consisted, as in assigning to that infringement any particular or specified portion of the gains made or prevented by a defendant's wrongdoing."

10. See *Williams v. Bridgeport Music, Inc.*, 2015 U.S. Dist. LEXIS 97262 (C.D. Cal. July 14, 2015).

The jury initially found the other co-defendants, including the record company defendants, not liable for infringement. Following post-trial hearings, however, the court found this verdict clearly in error and reversed, reasoning that the record companies had engaged in reproduction and distribution of a work the jury had deemed to infringe, and thus were "necessarily liable for infringement as a matter of law." Because defendants in a copyright action share joint and several liability for plaintiff's actual loss, the court's decision put the record company defendants ostensibly back on the hook for a share of the initial $3.19 million portion of the award.[11]

The court did not, however, (or perhaps could not, given the jury's decision) directly award any portion of the record company's profits from their reproduction and distribution of the Williams-Thicke recording.

Let's compare that result to two other well-known cases, both involving infringement of a composition and subsequent performance by a popular musician.

The first is *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, in which former Beatle George Harrison was accused of plagiarizing musical elements of the Ronald Mack song *He's So Fine*, a hit for The Chiffons in 1963, for Harrison's composition *My Sweet Lord.* Following a particularly tortured litigation, the court settled on an award that apparently included only a disgorgement of profits and no consideration of plaintiffs' actual losses. Notably, the court reduced the considerable fame and reputation of Mr. Harrison, together with all other factors involved in his recording of *My Sweet Lord*, to just 25 percent, awarding 75 percent to the tune on which it was based:

> Although this is not an area susceptible to precise measurement, I conclude that three-fourths of 'My Sweet Lord's' success is due to the plagiarized tune and one-fourth to other factors, such as the works and popularity and stature of George Harrison in this particular field of music.[12]

While we might pause to quibble with the court's apportionment—if the purportedly purloined melody were so instrumental to the popularity of *My Sweet Lord*, why hadn't Billy Preston's earlier recording of the same song been at least three-fourths as popular as Mr. Harrison's?—our purpose is to reflect upon the disgorgement of profits earned by the downstream infringers.

According to the court, the earnings being apportioned derived "from four principal sources: mechanical royalties, performance royalties, the sale of sheet music and folios, and the profits of Apple Records, Inc., the Harrison-owned manufacturer of the principal recordings of 'My Sweet Lord'."[13]

Notably absent from the above calculus was the U.S. record company, Capitol Records, which was apparently never named as a defendant, as well as producer Phil Spector. It should be noted that while Apple Records was the nominal "record label" for *My Sweet Lord*, Apple was not the "manufacturer," as the court describes. Apple had no independent manufacturing or distribution capability; it simply earned a "spread" on the manufacturing cost, presumably owing to its association with the Beatles and Mr. Harrison. Separate divisions of Capitol Records manufactured and distributed the physical copies of the record.

The third case we consider is *Three Boys Music Corp. v. Bolton*, in which singer-songwriter Michael Bolton was accused of infringement by the Isley Brothers in connection with his song *Love Is a Wonderful Thing.* The jury in that case awarded plaintiffs 66 percent of the profits from commercial uses of the song and 28 percent of the profits from the sale of the album, applied equally to all revenue streams, and applied equally to credited songwriters Bolton and Andrew Goldmark, as well as to the record company, Sony Music Entertainment.[14] Again, plaintiffs' losses do not appear to have been at issue.

Three remarkably similar cases, and, with respect to the record companies involved, three remarkably different results: in *Blurred Lines,* although the jury made a reasoned distinction between the profits attributable to the composition and the profits attributable to the performance by Williams and Thicke, the record company defendants were never ordered to disgorge a portion of their profits; in *Three Boys*, record company Sony was ordered to disgorge profits in the same proportion as the accused composers, Bolton and Goldmark, with no distinction between the profits attributable to the composition and those attributable to the recording; in *Harrisongs*, manufacturer and distributor Capitol Records were never named.

Discussion

The profit a composer earns from writing a song and the profit earned by a record company from a recording of that song derive from wholly separate efforts, and therefore differ on both a conceptual basis and an absolute or marginal basis. The economic substance of the

11. On rehearing, the court also granted a running royalty of 50 percent of the songwriter and publishing revenue, but this did not implicate the record company defendants, who do not as a rule share in composer royalties.

12. *ABKCO Music, Inc. v. Harrisongs Music, Ltd.*, 508 F. Supp. 798, 801 (S.D.N.Y. 1981).

13. Id. at 799–800 (citations omitted).

14. See *Three Boys Music Corp. v. Bolton*, 1996 U.S. Dist. LEXIS 22960, 3-4, 6-8 (C.D. Cal. Dec. 3, 1996).

two acts—composition, on the one hand, and recording, production and distribution on the other—differs in ways that can and should require substantively different measurement.

In this section, we examine value systems—how firms capture value as goods and services move from their raw state to finished products. We discuss infringement at various points in that system, and highlight instances in which an award of an infringer's profits in any amount may be unreasonable.

1. What is a Value System?

To understand the value derived from an act of creation (or infringement), it is helpful to understand how value is captured by a firm.

Each firm can be thought of as a collection of systems and subsystems, each with inputs, transformational processes, and outputs. Each such *value chain* fundamentally involves the acquisition and consumption of resources—money, labor, raw materials, and so on. How these steps are accomplished ultimately determines the firm's profitability.

Discrete value chains aggregate into a value system, which refers to the entire process by which an industry transforms raw materials into final, finished goods. Note that *raw materials* may refer to labor, information, or ideas, as well as to physical goods.

A value system may comprise one or several firms—firms that collect raw materials, firms that process raw materials into intermediate goods, firms that manufacture finished goods, and firms that distribute finished goods to consumers or end users. A simple example might include a farm, a food manufacturer, and a grocery store, which combine to produce, say, a granola bar or cereal. In recorded music, the parallel would include a composer and lyricist, one or more performers, a producer, a recording studio, a manufacturer (assuming physical media are involved), a distributor, and one or more consumer outlets.

Later stages in a value system—that is, those stages closest to the delivery of a finished good—are said to be *downstream*; earlier stages are *upstream*. Of course, a single firm can occupy more than one part of the value system; we call such firms *vertically integrated*.

Critically, to at least a first approximation, each firm in a given value system captures the profit derived from its contribution to the finished product. Put somewhat differently, a firm captures value through some positive transformation of its inputs—and not from prior or subsequent transformations.

The specific rights that define copyright—reproduction, transformation, distribution, and performance (or broadcast or display)—also describe stages in a value system. While all may be equivalent with respect to liability, each is not equivalent with respect to the economic value captured—or contributed—by individual firms along the value system.

2. Who Captures the Value of an Innovation?

Imagine a Company A, which introduces an innovation somewhere along its value chain. Note that an innovation can derive from any feature of a given product (or the product itself), including those that are protectable by copyright, trademark, trade secret, or patent.

An innovation can lead to an increase in the volume a firm is able to produce, a decrease in its cost of production, an increase in the price it is able to charge its customers or the volume its customers demand, or some combination. For this illustration, we imagine an innovation that leads to an increase in price for a given quantity demanded.

A downstream firm, Company B, may pay the higher price if it believes it can pass along that cost to its customers. Company B's contribution to the finished product may also be enhanced in some way by Company A's innovation, such that Company B is able to increase its price beyond the increase in its cost; it is equally possible that Company A's innovation will have no effect on Company B's profitability. In other words, in a normally functioning market, an innovator can—and often does—capture all of the value its innovation provides. Moreover, in economic terms, it is perfectly reasonable that it do so.

It is worth pausing to note that the *only* way in which Company B can profit from an innovation introduced by an upstream firm is through (1) an increase in its gross profit per unit (*i.e.*, a decrease in its costs or an increase in the price it is able to charge its customers); or (2) an increase in its volume of sales. If neither of the above occurs, then Company A has captured the entire value of its innovation, and Company B's profits are unchanged.

3. Who Captures Value from Infringement?

Now assume a Company X, which copies the innovation of Company A. Company X enjoys the same increase in price as Company A and thus clearly captures a benefit from its act of infringement. The incremental profit of Company X, therefore, to the extent it does not duplicate Company A's losses, would presumably be subject to disgorgement.

But what of our downstream company, Company B? Under the law, if Company B purchases its input (the infringing good) from Company X, transforms it in some way, or simply distributes the finished good to others, it has committed an act of infringement.

To assume that it has gained some advantage in doing so, however, is unwarranted. It may be, of course, that Company B has purchased the infringing good at a discount, in which case it will have benefited from the infringement even if it was ignorant of it (and arguably negligent). It may also be that Companies B and X will

be found to have colluded in the infringement, at prices and in a manner that benefit both.

But if it can be shown that Company B has paid the same price to Company X (including a royalty, if any) that it would have paid to Company A, and if it has sold the same quantity of finished goods and charged the same price, then as a matter of simple logic there can be no incremental profit to disgorge. No advantage has been gained by the infringement.

This points us to an important distinction between the infringement of a direct competitor and the infringement of any downstream firm: Company X, through infringement, seeks to *capture* the royalty, fee, or profits that rightfully belong to Company A; Company B benefits (if it benefits at all) by *avoiding* payment of a royalty or fee or an increase in the costs it would otherwise incur.

4. Blurred Lines Redux

A challenge to the above line of reasoning can be introduced with a single question—the very first question, in fact, posed by counsel for the Gaye parties on cross-examination of the record companies' apportionment expert in *Blurred Lines*:

> Q. Are you truly telling us that music doesn't sell a song?[15]

The question is compelling but misleading. Record companies don't sell songs; they sell *recordings* of *performances* of songs. The distinction is important: Even if the acts of performance, reproduction, and distribution are themselves violations of the Gaye's copyright, the economic implications of those actions differ substantially from the economic implications of the infringement by Williams and Thicke as composers, just as in the hypothetical examples discussed above.

In a further distraction, a few moments later, counsel for the Gaye parties posed a question in which he imagined that the alternative to a recording of *Blurred Lines* was a recording of silence:

> Q. Let me ask you this question . . . . Other than dead silence and a picture of Robin Thicke, what would the sound recording owner of *Blurred Lines* own if there was no song in the sound recording?[16]

Counsel's question is again misleading. The alternative for the record companies was to distribute a recording of Williams and Thicke performing a *non-infringing* song. To assume otherwise necessarily reduces the contributions of the performers, producers, engineers, and marketers to zero. Counsel's question would lead the expert to measure the value of a *song*—as if it were the only song in existence—not the value of Mr. Gaye's specific contribution to that particular song.

The question before the finder of fact is the incremental benefit gained by the infringer *"over what he would have had in using other means then open to the public and adequate to enable him to obtain an equally beneficial result."*[17] The obvious alternative for the record company defendants was to distribute a recording of Williams and Thicke performing Mr. Gaye's original song—which they had every right to do.[18]

Our task is to understand how the record companies' profits would have differed had that been the case. Did the record companies *capture* royalties, fees, or profits that rightfully belong to the Gaye parties? Demonstrably, no. Did they avoid payment of royalties or fees or any other increase in cost? No, they paid Williams and Thicke for their work on the recording of the song; they paid mechanical and synch royalties for the composition as required and at prevailing rates. On these straightforward facts, it appears that the record company defendants earned no incremental benefit from Williams' and Thicke's misappropriation of Mr. Gaye's musical ideas.

That is not to say that the profits of record companies are never enhanced by particularly successful compositions. A popular song can drive sales of albums and compilations on which the song appears, and in each of the above cases the finder of fact wrestled with the challenge of distinguishing the profits of a song from the contribution of the song to the profits of an album.

In our view, that effort was misguided. The music industry has set its royalty rates across transactions involving many thousands of composers and their representatives and across many millions of songs and recordings. Such rates capture the market's well-settled opinion as to the value of a composition to the profits of a record company, including the effect on album sales of a particularly popular song. It is certainly not the case that composers earn royalties on sales of songs they did not

15. Rep's Tr. of Trial Proceedings, May 4, 2015, p.m. session, at 52:9, *Williams v. Bridgeport*.

16. *Id*. at 58:13–16.

17. *Sheldon,* 309 U.S. at 400, quoting *Tilghman v. Proctor*, 125 U.S. 136, 146 (1888) ("'The infringer is liable for actual, not for possible, gains. The profits, therefore, which he must account for, are not those which he might reasonably have made, but those which he did make, by the use of the plaintiff's invention; or, in other words, the fruits of the advantage which he derived from the use of that invention over what he would have had in using other means then open to the public and adequate to enable him to obtain an equally beneficial result. If there was no such advantage in his use of the plaintiff's invention, there can be no decree for profits, and the plaintiff's only remedy is by an action at law for damages.'").

18. A particular feature of music copyright is that the rights holder retains the right to distribute a recording of the song for the first instance only, after which anyone can record a performance of the song under a compulsory license (subject to required notice and payment of royalties). See 17 U.S.C. § 115.

write. Thus a disgorgement of the incremental profits earned by record companies on album sales satisfies neither of the stated purposes of the disgorgement remedy—namely, to ensure that the infringer does not benefit unfairly from his wrongful act (again, the record company's profits are unchanged) and to ensure that neither party will have "what justly belongs to the other."

In the normal course of business, a songwriter does not earn profits from recordings and distribution of his song other than through the royalty and other compensation systems already in place (unless of course he produces and distributes the recording himself). Disgorgement of downstream profits introduces the possibility—indeed the likelihood—that a copyright holder can earn far more through litigation than he can through his own reasonable exploitation of his work.

This is the fundamental tension between the definition of infringement and the disgorgement remedy—when applied to a direct competitor, the disgorgement remedy properly guards against efficient infringement; when applied to firms at other points in the value system, it risks awarding plaintiff a windfall of profits he or she would never earn in a normally functioning market.

Conclusion

Although it was the product of a tangled jury verdict and subsequent corrections by the court, the result in Blurred Lines appears to have been the right one, at least with respect to the record companies. By focusing first on the harm to plaintiffs, for which the record companies shared joint and several liability, the final award established some initially equitable result with respect to the losses incurred by the Gaye parties. And—although it was apparently not the express intent of either the jury or the court—the conclusion reached correctly reflects that the record companies earned no incremental profit relative to what they would have earned from their marketing and distribution of the next best alternative—a recording by Williams and Thicke of Mr. Gaye's original song.

Coursing through the courts at any given time are numerous cases in which plaintiffs seek disgorgement of profits from downstream infringers with far deeper pockets. Given that the law requires a plaintiff to identify only those revenues attributable to the infringement (and plaintiffs are given considerable leeway even in that simple step), downstream defendants are left with the burden of demonstrating to often dubious finders of fact why and how their profits have not been enhanced by upstream acts of infringement.

Of course, not all such cases involve established royalty systems. In the absence of such a system, the first questions asked of each downstream infringer should be whether (1) gross profit per unit was enhanced (as through collusion or the avoidance of some rightful payment) or (2) the volume of sales was enhanced. If it can be shown that the defendant sold the same number of units at the same gross profit per unit, the conclusion that no incremental profit has been earned should be manifest. Attention then should rightfully return to the profits of the infringer who first copied plaintiff's work, as well as to plaintiff's legitimate losses. ■

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