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Awarding Profits in Trademark Infringement Cases Made Easier

Product counterfeiting has become an increasingly sophisticated and profitable business. While in the past counterfeiting was typified by street peddlers and flea market vendors, today's counterfeiters produce high-quality imitations, then insert them into the "secondary" or "gray goods" market, where they are resold by middle-persons to discount stores and chains.

These high-quality fakes are then offered to the public for substantial sums —a famous brand handbag retailing for $600 might sell for $400 at a discount chain.

What remedies does a trademark owner have when such a counterfeiting operation is discovered? Discount stores will always claim to be innocent victims of counterfeiting—who, so they aver, were also fooled by the high quality and high prices. Given their relatively established natures, they stand a good chance of avoiding a finding of willful infringement.

In the past, this may have left the trademark owner with little recourse.[1] Recent case law, however, has made monetary remedies easier to achieve —even absent a finding of willful infringement.

The recent U.S. District Court for the Southern District of New York decision in *Nike Inc. v. Top Brand Co. Ltd.*[2] has held that the prior U.S. Court of Appeals for the Second Circuit rule in trademark cases requiring a showing of willful infringement for an award of an infringer's profit is no longer good law and has in effect been overturned by Congress. According to

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District Judge Kimba Wood's decision, the 1999 amendments to the Lanham Act mean that willfulness is no longer a prerequisite to an award of profits. However, willfulness remains an important equitable factor to be considered. Procedurally, it remains unclear whether a trademark plaintiff can recover such an award on summary judgment, or whether the issue of willfulness will always necessitate a trial.

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History of Willfulness Rule

• ***The 'George Basch' Decision.*** Section 35(a) of the Lanham Act, codified at 15 USC §1117(a), originally provided as follows:

> When a violation of any right of the registrant of a mark registered in the Patent and Trademark Office or a violation under §43(a) of this title shall have been established in any civil action arising under this chapter, the plaintiff shall be entitled, subject to the provisions of §§29 and 32 of this title, and subject to the principles of equity, to recover (1) defendant's profits, (2) any damages sustained by the plaintiff, and (3) the costs of the action.

On its face, there is no willfulness requirement to such an award. The Second Circuit's 1992 decision in *George Basch Co. Inc. v. Blue Coral, Inc.*[3] reviewed the history of such awards under the common law and Lanham Act. Based largely on the then-draft Restatement of Unfair Competition, the Second Circuit adopted a per se rule requiring a showing of willful infringement before any award of profits. Since the statute makes an award "subject to the principles of equity," the Second Circuit reasoned that, absent willfulness, there was no equitable basis for such an award, and that awarding profits could create a windfall to the plaintiff.

The *George Basch* rule has met mixed reviews. Some circuits, notably the Third, adhered to the per se rule; others completely rejected it as a requirement; still others adopted the rule only in certain types of cases. The most notable rejection of this rule is Judge Richard Posner's opinion in *Louis Vuitton v. Lee*:

> But the principles of equity referred to in §[35(a)] do not in our view justify withholding all monetary relief from the victim of a trademark infringement merely because the infringement was innocent. As between the "innocent" infringer who seeks to get off scot-free, and the innocent infringed who has neither engaged in any inequitable

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conduct nor sought treble damages or treble profits (or indeed any part of the defendant's profits that is attributable to the defendant's superior efficiency rather than to the plaintiff's trademark), the stronger equity is with the innocent infringed. That clearly is the case here with regard to the untrebled component of the relief sought.

* * *

[A] plaintiff is entitled at the very least either to simple damages or to the defendants' profits. "Equity" is not a roving commission to redistribute wealth from large companies to small ones. The Lanham Act was not written by Robin Hood.[4]

The 1999 Amendments

In 1999, Congress, on two separate occasions, added two new causes of action to §43 of the Lanham Act: §43(c) created a federal tort of trademark dilution; §43(d) created a federal tort of cybersquatting. The bill creating the dilution tort also included an amendment to the monetary remedies section, i.e., §35(a), which was amended to read that damages and profits could be awarded for "a violation under §43(a) of this title, or a willful violation under §43(c) of this title."[5] By adopting an express willfulness requirement into the statute for the new federal tort of dilution, Congress implicitly indicated that it is not needed for other Lanham Act causes of action.

Then, later that year, when cybersquatting was added as §43(d), §35(a) was again amended to read: "a violation under §43(a), (c), or (d) of this title, or a willful violation under §43(c) of this title…."[6] The inclusion of subsection (c) in the first, nonwillful portion was apparently in error; in 2002 the "(c)" was removed.[7] The statute now permits an award of damages and profits where there is a violation of "any right of the registrant of a mark registered in the Patent and Trademark Office [i.e., infringement of registered trademarks], a violation under §43(a) or (d) of this title, or willful violation under §43(c) of this title." 15 USC §1117(a).

A plain-language analysis of the statute and the amendments indicates that Congress did not enact a willfulness requirement until it did so for dilution claims in 1999. Other claims—registered trademark infringement, unregistered trademark infringement under §43(a) and the new cybersquatting tort under §43(d), should not and never did require willfulness.

Fifth and Third Circuits

Since the 1999 amendments, two circuits have considered the *George Basch* rule and have rejected it, primarily on plain-language grounds. The U.S. Court of Appeals for the Fifth Circuit in 2003 rejected a per se willfulness rule and, instead, adhered to prior circuit precedent which looks to a six-factor test.[8] Even more notably, earlier this year, the U.S. Court of Appeals for the Third Circuit in *Banjo Buddies, Inc. v. Renosky*[9] overturned prior Third Circuit precedent that had adopted such a rule and instead adopted the Fifth Circuit's six-factor test.

Suppose an infringer sells counterfeit goods believing them, in good faith, to be real, as defendants in 'Nike' claim. Is that "palming off," albeit in good faith?

'Nike' Decision

The *Nike* case involved the famous sportswear manufacturer (along with co-plaintiff Adidas), who sued a multitude of infringers who had sold goods bearing counterfeits of various registered trademarks. Some defendants defaulted, others contested the plaintiffs' summary judgment motions.

After reviewing the relevant statutory history, Judge Wood held that the Third and Fifth circuits were correct and that, in effect, Congress has overruled the Second Circuit's *George Basch* rule. Notably, Judge Wood rejected an earlier holding of District Judge Denise Cote in a 2004 decision which held that *George Basch* was still good law because "it is presumed that incorporation of the prior language as to §43(a) incorporates the existing judicial interpretation of that language."[10] But, as Judge Wood pointed out in *Nike*, prior to the 1999 Amendments the circuits were seriously split about the *George Basch* rule. "Thus, there was no clear judicial consensus for Congress to incorporate when it enacted the 1999 Amendment."[11]

Standards on Profit Awards

One could understand the statutory phrase "subject to the principals of equity" as meaning no more than that a monetary award is subject to equitable defenses, such as laches, estoppel and unclean hands.[12] Federal courts seem to be unanimous in rejecting that reading—an award of an infringer's profits is not automatic but is subject to equitable discretion on the facts of the case. This doctrine traces back at least to the Supreme Court's decision in *Champion Spark Plug Co. v. Sanders*, 331 US 125, 131-32 (1947), where the Supreme Court upheld denial of an accounting because an injunction alone would "satisfy the equities of the case."

How should a court determine whether a profits award is "equitable"? As noted, the Fifth Circuit requires consideration of six factors:

(1) whether the defendant had the intent to confuse or deceive, (2) whether sales have been diverted,

(3) the adequacy of other remedies,

(4) any unreasonable delay by the plaintiff in asserting his rights,

(5) the public interest in making the misconduct unprofitable, and (6) whether it is a case of palming off.[13]

The Third Circuit and the *Nike* decision have adopted these factors, and they appear to be the wave of the future. The details of how these factors are to be applied in the individual cases have yet to be worked out. For example, what does a "case of palming off" mean, separate and apart from willful infringement? At common law, "palming off" or "passing off," meant simply selling one's goods as the goods of another; the tort had a strong basis in the law of fraud and deceit.[14] Suppose an infringer sells counterfeit goods believing them in good faith to be real—as indeed certain defendants in the *Nike* case claimed to have acted. Is that "palming off," albeit in good faith?

Counterfeiting cases—reminiscent of palming-off cases—seem to be a species of trademark infringement most ripe for an award for profits. By their very nature, counterfeits are meant to imitate the real goods, and someone who sells counterfeits is clearly trading on the trademark owner's

reputation. If the counterfeits are comparably priced to the original model, then there has likely been a diversion of sales, although quantities are often difficult to quantify. (To use one real-life example: a famous-brand handbag retails for $600; defendant is a discount chain who unknowingly obtained high-quality counterfeits of that brand from a jobber and sold them for $400. The discounter sold at least 300 counterfeits before being caught. Given the high price, it is not hard to see that the brand owner has suffered some loss of sales, albeit difficult to precisely quantify.)

Summary Judgment: Profits

A related issue is at what procedural stage a court can award profits. Trials are expensive; if a court can determine that there will be a profits award without a trial, it makes trademark enforcement that much more cost-effective.

The *Nike* court declined to grant profits on summary judgment, reasoning:

> [T]he Court holds that although willfulness is not a prerequisite to the recovery of profits for infringement and counterfeiting, it continues to function as an equitable consideration under the Fifth Circuit's multifactor test. Thus, the Court will be unable to determine whether or not Plaintiffs may recover the *Sahaya* Defendants' profits until a jury resolves the factual issue of whether or not the *Sahaya* Defendants' infringement was willful. Plaintiffs' motion for summary judgment as to these Defendants' profits is therefore denied.[15]

Generally speaking, a party's state of mind is not resolvable on summary judgment because, absent a blatant admission, a willfulness case will usually be inferential and based on ambiguous evidence.[16] It is therefore understandable that a finding of willfulness will rarely occur on summary judgment.

It is not clear, however, why this ineluctably means that an award of profits cannot be made on summary judgment. True, willfulness is one equitable factor to be considered. But, suppose "viewing the record in the light most favorable to the non-moving party" it is assumed that the defendants did not act willfully. Other factors may still weigh heavily in favor of awarding profits. For example, in a high-end counterfeiting case (i.e., one where the counterfeits are good quality and sold for a price substantially that of the usual retail price) it would seem that all factors but willfulness favor an accounting of profits.

An analogy can be drawn to determinations of likelihood of confusion in ordinary trademark cases. Likelihood of confusion is generally determined on consideration of a multifactor test; the leading Second Circuit case—*Polaroid Corp. v. Polaroid Elecs. Corp.*[17]—uses eight nonexhaustive factors. One factor is the defendant's bad faith, which, as noted, often is not amenable to summary judgment. Yet courts often do find likelihood of confusion on summary judgment, even though the evidence must be reviewed in the "light most favorable to the non-moving party." Even if some factors, because of the summary judgment standard, do not favor one side, the other factors may be enough to carry the day.

A good illustration is the Second Circuit's opinion in *Patsy's Brand, Inc. v. I.O.B. Realty*.[18] There, the Second Circuit upheld a summary judgment finding of trademark infringement. Notably, it held that in reviewing two of the *Polaroid* factors—including the bad faith factor—the district court had improperly failed to view the evidence in the light most favorable to the defendant. The Second Circuit held that while the "bad faith" evidence might permit an inference of bad faith, it did not compel one; accordingly that particular *Polaroid* factor did not weigh in favor of finding likelihood of confusion.[19] Nevertheless, the Second Circuit held that the "aggregate assessment" of the *Polaroid* factors was correct mainly because several other *Polaroid* factors strongly favored a finding of a likelihood of confusion.[20] In other words, while the summary judgment standard can often tilt things in the nonmoving party's favor on certain factors, other factors—where the issues may be more concrete or the evidence more objective—may still carry the day for the plaintiff.

The same should be the case for determining whether it is "equitable" to award an accounting of profits. Probably in most cases, willfulness will not be found on summary judgment. That said, even assuming that the infringer acted in good faith, there may be a powerful equitable claim to the infringer's profits based on other factors.

Finally, another issue, which we hope to deal with in a future article, is whether courts should treat "willfulness" as a black-or-white proposition, or whether they should recognize shades of gray such as negligent or grossly negligent conduct. The latter, if shown, might affect a court's determination that an award of profits is equitable.[21]

For now, it is enough to note that the courts seem to be dispensing with the per se willfulness requirement. The next step is for courts to seriously consider awarding profits on summary judgment—which, despite the tilted evidentiary standard, can, in appropriate cases, still result in a moving plaintiff prevailing on a multi-factor issue.

1. See *Gucci America, Inc. v. Daffy's, Inc.* 354 F3d 228 (3d Cir. 2003). The authors were counsel in the *Gucci* case.
2. No. 00 Civ. 8179 (KMW), 2005 WL 1654859 (SDNY July 13, 2005).
3. 986 F2d 1532 (2d Cir. 1992).
4. 875 F2d 584, 588-89 (7th Cir. 1989).
5. P.L. 106-43 (1999).
6. P.L. 106-113 (1999).
7. P.L.107-273 (2002).
8. *Quick Techs. v. Sage Group PLC,* 313 F3d 338, 347-49 (5th Cir. 2003).
9. 399 F3d 168, 171-74 (3d Cir. 2005), overruling *Securacomm Consulting, Inc. v. Securacomm, Inc.,* 166 F3d 182, 190 (3d Cir. 1999).
10. *Nike,* 2005 WL 1654859, at *10 n. 9, rejecting *MasterCard Int'l Inc. v. First Nat'l Bank of Omaha,* 2004 WL 326708 (SDNY 2004).
11. Id.
12. See Stolte, Keith M., "Remedying Judicial Limitations on Trademark Remedies," 87 Trademark Rep. 271, 275 n.25 (May 1997), suggesting such a reading.
13. *Quick Technologies, Inc. v. Sage Group PLC,* 313 F3d 338, 349 (5th Cir. 2003), citing *Pebble Beach Co. v. Tour 18 Ltd.,* 155 F3d 526, 554 (5th Cir. 1998).
14. See 1 McCarthy on Trademarks and Unfair Competition, §5:2.
15. *Nike* at *11.
16. See *Gelb v. Board of Elections,* 224 F3d 149, 157 (2d Cir. 2000) (Summary judgment is generally inappropriate where questions of intent and state of mind are implicated").
17. 287 F2d 492,495 (2d Cir.), cert. denied 368 US 820 (1961).
18. 317 F3d 209 (2d Cir. 2003).
19. Id. at 218-19.
20. Id.
21. See *Gucci America, Inc. v. Daffy's, Inc.,* 354 F3d at 244-45. (Rosenn, J., dissenting) (Arguing that defendant discount chain's sloppy authentication practice "seriously weakens [its] claim of innocence" and "favors [the trademark owner's] claim for relief.")