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Noting that reasonable royalty or hypothetical license remedies in the area of copyright infringement are in a state of flux, the authors say that counsel seeking reasonable royalties should be familiar with their client's business, should understand the context of royalties in the relevant industry, and should work with experts that can give a detailed analysis of licensing within the field of use.

The Relevance of 'Reasonable Royalties' to Copyright Infringement Remedies

BY ROBERT S. GERBER AND MICHAEL MURPHY

I. Introduction

Recent cases reveal that seeking a reasonable royalty as a copyright remedy can be an uncertain endeavor. Courts have differed regarding which evidentiary factors are relevant and necessary. Parties seeking to apply the reasonable royalty analysis frequently used in the patent litigation arena have sometimes found themselves successful, and other times frustrated.

A study of the development of the reasonable royalty remedy in copyright cases suggests that a party seeking a reasonable royalty needs to pay particular attention to developing a thorough evidentiary basis, and should also research the individual court as much as possible to determine how best to present its case. For parties seeking to avoid a reasonable royalty remedy, case law suggests lines of attack and ways to potentially limit the size of a royalty.

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II. Statutory Basis of Copyright Damages

The Copyright Act of 1976 as amended states at 17 U.S.C. § 504(a):

> An infringer is liable for (1) the copyright owner's actual damages and any additional profits of the infringer. . .; or (2) statutory damages . . . .

17 U.S.C. § 504(b) addresses actual damages and additional profits:

> The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is re-

quired to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.

III. Lost Licensing Fees as Part of Actual Damages

The current reasonable royalty remedy the courts are struggling with is an outgrowth of a lost license fee.

Several courts have recognized that a lost licensing fee may constitute actual damages to the copyright holder. Courts frequently characterize this lost licensing fee as the ''value of use'' of the copyrighted material, and some courts have gone the next step and determined that the value of use would be equal to what a hypothetical willing licensee would agree to pay a hypothetical willing licensor. However, some of these courts have distinguished these copyright value of use analyses from patent reasonable royalty analyses based on statutory and evidentiary grounds.

A. Cases Developing a Hypothetical Value of Use Remedy

In an early case, *Deltak Inc. v. Advanced Systems Inc.*, 767 F.2d 357, 360-362, 226 USPQ 919 (7th Cir. 1985), the court held that there were three factual premises on which actual damages could be awarded:

> (a) ''But for'' the infringement, the copyright holder could have sold more copies of the work to various customers.
>
> (b) The infringer might have purchased copies of the copyrighted work so as to avoid infringing.
>
> (c) When the infringer reproduced the infringing copies, it was manufacturing assets and thereby damaged the copyright holder to the extent of the value of use of the assets in terms of acquisition costs saved by the infringer.

The court held that ''[e]ach of the copies [the infringer] distributed had a value of use to it equal to the acquisition cost saved by infringement instead of purchase, which [the infringer] was then free to put to other uses. This is simply an application of the general principle that value of use amounts to a determination of what a willing buyer have been reasonably required to pay a willing seller for plaintiff's work.'' *Id.* at 361-362 (internal citations and quotes omitted).

However, the *Deltak* court also noted that while ''there are similarities between the concept of reasonable royalty in patent law and value of use as saved acquisition cost in copyright law . . . the two are not identical. Reasonable royalties are used when actual damages or profits are not provable, but value of use is a form of actual damage, not a substitute to be used when no type of damage or profit can be proved.'' *Id.* at 363.

In *Davis v. Gap*, 246 F.3d 152, 58 USPQ2d 1481 (2d Cir. 2001) (61 PTCJ 575, 4/13/01), the U.S. Court of Appeals for the Second Circuit reversed a district court ruling that a copyright holder cannot recover as actual damages the fair market value of a license fee for the use the infringer made. In reaching its conclusion, the court considered the following hypothetical:

> Assume that the copyright owner proves that the defendant has infringed his work. He proves also that a license to make such use of the work has a fair market value, but does not show that the infringement caused him lost sales, lost opportunities to license, or diminution in the value of the copyright. The only proven loss lies in the owner's failure to receive payment by the infringer of the fair market value of the use illegally appropriated. Should the owner's claim for ''actual damages'' under Section 504(b) be dismissed? Or should the court award damages corresponding to the fair market value of the use appropriated by the infringer?

Faced with this question, the *Davis* court held that ''the more reasonable approach is to allow such an award [of the fair market value of the use] in appropriate circumstances.'' 246 F.3d at 164. The court also concluded:

> If a copier of protected work, instead of obtaining permission and paying the fee, proceeds without permission and without compensating the owner, it seems entirely reasonable to conclude that the owner has suffered damages to the extent of the infringer's taking without paying what the owner was legally entitled to exact a fee for. We can see no reason why, as an abstract matter, the statutory term ''actual damages'' should not cover the owner's failure to obtain the market value of the fee the owner was entitled to charge for such use.

246 F.3d At 165

To deter a copyright owner from claiming unreasonable amounts as the license fee, the *On Davis* court noted that the law ''exacts that the amount of damages may not be based on undue speculation. The question is not what the owner would have charged, but rather what is the fair market value. In order to make out his claim that he has suffered actual damage because of the infringer's failure to pay the fee, the owner must show that the thing taken had a fair market value.''

The court further held that evidence of prior license fees was sufficient to provide a non-speculative basis from which to determine the fair market value of a license fee.

Shortly thereafter, in *Bruce v. Weekly World News Inc.*, 310 F.3d 25, 64 USPQ2d 1842 (1st Cir. 2002) (65 PTCJ 31, 11/8/02), the First Circuit upheld an actual damages award based upon the reasonable fair market licensing fees for the copyrighted work based upon prior licensing fees adjusted for inflation.

The Ninth Circuit staked out its ground on the issue of reasonable royalties in a copyright case in *Polar Bear Productions Inc. v. Timex Corp.*, 384 F.3d 700, 72 USPQ2d 1289 (9th Cir. 2004) (68 PTCJ 553, 9/17/04). The court in *Polar Bear* upheld a lost license fee following a jury trial. The infringer argued that the amount of amount of the license fee was speculative because it was more than the copyright holder had ever charged. However, the amount awarded by the jury was the ''amount [the copyright holder] actually quoted to [the infringer].'' The court held that an award equal to this amount was non-speculative. 384 F.3d at 708-709.

Following *Polar Bear*, and aligning itself with the First, Second, and Seventh Circuits, the Ninth Circuit held in *Jarvis v. K2 Inc.*, 486 F.3d 526, 82 USPQ2d 1711 (9th Cir. 2007) (74 PTCJ 63, 5/11/07), that a damages award based upon a fair market value estimate of a royalty could be acceptable. ''[I]n situations where the infringer could have bargained with the copyright owner to purchase the right to use the work, actual damages are what a willing buyer would have been required to pay a willing seller for plaintiff's work.'' 486 F.3d at 533. The court held the damages award in that case was not speculative because it was based upon several ''estimates of the fair market value of [the] infringed images.''

These estimates included testimony from the plaintiff's expert, testimony of a senior executive from the

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defendant; compensation the plaintiff had previously received from the defendant for similar work on three different occasions; and the plaintiff's settlement offer to the defendant.[1] 486 F.3d at 534.

B. Evidence Relevant to a Reasonable Royalty Is Not Necessarily Sufficient to Support Value of Use Damages

When told that the measure of damages is what a willing buyer would pay a willing seller to receive a license, many damages experts and counsel will immediately think of the reasonable royalty analysis from patent law. While there are several methods of calculating a reasonable royalty in the context of patent litigation, one of the best known is the application of the *Georgia-Pacific* factors. *Georgia-Pacific Corp. v. U.S. Plywood Corp.*, 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970).

Patent law's reasonable royalty analysis has recognized that a patentee's prior refusal to license an infringed technology may be taken into account and used as a factor suggesting a royalty rate. Similarly, the saved development costs of an infringer may also be factored into determining a reasonable royalty rate. *See Mahurkar v. C.R. Bard Inc.*, 79 F.3d 1572, 1580, 38 USPQ2d 1288 (Fed. Cir. 1996).

However, several recent cases have highlighted the difficulties of using such analyses in the copyright infringement scenario, and parties seeking to apply these patent law principles to support a value of use award in a copyright action have sometimes suffered significant surprises.

For example, one such case is *Oracle USA Inc. v. SAP AG*, 100 USPQ2d 1450 (N.D. Cal. Sept. 1, 2011) (82 PTCJ 654, 9/16/11). Following a trial on the issue of damages, a jury awarded the alleged infringer $1.3 billion in ''hypothetical license'' damages.

On post-trial motions, the court granted judgment as a matter of law that the plaintiff had failed to present non-speculative evidence of a hypothetical license:

> [T]he evidence [plaintiff] presented was insufficient to establish an objective non-speculative license price. Determining a hypothetical license price requires an objective, not a subjective analysis, and excessively speculative claims must be rejected. An objective, non-speculative license price is established through objective evidence of benchmark transactions, such as licenses previously negotiated for comparable use of the infringed work, and benchmark licenses for comparable uses of comparable works.
>
> Here, [plaintiff] failed to present evidence of benchmark licenses. Indeed, [plaintiff's] executives testified that [plaintiff] has never granted a comparable license . . . and that such a license would be ''unique'' and ''unprecedented.'' Nor were the [plaintiff's] executives aware of any analogous situations in which any other company had licensed software to or from a competitor to provide support services. Moreover, damages experts on both sides agreed that no benchmark licenses exist, and the evidence [plaintiff] did present proved that the parties would never have agreed to a license. Absent evidence of benchmarks, [plaintiff] cannot recover a lost license fee award, because any such award would be based on a subjective, not an objective, analysis of fair market value.

100 USPQ2d at 1457.

Perhaps after learning a lesson in its case against SAP, Oracle is faring better in an action against Google. *See Oracle America Inc. v. Google Inc.*, (N.D. Cal. Jan. 9, 2012). In that case, based upon a motion in limine to exclude the testimony of Oracle's damages expert, the court found:

> In the context of copyright infringement, the hypothetical lost license fee can be based on the fair market value of the copyright at the time of infringement.'' The court held further that ''to determine the work's 'market value' at the time of the infringement, the Court should apply a hypothetical approach, i.e., ''what a willing buyer would have been reasonably required to pay to a willing seller for the owner's work.'' The court further noted that ''[t]his standard is similar, if not the same, as the standard for calculating a reasonably royalty in the context of patent damages. For a reasonable royalty for patent infringement, the hypothetical negotiation also requires the court to envision the terms of a licensing agreement reached as the result of a supposed meeting between the patentee and the infringer at the time infringement began. [Citations omitted.]

In the latter case involving Oracle, Google made many of the same arguments that SAP had prevailed upon. Specifically, Google argued that because the copyright holder had never granted a license for similar use any calculation of the hypothetical lost license fee would be too speculative.

However, unlike the *SAP* court, the *Google* court rejected this argument, finding:

> In order to calculate the lost licensing fee, the hypothetical licensing agreement must be *reached* as the result of a hypothetical meeting between the parties. *See Rite–Hite Corp.*, 56 F.3d at 1554 (patent reasonable royalty). Although our court of appeals has not explicitly held so, the Second Circuit has held that whether the parties might in fact have negotiated is irrelevant to the purpose of the lost licensing fee calculation for copyright damages. *On Davis v. The Gap Inc.*, 246 F.3d 152, 171–72 (2nd Cir. 2001). The hypothetical negotiation is only a means for calculating the fair market value. It is the fair market value that must not be speculative under *Daubert*.

The court further found that the plaintiff's expert ''had a non-speculative factual basis to value a license . . . by starting with the real-world negotiations between [the parties] for a [related license], and then adjusting that amount up to compensate for the [differences between the related license and the hypothetical license]. The amount of the upward adjustment was based on [plaintiff's] own revenue projections.''

Accordingly, the court found that Oracle's damages calculation was not speculative under *Daubert*.

C. Cases Rejecting Hypothetical License Fee Remedies

A body of law rejects the reasonable royalty analysis, but sometimes the rejection is based upon the nature and quality of the evidence presented. For example, in *Getaped.com Inc. v. Cangemi*, 188 F. Supp. 2d 398, 406, 62 USPQ2d 1039 (S.D.N.Y. 2002) (63 PTCJ 400, 3/8/02), the plaintiff requested $35,000—its entire estimated cost to develop the infringed work as a hypothetical licensing fee.

The court found that the entire costs of development were too high and that there was insufficient evidence to determine what percentage of the development costs would have been a non-speculative hypothetical license

[1] It is unclear whether this offer was made under Fed. R. Evid. 408.

fee. The court then awarded statutory damages of $30,000.

Similarly, in *MGE UPS Systems Inc. v. GE Consumer and Industrial Inc.*, 622 F.3d 361, 367, n.2, 96 USPQ2d 1123 (5th Cir. 2010) (80 PTCJ 764, 10/8/10), the court held that testimony by an employee of the copyright holder regarding how much he would pay to prevent a competitor from entering the market was ''not cognizable as a 'reasonable royalty' calculation at which a buyer and seller would agree to be market value for a particular piece of software.''

More recently, in *Real View LLC v. 20-20 Technologies Inc.*, 789 F. Supp. 2d 268, 99 USPQ2d 1360 (D. Mass. 2011) (82 PTCJ 267, 6/24/11), the court found that a hypothetical license fee is possible even though ''it is difficult to fathom any situation in which [the copyright holder] would have given [the infringer] an unrestricted license . . . it could then use to create a copycat product.''

However, the court went on to find that the evidence presented by the copyright holder was too speculative because the jury was not presented with sufficient evidence to quantify the costs to produce the copyrighted work. The court also found that the amount the copyright holder paid to acquire a competitor was too speculative.

99 USPQ2d 1336.

D. Reasonable Royalty Theories May Apply to Remedies Seeking Disgorgement of the Infringer's Profits

Theoretically, an infringer's development costs that were saved because the infringer chose to infringe a copyright instead may be deemed to be wrongful profits that the infringer has received from its act of infringement. In patent law, this is understood as an element in the hypothetical negotiation that results in a reasonable royalty. *See, e.g., Mahurkar v. C.R. Bard Inc.*, 79 F.3d 1572, 1580, 38 USPQ2d 1288 (Fed. Cir. 1996).

However, courts have not embraced this theory of damages in the copyright infringement context. In *Oracle Corp. v. SAP*, *supra*, the district court noted that there was no case law supporting a theory of copyright damages based on ''saved development costs.'' The court went on to hold that copyright developers were not entitled to recoup all their research and development costs for defendants' infringement. *See Oracle Corp. v. SAP AG*, 734 F. Supp. 2d 956, 971-72 (N.D. Cal. 2010.)

In *Real View v. 20-20 Technologies*, *supra*, the court noted that an infringer's saved development costs could factor into a reasonable royalty analysis in the context of patent infringement. The *Real View* court also noted the decision of the *Oracle Corp.* court discussed above, but nevertheless appeared receptive to this theory of damages.

However, the *Real View* court found that the copyright holder had failed to introduce sufficient evidence to support such a theory because its only evidence of alleged saved development costs was testimony comparing the ''millions and millions'' of dollars the copyright holder had spent in its business over seventeen years to the $150,000 the infringer spent on its competing business over two years.

Thus, based on current case law, it is uncertain whether an infringer's saved development costs are available as a remedy for infringement.

IV. Lessons Learned

Courts differ significantly in both (a) whether they will consider a reasonable royalty or ''value of use'' theory when analyzing copyright damages, and (b) what nature and type of evidence they will consider sufficient to support such a theory.

Some courts refuse to grant such damages if the evidence suggests that the copyright holder and the infringer would never have entered into a license for the infringer's use of the work. Other courts will permit damages under such a scenario but require proof of similar baseline licenses.

If the copyright holder has no history of licensing the copyrighted design, then it behooves counsel to select an expert with a solid understanding of the specific industry and with copyright hypothetical license experience. Potential sources of such baseline license fees may include prior licenses the copyright holder has given for other works, or industry standard licenses fees.

For example, in the entertainment industry, one potential source of such industry standard fees may be the terms and rates set by the Copyright Royalty Board for a Section 115 statutory license. Such statutory licenses are called mechanical licenses and allow ''individuals to make their own recordings of copyrighted musical works for distribution to the public without the consent of the copyright holder.'' *See Recording Industry Association of America Inc. v. Librarian of Congress*, 608 F.3d 861, 863, 95 USPQ2d 1314 (D.C. Cir. 2010) (80 PTCJ 293, 7/2/10) (upholding mechanical license fees set by the Copyright Royalty Board).

If the copyright holder is unable to establish a baseline royalty rate from its own history of licensing or a survey of similar industry licenses, the likelihood of receiving a hypothetical license fee award varies significantly from one court to another. Some courts have suggested that a copyright holder's development costs could provide a basis for awarding a reasonable royalty fee, but copyright holders have had significant difficulty showing such hypothetical licenses are not unduly speculative.

Similarly, testimony by copyright holders of what they would have charged to license their works is likely to be too speculative unless there is evidence of actual offers to accept or impose similar license fees.

As noted above, at least one court has suggested that a copyright holder could theoretically seek an infringer's saved development costs as disgorgement of the infringer's profits. However, that court noted that it could find no case where such a remedy was in fact permitted, and found the evidence of the infringer's saved development costs too speculative to support a damages award. *See Real View*, *supra*.

These cases illustrate that reasonable royalty or hypothetical license remedies in the area of copyright infringement are in a state of flux and that it behooves counsel to be very familiar with their client's business, to understand the context of royalties in the relevant industry, and to work with experts that can give a detailed analysis of licensing within the field of use.

Moreover, these cases also illustrate that one must be careful of relying upon reasonable royalty analyses from patent litigation, which are sometimes analogous but not always accepted by the courts.